

**ASSESSMENT OF EFFECTS OF TAX-BREAKS ON ECONOMIC GROWTH
OF TANZANIA.**

**By
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**A Dissertation Submitted in Partial Fulfilment of the Requirements for the
Degree of Master of Business Administration in Corporate Management
(MBA-CM) of Mzumbe University**

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CERTIFICATION

The undersigned certifies that they have read and hereby recommends for acceptance by the Mzumbe University (MU) a dissertation entitled “Assessment of Effects of Tax-breaks on Economic Growth of Tanzania” in partial fulfilment of the requirements for award of the degree of Master of Business Administration of Mzumbe University.

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DEDICATION

This work is dedicated to my family and all those who truly care for me for their efforts, understanding and encouragement. Their support has led to the successful accomplishment of my study; they have stood with me at all times and to all my fellow students who made the journey worthwhile through their cooperation and team spirit.

ABBREVIATIONS AND ACRONYMS

BOT	The Bank of Tanzania
CIAT	Inter American Centre of Tax Administrations
CMA	Capital Markets Authority
CET	Common Exchange Tariff
EPZ	Export Processing Zone
ECOWAS	Economic Community of West African States
EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GRIPS	Graduate Institute for Policy Studies
TRA	Tanzania Revenue Authority
KRA	Kenya Revenue Authority
MENA	Middle East and North Africa
MNCs	Multinational Corporations
OECD	Organization for Economic Cooperation and Development
SEZs	Special Economic Zones
TIC	Tanzania Investment Centre
TJN	Tax Justice Network
UNCTAD	United Nations Conference on Trade and Development
VAT	Value Added Tax

ABSTRACT

This study intended to establish the effects of tax-breaks on economic growth of Tanzania. The study's specific objectives were to determine the tax-breaks that have been available for businesses, to determine the rate of economic growth of the country from 2006 – 2018, and to determine the relationship between tax-breaks and economic growth of Tanzania. The study employed a quantitative approach to research; the study collected only secondary data from four government agencies. The collected data were then analysed using statistical software known as Gretl which provided descriptive, correlation and regression analysis findings. The study identified over 80 tax breaks available in Tanzania, and being enjoyed by government institutions, parastatal organizations, religious organizations, Non-Governmental Organizations (NGOs), Donor Funded Project (DFP), private companies and individuals, mining sector, oil/gas exploration, military duty free shop and Tanzania Investment Centre (TIC) in addition the study determined that the economy of Tanzania has been growing at an average rate of 6.7% over the period between years 2006 – 2018. Furthermore, the finding indicates an existence of an insignificant negative relationship between tax breaks and economic growth.

The study concludes that too many tax breaks are been given, some do not even relate to business or investment of any sort. The government offices and international communities enjoy too much tax breaks. The fact that so many government offices have such benefits could lead to misuse of that privilege leading to the country losing more revenues, and recommends that rather than focusing on tax breaks as the main investor attraction criterion, the country should focus on creating a conducive business environment whereby there are good infrastructure such as affordable and reliable electricity, transport, high level education, unnecessary bureaucracies due to corruption practices, and political stability. Because other countries such as Mauritius, Costa Rica, Ireland and Malaysia have managed to attract huge number of investors with none or very little tax breaks OECD (2007), so why not in Tanzania. Furthermore, because there are other countries that have had a positive economic growth out of granting tax breaks as an investors' attraction strategy (UNCTAD, 2012). This study recommends the government seeks to learn how others have managed to do it successfully, and then model their success.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

This chapter introduces the research by presenting the background of the study, the statement of the problem, the objectives of the study as well as the scope and significance of the study.

1.1 Background of the Study

From the view of economists, a tax is a compulsory contribution of resources from the private to the public sector or government. It is levied on the basis of predetermined criteria and without reference to any specific benefits received by the tax payer. Governments levy different types of taxes at varying tax rates to distribute the tax burden among persons involved in taxable activities or to redistribute resources within the society. In addition, taxes are levied by the government to influence the macroeconomic performance of the economy through its fiscal policy, more specifically the taxation policies, and to adjust patterns of consumption or employment within an economy, by making certain transactions more or less attractive (Goode, 1984).

Taxes are justified as they fund activities that are necessary and benefit the majority of the population and social development (Holmes, 1904). Not everyone in the society agrees with the principle that governments must levy taxes. An anarchist in Russia, Emma Goldman wrote that the State itself is the greatest criminal, breaking every written and natural law, stealing in the form of taxes. Even so tax payment is enforced by the legal system there is still a view held by some people who view taxation as theft or extortion (Williams, 2008)

United Nations Conference on Trade and Development (UNCTAD, 1999) defines tax-breaks as any incentive that reduces the tax burden of any party in order to induce them to invest in particular projects or sectors. They are exceptions to the

general tax regime and may include, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market.

