

THE UNIVERSITY OF THE WESTERN CAPE

FACULTY OF LAW

**The Regulation of Foreign Direct Investment in Tanzania:
A Focus on Tax Incentives Schemes**

**A Mini-thesis Submitted in Partial Fulfilment of the Requirements for a Masters of Law
(LLM) Degree in International Trade, Investment Business Law**



Student Name: NDIKO, Amina

Student Number: 3281063

Mode II Mini-thesis

SUPERVISOR: Prof P M Lenaghan

Declaration

I declare that, **The Regulation of Foreign Direct Investment in Tanzania: A Focus on Tax Incentives Schemes;** 'Is my own work, has not been submitted before for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Amina NDIKO

Signed:.....



Prof Patricia Lenaghan

Signed:.....

Dedication

I dedicate this mini thesis to my children, Joel and Abigail



Acknowledgement

A lot of people have contributed in many ways to my attainment of this achievement. The big risk is always to forget some names. I am however owed primarily to the highest Almighty God whose mercies and favours have been flowing my way in unprecedented abundance throughout the writing of this mini thesis. I give all the glory to God.

My loving husband Julius Makara, his patience has been unlimited during my stay away pursuing the course work in Cape Town, enduring the trouble of our two toddlers during my absence and throughout the completion of this mini-thesis, just to say it all he has been part of the success of this mini-thesis in many ways.

To my responsible supervisor, Professor Patricia Lenaghan, you endured a lot in my struggle from the scratch during the formulation of the research topic, the proposal and throughout the writing of this mini-thesis. I acknowledge your constructive comments all the way through. All that I can say is blessings throughout your endeavours.

Finally I acknowledge the moral and material support of my class mates and colleagues who have always been supportive throughout my career advancement through my Masters course.

Key words

Economic growth, Investment, Investors, Foreign direct investment, FDI regulation, Mineral revenue, Misuse, Revenue losses, Tanzania, Tax revenue, Tax incentives



Acronyms

BEDIA	Botswana Export Development and Investment Authority
BITC	Botswana Investment and Trade Centre
BoT	Bank of Tanzania
BUR	Botswana Unified Revenue Services
DSE	Dar es Salaam Stock Exchange
EPZ	Export Processing Zone
EPZA	Export Processing Zone Authority
ICSID	International Chamber for Settlement of Investment Disputes
IFSC	Botswana International Financial Services Centre
IMF	International Monetary Fund
IPAs	Investment Promotion Agencies
MNCs	Multinational Corporations
MNEs	Multinational Enterprises
OECD	Organisation for Economic Co-operation and Development
OLI	Ownership Location and Internationalisation
REPOA	Research on Poverty Alleviation
SPZ	Special Processing Zone
TIC	Tanzania Investment Centre
TRA	Tanzania Revenue Authority



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Chapter one

1.0 Introduction and background of the problem

Tanzania is an African country which was founded under the political ideology of socialism and self-reliance.¹ In the first decades of its independence Foreign Direct Investment (FDI) did not have a good chance to grow. This was due to the policies of socialism which were not open to economic liberalisation and private property in general. After the Arusha declaration a few years after independence all private owned firms were nationalised following the initiative of socialism and self reliance policies.² However in the second half of the 1980s, owing to the structural adjustment policies imposed by the World Bank and the International Monetary Fund (IMF)³ Tanzania was forced to open doors by the global trends on liberalisation.⁴ Foreign investment to Tanzania started to grow in a fast pace from 1990s due to a number of government initiatives to improve the investment climate.⁵



¹ After the independence of Tanganyika in 1961 and later the union with the islands of Zanzibar in 1964 the government of Tanzania adopted the Arusha Declaration, 1967 (Part Two and Part three for Socialism and Self reliance respectively. The policy is enshrined in the Constitution of the United Republic of Tanzania, 1977 under Article 9)

² ‘Action began within twenty four hours of the publication of the Declaration and the Resolution. On 6th February, 1967 all private commercial banks were nationalised; on each of the succeeding four days further steps were taken to bring the economy of the country into the ownership and control of the people.’ See Nyerere JK The Arusha Declaration Ten Years available on line at

<http://www.tzonline.org/pdf/thearushadeclarationtenyearsafter.pdf> last accessed on 12/12/2012

³ Among the obligations imposed by the Bretton wood institutions to the poor countries were the opening of markets and liberalisation of economy. This is how countries including Tanzania began to adopt policies and laws in favour of FDI against the previous socialism, self reliance and nationalisation policies. See also <http://www.colby.edu/personal/t/thietien/macro-tan.html> and Tax SL ‘The Social Consequences of Structural Adjustment Reforms in Tanzania’ *Tanzanet Journal* 1(1) (2000) 4-18; 7,8

⁴ Tanzania adopted the Investment Promotion Policy, 1990 with the aim of responding to liberalization and opening doors for investment

⁵ Tanzania Investment Code 1990, the first law addressing investment in the country was adopted as a result of the economic reforms which began in 1986 information accessed online at finance.mapsofworld.com/economy_reform/Tanzania accessed on 20/9/2012

Given its natural resources endowments⁶ and the adoption of the free market policies Tanzania since then has witnessed an annual increase of FDI inflow rates. Massive FDI companies have been flocking in the country as evidenced by the number of registered projects and ownership, value of investment capital, employment and number of countries that have invested in Tanzania.⁷

The country has also been playing a role of attracting more FDI in the country by creating and constantly improving the investment climate by deploying various methods including a set of incentives both fiscal and non-fiscal.⁸ This work has been designed following these initiatives that are undertaken to attract FDI and particularly on the fiscal incentives used as have been challenged regarding their efficiency in the ascertainment of the role of FDI in contributing to country revenue.

A good number of available literature establishes that there is a relationship between the inflows of FDI and growth of the host country's economy due to several impacts and roles played by FDI enterprises through technology transfer, creation of employment, balance of foreign payments, increased revenue, to mention but a few. Ngowi,⁹ Ndulu and Mutalemwa,¹⁰ and Rusike¹¹ are some of the authors with this view and their position has also been supported by Bank of Tanzania (BOT),¹² United Nations Conference Trade and Development (UNCTAD),¹³ and

⁶ Tanzania is one of the countries rich in natural resources from its geographical and historical background. It includes plenty deposits of gold and other minerals, wildlife, fisheries, waters, forestry and woodlands together with a favourable equatorial climate conducive for agriculture and livestock.

⁷ Mnali JMSocial Accountability Session Report on the Contribution of Foreign Direct Investment to Local Economy in Tanzania: Achievements, Challenges and Prospects (2012) TIC 8

⁸ Through the Tanzania investment centre (TIC) and the Tanzania Investment Act a bunch of tax incentives are given to attract FDI as explained in chapter two of this work

⁹ Ngowi HP 'Tax Incentives for Foreign Direct Investments: Types and who should/should not Qualify in Tanzania' (2000) *Tanzanet Journal*, available on line at www.tanzanet.org; (accessed on 13/10/2012)

¹⁰ Ndulu&Mutalemwa *Tanzania at the Turn of the Century: Background Papers and Statistics* (2002) World Bank, Washington DC 44

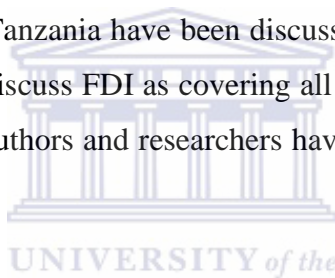
¹¹ Rusike TG *Trends And Determinants Of Inward Foreign Direct Investment To South Africa* (unpublished LLM thesis, Rhodes University (2007) 7

¹² BoT, NBS& TIC *Tanzania Investment Report, Report on the Study of Foreign Private Capital Flows in Mainland Tanzania* (2004) BOT, Dar es Salaam 37

¹³ UNCTAD *Global FDI Trends* (2010) UN Switzerland, *Investment Policy Review: United Republic of Tanzania* (2002) UN Switzerland 9

Research on Poverty Alleviation (REPOA).¹⁴ This has also been the case with Tanzania as it has for more than twenty years now been hosting a number of multinational investors.¹⁵ However reports have been recording an unimpressive status of growth in relation to the impact of FDI to the country's economy.¹⁶ It is argued that the asymmetry between investment and economic growth is not automatic. There are many prerequisites to be met in order for the country's economy to benefit from FDI.¹⁷ The OECD argues that in order for the host countries to minimise costs and maximise benefits of FDI to make such economic growth a reality it has to play some roles on its own side which includes the improvement of quality of policies, institutions to support FDI and adequate regulatory frameworks to mention just a few.¹⁸ The role of FDI in revenue increase to the host country particularly through taxation has been most challenged.¹⁹

Challenges of taxation on FDI in Tanzania have been discussed in two main perspectives. Some authors, researchers and analysts discuss FDI as covering all the economic sectors that means in broad.²⁰ On the other hand some authors and researchers have been sector focused.²¹ The highly



¹⁴REPOA Foreign Direct Investments (FDIs) Roles in Economic Transformation for Poverty Reduction: What Does it Take in a Tanzanian-type Economy? (2012) REPOA 6

¹⁵ Examples Barrick Gold (Canadian), Anglo Gold Ashanti (South African), Sun Flag Tanzania LTD (Indian), Sao Hill Industries.

¹⁶ TIC Report on the Study of Growth and Impact of Investment in Tanzania (2008) 30, 31, also TIC 2005, REPOA (2012)

¹⁷ TIC Report on the Study of Growth and Impact of Investment in Tanzania(2008) 29,30

¹⁸ OECD Foreign Direct Investment for Development Maximising Benefits, Minimising Costs Overview (2002) OECD 21,22 available online at

<http://www.oecd.org/investment/investmentfordevelopment/195981.pdf> this overview argues that 'The factors that hold back the full benefits of FDI in some developing countries include the level of general education and health, the technological level of host-country enterprises, insufficient openness to trade, weak competition and inadequate regulatory frameworks. Conversely, a level of technological, educational and infrastructure achievement in a developing country does, other things being equal, equip it better to benefit from a foreign presence in its markets.'²¹

¹⁹NgowiHP 'Tax Incentives for Foreign Direct Investments: Types and who should/should not Qualify in Tanzania' (2000), Ndulu and Mutalemwa(2002),Curtis (et al) *The One Billion Dollar Question:How Can Tanzania Stop Losing So Much Tax Revenue* (2012) TEC,BAKWATA&CCT Dar es Salaam, Lembrechts K (ed) *Breaking the curse: How Mineral Taxation and Fair Taxes Can Turn Africa's Wealth into Development* (2009) Southern Africa Resource Watch Johannesburg

²⁰ Example Ngowi(2000), Ndulu and Mutalemwa(2002), and Curtis (et al) (2012)

²¹ For example REPOA, 2012 focuses on agriculture

represented sector is the extractive industry, minerals in particular.²² This could be because of its lion share in Tanzania's FDI and its noticeable potential in contributing to the county's economy. This work however is not going to be sector specific.

Three clusters of thought are observed in the argument of FDI taxation in Tanzania. While some argue positively on the rationale behind the present tax regime on FDI (basing their discussion on the fact that Tanzania is providing a good investment climate and possesses well founded determinants of FDI's inflows),²³ some other arguments have been significantly critical to the current tax regime basing their arguments on the fact that unlike the reasonable expectation of the role of FDI to the country's economy through tax revenue, there have always been very minimal impacts on growth²⁴. Their concerns are mainly on tax incentives casting serious blames on the laws and policies regulating FDI. The third cluster is that arguing that the present tax regime is unfavourable to investment and overwhelming to investors and that they need to be revisited to grant more relief to the investors.²⁵

Given the above analyses by various stakeholders in the field of investment in the country both from within and without it is clear that there is an issue to be resolved. The urge of resolving this issue is more intensified by the fact that in the pursuit of trade liberalisation FDI is inevitable and its contribution to the host countries is viable.²⁶

²² Curtis (et al) 2012, Lembrechts k. (ed) 2009, Maganga & Mhinda *Extractive resource Industry in Tanzania: Status and challenges of the mining Sector* (2009) SID, Nairobi

²³ This school can be seen in TIC (2005), TIC (2008), Tarimo D Mineral Taxation: where to from here? (2006) PWC available on internet at www.pwc.com accessed on 18/9/2012

²⁴ Ngowi 'Tax Incentives for Foreign Direct Investments: Types and who should/should not Qualify in Tanzania (2000); REPOA Foreign Direct Investments (FDIs) Roles in Economic Transformation for Poverty Reduction: What Does it Take in a Tanzanian-type Economy? (2012)

²⁵ CUTS *Investment policy in Tanzania: Performance and Perceptions* (2003) Centre for Competition Investment & Economic Growth 34

²⁶ See UNCTAD *Investment Policy Framework for Sustainable Development (2012)* UNCTAD, Switzerland. It provides inter alia that, 'Over the last two decades, more and more governments have come to realize the crucial role of private investment, including FDI, in fuelling economic growth and development...' 1

1.1 Problem Statement

The problem is the tax incentives given to investors in order to attract foreign direct investment are not properly regulated hence offering a loophole for abuses and misuses of those incentives and lead to losses which costs the country's economy.

The manner in which investors can manoeuvre and manipulate tax incentives offered to them need both an off-sight and on-sight monitoring to bridge every possible gap that may be a loophole for abuses that lead to revenue loss to the country. for example by April 2011 it was reported that no gold companies had paid material income tax and prospects for any improvement are of no soon because of large tax holidays together with anticipated decrease of net income as a result of offsetting impacts of accumulated Value Added Tax (VAT) and fuel tax refunds.²⁷ This lead the main source of country's revenue from FDI to be basically on royalties and payroll taxes as it is the case in many African countries.²⁸

Acknowledging the effects of tax evasions and the siphoning of funds to tax havens as a challenge to investment sector in Africa that deprive countries of fiscal benefits of growth Pfister emphasises on the role of countries in developing effective responses to counter such challenges and make them central to their development agenda. He particularly addresses some sectors like export of crude fuel, mineral extraction and tax evasions to be the leading areas of abuse which deprive countries of their fair share.²⁹

²⁷ Curtis M, Ngowi HP &WarrisA *The One Billion Dollar Question: How can Tanzania stop loosing so much revenue* (2012) 12; it should be noted that large gold mining in Tanzania started on late 1998 so by 2011 it is a range of almost 13 years.

²⁸Lembrechts K (ed) *Breaking the curse: How Mineral Taxation and Fair Taxes Can Turn Africa's Wealth into Development* (2009) 21

²⁹Pfister M 'Taxation for Investment and Development: An Overview of Policy Challenges in Africa' Background paper presented in the NEPAD-OECD Africa Investment Initiative Ministerial meeting and Expert round table)11-12 November (2009) 6,11

1.2 Objectives of the research

The main objective of this work is to find out the best way in which Tanzania can regulate FDI tax incentives' scheme. This main objective is further sub divided as follows:

- i. To investigate the current regulatory framework of FDI tax incentives in Tanzania
- ii. To find out the implications of such regulations in relation to tax revenue
- iii. To investigate the approach of other countries in regulating FDI tax incentives
- iv. To come out with a best way in which Tanzania can regulate FDI tax incentives

1.3 Research questions

This research has been committed to answer the following questions in relation to the above objectives.

- i. What is the available scheme of FDI tax incentives in Tanzania?
- ii. How are FDI tax incentives regulated in Tanzania?
- iii. What are the implications of such regulation in relation to tax revenue?
- iv. What has been the approach in other countries?
- v. How best can Tanzania regulate FDI tax incentives to minimise abuses or misuse?

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1.4 Hypothesis

This mini thesis has been conducted under the assumption that; the country has a functional role on determining appropriate environment to attract investors while at the same time not compromising its economic growth. Tax incentives offered to investors are supposed to be well managed and regulated contrary to that they will be subjected to misuse and/or abuse and lead to significant revenue losses to the host country.

1.5 Significance of the research

There are very little academic writings in Tanzania in this area of FDI and tax incentives in particular. This research therefore has been conducted to provide an impartial analysis on FDI taxation in Tanzania. This is because most of the available literature has been provided by people and/or groups with inclinations to either side of the coin, investment/investors on the one side or some sectors of the economy on the other. In an academic perspective, understanding the

importance of international investment in fostering development the researcher has been put in a merit position to come out with an outstanding position as far as the above mentioned problem is concerned.

1.6 Scope and limitation of the study

The study is limited to the county Tanzania and the data presented herein is as of December 2012. Some theoretical issues which are universal have been explained in their broader perspective. A particular reference has however been specially made to Botswana which as stated below in the methodology section is a county which is considered a role model on management of FDI in general and maximization on its natural wealth in contribution to the country economy³⁰.

While FDI encompasses investment in various sectors, the discussions and literatures have sometimes been centred on investment sectors particularly the mineral sector and mineral revenue due to the lion share the sector has in the country's total investment. In this work however FDI is considered in its broader scope.

The concept of tax revenue in this work is also limited. The research is purely qualitative to the point that no data has been subjected into quantitative analysis; there is no numerical computation of taxes presented to that effect.

