The Political Economy of Tax Incentives for Investment in Export Processing Zones in Tanzania: Why Do Tax Incentives Persist?

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Abstract
The purpose of this study is to examine why the use of tax incentives in the Tanzanian EPZs has remained politically popular and whether the practice is influenced by rent seeking motive. The data used were collected through documentary review and interviews. Results show that tax incentives have often been motivated by political rather than economic considerations. Evidence of rent seeking behavior demonstrated by political influence and interest in the design and implementation of tax incentives policy is widespread when government executives and legislatures are unrestricted from doing business. The results are expected to challenge Government as regards the rationality of its current decision and position on tax incentives in EPZs.

Keywords – Export Processing Zones, Foreign Direct Investment, political economy, rent seeking, tax incentives, Tanzania.

1. Introduction
The use of tax incentives to promote flow of investment in sub Saharan Africa (SSA) has been of some concern to many, primarily because of some evidence of deteriorating countries’ tax bases with little demonstrable benefit in terms of increased investment (Hadari, 1990; Cleeve, 2008; Klemm & Parys, 2009; 2012; IMF/OECD/UN & World Bank, 2011; Gauthier, 2012; James, 2013b; IMF, 2008, 2015). Like many other SSA countries, Tanzania offers generous tax incentives under the EPZ scheme, to attract FDI. However, the incentives have resulted in heated debate in the country and the international arena, with some critics claiming that the incentive package is a waste of potential government earnings for the country’s social and economic development.

The World Bank’s expenditure review of 2006 asked the government of Tanzania to reconsider the tax breaks in the EPZ legislation on the grounds that tax exemptions and loopholes, tax fraud, as well as reduction of tax revenue could proliferate, thereby jeopardizing the country’s fiscal position without necessarily generating the anticipated level of investment (World Bank, 2006). Neither the World Bank concerns nor the issues raised by domestic observers have led to significant revisions to date.

In its annual Public Expenditure Review (PER) report, the World Bank (2011) observed and recommended that, although the country has been closing the gap between potential and observed tax revenue, further attention should be given to exemptions and tax avoidance. A report commissioned by Norwegian Church Aid to establish the magnitude of tax revenue losses in Tanzania estimates that Tanzania, is losing around US $ 1 billion in tax revenue annually mostly through tax incentives, tax evasion and capital flight (Curtis et al., 2012). Part of this
amount represents losses caused by tax incentives offered under EPZ scheme to investors that would have invested anyway although the study does not systematically indicate the amount. Controller and Auditor General (CAG) reports (2011/2012 up to 2012/2013) and the Tanzania Revenue Authority (TRA) have both criticized the government’s tax incentives regime as unsustainable (Kulaba, 2015).

Despite these concerns, the government has been somewhat reluctant to implement the recommendations. Although it has long been claimed that the tax incentives in EPZs are ineffective in attracting investors, yet governments in developing countries generally exempt firms in EPZs from almost all domestic taxes (Farole, 2011; Alarakhia, 2012). Many developing countries’ policymakers seem unaware or pay no attention to studies (including studies funded by the World Bank) which show that tax incentives have been less effective in attracting FDI, and a review of the same has been recommended by the International Financial Institutions (IFIs) which previously supported the idea.

It is not yet clear why the Tanzanian and other SSA governments lack enthusiasm on rationalizing their tax incentives despite the increasing resistance from international financial institutions such as the World Bank, IMF, African Development Bank (ADB), the donor community at large, NGOs, academicians, development activists, and different domestic stakeholders.

Given reluctance of the government to implement the recommended review and the resulting persistence of tax incentives, important questions then become: why is the use of tax incentives in EPZs has remained politically attractive?. Do tax incentives offered to EPZ investors serve as a rent seeking tool?. Much has been written in the literature about the ineffectiveness of taxation in attracting FDI but less has been done to find out answers to these questions in the context of late EPZs. This study aims to explain this gap.

The rest of the paper is organized as follows. Section 2 presents the theory and experience on the effectiveness of tax incentives, including a review of literature on the political economy of tax incentives for investment. Data and methodology are discussed in Section 3. Presentation and discussion of the findings are covered in Section 4. Section 5 concludes and offers implications of the study.

2. Tax incentives for investment: Theory and experience

2.1 Theoretical highlights

2.1.1 Definition of tax incentives

A key feature of any definition of tax incentives is the preferential treatment of particular tax payers relative to others. Tax incentives are special provisions in the tax laws which allow an exclusion from income, a higher-than-usual deduction or special deduction, a tax credit, or a reduction in the tax rate. In effect, it provides the taxpayer with a subsidy without having to go through the tax collection and budgetary dispensing process (Matziorinis, 1980). Bolnick (2004:1-4) describe tax incentives as “fiscal measures that are used to attract local or foreign investment capital to certain economic activities or particular areas in a country”. Through tax incentives, governments try to reallocate or attract domestic and foreign capital using selective tax incentives that give a more favourable tax treatment to certain economic activities (Klemm & Van Parys 2012).