Tax expenditures, on the other hand, refer to revenue losses that a government incurs by providing tax exemptions, deductions or allowances, tax credits, preferential tax rates or deferral of tax payments legally to any party in the economy (Gruber, 2005). The budget deficit of a government is a form of a negative saving and a reduction in the deficit can positively influence the net national savings more than any feasible changes in tax policies and encourage savings within an economy which will then stimulate investments (Goode, 1984).

Countries offering tax-breaks may benefit through non-economic gains from industrialization, creation of jobs, transfer of technology and training and an increase in tax revenues if the entities will exist in the long run and pay taxes (Gray, 1987). Some researchers have also concluded that investment decisions are fairly sensitive to tax breaks and therefore they suggest that the tax policy is a powerful tool in determining investments flow (Gruber, 2005). These benefits are meant to contribute to higher economic and employment growth rates and reduce poverty levels.

The key question however remains whether by offering huge tax breaks governments in developing nations have been able to increase investments to the extent of increasing economic growth rates and improving the welfare of its citizens. Studies in both developed and developing nations suggest that tax breaks are an inefficient and expensive way of encouraging investments. Most studies show that the most important determinants of Foreign Direct Investment (FDI) in developing countries consists of long term considerations affecting profitability, market size and market potential (Irish, 1978).

For many years the government of Tanzania like many other governments of other countries in the world has been granting tax-breaks and relief to individuals and organizations alike. The waiver and/or benefits are granted to taxpayers for payment

of Import Duty, VAT, Excise Duty, income tax and fuel levy under the Tanzania Investment Act, the Mining Act, and relevant Government notices applicable to Religious and Charitable Organizations, Donor Funded Projects and Investors (Tanzania Revenue Authority [TRA], 2019).

According to Utak, (2017). Several reasons have been identified as the motivation behind governments granting of tax-breaks. The reasons include; firstly, through tax breaks weak enterprises can strengthen by increasing production, or hiring better staff or employing better technology that could easily enhance their overall performance. Secondly, governments may grant tax-breaks to potential investors with the aim of attracting more investors to their country.

They expect that investors will bring employment opportunities to the local communities; they will bring superior technology which will lead to great production and consequently more export possibilities. The more the investors can produce, the more they can serve both the internal market and external market by bringing in more taxes and foreign currencies.

Moreover, tax breaks are granted to organizations that even though are not business oriented, still serve the community by contributing to the overall development of the country, such organizations are; Non-Governmental Organizations (NGO's), United Nations (UN), donor funded projects, foreign embassies, religious institutions, government and parastatal institutions.

Furthermore, tax-breaks may be granted to local industries, while at the same time raising taxes on imports from stronger foreign competitors, this is done to promote local industry's growth. However, in the course of protecting the local industries, governments should avoid falling into the trap of import substitution strategy, since many works of literature have shown this strategy has failed to produce the economic effect it was supposed to replicate (Utak, *ibid*).

Additionally, taxes may be levied to promote science and invention or to finance educational activities or to improve the efficiency of local police forces in the maintenance of peace and order through grant of subsidy (Utak, *ibid*).

While the above given reasons may substantiate the provision of tax-breaks by governments, still one of the key objective of a good tax system is raising tax revenue to fund various government operations and hence avoid burdening the country with excessive borrowing. Therefore, it is crucial that the government of Tanzania strike a fine balance between raising tax revenue to fund the ever increasing government operations such as development projects and the desire to grant tax – breaks for many good courses such as attracting investors. (Twaweza, 2010).

1.2 Statement of the research problem

UNCTAD (1999) defines tax-breaks as any incentive that reduces the tax burden of any party in order to induce them to invest in particular projects or sectors. They are exceptions to the general tax regime and may include, reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market.

Gruber, (2005) concludes that tax-breaks are powerful tools in determining investment decisions and as such many countries use tax-breaks as a strategy for attracting investments into their country especially foreign direct investments (FDI). The countries offering tax breaks look forward to benefiting through non-economic gains from industrialization, creation of jobs, transfer of technology and training and an increase in tax revenues if the entities indeed exist in the long run i.e. past tax holidays (Gray, 1987).

While the above two paragraphs supports the view that tax-breaks are an important strategy in attracting investments into a country, several other studies as seen below provide a different view, a study by Lipsey and Chrystal, (2007) stated that inspite of

most underdeveloped countries' governments playing an important role in developing policies including employment of tax-breaks to encourage investments and innovations there still have been reports of tax-breaks not resulting into an increase in FDI.

A study by Osoro et al., (2009) indicate that Tanzania lost TZS 772 billion in 2005/06, and in 2009/10 tax exemptions amounted to TZS 695 billion, and according to TRA (2019) Tanzania have lost an average of over TZS 1 trillion from 2010 to 2018 through wide ranging exemptions mainly to Multinational Corporations (MNCs) yet these tax breaks have not translated to substantial returns in FDI.