1.7 Methodology

This work was conducted basing on a typical desk review of literature. Available literature with reference to Tanzania was thoroughly consulted. Although there is no county with a typical, similar nature to Tanzania, in terms of economy, development and politics that has got such achievement to be considered as a role model, reference was drawn from Botswana on a basis

³⁰ See <http://www.africagoodnews.com/development/poverty/2254-botswana-shows-glimmer-of-hope-for-least-developed-countries.html>, it is provided Botswana has been a good model to the least developing countries in the utilisation of its resources to development. FDI in Botswana together with development policies are also said to be well articulated and managed. Last accessed on 25/09/2012)

that it is a country which managed to graduate from least developed countries to developing countries,³¹ through its successful policies which made it maximise on its diamond wealth.³² This was sought relevant because Tanzania is a least developed county and being the third major gold producer in Africa³³ plus other natural resources endowments,³⁴ it can be submitted that Tanzania could also maximise on its natural wealth to the same step of Botswana and more if such recourses are properly exploited. Another reason is that Botswana has been an FDI attraction since independence through which the country managed to pull together its revenue and benefit there from.³⁵

1.8 Key words

The following are the key words to this research:

- Economic growth
- Investment
- Investors
- Foreign direct investment
- FDI regulation
- Mineral revenue
- Misuse
- Revenue losses
- Tanzania
- Tax revenue
- Tax incentives



³¹ Information obtained on line at <http://www.africagoodnews.com/development/poverty/2254-botswana-shows-glimmer-of-hope-for-least-developed-countries.html> and <http://www.unohrlls.org/en/ldc/164/> (accessed on 20/09/2012)

³²It is presented that, 'Botswana's economy remains one of Africa's success stories ...The per capita income which stood at around USD 70 in 1966 is currently at about USD 6 500, bolstered by the discovery of diamonds.' Information available online at

<http://www.africaneconomicoutlook.org/en/countries/southern-africa/botswana/> (Accessed on 20/09/2012)

³³Curtis &LissuA *golden opportunity: How Tanzania is failing to benefit from gold mining* (2009)TEC, CCT & BAKWATA. Dar es Salaam 1

³⁴ See the government website at <http://www.tanzania.go.tz/naturalresourcesf.html>

³⁵Beaulier SA 'Explaining Botswana's Success: The Critical Role of Post-Colonial Policy' *Cato Journal*, 23(2) (2003)227-249

Chapter two

2.0 Theoretical framework of foreign direct investment and taxation

2.1 Introduction

This chapter examines some theories on taxation and Foreign Direct Investment (FDI). It describes the role of tax incentives on FDI (firms) decisions together with the efficiency of tax incentives as a tool on FDI inducements. The purpose is to develop sufficient background information for the other chapters particularly on the basis for regulating taxation regime for FDI as will be discussed in chapter four, without putting the country's revenue at stake. The meaning of FDI incentives is broadly explained, followed by theories on FDI. After this general overview of the theories is covered, the chapter will go further explaining the legislative framework of investment taxation in as for Tanzania aiming at understanding particular terms like the meaning of tax incentives and investment incentives. The regulatory framework is also provided focusing on how tax incentives are regulated. An account of the available tax incentives on FDI in Tanzania is also given as of the year 2012 including their implications.

2.2 Determinants of Foreign Direct Investment

The inflow of foreign investment into a particular country is an initiative which is subsequent to the realisation of some factors which are known as FDI determinants. These determinants can be firm driven, on the one hand, or recipient country driven, on the other. In whatever case that may be these are the factors which influence the firms' decisions to expand their operations internationally through FDI.

Analysing FDI determinants in his article titled 'Foreign direct investment and growth: Theory, evidence and lessons for Egypt', Rady mentions a number of factors to be contributory to the inflow of FDI like efficiency, stability and capability of host governments, this include the state of political rights, permissive investment regime, presence of necessary infrastructure, low levels of corruption to mention just a few. Corruption for instance is mentioned to be a great threat to business as it is a factor that increases tremendously the costs of doing business should one

choose to invest his capital in a country with a corrupt government and systems.³⁶ Lack of democratic accountability, prevalence of external conflicts and religious and ethnic tensions are noted to decelerate and scare off the inflow of FDI.³⁷ This is also mentioned by Asiedu³⁸ in her analysis of the determinants of FDI in Africa; that the significant factors attracting large number of FDI include the extent in which the country is open to trade,³⁹ its infrastructure (including roads, telecommunication, internet and other forms of infrastructure depending on the specific needs of a firm). She further categorically points the issues of political and economic challenges in the least developing sub- Sahara African countries that have been slowing the rates of FDI inflows in the late 1990s. These risk factors include political unrest, unstable exchange rate, economic growth, and government consumption and inflation rates.

It is also analysed that the nature of labour needed to perform a specific firm's activity plays a great role in determining the inflow of FDI to one country as compared to the other. Investments which require high level of skills will tend to flow into the countries with high skilled labour even if it is within the same region of developing countries. The factor of kind of labour required plays a great role as a determinant of location by a given multinational enterprise.⁴⁰ Deichman is also of a view that human and social capital play a significant role in attracting FDI, this included man power (labour) and social infrastructure in general.⁴¹

³⁶Manrique G and Vlad V 'Foreign Direct Investment Flows: An Examination Of Its Distribution Among Middle- And Low- Income Countries' *Global Conference on Business and Finance Proceedings* 6(2) (2011) 639-648 645

³⁷Rady T 'Foreign direct investment and growth: Theory, evidence and lessons for Egypt' *Journal of International Business Research*, 11(Special Issue 1) (2012) 1-14, 5

³⁸Asiedu E 'On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different?' *World Development*, 30 (1) (2002) 107-119, 108

³⁹It is trite important for the country to open for international trade to take place as most MNEs will produce to participate in the global value chain hence it is most likely for multinational corporations to flow to countries which have opened for trade rather than those countries which have not. See, Manrique G and Vlad V Foreign Direct Investment Flows: (2011) 645

⁴⁰Manrique G and Vlad V 'Foreign Direct Investment Flows' (2011) 641

⁴¹Deichmann, J (et al) Foreign Direct Investment in the Eurasian Transition States. *Eastern European Economics*, 41(1) (2003) 5-34, 7

While several authors, as analysed above, have been considering attractions for FDI inflows in terms of existing favourable social and economic conditions, Axaroglou, in his article,⁴² has categorised these factors that attract the inflow of foreign investment into four major groups namely, the sales opportunities the company foresees in supplying the foreign market, lower production cost the company expects by producing in the foreign market Also, the stage and structure of the foreign labour market in which the company operates and finally, a set of fiscal and economic incentives and disincentives available in the foreign market.⁴³ The last factor mentioned is of great interest in relation to this mini-thesis as it mentions specifically the role of fiscal incentives in attracting FDI into a given country. Like other literatures however, Axaroglou insists on the role of market size in attracting FDI; he on the other hand demonstrates the prevailing uncertainty as to whether relaxation of fiscal policies and taxation effects have a role in attracting the inflow of foreign investment. Some arguments are so far in favour of the proposition that fiscal incentives favour the inflow of FDI while some arguments are against it arguing that these policies tend to offset one another hence they end up not necessarily being a favourable influence in attracting foreign investors. He however acknowledges albeit with a critic on its success the fact that governments tend to offer fiscal incentives as a competing tool when competing for the country of the same investment conditions.⁴⁴

Taking it much more to the details Tuomi, made a specialised research with reference to South Africa comparing the roles of tax incentives and other investment climate variables in influencing firms in their investment decision. The outcome of both imperial findings and review of literature is appealing to the fact that countries over emphasise the use of fiscal incentives as an investment attraction tool while in the real world the country investment climate factors plays a major role that is mostly considered by investors in their decisions than the so emphasised relieved fiscal schemes. She further insists that operational costs reducing costs is

⁴²Axaroglou K 'What Attracts Foreign Direct Investment Inflows In The United States' *The International Trade Journal*, XIX(3) (2005) 285-308

⁴³Axaroglou K What Attracts Foreign Direct Investment Inflows In The United States 287

⁴⁴Axaroglou K What Attracts Foreign Direct Investment Inflows In The United States 289

rather a secondary issue of concern after a firm has made initial decisions of location which are primarily driven by perceptions and reality of country and sovereign risk.⁴⁵

In the light of the foregoing, the main lesson that can be learnt is that the attractions for FDI are often subjective. This means that while one firm may be attracted by some factors, the same factors may not attract another firm due to their differences in the nature of activities they carry in their investment ventures. It is therefore crucial to use a deliberate bias in analysing factors that attract foreign investment and the same should be the case in times of governments setting investment promotional tools. In other words, the government needs to be so strategic or else some investment incentives may turn into a waste of resources.

2.3 Tax incentives

A tax incentive is 'a deduction, exclusion or exception from a tax liability offered as an enticement to engage in a specific activity (such as investment in capital goods) for a certain period'.⁴⁶ Literally an incentive is that allowance given to a person in order to motivate or promote him to respond in a required manner; meaning that the giver of an incentive is creating himself a tool for gaining influence over decisions and actions of the receiver of that incentive to be in favour of and/or in line with the plans of the giver. An incentive is also defined as, 'something which encourages you to work harder, start a new activity, et cetera.'⁴⁷ When the incentives are aimed at improving investment climate they are sometimes referred to as inducements (economic inducements in particular when we are dealing with tax incentives) connoting the role they are sought to achieve. Tax incentives therefore fall within the same spectrum meaning an allowance given to a tax payer foregoing completely an otherwise payable tax amount or reducing the same with a purpose of signalling the beneficiary of that allowance to respond in a manner preferred and or favourable to the interest of the allowance provider. As for FDI therefore tax incentives will be that set of tax allowances accorded to foreign direct

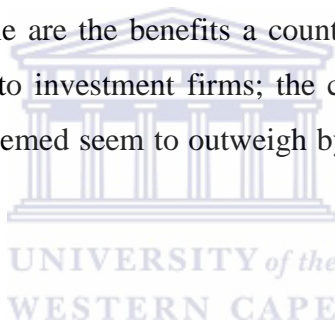
⁴⁵Tuomi K 'The Role of the Investment Climate and Tax Incentives in the Foreign Direct Investment Decision: Evidence from South Africa' *Journal of African Business* 12(2011) 133–147, 136

⁴⁶ Definition sourced online at www.businessdictionary.com/definition/tax_incentive.html (Last accessed on 25/9/2013)

⁴⁷ Longman dictionary of contemporary English for advanced learners (New Edition) (2009) Pearson Education Limited, 888

investors to motivate them in investing in the country in accordance with the preferences of the host country. These preferences may be sectoral driven,⁴⁸ geographically located or may be based on the national development policy/strategy as the fact may be. Tax incentives generally can be used as a tool of channelling investment in accordance to the government's priorities.⁴⁹ Ngowi⁵⁰ defines tax incentives as reductions intended to encourage business operations, FDI being one of them; they are special provisions intended to encourage certain kinds of behaviour in response to tax benefits. They refer to preferential host government policies over value added tax, corporate income tax, property tax, licensing fees, import duties, and sales tax.⁵¹

Countries worldwide have adopted varying tax incentives schemes as part of economic liberalization since the coming into effect of economic liberalisation in the 1990s.⁵² However past research demonstrate that little are the benefits a county receives in terms of returns as a result of fiscal incentives offered to investment firms; the costs the country has to suffer as a result of these fiscal incentives schemed seem to outweigh by far the benefits so accruing if any



⁴⁸This denotes the situation where there are some sectors which are considered as strategic sectors. Could be because of their vast contribution in the national GDP or because of they are the most rich and potential for investment compared to the other sectors.

⁴⁹James S & Nobes C *The Economics of Taxation* 7th Ed (2000) Pearson Education Limited: Great Britain pp 248, 251 provides that tax allowances have an economic role of shifting the allocation of resources towards investment to designated development areas; by making generous allowances to companies operating in those areas. It goes further that they are the means for encouraging certain kinds of investment by differing amounts of taxation paid by a company in proportion to the investment it carries out. Also an example from India is seen in Deloitte 2000, p 3 giving the same stand that investment incentives are given to promote investment to specific industries, to promote the development of economically lagging regions and encourage export. The same is seen in Dixon-Fyle SR 'Economic Inducements to Private Foreign Investment in Africa' *Journal of Development studies* (2004) 109-137, that economic inducements save a multipurpose function in the countries development policies including allocating g FDI activity according to the country's social and economic philosophy of development 111

⁵⁰Ngowi (2000) 22.

⁵¹ Li Q 'Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis' *The Journal of Politics* 68(1) (2006) 62-74, 62

⁵²Li Q 'Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis' 62

at all.⁵³ This mini-thesis has dedicated one of its sub-parts to discuss the designing of fiscal incentives the argument being whether a country should forego many of its revenue potential while on the other hand the investor firm acquires optimal benefits at the detriment of his counterpart. It would be prudent to have some incentives conditional to the fulfilling of some responsibilities which will benefit the country for instance meeting a certain quota on employing locals at a defined cadre, and/or investing a defined percentage of the firm's income on research and development projects, et cetera.⁵⁴ Li takes these finding much further arguing on the potential economic and political consequences of tax incentives offered to multinational FDI firms. Li sees incentives to foreign investors as representing direct government intervention in the capital market and they have distributive consequences for domestic and foreign interests. They thus affect the allocation of scarce financial resources, influence government revenues, and favour particular groups at the expense of others which is highly suspicious to their sustainability on profits accruing thereof for the respective country.⁵⁵

Research shows that in order for the country to benefit from the FDI incentives it offers as a tool for attracting investment, such inducement must correlate the investment processes underlying FDI decisions the relation which is so often disregarded or oversimplified.⁵⁶ It is for this reason the next part of this chapter describes various theories of FDI consequence to which one may draw some conclusions on the best way of regulating FDI incentives and tax incentives in particular for the purposes of this work. FDI processes includes the decisions underlying the capital diversification of a company like when a company decides to use some of its capital to open a subsidiary company in the same country or moving to one or more of the countries for direct investment.

⁵³Tuomi K 'The Role of the Investment Climate and Tax Incentives in the Foreign Direct Investment Decision: Evidence from South Africa' 139; in her study most of the respondent multinational firms affirmed that country investment climate play a major deterrent role in their decisions.

⁵⁴Allen B (et al) 'Designated Investment Funds and the Employment & Investment Incentive Scheme' Accountancy Ireland 44(5) (2012) 62-63

⁵⁵ Li Q 'Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis' 71

⁵⁶Dixon-Fyle SR(2004) 110

2.4 Other investment incentives

Apart from tax incentives which are the subject of this work, there are other incentives which are used in attracting foreign direct investment. These incentives vary in type, nature and quality as well as quantity provided as one move from one country to another given the economic, social and political disparities and the differences in investment policies.

While tax incentives are basically fiscal incentives, other kinds of incentives may be categorised as financial incentives and additional facilities. Financial incentives are aimed at empowering the investor to finance a given project that he is up to investing in. These include but not limited to cash incentives, funds for export promotion, loan guarantees against letters of credit, export subsidies and any other export credit guarantee schemes.⁵⁷ It also include provision of special funds used for enhancing loans in specific sectors as an initiative to improve and maximise investment in such sector which is sought to be promoted. For example a given state is seeking to promote investment in the agriculture sector and its federal bank designs some loan instruments special for investment in the agriculture sector with less stringent loan requirement like interest and collateral requirements. This is an incentive though not a direct provision of fund but a more competitive loan facility which is more preferable to investors.

Additional facilities that can be offered to investors would include relaxation of immigration laws to ease some requirements in order to facilitate the employment of expatriate and their families. It also includes relaxation of labour requirements against employees working in the FDI firms. This means non observance of labour obligations imposed by the law. Business/company laws may also be relaxed as an additional facility for attracting FDI. For instance the requirement of joint ventures between foreigners and citizen may be waived to allow FDI firms with 100% foreign equity.⁵⁸

Improved transport and communication infrastructure can be an incentive too as it puts a country into a comparative advantage and reduces investment costs hence investors especially foreign

⁵⁷Shah A Incentives: Tool for Attracting Foreign Direct Investment in Bangladesh University of Rajshahi, Bangladesh (2011) also available at www.wbiconpro.com/218-Alam.pdf last accessed on 26/09/2012. Also, Ngowi HP 'Tax Incentives for Foreign Direct Investments (2000) 20

⁵⁸ Shah A Incentives (2011) 5 and Ngowi HP 'Tax Incentives for Foreign Direct Investments (2000) 20

direct investors would find it favourable and can maximise investment costs more productively. This is part of the host country's conditions which on the other hand will include factors like political stability, availability of sound legal framework (including fair and equitably applicable laws and the legal system in general), and existence of rule of law and investment favourable policies.

In the light of the above discussion therefore, a county is free to exercise its discretion on deciding the types and nature of tax incentives it is to offer in an initiative for attracting/inducing multinational firms to tap investment opportunities in its territory.

2.5 The law on foreign direct investment tax incentives in Tanzania

The Tanzania Investment Act is the law governing all the matters of investment in the country hence it is a reference point on investment incentives in that manner. It is the only place where investment incentives have been defined and some types of incentives have been mentioned however there are other laws governing various sectors which also provide for more elaborate incentives given to investor in those specific sectors.

In the Tanzania investment Act, the term incentive is defined as:

Tax reliefs and concessional tax rates which may be accessed by an investor under the Income Tax Act, 1973, the Customs Tariff Act, 1976, the Sales Tax Act, 1976 and any other law for the time being in force, and includes additional benefits that may be accessed by an investor under sections 19 and 20,⁵⁹

It is under the light of this definition most of the investment incentives offered by Tanzania are fiscal/tax incentives. It is however questionable as to whether the term incentives if limited to tax allowances only the question which will also be addressed in chapter three of this work, since it is sought to be one of the weak point which makes Tanzania to play down or overlook other possible investment incentives which would have balanced the issue of revenue losses and optimise FDI into profits.

⁵⁹s. 3 of the Tanzanian Investment Act

In a broader perspective investment incentives can cover many other things such as tax incentives, guarantees against government appropriation, relaxation of immigration laws (e.g. Immigration quotas), reduction or elimination of import tariffs, relaxation of employment laws, access of utilities like water and electricity on a subsidised rate, improved infrastructure, etcetera.⁶⁰ It may also include financial/cash incentives like subsidised loans, funds for export promotion (export subsidies), export credit guarantees, and numerous additional facilities such as permission of 100% foreign equity in investment.⁶¹ As from the dictionary meaning an incentive is ‘something which encourages you to work harder, start a new activity, et cetera’⁶² meaning that it can be construed to be anything provided that it aims at encouraging or inducing someone to work start an new activity or to work harder. Given the very limited definition of incentives in the Tanzania investment Act, this aspect is referred to chapter three for a critical review.