2.1.2 Types of tax incentives

Investment tax incentives generally take the form of direct or indirect taxes (World Bank, 2013). Incentives through direct taxes target the tax rate as well as capital recovery of invested
amounts, and typically include temporary exemptions on corporate income taxes (tax holiday), preferential tax rates/reduced tax rates, accelerated depreciation, investment allowance, and tax deductions through investment tax credit (Bolnick, 2004; Easson, 2004; Klemm, 2009; Klemm & Van Parys 2012; World Bank, 2013). Tax incentives through indirect taxes are usually done by exempting certain inputs from import tariffs, excises and VAT (Klemm, 2009; World Bank, 2013). Indirect tax incentives are either partial or full exemptions from import duties, and/or Value Added Tax (VAT) on raw materials and capital goods purchased by qualified firms. Tax incentives can also take a form of financing incentives, which is provided through reductions in tax rates applying to providers of funds, for instance, reduced withholding taxes on dividends and interest (Klemm, 2009).

Typical tax incentives in EPZs include tax holidays and duty-free imports of capital goods and raw materials import duty, and exemption on VAT on purchases used for the purpose of production for export. Tax holidays cover exemptions from corporate income tax, withholding taxes on dividends and interests for a specified period, usually between 5-10 years depending on a country. Also, in some countries, EPZ investors are exempted from paying Local Government Authority’s taxes and levies (World Bank, 1992 Njeru, 2012; Njeru & Ndimitu, 2015).

2.1.3 Why government introduces and preserves tax incentives?
Convincing economic justifications for granting tax incentives are rare (Easson, 2004; Goorman, 2005). It is argued that if properly designed and implemented, tax incentives are a useful tool in attracting investments that would not have been made without the provision of tax benefits (Zolt, 2015). Thus, such tax incentives are considered desirable, in that without government intervention the level of FDI will be sub-optimal (Zee et al., 2002; Margalioth, 2003; Easson, 2004; Zolt, 2015). Use of tax incentives is also justified by positive externalities arising from investments generated. It is also argued that tax incentives are relatively easy to target and fine tune to suit other policy objectives such as job creation, regional development, and upgrading of the workforce. Moreover, introducing investment tax incentives is an indication of openness to private investment, and can signal a country’s commitment to facilitating investment. It also markets the country as a favourable investment location (Bolnick, 2004).

Another popular justification for the use of tax incentives argues that, they are necessary for responding to tax competition from other jurisdictions (Bolnick, 2004; Klemm, 2009). When other countries compete for the same investment through tax incentives a rational decision would be to match the tax incentives (Bolnick, 2004). In a global economy with high mobility capital, the effective tax rate on capital has to be low in order to remain attractive to investors (Edwards & Veronique de Rugy, 2002; Klemm, 2009).

Another common argument for the use of tax incentives in developing countries is that tax incentives may compensate for other deficiencies in the overall investment climate, thereby, enticing investors who would otherwise not consider investing because of the infrastructural and governance problems prevalent in these countries (Bolnick, 2004; FIAS, 2008; Farole, 2010). It is also argued that tax incentives offer political advantages over other types of government action available to stimulate investment such as direct expenditure (Bolnick, 2004; Zolt, 2015). These studies argue that the cost of tax incentives is less visible than that of investment promotion policies that involve explicit cash outflows.
2.1.4 Limitations of tax incentives

Despite their widespread use, and the theoretical justification just described in previous section, the usefulness of tax incentives is often challenged in the literature (IMF, 2008). Even though the granting of tax incentives might be economically rational under certain circumstances, this policy presents severe shortcomings. Tax incentives often have more harmful side effects than the market inefficiencies they attempt to correct (Sanchez-Ugarte, 1995). Granting tax incentives clearly entails different costs: revenue costs; distortionary effects, i.e. distortions between investments granted incentives and those without incentives; administrative resources required to administer them; and the social costs of corruption and/or rent-seeking activities connected with abuse of tax incentive provisions (opportunities for corruption and rent-seeking behaviour).

The tax revenue losses from tax incentives come from two primary sources: first, forgone revenue from projects that would have been undertaken even if the investor did not receive any tax incentives; and, second, lost revenue from investors and activities that improperly claim incentives or shift income from related taxable firms to those firms qualifying for favourable tax treatment (Zolt, 2015). Tax incentives also contribute to indirect revenue costs where, for example, goods from a company operating in an EPZ leak to the domestic economy (e.g. through smuggling), which then reduces the income of domestic competitors. Indirect revenue losses also arise where companies which enjoy tax benefits bid away skilled labour and raw materials from local firms who pay full tax (Bolnick, 2004). Other revenue leakages occur through abusive tax planning. Through tax planning, well-intended tax incentives can be converted into a revenue loss. For example, when a tax holiday period is about to expire, an existing company can close down all of its operations and establish a new company that qualifies for a full tax holiday which is usually available to only new firms.