Retrospectively, while UNCTAD (2012) supports Gruber (2005) and Gray (1987) in that Tax- breaks are powerful tools in determining investment decisions and as such many countries use tax-breaks as a strategy for attracting investments into their country especially foreign direct investments (FDI), and consequently, affecting the economic growth of the respective country.

Tax Justice Network [TJN], – Africa, (2013) on the other hand supports; Lipsey and Chrystal, (2007), Osoro et al., (2009), and Organization for Economic Cooperation and Development [OECD], (2007) on their reports that generously granting tax-breaks does not translate to attracting investors into that particular country, and hence does not automatically guarantee economic growth.

Because of the conflicting reports on the effect of tax breaks on economic growth in general. In addition to the fact that on average tax breaks costs have kept on rising with every passing year (TRA, 2019). It was of paramount importance to get to the bottom of the whole issue, so that to understand if it is worth it for the government to keep on granting tax-breaks. The study therefore set out to assess the effect of tax breaks on economic development in Tanzania by collecting information about tax breaks and economic development of Tanzania which were then used to conduct a regression analysis.

1.3 Objective of the Study

To assess the effect of tax-breaks/incentives on economic growth in Tanzania

1.3.1 Specific Research Objectives

- i. To determine the tax-breaks that has been granted in Tanzania from 2000 to 2018.
- ii. To establish the rate of economic growth of Tanzania from 2000 to 2018.
- iii. To assess the relationship between tax-breaks/incentives and economic growth in Tanzania.

1.4 Main Research Question

What is the effect of tax-breaks/incentives on economic growth in Tanzania?

1.4.1 Specific Research Questions

- i. Which tax-breaks/incentives have been granted in Tanzania from 2000 to 2018?
- ii. What is the rate of economic growth of Tanzania from 2000 to 2018?
- iii. What is the relationship between tax-breaks/incentives and economic growth of Tanzania?

1.5 Significance of the Study

The results of the research will be useful to the Tanzanian government, policy makers, legislature and regulatory bodies such as the TRA in improving taxation systems and therefore, tax policies in Tanzania.

To the investors and citizens, this study provides an insight into Tax breaks and their impacts on economic growth. Investors needs to establish business strategies putting into consideration the long term effects (and consequences) of their decisions on the business and the economy. It is necessary to educate potential investors and citizens so as to encourage support and compliance for good macroeconomic policies.

To the academicians, the study adds to the existing literature in this field which will form a good base of literature for review by researchers in the future. Researchers may use the study as a foundation to carry out any further research in this area.

1.6 Scope of the study

According to Kothari (2006) the scope of the study clarifies the boundaries of the research or the extent to which the study intends to cover, this enables the researcher only to deal with tasks the researcher focuses to in order to make decisions about the changes required in the study. As much as one might want to, they cannot study everyone, everywhere and everything (Miles and Huber man, 1994). According to the statement of related problems in this study, the researcher narrowed down the scope of the study to make it more pertinent. Accordingly, the study aimed to assess the effect of tax-breaks on economic growth in Tanzania, the study mainly used secondary data to assess the rate of economic growth of Tanzania and the granted tax breaks in Tanzania for the specified period.

1.7 Limitations and delimitations of the Study

The study mostly used secondary data sourced from TRA statistical publications, the National Bureau of Statistics (NBS), Tanzania Investment Centre (TIC) and the Bank of Tanzania (BOT). The study was limited to the degree of precision though the data was sourced from reliable sources. With the exception of tax breaks information which was readily available at TRA offices, data on other variables could not whole be found on one source they were supposed to be. To eliminate this limitation the study had to source data from international sources such as the World Bank data bank.

Also, there was time limitation to carry out the study which necessitated the use of secondary data from databases. The data from in-depth inquiry involving collecting primary data may have provided more information that would give better information on tax breaks and their specific impact on the economy. However, the study reduced the effect of this fact by collecting data from multiple reliable sources to ensure data accuracy and collected time series data of over 10 years to avoid one off fluctuations.

1.8 Organization of the study

The first chapter introduced the concept of tax breaks and economic growth, the statement of the problem, research objective, and research question, scope and significance of the study.

The second chapter covered literature review which carried an overview of the tax breaks and economic growth, theoretical framework, empirical review, and conceptual framework.

Chapter three covered the research methodology for this study whereby the research design, the study area, the data types used by the study were introduced. In addition, variables and the estimation model were developed in this chapter.

In chapter four, the findings of the study are presented in line with the research questions.

Chapter five discussed the findings presented in chapter four, starting with the discussion of descriptive statistics summary where by the measure of the central tendency of the variables and their implications was discussed. The estimation findings and their implication to the study were discussed.