The law gives general rates of tax allowances given to investor including some non income tax allowances as shown in the matrix/table that shows investment incentives available in Tanzania. As regard the quantity and quality, apart from those figures presented in the matrix, there are no elaborate methods given towards arriving into a specific rate/amount. Also there are no factors given which explains the reasons for the variation of rates from one sector to another. It is however thought that these missing details would have been useful for the analysis and evaluation of the efficiency of incentives given to foreign investors in Tanzania. It would further reduce some elements of doubts as to the integrity and prudence of the FDI sector in the country.⁶³

The income tax Act⁶⁴ is another main document that stipulates various tax incentives offered to investment companies both local and foreign. It states a range of tax allowances of various kinds

⁶⁰Ngowi HP Tax Incentives in Tanzania (2001) 21

⁶¹Shah A Incentives: Tool for Attracting Foreign Direct Investment in Bangladesh University of Rajshahi, Bangladesh (2011)4,5also available at www.wbiconpro.com/218-Alam.pdf last accessed on 26/09/2012

⁶² Longman dictionary of contemporary English for advanced learners (New Edition) (2009) Pearson Education Limited 888

⁶³The famous OLI theory by Dunning is one example in this category, fully explored in Dunning, JH. ‘The Eclectic (OLI) Paradigm of International Production: Past, Present and Future’ *International Journal of Economics and Business* 8(2)(2001)173-190

⁶⁴ 2011

in various sectors and on varying time frames, ranging from reduced rate of income tax to companies listed with the Dar es Salaam stock market, wholly exemptions on capital goods in some sectors like agriculture, exemptions on withholding taxes, tax credits, and other special exemptions in incomes earned in special economic zones (SEZs) like the export processing zones.⁶⁵

2.6 Theories on foreign direct investment and taxation

There are no agreed sets of theories to FDI.⁶⁶ Its roots can however be traced as far back to 1960, more than half a century now.⁶⁷ These theories have been responding to various disaggregated elements of FDI such as reasons behind the location of firms. It thus comes to the effect that these sets of theoretical explanations of the phenomenon of firm internationalization/ FDI are highly heterogeneous and not entirely consistent.⁶⁸ However, they all directly or indirectly incline into the so called OLI⁶⁹ approach pioneered by Dunning which relates firms' cross border investment to three main motives which are ownership, location, and internalisation. Basically, taxation can affect each of them as summarised hereunder:-

'Taxation may influence the incentive of MNE to establish a foreign subsidiary by increasing or reducing the advantage associated with ownership (e.g., tax treatment of royalties, dividend repatriation). At the same time, the host-country corporate tax rate

⁶⁵ To be discussed in detail in the upcoming subsection 2.7

⁶⁶ Grubert H & Mutti J 'Empirical asymmetries on Foreign Direct Investment and Taxation' *Journal of International Economics* 62 (2004) 337– 358, 337

⁶⁷ Oehler-Şinca M L 'Brief Reflections on the Development of the FDI Theory' *Theoretical and Applied Economics XVIII 11(564) (2011) 35-42, 37*. In his article Oehler-Şinca refers a 1960 PhD thesis by Hymer S H titled *The International Operations of National Firms: A Study of Direct Foreign Investment*, and mentions him to be one of the propounders of the FDI theories along others like Denning JH and Penrose E.

⁶⁸ Trapczyński P 'Does foreign direct investment theory explain subsidiary performance? A critical literature review' *Poznań University of Economics Review* 13 (2) (2013) 43-64 Trapczyński explains relying on the fact that the 'field of International Business has not developed a coherent theoretical foundation, instead relying on a mosaic of partial concepts, addressing the issues of 'why' (causality), 'how' (modality), 'when' and 'how fast' (temporality) and 'where' (location) of the foreign expansion'. 49,50

⁶⁹ OLI is an abbreviation for Ownership Location and Internationalisation as propounded by Dunning to be the necessary aggregates affecting FDI decision by firms.

contributes to determine the comparative location advantage that it can offer to international investors relative to other destination countries. More generally, corporate taxation and the tax treatment of foreign corporate income are likely to affect the wedge between the pre-tax and post-tax rates of return on FDI. This will affect the extent to which MNE can enjoy internalisation advantages relative to the alternatives of exporting or licensing their products in host countries'.⁷⁰

Basing on the available literature this work has come out with some of the theories as presented hereunder. According to Grubert and Mutti⁷¹ theories of FDI are categorised into three.⁷² These are underscored in the following sub part supplemented with the views of other author.

2.6.1 Factor endowment theory

The factor endowment theory is popularly known as the modern theory of international trade⁷³. It is also named after the names of its propounders, Heckscher and Ohlin thus the Heckcher-Ohlin theory of international trade. It is referred to as the modern theory of international trade as it comes after the classical theory of international trade. Though the former does not contradict the latter it goes much into details on explaining the factor elements on cost differences in production between nations which is basically the cause for international trade. These theories answer the question as to why does international trade happen. In both theories the comparative advantage on costs of trade are mentioned but the Heckscher-Ohlin theory goes further to explaining causes responsible for such cost differences. It states that, "The difference in relative factor endowments and factor prices between nations is the most important cause of

⁷⁰Hajkova D (et al) Taxation, Business Environment and FDI Location In OECD Countries ECO/WKP(2006)30 an OECD Economics Department Working Paper No. 502, 7

⁷¹Grubert&Mutti, Empirical Asymmetries in Foreign Direct Investment and Taxation

⁷²It should however be noted that the theories of FDI as categorized by Grubert and Mutti are not considered to be classical rather the author of this work has opted to venture in the those lines because of their closer interrelation to the main theme of this work that those theories as given by Grubert and Mutti give a best explanation with regard to both FDI and taxation. However the three theories are underscored along with other theories by other authors included in accordance with their correlation to the three categories given by Grubert and Mutti.

⁷³The term factor refers to the factors of production. Though they are more than two in this theory only two factors have been considered hence raises a criticism to that effect. See Jain TR and Kaur SJ (Revised Edition) *Public Finance and International Trade* (2009) FK Publishers 143

trade.”⁷⁴ According to Heckscher-Ohlin two factors have been considered, labour and capital thus in a country where labour is abundant they will specialise on labour intensive production and where a country is capital abundant it attracts capital intensive production.⁷⁵

According to Grubert and Mutti, this theory presupposes the fact that the wealth endowment of a country plus its cost conditions will dictate the FDI patterns internationally. This theory however applies mostly to vertically integrated companies⁷⁶ which tend to multiply their productions in other countries depending on costs required in each process upon such expansion. In this case MNEs tend to multiply their activities in their own countries and elsewhere in the world by opening or acquiring new firms in the supply chain of the products they deal with.⁷⁷ Vertically integrated firms make investment decisions to expand to other locations even cross border mainly to exploit inter-locational differences in relative factor endowment.⁷⁸ A manufacturer of plastic for instance may decide to open or acquire a plant that makes machines for manufacturing plastic in its own country or elsewhere in the world hence vertically integrated upstream and the same firm may further decide to integrate downstream by opening or acquiring distributor companies and department retail stores hence vertical integration downstream. Since this can happen both nationally and international, given the nature of entrepreneurial spirit firms decide to engage into FDI by way of Greenfield investments or through mergers and acquisitions. It has also been provided that vertical integration occurs as a firm becomes more competent and thus confident of a manager providing various production services most efficiently that could have been with the case of a group of smaller firms.⁷⁹ Vertical integration may also be achieved by a long-term or relational contract between two vertically related firms that maintained legally

⁷⁴Jain TR and Kaur SJ (Revised Edition) *Public Finance and International Trade* (2009) 136

⁷⁵Jain TR and Kaur SJ (2009) 136

⁷⁶Vertical integration of companies is when a parent firm decides to establish foreign subsidiaries to produce intermediate goods that go into the production of finished goods or to market the finished goods of the parent company in the foreign market. See Kennedy PL and Koor WW *International Trade and Agriculture: Theory and Practices* (2008) John Wiley & Sons 236; Hovenkamp writes that ‘Vertical integration occurs whenever a business firm does something for itself that it might otherwise have obtained on the market.’ See Hovenkamp H ‘The Law of Vertical Integration and the Business Firm: 1880–1960’ *Iowa Law Review* 95(2010) 863-918, 863

⁷⁷Hovenkamp H ‘The Law of Vertical Integration and the Business Firm: 1880–1960’ 864

⁷⁸Heckemeyer JH & Feld PL ‘FDI and Taxation: A Meta-Study’ *Journal of Economic Surveys* 25(2) (2011) 233–272, 234

⁷⁹Hovenkamp H ‘The Law of Vertical Integration and the Business Firm: 1880–1960’ 885

separate ownership within the same country or cross borders. The relationship between vertically integration of firms and the factor endowment theory is however arguable as challenged by Macchiavello⁸⁰ that the issue of vertical integration is much determined by industry financial development rather than the country's advantage. This work however argues both factors to be contributive because while on the other hand the financial development of a firm can trigger its intention to integrate, at the same time the wealth of the host country can reduce the costs of operation hence motivating the firm to invest in that country.

Most green field investment occurs under this mode as companies seek to explore virgin resources in countries or places which are endowed with such wealth than it is in their home countries. It is further formulated that multinational corporations consider country specific advantages (CFAs) when deciding to internationalise their operations. These are the specific benefits a firm gets as derived from that specific country. In this case they consider things like natural resources, the quality and size of the labour force, cultural factors, tariff and non-tariff barriers, public policies etc.⁸¹

In Tanzania for instance it is argued⁸² that the availability of untamed investment opportunities supported by policies that support foreign investors to exploit available opportunities has been a driving force to companies entering under this theory. It has further been mentioned that in sub-Saharan countries Tanzania is one of the counties that attract high percentage of FDI due to its riches in natural resources like minerals and now oil and gas.⁸³

Multinational Enterprises (MNEs) when assessing the location to set their projects, normally addresses issues like the determinants of a specific intended project together with country factors

⁸⁰Macchiavello R 'Financial Development and Vertical Integration: Theory and Evidence' *Journal of the European Economic Association* 10(2) (2012)255–289, 258

⁸¹Oehler-Şinca M L 'Brief Reflections on the Development of the FDI Theory' 37

⁸²Ngowi H 'Foreign direct Investment Entry modes in Tanzania' *Tanzanet Journal* 3(1): (2000) 1-12, 8

⁸³Mlambo K *Reviving Foreign Direct Investments in Southern Africa: Constraints and Policies* (2005) African Development Bank Blackwell Publishing, Oxford. The author explaining that 'Countries rich in natural resources, such as Angola and South Africa, Botswana, Namibia and the United Republic of Tanzania, are the principal destinations of FDI inflows in the sub-region' 7

which are likely to influence a given project.⁸⁴ There might be a long list of locations which possess some common necessary FDI determinants. In such cases the priorities will also be set depending on some few other factors like the availability of skilled and cost efficient labour, market and other incentives that may be offered by the government of the intended location. The determinants of the project include principally availability of raw materials/ capital resources which render a given location to have a competitive advantage over others and thus lessen investment costs when compared to projects which operate by importing raw materials. In this case, one can learn that while investment incentives are important in influencing multinational decisions, it can be considered a complimentary element as it is not a primary thing considered by multinationals.

The determinants of location decisions by multinationals are mainly availability of resources, availability of markets, efficiency in terms of labour costs, soft legal and investment regulatory framework and availability strategic assets. Wilson provides that, 'Resource-seeking investments are made in locations with an abundance of physical resources and the infrastructure necessary to process and transport these resources'⁸⁵ in a very exceptional way Wilson explores how managers of multinationals are influenced by promotional activities by investment promotion agencies (IPAs) specifically the role of advertising in persuading a prospecting investor to top listing a country as a location to explore more on its suitability for investing. Addressing the criticism to this proposition he states that for this to work it is imperative for the IPAs and/or responsible bodies consider factors that affect county image like policies, international relations and culture to mention a few⁸⁶

⁸⁴Wilson RT 'Attracting Foreign Direct Investment: Applying Dunning's Location Advantages Framework to FDI Advertising' *Journal of International Marketing*20(2) (2012) 96–115; in this article Wilson states the five stages undertaken by multinationals when pursuing their decisions to invest in a different location. The prospecting investor will primarily satisfy himself of factors that play a role in the realization of his project along with other attractions in the country, and then will compare costs in relation to other possibly similar locations. 97

⁸⁵Wilson RT Attracting Foreign Direct Investment (2012) 97

⁸⁶Wilson RT Attracting Foreign Direct Investment (2012) 98

2.6.2 Horizontally integrated multinational companies theory

Horizontal integration of companies is formed when a parent company producing a commodity sets up a subsidiary to produce identical products in the host country.⁸⁷ This theory presupposes the fact that horizontally integrated multinational corporations (MNCs) open multiple production activities in many different countries in order to reduce and/or avoid trade barriers while at the same time gaining a lucrative market access.

This theory correlates with what Dixon-Fyle⁸⁸ describes as the operational theory of FDI decision making. On his perspective he views investment decisions as an integral part of companies overall investment and growth policies. He explains further that the fundamental determinants of demand and supply apply to the aspect of capital movement to developed countries.⁸⁹ In this particular theory it can be perceived that FDI in general can happen without the initiatives of the host countries. That whether it should happen or not is a firms' driven factor depending on their resources and on whether according to their policies it is the right time to expand to a particular place. It contradicts the role of FDI inducement or generally the improving of FDI climate as a tool for attracting foreign investment; that if in its internal strategies and policies a company's expansion plan has not matured then no matter what the inducements will be imposed by the countries according to this theory, they will not affect the investors' decisions which according to them will be the roadmap in whatever initiative they put in place.

Hymrer explains further some facts relating to this theory that companies undergo a natural reaction against market imperfections under which they strategically decide to internationalise their firms and activities.⁹⁰ Providing a brief account on the development of FDI theory Oehler-Şinca analyzing a good number of literatures on FDI theories realizes that there are four major reasons for multinational firms' internationalization by way of FDI but the most pertinent is search for strategic and/ or created assets.⁹¹ This is reflecting the words of Dunning that 'the

⁸⁷Kennedy PL and Koor WW *International Trade and Agriculture: Theory and Practices* (2008) 236

⁸⁸Dixon-FyleSR(2004) 110

⁸⁹Dixon-FyleSR(2004) 110

⁹⁰Oehler-Şinca M L 'Brief Reflections on the Development of the FDI Theory' 36

⁹¹Oehler-Şinca M L 'Brief Reflections on the Development of the FDI Theory' 38 if this is a book italics the title

modern MNE is rather a vehicle for the transfer of the entrepreneurial talent than of financial resources.⁹²

2.6.3 Host country's economy theory

This theory addresses the fact that giant economies will impose higher taxes to FDI because they are guaranteed of the offsetting benefits they offer like well established infrastructure and agglomerations. The importance of this theory is on drawing the peculiarity of taxation regimes between countries. When a country offers well established infrastructure and non bureaucratic processes on FDI, these characteristics on themselves a benefit hence the demand of tax incentives will relatively be lower or unnecessary. Though it is argued that high taxation acts as a drawback to the inflow of FDI (according to the standard view of international capital), hence the country may lose the otherwise potential income, Becker, Fuest and Riedel⁹³ provide a contra argument that the quality of FDI matter most than the quantity. Their argument is backed by the fact that in such cases where the country's taxes are high though the inflow of FDI will be low the marginal unit of investment will have higher marginal returns plus larger taxes hence much revenue that would have otherwise been in the low-tax regimes. This second proposition, according to this mini-thesis is moving the researcher to accept that what matters most is the marginal return of a country given the amount of taxes it collects from the net income of the company. There may be few investment firms in a particular country which make optimum profits and hence a high tax margin to the government which is relatively favourable and beneficial when compared to multiple investment companies flocking into the country because of lesser taxes charged and later report losses thus not paying taxes at all.

On the other hand therefore a country with underdeveloped infrastructure and embodied with very bureaucratic FDI processes will suffer much in dispensing FDI incentives including making loose its taxes to an alarming state, the fact which is witnessed in many undeveloped countries. Whether this should remain the situation by compromising countries' revenue for lack of

⁹²Dunning, J H 'Ed' *Studies in International Investment* (1970) 321

⁹³ Becker J, Fuest C & Riedel N Corporate Tax Effects on Quality and Quantity of FDI (2009) WP 10/13 Centre for Business and Taxation, University of Oxford 1, 13, 14. Available online at eureka.bodleian.ox.ac.uk/3255/1/WP1013.pdf last accessed on 26/09/2012

infrastructure and other facilities is the question which will also be answered when discussing the basis for regulating FDI tax incentives in chapter four.

2.7 Foreign direct investment tax incentives in Tanzania

Sources on Tanzanian tax incentives on FDI are scarce and sparse. There is no single document envisaging tax incentives or FDI incentives in general. The Tanzania investment centre (TIC), an FDI promotion agency in Tanzania is an informative and generally FDI resource Centre. It has publications, some of them outdated though thus one cannot rely fully on the information in some of the publications like on its Tanzania Investment guide book⁹⁴ which is sought to cater for information on FDI generally investing in Tanzania from the year 2008 and beyond. Some laws and/or provisions of law which have recently been repealed and replaced are thus not featured in the Tanzania investment guide.⁹⁵

The guide stipulates a number of tax incentives which are said to be incomparable to what is offered by other countries with similar social, economic and political characteristics hence to render the country highly competitive as far as FDI is concerned.⁹⁶ These tax incentives are offered in the form of enhanced capital deductions and allowances structured in accordance with the lead industries and/or priority sectors. The sectors are said to include agriculture, agro-based industries, mining, tourism, petroleum and gas, and economic infrastructure.