Perhaps the main theoretical objection on the use of tax incentives rests on the argument that tax incentives create distortions (Zee et al., 2002; Bolnick, 2004; Easson, 2004; Zolt, 2015). According to this literature, the distortionary effects of tax incentives are of two types: first, business decisions of firms are distorted; and, second, competition between firms is also distorted. In some cases, investment decisions are made that would not have been made without being encouraged through tax incentives, resulting in an inefficient allocation of resources. Thus, tax incentives interfere with the normal working of the market. Another distortion caused by tax incentives arises from the competition between those firms that qualify for tax incentives and those that do not (Easson, 2003; FIAS, 2008). Tax incentives distort resource allocation as some activities are encouraged over others not because they are necessarily more economically productive, but simply because they have been granted tax benefits (Easson, 2004; Zee et al., 2002). Further critics challenge tax incentives on the ground that are not based on investors’ performances, as a result poor performing companies benefit along with better performing (ILO, 1998). It is further argued that, such distortionary effect would also arise wherever tax incentives are incorrectly granted to investment with no positive externalities (Njeru, 2012; Njeru & Ndimitu, 2015). Moreover, investors may not wish to remain in the country once their tax holidays end, and they may arrange to come back as new investors in order to qualify for the tax advantage. Too often, tax incentives are endorsed without sufficient consideration to their potential harmful effects (Easson, 2004).

Another limitation concerns the difficult to administer tax incentives and high vulnerability to abuse (Zee et al., 2002; Easson, 2004). Enforcement and compliance costs may be enormous given multitudes of tax incentive schemes to be administered by a tax authority in a country (IMF, 2008). Tax administrators may spend most of their time monitoring and regulating
incentives although it is also difficult to get revenue authorities committed to spending resources to monitor tax incentive schemes (IMF, 2014).

There is a growing concern in the literature that granting of tax incentives creates opportunity for corruption and socially unproductive rent seeking activities (Zee et al., 2002; Njeru, 2012; Njeru & Ndimitu, 2015). According to Sanchez-Ugarte (1995), tax incentives have often been motivated by political rather than economic factors, generating rent seeking actions by economic agents. This matches IMF’s (2008) and OECD (2013) reports which concur that tax incentives seriously contribute to the risk of corruption, rent seeking and other undesirable activities. Further to this, international experience gathered through IMF (2014) indicates that tax incentives create inefficiency and inequalities through socially destructive rent seeking behaviour by prospective applicants.

2.2 Empirical evidence on the effectiveness of tax incentives

There is a well-established consensus that tax incentives often play only a minor role in FDI location decisions. A wide range of factors including labour costs, labour skills, proximity to strategic markets and the general institutional and business environment including corruption, have been identified as important (Gibbon et al., 2008). Though justifiable in some circumstances, tax incentives are still regarded as essentially undesirable (Easson, 2004).

One key consideration why developing countries in Sub Saharan Africa continually preserve tax incentives is to compensate for the inefficient broader investment climate (Bolnick, 2004). However, empirical evidence has failed to confirm this claim. For many developing countries, tax incentives do not effectively counterbalance unattractive investment climate conditions such as poor infrastructure, macroeconomic instability, and weak governance (James, 2009, 2010, 2013a). It is argued that a lower tax burden cannot compensate for a generally weak or unattractive FDI environment (OECD, 2008). Wells et al. (2001) highlight that tax incentives will generally neither make up for serious deficiencies in the investment climate nor generate the desired externalities. Admittedly, tax incentives are unlikely to attract FDI effectively if non-tax factors are not conducive (Rolfe & White, 1999).

Having observed that tax incentives rarely have any substantial effect on FDI, it may be useful to examine more the reasons why tax incentives tend to be ineffective. As concluded by Sanchez-Ugarte (1995) (see also Zee et al., (2002) and Easson (2004)), tax incentives have been ineffective and inefficient for the following reasons. First, too many objectives have been pursued through tax incentives reducing the effect of any one of these objectives. Second, tax incentives have often been motivated by political rather than economic considerations, resulting into rent seeking behaviour by economic agents. There is too much political influence of vested interests in the design of tax incentives policy. Third, tax incentives are often granted to correct market distortions especially to counteract the effects of macro policies. Finally, the granting of tax incentives has been uneven and unpredictable, so it is unlikely that they have affected the investment behaviour or planning of the targeted investors.

However, the available empirical evidence does not disprove that under certain circumstances, well targeted investment tax incentives could be a factor influencing investment location decision. Neither does it infer that investors would not ask for the tax incentives they could get from host country (Basu & Krishna, 2002; IMF, 2008). Nevertheless, in the end, tax incentives rarely appear to be the most important factor in determining investment location decisions (IMF, 2008).
2.3 Political economy of tax incentives for investment

In order to understand why the use of tax incentives in developing countries has persisted and remained politically attractive, and whether there is a rent-seeking motive in its application, it was necessary to review a literature on political economy of tax incentives for investment. Since offering tax incentives is not obviously an economic decision, political consideration is anticipated, and as such, a knowledge regarding how key actors can use institutions and regulations in their own favour is useful. Conceptually, the political economy focuses on the relationship between political actors and institutions that produce a given outcome (Santos de Souza, 2013). Political economy logics treat governments and the people within them as having their own goals (Farole & Moberg, 2017). Further, as OECD (2014a) ascertained, groups that are bound to profit from preferential regimes naturally form a lobby to influence the design and implementation of such regimes, and to guarantee their permanence. Additionally, once a system creates a precedent, there is considerable pressure for additional ones to emerge (Klemm, 2009; OECD, 2014a).

