PROCEEDINGS OF THE CONFERENCE ON FISCAL INCENTIVES AND COMPETITION FOR FOREIGN DIRECT INVESTMENT IN THE BALTIC STATES HELD IN VILNIUS ON 30TH MAY 2000

This document is circulated for information under item 7f of the agenda of the CIME meeting on 19-20 September 2000.
PROCEEDINGS OF THE CONFERENCE ON FISCAL INCENTIVES AND COMPETITION FOR FOREIGN DIRECT INVESTMENT IN THE BALTIC STATES HELD IN VILNIUS ON 30TH MAY 2000
CONTENTS

1) Foreword

2) Conference Agenda

3) Conference Conclusions

4) Session I: Policy Competition and Foreign Direct Investment in the World Economy
   
   Policy Competition for Foreign Direct Investment – A Study of Competition among Governments to attract Foreign Direct Investment
   Presentation by Mr. Charles Oman, Head of Research Programme, OECD Development Centre

   Direct Investments around the Baltic Sea. Is there Policy Competition among the Countries?
   Presentation by Dr. Inkeri Hirvensalo, Centre for Markets in Transition, Helsinki School of Economics and Business Administration

5) Session II: Effectiveness and Pay-off of Corporate Income Tax Incentives

   Attracting Foreign Direct Investment to the Baltic Nations – The Role of Fiscal Incentives
   Presentation by Mr. Joel Bergsman, Foreign Direct Investment Expert (formerly of Foreign Investment Advisory Service, IFC/World Bank)

6) Session III: Review of Corporate Income Tax Policies including Incentives for Foreign Direct Investment in the Baltic States

   Taxation of Foreign Investors in Lithuania
   Presentation by Mr. Vitas Vasilauskas, Director, Revenue Department, Ministry of Finance, Lithuania

   Corporate Income Tax Policy in Estonia
   Presentation by Ms. Lemmi Oro, Deputy Head, Tax Policy Department, Ministry of Finance, Estonia

   Direct Tax Policy Including Incentives for FDI in Latvia
   Presentation by Ms. Gunta Kaulina, Director, Tax Policy Department, Ministry of Finance, Latvia

7) Session IV: International Policy Implications

   Presentation by Mr. Eric Tonon, Phare Programme Manager for the Financial Sector, Delegation of the European Commission in Vilnius

8) List of Participants
FOREWORD

This Conference on Fiscal Incentives and Competition for Foreign Direct Investment in the Baltic States was organised in Vilnius in May 2000 under the auspices of the Government of Lithuania, the OECD Committees on International Investment and Multinational Enterprises and on Fiscal Affairs and the Centre for Co-operation with Non-Members with the financial support of donor countries to the Baltic Regional Programme. Invited participants involved a representative mix of government officials, corporate executives, academia and concerned non-governmental organisations.

It was a follow-up to the Conference “FDI Policy and Private Sector Development in the Baltic States” which was organised by the OECD in Tallinn, Estonia in November 1999 with the support of the Estonian Investment Agency. This event concluded with a general expression of interest in further work on the particular merits and role of fiscal incentives in attracting and sustaining FDI in the Baltic Region.

The OECD Baltic Regional Programme has been the basis for co-operation between the OECD and Lithuania, Latvia and Estonia since 1998. It has brought to light the prominent role of foreign direct investment (FDI) in the economic transformation process of the Baltic States. In this region equity investment has provided one of the most efficient and expeditious ways of transferring greatly needed capital, technology and expertise and integrating these economies into the main stream of European and world economic activity.

However, as in the case of other transition and emerging market economies, a significant portion of FDI inflows until now has been generated by the sale of public enterprises and assets to private operators. The near-completion of this process in the Baltic States has substantiated the belief that the positive FDI trends of the 1990s may not be sustainable in the longer term. Policy-makers have recently turned their attention to the potential pay-off of FDI promotional activities and investment incentives, notably for greenfield investment. This has given rise to concerns about increased competition for FDI between the Baltic states.

Recent developments have stimulated interest on this subject. On 1 January 2000, a new income tax reform entered into force in Estonia. One of main features of the new legislation is to exempt reinvested profits of companies from income tax with the explicit objective of “attracting foreign investors and accelerating economic growth”. Lithuania has also significantly reduced its corporate income tax at the end of last year to stimulate investment. Latvia is considering similar measures.

The issues of financial incentives, investment incentives in general and harmful tax competition are currently being given a high profile in the current work programmes of the CIME and Fiscal Affairs Committee and their outreach activities. At the annual meeting of the Council of Ministers in June 2000, OECD Ministers expressed their support for continued work on harmful forms of policy-based competition for FDI. This document contains a selection of papers presented at the Conference in Lithuania which reflect the role of corporate tax incentives for FDI and important design considerations to improve the efficiency in their delivery. The papers also address the variety of tax incentives that can be used and their main channels of influence. A key to efficient design of tax incentives is the basic question of how much incremental investment is generated by a given tax incentive and at what costs, such as foregone tax revenue, increased tax system complexity and vulnerability to tax avoidance. Consideration is also given in some of the papers to the importance of non-tax considerations to FDI decisions, which in many cases can be expected to overshadow the relevance of tax incentives.

This document is intended for information purposes and to contribute to the discussion on the issues involved.
AGENDA

08.00    Registration

08.30    Opening remarks by Mr. Algimantas Rimkunas, Deputy Minister of Foreign Affairs, Lithuania, Mr. Thorbjørn Gjølstad, Director General of Tax Law Department, Ministry of Finance, Norway and Representative of the Baltic Regional Programme and Miss Marie-France Houde, Co-ordinator for Foreign Direct Investment, Directorate for Financial, Fiscal and Enterprise Affairs, OECD

Session I: Policy Competition and Foreign Direct Investment in the World Economy

The purpose of the session will be to highlight recent international trends in incentives-based competition for FDI, their relative importance and distorting effects.

Chairperson: Miss Marie-France Houde,

08.45    Presentation by Mr. Charles Oman, Head of Research Programme, Development Centre, OECD

09.00-09.30

Commentators:

Dr. Inkeri Hirvensalo, Director, Centre for Markets in Transition, Helsinki School of Economics, Finland

Mr. Per Altenberg, Senior Research Officer, Swedish National Board of Trade, Stockholm

09.30-10.15

General Discussion
10.15 Coffee break

10.15 Press Conference (participants welcome)

Speakers: Mr. Algimantas Rimkunas, Deputy Minister of Foreign Affairs; Mr. Vytas Gruodis, Director General of Lithuanian Development Agency; Ms. Susan Himes and Ms. Marie-France Houde, OECD

Session II: Effectiveness and pay-off of corporate income tax incentives

The session will focus on the arguments in support of corporate income tax incentives and the cost-benefit and design considerations relevant to maximising efficiency in their delivery. Important lessons from OECD countries will be reviewed. Basic questions such as incremental investment generated by a tax incentive, revenue loss and the interaction between host and home country tax systems will also be addressed.

Chairperson: Mr. Agu Remmelg, Director General, Estonian Investment Agency

10.30 Presentation by Mr. Joel Bergsman – Foreign Direct Investment Expert (formerly Manager, Foreign Investment Advisory Service, IFC/World Bank)

10.50-11.30

Commentators:

Ms. Susan Himes, Head of Unit for Co-operation with Non-Members, Fiscal Affairs Division, Directorate for Financial, Fiscal and Enterprise Affairs, OECD

Mr. Vytas Gruodis, General Director, Lithuanian Development Agency

Mr. Andris Liepins, Director of Investment Department, Latvian Development Agency

Mr. Agu Remmelg, Director General, Estonian Investment Agency

Mr. Tapio Aho, Relationship Manager – Emerging Markets, SEB Merchant Banking, Skandinaviska Enskilda Banken AB, Helsinki, Finland

11.00-12.00

General Discussion

12.00 Lunch
Session III: Review of the corporate income tax policies including incentives for FDI in the Baltic States

Each of the Baltic states will be invited to present their respective corporate income tax policies, in particular how these promote foreign direct investment through tax incentives and treaty policies, the main underlying considerations and evidence of their economic returns.

Commentators and participants will be invited to react to the arguments presented by officials of the Baltic states and discuss the merits of alternative policies.

Chairperson: Mrs Ilga Preimate, State Under-secretary, Ministry of Economy, Latvia

14.00 Presentation by Mr. Vitas Vasilauskas, Director of Revenue Department, Ministry of Finance, Lithuania

14.10 Presentation by Ms. Lemmi Oro, Deputy Head of Tax Policy Department, Ministry of Finance, Estonia

14.20 Presentation by Ms. Gunta Kaulina, Head of Tax Policy Division, Ministry of Finance, Latvia

Commentators:

Mr. Finn Gallen, IDA Ireland – Industrial Development Agency of the Republic of Ireland

Mr. Andy Vikta, “Kraft Foods Lietuva”, Finance Director Baltics, Kaunas, Lithuania

14.45-15.30 General Discussion

15.30 Coffee break

Session IV: International policy implications

This session will be divided into four parts: (a) a review of international disciplines governing corporate income tax-based FDI (namely OECD and EU disciplines), (b) a discussion of the “precedent value” of the Baltic States’ actions and their international implications and (c) formulation of policy recommendations/approaches for addressing outstanding issues.

Chairperson: Mr. Vytas Gruodis, Director General, Lithuanian Development Agency
15.45 Presentation by Mr. Eric Tonon, Phare Programme Manager for the Financial Sector, Delegation of the European Commission to Lithuania, Vilnius

Commentators:

Mr. Cato Adrian, Advisor, Accession Division, World Trade Organisation

Ambassador Herluf Hansen, OECD Committee on International Investment and Multinational Enterprises

Mr. Valters Gencs, Tax Lawyer, Ernst & Young, Latvia and Chairman of the Tax Ad Hoc Committee of the Foreign Investors’ Council in Latvia (FICIL)

17.30 Session V: Concluding remarks by Mr. Vytas Gruodis, Director General of Lithuanian Development Agency and Ms. Susan Himes, OECD
CONFERENCE CONCLUSIONS

The following are the principal conclusions reached by participants at the Conference on Fiscal Incentives and Competition for Foreign Direct Investment in the Baltic States organised by the OECD with the support of the Government of Lithuania on May 30th 2000, in Vilnius.

The three Baltic countries, the subjects of this Conference, are facing increased competition in their efforts to attract the FDI that they need. There are two main reasons for this increase in competitive pressure.

One is general: competition to attract FDI is increasing worldwide and in the Central and Eastern European region as more and more countries improve their investment climates.

The other relates to the particular situation in Estonia, Latvia and Lithuania: as they complete the privatisation process, they will be more and more dependent on attracting greenfield investments, which by their nature can be located in any of a number of different sites in different parts of the world.

However, most competition for FDI, all over the world, tends to be among neighbouring countries. Thus investors seldom see the Baltics as alternatives to, say, Asian or Latin American countries. The competition is usually effectively among the three nations themselves as well as with others in the region.

The conference participants were unanimous that fundamentals such as the rule of law, stable and sound economic policies, sound legislation and institutions to enforce it, and a basically facilitating attitude on the part of the government are prerequisites in any attempt to attract FDI. This is particularly true for small countries such as the Baltics, which lack the overwhelming attraction of large, unsaturated domestic markets such as Brazil or China.

Beyond these basics, the location of a considerable amount of FDI is determined by factors specific to a particular destination, such as existing business relationships, regional market access, competitive skilled labour, among others. Nevertheless, for much other FDI, investors consider several alternative locations. The final choice of host country for this kind of FDI is often determined by the availability of inducements that may be offered by the would-be host government.

Such inducements – parts of the whole package that the investors evaluate – may include fiscal incentives. For various reasons, the Baltic countries have, during some periods in the last ten years, used fiscal incentives as one important instrument in their efforts to attract FDI.

Much of the discussion during the Conference focused on the cost-effectiveness of these incentives. In spite of – or perhaps because of – the enormous literature on this subject, the question of what kinds of incentives, if any, are worth their costs remains in dispute. Not in dispute are the benefits to be gained from increased international co-operation in this field.

The Conference in Vilnius was a follow-up to the Conference “FDI Policy and Private Sector Development in the Baltic States” which was organised by the OECD in Tallinn, Estonia in November 1999 with the support of the Estonian Investment Agency. This event concluded with a general expression of interest in further work on the particular merits and role of fiscal incentives in attracting and sustaining FDI in the Baltic Region.

Some 70 participants attended the Conference, among them senior government officials and experts from the Baltic Sea region, OECD member countries, representatives of business and academic circles. The Conference was opened by Mr. Algimantas Rimkunas, Deputy Foreign Minister of Lithuania and, on
behalf of the OECD Baltics Regional Programme, Mr. Thorbjørn Gjølstad, Director General of the Tax Law Department of the Norwegian Ministry of Finance, and Miss Marie-France Houde, Co-ordinator for FDI, OECD Directorate for Financial, Fiscal and Enterprises Affairs.

The first session was devoted to the broader issue of policy competition and FDI in the world economy. This session featured a presentation by Mr. Charles Oman of the OECD Development Centre who has recently published a study of competition among governments to attract FDI. His presentation traced recent developments in competition for FDI, and its significance and implications for host countries. Mr Oman, noting that this competition is increasing all over the world, differentiated between rules-based and incentive-based competition. Some speakers noted that in the past, rules-based competition has mainly consisted of liberalisation and relaxation of restrictions on FDI. Oman and others stressed that for the future, rules-based systems should maintain or strengthen environmental and labour standards. Yet other speakers at this session addressed the actual use of fiscal incentives within the Baltic Sea Region.

Under the chairmanship of Mr. Agu Remmelg, Director General of the Estonian Investment Agency, the second session focussed on the efficacy of fiscal incentives, their costs, benefits, and appropriate design. Mr. Joel Bergsman, an FDI expert, argued in his presentation that the Baltic States must continue to compete using their fundamental strengths of sound macroeconomic policies, good legislation, a facilitating business climate, a skilled workforce, and good export potential. A sound tax system, which includes a reasonably low tax burden and fair administration, should be a part of their future promotional strategy. With such an attractive package, the need for fiscal or other incentives diminishes. Representatives of the investment policy and promotion authorities of the individual Baltic States presented differing views on the importance of tax incentives.

Although there was general agreement that increasing competition for FDI has heightened the pressure on the Baltic countries, many questioned whether tax incentives are necessary or desirable as instruments in this competition. Concerns that were raised included revenue losses, increased opportunities for tax avoidance, distortionary effects and the interaction of host and home country tax systems.

The third session, chaired by Mrs. Ilga Preimate, State Under-secretary of the Ministry of Economy of Latvia, provided a review of general and FDI-oriented corporate income tax policies with contributions from tax experts in the three Baltic States. These reflected the underlying considerations in the use of fiscal incentives to promote FDI and the perceived economic returns.

The discussion also reflected most recent developments in the region in this respect, namely Estonia's new tax law, effective since the beginning of this year, which defers the tax on profits until the time of their distribution.

The final session of the Conference under the chairmanship of Mr. Vytas Gruodis, Director General of the Lithuanian Development Agency was devoted to international policy implications, emphasising OECD, EU and WTO disciplines. Current and future practices in the Baltic nations need to, and are, taking these into account in designing their policies as they accede to these organisations. Beyond this, several speakers underlined the desirability of strengthening international disciplines on investment incentives.