Chapter six simply, presents the summary of the study, conclusions of the study, recommendations for stakeholders, and areas for further study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents a review of the literature on the effect of tax-breaks on economic growth of Tanzania. The chapter discusses various theories relating to economic growth; the relationship between tax-breaks and economic growth and defines the variables as well as the conceptual framework for the study.

2.2 Overview of tax-breaks and economic growth

2.2.1 Tax-breaks

Tanzania like many other countries grants various tax-breaks for different reasons, chief among them being to attract potential investors to their respective countries. These exceptions to general tax regime may include reduced tax rates on profits, tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market (Goode, 1984).

It is reported that countries offer tax-breaks with the expectation of benefiting through non-economic gains from industrialization, creation of jobs, transfer of technology and training, and the expectation that in the long run the investors will be able to benefit the country by paying more taxes that automatically offset the tax breaks received at the beginning an (Gray, 1987).

2.2.2 Economic growth

Economic growth refers to an increase in the capacity of the economy to produce goods and services compared from one period to another. It can be measured in nominal terms, where it is not adjusted for inflation, or in real terms, where it is adjusted for inflation. The growth of an economy is thought of not only as an

increase in productive capacity but also as an improvement in the quality of life to the people of that economy and it is associated with technological improvements.

Gross Domestic Product (GDP) refers to the monetary value of all the finished goods and services produced within a country's borders in a specific time period. It includes all of private and public consumption, government outlays, investments and exports less imports that occur within a defined territory and is measured annually. GDP is commonly used as an economic indicator of the overall health of an economy, as well as to measure the standards of living in a country (Lipsey and Chrystal, 2007).

Fiscal policies are concerned with government spending and taxation policies. The burden of resource mobilization to finance essential public development projects must be focused on how the government will raise adequate revenues for its development efforts. In the long-run, the government can only rely on the efficient and equitable collection of taxes as a more sustainable way to raise revenue to meet its development goals (Todaro and Smith, 2003).

2.2.2.1 Determinants of economic growth

Economic growth is the economy's most powerful engine for generating long-term increases in living standards. It refers to an increase in the real GDP of a country which is measured by changes in the national aggregate output. GDP is used to measure economic growth within the boundaries of a country because it only considers the value of goods and services produced within that country.

Among the determinants of economic growth are the quality and quantity of investments, the country's stage of development, population size and structure, level of education and training of the population and how liberalized the market is in a country. Several economic theories also give a different view on what affects economic growth in a country. Adams Smith, and Cheney both stated the importance of resources in economic growth, Harrod- Domar stated the importance of policies such as tax breaks while Solow explained the importance of technology progress in economic growth (Beardshaw et al, 2001).

2.2.2.2 Stages of economic growth

Attempts have been made to classify the pattern of economic growth as a passage through a number of defined stages. Marx classifies societies as passing through primitive, communism, slavery, feudalism, capitalism and finally socialism and communism. However, in recent times, countries do not necessarily go through these stages sequentially a good example being China. Rostow classifies these stages differently from an early stage up to the take-off time when the economy can experience self – sustaining growth. Development of markets and accumulation of capital are therefore necessary for economic growth (Beardshaw et al, 2001).

2.2.2.3 Level of investments

The effect of foreign direct investment (FDI) on the host economy has attracted much research. Economic theorists and policy makers frequently emphasize purported benefits of FDI. Rigorous empirical evidence has been less abundant. Most studies examine the impact of FDI on developing economies, but FDI is mainly received by developed countries (Lucas 1990; Gourinchas and Jeanne 2013).

Macroeconomic analyses that account for groups of developed countries often report either a negative impact on growth (Mencinger 2003; Carkovic and Levine 2005; Johnson 2006; Türkcan, Duman, and Yetkiner 2008; Herzer 2012) or an inconclusive effect (De Mello 1999). By contrast, several macro-based articles on both developed and developing countries indicate a positive effect of FDI inflows (Olofsdotter 1998; Reisen and Soto, 2001), albeit differing by country, and indicating the importance of host economy characteristics (Alfaro et al. 2004; Li and Liu 2005; Batten and Vo 2009).

A number of studies reported support for the theory that FDI benefits growth, Reisen and Soto (2001) report that foreign portfolio and direct investment boost growth. Basu and Guariglia (2007) conclude the link between FDI and growth is positive and significant in 119 countries (as is FDI and income inequality). Several studies find growth-enhancing effects of FDI conditional on the host environment (De Mello 1997). Borensztein, De Gregorio, and Lee (1998) argue that FDI boosts growth via

technology diffusion, if the host economy boasts sufficient absorptive capacity. Hermes and Lensink (2003) concur, finding a needed minimum level of human capital. Durham (2004) finds in a large multicounty study that FDI is not significantly correlated with growth, interpreting this as evidence of needed absorptive capacity of the host economy.