Studies such as Tulloc (1962), Niskanen (1971) and Tullock (1987) (cited in Farole & Moberg, 2017) recognize politicians and executives as rational and utility maximizing just as economists treat businesses and households, although with separate motives and pursuits. By this recognition, the self-interest of policy makers and executives often conflict with their assumed goal of maximizing social welfare. The result that stands out here implies that while the logics underlying rational self-interest idea may produce optimal policies in the free market, in politics, they can lead to corruption and other forms of rent-seeking (Farole & Moberg, 2017). In this line, it is argued that policy makers and executives may use trade policy for personal gains by, for instance, adjusting tariff rates to please interest groups (Grossman and Helpman 1994 cited in Farole & Moberg, 2017).

Admittedly, a tax policy may therefore be designed to benefit government officials both financially and politically at the expense of the economy as a whole (Farole & Moberg, 2017). The existing political economy literature on tax reform and tax incentives in particular establishes that, in addition to domestic and international pressure, approaches to tax incentives have been in large part influenced by the following political elements: mobilizing electoral support; the strength of political parties and coalitions in the legislature; elite control of tax policymaking or tax administration; the degree of popular acceptance of tax policy; and political survival that depends on a winning coalition of supporters (Santos De Souza, 2013; OECD, 2014b).

It has been suggested that tax reforms aimed at introducing and preserving tax incentives are often the central platforms for politicians to obtain votes ((Profeta and Scabrosetti (2007) cited in Santos De Souza (2013)). Tax reforms appear to be a politically viable and favourable strategy to attain support. Further, it has been argued that the relative strength of political parties can have an effect on the approval of a tax reform, given the possibility of deadlocks and conflicts in legislatures (Lledo 2004; Melo et al. 2010 cited in Santos De Souza, 2013). According to this literature, widespread democracy tends to give rise to weak political parties characterized by ‘clientelism’ and ‘personalism’. This gives rise to party systems whose main features worsen further the problems of deadlock between executive and legislature. It follows that, the only possible way for executives to get tax legislation passed would be to seek support and acceptance from legislative allies in exchange for tax incentives or spending programs (Santos De Souza, 2013).

Fairfield (2010) (cited in Santos De Souza, 2013) explores the power of the business sector which is exerted through organized associations or by individual firms and investors. The study revealed that, during the reform of the tax system including a proposal to introduce or retain tax incentives, businesses aggressively engage in intentional political action with a view of protecting the interests of upper-income groups as well as corporations. In other words, a bias in tax policymaking
favouring business interests can be created through recruitment of business leaders into government, government-business coordination, and partisan linkages. As Santos De Souza (2013) clearly put it, recruitment into government provides an opportunity for business leaders to take direct part in policymaking by occupying high-level executive positions; cross-sector coordination in the form of regular government consultation and collaboration with a range of business associations can produce incentives to avoid conflict over taxation; and partisan linkages can provide representation of business interests in the with veto power on taxation issues. The combination of these factors suggests that tax policy is therefore influenced by powerful interest groups that lobby to keep the tax burden unevenly distributed (Santos De Souza, 2013).

Because naturally offering tax incentives is not primarily an economic decision, it is plausible to argue that what motivates developing countries to pursue tax reforms majored in tax incentives depends more on politics than the economics of taxation (OECD, 2014b). It is found that politics determine to a large extent the capacity of these countries to design, approve, and implement effective public policies. Therefore, thinking and vested interests, and the political institutions within which the elements (just reviewed) interact, shapes tax policy (Santos De Souza, 2013). In line with this, it is established that, in developing countries a combination of weak institutions and powerful lobbies is responsible for the persistence of tax incentives (OECD, 2014b).

3 Data and methodology

3.1 Population and sample

The study’s population included the following categories of respondents: the Exports Processing Zones Authority (EPZA) management; and key informants, independent from the direct influence of government. Three EPZA top officials were selected purposefully from the EPZA and these included Chief Executive Director, Director of Planning and Administration and Investment Facilitation Manager. Given the role and autonomy of the EPZA, its top management’ views largely represent government’s view. They were, therefore, targeted by virtue of their strategic role and vast experience on EPZ matters.

As a matter of data triangulation, additional three interviews were conducted with purposefully selected key informants distinct from public offices. These were the Chief Executive Director of Tanzania Private Sector Foundation (TPSF), the Director of Research on Growth and Development working at Policy Research for Development (REPOA) and a Chairperson to the Confederation of Tanzania Industries (CTI).