The conference closed with remarks made by Mr. Vytas Gruodis, Director General of the Lithuanian Development Agency, and Ms. Susan Himes, Head of Unit for Co-operation with Non-Members, Fiscal Affairs Division, OECD Directorate for Finance, Fiscal and Enterprises Affairs. It was concluded that the attractiveness of each Baltic country to foreign investors can be enhanced by regional co-operation on investment and tax strategies.
POLICY COMPETITION FOR FOREIGN DIRECT INVESTMENT
PRESENTATION BASED ON A STUDY OF COMPETITION AMONG GOVERNMENTS
TO ATTRACT FDI

by
Charles P. Oman

Summary

Globalisation, and in particular the move by many developing and emerging economies in recent years to seek more actively to attract foreign direct investment, is raising policy makers’ concern that intensifying global competition among governments to attract FDI may have undesirable effects. The main concern is that global “bidding wars” to attract FDI may be producing an uncontrolled upward spiral in costly “investment incentives” that weaken public finances while introducing market distortions in the allocation of real investment, and/or that such “wars” are putting excessive downward pressure on global standards of protection of the environment and/or of workers’ rights (the so-called “race to the bottom”).

Intensifying global competition among governments to attract FDI could also, however, produce beneficial effects. These effects may include inducing governments to strengthen their economies’ “fundamentals” (e.g. by pursuing policies to enhance the supply of modern infrastructure and appropriately trained workers, by achieving greater macroeconomic and political stability, by improving long-term economic growth perspectives) which should in turn promote economic development – almost independently of their impact on FDI flows per se. Another effect may be to increase the global supply of FDI, to the benefit of investors and host economies alike.

The actual degree of global competition to attract FDI is not known, moreover, and while there is considerable evidence that such competition is widespread, involving sub-national as well as national governments both in OECD countries and in developing and emerging economies, it is difficult to predict whether that competition will intensify in the coming years.

It is against this backdrop that the present study addresses three sets of questions: (i) To what extent do governments – national and sub-national governments in OECD and non-OECD countries – actually compete with one another to attract FDI; to what extent is that competition intensifying, or likely to intensify; and what are the principal policy instruments or means by which governments compete to attract FDI? (ii) What are the effects of that competition – on FDI flows, on policy-making more broadly, and on the economy? and (iii) What are the implications for policy makers? The study addresses these questions from the dual policy perspective of enhancing economic and social development in the developing and emerging economies, and of strengthening relations between those economies and OECD Member countries.

Chapter 1 lays out the policy and conceptual issues and the working hypotheses that guide the study. Chapters 2 and 3 present the evidence. Chapter 2 looks at governments’ use of financial and fiscal incentives (“incentives-based competition”) while Chapter 3 focuses on governments’ use of “rules-based” means of competing to attract FDI – means such as environmental and labour standards, export-processing zones, international regional-integration agreements, privatisation of state-owned enterprises and strengthened judicial systems. Chapter 4 concludes with a presentation of the overall findings and policy conclusions.
Those findings and conclusions may be summarised as follows:

− Incentives-based competition for FDI is a global phenomenon: governments at all levels (national and sub-national) in both OECD and non-OECD countries engage in it worldwide.

− As barriers to international investment have fallen over the last two decades, the significance of competition for FDI has increased.

− Incentives-based competition can be intense, but the evidence – which is insufficient to draw more than tentative inferences – suggests that the competition tends to be quite intense only in particular industries (e.g. automobiles) or for particular investment projects (especially large ones) and in some industries is intense only during particular periods.

− Most incentives-based competition is effectively intra-regional, since much of the real investment for which national and sub-national governments compete is investment the investor intends in principle to locate in a particular region.

− While the evidence does not clearly point to any inexorable tendency towards global “bidding wars” among governments in their competition to attract FDI, the “prisoner’s dilemma” nature of the competition creates a permanent danger of such “wars”.

− Data on the direct financial and/or fiscal “cost-per-job” of incentives received by investors in the automobile industry reveal similar orders of magnitude of that cost in OECD and in developing and emerging economies (a cost that often exceeds $100 000).

− Evidence of the effects of incentives on corporations’ real investment-location decisions, particularly for major new investment projects, is consistent with the view that the decision is normally a two-stage (or multi-stage) process in which investors first draw up a short list of acceptable sites on the basis of the economic and political “fundamentals” of alternative sites, largely irrespective of the availability of fiscal and financial incentives from potential host governments, and only later, after the short list is drawn up on the basis of the investment “fundamentals”, do investors consider – and often seek out – investment incentives, sometimes playing one government off against another at this stage of their location decision. Incentives and other discretionary government policies to attract FDI can thus be decisive in investors’ location decisions, despite the much greater overall importance investors attach to the “fundamentals”.

− There is little evidence that increasing global competition for FDI over the last two decades has contributed in any significant way to the major growth of global FDI that has occurred over the same period. Rather, any relationship of cause and effect between the two phenomena appears more to work in the opposite direction: as the global supply of FDI has risen significantly, governments have intensified competition with one another to attract “their share” of that growth. (Several factors have stimulated the growth of FDI, including Europe’s Single Market and Maastricht Accords and other regional phenomena, e.g. NAFTA, as well as worldwide economic policy liberalisation and market deregulation and the globalisation of corporate activity and competition.)

− Even in the absence of global bidding wars for FDI, the distortionary effects of incentives — which tend to discriminate against smaller firms, against local firms (de facto, though
rarely on a *de jure* basis) and against firms in sectors or types of activity that are not targeted — can be significant.

- It can be counterproductive for a government to offer costly investment incentives if the “fundamentals” of the potential investment sites within its jurisdiction fail to meet serious long-term real investors’ basic requirements, because the incentives – in addition to the distortions they inevitably introduce – will tend to attract the “wrong kind” of investor. They also tend to render the broader policy-making process more vulnerable to rent-seeking behaviour, perhaps including corruption, which can be very costly – and can even spread and become quite destructive for the economy, for democracy and the development of a modern state, and thus for the very process of development.

- Undiscerning use of investment incentives and other discretionary policies by governments to attract FDI can have a negative effect on FDI inflows, in part because the incentive programmes and policies tend to be seen by investors as unsustainable.

- Many of the governments that are most successful in attracting FDI are also among those that best meet the requirements for good governance (requirements that include sound public finances because they lend credibility to incentives programmes in the eyes of investors, and legitimacy in the eyes of voters, by making them likely to be seen as sustainable).

- There is little evidence to support the hypothesis that intensifying competition to attract FDI induces governments significantly to enhance local supplies of infrastructure and of skilled labour; one cannot reject the hypothesis that incentives tend more to compete with than to augment the use of public resources to increase local productivity-enhancing human-capital formation and the supply of modern infrastructure.

- Whether or not induced by competition to attract FDI, policies to enhance local supplies of human capital and modern infrastructure, if successful, can nevertheless play a powerful role in attracting FDI – as well as to promote economic development – if the other “fundamentals” are sound.

- While governments often “justify” providing investment incentives with the argument that they are needed to steer corporate investment to poorer areas within their economy, in practice incentives are often of limited effectiveness in this regard (though there are exceptions) and they sometimes actually reinforce inequalities instead.

- Competition for FDI among sub-national governments has been “activated” by, but also contributes to, a broader process of reform of policy-making which includes regulatory reform, privatisation and liberalisation of trade and investment policies. In addition to strengthening market forces, this process tends to induce sub-national governments to modernise and organise themselves better, and more flexibly, to enhance the competitiveness of the economies under their jurisdiction.

- Investors often choose sites where the host government’s strategy to attract investors is part of a broader process of mobilisation around a project of social and political reform in which the government redefines its role, turning away from rigid structures and exclusive relationships with vested interest groups in favour of greater transparency, democracy and market competition. This process both enhances and is reinforced by growing exposure of local and foreign firms in the domestic market to international competition.
Policy competition raises the delicate question of how to ensure the accountability of government officials, particularly those involved in the negotiation of discretionary incentive packages, and points up the need for governments to be able to monitor their own use of incentives. That monitoring could in turn constitute the needed basis for cooperation among governments to ensure that competition for FDI does not lead to beggar-thy-neighbour policy competition and incentives “bidding wars”.

There is little evidence in support of the stronger versions of the “race to the bottom” hypotheses regarding governments’ defence of labour and environmental standards. The evidence cannot tell us, however, to what extent competition to attract FDI is inhibiting a socially optimal raising of those standards, and the danger of such “races”– or at least of increasing downward pressures on those standards – always exists. There is, at the same time, evidence that competition to attract FDI can exert some upward pressure on those standards, particularly by local governments.

Policy makers must remain vigilant to ensure that competition to attract FDI does not lower labour and environmental standards but works, if anything, in the opposite direction. Governments and society would benefit in this regard from enhanced international policy co-ordination on environmental standards, perhaps also on core labour standards.

International regional-integration agreements can be a powerful policy tool both for attracting FDI (which requires relatively open regional agreements) and for enhancing cooperation among governments to limit the potential negative effects of policy competition – including downward pressures on labour and environmental standards as well as costly beggar-thy-neighbour policy wars and incentive wars.

For developing and emerging economies, whose scarce financial resources often push them into a heavy reliance on fiscal incentives to attract FDI, it is important to stress the value of moving away from discretionary incentives towards greater reliance on rules-based means of attracting FDI – national and international rules that maintain or strengthen environmental and labour standards and create stability, predictability and transparency for policy makers and investors alike. A strong rules-based approach, which should include a strong and independent judiciary system, can also provide the policy transparency necessary to limit the rent-seeking behaviour that can be very damaging to development.
The prisoner’s-dilemma nature of competition for FDI creates a permanent risk of costly beggar-thy-neighbour bidding wars and downward pressure on environmental and labour standards that cannot be fully addressed by national governments in the absence of strengthened international policy co-ordination.
DIRECT INVESTMENTS AROUND THE BALTIC SEA.  
IS THERE POLICY COMPETITION AMONG THE COUNTRIES?

by  
Dr. Inkeri Hirvensalo

FDI to Eastern Europe in global FDI developments

According to the World Investment Report 1999, Central and Eastern Europe has attracted an average of 3.6 per cent of foreign direct investment (FDI) during 1995-1998. As direct investments have increasingly flown into the developed economies of North America and Western Europe, the share of Central and Eastern Europe in investment flows has remained low.

Among Central and Eastern European countries, Poland attracted the largest FDI inflows in 1998-99. Russia started to attract significant inflows of FDI in 1995. However, unlike the other Eastern European countries, FDI outflows from Russia have also been considerable and, as a result, the net inflows have remained at a relatively low level particularly in comparison with Hungary and Poland (Chart 1).

Chart 1

<table>
<thead>
<tr>
<th>Year</th>
<th>Czech Republic</th>
<th>Estonia</th>
<th>Hungary</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Poland</th>
<th>Russia</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*Estimated values
In terms of cumulative net inflows, Hungary still leads among the Eastern European countries, although Poland is likely to catch up in the near future. Cumulative FDI in Russia also lags behind Hungary, Poland and the Czech Republic. The relative significance of FDI (per capita or in relation to the GDP) is also relatively high and above the world average in Hungary, the Czech Republic, Estonia and the Baltic countries compared to Russia and the other CIS countries (Charts 2 and 3).

**Chart 2**

*Cumulative net inflows of FDI in Eastern Europe 1989-98*  
(USD millions, EBRD Transition Report 1999)
The sources of FDI in the Region

The geographic distribution of investing countries in the five transition economies of the Baltic region is depicted in Table 1. The neighbouring northern European countries are all among the major investors in the region. In addition, the United States is among the three largest investors in all five countries and the source of the largest investments in Russia with as high a share as 34 per cent of FDI in that country in 1999. Germany is the home country of most investors in Poland and the second largest source of FDI in Russia and Latvia. Russia is also among the major sources of investment in Latvia. Sweden is the largest source of FDI in both Estonia and Lithuania and Finland the second largest source in both these countries.
### Table 1. Major sources of FDI in the Baltic region transition economies

<table>
<thead>
<tr>
<th></th>
<th>Estonia **</th>
<th>Latvia***</th>
<th>Lithuania****</th>
<th>Poland *****</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FDI position end 1999</strong></td>
<td></td>
<td></td>
<td>Cumulative FDI in 1999</td>
<td></td>
</tr>
<tr>
<td><strong>FDI stock 1999 III</strong></td>
<td>United States 10%</td>
<td>Sweden 22%</td>
<td>Germany 17%</td>
<td></td>
</tr>
<tr>
<td>United States 34%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cyprus 22%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany 8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Great Britain 6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands 4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland 3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden 2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>France 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other 17%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>FDI stock end 1999</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>United States 5%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cyprus 22%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Germany 8%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Great Britain 6%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Netherlands 4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Switzerland 3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweden 2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>France 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Italy 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Japan 1%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others 24%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources:
* The Russian Statistical Office Goskomstat
** Bank of Estonia
*** Latvian Development Agency
**** Lithuanian Development Agency
***** Polish Agency for Foreign Investments PAIZ

In many cases, the investing companies are present in several Baltic region transition countries, not just in one single market. In particular, the same foreign investors tend to be present in all three Baltic countries.

The sources of FDI in Russia are of particular interest. The origin of the 10 largest foreign investors in Russia by September 1999 is depicted by Chart 4. Germany, the United States, Great Britain, France and Cyprus form the group of the five largest foreign investors in general. The investments of the second group, Italy, Holland, Switzerland, Sweden and Japan are much smaller than those of the first group. Among the five largest there is, however, a great difference between direct investors and those who have extended credits to Russia. The United States and Cyprus are the largest direct investors while Germany, France and Great Britain have mostly extended credits to Russia. The investors from Cyprus are generally believed to be of Russian origin, which could indicate a reversion of capital flight back to Russia.
Chart 4

Major foreign investors in Russia by September 1999 (cumulative investment, Goskomstat)

- Direct investment
- Other investment
- Portfolio investment
- Total

Millions of dollars

Germany, USA, Great Britain, France, Cyprus, Italy, Holland, Switzerland, Sweden, Japan
FDI by economic sectors

The economic sectors, which have attracted most FDI in the region differ by country. Industry and manufacturing in general have received the most FDI in Russia and Poland, while the finance sector and telecommunications have attracted the greatest share of investments in the Baltic countries. In Russia the energy sector and food industries have been targeted most by investors. In Poland the most popular industrial sectors have been the food and transportation equipment industries.

Table 2. FDI by economic sector in the Baltic region transition economies

<table>
<thead>
<tr>
<th>Country</th>
<th>Sector</th>
<th>Estonia** End 1999</th>
<th>Latvia *** End September 1999</th>
<th>Lithuania**** End 1999</th>
<th>Poland ***** End 1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia*</td>
<td>Industry 64% (Energy 35%, food 19%)</td>
<td>Transport, warehousing and telecommunications 27%</td>
<td>Transport and telecommunications 31%</td>
<td>Post and telecommunications 30%</td>
<td>Manufacturing 44% (Food, beverages and tobacco 12%; Transport equipment 11%; Non-ferrous goods 6%)</td>
</tr>
<tr>
<td></td>
<td>Trade and catering 13%</td>
<td>Finance 24%</td>
<td>Finance 23%</td>
<td>Manufacturing 27%</td>
<td>Finance 20%</td>
</tr>
<tr>
<td></td>
<td>Transportation 10%</td>
<td>Industry 23%</td>
<td>Manufacturing 17%</td>
<td>Wholesale and retail trade 21%</td>
<td>Trade and repair services 9%</td>
</tr>
<tr>
<td></td>
<td>Telecommunications 4%</td>
<td>Wholesale and retail trade 16%</td>
<td>Trade 16%</td>
<td>Financial services 12%</td>
<td>Construction 5%</td>
</tr>
<tr>
<td></td>
<td>Others 9%</td>
<td>Others 10%</td>
<td>Others 18%</td>
<td></td>
<td>Transport, warehousing and telecommunications 5%</td>
</tr>
</tbody>
</table>

Sources:
* The Russian statistical office Goskomstat
** Bank of Estonia
*** Latvian Development Agency
**** Lithuanian Development Agency
***** Polish Agency for Foreign Investments PAIZ

Is there policy competition?

A search on the websites of national investment promotion agencies around the Baltic Sea region reveals that the main selling arguments of the countries are very similar. Tables 3 and 4 list the arguments as presented on the home pages of the agencies of 8 countries: 5 transition economies (Russia, Estonia, Latvia, Lithuania and Poland) and 3 members of the European Union (Denmark, Sweden and Finland). The tables do not provide a comparison of the actual investment environments in each country – as researched by an outside body – only the selling arguments of the agencies. It is assumed that these reflect the competitive advantages of the countries as judged by the promotion agencies.