⁹⁴ Example part 17 .0 of the guide which is headed investment incentives some tax rates are given based on outdated legislations without considering the effects of repeals and other changes. The use of the provisions of the 1998 mining legislation is noticed in this example given that there is a new legislation in that area which is the mining Act, 2010

⁹⁵ The incentives in the minerals sector for instance the incentives listed in the guide are as in the Mining Act, 1998 while there is a new Act, 2010 which enumerates new incentives rates. This suggests that the guide is not such a reliable instrument when one needs up to date information on FDI in Tanzania

⁹⁶ TIC Tanzania investment guide: (2008) p 39 It is however full of doubt as far as this paper is concerned as to whether the contention that due to the lucrative nature of tax incentives offered by the country the competitiveness of the latter will not be tested by other countries of the same social, economic and political characteristics. It is also doubtful whether these tax incentives offered are efficient as far as the overall role of FDI to the host country is concerned. This last point will be examined later in the chapter designed for a critical analysis on the regulation of FDI incentives in Tanzania.

After a thorough look on the TIC's Tanzania investment guide and relevant enactments⁹⁷ the tax incentives offered on FDI in Tanzania as of the year 2012 can be summarised as follows:

First of all, corporate taxation charged to investment companies in Tanzania is not far different from what is offered by many other sub-Saharan countries.⁹⁸ It has a corporate tax of 30% which is applicable to all companies foreign and domestic. A modest relief is offered to companies which are listed with the capital market, the Dar es Salaam stock exchange (DSE) where a 5% relief is provided hence the listed companies are eligible to a 25% corporate tax.

Investment companies enjoy a number of allowances both fiscal (tax foregone) and non fiscal. These however are sector specific. For companies investing in economic infrastructure for instance, they enjoy an allowance of 0% duty to all capital goods, and a modest rate of 10% withholding tax on both dividends and interest, VAT is exempt to all goods across the sector. In respect to losses the companies can carry forward incurred losses indefinitely.

As an initiative for promoting investment in the agriculture sector in fostering the implementation of the government's policy for prioritising agriculture (the Kilimo Kwanza policy), companies investing in agriculture enjoy a vast number of fiscal incentives at 0% duty on all capital goods, agricultural machinery and equipment like tractors, power tillers and combine harvesters and the likes, to mention but a few; there is also another allowance of 0% duty on all agro inputs and farm implements like fertilizers and pesticides together with all agriculture technologies. Just as in other industries losses are carried indefinitely and withholding taxes on interest and dividends are set to a modest rate of 10% while VAT is exempt throughout the sector.

Mining is another priority sector which enjoys a wide range of incentives. Companies investing in mining enjoy a 0% duty on all capital goods, spare parts, fuel/oil, explosives and other

⁹⁷At least each sector has its separate laws and regulations which have been considered as the table indicates as although some laws like the Tanzania Income Tax Act, 2006 is crosscutting.

⁹⁸Rusike TG *Trends And Determinants Of Inward Foreign Direct Investment To South Africa* (unpublished LLM thesis, Rhodes University (2007) 8

supplies. There is also a 100% capital allowance while corporate tax and withholding tax on dividends and interest is the same as for other sectors which is 30% and 10% respectively. In cases of goods and service imported exclusively for exploration, prospecting and drilling purposed companies enjoy an allowance of 0% duty. Losses can be carried forward indefinitely. Other non tax incentives include a royalty of 3% to minerals and precious gem other than diamond, a 5% royalty for diamond, 12.5% for petroleum and gas. There are no taxes or any fiscal impost on dividends and no capital gain tax. Companies also enjoy a further 5% duty rate and VAT refrained for five years of commercial production and a yearly appreciation of unrecovered capital on investment.

The tourism sector like many other sector pay the 30% corporate tax and 10% withholding taxes on dividends and interest. While duty on all capital goods is at 0%, these companies also enjoy a 50% capital allowance. Likewise losses are carries forward indefinitely and they are exempted from import duty on imported four wheel drive (4WDs) designed and built for tourism purposes.

Oil and gas in a currently very important sector in Tanzania followings the current discovery of massive oil deposits in the country. Like many other sectors the oil and gas industry enjoys some fiscal and non fiscal incentives offered to its investors domestic and foreign. The sector charges a 0% duty on equipment and materials on explorations, 0% duty on goods and service imported exclusively for exploration, prospecting and drilling purposes, a long exploration period of 4 initial years subject to extension of two more instalments of 4 years to the first and 3 years for the last which makes a total of 11 years. Other non fiscal incentives include negotiated levels of cost oil or gas split after the discovery of oil or gas for the purposes of recovering costs for exploration, development and production and negotiated levels of profit oil or profit gas split (in fact there are no fixed programs and/commercial terms in relation to investment in oil and gas industry). Companies are also responsible to payment of a royalty of 12.5%.⁹⁹

In regards to companies investing in special economic zones like the EPZs they also enjoy a number of exemptions on income tax, like 100% exemption of income tax for 10 years, 100%

⁹⁹www.tic.co.tz/media.incentives%20list%202012.doc last accessed on 15th October 2013

relief on withholding taxes for foreign loans granted to investors with EPZ and SEZ for the first 10 years of its operations. The same applies to withholding tax on dividends and rent. Investors investing in free zones are also exempted from paying any taxes on goods destined for export, exemption for local taxes in all goods produced in Freeport for export, corporate tax is also exempted for 20 years, the duration for storing goods in Freeport is unlimited; investors in Freeport are guaranteed 100% retention of profit together with free repatriation of profit and 100% foreign ownership of firms is also allowed.¹⁰⁰

Investment incentives available in Tanzania for the lead sectors as explained above is hereby summarised in the matrix below:

Lead/priority sector	Tax incentives offered			Other non income tax incentives
	Particulars	Duty	Vat	
Economic infrastructure	All capital goods	0%	Relieved	-Losses carried forward indefinitely
	Corporate tax	30%		
	-Listed company to DSE	25%		
	Withholding Tax on dividends	10%		
	Withholding tax on interest	10%		
Agriculture	All capital goods	0%	Relieved	-losses carried forward indefinitely
	Agricultural machinery/ equipment	0%	Exempt	
	Fertilizers and pesticides	0%	Exempt	

¹⁰⁰www.tra.go.tz/index.php/tax.incentives last accessed on 15th October 2013

	Farm implements and inputs	0%	Exempt	
	Corporate tax	30%		
	Capital allowance	100%		
	Withholding tax on dividends	10%		
	Withholding tax on interest	10%		
Minerals	All capital goods	0%	Relieved	-losses carried forward for unrestricted period -royalty of 3%, 5% for diamond, 12.5% for petroleum and gas -no taxes or any fiscal impost on dividends -no capital gain tax 5% duty rate and VAT refrained for five years of commercial production -Yearly appreciation of un recovered capital on investment
	Spare parts	0%	Relieved	
	Explosives and other supplies	0%	Relieved	
	Fuel and oils	0%	Relieved	
	Corporate Tax	30		
	Capital allowance	100%		
	Withholding tax on technical services	5%		
	Goods and service imported exclusively for exploration, prospecting and drilling purposed	0%		
Tourism	All capital goods	0%	Relieved	-Losses are carries forward indefinitely -Exempt import duty on imported 4WDs designed and built for tourism purposed
	Corporate Tax	30%		
	Capital allowance	50%		
	Withholding tax on dividends	10%		
	Withholding tax on interest	10%		

Petroleum and gas	Equipment & material on exploration	0%	Relieved	-Negotiated levels of cost oil or gas split after the discovery of oil or gas for the purposes of recovering costs for exploration, development and production -Negotiated levels of profit oil or profit gas split -Royalty of 12.5%
	Goods and service imported exclusively for exploration, prospecting and drilling purposed	0%		
	Capital allowance	100%		
	Corporate tax	30%		
	Withholding tax on dividends			
	All capital goods			
SEZ companies	Corporate tax	0% for ten years	relieved	-100% retention of profits -100% repatriation of profit -0% export tax for goods destined for export -100% foreign ownership is allowed
	Capital allowance			
	Withholding tax on dividends	Relieved for ten years		
	withholding taxes on rent	Relieved for ten years		

Source: Tanzania investment guide 2008 (with additional content by the researcher)

2.8 Implications of the current foreign direct investment taxation

Three clusters of thought are observed in the argument of FDI taxation in Tanzania. While some argue positively on the rationale behind the present tax regime on FDI (basing their discussion on the fact that Tanzania is providing a good investment climate and possesses well founded determinants of FDI inflows).¹⁰¹ Other arguments have been significantly critical to the current tax regime basing their arguments on the fact that unlike the reasonable expectation of the role of FDI to the country's economy through tax revenue, there have always been very minimal impacts on growth; their concerns are mainly on tax incentives casting serious blames on the laws and policies regulating FDI.¹⁰² The third cluster is that arguing that the present tax regime is unfavourable to investment and overwhelming to investors and that they need to be revisited to grant more relief to the investors.¹⁰³ This sub part discusses the three clusters in detail each in turn.

The TIC in its publications and reports for instance argues for the current tax incentive provided by the Tanzanian laws that they create an attractive environment compared to other countries of similar social, economic and political characteristics.¹⁰⁴ Nothing on revenue loses is mentioned according to TIC perspectives. In its Growth Impact Report,¹⁰⁵ TIC demonstrates that according to empirical evidence there is a relationship between investment and growth (per capita) from the point of view of revenue collected as a result of such investment. This kind of relationship is drawn from the researches conducted on the countries of China, Taiwan, South Korea and Japan.¹⁰⁶ On the other hand however the above theory is contested in Africa given the research conducted on 29 African countries¹⁰⁷ which found that there is little correlation between

¹⁰¹ TIC 2005, 2008, Tarimo D Mineral Taxation: where to from here? (2006) PWC available on internet at www.pwc.com accessed on 18/9/2012

¹⁰² Ngowi, 2000; REPOA, 2012

¹⁰³ CUTS *Investment policy in Tanzania: Performance and Perceptions* (2003) CUTS Centre for Competition Investment & Economic Growth at 34

¹⁰⁴ TIC, Tanzania Investment Guide (2008) 39 also available online at www.tic.co.tz

¹⁰⁵ TIC *Report on the Study of Growth and Impact of Investment in Tanzania* (2008) Tanzania Investment Centre. Dar es Salaam 29

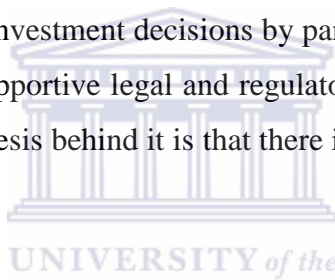
¹⁰⁶ TIC *Report on the Study of Growth and Impact of Investment in Tanzania* (2008) 29

¹⁰⁷ CUTS *Investment policy in Tanzania: Performance and Perceptions* (2003) CUTS Centre for Competition Investment & Economic Growth 30 available at www.cuts-international.org/CR_tanAB.pdf (Last accessed on 28/10/2012)

investment and growth rates. In this research on 29 African countries, Botswana was cited as an exception because its growth impact correlates with its investment rate. Chapter four explains in details Botswana's success taking it as a role model to other African countries.

The issue of main concern here is not whether there is growth in the country or not rather is on the revenue consequent to which growth is effected. As the theory which accords with the correlation between investment and growth establishes its logic on the revenue collected in term of taxes it is therefore not negligible to so often flash back to the point of growth despite the fact that the focus is on revenue losses.

Explaining the insignificant correlation investment and growth in Tanzania, many factors have been enumerated by the TIC growth report including weak macro-economic policies that led to foreign exchange shortages, Poor investment decisions by parastatal organisations that resulted in over-capacities, and Inadequate supportive legal and regulatory framework. The last factor is of interest to this work because the thesis behind it is that there is poor regulatory framework which results to the revenue losses.



Another school of thought in as far as the implications of the current taxation regime for FDI is concerned is that which would like a more simplified tax system than the current one basing their discussion on the fact that still the investors are subjected to multiple taxation requirement which make cost of doing business in Tanzania very expensive.¹⁰⁸ This suggests that the current taxes should be either reduced and/or be modified get a more lenient taxation regime to impress the investors by placing them to a fair business environment.

In a report entitled 'The One Billion Dollar Question'¹⁰⁹ it has been questioned by the authors as to why Tanzania has least revenue from investment. They went further suggesting ways on how can Tanzania stop losing so much tax revenue. The authors discussed the various ways by

¹⁰⁸CUTS *Investment policy in Tanzania: Performance and Perceptions* (2003) CUTS Centre for Competition Investment & Economic Growth 34

¹⁰⁹ Curtis M, Ngowi HP &Warris A *The One Billion Dollar Question: How can Tanzania Stop Losing so Much Tax Revenue* (2012) 16-21

which Tanzania is losing revenue. Among the reasons enumerated in that report is the case of multinational companies evading taxes through evasions by understating profit and overstating losses has been mentioned as one of the many ways multinationals are involved in looting the country's revenue. This poses a serious concern on the regulatory efficiency as far as the taxation regime is concerned. The implication of this scenario as far as tax incentives is concerned comes to the point where tax holidays are given as an incentive and within that period the company overstates its losses which as a result fall in the line of losses carried forward indefinitely¹¹⁰ as a result the taxes which would have otherwise been collected from the profits after the tax holiday years will be lost in offsetting the losses. Some other factors like the channelling of the multinationals' wealth through tax havens have been mentioned as another factor resulting in tax losses¹¹¹ a factor which can possibly be addressed in case of a well managed and regulated taxation regime in general. Ngowi, a prominent FDI analyst in Tanzania in his article on tax incentives,¹¹² has broadly considered the issue of tax incentives as a tool for attracting FDI. On his perspective he accords with the fact that tax incentives are a useful tool to the country for attracting FDI. He qualifies this position by stating that there are circumstances which determine who should or should not deserve the FDI incentives. In his analysis he is also alarmed by an irregular incentives system where some tax incentives are offered by other bodies arbitrarily hence putting the otherwise potential revenue into jeopardy.¹¹³

2.9 The legal/ regulatory regime for foreign direct investment incentives

In this mini-thesis the regulation concept is taken in its wider scope that is envisaging the issuing of rules and monitoring implementation/ compliance. In this section therefore a set of laws governing investment¹¹⁴ in general are given together with the regulating bodies. This section however is limited to a brief summary of applicable laws to avoid venturing into a new activity

¹¹⁰Refer the taxation table above, all the sectors provide an aspect of carrying forward losses indefinitely which can be very dangerous to the tricky investors who keep understating profits and overstating losses

¹¹¹Curtis M, Ngowi HP & Warris A *The One Billion Dollar Question: How can Tanzania stop losing so much revenue* (2012) 17

¹¹²Ngowi HP 'Tax Incentives for Foreign Direct Investments: Types and who should/should not Qualify in Tanzania' *Tanzanet Journal* (2000) 4

¹¹³Ngowi HP 'Tax Incentives for Foreign Direct Investments (2000) 21

¹¹⁴This refers to a number of legislations enacted by the law making body of Tanzania named the parliament.

of analysing the laws and/or providing investment guide which can be dealt with in a separate work for such purposes.

A number of laws applicable for investment regulation in Tanzania are hereby listed as a reference package to the reader and/or a prospective investor.

- *Tanzania Investment Act No. 26 of 1997* aimed at guiding investment activities in Tanzania except for the mining and oil exploration projects;
- *The Village Land Act No. 5 of 1999* which provides for the management and administration of land in the village and for related matters;
- *The Land Act No. 4 of 1999* which provides for basic law in relation to land other than village land, the management of land settlement of disputes and related matters;
- *Banking and Financial Institutions Act No.12 of 1991* which intends to harmonise the operations of all financial institutions in Tanzania. To regulate credit operations and to provide for other related matters;
- *Mining Act No. 5 of 2010* which provides for mineral mining, trading and any other related matters;
- *Capital Markets and Securities Act No.5 of 1995* which provides for establishment of capital markets and securities authority (CMSA) for the purpose of promoting and facilitating the development of capital markets and securities in Tanzania.
- *Export Processing Zones Act 2002* provides guidance on the set up of processing zones, export requirements and other related matters;
- *Special Economic Zones Act 2005* which involves investment in other sectors than manufacturing for both export and local markets;
- *Income Tax Act, 2011*
- *Foreign Exchange Act, 1992* to administer and manage matters related to foreign currency, securities, payment, debts, import/export, transfer of funds and other related matters;
- *Petroleum (Exploration and Production) Act 1981* which governs investment in the petroleum exploration and production sector;

- *Public Private Partnership Act, 2010* which provides for investment in the public private partnership projects such as investment in the Infrastructure Sector;
- *Value Added Tax Act, 1997* which provides for the imposition of value added tax on supplies of goods and services and related matters;
- *Immigration Act, 1997* for control of immigration in Tanzania and for matters related to immigration.

The above legislation framework guides any prospective investor towards the applicable procedure when he is looking to invest in Tanzania in any sector of his choice. These laws encompasses the prerequisites around the investment transaction from the immigration policies, acquiring property, related fiscal policies and regulations as well as sector specific policies and guidelines. It makes a full package for any prospective investor to go through in the course of his initiative to investing in Tanzania.

Beyond the national legislations Tanzania is also a member of the International Chamber for Settlement of Investment Disputes (ICSID) and as a member to the East Africa Community it is a member to the East African Investment Code which is a non binding instrument but can be used to guide the countries in its legislations by incorporating its concepts.¹¹⁵

The Tanzania Revenue Authority (TRA) is the main tax regulatory body that is directly responsible in managing and regulating taxes in general and therefore tax incentives in particular. It enforces tax rules and regulations as well as imposing sanctions to tax payers who are in short of compliance. The investors registered with the Tanzania investment centre obtain a tax exemption certificate which is consequently filed with the tax regulatory authority which will in turn effect as a basis for exempting the holder of the certificate from paying taxes.