3.2 Data collection methods

3.2.1 Documentary review

Document analysis (documentary review) is used as a tool for obtaining relevant documentary evidence to support and validate facts stated in a study. Documentary evidence is required in order to determine what is known already and what new data is required (Corbetta, 2003). While reviewing the literature and other documents, the analysis involved analytic reading and review of written material including local public documents such as tax laws, investment promotion policy documents, investment incentives schemes including EPZ and SEZ Acts, EPZA annual performance report, Controller and Auditor General reports and various Tanzania Investment
Review Reports (TIRR). Such documents and analyses allowed the researcher to synthesize relevant information that can be considered as facts to answer why tax incentives persist and whether there is rent-seeking motive in its use.

3.2.2 Semi-structured interviews

First, it was important to understand the government’s experience on the continued use of tax incentives and why they consider the practice rational. It was therefore decided to conduct semi-structured interview with three top government officials working at EPZA to explore their views about why tax incentives has remained popular and attractive despite ample evidence that the strategy has been ineffective in attracting investment. Second, as a matter of data triangulation and thus enhancing the quality of the findings, three additional interviews were conducted with key informants currently not holding a position in public office. Views from the private sector and the industry where investment is practiced were very important not only in corroborating but also augmenting government’s views. Therefore, six interviews in total were conducted and each interview lasted between 45 and 60 minutes.

3.3 Data analysis

3.3.1 Documentary evidence

A descriptive method of analysis was used to describe the results obtained from the analysis of the documents. Various documents reviewed were read carefully, and the findings relevant to research question were organized and summarized. In particular, document analysis provided evidence regarding typical incentives available to EPZ investors.

3.3.2 Analysis of interview data

Transcription of the recorded interviews was guided by the rule that, only the portions of the interview that were relevant to the research question were summarized. Transcription from recorded interviews and the manual notes were analysed through repeated re-reading of them. Content analysis of the interview data attempted to identify ideas which explain why use of tax incentives has remained politically attractive in EPZs despite several efforts to rationalize them.

4 Findings and discussion

4.1 Government views

The analysis of each interview and across three interviews conducted with government officials yielded five main reasons related to why the use of tax incentives is popular in EPZs. In addition, three other secondary reasons were identified.

4.1.1 The claim that tax incentives drain government revenues is flawed

The first questions in the first part of the interview were about the validity of the claims that tax incentives are ineffective in attracting investment and simply represent a loss to the government revenues. All three interviewees were asked to verify this claim. This was a necessary question as it could lead to further exploration of the reasons for the desirability of tax incentives. All three interviewees disagreed with the claim that tax incentives are simply a loss to government
revenue. They defend their objections on account that in a country which seems to be increasingly exhibiting high unemployment rate, no valid claim can be made that tax incentives are just a loss to the government revenue without considering the quantitative job creation effect of the investment. These views match what some studies disclosed previously. According to Holland & Vann (1998), one reason countries enact tax incentives, despite their drawbacks, is that some politicians or their advisors may simply disagree with the analysis presented in the literature regarding the costs associated with tax incentives.

4.1.2 Motives to stay competitive
In this study, as with others (e.g. Holland & Vann, 1998; Bolnick, 2004; Klemm, 2009; IMF/OECD/UN & World Bank, 2015; Zolt, 2015), competition is a strong reason, with countries introducing and preserving tax incentives despite their drawbacks. The interviews demonstrated that failure to offer tax incentives is more risky and costly than offering these incentives so long as other countries with which Tanzania competes for FDI, including countries with better infrastructure and governance, offer similar tax incentives. According to the three interviews, tax incentives are necessary in a globalized world, characterized by growing flows of trade and investment, where international investors are free to locate in any country. It is revealed that the practice is even more important in SSA countries as they share common disincentives to invest, hence, offering tax incentives serves as a tool to enable these countries to compete against each other within the region on an equal footing. Interviews exposed that tax incentives confer a relevant competitive edge where the broader investment climate is generally poor across countries, and the competition for FDI is stiff, as in the case of SSA.

4.1.3 Pressure from investors
Analysis of the three interviews shows that governments retain tax incentives as an effort to respond to pressure from investors. Two sources of pressure were identified, namely investors’ perception of tax incentives and the perceived investors’ relocation behaviour. There is a feeling among respondents that investors often take the offering of tax incentives as a given. It became apparent that one of the most often asked questions during investment promotion campaigns relates to the tax benefits available to investors and how they compare with those of neighbouring countries. However, this tendency does not support evidence from numerous investor survey studies (e.g. Van Parys & James, 2010; James, 2013a, 2013b; Tavares-Lehmann et al., 2015) which have disclosed that investors are less sensitive to tax incentives. All interviewees indicated awareness of different survey results, which claim that most investors would invest even without tax incentives. Government works against the survey results due to uncertainty involved; that is, the most convenient way to circumvent future uncertainty is to promise tax incentives without considering whether and the extent to which they will have an influence on the initial location decisions. Previous research places foreign investors’ behaviour and characteristics at the centre of the problem (Basu & Krishna, 2002; IMF, 2008). These foreign investors play different governments against each other to gain the best possible tax benefits, even if their investment location decisions are not necessarily being influenced by tax benefits.