Almost all countries use their geographic position at the intersection point of East and West as one of their main arguments. For each country the position is, however, somewhat different. While most countries consider the Baltic Sea region, including the Russian and other CIS-markets as the targeted eastern
markets, in the case of Russia these markets are further east than those of the other countries. Particularly in the case of Poland, the proximity of western markets is also highlighted. In addition to the geographic position, market growth is also a common argument among the countries.

Stressing the favourable investment climate, the transition economies refer to enquiries among multinational companies or just to the sheer number of investors (as in the case of Poland), while the Scandinavian agencies (Denmark and Finland) draw attention to high ratings in the World Competitiveness Yearbook. In reference to the living environment, the Estonian agency stresses equal treatment with locals while the Swedish agency points out that “amenities and living conditions for expatriates are highly attractive”. A well developed infrastructure, particularly in the areas of telecommunications and transportation are major selling arguments of most countries. The same applies for a highly educated workforce throughout the region. A competitive cost level is used as a selling argument for Russia, the Baltic states and Denmark.

Potential opportunities for investment in the five transition economies include mainly those sectors, which already have attracted investments, such as the energy sector in Russia. The Scandinavian countries have a number of potentially attractive industries in common, in particular the information technology and food sectors. Investors’ attention is drawn to export-orientation and growth in the export-led industries by Russia, Latvia, Lithuania and Denmark.
Table 3. Reasons for investing in the Baltic Sea Region according to the national investment promotion agencies of the Baltic Region transition economies

<table>
<thead>
<tr>
<th>Arguments</th>
<th>Russia</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geographic position</td>
<td>Natural bridge between East and West</td>
<td>Baltic Sea Region – a fast growing market</td>
<td>Unique geographic location in the heart of fast growing region/ access to CIS market</td>
<td>Central European location; proximity to Western markets; gateway to Eastern markets</td>
<td></td>
</tr>
<tr>
<td>Market size and growth; natural endowments</td>
<td>Vast market; extensive natural resources</td>
<td>One of the strongest growths in the region</td>
<td>Strong macro-economic indicators</td>
<td>New leader in economic growth</td>
<td>A population of 39 million ranks eighth in Europe; strong growth in the 1990s</td>
</tr>
<tr>
<td>Investment climate</td>
<td>Strong support from authorities</td>
<td>Favourable investment climate, liberal and open economy</td>
<td>Positive country ratings; business climate conducive to growth</td>
<td>Multinational investor satisfaction</td>
<td>Positive country ratings; rapidly growing investments</td>
</tr>
<tr>
<td>Living environment</td>
<td>Pleasant place to live and work – equal treatment with locals</td>
<td></td>
<td></td>
<td>Political and ethnic stability</td>
<td>Ethnically homogeneous population</td>
</tr>
<tr>
<td>Potential sectors for investment</td>
<td>Investment potential in energy sector</td>
<td>Wide range of investment opportunities</td>
<td>Potential for high value added wood-based production</td>
<td></td>
<td>Insurance Building materials Telecommunications &amp; electronics Transportation equipment Mechanical &amp; metal industry Chemical, food, Packaging, Textile &amp; leather industry Natural resources and agriculture</td>
</tr>
<tr>
<td>Export-orientation</td>
<td>Fast growth in export-oriented industries</td>
<td>Changing pattern of foreign trade</td>
<td>World-standard export production</td>
<td></td>
<td>Sea connections; transit position</td>
</tr>
<tr>
<td>Infrastructure/ technological base</td>
<td>High-technology niches</td>
<td>Advanced telecommunications infrastructure</td>
<td></td>
<td></td>
<td>Sea connections; transit position</td>
</tr>
<tr>
<td>Workforce attributes</td>
<td>Highly educated population</td>
<td>Highly skilled productive work-force; excellent communication skills</td>
<td>High intellectual potential of workforce</td>
<td>Highly educated, low-cost workforce</td>
<td>One of the youngest workforces in Europe</td>
</tr>
<tr>
<td>Cost level</td>
<td>Relatively low labour costs</td>
<td>Secure, low cost base</td>
<td>Significant cost efficiencies; growing industrial productivity</td>
<td>Low operating costs</td>
<td></td>
</tr>
<tr>
<td>Special</td>
<td>Extraordinary business opportunities</td>
<td>A popular destination</td>
<td>Special economic zones/ Free ports</td>
<td>Free economic zones and industrial parks</td>
<td>14 special economic zones</td>
</tr>
</tbody>
</table>
Table 4. Reasons to invest in the Baltic Sea Region according to the national investment promotion agencies of the Scandinavian EU members

<table>
<thead>
<tr>
<th>Arguments</th>
<th>Denmark</th>
<th>Sweden</th>
<th>Finland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Geographic position</td>
<td>Gateway to the Baltic region</td>
<td>Strategic base in the Baltic Sea Region; cultural and historic links with neighbouring countries</td>
<td>The business centre of the new Northern Europe; A total of 80 million consumers</td>
</tr>
<tr>
<td>Market size and growth; natural endowments</td>
<td>Strong economy with balanced budget, stable currency and low inflation and interest rates</td>
<td>The largest market in Scandinavia</td>
<td>Strong Scandinavian purchasing power and surging demand from East; one of the most rapidly growing markets</td>
</tr>
<tr>
<td>Investment climate</td>
<td>One of top ten investment countries in the world according to the World Competitiveness Report</td>
<td>Home of many world-class multinational corporations, with a long tradition in international business operations</td>
<td>Number three in the World Competitiveness Yearbook of 1999</td>
</tr>
<tr>
<td>Living environment</td>
<td>Danish way of life ranked best in the world</td>
<td>A fair, open and productive society; Highly attractive amenities and living conditions for expatriates</td>
<td>Reasonable cost of living</td>
</tr>
<tr>
<td>Arguments</td>
<td></td>
<td>Denmark</td>
<td>Sweden</td>
</tr>
<tr>
<td>Potential sectors for investment</td>
<td>IT, Telecommunications / Electronics</td>
<td>Automotive</td>
<td>Mineral Exploration</td>
</tr>
<tr>
<td></td>
<td>New media in Denmark</td>
<td>Food industry</td>
<td>Health Care</td>
</tr>
<tr>
<td></td>
<td>Denmark as a business hub</td>
<td>Food industry</td>
<td>Health Care</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Growing exports to and investments in the Baltic Region</td>
<td>Integration with the Baltic countries</td>
</tr>
<tr>
<td>Export-orientation</td>
<td></td>
<td>Extensive road and rail network, three international airports and ten seaports with free port and trade zone facilities</td>
<td>Excellent telecommunications and air transport connections; leading IT-nation</td>
</tr>
<tr>
<td>Infrastructure/technological base</td>
<td></td>
<td>Excellent telecommunications and air transport connections; leading IT-nation</td>
<td>Northern Europe’s value added logistics centre; Highly developed level of information technology; Best telecommunications network worldwide</td>
</tr>
<tr>
<td>Workforce attributes</td>
<td>Well educated, motivated and creative</td>
<td>Freely available speak English, Finnish, Norwegian, Danish, German, Polish, Estonian and Russian-speaking personnel</td>
<td>Labour force, which responds to new challenges</td>
</tr>
<tr>
<td>Cost level</td>
<td></td>
<td>Competitive cost framework</td>
<td>Competitive operating costs</td>
</tr>
<tr>
<td>Special/incentives</td>
<td></td>
<td>Financial and industrial incentives</td>
<td>Stockholm’s position as the financial centre of the region; corporate tax rate of 28 per cent</td>
</tr>
</tbody>
</table>
The role of incentives in the selling arguments of the investment promotion agencies is not very pronounced. Of the transition economies, Latvia, Lithuania and Poland list special economic zones, industrial parks or free ports, while the EU-members list both industrial and financial incentives (Table 5). However, general tax incentives are the major inducements directed at the potential foreign investors, and among them, tax levels on profits. According to Table 5, the profit taxation rate ranges presently from 25 per cent in Latvia to 33 per cent in St. Petersburg\(^1\) according to the information given by the national investment agencies. In addition, there are plans in Poland to reduce the rate to 22 per cent by 2004. Estonia and Lithuania have, in turn, introduced legislation, which exempts undistributed profits (Estonia) and profits retained for investments (Lithuania) from profit tax. Thus there are clear signs of tax incentives becoming more relevant around the Baltic region in the competition to attract foreign direct investment. A direct comparison of the rates is, however, made very difficult particularly among the transition economies, as the financial statements are still mostly produced according to national accounting regulations, which vary considerably in detail.

In compensation for the absence of tax incentives, the Scandinavian countries offer a wide range of financial incentives, such as special investment loans and guarantees as well as venture capital firms, which are not yet widespread in the transition economies.

**Table 5. Tax and financial incentives**

<table>
<thead>
<tr>
<th>Country</th>
<th>Corporate income tax rate</th>
<th>Special aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>Profit taxation rates in 1998: St. Petersburg 33% (Federal 13%, Local 20%)</td>
<td>16 free economic zones with different incentives; international financial organisations and investment funds with high transparency requirements</td>
</tr>
<tr>
<td></td>
<td>Profit is defined as revenue minus limited expenses</td>
<td></td>
</tr>
<tr>
<td>Estonia</td>
<td>26%; exemption from income tax on undistributed profits</td>
<td>Regional investments subject to tax concessions</td>
</tr>
<tr>
<td>Latvia</td>
<td>25%; substantial depreciation rates for fixed assets; exemption from VAT and customs duties on investment in fixed assets</td>
<td>Tax concessions in free economic zones</td>
</tr>
<tr>
<td>Lithuania</td>
<td>29%; exemption on profit retained for investments 10% for companies producing agricultural products</td>
<td>Tax concessions in free economic zones</td>
</tr>
<tr>
<td>Poland</td>
<td>30%, decreasing to 28% in 2001-2, 24% in 2003, 22% in 2004</td>
<td>Income tax exemptions in 14 special economic zones</td>
</tr>
<tr>
<td>Denmark</td>
<td>32%</td>
<td>EU-funded support R&amp;D-grants for start-ups Venture capital firms with a state guarantee</td>
</tr>
<tr>
<td>Sweden</td>
<td>28%</td>
<td>Investment and other aid for SMEs R&amp;D incentives EU-funded regional support Investment loans and guarantees for SMEs</td>
</tr>
<tr>
<td>Finland</td>
<td>28% 29% on capital gains</td>
<td>Investment and other aid for SMEs R&amp;D incentives EU-funded regional support Investment loans and guarantees for SMEs</td>
</tr>
</tbody>
</table>

\(^1\) For 1998, in early 2000 the profit tax was lowered to about 30 per cent in St. Petersburg (11 per cent federal taxes and 19 per cent local)
Tentative conclusions

Some tentative general conclusions on the FDI situation in the transition economies of the Baltic region can be made:

- FDI has been growing very rapidly in Poland and the Baltic countries both in absolute and relative terms.
- The growth of FDI in Russia was curtailed by the economic crisis of 1998.
- The major investing countries include the United States and northern European neighbouring countries; in Russia there is also some evidence of capital of Russian origin returning to the country.
- The economic sectors which have attracted FDI are largely the same: telecommunications and financial services in all three Baltic countries, while Poland and Russia have attracted more investment in industry and manufacturing, notably the energy and food sectors.
- To a certain extent the countries are competing with each other in order to attract FDI, as the sources of FDI are mostly the same and also the economic sectors, which have attracted most investments, do not differ greatly among the countries.
- There are clear signs of tax incentives becoming more prevalent around the Baltic region in the competition to attract foreign direct investments.
- Instead of tax incentives, the Scandinavian countries offer a wide range of financial incentives, such as special investment loans and guarantees as well as venture capital firms, which the transition economies do not yet have.
ATTRACTING FDI TO THE BALTIC NATIONS: 
THE ROLE OF FISCAL INCENTIVES

by

Joel Bergsman

This note is an expanded and more formal version of remarks prepared by the author and presented at the OECD conference on fiscal incentives and competition for foreign direct investment (FDI), which took place in Vilnius on 30 May 2000. It takes into account the other presentations and the discussion at that conference. All statements in this paper are the sole responsibility of the author, and do not necessarily represent the views of the OECD or of any of the nations, institutions or individuals participating in the conference.

Executive Summary

Competition does exist for some, but not all, of the FDI flows in today’s world.

Much of the explosion in FDI (foreign direct investment) in the world as a whole, during the last ten years or so, has been a response to the opening of many countries (including the Baltic nations) to such investment, and the improvement in business conditions in even more countries worldwide. A lot of the decisions about making these investments, especially those that went to developing and transition countries, were in a positive-sum mode: a “go – no go” decision whether or not to make a particular investment in a particular place, without any competition from alternative places. This decision mode is common for privatizations, other mergers and acquisitions (M&A), and for most investments aimed at the domestic market of the host country.

Other investment decisions, especially for greenfield manufacturing investments aimed at exporting, are typically taken in a competitive framework: the decision is made to make an investment somewhere, usually in a particular region (such as central and eastern Europe), and different alternative sites within that region are considered for that investment in a zero-sum framework.

What is the role of taxation and tax incentives in these investment decisions? A very bad tax system – very high rates, very unstable rules, and/or very corrupt administration – may remove an otherwise attractive place from consideration. But the opposite is not true: very low tax burdens do not, by themselves, attract investment to an otherwise uninteresting place. This can be seen most clearly in most of sub-Sahara Africa, where incentives typically reduce the corporate tax burden to zero or almost, but very little FDI comes. At another extreme, much more than half of all FDI goes to countries with moderate to high tax burdens: western Europe and the United States. So moderate taxation, by itself, does not keep FDI away, any more than low or zero taxation, by itself, attracts FDI.

Given a reasonable tax system and a reasonable investment environment, taxation considerations play only a limited role in the first kind of investment decisions mentioned above, but may play a bigger role in the second, i.e. where alternative sites are being compared. Taxation, including lower burdens achieved by fiscal incentives or other means, tends to be most important in the following situations:
– for foot-loose, export-oriented investments,
– in countries or regions that are similar to neighbouring countries or regions,
– in places with good business climates, and
– incentives that occur sooner in the project’s life and are more certain.

Many commonly used fiscal incentives, especially tax holidays, do not affect most investment decisions. This implies a lower benefit/cost ratio of such incentives. The revenue foregone by the incentive, on all investments, produces only the benefits of the relatively small share of those investments that are additional. Promoters often claim high additionality, or do not even recognise that many investments were not additional and thus implicitly claim 100 per cent additionality, in arguing that benefit/cost ratios of incentives are high. But with reasonable estimates of additionality, the benefits look much smaller in relation to the revenues foregone.

Estonia, Latvia and Lithuania share four characteristics that are important in analysing the role of fiscal incentives in attracting FDI:

– Their internal markets were completely unpenetrated by western goods and services at independence. But, individually or even in combination, they are too small to be so attractive that investors will come even if conditions are bad.

– Their labour forces are for the most part well-educated, and their living standards are moderately high. This limits to a significant extent the attractiveness of the countries for investments seeking the lowest paid unskilled labour for assembly of simple products.

– Especially in the past decade, they have offered many interesting opportunities for M&A through privatizations and other deals with existing companies. Foreign investors were attracted to specific opportunities in each country.

– Competition with neighbouring countries is likely to get stronger, as more of the neighbours establish decent business environments and as more of them move to attract greenfield investments which are inherently more able to choose among alternative sites.

All three Baltic countries have performed very well, on a worldwide scale and in proportion to their economic size, in attracting FDI. A very great part of the FDI that has come to all three countries – well over two-thirds – has been of kinds that are not particularly sensitive to incentives or tax considerations in general – privatizations and/or domestic-market-oriented investments – i.e. the “go – no go” kind rather than the “here or there” kind. Export-oriented, greenfield, manufacturing investments have been only a very small share of the total FDI.