¹¹⁵EAC Information Guide for Investors (2012) 10, 12 available online at www.eac.int/invest/index.php?option=com_docman&task. . Last accessed on 01/04/2013

As part of its own initiative Tanzania does not have an established body entrusted with the regulatory functions. Matters regarding, monitoring implementation and ensuring compliance with the law fall under the respective ministry under which a particular sector falls.

2.10 Conclusion

Given the above theoretical analysis, some controversial issues on the regulation of FDI incentives have been identified. It has been learnt that there are many determinants of FDI inflow in a particular country. These may however vary depending on socio-economic and political conditions prevailing in that country as it has been the case for Tanzania. These determinants play a great role in the companies' decisions in their choice of place, and type of industry to venture their business in; a vivid example can be seen in the discovery of oil and gas in southern Tanzania. The inflow of FDI firms to the once neglected and less developed region has considerably mushroomed. At the same time, for the hosting country which is the key player in determining the investment environment including the taxation regime which states the particular tax incentives, this chapter has demonstrated the necessity for a country to link the FDI inflows theories with its tax incentives schemes. It is further evident from the above analysis that there is a gap, and generally something is wanting in the regulation and/or management of FDI incentives in Tanzania. In fact, there is no evidence in literature which draws the correlation between the tax incentives offered in Tanzania and other determinants of FDI inflow.

On the other hand theoretical analysis of FDI as underscored in the preliminary parts of this chapter shows that most of FDI theories have specifically measured the factors that influence the inflow of FDI firms and/or factors determining firms' internationalisation but very few writers have related their theories with aspect of incentives and/or tax incentives in particular. Despite that factor however, it has been learnt that apart from tax incentives aspects as derived from the host country and international tax regulation framework, there are already well founded reasons that compels the multinational enterprises to expand their operations internationally.

Chapter Three

3.0 Critical analysis on the regulation of foreign direct investment incentives in Tanzania

3.1 Introduction

This chapter is a critical analysis of the regulation of FDI in Tanzania. It is thought to critically examine the scheme of tax incentives regulation pointing out areas of weaknesses which provide a gap that allows the loss of country's revenue which would otherwise have been earned and used for development purposes. Basing on the preceding chapter, and given the tax incentives in Tanzania, some issues are raised in this chapter which are considered to be not properly addressed in the Tanzanian tax incentives scheme (on FDI). The main areas considered are the substantive law¹¹⁶, the procedural part pertaining to the regulation of incentives¹¹⁷ and finally the regulatory institutions.¹¹⁸ At the end of the chapter a conclusion is given.

3.2 The substantive law

It has been indicated in section 2.9 of this mini-thesis that Tanzania has no a single piece of legislation as far as FDI taxation particularly tax incentives is concerned. The situation is that just as many as the investment sectors are, likewise are the pieces of legislations which provides for the law applicable in all matters regarding investment in every particular sector.¹¹⁹The general applicable law is the Tanzania Investment Act, which however does not provide for specific incentives to FDI as they are covered in those other legislations particular to each sector.

The fact that the legal regime for FDI taxation is administered by different laws as per respective ministries, under which a given sector falls, is also a factor which imposes more contradictions

¹¹⁶Some matters which contribute to the list revenue in the FDI sector are attributed to the mischiefs arising from the law (s) governing investment. A lot is falling short of clarity with many contradictory and unclear provisions which are to be addressed here in this regard

¹¹⁷The law has a strong and very impressing object it longs to achieve. The procedure to arrive at a yielding end is lacking. That is what is addressed in this chapter

¹¹⁸The issue of a separate independent regulatory body is challenged in this part

¹¹⁹Example the Mining Act, 2010 for the mining sector and The Income Tax Act, 2004

and complexities in the regulation of DFI and tax incentives in particular. This implies that although the subject of each law is to define tax incentives and administer them, each law with its administering mechanism will work in a different mission and/or vision hence keeping dispersing the core elements to be considered in the administration of tax incentives.

A good example here is when one company like those investing in the mineral sector is exempted from capital gain taxes which are paid by other companies in other sectors. There is no literature no any explanation found giving the basis for providing such an incentive to mining companies. Without knowing the basis for such incentives it is difficult to justify it before any reasonable man and that is why one can learn that while companies are claiming for more incentives there is increasing demand for accountability to the government that these incentives to FDI are too generous.

The Tanzania Investment Act has mentioned something called ‘strategic or major investments;’ these are given additional incentives because of the category they belong¹²⁰. The Minister again is mentioned here together with the board and the president who together at different instances have power in designating some projects to be of major or strategic category and providing additional incentives to a so designated investor.¹²¹ This is an arbitrary provision as it leaves at the minister and board’s discretion some powers which is exercised with ill intentions or any trace of negligence it can jeopardise the interest of the majority Tanzanians. The board which is being referred to here is the one established under s. 21 of the Tanzania Investment Act whose members are presidential and ministerial appointees. In this case they will hardly dispense their responsibilities with full impartiality. For example the Minister has a motion that this is a strategic of major investor, once the board disagrees with the incentives part of that coin the Minister refers the matter to the president (who in turn is the one who put him in office). In this sort of scenario one can see why all the mischiefs in the investment sector are not being taken care as would reasonable been supposed to.

¹²⁰ The Act does not define strategic/ major investments

¹²¹s.20(20)1 of the Tanzania Investment Act

3.2.1 The limited scope of investment incentives

Most of the investment incentives offered to FDI firms in Tanzania are basically tax incentives which appear in various forms like the reductions and elimination of tariffs on imports of capital goods, reduced corporate tax rates, reduced or deferred payment of value added tax (VAT) to mention but a few. This also can be seen as provided in detail in one of the investment promotion tools in Tanzania, the Tanzania Investment Centre (TIC)'s Investment Guide book. It explains in details many aspects towards investing in Tanzania. As the guide book expresses itself, it is supposed to be an informative tool to prospective investors giving the insights on the country's wealth, laws and procedures to be considered in the instance where a firm or individual wishes to invest in Tanzania.

In part 17 of the abovementioned investment guide, investment incentives offered by Tanzania are underscored. Although investment incentives appear in various types varying in nature and character, it can be noticed that the incentives offered by Tanzania are mainly fiscal incentives. Prior to the list of incentive given in the investment guide, the following paragraph is expressed.

‘A number of tax incentives are granted to both local and foreign investors as per the Tanzania Investment Act, 1997. Currently, tax incentives are granted in the form of enhanced capital deductions and allowances structured according to lead and priority sectors which include agriculture...’

In its interpretation section the Tanzania Investment Act defines incentives as follows:

‘Tax reliefs and concessional tax rates which may be accessed by an investor under the Income Tax Act, 1973, the Customs Tariff Act, 1976, the Sales Tax Act, 1976 and any other law for the time being in force, and includes additional benefits that may be accessed by an investor under sections 19 and 20;’¹²²

This definition therefore emphasises on tax incentives. It implies that the whole motive on investment incentives has in its first instance the concept of tax deductions. If this is how the

¹²²s. 3 of the Tanzanian Investment Act

investment promoting agency is groomed to believe yet it is expected to advise the government on policy and other matters it will be a lost presumption to think this agency side by side with its primary role of investment promotion will have anything to propose other than tax deductions.

The Tanzanian investment incentives therefore are basically the tax relieves (relaxed tax rates) which are offered to investors in various sectors. Even on a layman's perspective one would argue as to whether investment incentives in Tanzania are tailored to mean only tax relieves or whether this is the only way in which investment can be attracted.

In his work, *Attracting New Foreign Direct Investments to Tanzania*,¹²³ Ngowi explains a wide spectrum of other incentives that can be used in the context of Tanzania which if explored would pin down the massive foregone revenue that is being lost when the only incentive given is by way of tax deductions. He mentions things like provision of relatively cheap skilled and unskilled labour, improve physical infrastructure and utilities like water and electricity, continued economic and structural reforms, rule of law and political stability which can in their own way act as incentives in attracting FDI. Further investment incentives can be in the form of guarantees against arbitrary treatment in case of nationalisation, government provision of such utilities as communication at subsidised prices or free of cost; interest rate subsidies; guarantee for loans and coverage for exchange rate risks; wage subsidies; training grants and relaxation of legal obligations towards employees.¹²⁴

It can be argued that the substantive law is therefore in itself in an astray. If at all it would have broadened the definition of investment incentives it is the contention of this work that even in the interpretation and implementation of the Act, the persons so doing would have got a broad picture of the matter and some good end will have reached. Even the investment promotion agency would have had this born in mind and address it in its investment promotion missions instead of focusing mainly on tax incentives.

¹²³Ngowi HP 'Attracting New Foreign Direct Investments to Tanzania' (2005) 37

¹²⁴Ngowi HP 'Tax Incentives in Tanzania'(2000) 21

It is important here to explain also some of the reasons as to why would a country focus on relaxing its taxes as a major way of attracting FDI. This is to combat the problem of capital inflow whereby investors will not find it prudent to take their capital to a foreign country if they are confronted with higher taxes (capital taxation). To this effect countries decide to relax their taxes as means for disarming this problem. The same approach is done in Tanzania by providing very generous taxes to investors as have been indicated in chapter two. Though it is evident that investors will be more attracted to invest where they are not heavily burdened with taxes, hence the country may assume maximum attraction of FDI by providing very generous taxes, this work argues that it is still important to see whether there is any positive impacts to the future revenues of the country as compared to the current foregone revenues. The analysis on the relationship between revenue loss in attracting FDI and the amount of FDI so attracted (total inflow), Curtis¹²⁵ presents that the loss in government revenue by way of tax incentives is greater than FDI so attracted. A comparison of \$288 incentives per year and \$710 FDI for ten years was given which shows massive loss in potential country's revenue.

Countries such as the United States of America and other western countries with well developed infrastructure and little bureaucracy offer higher taxes but still investors are flocking in those places. As it has been stated earlier¹²⁶ this is because those countries would assume their high infrastructure as a benefit and a way of offsetting tax strains to their investors thus the investors find it reasonable. The question now is as to whether Tanzania has nothing else to provide an incentive in order to mitigate the high losses suffered as a result of focusing on tax incentives only as a tool for attracting investment. It has further been very well established that tax incentives is not an efficient means for attracting FDI.¹²⁷ This means that besides tax incentives there is a very important need for enumerating other investment attracting mechanisms example turning its efforts in improving infrastructure, facilitating and enhancing the access of education

¹²⁵Curtis M, Ngowi HP &Warris A The One Billion Dollar Question: How can Tanzania stop loosing so much revenue (2012) 14

¹²⁶ Discussed in chapter 2, section 2.6.3 Host country's economy theory

¹²⁷IMF, *Kenya, Uganda and United Republic of Tanzania: Selected Issues*, 1 December 2006, 11 also the same has been the findings of the Joint IMF, OECD, UN and World Bank report for the G20, 2011 ,IMF, OECD, UN and World Bank *Supporting the Development of More Effective Tax Systems*, Report to the G-20 Development Working Group, 2011, 19

to a larger population to ensure availability of skill labour force, improving and ensuring availability of raw materials.

The task of assessing what a country gets from a particular investor is supposed to go along with listing the best things the country has in nature or that it can provide which is in itself an attraction tool which would induce the investor to feel the urge of investing in the country. When this is put forward then the a fair bargaining will be reached because each side will see itself giving out something hence meeting at a common ground and non will exercise the bully/ giant power against the other.

3.3 The procedure of designing investment incentives

While good policies and laws may be in place, it is very necessary to have a very well established procedure towards implementing the substance that is in the law.¹²⁸ This sub part is sought for enumerating some mischiefs that exist in granting some tax incentives to FDI companies in Tanzania. It is the contention of this work that the government has a functional role to safeguard the interest of its people and the country in its entirety against any prejudice that may compromise the well being of the nation economically or socially. This being the case it is therefore the role of the government to take serious initiative to see that a best means it taken towards the destination set in its policies, laws, development strategies as well as any other common international instruments that the country is party to. This implies that since the purpose of FDI is to improve the country's economy by raising its revenue through increased investment hence higher tax collections, increased job opportunities, increased skills and enhanced export trade, it all takes the government's initiative to commit to adopt proper and efficient procedure which could bring optimal results to the country.

Investments incentives are so often designed as a motivation tool to attract investors. It is just for unknown reason that countries design non profit directed motivations. It has been pointed out

¹²⁸ There is a need of that process of monitoring and enforcing legislations and/or a written instrument containing rules that have law on them, this thus calls for proper defined regulations which may bring into realisation the provision of the laws relating to investment.

this to be an aspect of inefficiency to African inducement policies.¹²⁹ Countries have been offering tax incentives even to investment projects that not sensitive to lower taxes.¹³⁰ This work argues that the theories that underlined the adoption of policies and legislations during the colonial regime have been carried forward in the post independence Africa resulting to laws which confer monopoly to foreign capital and seal off national interests against the businesses of the foreigners.

The country has laws in place but regarding the investment incentives there is nothing in place on how a given figure/rate is arrived at. This being the case the awarding of tax incentives is sometimes arbitrary and raises lots of question to citizens. In an article published by Policy Forum¹³¹ a number of FDI mining contracts were analysed for demystification purposes. Regarding the government revenue in terms of taxes, the article points out clearly the uncertainties that exist in the actual tax rates in the contracts negotiated with foreign investment companies in the mining sector.

“.... the taxes received by the Government of Tanzania differ from contract to contract, even when the government is negotiating with the same company....”¹³²

The above example sets one of the loopholes which needs explanations on how some tax allowances are arrives at from firm to firm and contract to contract. This mini thesis argues that

¹²⁹Dixon-Fyle SR (2012) 117

¹³⁰Heckemeyer JH & Feld PL ‘FDI and Taxation: A Meta-Study’ 235, The authors of this article conclude that tax sensitivity by FDI differs depending on the basis with which a given investment is financed. While investments financed by transfers of funds exhibit lower tax sensitivity, the opposite is the case with investments financed by retained earnings. All these are factors necessary to be considered when tailoring investment incentives.

¹³¹ ‘The Demystification of mining contracts in Tanzania’ available at www.sdsg.org/wp.content/uploads/2010/02/article-re-mining-contracts-in-Tanzania.pdf last accessed on 25/03.2013

¹³² ‘The Demystification of mining contracts in Tanzania’ 6. The same situation is mention by OECD pointing out the arbitrary decisions made basing on undisclosed or changing criteria. Regulatory Environment for Foreign Direct Investment: Preliminary inventory for selected African countries. A working paper by OECD, 2005. 3. The Tanzania Investor Roadmap, 1999. 9 also states the availability of more incentives to TIC registered companies for example the FDI firms such registered are allowed to employ expatriates (5), however no skill requirement or conditions are imposed to this incentives. This adds up on the arbitrary nature of the laws and processes involved.

the government needs to have in place a well founded systematic evaluation of the factors which motivate a potential FDI¹³³. The government is supposed to conduct an in-depth research on firms' strategic plans to understand their objectives and what it takes for their realisation in order to reflect back to creating strategic plans which in turn reflect to what the investor is up for. This will enable the country to make a proper choice on the approach to be undertaken in its investment promotion initiatives.¹³⁴ It will further enable the country assess its position on which incentives are relevant to a particular sector, a particular firm or a given contract falling under a particular sector. Some incentives may be case driven but that does not mean there should not be regulations put down on how to arrive to a particular decision even in such case driven situations. If only the country would realise that an investor is accessing local market, cheap efficient labour force and or privilege to trade within the regional tariff walls then these are a lot of benefits necessary to be addressed in bargaining tax incentives. Some percentage of tax incentives could be foregone given the above benefits which maximise the investors' side.

3.4 The lower or higher tax incentives rates

One of the critical observation by some analysts is that Tanzania has been so generous in its tax rates more especially on royalties;¹³⁵ meaning that the rates charged are too low leading to losses of potentially high revenue which would have been earned through royalties. This work does not dispute the rate whether low or high. It however inclines its argument on the fact that is the root cause of these low or high tax rates.

So often comparison is done with either other countries in the region, or other similar sectors in different countries; this is however disputed as to its relevancy and efficiency. The reason is that

¹³³These factors may very widely differ from sector to sector as well as from firm to firm those prospecting to invest in a particular sector.

¹³⁴Some of the factors which influence FDI resources are resource limitation and efficiency consideration, increase foreign demand and access to foreign markets, resource endowment together with other discretionary matters like increasing sense of social purpose on international business, just to mention but a few.

¹³⁵ Curtis M, Ngowi HP &Warris A The One Billion Dollar Question: (2012) 23,26 . In this report some cases of undervaluation of product costs and under collection of royalties have been mentioned which according to this mini thesis, all this are the factors that call for setting clear plans and giving proper implementation and monitoring to optimise the national revenue.

countries tend to exercise tax competition leading to companies locating where there are low taxes which consequently forces the countries to lower taxes and compromise revenue.¹³⁶ As a result the competition war for foreign capital between countries causes a race to the bottom phenomenon in tax incentives policies, narrowing the financial resources of the host country and compromising their future interests in the long run.¹³⁷

It has however been argued that lower taxes do not guarantee profit to investors nor do the higher taxes necessarily lead to losses.¹³⁸ Higher taxes will only be disincentives to investors if it will draw back the potential earning rate lower than the investor's minimum rate of return. In this case therefore is when the investor would need incentives like lower taxes.