Investor pressure also emanates from the footloose nature of EPZ investors. The interviews demonstrated that tax incentives are persistently employed in response to the relocation behaviour of EPZ firms, especially given the ease with which they can relocate elsewhere when they feel that they will enjoy more favourable tax benefits. The results match previous research regarding relationship between popularity of tax incentives in EPZ and the footloose nature of
EPZ investment (Linnenmann et al., 1987; Holland & Vann, 1998; Palley, 2003; Tuomi, 2012; OECD, 2014a; Kulaba, 2015). The evidence from these studies exposed that the export-oriented strategy implemented through EPZ promotes footloose export activities, often driven by cheap labour and tax incentives (Linnenmann et al., 1987; Palley, 2003). The sustainability of footloose industries established in EPZs cannot go beyond the lifespan of the tax exemptions (Kulaba, 2015). Given their ability to adjust quickly in case of changes in external investment climate conditions (i.e. footloose), these investors tend to move out as soon as the tax benefits (tax holidays) expire (Tuomi, 2012; OECD, 2014a). In responding to pressure from footloose investors who threaten to locate investment elsewhere if they are not given concessions, some countries tend to preserve tax incentive (Holland & Vann, 1998). However, no clear explanations were given to support the low level of the so called “footloose investment” in Tanzanian EPZs which confers generous tax incentives. That is, interviewees failed to provide adequate and convincing explanations to support the mismatch between investment level in the EPZs and the voluminous tax incentives offered for the inducement purpose.

4.1.4 Budgetary implications of tax incentives
Another factor that contributes to the attraction of tax incentives in Tanzanian EPZs is that their use has no direct or immediate budgetary impact, as such, tax incentives are viewed as costless. The interviews revealed that the use of tax incentives serves the government well when operating in a budgetary constrained environment. It is more convenient to rely on tax incentives, as they do not seem to affect the current budget (Chief Executive Director, EPZA). There is a thinking among interviewees that government money is in fact not lost if tax incentives are used compared to other measures which require immediate funds. It became apparent that given overambitious EPZ expansion plans and the urgent demand for FDI, the government finds itself unable to put in place all relevant considerations for successful EPZ development mainly due to lack of sufficient funds. As a result, in order to accelerate the process of attracting investment, the government is compelled to use tax incentives as a short-term measure to circumvent the budgetary deficit problem. Based on the interviews, the use of tax incentives is therefore a preferred fiscal tool because it does not involve direct cash outflows from the current budget.

This supports the conclusions of Sanchez-Ugarte (1995), Holland & Vann (1998), Bolnick (2004), Chen (2015), and Zolt (2015), which sustain similar perspectives on the costless nature of tax incentives as contributing to its political attraction. Governments prefer tax incentives because it is possible to provide the investor with a subsidy without having to go through the tax collection and budgetary dispensing process (Matziorinis, 1980). Hadari (1990) contends that it is easier for host countries with large budgetary deficits to sacrifice potential future tax revenue to out-of-pocket expenditures, even if such an attitude is economically wrong. In instances of business failures, the study argues, no government money is lost if tax incentives are used instead of direct government expenditure. The results are also consistent with Holland & Vann (1998), who were of the opinion that tax incentives are at least something over which the government has control and which they can enact relatively easily and quickly. Hence, tax incentives are politically attractive because they offer a political advantage over other government action available to stimulate investment (Bolnick, 2004; Zolt, 2015).

4.1.5 Proliferation and prevalence of single factory EPZ scheme
During the interviews, it became apparent that the potential for EPZ programs to extend a quality infrastructure environment to all its investors is extremely limited when the program is
largely dominated by single factory operators. The interviews revealed that the prevalence of single factory units contributes to the attraction of tax incentives. The government is reluctant to remove or revise some tax incentives in EPZ programs because the programs involve a large number of single factory units. Investment Facilitation Manager revealed that, in the absence of tax incentives, the business investment environment in which single factory units operate would not be much different from the rest of the domestic economy. The other two interviewees held similar views, arguing that where the single factory EPZ scheme is common in EPZ programs, the program risks losing its attractiveness given that the EPZ concept is essentially attractive because of its potential to address the infrastructural problem within a designated area. This finding matches the existing view in the literature, which argues that tax incentives are necessary in order to enhance competitiveness in the presence of inadequate infrastructure. Apart from offsetting inefficiencies confronted by stand-alone (single factory units) EPZ firms just discussed above, interviews strongly supported the use of tax incentives as an alternative to inadequate infrastructure countrywide. To explore this concern, interviewees were asked to verify the existing claim that in countries where poor infrastructure and weak governance predominate, tax incentives are offered in order to offset these disadvantages. This particular question was posed to Chief Executive Director, EPZA, and the claim was confirmed. This matches the existing literature which argues that one key reason developing countries in SSA offer generous tax incentives is to compensate for the inefficient broader investment climate (Bolnick, 2004). This claim is, however, not without criticisms. For many developing countries, tax incentives do not effectively counterbalance unattractive investment climate conditions such as poor infrastructure, macroeconomic instability, and weak governance (James, 2009, 2010, 2013a). A lower tax burden cannot compensate for a generally weak or unattractive FDI environment (OECD, 2008). This conclusion is shared by other studies such as Wells et al. (2001), who emphasized that tax incentives will generally neither make up for serious deficiencies in the investment climate nor generate the desired externalities. Rolfe & White (1999) highlighted that even where tax incentives appear to have a small effect on FDI (as in the case of industrialized countries), tax holidays and import duty exemptions are unlikely to attract FDI if non-tax factors are not conducive. Holland & Vann (1998) advised if the reasons for offering tax incentives are to offset other disadvantages facing investors, the appropriate solution is to reform the existing laws responsible to the problems and to build the necessary administrative capacities and infrastructure.