Compared to developing and transition countries worldwide, the outstanding investment attraction feature of the Baltics, led by Estonia, was the early and rapid establishment of the basics of a good business environment – although each country can still find improvements to make. Estonia has become well known as a successful country that created its own competitive advantage. Decent tax systems were part of this crucial good environment, but fiscal incentives do not seem to have been crucial.

Indeed all three countries have offered few or no fiscal incentives for parts of the last ten years, with what may be a trend toward less use. Today, Estonia offers no discretionary or otherwise selective incentives. Latvia is also contemplating a system with no discretionary incentives, but an automatic 30 per cent
reduction in the corporate income tax (CIT) rate for all investments meeting a to-be-published list of criteria. Lithuania continues to offer discretionary incentives to large investments, some of them fiscal. All three countries are reducing effective CIT rates, which they correctly see as a good alternative to fiscal incentives.

One of the characteristics of tax systems that is universally accepted as desirable is stability. Since all three of the countries have decent systems, no one should lightly recommend more changes. Nevertheless, issues that should be considered in further analysis, perhaps for change some years in the future, include:

- For Estonia, possible problems with its zero tax on undistributed profits, including tax avoidance, excessive revenue loss relative to additional investment attracted, and legal complications under tax treaties and elsewhere. These all suggest a careful examination of alternatives – such as accelerated depreciation, or investment tax allowances or credits.

- For Latvia, the political and administrative aspects of the contemplated incentives for investments meeting certain “high-tech” criteria suggest examination of alternatives such as labour training and/or research subsidies of one form or another, targeted at the same class of business.

- For Lithuania, a second look at the cost-effectiveness and the administrative aspects of the CIT exemption for reinvested retained earnings, and also at the desirability of a legal provision that mandates discretionary incentives, for large investments only, in the inevitable competition for the most desirable potential foreign investments.

Of course every country, each of the three Baltic nations included, needs to consider these and other options in designing a tax system that will enable it to face the growing competition for FDI – and at the same time be stable over time, facilitate adequate revenue collection, discourage tax avoidance, treat taxpayers equally, and be reasonably easy to administer. This is particularly important in the Baltics where future rapid growth must be based mainly on exports of goods and services, and FDI with this orientation tends to choose among locations. To do a good job in improving their tax systems in this environment requires a good understanding about the effects of the country’s current system, and about how the country is seen by foreign investors in the context of those investors’ corporate strategies. Feedback from existing companies, both foreign-invested and purely local, is needed to learn more about how the system actually operates and what aspects of it, if any, are seen as particularly negative. Quantitative analysis of the tax burden of the system as a whole, done comparably for competing countries, and with sensitive analysis to show the effects of possible changes in the system, is essential to see where the country stands and how changes in the rules might affect that standing. On the basis of such knowledge and analysis the countries could confidently consider further improvements in their business tax systems.

**Context and General Considerations**

Even after decades of experience all over the world, and considerable analysis, it seems that disagreements continue concerning the proper role for fiscal incentives in attracting FDI. The discussion at the OECD conference in Vilnius on May 30, 2000 was no exception.

**Competition for FDI**

Competition among countries to attract FDI has been building for the last twenty or thirty years. A revolution in attitudes of countries towards incoming direct investment has transformed fear of foreign
influences to recognition of the need for not only capital but also management skills, technology and access to export markets. “Multinational” corporations (MNCs), spurred by revolutions in communications and transport technologies, have become more and more truly “transnational”, allocating production of various parts and components, assembly, accounting, and other functions to various places according to something that approximates a worldwide or region-wide strategy. Such a strategy involves not only subsidiaries or other companies linked by common ownership, but also quite a few other companies with whom they have less formal alliances. These MNCs locate different operations in different countries according to how well it all works; even within a single product line, engineering may be in one or two places, production in different ones, financing in yet another, etc.

In Central and Eastern Europe, this competition to attract MNCs is very strong. The region has, taken as a whole, a large and still unsaturated market. And more and more countries within it are making progress with reforms to offer basically good business conditions, to complement their generally well-educated labour and low production costs, as investment attractions. Thus the region is attractive as a site to serve both its own markets, those of western Europe, the former Soviet Union to the extent of the attractiveness and accessibility of those markets, and even more distant ones elsewhere in the world.

These and other changes in international production all around the world – “globalisation” – have raised the stakes for a country or region in relation to attracting FDI. The MNCs themselves are in a much more competitive environment today, and their own choices of sites are constrained: they cannot afford to pick a non-competitive place. Places that don't get MNCs find it much more difficult than it used to be to acquire or develop up-to-date technology, or to break into export markets. So, from the viewpoint of world trade and industrial competitiveness, the distribution of nations is tending to become almost dichotomous: either you offer conditions that attract MNCs and you are competing, or you do not and you cannot. ²

In their quest for more FDI in this environment, country after country has established its investment promotion agency, and these agencies are vying to attract the most investment – often engaging in bidding wars, especially for large and/or “high tech” investments. Officials of these IPAs seem to be in no doubt that they are in a fiercely competitive business. They see the product that they sell – their country as a site for foreign investments – as competing with other countries, and they are inventing and using all the marketing devices they can think of (or can afford) to convince the potential buyers – executives of MNCs – to buy from them and not from the competition – that is, to locate in their country rather than somewhere else.

But is it so? In what senses are these countries actually competing with each other? If Indonesia gets a motorcycle plant, does that mean that Thailand – or the Czech Republic, or Mali – does not get one? If Estonia attracts an MNC bank from western Europe, have Latvia or Lithuania lost that investment? Do MNC executives start with an idea for an investment project and analyse mutually alternative sites for it in a zero-sum framework? Or do these executives look at sites, one by one, and in each case decide what kind of investment, if any, they should put there – making more investments if there are a larger number of attractive locations?

The huge boom in FDI during the last ten years or so is clearly, to some extent at least and especially to the developing and transitional countries, a result of the general improvement in business conditions – including simply the removal of prohibitions on FDI – in country after country. So some foreign investment decisions have not been taken in a zero-sum framework. But to answer these questions in more detail and with more sophistication, we need to know some of the same things that tell us about the efficacy of fiscal incentives.

². See, e.g. Michalet (1997).
The role of fiscal incentives

Many economists disdain tax incentives, seeing them as at best not effective in attracting additional investments while at the same time losing revenue for the Treasury, and at worst as expensive distortions that actually reduce the true value of output. Much research suggests that most fiscal incentives are not likely to be cost-effective; executives of multinational corporations usually downplay the importance of incentives in their decision-making. Most directors of foreign investment promotion agencies, on the other hand, have never met an incentive they didn’t like. These FDI promoters argue that they cannot do their jobs without being able to grant incentives.

It’s obvious that very generous incentives, or simply very low tax burdens, don’t by themselves attract FDI. (High burdens and/or unstable rules may repel FDI, so reducing taxes from very high to moderate could result in increased FDI inflows.) If anyone doubts this statement, consider most countries in sub-Saharan Africa, which have very generous tax holidays and other tax incentives that reduce effective tax burdens to foreign investors to very low levels. These countries are receiving very little FDI. Nepal is another example. The reasons for the ineffectiveness of incentives in these cases are obvious: other than some resource-based activities, these countries do not offer a lot of good opportunities to make money in the kinds of activities that FDI is active in; many of them are also unstable or present other non-economic difficulties; their domestic markets are small and they are isolated from sources of both inputs and foreign markets. So even zero taxes will not “attract” much FDI to these countries or regions, because zero taxes on no income, in a difficult environment, is not an attractive business proposition. What little FDI does come to these places is attracted by some location-specific niches – minerals, petroleum, tourist sites, etc. – and within those attractive niches FDI would probably not be repelled by a moderate tax burden. The only important exception, if there is one, is simple assembly of goods using cheap unskilled labour – garments; shoes; toys and sporting goods; the simplest kinds of electrical or electronic equipment, etc.

It’s equally easy to see the opposite kind of example. Almost all the FDI in the world goes to places where the taxes (net of any fiscal incentives) are moderately high: The United States, the European Union, Brazil, Mexico, etc. Perhaps 80 per cent of current FDI flows are to countries where the effective corporate income tax burden is at least 25 per cent, and in most of them even higher. This FDI is attracted by the most powerful of all investment attractions: markets. Most of these countries also have the other basics that are needed to attract FDI:

- stable politics, decent governance, and stable and sensible economic policies;
- a convertible currency or access to it; no restrictions on conversion, repatriation of profits and/or of capital (once any taxes due have been paid)
- avoidance of excessive restrictions and regulations; a business-like government that delivers what it promises and facilitates the operation of privately-owned companies in an open market environment;
- a labour force that’s educated, trainable, and working under laws and rules that permit flexibility; and
- a decent and functioning legal system, including international treaties, domestic laws, courts, international arbitration, and effective local enforcement institutions and mechanisms.

For small economies (such as those of the Baltic nations), a very good export climate is also very important (as the Latvian paper presented at the conference well describes). This includes a good system of exemption, postponement or prompt reimbursement of any import duties and VAT paid on exported
products, good physical infrastructure for trade, and quick, efficient and honest border procedures for both imports and exports.

What role is left for fiscal incentives, or even for tax policy in general?

Going one level of detail beyond the above generalisations shows that tax relief, including possibly fiscal (or more generally cost-reducing) incentives, can make a difference in some cases. These cases are defined by three dimensions:

- the kind of place;
- the kind of investment; and
- the kind of incentive.

Kinds of place

A lower tax burden, which can be achieved by an infinite number of combinations of low tax rates, accelerated depreciation, investment tax credits or allowances, tax holidays, and other provisions, can possibly be effective in two apparently different but basically similar kinds of places:

- similarly attractive platforms (such as Taiwan), to attract investment aimed at producing for export to other markets, or
- similarly attractive parts of one large market (such as states within the United States or Brazil, or countries within the European Union), to attract investment aimed at that market.

As previously noted, even zero taxes forever will seldom induce an investment in an unacceptable environment. But where the investor is considering alternative locations that offer acceptable and roughly comparable conditions for producing for export to a market that is a lot larger than the political jurisdictions in question, he faces actual or potential competition from other investors who may choose any of the same locations, so reducing his costs is very important. Investment promotion agencies in North Carolina, or Ireland, know this and that is why they offer generous tax incentives, cash grants, cheap land, labour training incentives, and other inducements – in spite of the many econometric studies, investor surveys, and economists who seem to tell them not to do so. North Carolina is competing for investments that have already been committed to the United States, and Ireland for other investments already committed to Europe. Since there are many good sites all over the United States, and all over the European Union, the smaller jurisdictions within these markets face competition from their neighbours in attracting those investments.

This also explains why most large attractive countries do not offer incentives on the national level – the national governments of the United States, Brazil, and Mexico, for example, offer no incentives to foreign investments (although Brazil and Mexico, and the United States in earlier days, offered high protection in their domestic markets, and Brazil still has not completely abandoned this strategy).

3. An exception, China, is an interesting case. When China opened to FDI in 1979 it put in place what became three important ways in which FDI was treated better than domestic enterprises (which were virtually all SOEs): lower corporate income tax, freedom to retain 100 per cent of all foreign exchange earnings, and more freedom to hire and fire workers. The latter two items were nothing more than giving FIEs what is normal international treatment, in recognition of the fact that the way Chinese SOEs were
Kinds of investments

As already noted, fiscal incentives or other ways to achieve low tax burdens are unlikely to be particularly effective, or even necessary, to attract the “go – no go” kind of investment decision. Most privatisation or other M&A investments are of this type. So are investments in most services to serve domestic markets; e.g. banks. Investments tied to location-specific resources such as minerals, hydrocarbons, beautiful beaches, etc. are also less sensitive to taxation, as long as it is not excessive or administratively very difficult. Most sensitive are the kinds of investments for which many different locations are possible; essentially, manufacturing to serve regional or worldwide markets beyond the jurisdiction where the investment will be located.

Kinds of incentives

Research has also shown that incentives tend to be more effective if they occur sooner in the life of a project, if they are more certain, and (the combination of the two) if they reduce the investment cost. Thus, corporate income tax holidays are useful only if the investment produces profits, and only when that happens – which is usually a few years after the investment expenditures commence. Such incentives are considerably less powerful than grants or other instruments that can actually reduce the cost of the investment, at the time the costs are incurred and independently of whether the investment ever generates profits. Debt-equity swaps, widely used in Latin America in the 1980s, induced a lot of investments that otherwise would not have taken place, because they reduced the amount of money the company had to put up to make the investment in the first place.4

To sum up this part of the discussion, the effectiveness of lower taxation, including fiscal incentives, differs depending on the kind of investor, the kind of incentive, the degree of competition for the investment, and the quality of the place. Lower taxation, fiscal incentives, or other cost-reducing incentives tend to be most effective:

- for foot-loose, export-oriented investments,
- in countries or regions that are similar to neighbouring countries or regions,
- in places where the other relevant aspects of the business climate are also acceptable, and
- where the incentives occur sooner in the project’s life and with more certainty.

Investors consider the entire “package” that a particular site offers – including inherent and/or unchangeable attributes as well as those subject to government policy. Many investment decisions are not choices of place, but rather “go – no go” decisions for a specific investment in a given place. Tax considerations are seldom paramount in these decisions. Other decisions involve where to put a facility for which the decision to put it somewhere has already been taken. In some of these cases, where most other factors are positive in more than one place, a major difference in the tax regime can make a difference. Instability, bad administration, or very high tax burdens can be decisively negative, and very low taxes can be decisively positive, in such cases.

---

restricted would impede almost all FDI. The lower tax rates, in retrospect, probably did not generate much additional FDI and therefore were probably mostly just losses for the treasury.

So there have been cases where tax incentives have been decisive in attracting an investment. This does not mean that such incentives are a good idea. Remaining questions include what proportion of all investments would have been made anyway, and what policies other than incentives might work even better. After that there are still issues about what incentives to use, and how to administer them (e.g. automatic or discretionary).

As the previous discussion suggests, many commonly used fiscal incentives do not affect most investment decisions relating to most host countries. This is especially true of one of the most commonly used incentives, tax holidays. A study recently done for FIAS of the effectiveness of such incentives in Thailand concluded that only about 20 per cent of the investments that received incentives would not have been made in the absence of the incentives. I personally find this estimate surprisingly low – I suspect that the additionality may have been slightly higher, especially for export-oriented investments. But except for the most footloose, low-wage simple assembly investments, there is a broad consensus that the additionality of tax holidays is low.

The lower the additionality, the lower the benefit/cost ratio of such incentives. Whatever variable is used to measure some of the benefits of the investment attracted by the incentive – new jobs created is a common one – the benefits are only those produced by the relatively small share of investments that are additional. The cost, in terms of revenue foregone by the government and, in the case of foreign investments, by the entire economy, accrues from all investments that get the incentive, whether they are additional or not. Promoters often claim high additionality, or in some cases do not even recognise that many investments were not additional and thus implicitly claim 100 per cent additionality, in arguing that the benefit/cost ratios of incentives are high. But with reasonable estimates of additionality, the benefits look much smaller in relation to the cost in terms of foregone revenues.

Even for those cases where the tax system matters, incentives are only one of many dimensions considered by investors. Of course, all investors will bargain hard to get every possible tax break, and if incentives are allowed by the country’s laws then investors will insist on them. It can be predicted that no investment of over US$50 million will be made in Lithuania unless it is granted all the incentives available under the recently passed law that authorises the government to use its discretion in granting incentives to these large investments. This type of behaviour, common all over the world, makes it seem to investment promoters that incentives make a big difference to the investors. But the world (and the region) is full of examples of countries that do not offer tax holidays or other such “incentives”, but still attract a lot of investment. Czechoslovakia and later the Czech Republic, and all three Baltic nations, are examples for much of the 1990s. Poland has recently adopted the same approach, and Romania may be about to do so. A tax package can be competitive for most investments (other than the most footloose) without incentives if it embodies the basics:

- reasonably low or moderate tax rates,
- reasonably honest and businesslike administration and enforcement system,
- adequate or even generous depreciation allowances and loss-carry-forward provisions, and
- adherence to international accounting practices as to the deductibility of normal business expenses.