So developed economies with greater human capital should benefit more from FDI. This is supported by Prasad, Rajan, and Subramanian (2007) and Batten and Vo (2009). Likewise, Blomström, Lipsey, and Zejan (1994) find no relationship between education and FDI inflows for developing countries. But other studies fail to concur: Campos and Kinoshita (2002) reestimate the model in Borensztein, De Gregorio, and Lee (1998) and find that FDI exogenously affects growth, irrespective of human capital. Li and Liu (2005) report a positive and significant effect for both developed and developing countries, and a significant role for human capital to enhance the impact of FDI.

The empirical literature seems to agree that any positive effect of FDI on growth is largest among developed countries, since they have the absorptive capacity to benefit from the foreign investment. The idea of the need for sufficient absorptive capacity is supported by research on socioeconomic conditions for R&D investment to be turned into innovation and growth (Bilbao-Osorio and Rodríguez-Pose 2004). It was expanded in the context of FDI by Hermes and Lensink (2003), who report that FDI is an insignificant determinant of growth and can only exert a positive effect when the domestic financial system has developed enough—suggesting that FDI should be more beneficial to developed economies.

Alfaro et al. (2004) support Hermes and Lensink (2003). Later studies tried to incorporate all aspects of absorptive capacity: Carkovic and Levine (2005) test the hypotheses that the effect of FDI depends on the level of human capital, domestic financial markets (Hermes and Lensink 2003; Alfaro et al. 2004), and initial income (Blomström, Lipsey, and Zejan 1994). Accounting for country-specific effects, they, however, conclude that FDI inflows do not robustly affect economic growth.

Carbonell and Werner, (2018) empirical findings show that FDI had no significant positive effect on Spanish GDP growth from 1984 to 2010, despite both high FDI and economic growth and ideal conditions for FDI to boost growth, as judged by previous literature. FDI was not a determinant of Spanish economic growth. What was beneficial for Spanish economic growth is the stimulation of productive domestic credit creation, employment, foreign demand, and education. Tax breaks and other benefits to attract FDI have been criticized by economic geographers (e.g., Zhang 2011). We find they are indeed inadvisable: Spanish policy makers had better not waste Spanish taxpayers' funds on attracting FDI and instead spend more on domestic education.

2.2.2.4 Population growth and structure

The effects of population growth on economic growth depends on the how developed a country is and the participation rate in the economy. In developed countries, stagnation in population growth may negatively affect economic growth as it is the case in Western Europe while countries with faster growing populations like Australia have maintained higher economic growth rates. On the other hand, population growth rates have been known to be an inhibiting factor in increasing GDP per Capita in developing countries hence major advances in living standards for many people in such countries depends on limiting the sizes of their families (Peterson, 2017).

The age, sex and geographical distribution of the population are also an important aspect to consider. A country with a higher percentage of a dependent population means that more resources will be devoted to caring for these people hence diverting necessary resources for investments (Peterson, *ibid*). Also, one must consider the participation rates that is, the proportion of the population which is economically active and the age of the population. A rise in this rate increases the size of the labour force.

It is determined by the extent to which the different age groups and sexes in the population are by law, customs, tradition and labour regulations and the attitudes within a society, allowed to participate in the labour market activities (Hardwick et

al, 1994). Since population growth causes an increase in the number of consumers and an expansion in the labour force, the rate of economic growth caused by population growth must exceed the rate of population growth if output per head is to be increased and hence the potential to improve on the social welfare of the society (Hardwick et al, 1994).

The relationship between population growth and growth of economic output has been studied extensively (Heady & Hodge, 2009). Many analysts believe that economic growth in high-income countries is likely to be relatively slow in coming years in part because population growth in these countries is predicted to slow considerably (Baker, Delong, & Krugman, 2005). Others argue that population growth has been and will continue to be problematic as more people inevitably use more of the finite resources available on earth, thereby reducing long-term potential growth (Linden, 2017).

Population growth affects many phenomena such as the age structure of a country's population, international migration, economic inequality, and the size of a country's work force. These factors both affect and are affected by overall economic growth. The purpose of this article is to use long-term historical data and a review of both theoretical and empirical work on the relationship among growth of population, total output and per capita output to assess the implications of their evolution for economic inequality, international migration policies, and general economic growth.

Thomas Piketty (2014) observes that economic growth. Always includes a purely demographic component and a purely economic component, and only the latter allows for an improvement in the standard of living (p. 72). Economic growth is measured by changes in a country's Gross Domestic Product (GDP) which can be decomposed into its population and economic elements by writing it as population times per capita GDP. Expressed as percentage changes, economic growth is equal to population growth plus growth in per capita GDP.

GDP is a measure of economic output and is also an indicator of national income which can be defined as total output net of capital depreciation plus net income from sources outside the country (Piketty, 2014, p. 45). Piketty (2014, p. 73) points to

evidence that average annual world economic growth between 1770 and 2012 was 1.6% made up of equal parts population growth and per capita output growth of 0.8% each. While these growth rates may appear to be very small, they can lead to impressive increases over long periods of time.