Given theories on investment and taxation covered in the previous chapter, it is trite clear that in order for a country to have efficient investment incentives (FDI incentives in general and tax incentives in particular), the authority (ies) governing matters pertaining investment incentives should bear in mind the aspects of each theory before determining the type, nature and extent of incentives to be offered for FDI including both quantity and quality of such incentives. On a research by SRI as reported in Dixon- Fyle this fact is observed that there is a big difference in the policy strategies for attracting FDI in African countries when compared to the investors ranking on the factors which impact their investment decisions.¹³⁹ Considering the observation by Tuomi when researching on the roles of investment climate and investment incentives in attracting inward flow of FDI to South Africa, through her literature review and empirical findings it can be learnt that little is the role of fiscal incentives (lifted tax burdens and cash credits) in influencing firms' decisions to invest in a certain location as compared to the role of other investment climate variables like political risk, exchange volatility, and rule of law. Despite

¹³⁶ Tax Justice Network Africa & Action Aid International *Tax Competition in East Africa: A Race to the Bottom* (2012) TJNA&AAI. Nairobi Kenya. 22

¹³⁷ Li Q 'Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis' 72

¹³⁸ Dixon-Fyle (2012) 121; also Curry demonstrated that there is no conclusive evidence that validates the contention that there is a positive relationship between provision of investment incentives and development of inward investments. See, Curry R L Jr *Mining Revenues for Development Finance: Some added Comments* *American Journal of Economics and Sociology* 48(3) (1989) 323-326; 324

¹³⁹ Dixon- Fyle SR (2012): 117

these findings though still countries are compelled to offer incentives to remain in the bidding list; incentives in this case therefore are used not as a tool of attracting FDI but rather as a competition tool against other countries with the same investment climate conditions.¹⁴⁰ Likewise there are many variables to be considered in designing investment incentives in different countries and also may vary in sector and in each particular firm. The probability is thus very high for these variables to differ from country to country given very distinct economic, social, political characteristics and natural endowment. Therefore whether to grant lower rates or higher rates will depend on the results of such assessments and the comparative advantage possesses by a country.

The national investment laws should come along with an efficiency assurance mechanism such as a regulation which will describe in detail the procedure that will lead to the realisation of some investment objectives as stated in the national investment policy. The mere proliferation schemes are no more than putting the country into a prisoner dilemma for a negligible cause with a lot risking of financial resources and much more on the future of the interests of the host country.

3.5 The regulatory institution(s)

The situation of the regulation of foreign direct investment has widely been lacking in many African countries,¹⁴¹ Tanzania is not an exception in this case. High degree of political and administrative discretion in the whole process of FDI business has been noticed to be a problem; example in the issuing of licences, basing decisions on undisclosed or changing criteria, etc.¹⁴² A cross country theoretical and empirical research by Li has emphasises on the many abuses that happen in the designing of tax incentives policies like the often concern that reelection oriented

¹⁴⁰Tuomi K 'The Role of the Investment Climate and Tax Incentives in the Foreign Direct Investment Decision: Evidence from South Africa' *Journal of African Business* 12(2011)133–14, 138

¹⁴¹Regulatory Environment for Foreign Direct Investment: Preliminary inventory for selected African countries. A working paper by OECD, 2005. 3

¹⁴²An example can be seen in the famous case of City Water where upon breach of the contract by a foreign investor the then minister responsible for water and livestock development abruptly denounced the contract. This was a vivid excessive use of administrative powers in investment contracts. Full facts are available in *BiwaterGauff (Tanzania) Ltd. v United Republic of Tanzania* (ICSID Case No. ABR/05/22) Award, July 24, 2008. Available at

https://icsid.worldbank.org/ICSID/FrontServlet?requestType=CasesRH&actionVal=showDoc&docId=DC1589_En&caseId=C67(last accessed on 23/12/2012)

politicians favour generous tax incentives because they pursue the latter's financial support, rather than for the sake of maximising social welfare. On the other hand there are the bureaucrats who tend to engage in corruptive practices because incentive programs are not monitored closely and their costs remain unknown to the public. Equity issues also involve in tax incentives offering.¹⁴³ In cases like this involving political or administrative interference one would recall the essence of having a regulatory institution particular to matters pertaining investment.

Regulation is specifically needed in any sector for multiple factors like promoting efficiency, monitoring and evaluating performance, sanctioning defaults and regulating balance of rights interests among and between stakeholders. This means that there is a need for appropriate and quality regulatory institutions.¹⁴⁴

FDI in Tanzania have recorded some unimpressive and unethical practices some of which include tax evasions, importations of junk products, sub-standard industrial parts, obsolete machines and unfair labour practices.¹⁴⁵ All these are issues calling up for regulation.

As far as FDI in general is concerned there is no institution set for regulatory purposes despite many mischiefs¹⁴⁶ which are so often reported in the sector. The FDI promotion agency, Tanzania Investment Centre (TIC) cannot reasonably be expected to act successfully as an investment promoting agency and a regulatory unit at the same time because its sole purpose is to see more flow of FDI in the country but does not have that in-depth demanding responsibility

¹⁴³Li Q 'Democracy, Autocracy, and Tax Incentives to Foreign Direct Investors: A Cross-National Analysis' 72

¹⁴⁴Busse M & Groizard JL Foreign Direct investment, Regulation and growth (2006) World Bank Policy Research Paper 3882; 5, 8 this paper points out that regulatory quality Is an important determinant of overall income levels. The possibility of a county to benefit from FDI is highly dependent on the availability of appropriate local government regulations and institutions.

¹⁴⁵Ngowi HP 'Attracting New Foreign Direct Investment to Tanzania' *TanzanetJournal* 1(2) (2005) 23-39; 24,32

¹⁴⁶Tanzania has many cases/scandals on investment which result from poor and/ non regulation. Good examples are cases of mining companies which after a long time of non and/ or little payment of taxes the then Mining Act 2008 had to be repealed and a law was enacted in the year 2010 to bridge some loopholes which were previously depriving the country a lot of its resources. Also the Famous Richmond case, a dubious investment contracts with a nonexistent electricity company which has cost the country billions of money which belongs to the taxpayers.

for monitoring compliance to the laws and/or efficiency. Any other policy recommendations and FDI jurisprudence in general will best be undertaken if there is a different separate independent entity to deal with all matters pertaining to efficiency. One of the TIC objectives is to advise the government on investment policy and other matters¹⁴⁷. Further under s. 6 of the Tanzania investment Act, more functions are stated amongst which is to promote and attract FDI. It is the contentions of this mini-thesis that the agency being a government organ under the Minister¹⁴⁸ would not dispense fully and impartially the role of advising the government on policy matters and especially because it had the primary role of investment promotion. While the policy is for the best interest of the citizen/public the government would in some way act in jeopardy of the people. Generally this work argues that it is not proper and it is against the rule of law to entrust the role of implementing the law and policy recommendation at the same time to a single entity and mostly the government agency. The concept of checks and balances is in itself questionable in this case. There is a need for Tanzania to have a separate and independent entity for regulation which will be the auditing unit over all the implementations done including the works carried out by TIC. Records in both FDI reports and country's strategic plan do not show any initiative to curb the problem of non regulation in the sector which is seriously shocking.

UNIVERSITY of the

The Tanzania revenue authority (TRA) can be regarded in some way as one of the body instituted for regulatory purposes. This is however applying to a very limited scope of taxes only. That is enforcing the laws pertaining to taxation and ensuring compliance to payment of taxes. The argument of this mini-thesis is the need of an independent body which will oversee all investment activities from the day go throughout the life of investment projects and balances the interests of all stakeholders who are directly or remotely affected by a given investment venture.

Along the same lines Tanzania has another body responsible for the export processing zones (EPZs), the export processing zone authority (EPZA) as established by the export processing

¹⁴⁷This is stated under s.5 of the Tanzania investment Act 1997 'The Centre, which shall be a one-stop centre for investors shall be the primary agency of Government to co-ordinate, encourage, promote and facilitate investment in Tanzania and to advise the Government on investment policy and related matters'.

¹⁴⁸ Under s.4 (2) of the Tanzania Investment Act, 1997 it is stated that 'The centre shall be the Agency of the Government and shall be under the general supervision of the Minister'.

zones Act.¹⁴⁹ The EPZA is an autonomous government agency which operates under the ministry of industry and trade with a responsibility to steer and implement government policy on promotion of special economic zones (SEZ) in the country. Its roles are not far from those of the Tanzania investment centre as the EPZA is mandated to issuing of licenses to investors in EPZs and another range of activities/services for investor support like the development of EPZ infrastructure, facilitation and linking investors to various investment opportunities.¹⁵⁰

The regulatory institution is needed perform roles like monitoring the implementation of contracts,¹⁵¹ regulating tax rates and other charges, to conduct studies necessary for the administration of the investment sector, and other functions incidental or ancillary to the sector given the fact that some MNCs would sometimes be comparatively advantaged through high experience in investment and possess higher bargaining and entrance techniques which may way outsmart the experience and bargaining power of a country which may be considered at its infantry stage as far as investment is concerned.¹⁵²

3.6 Conclusion

This chapter has covered areas of weakness in the investment laws regulating tax incentives. These includes some contradictions in the subject of incentives , some practical defaults which lead to poor performance of the sector and some gaps which lets in a lot of junk which would have been sieved had there been appropriate and efficient regulatory regime including the regulatory institutions and the laws. A detailed critique on the current tax incentives scheme in Tanzania has been covered. Four main areas have been addressed considering what is in existence and why it is sought to be a weakness. The substantive law itself has been challenged, the procedure regarding the designing of investment incentives, the controversy as to whether

¹⁴⁹S 6 of the export processing zones (amendment)Act 2006

¹⁵⁰Information obtained online at epza.go.tz/about.php?p=253 (last accessed on 15/10/2013)

¹⁵¹Among the weaknesses that have been mentioned on the side of investors to the host country is the non observance of contractual terms for instance misrepresentation and understatement of profit, refrain from observing environmental protection requirements and unfair labour practices like abuse of employees, racial discrimination and child labour. (Ngowi HP (2005) 5) All this would need a regulatory institution to monitor the observance of contractual obligation for the best interest of the parties.

¹⁵²FDI multinationals are mentioned to possess strong bargaining power towards host economies' governments. See Ngowi HP (2001) 24

investment incentives are limited to tax incentives and finally the issue of the regulatory institution. This mini-thesis has also pointed out what would have been the best way of addressing those weaknesses in avoiding the negative effects that are drawing back the success of the investment sector in the country. These matters are featured in the next chapter which gives in-depth information on the basis for regulating FDI incentives including lessons learnt from Botswana

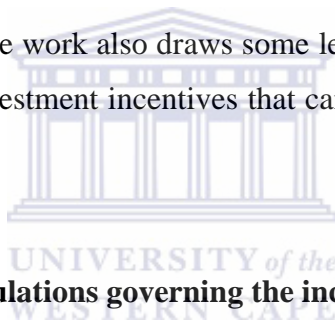


Chapter Four

4.0 Regulating foreign direct investment toward maximising government's revenue

4.1 Introduction

What a country should consider to optimise the inflowing capital through inward foreign direct investment (FDI) to increase government revenue is a big issue that need to be answered. After a reasonable consideration of the problem of improper regulation of tax incentives that leads to massive losses of country revenue, this chapter discusses the basis for regulating tax incentive for FDI to increase country's revenue. The next subpart will address an importance aspect regarding the coherence of relevant investment and development policies, laws and regulation, the regulatory aspect as an important pillar to maximise FDI revenue will also be discussed. Thereafter Botswana's foreign direct investment will be explained giving a brief economic picture of Botswana, exploring the factors behind her success with a specific look on the tax incentives offered in Botswana. The work also draws some lessons on the on the better approach in the regulation of the foreign investment incentives that can be learnt for Tanzania and finally the conclusion will be given.



4.2 Proper policies, laws and regulations governing the incentives for foreign direct investment

There is an important and a very crucial correlation between certain legislation (law), its underlying policy, together with the regulations put forth as an implementation measure of the given legislation. While the policy is a framework in which the objectives and strategies of a particular socio-economic aspect are set consequent to which a law is made reflecting that framework, regulations are a set of simplified, implementation guidelines under which a given law is put into action.¹⁵³ A policy is basically a statement of beliefs, goals, objectives and recommendations on a specific subject area.¹⁵⁴ Under this situation the policy is a backbone of that law and the law is enacted in-line with the founding policy. This denotes that if the policy is

¹⁵³See difference between act and regulation in <http://www.differencebetween.net/business/difference-between-an-act-and-a-regulation/>(last accessed on 17/04,2013)

¹⁵⁴See <http://www.racgp.org.au/support/policies/what-is-a-policy/> last accessed on 17/04/2013, policies infact are general principled by which a government is guided in its management of affairs or the legislature in its measures, see <http://legal-dictionary.thefreedictionary.com/policy> A policy is an established order, a course of action or a general guideline.

short of any important aspect of national interest the law will likewise be in the same deficit. The law gives provision of formulating regulations for putting into effect the provisions of the law. If the law remain silence in that respect or may be falls short in defining the scope of the regulation to be made then the regulation would in no way be sufficient. It is under this correlation this mini thesis suggests that among the basic factors that would facilitate the regulation of FDI incentives to maximise government revenue is having proper and well founded policies, laws and regulations which are in consonance to each other.

In chapter three of this mini thesis,¹⁵⁵ a concern was raised on the relevancy and the correlation between the national investment promotion policy and the Tanzania investment Act.¹⁵⁶ In the national investment promotion policy as the name literary suggests focus has been mainly on creating a way or ground to facilitate the inflow of foreign capital through FDI thus the policy sets various investment objectives which can generally be summarised as to encourage and facilitate investment in various sectors.¹⁵⁷

Having this as the case, among the strategies set towards achieving those objectives are provision of institutional framework (Tanzania Investment Centre (TIC) in this case) and its role, provision of financial and investment support institutions, provision of fiscal and non-fiscal incentives for FDI, establishment of a transparent legal framework that facilitates and guarantees investment protection of all forms of investment activities, provide social economic infrastructure and promote growth of export.¹⁵⁸ A thorough observation of these objectives will reveal that they are not elaborate as to how they reflect back to the overall national development goals specifically their role in contribution to attaining the high rate of Gross Domestic Per capita (GDP).¹⁵⁹ The policy should in the forefront be a corner stone in facilitating the optimal contribution of FDI in increasing revenue hence GDP growth. In this case the laws and regulations will follow in the

¹⁵⁵See section 3.2.1 of this mini-thesis

¹⁵⁶While the investment promotion policy has a lot to do with safeguarding public interest, the Act which came subsequent to the policy does not guarantee such safeguards.

¹⁵⁷ Sectors like agriculture, mining, industry, tourism, transport, communication, energy and social services are a good example, see National investment Promotion Policy (2008) 16-25

¹⁵⁸ National investment Promotion Policy 25

¹⁵⁹Viz. growth of eight to nine percent per annum National investment Promotion Policy 13

same line towards reflecting policy objectives by designing relevant and efficient provisions and regulation in that respect.

The legal regime for FDI should give priority to the interest of the people i.e. the citizen of the country and not primarily focus on enhancing the business of the outsiders. This includes all development policies and strategies. The concept of afro-centricity¹⁶⁰ of policy should be considered in any foreign policy. The core objective should be to consider the needs and concerns of the people together with the long term implications of any foreign policy or engagement to the masses of the citizen.¹⁶¹

4.3 Proper and requisite regulatory body for foreign direct investment

The government should show all necessary readiness in formulating and adjusting its regulatory structures in accordance to the policies, laws and regulations governing foreign direct investment.¹⁶² Despite the government intention to increase collection of revenue by reducing tax exemptions there is no a designed mechanism or legislation which has been made to that effect since then.¹⁶³ Some foreign investment companies have reportedly been claimed to play tricks to reduce their tax burdens a situation which need the country to have a closely monitoring strategy to ensure that these loop holes are bridged for the maximisation of revenue.

Identification of loose areas that allow the revenue flight by foreign investment companies is necessary to facilitate the definition of the framework to underline the institutional regulatory regime including its scope of authority and mandate. Since it has been observed in chapter three (section 3.5) that the Tanzania revenue authority (TRA) is challenged in its capacity to regulate

¹⁶⁰This means putting the policy in African terms, not to be governed by western terms which may not suit the development contexts of Africa

¹⁶¹ See, McDougal S 'African Foreign Policy: A Question of Methodology' *The Journal of Pan African Studies* 2(9) (2009) 64-76; 66 'African foreign policy must be *Afrocentric* in that it should prioritize the needs and concerns of African people first, and consider the long term implications of any foreign policy for the masses of African people'

¹⁶² See the suggestion in Xiaoyang Z 'Eliminating Privileges Enjoyed by Investors in China: Rationality and Ramifications under a Unified Tax Code' *Deakin Law Review* 12(2) (2007) 79-103; 95, explaining that although there has been a unification of the tax codes to eliminate tax preferences given to FDI enterprises, the government must respond in adjusting its super structures in that respect.

¹⁶³ Curtis M, Ngowi HP &Warris A *The One Billion Dollar Question* (2012) 28

some sectors such as financial and banking sector as well as the tourism sector,¹⁶⁴ it is trite clear therefore that this is among the loose areas which need to be resolved. Despite the fact that the TRA is the authority mandated to all the functions pertaining to taxation including assessing and collecting taxes the failures in the foreign investment sector that have been reported to account for massive revenue losses need to be seriously and effectively addressed to ensure an efficient administration of taxes is imposed in the sector. In this case such initiatives will also address the misuses of tax exemptions given to investor such as the abuse of a grace period of non tax payment which has repeatedly being reported to be done by companies through footloose investment where they invest and quickly diversify.

In this case a proper regulatory institution will have capacity to monitor FDI processes including time to time on-sight audits to ensure that every possible evil activity that may lead to tax avoidance and/or flights is blocked. This will further ensure that the mandate of this agency is cross cutting through all sectors to avoid the now challenges faced by authorities like TRA which have limited mandate to some sectors or poor and lack of coordination across sectors which are basically the main cause of some of the loopholes. It will also have mandate and broader capacity to advice the government on any measure it wished to impose in the investment sector basing on research and professional capacity as a specialised regulatory agency.