**Automatic vs. Discretionary Incentives:** Most FDI promoters want to have discretion in granting incentives or other inducements. There are only two rationales for discretion that make sense, even in principle: (a) to avoid “wasting” incentives by not giving them to FDI that would come anyway, and (b) to focus them only on activities that are especially desired; i.e. to implement an industrial policy. The latter
rationale, implementing an industrial policy, may have more practical application. It is beyond our scope in this note as it is a different question than that of attracting FDI.

The former rationale, to give incentives only where the investment would not come without it, sounds appealing. In terms of the previous discussion, discretion opens the potential for increasing the additionality of incentives considerably. Compared to low taxes for all, the discretionary incentive promises to collect taxes from investments which would have been made anyway, but to concede advantages only to investments which (a) are especially desirable; e.g. “high tech,” and (b) would have gone elsewhere without the incentive.

Denying incentives to domestic investors is one way such discrimination is sometimes practised; this does not seem to require a case-by-case discretion but can be applied automatically. However, in several Central European countries that tried this, including Hungary (and Lithuania, as suggested by the note on that country’s system presented at the Vilnius conference), many domestic investors found cousins or friends or, anyway, someone across the border who became a partner and enabled their businesses to become foreign investments benefiting from tax incentives. (In China, incidentally, this process is legal and has “caused” perhaps 25 or 30 per cent of the reported FDI going to China. These flows were in fact investments by Chinese-owned companies established in Hong Kong or elsewhere in order to take advantage of the incentives available.) Minimum size thresholds are sometimes then used, in an attempt to suppress the smaller of such deals. These thresholds then create resentment in other, smaller legitimate foreign investors. Such discrimination also causes resentment at the more favourable treatment of foreigners. For these reasons, few countries have maintained this strategy for more than a few years.

In fact, in most countries that have tried case-by-case granting of fiscal incentives, this ability to discriminate and grant the incentives only where deemed to be necessary has not worked very well. Most FDI promoters have neither the expertise, nor the stingy integrity that would be needed to exercise that expertise if they did have it. Once the possibility of a discretionary incentive is available, every potential investor insists on getting it – and more if he has a really attractive deal. And to the extent that some investments are actually denied the favours, the use of such discretion can create lots of arguments and dissatisfaction from investors who fare less well than others. Many of the south-east Asian nations continue to use such instruments, but their popularity among national governments has fallen drastically in the rest of the world and is continually being questioned even in Asia. Sub-national governments do continue to use discretionary incentives of many kinds – often not fiscal.

Even legally fixed discrimination – i.e. discrimination without discretion – can cause more problems than it may be worth. The package of incentives introduced in the Czech Republic in April 1998, including tax holidays, excluded any investment below $25 million. Faced with furious investors who were investing smaller amounts (often, several times so that their total investment over a few years was well above the minimum), this threshold was lowered to $10 million in less than one year. More recently a further liberalisation, lowering it to $5 million, was established for investment in distressed areas. Why smaller investments are less valuable than big ones for the Czech economy is not clear; perhaps what is clear is that the weaker political clout of these smaller investors has led the Czech government to treat them less well than other investments which may not be in any way better, but are just bigger. In fact the minimum size limits were a compromise between the promoters who did not want any limits, and the Ministry of Finance who wanted no tax holidays at all. The changes in this scheme since its initial establishment only two years ago shows how difficult it is to offer more incentives to some investors than to others.

In cases of whole sectors where rents are high and it is obvious that incentives are unnecessary, the law or regulation can automatically exclude FDI in such activities from any incentives generally on offer. While this may also generate resentment, at least its rationale is clearer and somewhat more defensible. There do not seem to be many candidate sectors to which this principle applies in the Baltics, however.
The unspoken third reason why some investment promoters like discretion is that it increases their power, permitting them to attract bribes or other perquisites that can be attracted by that power. In some countries such abuse has become notorious; in any country it is a temptation and at least potentially a danger.

It does seem to be a fact that big, attractive investments seem to get some kinds of discretionary inducements in virtually every place in the world. If the national government doesn’t do it (or often even if it does) provincial and/or municipal governments will fight to land the large automotive or machine tool or computer chip plant. When the Intel site selection team gets off the plane to look around, they are not ignored. Without denying this fact of life, we can confidently recommend a package of (a) reasonable tax rates, depreciation rules, etc., within a stable and at least minimally honest tax system; (b) automatic inducements that operate through the tax system, e.g. an investment tax allowance, if anything more is considered necessary; (c) inevitably, some kind of very low tax rate environment for low-skilled export processing investments if the country wants to attract them. For the small number of extremely attractive investments that can demand more, it seems both preferable and possible to limit the incentive to deal-specific inducements such as cheaper land, provision of required infrastructure, etc. rather than to grant tax concessions which then become very difficult to withhold from all subsequent potential investors.

Policies and Results in Estonia, Latvia and Lithuania

How do the countries fit in the general context?

All three Baltic countries, while different, resemble each other in some ways that are relevant to the previous discussion:

- At independence, internal markets were hungry for western-quality goods and services. Although small, they were almost virgin territory and hence attracted considerable manufacturing and services to serve those domestic markets. However, they were, and are, too small to be so attractive that investors will come even if conditions are bad.

- Well-educated labour forces and moderately high standards of living limit the attractiveness of the countries to investments seeking low-paid unskilled labour for simple assembly tasks. This limitation is not absolute, but significant.

- Especially in the past decade, many interesting opportunities for M&A through privatisations and other deals with existing companies existed. A very high share of all FDI so far has been linked in one way or another to pre-existing attractive companies.

- Competition with neighbouring countries is strong and is likely to get stronger. The first wave of FDI that was attracted by privatisation and the production of consumer goods and services is nearing completion in the Baltics. Moreover, more and more of the other countries in the region are establishing decent business environments, and are also, necessarily, moving to attract greenfield investments which are inherently more able to choose among alternative sites.

In the past decade, the importance of privatisation and initial investments for the domestic market are consistent with the facts that the three countries have attracted considerable FDI during periods when they

---

5. For a report on how Costa Rica attracted an Intel plant without Costa Rica’s either breaking its rules or giving away the store, see Spar (1998).
did not grant fiscal incentives. About two-thirds of the FDI in the region was in non-tradable activities, which are generally insensitive to fiscal incentives. Most investments in the manufacturing of tradable goods were oriented at the domestic market. For example, in Lithuania it appears that there were no export-oriented investments among the top 10, and only about 8 among the top 30. For Latvia there seems to be at most one export-oriented investment (excepting trade and transport) among the top 10, and perhaps 8 in the top 40. Even among the few investments in manufacturing that were oriented at export markets (where fiscal incentives in general may be more effective), many of the initial investments were attracted by some existing company with whom the investor had done business in the past, or some other specific asset that a particular country offered. So even these investments, to a great extent, were not likely to go elsewhere in the absence of fiscal incentives.

The future will be different. Privatisation still has some scope, notably in Lithuania, and there is still room for additional domestic-market-oriented investments (in both services and manufacturing). However, the only possible fast-growth scenario for the future for these economies, and in particular as destinations for continuing large inflows of FDI, can only be based for the most part on exports (of services as well as goods). Further improvements in the business climate, mainly in making the governments even more hassle-free, business-friendly and efficient, will be crucial. Improving existing telecoms and transport infrastructure strengths is similarly important. Tax competitiveness will play a basic role; a detail here or a few percentage points there will not be crucial, but woe to the country whose business tax system as a whole is significantly worse than that of its neighbours. Administration of tax systems will play as big a role as tax rates or incentives, in investors’ evaluations.

**Past policies and results**

All three countries have done very well in attracting FDI, led by Estonia and more recently Latvia and also Lithuania. All three have changed their policies on taxation and fiscal incentives considerably over the last decade, using more or less complicated incentives for some periods, as for example the Lithuanian note for the conference mentions. All three now seem to be at least partly disillusioned by their past use of complex and/or discretionary incentives.

- As I understand it, Lithuania exempts retained profits that are used for new investments from the CIT, and is now formally using discretionary, case-by-case incentives for investments of over US$50 million. These incentives may take various forms; on the tax side they are apparently limited to a guarantee of no increase in the CIT rate for five years with a possible additional five added on. Lithuania is also said to be moving toward a low CIT rate of 15 per cent, and it was not made clear whether any discretionary incentives would remain available if and when this happens.

- Latvia is contemplating an automatic 30 per cent reduction in the CIT rate for companies with ISO certification and producing certain high-tech products (to be listed in the near future) beginning in 2001.

- Only Estonia has apparently completely abandoned the more traditional incentives, preferring to lower the tax burden by deferring all CIT until distributed to foreign or Estonian natural owners. (In other words Estonia does not tax corporate income as such, but only that portion

---

6. I have estimates of at least 67 per cent not-tradable for Estonia, 70 per cent for Latvia and 60 per cent for Lithuania. The actual number for Latvia is probably about 80 per cent.

7. See OECD (2000b) and OECD (2000c) for a wealth of information regarding FDI in Latvia and Lithuania. Some of the country-specific material in this paper is based on these draft papers.
of it that is paid as dividends, and with the further exception of dividends paid to other Estonian corporations.)

All three countries claim good loss-carry-forward provisions, reasonable or generous depreciation schedules, and normal deductibility of all business expenses.

Of course the outstanding feature of the Baltics, led by Estonia, was the early and rapid establishment of the basics of a good business environment. This was their basic way of attracting FDI. Estonia has become well known internationally as a country that to a great extent created its own competitive advantage, with great success.

It is not possible to be sure just how much of the FDI that did come to the Baltics thus far was due to the incentives used, at various times, by the three countries. What we think we know about incentives in general suggests that there was little additionality. This is because most of the FDI was in privatisation, and/or aimed at selling in goods or services in domestic markets, and/or attracted to a particular company that the investor already knew and valued. Most of such investment would have come without any special fiscal incentives; perhaps the sales prices for the assets being privatised might have been somewhat lower.

The incentives may also have had some value as signalling devices, telling foreign investors that even as these countries worked to get their business climates in order during the early years of independence, the investors were welcomed and would not be heavily taxed. Whatever the importance of this phenomenon was in the past, the need for it in the future seems doubtful.

**Policies for the future**

In considering the future, two very different general considerations must be taken into account by all three countries:

- It is almost a certainty that, whatever the nature and intensity of competition the countries faced during the 1990s, this competition will increase. This is especially true for Estonia and Latvia; in Lithuania there is still considerable privatisation to be done, which is inherently less competitive in terms of attracting FDI.

- Since all three countries want to join the European Union, that body’s restrictions on state aid and its code of conduct rules may require rollbacks of some existing incentives as well as limiting any additional ones in the future. Of most concern in this regard are the tax holidays and other fiscal incentives that all three countries may be granting to investments in export processing zones of one sort or another, which in general are not condoned by the European Union. Discussions on this point are in progress between European Union accession officials and officials of the Baltic countries.

Estonia’s deferral of profits tax until paid out in dividends may be problematical in several different ways.\(^8\)

On the economic side, this provision may induce some tax avoidance behaviour, a subject that needs to be analysed in detail by tax experts. On the legal side, this provision is not normal practice in most advanced countries, in the European Union and elsewhere, and thus may cause problems in interpretation: Is it covered in the many bilateral treaties that Estonia has negotiated? Is it to be interpreted as a tax on corporate income, or on dividends? (The Estonians make a good case for the former interpretation, but others may disagree.) Since this tax deferral is, in effect, a tax holiday on prosperous companies, it may

---

\(^8\) See OECD (2000a) for a more detailed discussion.
also be relatively inefficient in inducing additional investment – its costs in terms of revenue foregone might be very high relative to investments that would not have come without it.

For all these reasons, it would seem a good idea to investigate the pros and cons of alternatives, such as investment tax credits or allowances, more rapid depreciation, etc. The quantitative impact of the deferral in the context of the entire Estonian system, including the moderately high tax rate of approximately 35 per cent on dividends, needs to be included in this analysis, to calculate the effective tax burden of the combined set of policies on various typical investments. It may well be that a different alternative would have fewer potential problems attached to it and at the same time be more efficient in terms of inducing more investments in relation to the foregone revenue costs.

Latvia’s avoidance of incentives other than automatic holidays to specified high-tech companies may work reasonably well, but it can be predicted that the definition of the eligible list of products will be a source of controversy, and may also be difficult to administer. Whether this tax holiday is the best way of trying to attract such investments is also a question; providing education and training as well as other things such companies need might be a better way of doing so, while at the same time enriching the Latvian economy directly by improving its human and physical capital.9

Lithuania remains the only country to grant case-by-case discretionary incentives, and these to foreign investors only. The less than satisfactory experience of other countries, including near neighbour Czech Republic, which are briefly described above, should raise a signal for caution about this approach.10 The availability of these incentives is specified in law, which means that every investment over the US$50 million threshold will insist upon them, and every investment anywhere near that threshold will also demand them, raising a large public complaint if and when they are reminded that they are ineligible. The possible incentives in this package are unspecified and apparently varied; on the fiscal side they appear to be limited to no more that a guarantee of no increase in the CIT rate for five or even a possible ten years. This particular privilege does not seem very costly. The exemption from the CIT of profits retained and used for additional investments, however, seems possibly difficult to administer and also likely to be relatively inefficient; companies already operating and making profits will invest more if they see additional profits, but an exemption from a 29 per cent CIT is hardly likely to induce many companies to increase such reinvestments if they do not see additional profits coming from them. The contemplated move to a 15 per cent CIT rate would seem to make both incentives, or indeed fiscal incentives of any sort, less needed and even less desirable.

However, taking into account the importance of stability, I would be hesitant to recommend any significant change in tax rules for these countries, for several years at least.

Looking at the medium term, to form a sounder basis for more detailed, more assured, and more concrete suggestions as to proper tax and incentive policy for any of the three countries, more needs to be known. More needs to be known about the effects of their actual systems, and more needs to be known about how investors see each country and how the nature of the competition they face is likely to evolve in the next five years or so.

Feedback from existing investors, both foreign and local, is needed to know how the actual tax system operates. Is it generally administered in honest and fair ways? What if any administrative improvements

9. See, again, Spar.

10. This less than fully approving judgement is not based on any wish that Lithuania “be a good boy” on the international scene and not pursue its own economic interests in trying to attract FDI that it finds desirable, as was suggested by one speaker at the conference. Rather the caution is exactly, and only, based on doubts as to whether the approach adopted is in fact a good way for Lithuania to pursue its own interests.
might be especially valued by honest businesses? What if any particular taxes seem excessive by international standards?

Other information from existing and potential investors is also needed as to how the country does or does not fit into their corporate strategy. Why did they come, or not come, to a particular country? Were other countries considered for the investment, and if so, which ones and why? What elements of the business climate were important in the decision, both in positive ways and in negative ways? What if any specifically tax-related aspects mattered? This analysis should be stratified by sector and market orientation of the investors, so as to see more clearly how the extent and nature of competition may vary among different kinds of investors, who may be more or less sensitive to different aspects of the business climate.

The effective tax burdens, taking into account the whole package of the tax rates and rules, need to be calculated for all three countries and some of their neighbours, on a consistent basis.¹¹ These numerical results would give a good idea of whether any of the countries offers either a particularly favourable tax environment, or a particularly unfavourable one, in comparison to others in the region. The results, with appropriate sensitivity analysis, would also show the effects of specific provisions such as Estonia’s tax deferral, and alternatives to it such as, e.g. an investment tax allowance.

Finally, all this analysis should be done in the context of designing and implementing a development strategy focused on exports of goods and services. The future attractiveness of each of the three countries to FDI will depend, to a great extent, on their attractiveness for export production.