Population growth at an average annual rate of 0.8% over the period 1770 to 2015 resulted in a 12-fold increase in world population from about 600 million in 1700 to over 7.3 billion in 2015 (Maddison, 2001 and World Bank, 2017). Piketty (2014) develops a number of economic relationships to describe the workings of a capitalist economic system and traces the implications of these relationships for changes in economic inequality. The relationship between economic growth and the rate of return to capital is of central importance in his analysis. He argues that when the rate of return to capital is greater than the economic growth rate ($r > g$ in his notation), the likely result will be concentration in the ownership of capital leading to increasing inequality.

In a later article, Piketty (2015) clarifies this result noting that other factors as well as economic policies contribute importantly to the evolution of economic inequality, suggesting that large gaps between r and g will tend to amplify the effects of these other factors. This qualification does not diminish the importance of economic growth in Piketty's analysis of the causes and consequences of rising inequality. He argues that economic growth is likely to be relatively slow in the future, less than the rate of return on capital, in part because its demographic component is expected to grow very little. Baker et al. (2005) agree noting that slowing population growth in the United States is part of the reason that future U.S. economic growth will be lower than it was for most of the 20th century.

Population growth is falling in many parts of the world and once the demographic transition is completed in sub-Saharan Africa and other areas of robust population growth, world population growth will probably return to historic levels of less than 1% per year. Average annual growth in per capita output has also been fairly modest over the past 200 years accelerating during periods when very poor countries begin to catch up with more highly developed economies or when rapid productivity growth is achieved as was the case in many countries during the 20th century.

The danger of slow economic growth in Piketty's view is that the resulting concentration of capital will help to bring back the patrimonial capitalism of the 19th century when one's fortune was more effectively made by marrying an heir to great wealth than by working to develop one's talents in the service of a productive career. Piketty's explanation of the importance of economic growth is not the only possible account, of course. Economic growth is important for raising living standards around the world and the role of population growth in the evolution of living standards is a significant policy issue (see Heady & Hodge, 2009).

In addition to the potential effects of population growth on economic inequality, population and economic growth have significant impacts on such controversial topics as international migration and global resource use. In the following sections of the article, the relationships between population and economic growth are analyzed to assess the implications of their likely evolution for growing inequality around the world and for population and migration policies. There is an extensive literature on these relationships but little consensus on the actual effects of population on economic growth (Heady & Hodge, 2009).

Some authors offer theoretical arguments and empirical evidence to show that robust population growth enhances economic growth while others find evidence to support the opposite conclusion. Still others find that the effects vary with the level of a country's development, the source or nature of the population growth, or other factors that lead to non-uniform impacts. Heady and Hodge (2009) point to wide variation in empirical analyses of the link between population growth and growth in

per capita income due to different methods, control variables, and other factors. In the next section, statistical evidence on the long-term evolution of population, per capita output, and the total economic product for various regions and selected countries is laid out.

This is followed by a review of the theoretical and empirical analyses of the role of population in economic growth and a discussion of the impacts of productivity increases and international migration on economic growth. The final section summarizes the evidence on the effects of population growth on economic growth and examines the predictions that long-term economic growth will be low as countries around the world complete the demographic transition and the potential for high economic growth from low-income countries catching up with countries with more advanced technological capabilities is exhausted.

2.2.2.5 Level of education and training

It is said that the wealth of a nation lies in the skills of its population. A country must, therefore, ensure that it has adequate skills it needs to advance its economy. An investment in human capital is, therefore, a priority for the economic well-being of a country. Education is also a component in the quality of life thus those receiving higher education consume an economic product which will improve their standard of living by improving their quality of life (Eric et al, 2007).

There is also a positive feedback from improved education to greater income equality, which, in turn, is likely to favor higher rates of growth. As education becomes more broadly based, low-income people are better able to seek out economic opportunities. For example, a study of the relation between schooling, income inequality and poverty in 18 countries of Latin America in the 1980s found that one quarter of the variation in workers' incomes was accounted for by variations in schooling attainment; it concludes that 'clearly education is the variable with the strongest impact on income equality' (Psacharopoulos, 1992).

Another study suggested that a one percent increase in the labor force with at least secondary education would increase the share of income of the bottom 40 and 60% by between 6 and 15% respectively (Bourguignon and Morrison, 1990). An investigation of the determinants of income distribution in 36 countries found secondary enrolment rates to be significant (Bourguignon, 1995:53-86).

Education may affect per capita income growth via its impact on the denominator, i.e. population growth. For example, a study of fourteen African countries for the mid-eighties showed a negative correlation between female schooling and fertility in almost all countries, with primary education having a negative impact in about half the countries and no significant effects in the other half, while secondary education invariably reduced fertility (Birdsall 1995, Behrman and Wolfe 1987). The three success countries in terms of reduced fertility, Kenya, Botswana, and Zimbabwe, had the highest levels of female schooling as well as the lowest child mortality rates (Ainsworth, 1995).