Having explored a lot related to Tanzania on how foreign direct investment can be regulated to ensure maximum revenue to the country; the next sub part of this mini thesis is sought to extend its endeavours to drawing a comparative analysis of the investment regulation particularly FDI in the country of Botswana as previously mentioned in the introduction chapter that a comparative analysis is undertaken for the main purpose of exploring the best lessons that can be learnt by Tanzania to enhance its maximum benefits from the vast growing FDI. It therefore considers FDI as general, FDI incentives and the legal regulatory framework for investment incentives in Botswana.

¹⁶⁴ Curtis M, Ngowi HP &Warris A *The One Billion Dollar Question* (2012) 31

4.4 The Botswana foreign direct investment

4.4.1 Economic history

Botswana has been recorded to be a unique country with a very significant economic growth history which has led the country to move from the least developed nation as of then during independence, 1966 to the upper-middle-income status with a per capita income competing with the African's giant South Africa.¹⁶⁵ Over the past twenty five (25) years Botswana has been the fastest growing economy in the world.¹⁶⁶ It is also among the fastest growing economies in Africa over the past forty (40) years.¹⁶⁷ Botswana is ranked as the 40th freest economy in the world, and the second freest out of 46 countries in sub-Saharan Africa in the 2011 index of economic freedom.¹⁶⁸ After independence Botswana opened up their diamond mines to foreign investors in 1978 and established strong international ties.¹⁶⁹

All this success is related to sound macroeconomic policies and good governance from very strong and patriotic government leadership¹⁷⁰ since independence where they managed to rid the country against the so common bad governance curse prominent in most resource endowed countries. These leaders have managed to design and foster conditions of governance that maintained stability and socio economic progress.¹⁷¹

‘Although these people operated in a relatively helpful institutional environment, they probably also made a big difference. Seretse Khama’s handling of the independence negotiations and constitutional conventions, minerals policy and

¹⁶⁵http://www.indexmundi.com/Botswana/economy_profile.html (last accessed on 19/4/2013)

¹⁶⁶http://www.indexmundi.com/Botswana/economy_profile.html (last accessed on 19/4/2013)

¹⁶⁷<http://iss.co.za/Af/profiles/Botswana/economy.html> (last accessed on 19/4/2013)

¹⁶⁸<http://www.africalegalnetwork.com/wp-content/uploads/2012/03/Investment-Guide-Botswana.pdf> Last accessed on 19/4/2013

¹⁶⁹Beulier SA Explaining Botswana's Success: The Critical Role of Post-Colonial Policy *Cato Journal* 23(2) (2003) 227-240, 234 also it has been explained that Botswana opened up for FDI since independence as can be read online at <http://www.nationsencyclopedia.com/Africa/Botswana-FOREIGN-INVESTMENT.html#b> (last accessed on 18/09/2012)

¹⁷⁰ Botswana investment guide 2, <http://www.state.gov/r/pa/ei/bgn/1830.htm> last accesses on 26/9/2012,

¹⁷¹<http://siteresources.worldbank.org/AFRICAEXT/Resources/258643-1271798012256/Botswana-success.pdf> and <http://oecd.org/dev.emea/40573959.pdf> (last accessed on 19/4/2013), Beulier SA Explaining Botswana's Success: The Critical Role of Post-Colonial Policy *Cato Journal* 23(2) (2003) 227-240, 237

generally political issues ensured that political stakes remained low contributing to political stability and an environment with secure property rights.¹⁷²

4.4.2 The investment sector of Botswana

The investment sector of Botswana is under the ministry of trade and industry. The authority responsible for investment promotion is now the Botswana Investment and Trade Centre (BITC) as established in December 2012 to replace the former Botswana Export Development and Investment Authority (BEDIA);¹⁷³ the BITC has come into existence as a result of the merger of two institutions, BEDIA and the Botswana International Financial Services Centre (IFSC).¹⁷⁴ BEDIA was basically an autonomous private sector led organisation formed by an Act of parliament which was also a focal point for investment and export promotion activities. Among its roles is the promotion of inward investment by encouraging establishment of manufacturing enterprises specially focussing on export manufacturing. It has also been a promoting agent for joint venture investments among the citizen of Botswana and foreigners. It has been acting as a one stop shop for all activities related to FDI including clearances, residence permits, working permits factory space, land etc. BEDIA basically facilitates investors on the procedural requirements upon their quest for investing in the country. Along with promoting foreign investment it also plays the role of promoting export trade by identifying foreign markets for locally manufactured products together with constructing buildings for establishing manufacturing enterprises. Despite being an autonomous private sector led organisation it works hand in hand with the government to ensure diversification and industrialisation of the economy.¹⁷⁵ All these functions have currently been vested to BITC a newly established institution to undertake both BEDIA's and IFSC's function.

¹⁷²Acemoglu J, Johnson S & Robinson JA 'An African Success Story: Botswana' in Podrik D (Ed) *In Search of Prosperity: Analytic Narratives on Economic Growth* (2003) 80-122

¹⁷³BEDIA is established by statute, the Botswana Export development and investment authority, Cap 74:08, s 3

¹⁷⁴BITC has been formed as a merger of the former BEDIA and Botswana International Financial services Centre (IFSC) as an initiative towards reducing public expenditure, improving efficiency and developing functional and efficient policy coordination between national investment promotion and export development activities. See <http://www.bedia.co.bw/news.news.php?NewsID=54> last accessed on 19/4/2013

¹⁷⁵This is seen in the Botswana Business investment guide 22 available at http://www.fdi.net/documents/WorldBank/databases/botswana/Botswana_Investment_Guide.pdf last accessed on 20/9/2012

As for the roles of IFSC it is not any far from what BEDIA has been doing. The IFSC has been another initiative to attract and promote investment at both national (domestic) and foreign by facilitating the expansion of companies operating in Botswana into other countries and vice versa. The IFSC however deals mostly with financial and business services institutions like banking investors, provident funds, insurance companies, property development companies and the likes. From its establishment in 2003, the government was striving to diversify its economic dependency on diamond economy to other investments. The roles of IFSC thus have been mainly to develop Botswana as a world class hub for cross border financial and business services into Africa and the region; it also had some other roles aligned with the major purpose of improving national economy thus it works for the creation of sustainable employment opportunities for suitably qualified citizen, enhancement of the skills base of the Botswana workforce, fostering of innovation and sophistication in financial and business services and enhancement of Botswana's already excellent reputation in the international financial and business community.¹⁷⁶

The companies accredited to IFSC enjoy high standards of regulations and later will ensure a rigorous screening of their projects for approval. These so accredited companies are consequently entitled to a number of incentives including tax allowances. To investors aspiring to invest in international business companies, investments funds, international insurance, call centers, international banking and business process outsourcing, the Botswana IFSC therefore becomes a competitive advantage as it propels such business into the rest of Africa.

For purposes of cutting down government expenditure and improving policy efficiency, these roles which were undertaken by the IFSC and BEDIA are now together implemented by the newly established BITS as of December 2012.¹⁷⁷

The leading sector in FDI is the mining sector given its world leading quality diamond riches. It accounts to up to 40% of the national GDP.¹⁷⁸ Some other sectors important areas in FDI include manufacturing and financial services.

¹⁷⁶ <http://www.botswanaifsc.com/welcome.php>

¹⁷⁷ http://www.ifsc.co.bw/news_article.php?ID=60 last accessed on 16/10/2013

The key factors which have been figured to be important in improving the investment climate of Botswana and attracted FDI are its sound macroeconomic policies which have contributed to control expenditure and create foreign reserves, well managed monetary policies which successfully maintained low inflation rate, the management of exchange rate and remove of exchange control.¹⁷⁹

4.4.3 Investment taxation in Botswana

Botswana corporate taxation rate is said to be lower than any other country in the SADC region. In this case however the taxes are given in categories. To companies investing in manufacturing and those registered under the IFSC their rate is 15% and the non manufacturing companies fall in a more generalised rate of 25%.¹⁸⁰ Companies are accountable to payments of royalties ranging from 10%- 3% depending on the type of minerals. For diamond and precious metals royalties are 10% and 5% respectively while the rest of minerals rate at 3%.¹⁸¹

The improved incentives in taxation include the reduction of the royalties' rates to rest of minerals other than precious metals which was previously ranging 5% to 3% to a flat rate of 3% as an initiative to improve attraction to FDI. A 100% write-off is given on capital expenditure in the first year of investment and losses can be carried forward unlimitedly. The former right of the government for 15% share has been waived to merely optional.

The big differences on corporate tax rates between the manufacturing and non-manufacturing sectors is said to be in response of the move of the country to diversify the economy from the now diamond dominated economy because it is very risk for the country. During the global financial turmoil for example it was reported that the value of FDI in Botswana dropped by 69%

¹⁷⁸Botswana Statistics 2010,11 available at <http://www.bedia.co.bw/uploads/media/BOTSWANA%20STATISTICS%20WEB.pdf>

¹⁷⁹Selelo SE &Sikwila MN 'Determinants of Fixed Foreign Direct Investment in Botswana' *Journal of economics and behavioral change* 4(7) (2012) 144-422; 415

¹⁸⁰Botswana Business investment guide 13,Selelo SE &Sikwila MN (2012) 415

¹⁸¹Botswana investment guide 12.

which was a significant pinch to the national GDP.¹⁸² The diamonds demands dropped down as it is considered a luxury good compared to necessities which were given a priority during the crisis. This necessitated the economic diversification strategy.¹⁸³

Below is a summary of investment taxation in Botswana as explained above:

Sector	Incentives offered				Other non income tax incentives
	Corporate Tax		VAT		
	BEDIA	IFSC	BEDIA	IFSC	
Minerals	25%	NA	12%	NA	- 10% royalty for precious stones/diamonds - 5% royalty for precious metals - 3% royalty for the minerals and mineral products
Manufacturing	15%	15%	12%	0%	- 8-25% duty rebate for export of clothing and clothing facilities given a specific

¹⁸² “Botswana experienced its worst recession in over 40 years in 2009 as real GDP contracted by 3.7 percent in the wake of the global financial crisis and the collapse of world demand for diamonds”. See <http://www.mfw4a.org/country-focus/botswana/botswana-financial-sector-profile.html> (last accessed on 21/4/2013)

¹⁸³ http://www.debeersgroup.com/ImageVaultFiles/id_621/cf_5/OFR_Performance_Overview.PDF (last accessed on 21/4/2013) “In line with most products in the luxury goods sector, the diamond industry was severely affected by the global recession. Reduced consumer demand, constricted liquidity and high levels of inventory in the pipeline combined to produce particularly challenging economic conditions for rough diamonds.” Gareth Penny Managing Director, De Beers

					<p>category of clothing and accessories</p> <ul style="list-style-type: none"> - 0% to industrial raw materials for textile, foodstuffs and beverages destined for domestic and export purposes - 0% to all machinery and equipment for manufacturing companies the output of which is 100% exported - 0% to companies exporting outside the common custom area (CCA)
other sectors	25%	15%	12%	0%	

Source:

4.4.4 Scope of Investment Incentives in Botswana

Botswana offers a wide range of investment incentive ranging from fiscal incentives like taxes foregone and or relaxed rates, duty rebate facility to particular kinds of imports and industries, duty drawback facility, export credit guarantee scheme,¹⁸⁴ relaxation of immigration requirements for foreign companies' executives and other special packages subject to meeting set requirement as discussed hereunder.

¹⁸⁴http://www.bedia.co.bw/article.php?lang=&id_mnu=8 (last accessed on 16/10/2013)

There is no a standard procedure for the structuring of investment incentives in Botswana. Investment incentives are however offered in a consideration of a number of disaggregated measures which as a result differentiate the incentives enjoyed from sector to sector and/ or different investors in the same sector. As much as a project is sought beneficial to the improvement of the country's economy through demonstrated potential, that investor would enjoy investment incentives because the country would like to have FDI in projects that will boost the economy of the country. Amongst the factors that are considered in this case include but not limited to the following:

- Creation of employment to citizen
- Company's training plans to provide its commitment to knowledge transferring and localisation of non citizen positions
- Involvement of citizen in the management position
- The place where the project is situate
- The role of the project in accelerating other economic activities
- Roles of the project in reducing local consumer prices

4.4.5 Regulating Investment Incentives in Botswana

The country of Botswana has adopted a number of legislations which together stipulate some aspects on the regulation of investment incentives. There are sector specific legislations as well as general legislations which provide for crosscutting stipulations.

The Institutions/organs that regulate investment in general and/ or incentives in particular includes BEDIA, IFSC, the Botswana Unified Revenue Services (BURS), the Attorney General's Chambers as well as the Ministry of Trade and Industry which is the Apex.

While BEDIA is a private sector led organisation which acts as a focal point for investment and export promotion activities through promotion of inward investment by encouraging establishment of manufacturing enterprises specially focussing on export manufacturing, promoting joint venture investments among the citizen of Botswana and foreigners, it has further been acting as a one stop shop for all activities related to FDI including clearances, residence

permits, working permits, developing factory space, land etc. BEDIA is basically designed to facilitate investors on the procedural requirements upon their quest for investing in the country. Along with promoting foreign investment it also plays the role of promoting export trade by identifying foreign markets for locally manufactured products together with constructing buildings for establishing manufacturing enterprises.¹⁸⁵

The Botswana unified revenue services (BURS) is established by the Botswana unifies revenue services Act¹⁸⁶ and it is mandated to perform tax assessment and collection on behalf of the Government and to take appropriate measures to counteract tax evasion on the one hand, and to improve taxpayer service to a much higher level on the other. Its specific roles include but not limited to the following:

- Administering and enforcing the revenue laws; promoting compliance with the revenue laws;
- Taking such measures as may be required to improve service given to taxpayers with view to improving efficiency and maximizing revenue collection;
- Taking such measures such as may be required to counteract tax fraud and other forms of tax evasion;
- Advising the Minister on matters relating to the administration and collection of tax;
- Performing such other functions in relation to tax as the Minister may direct.¹⁸⁷

Apart from these specific roles which directly relate to taxation matters and most especially the administration and enforcement of revenue laws, there has not been a power vested to this institution as specially designed for investment incentives per se. It is however inferred from the scope of section 4 of the BURS Act that in implementing its duties this institution directly performs regulatory functions.

¹⁸⁵The detailed explanation on BEDIA in fully covered above in section 4.4.2.

¹⁸⁶ Cap 53:03, s. 3

¹⁸⁷http://www.burs.org.bw/index.php?option=com_content&view=article&id=38&Itemid=136

accessed on 16/10/2013) also s. 4 of the Botswana unified revenue services Act

The attorney general's chambers under its international commercial division (ICD) provide legal advice to respective ministries on the negotiation and drafting of commercial and international agreements. In this respect areas of business law, trade and investment law are covered among many other things. ¹⁸⁸Such legal advice involves, among others, areas in international law, environmental law, international trade law, and the procurement of supplies, goods and services. Therefore, as far as investment taxation is concerned in its entirety and incentives in particular the attorney general's chambers plays a great role in serving the best interest of the public as the government adviser in all matters of legal nature. It is for that reason the attorney general's chambers falls within the regulatory framework of investment taxation.

In respect of legislation the regulatory framework for Botswana is governed by the following laws and agreements:

- *Collective investment undertakings Act 2001*
- *Trade Act [Cap 43:02]*¹⁸⁹ this Act is enacted to simplify trade licensing procedures; to empower a licensing committee in a council to issue trade licenses within the council area; to provide for comprehensive regulation of trade and formatters incidental thereto.
- *Industrial Property Act [Cap 68:03]*
- *Immigration Act No.3/2011*
- *Companies Act [Cap 42:01]*
- *Capital Transfer Tax Act 1985 [Cap 53:02]*
- *Industrial Development Act [Cap 43:01]* this Act is enacted to establish an Industrial Licensing Authority to supervise industrial development.
- *Income Tax Act [Cap 52:02]* which provides for taxes imposed, manner assessing and collecting taxes on income
- *Value Added Tax Act Cap.50:03*
- *Bilateral Agreements* (double taxation avoidance agreements)

¹⁸⁸http://www.agc.gov.bw/index.php?option=com_content&view=article&id=22&Itemid=146 (last accesses on 5/10/2013)

¹⁸⁹Cap is an abbreviation of Chapter of the laws

- *Trade Agreements* (Botswana-Zimbabwe trade agreement and the southern Africa Customs Union (SACU) agreement)
- *Mines and minerals Act, 1999* for regulation of the law relating to Mines and Minerals; to provide for the granting, renewal and termination of mineral concessions; to provide for the payment of royalties; and for matters incidental to and connected therewith

4.5 Some lessons from Botswana

On the overview information given above about the country of Botswana, particularly its economic background and investment and taxation situation some important facts can be learnt by Tanzania which would be used to help in improving investment climate and taxation in general.