Only with such information available can one conduct a truly sensible, well-informed conversation with the authorities of any of the countries. This information is needed to fashion a system, with or without particular incentives, that will enable the country to face the growing competition for FDI in the region – and at the same time maintain a tax system that can be stable over time, which will facilitate adequate revenue collection, discourage tax avoidance, treat taxpayers equally, and be reasonably easy to administer.

¹¹. See Mintz and Tsiopoulos (1992) for an example.
REFERENCES AND OTHER BACKGROUND


Organisation of American States (1990), The Impact of Tourism Incentives in the Caribbean Region.


TAXATION OF FOREIGN INVESTORS IN LITHUANIA

by

Mr. Vitas Vasilauskas

Lithuania is very interested in attracting foreign investors to bring their capital and know-how to Lithuania. We are acutely aware that foreign investment is one of the fundamental keys to the economic future of the country. Creating the appropriate legal and tax environment for foreign investment has been one of the principal goals in the reforms we have undertaken of our laws and regulations. The focus here is only on the measures taken and planned with respect to the taxation of foreign investment.

We believe that there are at least two basic approaches to take with respect to establishing a good foundation for foreign investment: (1) adopting special tax incentives that apply exclusively to foreign investments; and (2) creating a tax system that is solid, stable, and conducive overall for business, whether the enterprise be financed by domestic or foreign capital.

Our tax laws take both approaches. The Lithuanian tax system began with a number of different tax holidays. These tax holidays, special exemptions, and reduced tax rates for foreign investment seemed the easiest solution at first. However, administering the laws and rationalising the difference in treatment between foreign investors and our own business ventures was not as simple as the original idea to simply grant holidays. We think these tax holidays were useful in their time, since they certainly attracted foreign capital, and provided predictability in taxation for foreign investors who were unfamiliar with the Lithuanian system. The Lithuanian tax system, during the 1990s, we must admit, has gone through many changes, as have the tax systems of our neighbours. The tax holidays helped to bridge this period of great change, by guaranteeing a certain stability to our foreign investors.

Over the years, our emphasis has shifted. While we still have tax benefits specially aimed at foreign investors, we are concentrating more on creating a stable tax system. We cannot neglect our domestic businesses, and we believe that sophisticated, serious foreign investors will appreciate a tax system that is rational, that is neutral, that does not create burdens against repatriating profits, that permits the deduction of normal expenses, with a possibility of carrying forward net operating losses. This is the system we are intending to put in place. We hope to attract foreign investors who will bring in their capital to Lithuania as a natural extension of their activities in the global market.

In combination with particular tax benefits specially aimed at foreign investments, a stable tax system should make Lithuania an attractive place for foreign investors. Please bear in mind that we do not intend that Lithuania become a tax haven for foreign investors seeking to evade taxes in their home countries. Rather, we want Lithuania to be an honourable member of the world economic community. Foreign investors will have to decide for themselves whether the other conditions present in Lithuania, such as our labour force, our market, and our resources, will make investment worthwhile. Taxes are only part of the picture. Our intention is that taxes be designed so as to stimulate and not hinder investment.
Special Tax Incentives for Foreign Investors

1. The Law on Investments into Lithuania of July 7, 1999 – "Strategic Investors"

The Law on Investments of July 7, 1999, provides that, when a foreign investor invests no less than 200,000,000 litai and meets certain other criteria, the investment may be considered a “strategic investment”, and the Government of Lithuania may enter an agreement with the investor that the tax rates in effect at the time the threshold investment is committed, will not be changed for a period of five years (with a possibility of extending the term for an additional five years). In other words, tax benefits may be granted to major investors, at the discretion of the Lithuanian government.

We believe that this tax benefit is preferable to the granting of outright tax holidays. Our strategic investor plan is a more flexible mechanism. The tax relief may be designed especially for the investor and the particular business involved. For instance, the Government can refuse to grant incentives if it finds that there are elements of tax avoidance motivating the investment.

The Government will consider whether the investor is a bona fide “foreign investor.” We need to ensure that the company organised under the laws of a foreign country is a “genuine” foreign company. We must ensure that local Lithuanian businessmen might not have formed a company in another country simply for the purpose of investing in Lithuania as a foreign investor and thereby gaining the benefit of the special tax benefits for foreign investment.

Also, we need to consider carefully exactly what constitutes an “investment” for purposes of this benefit, as well as the point at which we will consider that the threshold investment has been reached to qualify as a potential strategic investment.

Indeed, the granting of the status of a strategic investor, is not always as obvious as it might seem. But we believe the fact that each case is determined on its own merits is a good way to avoid the problems that make broad, automatic tax incentives for foreign investors so difficult to administer.

2. Former Tax Incentives (repealed after 1997)

For information, we would like to summarise quickly some of the former tax incentives granted to foreign investors in Lithuania. You will see that Lithuania too has tried very broad tax benefits, but we were discouraged by the difficulty of their administration and of preventing their abuse.

Foreign investment made before December 31, 1993

29 per cent tax rate reduced by 70 per cent (i.e. special rate of 8.7 per cent) applied for the first 5 years after registration of a corporation in which foreign capital was invested before December 31, 1993, but the special rate only applied to that proportion of taxable income equivalent to the proportion of foreign capital in the business’s total capital, and only to the extent that such income was not used for wages, but reinvested in the business of the enterprise.

29 per cent tax rate reduced by 50 per cent (i.e. special rate of 14.5 per cent) applied for the sixth to eight year after registration of a corporation in which foreign capital was invested before December 31, 1993. The special rate only applied to that proportion of taxable income equivalent to the proportion of foreign capital in the business’s total capital, and only to the extent that such income was not used for wages, but reinvested in the business of the enterprise.
Foreign investment made from January 1, 1994-August 1, 1995

29 per cent tax rate reduced by 50 per cent (i.e. special rate of 14.5 per cent) applied for the first 6 years after registration of a corporation in which foreign capital was invested, but the special rate only applied to that proportion of taxable income that is attributable to the foreign investment.

Foreign investment of 2 million US$ or more (before April 1, 1997)
(excl. wholesalers and retailers of oil products if proceeds from oil products are >30 per cent of sale revenues)

29 per cent tax rate reduced to 0 per cent for the first 3 years after first quarter during which the level of foreign capital investment of a foreign investor reached 2 million US$.

29 per cent tax rate reduced by 50 per cent (i.e. special rate of 14.5 per cent) applies for the fourth to sixth year after the 2 million US$ threshold is reached.

The complexity and difficulty of interpreting and administering these tax benefits, even though we had the best of intentions, made them too inefficient to continue.

We learned another important lesson: that it was important to attract serious, sophisticated investors who valued Lithuania and would contribute to Lithuania’s economic development. Investors who could afford to ignore the conditions of their investment, other than the tax benefits, were precisely those who invested only for so long as the tax benefit lasted. They quickly pulled out their investments and moved to another advantageous location as soon as the need arose (i.e. the tax break ended). We learned to place greater emphasis on developing a coherent and neutral tax system to help both foreign as well as domestic investors.

3. The Lithuanian legislation relating to free economic zones and related tax measures

The creation of free economic zones in Lithuania has been accomplished by means of the special law on the basic principles governing free economic zones, the specific laws setting up free economic zones in areas such as Siauliai, Klaipeda and Kaunas, and the provisions of the tax laws that grant special tax incentives to companies organised in such zones.

Under the provision of the current corporate income tax law, the regular tax rate of 24 per cent reduced by 80 per cent (i.e. a special rate of 4.8 per cent) applies for the first 5 years after the registration of a corporation in a free economic zone. The regular rate of 24 per cent reduced by 50 per cent (i.e. a special rate of 12 per cent) applies for the sixth to the tenth year after the registration of a corporation in a free economic zone.

Special provisions apply to corporations that are registered in free economic zones and that are at least 30 per cent (in value) owned by foreign investors that have invested no less than 1 000 000 US$. That is, a 0 per cent tax rate applies for the first 5 years after registration, and the regular 24 per cent tax rate reduced by 50 per cent (i.e. a special rate of 12 per cent) applies for the sixth to the tenth year after registration.

For all businesses in free economic zones, taxable income is reduced by expenses incurred for the acquisition of essential fixed assets, research costs, technology costs and for investment and capital investment.
Our free economic zones have been criticised by the European Commission. They are considered to have created special privileges for enterprises to attract them to Lithuania rather than the enterprises’ home countries. The free economic zones, according to European Union experts constitute harmful tax competition, as well as a form of unacceptable state aid. The European Union tolerates some tax privileges as part of a strategy for regional development, but we are still debating with the Commission as to whether the benefits to be offered in the Lithuanian free economic zones exceed those tolerated by the European Union principles.

Creation of a Stable Business Income Tax Law

We believe that special tax incentives are not the only reasons serious investors are attracted to a particular country. It seems to us that serious investors will consider also the economic and political stability of our country, our well-trained low cost labour, access to markets and materials, as well as the legal infrastructure. We believe it is critical for Lithuania to have in place a “normal” tax system. We are in the process of drafting a new business income tax law, which we believe will be fair and neutral to all businesses.

The new business income tax law will provide for a greatly reduced tax rate for all taxpayers – 15 per cent. Taxable income will be determined after the deduction of most ordinary business expenses, including the possibility of accelerated depreciation of long-term assets. Of course, we will continue to permit the carry-forward of net operating losses to the next succeeding five years. The taxation of shareholders and corporations will be co-ordinated so that double taxation of distributed profits will be minimised. We are also preparing laws to permit the tax-deferred reorganisation and liquidation of business entities.

Foreign companies that operate a trade or business in Lithuania through a branch will be taxed on the income earned through this branch, after deduction of expenses attributable to these activities. Payments or transfers of assets from the branch to its home office outside Lithuania will not normally be subject to tax in Lithuania, since the branch is considered part of the same legal entity as its home office.

Foreign companies that derive occasional profits from sources in Lithuania, but do not have a trade of business in Lithuania, will be subject to a withholding tax of 15 per cent. As in all cases when taxes are withheld at the source, no deductions are permitted.

We intend to implement a neutral and reasonable policy that will not overly burden profits that are repatriated from Lithuania by our foreign investors.

However, we must note that there has been significant political pressure to eliminate the corporate income tax altogether in Lithuania. Persons arguing in favour of this say that this will stimulate the development of enterprises in Lithuania and that it will attract foreign investors. We have attempted to draft laws along these lines, but the Ministry of Finance has found it practically impossible to devise a satisfactory scheme that will ensure fair and efficient taxation of both Lithuanian residents and foreign investors. All drafts of an income tax law without a corporate-level income tax push the entire burden of taxation onto persons who receive payments from Lithuanian businesses. In fact, they end up discriminating against foreign investors, who repatriate their earnings from their tax-free businesses. Lithuanian business would not be taxed if they received similar payments. Of course, foreign investors can always repatriate profits in less direct ways, through, for instance, manipulative transfer pricing practices. But, this is not a situation we wish to encourage. The Ministry, for now, continues to support the goal of a neutral, efficient tax system. We believe a well-balanced and fair tax system will do more to stimulate investment than special schemes.
Lithuania’s Tax Treaty Network:

Of course, the treaties that Lithuania has entered into with other countries to eliminate the double taxation of profits earned in international operations will affect the taxation of investments made by residents of a treaty contracting state in Lithuania. It is obvious that tax treaties are very important to ensure fair taxation of foreign investments in Lithuania, as well as provide reduced tax rates for repatriated profits. For that reason, we intend to pursue as actively as possible tax treaty negotiations with as many countries as we can, a policy we have followed throughout this last decade.

At the present time, Lithuania has entered tax treaties with the following countries:

- Belgium (signed 26 November, 1998)
- Byelorussia (signed 18 July, 1995)
- Canada (signed 29 August, 1996)
- China (signed 3 June, 1996)
- Czech Rep. (signed 27 October, 1994)
- Denmark (signed 13 October, 1993)
- Estonia (signed 13 September, 1993)
- Finland (signed 30 April, 1993)
- France (signed 7 July, 1997)
- Germany (signed 22 July, 1997)
- Ireland (signed 18 November, 1997)
- Iceland (signed 13 June, 1998)
- Italy (signed 4 April, 1996)
- Kazakhstan (signed 7 March, 1997)
- Latvia (signed 17 December, 1993)
- Moldova (signed 18 February, 1998)
- Norway (signed 27 April, 1993)
- Poland (signed 20 January, 1994)
- Russia (signed 29 June, 1999)
- Sweden (signed 27 September, 1993)
- Netherlands (signed 16 June, 1999)
- Turkey (signed 24 November, 1998)
- Ukraine (signed 23 September, 1996)
CORPORATE INCOME TAX POLICY IN ESTONIA

by
Ms. Lemmi Oro

Taxation of profit distributions is according to the Income Tax Act of Estonia, in force since 1 January 2000.

The main principles in the Income Tax Act concerning the profit distributions, are taxation of the distribution, not the accumulation of the income, and the application of the tax exemption on the profits reinvested within the company. Residents and non-residents are treated in the same manner to the maximum possible extent.

Dividends

The transfer of capital in order to distribute profits is usually done in the form of dividends. The dividends paid by the non-resident companies to Estonian resident natural persons are taxed at the usual tax rate of 26 per cent (Article 18 section 1, tax rate Article 4 section 1), with the possible adjustment deriving from the use of the ordinary credit method to avoid the double taxation of foreign investment (Article 45).

The dividends paid to Estonian resident companies and to non-resident legal persons having a permanent establishment in Estonia are tax-exempt irrespective of the place of residence of the person paying the dividends. No effective economic relation between the activities of the permanent establishment and the person paying the dividends is required. The existence of the permanent establishment in Estonia is sufficient to obtain the exemption.

The dividends paid to resident natural persons and non-resident natural and legal persons by an Estonian resident are in fact taxable but, as a general rule, the tax is collected at the level of the company paying the dividends and not at the level of the beneficiary owner. Therefore it is certainly a corporate tax, since the person receiving the dividends has no obligation to pay the tax even if the company has not fulfilled the requirements of calculating and paying the tax on dividends at the time of distribution. According to Article 18 section 1 and Article 29 section 8 of the Income Tax Act the dividends received by the resident natural person and non-resident direct investor are tax exempt. The respective articles do not contain reference to Article 50 which establishes the arrangement for paying the dividend tax. Consequently, the dividend tax exemption at shareholder level does not depend on the payment of the corporate tax.

The tax rate for the company paying the dividends is 26/74 of the gross amount of the dividends.

The exemption of the dividend tax is not applicable if dividends are paid by an Estonian resident to the foreign portfolio investor (the non-resident holding less than 25 per cent of stock or share capital). Application of this principle is explained by the need to attract direct investments into Estonia, as experience shows that real economic activity is mostly carried out only in these cases. Attention should be drawn to the fact that the parent-subsidiary directive does not cover dividend payments to the companies that have less than 25 per cent holding in the company paying the dividends; thus, there is no restriction to impose the additional tax in the tax legislation of the European Union.
The taxation of dividends is best illustrated in the following table:

<table>
<thead>
<tr>
<th>Person making the payment</th>
<th>Beneficial owner</th>
<th>Tax liability</th>
<th>Withholding obligation</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resident</td>
<td>Resident legal person</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Resident</td>
<td>Resident individual</td>
<td>At corporate level</td>
<td></td>
<td>26/74</td>
</tr>
<tr>
<td>Resident</td>
<td>Non-resident direct investor</td>
<td>At corporate level</td>
<td></td>
<td>26/74</td>
</tr>
<tr>
<td>Resident</td>
<td>Non-resident portfolio investor</td>
<td>At corporate and shareholder levels</td>
<td></td>
<td>26%</td>
</tr>
<tr>
<td>Non-resident</td>
<td>Resident legal person</td>
<td>26%, credit</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Non-resident companies having a permanent establishment in Estonia are treated in the same manner as Estonian resident companies.