Some countries have successfully combined openness and investment in learning and education, forming a virtuous circle: openness creates demand for education, and learning and education make a country's export sector more competitive. Knowledge accumulation influences a country's trade performance and competitiveness (Grossman and Helpman 1989); trade, in turn, enhances knowledge accumulation, especially through imports (Ben David and Loewy, 1995). Lucas notes that to sustain any kind of knowledge accumulation, a country has to be outward-oriented and a significant exporter. Young and Keller find that trade itself cannot be the engine of growth, but rather must operate throughout some mechanism, such as the formation of human capital, to affect growth.

A World Bank study found that economic growth rates in a sample of 60 developing countries during 1965-87 were especially high where there was a combination of a high level of education and macroeconomic stability and openness (Tilak, 1989). The impact of trade openness on long-term growth thus depends on how well people are able to absorb and use the information and technology made available through trade

and foreign investment. It is widely accepted that in order to adapt to an environment of stronger competition and to a world emphasizing the role of information, knowledge and skills, advanced economies need continuously to upgrade the overall quality of their labour force.

Conclusively, the economies of low-and middle-income countries have been growing at historically rapid rates. Progress in education-expanded enrolments and longer schooling-has contributed to this growth and so has helped to reduce poverty in developing countries. In 1990 a typical six year-old child in a developing country could expect to attend school for 8.5 years, up from 7.6 years in 1980. In Eastern Europe and central Asia schooling for 9 to 10 years is the rule; in East Asia and in Latin America and the Caribbean primary education is almost universal.

Countries in the Middle East and North Africa are making steady progress; so are those in south Asia, although they have a considerable distance to go. Sub-Saharan Africa is lagging; certain countries there are making gains, but overall, primary enrolment ratios are actually declining. Yet despite these substantial achievements in the world as a whole, major challenges remain: these are to increase access to education in some countries, to improve equity, to improve quality, and, where needed, to speed educational reform. In most countries, more children wish to go to secondary schools than are able to enrol, and the demand for higher education is in general increasing faster than the supply.

The enrolment gap between the transition economies of Europe and central Asia and the members of the OECD is also widening as enrolment ratios decline in the former and rise in the OECD countries. The issue of equity mainly affects several overlapping disadvantaged groups, including the poor, linguistic, and ethnic minorities, nomads, refugees, and street and working children. The different access that boys and girls have to the education system in some parts of the world is also very important because it contributes to gender differences later in life.

The gender gap in expected years of schooling is now very small in most countries in Europe, central Asia and in Latin America. It remains large in the Middle East and North Africa and in south Asia, where it is not closing at all. The quality of education is poor at all levels in low and middle-income countries. Students in developing countries have a mean level of achievement below that in industrial countries, and their performance shows a much greater variation around the mean. Delays in reforming education systems to keep pace with economic structures are most apparent in the transition economies of eastern and central Europe. Lags in reform can hinder growth; conversely, timely reform can pay off in terms of economic growth and poverty reduction, as evidenced by the East Asian countries that have generally invested heavily in basic human capital, both male and female.

2.2.2.6 Market liberalization and trade

A country benefits immensely by allowing free markets and by taking measures to increase international trade hence promoting liberalization. Competition in the market place encourages specialization and creates efficiency which encourages trade and investments. A government may take measures to increase the proportion of exports to imports and also employ taxation policies that will encourage market liberalization (Sinclair, 2013).

2.2.2.7 Public expenditure

There are many conflicting views regarding the effects of public expenditure on economic growth. Ghosh and Gregoriou (2008) and Benos (2009) had different outcomes even if they used the same methodology (the generalized method of moments). Ghosh and Gregoriou (2008) showed that the current component of public spending had a significant and positive effect on growth for a sample of 15 developing countries. Meanwhile, Benos (2009) affirmed that infrastructure and human capital had a significant effect on long-run growth for a group of 14 European Union (EU) states.

Lamartina and Zaghini (2008), Arpaia and Turini (2008), Szarowská (2012), tested the link between public spending and economic growth using the Wagner's law. For example, the results of the analysis made by Lamartina and Zaghini (2008) confirmed Wagner's theory, because the public expenditure elasticity coefficient compared to GDP takes values above par. The analysis also concludes that the expected long-term elasticity coefficient values are higher in countries with lower GDP per capita, suggesting an attempt to realize economic development funded by the state.

Szarowská (2012) analyzed the direct link between public spending and output (GDP) in short and long-term for Bulgaria, Czech Republic, Hungary, Romania and Slovakia and also investigated if public spending is countercyclical. Her results reject the counter-cyclical effect of the two variables. Many recent papers for the Organization for Economic Cooperation and Development (OECD), developing countries, Latin America showed that contrary to the theory, public spending is procyclical (Alesina et al. 2008; Abbott and Jones, 2011).