### 4.1.6 Other reasons
Further to these findings, the interviews provided support for three other reasons reflected in previous research. The longstanding image of a bad policy environment in Sub SSA countries was mentioned as an additional factor contributing to the attractiveness of tax incentives. This matches perceptions in previous research, which observed that introducing investment tax incentives is an indication of openness to private investment, and can signal a country’s commitment to facilitating investment. It also markets the country as a favourable investment location (Bolnick, 2004). Moreover, interviews revealed that claims made against the use of tax incentives overlook the fact that this strategy has not failed everywhere. This support the argument presented in the literature review that tax incentives have been successfully used in a number of countries. In addition, as with other previous research (e.g. Wasylenko, 1981; Wolman, 1988) tax incentives are politically attractive as a symbolic and often political gesture, suggesting that the government offers tax incentives as a symbol of goodwill. In this study,
offering tax incentives was said to be of great importance as a strategy to maintain previous and, or existing relationship with the investor’s home country.

4.2 Views from other key informants
In addition to exploring their views on why the use of tax incentives is politically attractive, this particular group of interviewees was used to explore whether there is a rent-seeking motive in the use of tax incentives. Interviewees were asked their opinions about the reasoning for the continued use of tax incentives in late EPZs despite the advice to review them. Then, where possible the interviewees were asked to give their evaluations of the government perspectives presented previously. The analysis of the interview data from this group has produced interesting opposing views. According to their views, institutional and governance constraints are responsible to the persistence of tax incentives. In this line, it is argued that the reasons governments in developing countries introduce and preserve tax incentives is largely attributed to the political economy surrounding tax incentives. The analysis of each interview and across the interviews in this category identified the following specific reasons as responsible in explaining why government preserves tax incentives, and whether there is a rent seeking motive in its application.

4.2.1 Weak enforcement mechanisms
Throughout the interview it became apparent that the difficulty in reviewing, rationalising, and reducing tax incentives is due to the lack of an effective enforcement mechanism needed to cease the current provisions of tax incentives so that additional unjustified tax incentives are not introduced. The interview data revealed that the existing enforcement mechanism is weak on a number of issues: for example, it does not compel executives and legislatures to undertake tax expenditure analyses to better and prudently assess the offering of tax incentives.

4.2.2 Weakness on the current budget practices and procedure
A perception exist among the three interviewees that the manner in which current legislative budget practices and procedure are conducted is another constraint on the ability of the government to better review tax incentives because with tax incentives the tax expenditure entailed are not accounted for nor reported in the regular parliamentary budgetary procedure. Stated quite simply, one of the informants argued that tax incentives are preferred because of the possibilities of being outside the budget and non-transparent.
It was learnt that the current practice places the onus on Ministers whereby the process of granting tax incentives involves the exercise of discretionary powers by respective Ministers without necessarily undergoing regular parliamentary budgetary procedure. As such, those involved are not tied up. The findings discussed under weak enforcement and weaknesses on the current budget practices and procedure validate reasons previously revealed by the government officials on the budgetary implications of tax incentives, and also reflect previous research, which disclosed that the use of tax incentives is preferred because it does not tie hands of the politicians in power. With tax incentives, the extent of their cost is not accounted for nor reported in the regular parliamentary budgetary procedure. As such, the political costs of expenditure are lowered when compared to the political costs of budgetary expenditure, which are subjected yearly to parliamentary debate and public scrutiny (Matziorinis, 1980). Tax incentives are politically preferred due to the ease of use since an actual payment is not involved nor does the normal budgetary process control them (Sanchez-Ugarte, 1995). Being outside the
normal budgetary procedure, implies less scrutiny, as a result politicians in power are less tied (Chen, 2015).

4.2.3 Possibility of gaining from corruption and rent seeking actions
The interviews spontaneously revealed that some responsible government officials are unwilling to revise tax incentives as advised because of the possibility of gaining from corrupt practice. It became apparent that tax incentives are preferred given high possibility of abuse. The interviews revealed that as the administration of tax incentives is often abused, there are also loopholes to gain from corrupt and rent seeking. The evidence of corruption and rent seeking motives reflect well in the following case as one interviewee presented it. This case refers to one of the recent parliamentary sessions in which a bill related to well-paid investment in natural gas that has been discovered recently in large scale in the country was tabled and discussed. The interview revealed that, claims existed that some members of parliament were consulted informally in advance in order to make sure that the bill is passed despite several contractual weaknesses on it. Notably, unclear terms of contract with regards to royalty and whether it is rational to grant generous tax incentives to such economically viable project were the most integral issues in the debate.