**Capital Transfers**

Capital transfers are taxed according to their relation to the business activities of the person making the transfer.

The taxation of the capital transfers made by the Estonian permanent establishment of a non-resident is based on the principle according to which the permanent establishment is, for taxation purposes, treated like a separate legal person distributing the profits.

The system of dividend taxation is applicable to taxation of the property of the permanent establishment or the profits earned by it. This means that if it transfers the capital, the permanent establishment has to calculate and pay tax equal to 26/74 of the amount of the capital transferred. The tax is imposed (Article 53, section 4):

1) on the property or the capital of the permanent establishment, if it is transferred to the third parties outside Estonia and no goods are given or services provided in return;

2) on the property or the capital of the permanent establishment, if it is transferred to the other units of the same legal person or to its headquarters outside Estonia and no goods are given or services provided in return.

The capital transferred by an Estonian resident company to its permanent establishment outside Estonia is not taxed, as in this case the transfer is always treated as effectively connected to the business activity of the company.

The capital transferred by an Estonian resident company to a non-resident is treated as a distribution of profits and consequently taxed as dividends in the following cases (Article 52 section 2):

1) if, in return for this capital, the property is not necessary for business activity, or the securities are issued by a legal person located in a low-tax jurisdiction (Article 10), or the participation in such a legal person, or the right of claim against such a legal person is acquired;

2) if the payment is characterised as a fine for delay, penalty payment or compensation for damage without a court decision to a legal person located in a low-tax jurisdiction;
3) if the loan is given or an advance payment made to a legal person located in a low-tax jurisdiction.

The capital transferred to an Estonian resident is tax exempt, following the rule that the taxation object is not the accumulation, but the distribution of the profits. Resident legal persons are taxed only on the profit distribution payments mentioned in articles 48-52. According to these provisions capital transfer into Estonia is not a taxable event at all.

NOTE: Income tax law can be found at the following web-site: www.fin.ee
DIRECT TAX POLICY INCLUDING INCENTIVES FOR FDI IN LATVIA

by
Gunta Kaulina

Before this meeting we analysed the Latvian corporate income tax policy and, surprisingly, found that at present there are no special corporate tax reliefs applicable only to foreign investors or companies with foreign participation.

However, until April 1 1995 our Law on Foreign Investment provided for tax holidays that were granted automatically to any company registered in Latvia in which foreign participation was at least 30 per cent and the capital invested was not less than US$50 000. In this case the tax holidays were granted for two years from the first year of profitability (three years if foreign participation was at least 50 per cent and the capital invested was not less than one million US$).

The tax holidays applicable under the Law on Foreign Investment were abolished as of April 1 1995, but those already granted before that date remain in force. Thus, a very small number of companies in Latvia at present enjoy special tax incentives designed to attract foreign investment.

Instead of automatically applicable corporate tax incentives available only to foreign investors, various generally applicable tax incentives were introduced from April 1, 1995. The new incentives are based on the actual results of economic activity, value of fixed assets used in the generation of taxable income and other criteria based on the actual business activity of a taxpayer. The incentives are not based on the fact of foreign participation in the capital of an enterprise. It is important that the new incentives are applicable to any company registered in Latvia, with or without foreign participation. Instead, therefore, of corporate tax incentives for foreign investors, in the case of Latvia there are corporate tax incentives applicable to any company registered in Latvia whether there is foreign participation or not.

The following are the main corporate tax incentives available to Latvian companies (including companies with foreign investment):

**Accelerated depreciation**

On determination of its taxable income, a company may deduct annual depreciation of fixed tangible assets used in its business. The depreciation for tax purposes shall be calculated at increased rates that vary from 10 per cent (buildings, constructions and plant) to 70 per cent (computers, information systems, software products and data storage systems).

**Special regional support schemes**

Companies established to carry on business in areas recognised as special (supportable) regions under the law are entitled to two additional types of tax benefit: the first – depreciation of fixed assets used within the special regions may be computed using an increased depreciable base. The depreciable bases are increased by coefficients from 1.5 to 2 depending on the type of an asset, and the second – losses may be carried forward for 10 years instead of 5 years allowed under the generally applicable provisions.
Transfer of losses

Companies of the same group are allowed to transfer losses within the group. A group consists of a principal company and its subsidiaries. The term “principal company” means a legal person (a principal “company” may also be an individual) that has resident status in Latvia or in a state with which Latvia has a tax treaty in force. The term “subsidiary” means a resident company in which (i) the principal company, (ii) one or more of its subsidiaries or (iii) a combination of the principal company and its subsidiaries holds an interest of at least 90 per cent.

The main conditions for transferring losses between two companies within one group are as follows:

− both companies must have resident status in Latvia and not in any other state;
− both companies must have been members of the group for the entire tax year in respect of which losses are transferred;
− the tax years of both companies must end on the same date; and
− neither company may be exempt from or enjoy a reduced rate of corporate income tax;

Losses may be transferred to a company only to the extent that they do not exceed the taxable net income of that company.

Incentives available to companies meeting special criteria

(This tax relief is granted in the form of a tax credit against the corporate income tax computed under the generally applicable provisions).

Tax relief for Hi-Tech companies

The tax relief for hi-tech companies is 30 per cent of the corporate income tax computed under the normal rules. An enterprise qualifies as a hi-tech company if the following two criteria are met:

− hi-tech products (recognised as such by the Cabinet of Ministers) constitute at least 75 per cent of the net turnover of the enterprise, and
− the company has received ISO 9000, ISO 9001 or ISO 9002 certification.
Small enterprise tax relief

The tax relief for small enterprises is 20 per cent of the corporate income tax computed under the normal rules. A company qualifies as a small enterprise in a given tax year if at least two of the following criteria are met:

- the balance-sheet value of fixed assets must not exceed LVL 70 000;
- the net turnover must not exceed LVL 200 000; and
- the average number of employees must not exceed 25.

Agricultural enterprise tax relief

The tax relief for companies engaged in agricultural production is equal to LVL 10 per calendar year for each hectare of land used for agricultural production.

Special economic zone corporate tax relief

Two special economic zones (SEZ) have been established in Latvia: in the port of Liepaja and the surrounding area a zone has been established for a period of 20 years, from 1 March 1997 to 1 March 2017; another zone has been established in Rezekne, also for 20 years, from 4 November 1997 to 4 November 2017.

Domestic or foreign investors wishing to operate in a zone must establish a SEZ company that can be either a joint-stock or a limited liability company established under Latvian law. Certificates that entitle companies to the tax benefits of the particular zone are issued for a specific period of time. During a certificate’s period of validity, the SEZ company is protected from changes in law; i.e. a company will enjoy the tax benefits available at the time of incorporation for the period stated in the certificate. At the moment, the following direct tax benefits apply to SEZ companies:

1) the amount of corporate income tax is reduced by 80 per cent. Since the normal rate of corporate income tax is 25 per cent, the effective rate of tax is 5 per cent;

2) depreciation at rates of up to 100 per cent may be applied to all categories of fixed assets, but only if less than 20 per cent of the goods manufactured are brought into the territory of Latvia (other than the special economic zones);

3) losses may be carried forward for 10 years;

4) immovable property tax levied on immovable property located in the zone and owned by a SEZ company is reduced by 80 per cent. In addition, local authorities may grant a further reduction of 20 per cent and, consequently, the company may be fully exempt from immovable property tax;

5) immovable property tax on land located in the zone and owned by or allocated to a SEZ company is also reduced by 80 per cent. Local authorities may grant an additional reduction in tax of up to 20 per cent, and the company may therefore be fully exempt from tax;
6) withholding tax on payments to non-residents (see 6.3.) is reduced by 80 per cent (this reduction does not apply to the withholding tax on payments to residents of tax havens, however). Thus, the effective rate of withholding tax is 2 per cent on dividends and on management and consultancy fees. Royalties are subject to withholding tax at the effective rate of 1 or 3 per cent, depending on the type of royalties.

**Tax treaties and incentives**

In connection with tax incentives granted under the Latvian law it should also be mentioned that some of Latvia’s tax treaties contain special provisions that allow foreign investors from certain countries to benefit from the Latvian tax incentives granted in the form of a credit. In tax treaties concluded with the Nordic countries, these countries agreed to grant a so-called “tax-saving” credit for Latvian income taxes payable in Latvia, but from which an exemption has been granted for the purpose of promoting economic development in the country. Under the special provisions of treaties, Nordic countries agreed, in order to eliminate double taxation of their residents, to recognise the Latvian tax for which the exemption has been granted in Latvia, as tax actually paid in Latvia. As a result, the taxpayer in his country of residence will save the amount of tax equal to the tax exemption granted in Latvia.

Thus, the Latvian corporate income tax law together with two other laws on special economic zones and on special (supportable) regions provides for various tax incentives applicable to any company operating in Latvia. Taken together, the incentives result in considerable tax savings, and after the introduction of the new corporate income tax law in 1995, the budget revenues from corporate income tax decreased. However, from 1996 onwards, the total budget revenues from corporate income tax increased year by year. Thus, it can be concluded that the corporate income tax introduced in 1995 is relatively liberal for potential investors and at the same time also fulfils its basic task of ensuring a considerable share of revenues for the state budget.

**Immovable property tax**

Development of property taxation also should be mentioned to evaluate the influence of direct taxes on foreign direct investments in Latvia.

Latvian property tax at rates of 0.5 per cent to 4 per cent was levied also on fixed assets (equipment), which considerably slowed down foreign investments in Latvia and it was decided to replace it with the immovable property tax applicable only to immovable property (land, buildings and constructions). In 1997, the Law on Immovable Property Tax was enacted to replace the Law on Property tax as of January 1 2000.

Thus, as from January 1 2000 only immovable property tax is levied on immovable property such as land, buildings and constructions.

The rate of immovable property tax at present is 1.5 per cent. Until 1 January 2002 the taxable base for land is its cadastral value and for buildings and constructions – their book value. As of January 1 2001, the tax rate will be 1 per cent, and the taxable base for land as well as buildings and constructions will be the cadastral value.

Thus, the taxable base of immovable property tax has been considerably narrowed (fixed assets-equipment is no longer subject to property taxation), the rates have been decreased – from 4 per cent to 1.5 per cent (1 per cent from January 1, 2002) and investors (foreign and domestic) will no longer be “punished” for investing in fixed assets – equipment.
Earlier application of property tax to fixed assets – equipment was widely criticised by domestic and foreign entrepreneurs performing business activity in Latvia and the reduction of taxes on property shows the willingness of the Latvian government to take the necessary steps to meet the needs of all potential investors – domestic and foreign – as well as to improve the general investment climate in Latvia.
A PRESENTATION
by
Mr. Eric Tonon

It is a great pleasure for me to be given the opportunity to address this OECD Conference on Fiscal Incentives and Competition for Foreign Direct Investment in the Baltic States.

The European Commission and its Delegation in Lithuania, have had the opportunity to discuss intensively the issues linked to taxation with the Lithuanian authorities for a long time.

The same issues are dealt with in the other candidate countries.

I should like to mention in particular the multilateral screening and bilateral screening where taxation issues were discussed in detail. In addition, these subjects are discussed twice a year during one specific sub-committee as agreed under the framework of the European Agreement.

With the opening of negotiations for European Union accession the momentum of these discussions will accelerate.

The European Union is also assisting the Candidate Countries in their efforts for accession to the European Union through the Phare Programme. We are currently implementing here in Lithuania a major project for the modernisation of the Tax Administration. One year ago a Phare project also included a seminar to increase Lithuania’s awareness of the European Union Acquis Communautaire and policies in the field of taxation.

The subject of my speech concerns European Union discipline governing corporate income-tax.

It is indeed crucial for the candidate countries in the context of the accession preparations to have a comprehensive understanding of the European Union standards regarding taxation so as to avoid the use of fiscal incentives that may create problems with the European Union.

The subject of taxation has been appearing more and more on the European Union agenda for over a decade. This accounts for the fact that taxation has been one of the factors, which has prevented the completion of the Single Market.

In the same period taxation has become more and more crucial under the influence of globalisation, as a consequence of the removal of legal, financial and technical barriers to trade. The introduction of the euro is reinforcing this tendency even more. Companies and their production bases are more mobile. Tax has therefore become an important factor in location decisions. The Ruding Committee in its 1992 report,

---
12. The views expressed in this paper are those of the author and do not necessarily represent the views of the European Commission.

13. Defined in the Article 7a of the Treaty as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured”.

56
concluded on the basis of an empirical survey that tax differences among Member States affect foreign
location decisions by multinational firms and cause distortions in competition, especially for mobile
activities such as in the financial sector.

This, in turn, has encouraged national, regional and local authorities to compete in attracting firms to their
areas through various “tax breaks”. As already mentioned today, harmful tax competition means installing
tax regimes which seek or have the effect of gaining tax benefits at the expense of other Member States.

This has two unacceptable consequences. First, an erosion of the fiscal bases; and second, a change in the
structure of tax systems: an increasing proportion of total taxation falls on the relatively immobile factor,
labour, compared with the more mobile capital.

Statistics have shown that between 1980 and 1997 the average effective rate of taxation on employed
labour increased steadily during the period in question from 35 to 42 per cent, while the corresponding rate
for capital and self-employed labour decreased overall from 42 to around 37 per cent.

As a consequence, Mario Monti, who took on the tax portfolio in 1995, launched a new initiative on
taxation in 1996. A “reflection document”, entitled Taxation in the European Union, was approved by the
informal Council of Economic and Finance Ministers (ECOFIN) at its meeting in Verona in April 1996.

The Commission then published, in October 1996, Taxation in the European Union, which summarised the
views of a high level group. The report of this Group mentioned that “any proposal for Community action
in taxation must take full account of the principles of subsidiarity and proportionality”, and recommended
that action should result in “co-ordination” rather than “harmonisation”.

This was then transformed into a formal Communication to the Council in 1997: A package to tackle
harmful tax competition in the European Union.

The “package” of measures envisaged covered measures to eliminate distortions to the taxation of capital
income and to eliminate withholding taxes on cross-border interest and royalty payments between
companies and a “code of conduct” for business taxation.

The European Commission’s approach in proposing this package has been based on two principles. Firstly,
the move towards tax co-ordination should not lead to an increase in the tax burden, which on the contrary
has to be reduced. Secondly, there is no aim of harmonisation in itself. In the discussions in the high level
group, Member States were assured that the Commission's objective is only, in full respect of the principles
of subsidiarity and proportionality, to put forward co-ordinated solutions to problems which the Member
States could not resolve by acting individually.

The central proposal of the package was the Code of Conduct. This was to cover “those business tax
measures which affect, or which may affect, the location of business activity in the Community in a
significant way”; and identified as “potentially harmful those tax measures which provide for a
significantly lower effective level of taxation, including zero taxation, than that which generally applies in
the country in question”.

Five categories of harmful tax measures were particularly highlighted:

- benefits that are given only to non-residents of the country in question or are given only in
  respect of transactions carried out with non-residents;
- benefits that are otherwise ring-fenced from the domestic economy so that they do not affect
  the national tax base;
benefits that are available without there being any real economic activity;

- a basis of profit determination in respect of activities within a multinational group of companies that departs from internationally-accepted rules;

- measures lacking transparency, including those where benefits are given by relaxing statutory rules at an administrative level in a way that is not made public.

The idea of the Code was immediately accepted by both Parliament and Council, and the final text was adopted by the Council of Finance Ministers on December 1st 1997.

The Code represented a completely new strategy. Instead of legally-binding instruments, the Code of Conduct has taken the form of a political agreement that engages Member States to respect principles of fair competition and to refrain from those tax measures which are harmful.

Member States were to inform each other of any “existing or proposed” tax measures likely to fall within the scope of the Code. They were to undertake “not to introduce new tax measures harmful to the Community interest, including the effective operation of the Single Market”; and to re-examine their existing laws and make the necessary amendments as soon as possible with a view to eliminating harmful elements. The Code would also cover co-operation in the “fight against tax evasion and avoidance”; and would require “strict adherence” to Community rules on state aids under Articles 92-94 of the Treaty.