‘Policy choice at a critical point in time—was the key factor determining the wealth and poverty of African nations. Seretse Khama’s policy decisions could serve as a useful guide for other African nations’.¹⁹⁰

An important element to be primarily born in mind is that upon the analyses of Botswana success, findings have basically reasoned out that the factors behind such success are multifaceted. The fact that investment revenue in the diamond sector is a major contributor of the national GDP (about 40%), is just the end result of a combination of other factors like sound macroeconomic policies, prudent governance and committed leadership which has put the interest of the Botswana people at the centre of every arrangement including investment arrangements. These have strengthened the country economic position which in themselves acted in attracting and supporting foreign investment in Botswana. In that respect, Botswana has not suffered much on foregoing some of its potential revenue by way of tax incentives because there were already a good foundation which that was very significant guarantee for investors to flow in

¹⁹⁰Beaulier SA Explaining Botswana's Success: The Critical Role of Post-Colonial Policy *Cato Journal* 23(2) (2003) 227-240, 237,238 he further states that the stake of the nation lies on those who are in power.

the country. Such policy choices included the choice of pro-market policies, free market institutions and limited government. Towards investing companies Khama's government provided low and stable taxes to mining companies, liberalized trade, increased personal freedoms, and kept marginal income tax rates low to deter tax evasion and corruption.¹⁹¹

On the rates of taxes offered in two categories (i.e. 15% for manufacturing and IFSC registered companies and 25% for other sectors), there is a great and a very important lesson to be learnt. The reasons given that the country is seeking to attract more investors in the manufacturing and financial services sector hence provide such a subsidy is very relevant and crucial. An additional reason that diversification is necessary because of the volatility nature of the GDP dominating diamond industry which in cases of recession like the year 2008-2009 it shakes the economy severely. What to learn here is such a long range focused initiative. There is no much to gain if the policies and laws will be very short focused hence it is very important in every instance involving FDI arrangements and concessions to have a thorough analysis of the immediate and long term benefits to the country and its economy.

It is also so appealing on the approach of Botswana to offer low tax rates to avoid burdening investors with much taxes which as a result encourage them to search ways of avoiding the payments like tax evasions and creating tax havens. The concepts of predatory and proprietary policies are also very relevant for learning. That the country should not be over cautious to the extent of giving priority to short term outputs foregoing the long term benefits which are rather more important. At this point that is when proprietary policy measures are relevant.

There is a proper and very sound relationship between various development policies which is also key to achieving the economic success that put Botswana on a significant growth pace worldwide. Very cautious of all risks associated with mineral reliant economy, Botswana focused its policies on the balancing of fiscal servings, surplus on current account of the balance

¹⁹¹In this course it is also argued that unlike Botswana most African countries failed in their post independent policies because of setting predatory states instead of proprietary ones. That is the reason why most policies failed to have long term achievements they simply aimed at getting back what would potentially be possible from the former enemies, colonialists. Beaulier SA Explaining Botswana's Success: The Critical Role of Post-Colonial Policy *Cato Journal* 23(2) (2003) 227-240, 237

of payments, and its development policies invested heavily on infrastructure development and human capital.¹⁹²

Given the above account therefore, it can be argued that there is a need to flash back to various development and fiscal policies of Tanzania to see if that necessary coherence exist which would support the collection of maximum investment revenue. How a country balances other development factors like infrastructure and improvement of human capital as a catalyst on investment is a matter of a great concern. It comes again to the point that a country may end up offering incentives (and mainly tax deductions) for failure to integrate various sector for the achievement of the optimal benefit.¹⁹³

In the year 2010 Tanzania enacted a new mining law for instance in response to the ever demands from the citizen and various natural resources activist that the law was very loose especially on very generous incentives given to mining FDI firms. The above lessons from Botswana suggest that still the review of one piece of legislation may not be sufficient to curb the problem of revenue loss. There are many other sectors in which investment take place and there are many other development policies which are relevant in the endeavour on ensuring optimal results associated with investment revenue. Fiscal administration policies are very relevant here which will also need review.

4.6 Conclusions

This chapter has mainly focused on how to regulate FDI in order to maximise government revenue. It has also gone further to exploring from the successful country of Botswana on the

¹⁹² “Together these policies limited the erosion of domestic productivity and competitiveness that can result from the appreciation of the real exchange rate. High fiscal saving limits current consumption, reducing pressure on domestic price inflation, a typical problem in natural resource booms.” Lewin M Botswana’s Success: Good Governance, Good Policies, and Good Luck available online at <http://siteresources.worldbank.org/AFRICAEXT/Resources/258643-1271798012256/Botswana-success.pdf> last accessed on 12/12/2012

¹⁹³ “There is nothing sadder in this business than a very poor country, with almost nothing that will attract FDI beyond a few rent-generating niches, ready to allow any foreign investor to pay little or no taxes in the hope of attracting more FDI. The result in this situation is that almost all the investment that does come, comes to the rent-generating niches for which investors would not have been deterred by a reasonable tax burden. The incentives generate almost no additional foreign direct investment and are mostly a dead loss to the treasury.”Beaulier SA (2003) 239

factors behind its success basically on FDI to find out any lessons that can be taken by Tanzania in its endeavours to regulating its investment sector particularly tax incentives in order to maximise government revenue. It has been found that there are numerous measures that need to be combined in an initiative to improving the regulation of FDI and revenue collection from the investment firms. Firstly is the observance of coherence between all policies, laws and regulations relevant in ensuring optimal achievement of national development goals. Every relevant policy should be properly addressed in correlation with other laws. Any departure of one will be a loop hole in the whole endeavour. This has also been observed from the Botswana success story that it has been a key observation area. The so complicated and tricky abuse methods used by investors need a high consolidated and specialised regulatory agency. It may necessitate the country to have one special organ for regulating the investment sector to curb the current problems faced by the tax administration authority which are beyond its technical capacity and authority as well. The country should consider long term gains it is put to achieving in order to be able to optimise every transaction engaged in with investors. However, all these are subject to quality leadership and quality policies in general. The stake of a country lies up on those who are in power so they may opt to take sound policies or lead the country into the pit of failure.

Chapter five

5.0 Observations, recommendations and conclusions

‘Countries may only benefit from foreign investment inflows if they have appropriate local government regulations and institutions in place.’¹⁹⁴ “It is safe to conclude, albeit tentatively that the confrontation of significantly non-profit directed motivation by an approach emphasising tax incentives points to relative inefficiency in African inducement policies and legislations.’¹⁹⁵

The objective of this mini-thesis was to find out the best way which Tanzania can use to regulate its FDI incentives following the problem which has been indicated in chapter one that the current investment incentives offered by the country are not properly regulated hence some loop holes exist which render abuse and misuse of such incentives which result into poor revenue.

The objective of this mini thesis was therefore to find out the best way in which Tanzania can regulate FDI tax incentives’ scheme. In this case this mini- thesis was centred in investigating the current regulatory framework of FDI tax incentives in Tanzania and finding out the implications of such regulations in relation to tax revenue. Another point of reference as a sub objective was to investigate the approach of other countries (with a particular reference to Botswana) in regulating FDI tax incentives and finally in the light of the research done through various literature sources and lessons learnt thereof come out with a best way in which Tanzania can regulate FDI tax incentives.

The work has therefore explained some theoretical issues regarding FDI taxation and explained the current FDI taxation scheme in Tanzania together with the regulatory scheme which exist with the implications of such schemes followed by a critical analysis which discussed in detail

¹⁹⁴Busse M & Groizard JL Foreign Direct investment, Regulation and growth (2006) World Bank Policy Research Paper WPS3882; 5

¹⁹⁵Dixon-Fyle SR ‘Economic Inducements to Private Foreign Investment in Africa’ *Journal of Development studies* (2004) 109-137; 117

the mischiefs of the tax incentives scheme of Tanzania and its regulation. It has also made a representation of the FDI of Botswana which was considered to be a good role model in regulating its economy in general and the FDI in particular. Some lessons from Botswana have been observed which are considered relevant to be considered in improving the regulation of FDI incentives in Tanzania.

From the review of the literature as covered in chapter two of this mini thesis, it has been found that FDI as a form of firms' internationalisation has theories behind it (although no agreed set of theories) which need to be well regarded in any case when a host country is dealing with multinational corporations flowing into the country. As for Tanzania it has also been observed that in cases of investment incentives there is no coherence between its regulations and the existing theories of FDI. It has further been found out that while in the theory reveals is that there are numerous kinds of investment incentives offered on varying bases as of one investor and another, Tanzania has mainly focused on fiscal incentives with no explicit reason even where the conditions demonstrate that investment decision of a particular investment firm would not be negatively affected had there not been any fiscal incentives offered to them. In other words incentives offered by Tanzania seem to be provided on haphazard bases even where not necessarily required. A critical analysis done in chapter three of this mini-thesis demonstrated that there exist some practical draw backs which render the Tanzanian FDI ineffective especially in relation to tax incentives schemes. It has been realised how Tanzania has put less efforts on the issues which would otherwise require practical and systematic regulation for maximum realisation of profits in the sector.

This mini thesis has gone further to finding out the best way in which Tanzania can observe to maximise better in its investment sector. A number of roadblocks were also realised, and it was found that there is a great mismatch between policies, laws and regulations relevant to the realisation of national development goals. In this the necessary consonance that would have enabled policies to address the same priorities and objectives is lacking hence the situation the country is in now. It has been observed that it will be of temporary (if at all any) relief if the count will bother to address specific issues that arise in one sector while in the real sense there are parent sectors which are the root cause of the problems. It is at this juncture that this mini

thesis came out with the idea of overhauling policies and legislations to ensure common objectives and priorities in all related sectors.

In the light of the above conclusion and the work detailed in the previous four chapters below are the author's observations, and recommendations.

5.1 Observations and recommendations

This work has observed that the regulation of tax incentives offered to FDI in Tanzania is lacking in many ways which makes it possible for the abused like tax flights and thus depriving the country of its revenue. The main area which has been found to be weak is the nature of incentives that they are too much generous while at the same time they do not provide for any basis for such generosity. The theories of FDI and taxation as provided in chapter two provided for various aspects to be considered when offering FDI incentives but the incentives offered by Tanzania (mainly tax allowances) do not indicate or provide the rationale behind those rates and allowances. The absence of this rationale justifies the arguments of whatever base such as those who argue against the incentives claiming that such generosity lead to country losses well as those who argue for more incentives. This means that without a clear and a logical basis explaining the reason for offering a certain allowance the investors will keep demanding more allowances and the citizen will keep advocating for their removal. It also goes that in order to ensure efficiency of the incentives to be awarded to investors consideration need to be given to other sectors related to the investment sector such as the role of education in scheduling incentives as well as the role of infrastructure. If these are well addressed by the country the quantities of incentives will be affected positively as the two aspects in themselves play a great role in favour of enhancing the attraction for FDI.

Another area of observation was on the regulatory body for FDI and/or investment in general. The fact that the regulation of foreign direct investment is not institutionalised is another area which has made possible some revenue flights and failures in general which are facing the FDI sector for lack of proper revenue. The role of TIC as both an investment promotion agency as well as a government agency to advise the government on how to better achieve its investment goals is conflicting. This work argues that one institution cannot fairly play the two roles. If the investment promotion agency is the government agency there should be on the other hand an

independent private led regulatory authority which will play roles for monitoring and ensuring compliance with the rules. This body may be entrusted both rule making as well as supervisory powers. In this case while the promotion agency will be interested to see the increase of FDI inflow as much as possible, the regulatory authority will play the roles for checks and balances towards a fair attainment of the investment and development goals by monitoring performance and preventing and/or sanctioning abuses.

The TRA which is responsible with the roles of taxation in general is also found to be overwhelmed with some challenge including limited audit powers to some sectors and lack of coordination and integration with other sectors which is a very alarming situation that renders possible for abuse of tax incentive and revenue flight. Some sectors have many key players hence there is a need to have an overall authority that will surpass every other institution by possessing super powers to go through all sectors regardless of the nature or any other possible limitations.

The work has further observed that some loop holes exist pending the lack of coherence between policy, laws and regulations governing investment. While the policy is a frame work within which the law is enacted the National investment promotion policy and the Tanzania investment Act are not in consonance in many ways. While the national investment promotion policy has given the detailed objectives of investment the Act is basically focused on investment promotion. This is where a gap in the law exists that neglects the object of optimising investment activities to increase county revenue.

Regarding the policy aspect it has also been observed that policies play a major role in ensuring optimal results in whatever sector of the economy. As the case ha been for Botswana despite the volatility of the mineral dependent economy and despite the hit of the global financial crisis it has managed to maintain a strong economy due to its sound macro-economic policies which have a great coherence with other policies such as development policies, infrastructure and education.

Mentioning Botswana as a role model of a strong growing economy is indeed a good thing to say. However, if one aspires that kind of success there is a lot to commit. The foundations under

which the strength of Botswana is grounded consist of multiple pillars some of which to countries which have already had a different beginning it is difficult to follow those lines except for some possible imitations which will mean rectifying the mistakes and getting determined to no more defaults committing reviewing policies and enshrining strong and committed government into power which will for all means put first the interest of the country and fight all corruption and self-centredness of the leaders.

In this work it has been also learnt that the revenue loss is just the final results of many social political and economic defaults which have been committed in the course of liberalising the economy. Therefore, responding to the immediate problem will be a temporary solution to a deep rooted problem the effects of which will be the recurrence of the same problem after every bit of time. This suggests that the solution for this revenue problem suffered by the country need to be very well founded. The next subpart provides for some recommendations to that respect.

5.2 Recommendations

Given the above observations which are based on the work carried out in the previous four chapters, this work makes the following recommendation in order to improve the FDI revenue in Tanzania against the current losses accruing from the poor regulation of incentives offered to FDI.

That the government should make an initiative to engage experts in reviewing its development and economic policies for the purpose of harmonising the objectives of each to remove the existing inconsistency which hamper proper implementation of the law. All the initiative of economic and development policies should be focused to achieving one or some common major goals.

Along with the first comment of reviewing development and economic policies to get them in a good alignment, the designing of tax incentives should also be clearly considered. There is a need of high levels of transparency and setting clear the criteria that would render a firm eligible for a set of tax incentives. Although a country may be forced to engage into high tax incentives from external pressures by the competitors of other countries still the host country has the autonomy on how to structure and rate its tax incentives. Other competitive advantages should be well explored to compensate some rates of tax incentives which heavily burdens and limits the

financial resources of the country. For instance Tanzania can commit to strengthen the rule of law, right to property and development of infrastructure like roads and utilities (water and electricity) and deploy those as bargaining tools to FDI firms which would otherwise demand high tax reliefs in cases of poor governance and unstable political conditions.

On the part of the regulatory regime it is hereby recommended to improve the laws on their quality and efficiency. The Tanzania investment Act should be reviewed especially on the incentives packages. Some of the sectors which are governed by separate legislations should be put into harmony with the Tanzania investment Act to reduce the differences which appear in incentives from sector to sector. The same should apply with the Tanzania income tax Act. There should be one major document which should be designed upon specialised consideration of factors affecting FDI taxation and come out with tax rates for all sectors.

In case of the regulating body, this work recommends that due to the challenges facing the TRA and the conflicting responsibilities of the TIC the government should now make a consideration to form a specialised independent private led entity that will play the regulatory role to ensure compliance and necessary efficiency in attaining the major objectives of the sector including balancing both the interests of the government and of the investors. The TIC should remain solely with the promotional role and the TRA should remain with its general role of tax administration.

This mini-thesis has explored only the facts relating to FDI tax incentives and not investment in general. A lot is therefore attracting future research including the general evaluation of role the Tanzania investment sector in improving the national GDP, the contribution of policy inefficiency in the poor economic performance in Tanzania, the role of good governance in motivating the policy efficiency and improving the economy in general. Many other areas can be explored along the same lines.

Final Word Count =27389

Appendix

Year	Value of FDI (in US\$ Million)
1995	150.86
1996	148.64
1997	157.8
1998	172.2
1999	516.7
2000	463.4
2001	467.2
2002	387.6
2003	308.2
2004	330.6
2005	447.6
2006	616.6
2007	653.4
2008	744
2009	650

Table 1: value of export 2005-2009

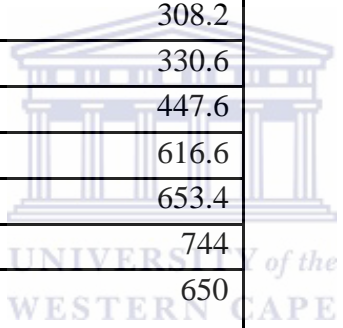


Table 2: Government tax revenues 2009/10 – 2010/11

Year	2009/10 Actual collection (Bill TShs)	2010/2011 Approved Estimates (Billion Tshs)
Value of FDI (in US\$ Million)		
Taxes on international trade	1,979	2,476
<i>Of which:</i>		
<i>VAT on imports</i>	748	874
<i>Excise duty on imports</i>	533	741
<i>Import duty</i>	374	535
<i>Fuel levy</i>	256	303
<i>Other</i>	68	23
Taxes on income, profits and capital gains	1,250	1,673
<i>Of which:</i>		
<i>PAYE from government, parastatal and private sector employees (non-large taxpayers)</i>	267	285
<i>PAYE from government, parastatal and private sector employees (large taxpayers)</i>	433	663
<i>Limited companies (non-large taxpayers)</i>	95	115
<i>Limited companies (large taxpayers)</i>	319	424
<i>Withholding taxes (non-large taxpayers)</i>	37	22
<i>Withholding taxes (large taxpayers)</i>	84	124
<i>Individuals – Presumptive and assessed tax (non-large taxpayers)</i>	50	60
<i>Individuals – Assessed tax (large taxpayers)</i>		1
<i>Capital gains tax (non-large taxpayers)</i>	6	12
<i>Capital gains tax (large taxpayers)</i>	6	0
<i>Unclassified income tax refund (non-large taxpayers)</i>	-51	-57
<i>Others</i>	3	25
Payroll and skills development levy	108	130
Taxes on goods and services	967	1,221
<i>Of which:</i>		
<i>Value Added Tax (non-large taxpayers)</i>	159	225
<i>Value Added Tax (large taxpayers)</i>	501	554
<i>Excise duty (large taxpayers)</i>	299	438
<i>Others</i>	8	4
Motor vehicle taxes/fees	85	72
Others	67	80
TOTAL	4,456	5,652

Source: The one Billion Dollar Question: How can Tanzania stop loosing so much tax revenue

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