4.2.4 Involvement of government executives and legislatures in doing business
The analysis of the interview data suggests that ever-increasing involvement of politicians in well-paid businesses explains why government is inactive on taking rational decisions as advised. Explaining this phenomenon, one of these interviewees revealed that recent trend in growing involvement of politicians in business is the outcome of trade liberalization, in particular a shift to a free market economy which dropped some useful laws, rules and regulations governing and influencing leadership ethics. In particular, following introduction of trade liberalization reforms in late 1980s there have been major abuses, in particular violation of fundamental leadership ethics in the past two decades. Interview revealed that, a shift to free market economy resulted into misuse of ethical guidelines previously stipulated in Arusha Declaration. Arusha Declaration is a political manifesto announced in 1967, six years after the independence as an important strategy by then to ensure that local investors would be able to take command of the economy. All the three informants revealed that not all the contents of Arusha Declaration were unsuitable for private sector development although some were intentionally abolished as they introduced stringent bans to unfaithful leaders. A perception exist among these interviewees that tax incentives will hardly cease to exist so long as currently politically elected leaders including government executives and members of parliament are not banned by any formal law from doing business. The interviews revealed that by virtue of their positions and the role in the process, there is a greater possibility for a conflict of interest to arise in absence of clear provisions, for example, provided in the country’s constitution. Neither, existing arrangements to declare interest are honoured nor implemented in an effective and transparent manner. The results from this analysis, as with others (e.g Sanchez-Ugarte, 1995; Abramovsky et al. 2014; Whitfield et al. 2015; Zolt, 2015; Cooksey, 2016) suggest that the reluctance of the governments especially in SSA countries to revise tax incentives as advised is because politicians in power work for their best self-interests. The results support previous studies which have shown that there is a positive relationship between the growing interests on the use of tax incentives and rent seeking actions. The findings of this study support existing and growing concern in the literature that granting of tax incentives creates opportunity for corruption and
socially unproductive rent seeking activities (Zee et al., 2002; Njeru, 2012; Njeru & Ndimitu, 2012).

4.2.5 Lack of sustained political will, commitment
It became apparent that government often makes pledges about reviewing and harmonizing various provisions of tax exemptions but such pledges have not yet materialized due to lack of sustained political will and commitment to do so. Interviewee cites several budget speeches in which various Ministers for Finance have agreed to minimize tax exemptions but in the end none of the promises has been fulfilled. The fact that these commitments and deadlines have continually been missed suggests that the government lacks true political will to implement the commitments. This matches the findings revealed by the IMF/OECD/UN & World Bank’s (2015) report which declared that the common reluctance to scale back tax incentives may reflect political disinterest.

5 Conclusion and implications
This study, examined why use of tax incentives in Tanzanian EPZ program has remained popular and whether there is rent seeking motive on its application. This question was particularly important given reluctance of Tanzanian government to review tax incentives as recommended by different observers, including International Financial Institutions such as the World Bank and IMF.

The results of this study revealed that tax incentives are attractive because other alternatives available to stimulate investment involve actual transfer of resources, and requires parliamentary approval which may delay the process. In which case, government prefers tax incentives because it is something which it has control and which it can endorse relatively easily and quickly. Government prefers tax incentives because it is possible to provide the investor with a subsidy without having to go through the tax collection and budgetary dispensing process. This view had also been observed in the literature; however the present study further confirmed its existence, and especially so in a latecomer EPZ context. The results also revealed that, developing countries tend to use tax incentives for investment if their competitors also use the same. The use of tax incentives is a preferred method to maintain countries’ competitive position against neighbouring countries. These results support and extend the literature by showing that use of tax incentives is politically preferred because it has proved to work at an intra-regional level. The study has also demonstrated that there is stronger political motive to use tax incentives for investment in a country with high unemployment rate.

Concerning whether there is rent seeking motive on the use of tax incentives, the findings of the study clearly demonstrated that tax incentives have often been motivated by political rather than economic considerations, often influenced by rent seeking behaviour. The findings revealed presence of too much political influence of vested interests in the design and implementation of tax incentives policy. These results fully concur with their literature, and extend the exiting literature to take account of the fact that the political economy and rent seeking motive surrounding use of tax incentives is magnified when government executives and legislatures are unrestricted from doing business.

Based on these findings, and also the evidence of relatively low level of investment in EPZs, it is clear that tax incentives alone cannot work effectively to attract investment. Improved infrastructure including competitive utility costs, and improving governance are more important factors. This study calls for the government actions that pay more attention on modern, well-functioning infrastructure. Drawing from the evidence that modern infrastructure can, in fact,
acts as a powerful attraction to investors, this study calls for the need to improving zone’s physical infrastructure in order to increase the chances of attracting investment on a real long-term basis.

6 References