The Council requested the Commission to co-ordinate the exchange of information between the Member States.

The Council emphasised the need to assess the effects which tax measures have on other Member States; and, in so far as they are used to support the economic development of particular areas, to evaluate the extent to which the measures are effective in achieving their aims.

A “follow-up” Group was established by ECOFIN on March 9th 1998, and met for the first time on May 8th 1998, when the United Kingdom Treasury Minister, Dawn Primarolo was elected as its Chairman. This group has therefore become known as the “Primarolo Group”.

The Group's first task was to examine a list, compiled by the Commission, largely on the basis of information supplied by Member States, of national tax provisions which fall within the scope of the Code.

The Commission identified a number of tax schemes and classified them under five headings:

1) Intragroup services.

2) Financial and insurance services, including “offshore” financial services in territories under the jurisdiction of a Member State (e.g. in Gibraltar).

3) Special tax treatment for certain industrial or service sectors (e.g. the film industry).

4) Tax advantages for certain geographical areas (e.g. the Canary Islands).

5) Other measures, including tax incentives for certain kinds of companies (e.g. “micro” enterprises).

The Group's first interim report was published at the end of November 1998.
The European Council in Vienna invited the ECOFIN Council to pursue work on taxation in December 1998.

The second interim report of the Primarolo Group was submitted in May 1999 and the final report was submitted to the Council of Economic and Finance Ministers (ECOFIN) at its meeting in November 1999. The report identified 66 tax measures which were of a harmful nature. Thus, an excellent basis for further work in this field has been established. At its session of February 28 2000 the Council decided to make this report accessible to the public without taking any position on its content and it can be consulted on the internet site of the Council (http://ue.eu.int).

As you will recall, the tax package consists of three elements. No agreement on the proposal for a Directive concerning the taxation of savings income of individuals could be reached as had been hoped at the European Council in Helsinki in December last. Consequently, the outcome of the tax package is unclear at present.

Nevertheless, as far as the Code of Conduct is concerned, the “follow-up” Group met for the last time in April of this year. During the next ECOFIN meeting the mandate of the High Level Group should be renewed and a new Chairman elected. A first success is the Member States’ clear commitment not to introduce new harmful tax measures. A further step forward would be to decide on concrete measures to eliminating harmful elements.

As far as the candidate countries are concerned, I remind them that the Code of Conduct is politically, but not legally, binding. It is assumed that the Candidate countries would have to sign up to the Code at the time of accession.

Finally, I should mention that Commissioner Monti has recently instructed the Commission's Competition Department to examine all the relevant cases of fiscal state aids in business taxation, so as to allow the Commission to comply fully and promptly with its own institutional obligations, also on the basis of the Commission notice of November 11th 1998 on the application of the state aid rules for measures relating to direct business taxation.

In conclusion, it can generally be said that it is obvious that action against harmful tax competition should ideally be taken at a worldwide level, so as to protect the competitiveness of the European Union vis-à-vis third countries. It is for this reason that under the Code of Conduct Member States undertook to promote the adoption of the principles laid down in the Code in third countries and in their dependent and associated territories.

From this description of the European Union measures against harmful tax competition it appears that the OECD and the European Union are following a similar approach. In fact, the work within the OECD on harmful tax competition in a wider geographical context is reinforcing the discussions within the European Union on the Code of Conduct. The European Commission and European Union Member States are fully involved in these OECD discussions. If a satisfactory solution can be reached at the OECD this will minimise the risk of misallocation of investment.
LIST OF PARTICIPANTS

DISCOURS D'OUVERTURE/OPENING REMARKS

Mr. Algimantas Rimkunas
Deputy Minister
Ministry of Foreign Affairs of Lithuania
J. Tumo-Vaizganto 2
2600 Vilnius
LITHUANIA

Mr. Thorbjørn Gjølstad
Director General, Tax Law Department
Norwegian Ministry of Finance
Postboks 8008 Dep
0030 Oslo
NORWAY

Mlle Marie-France Houde
Co-ordinator for FDI
Directorate for Financial, Fiscal and Enterprise Affairs, OECD

PRESIDENTS/CHAIRPERSONS

Mr. Vytas Gruodis
Director General
Lithuanian Development Agency
Sv. Jono st. 3, Vilnius LT2600
LITHUANIA

Ms. Ilga Preimate
Under Secretary of State
Ministry of Economic Affairs
Bribivas bulv. 55, Riga 1519
LATVIA

Mr. Agu Remmelg
Director
Estonian Investment Agency
Roosikrantsi 11, Tallinn
ESTONIA

Tel. 3702 618537  
Fax 3702 224 168  
E-mail

Tel. 47 22 24 44 26  
Fax 47 22 24 95 11  
E-mail thorbjorn.gjolstad@finans.dep.no

Tel. 33 1 45 24 91 26  
Fax 33 1 44 30 63 04  
E-mail marie-france.houde@oecd.org

Tel. 3702 627438  
Fax 3702 220160  
E-mail lda@lda.lt

Tel. 371-7013106/3109  
Fax 371-7280882  
E-mail Preimatel@lem.gov.lv

Tel. 372 6 279 420  
Fax 372 6 279 427  
E-mail
## INTERVENANTS/SPEAKERS
### COMMENTATEURS/COMMENTATORS

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Tel.</th>
<th>Fax</th>
<th>E-mail</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mr. Cato Adrian</td>
<td>Accession Division</td>
<td>41-22 739 5469</td>
<td>41 22 739 5776</td>
<td><a href="mailto:Cato.adrian@wto.org">Cato.adrian@wto.org</a></td>
<td>Centre William Rappard, Rue de Lausanne 154, CH-1211 Geneva 21, Switzerland</td>
</tr>
<tr>
<td>Mr. Tapio Aho</td>
<td>Relationship Manager</td>
<td>358 9 6162 8519</td>
<td>358 9 6162 8690</td>
<td><a href="mailto:tapio.aho@enskilda.se">tapio.aho@enskilda.se</a></td>
<td>SEB Merchant Banking, Skandinaviska Enskilda Banken AB, PO Box 630, Helsinki, Finland</td>
</tr>
<tr>
<td>Mr. Per Altenberg</td>
<td>Senior Research Officer</td>
<td>46 8 6904926</td>
<td>46 8 6904840</td>
<td><a href="mailto:per.altenberg@kommers.se">per.altenberg@kommers.se</a></td>
<td>Swedish National Board of Trade, Box 6803, S-113 35 Stockholm, Sweden</td>
</tr>
<tr>
<td>Mr. Joel Bergsman</td>
<td>FDI Expert</td>
<td>1 301 494 0768</td>
<td>1 301 494 0768</td>
<td></td>
<td>St Leonard MD 20685, 7360 Stone Ct, St Leonard, MD 20685, United States</td>
</tr>
<tr>
<td>Mr. Finn Gallen</td>
<td>Industrial Development Agency of Ireland</td>
<td>351 603 4158</td>
<td>351 603 4250</td>
<td><a href="mailto:finn.gallen@ida.ie">finn.gallen@ida.ie</a></td>
<td>Industrial Development Agency of Ireland, Dublin 2, REP. of IRELAND</td>
</tr>
<tr>
<td>Mr. Valters Gencs</td>
<td>Tax Lawyer, Ernst &amp; Young, Latvia and</td>
<td>371-7225700/7228215</td>
<td>371-7227753</td>
<td><a href="mailto:valters.gencs@lv.eyi.com">valters.gencs@lv.eyi.com</a></td>
<td>Tax Lawyer, Ernst &amp; Young, Latvia and Chairman of the Tax Ad Hoc Committee of the Foreign Investors’ Council in Latvia (FICIL), Kalku str. 20, Riga LV-1050, Latvia</td>
</tr>
</tbody>
</table>
Mr. Agu Remmelg  
Director  
Estonian Investment Agency  
Roosikrantsi 11, Tallinn  
ESTONIA

Ms. Raimonda Sadauskiene  
Director, Lithuanian Devt Agency  
Sv.Jono st. 3, Vilnius LT2600,  
LITHUANIA

Mr. Eric Tonon  
Phare Programme Manager, Lithuania  
EC Delegation  
Naugarduko 10  
2001 Vilnius  
LITHUANIA

Mr. Vitas Vasilauskas  
Director, Revenue Dept  
Ministry of Finance  
J.Tumo-Vaizganto 8A/2  
2600 Vilnius  
LITHUANIA

Mr. Andy Vikta  
KJS Finance Director, Baltics  
Kraft Jacobs Suchard Lietuva  
Taikos ave. 88  
3031 Kaunas  
LITHUANIA

CZECH REPUBLIC

Mr. Stanislav Hlavacek  
1st secretary of the Czech Republic’s Embassy  
in Vilnius  
Cekjos Respublikos Ambasada  
Juozapaviciaus g. 11, 2a, 2600 Vinlius  
LITHUANIA

ESTONIA

Mr. Argo Kuunemae  
2nd Secretary,  
Embassy of the Republic of Estonia  
A. Mickevicius 4A  
2004 Vilnius, Lithuania  

63
Ms. Evelin Krõlov
Attaché, Ministry of Foreign Affairs
Islandi Valjak 1, Tallinn 15049
ESTONIA
Tel. 372 6317 243
Fax 372 6466 388
E-mail Evelin.krolov@mfa.ee

Mr. Roy Eriksson
First Secretary
Ministry of Foreign Affairs
P.O. Box 176
Laivastokatu 22
00161 Helsinki
FINLAND
Tel. 3589 13415071
Fax 3589 1341 5070
E-mail Roy.Eriksson@formin.fi

Mr. Jukka Nysten
Counsellor
Ministry of Foreign Affairs
P.O. Box 176
Laivastokatu 22
00161 Helsinki
FINLAND
Tel. 00358 9 160 4689
Fax 00358 9 160 2666
E-mail Jorma.immonen@ktm.vn.fi

Mr. Jorma Immonen
Deputy Director General
Ministry of Trade and Industry
FINLAND

Mr. Walter Kittel
Advisor to Lithuanian Prime Minister
German TRANSFORM Program
53757 Sankt Augustin
Erfurstr. 14
GERMANY
Tel. 49 2241 338909
Fax 49 2241 343197

Mr. Valdis Dombrovskis
Senior Economist, Monetary Policy Department
Bank of Latvia
K. Valdemara Iela 2a
LV 1050 Riga
LATVIA
Tel. 371 702 2300
Fax 371 702 2420
E-mail Valdisd@bank.lv

Mr. Maris Elerts
Director General
Latvian Development Agency
Perses iela 2, Riga LV 1442
LATVIA
Tel. 371-7283425/728 7995
Fax 371-782524
E-mail Melerts@lda.gov.lv
Ms. Kristine Gosa
Chief Economist, Monetary Policy Dept
Bank of Latvia
K. Valdemara Iela 2a
LV 1050 Riga
LATVIA

Ms. Daina Robezniece
Deputy Director of the Tax Policy Dept.
Ministry of Finance
Smilsu iela 1, Riga LV 1919
LATVIA

Ms. Gitana Albaityte
Senior Economist, Direct Taxes & Indirect Revenues Division
Revenues Department
Ministry of Finance
J. Tumo-Vaizganto 8a/2
2600 Vilnius
LITHUANIA

Ms. Alma Kvederiene
Senior Tax Inspector
Ministry of Finance
Vasario 16- OSIOS 0915
2600 Vilnius
LITHUANIA

Mr. Algis Avizienis
c/o AB Lietuvos Telekomas
Lvovo 21a, Room 303
2726 Vilnius
LITHUANIA

Ms. Jurate Baleviciene
Deputy Director, Revenue Dept.
Ministry of Finance
J. Tumo-Vaizganto 8a/2
2600 Vilnius
LITHUANIA
Ms. Gitana Grigaityte
Head, Division of International Economic Organisations
Ministry of Foreign Affairs
J. Tumo-Vaizganto 2
2600 Vilnius
LITHUANIA

Ms. Zina Jomantiene
Chief Specialist, Planning & Analysis Div.
Ministry of Finance
J. Tumo-Vaizganto 8a/2
2600 Vilnius
LITHUANIA

Ms. Aurelija Jurgutyte
Chief Specialist, Macroeconomics Div.
Ministry of Finance
J. Tumo-Vaizganto 8a/2
2601 Vilnius
LITHUANIA

Mr. Andrius Kalindra
2nd Secretary, Division of International Economic Organisations
Ministry of Foreign Affairs of the Republic of Lithuania
J. Tumo-Vaizganto 2
2600 Vilnius
LITHUANIA

Ms. Elena Leontjeva
President
Lithuanian Free Market Institute
Birules st. 56
2004 Vilnius
LITHUANIA

Ms Ingrida Simonyte
Head of Indirect Taxes Division
Revenues Department
Ministry of Finance
J. Tumo-Vaizganto 8a/2
2600 Vilnius
LITHUANIA
Mr. Romas Svedas
Director of Economics Department
Ministry of Foreign Affairs
J. Tumo-Vaizganto 2
2600 Vilnius
LITHUANIA

Ms. Raimonda Zutautienė
Senior Economist
Division of Sector Analysis
Fiscal Policy Dept., Ministry of Finance
J. Tumo-Vaizganto 8a/2
2600 Vilnius
LITHUANIA

Ambassador Jon Atle Gaarder
Royal Norwegian Embassy
Poskos gatve 59
2004 Vilnius, Litauen
LITHUANIA

Ms Dorota Wszniewska
Direct Taxation Dept
Ministry of Finance

Ms Beata Andrzejewska
Direct Taxation Dept
Ministry of Finance

Mr. Bruno Kaspar
Swiss Baltic Chamber of Commerce
Ankstoji 3 -6a
2001 Vilnius, LITHUANIA

Mr. Rudolf Müller
Chef suppléant Stratégies économiques et mandats spéciaux
Secrétariat d’État à l’économie (seco)
Effingerstrasse 1
CH-3003 Berne
SUISSE

NORWAY

POLAND

SWITZERLAND
UNITED STATES

Mr. Rasa Ciceniene
Lithuania Fiscal Policy Activity Manager
USAID, Ciurlionio 66, LT 2600 Vilnius
LITHUANIA

Ms. Diana Juzaitis
Tax lawyer working on tax issues in MOF
USAID-funded
LITHUANIA

Mr. Anthony Spakauskas
Deputy Chief of Mission
United States Embassy
Akmenu 6, 2600 Vilnius
LITHUANIA

Ms Aldona Brogiene
Chamber Director
American Chamber of Commerce (ACC)
Lukiskiu 5-204
LT-2600 Vilnius
LITHUANIA

INTERNATIONAL ORGANISATIONS

Mr. Valdas Vitkausas
EBRD, Vilnius office
Jaksto 5, 3rd floor
2600 Vilnius
LITHUANIA

BUSINESS COMMUNITY

Ms. Rasa Bagdoniene
Corporate Affairs Manager, Baltics
Kraft Jacobs Suchard Lietuva
Taikos ave. 88, 3031 Kaunas
LITHUANIA

Mr. Lenny Henry
Financial Controller, Philip Morris Lietuva
LITHUANIA

Mr. Rommaldas Krukauskas
General Director, IBM Lietuva
LITHUANIA
OECD SECRETARIAT

Susan Himes – Fiscal Affairs Division, Directorate for Financial, Fiscal and Enterprise Affairs

Marie-France Houde – Capital Movements, International Investment and Services Division, Directorate for Financial, Fiscal & Enterprise Affairs

Charles Oman – Economic Analysis and Development Policy Dialogue, International Policies Division, Development Centre

Eudes Brophy – Capital Movements, International Investment and Services Division, Directorate for Financial, Fiscal & Enterprise Affairs

Christine Hude – Fiscal Affairs Division, Directorate for Financial, Fiscal & Enterprise Affairs