Benoit (1978), Pieroni (2009), Ho and Chen (2014) investigated the influence of military spending on economic growth. Many researchers concluded that defense spending has a negative effect on growth. Benoit (1798) was the pioneer in his field and found that for less developed states military spending had a positive effect on economic growth. The assumption that this component of public spending can have a positive effect depends on the samples, the different theoretical specifications and the time period. McDonald and Eger (2010) affirmed that defense expenditure had a small or rather insignificant effect on economic growth. On the other hand, Pieroni (2009), Ho and Chen (2014) concluded that military expenditure has a negative influence on economic growth.

2.2.2.8 Conclusions on economic growth

Economic growth is a powerful weapon in the fight against poverty. It leads to a transformation in the lifestyles and living standards of ordinary citizens and the technological advancements made enhance the production of new and more superior

products which improves the living standards of the citizens. Economic growth requires heavy investment of resources both in physical capital and human capital and these investments do not yield returns immediately.

Due to the scarcity of resources, sacrifices have to be made in the current period to make provision for better goods and services in the future and therefore, consumers must be willing to consume less and invest more now so as to reap greater benefits tomorrow. This is the opportunity cost and the main cost of economic growth (Lipsey and Chrystal, 2007).

The government has the responsibility of developing the framework for the economy, provide infrastructure that will support the economy and invest in capacity building. It is also responsible for designing favourable fiscal policies that will enhance economic growth and reduce poverty rates.

It is debatable whether the government should intervene directly in the market in order to boost sectors of the economy. Studies have shown that in certain instances such interventions have yielded positive results such as the Japan automobile sector, Taiwan's electronic sector and the US semiconductor industry (Lipsey and Chrystal, 2007).

2.3 Theoretical Framework

The theoretical approach adopted defines and explains the various economic theories or models that economists have used to explain the factors that really drive economic growth in a country. Taxation policies are studied for their macroeconomic effects on the economy and these theories attempt to explain what is important or necessary to improve the economy.

Exogenous theories are based on constant returns to accumulation that is, choices on investments and savings affect the long-run growth rates while neoclassical theories assume that actual output equals potential output and therefore only technology can explain the differences in the economies of various countries (Begg et al, 2005). Endogenous theory, on the other hand, explains technology advancements as part of

the growth model (Lipsey and Chrystal, 2007). Examples of economic growth theories are discussed below.

2.2.1 The Harrod-Domar Model

This model was used in development economics to explain an economy's growth rate in terms of the level of saving and capital productivity. It was developed by (Sir Roy and Domar 1946). This model was the pioneer to the exogenous growth model. It states that there are three concepts of growth which include warranted growth (output growth rate at which firms believe they have the correct amount of capital and therefore do not alter their investment levels), the natural rate of growth (rate at which the labor force grows, indicating a change in aggregate output) and actual growth (the actual aggregate output change) (Friedland and Sanders, 1985).

The model suggests that in the absence of government interventions, the growth rate of national income will directly be related to the savings ratio, therefore, the more an economy is able to save and invest, the greater the growth in GDP. It further states that the growth rate of national income will be inversely related to the economic capital-output ratio - the higher the capital is, the lower the GDP growth rate (Friedland and Sanders, *ibid*).

According to the model, there are two possible problems which can be experienced in an economy. First, the relationship between the actual and natural (population) growth rates can cause disparities between the two, as factors that determine actual growth are separate from those that determine natural growth. Factors such as birth control, culture, and general tastes determine the natural growth rate. However, other effects such as the marginal propensities to save and consume influence actual output.

There is no guarantee that an economy will achieve sufficient output growth to sustain full employment in a context of population growth. The second problem is the relationship between the actual and warranted growth. If output is expected to increase then investments will increase to meet the extra demand but when actual

growth either exceeds or fails to meet warranted growth expectations, attempts to meet the actual demand will be exaggerated causing economic instability (Todaro and Smith, 2003).

Exogenous theorists observed that countries which were able to save 15% to 20% of GDP could grow at a much faster rate than those that saved less and this growth was self-sustainable. They stated that the mechanism of economic growth and development is a matter of increasing national savings and investment (Todaro and Smith, *ibid*). A good example of a country which has achieved economic growth by encouraging savings is Singapore. However, while the model has proved valid in some economies and economic aspects, it also has its weaknesses, below are some of the model's drawbacks;

The foremost drawback of these growth models is that they are based on unrealistic and unscientific assumptions. They have assumed the key determinants such as propensity to save and capital output ratio remains constant. But in reality, they are likely to change over a long period. The changes in these ratios are the essential requirement of steady growth. Further, it is also assumed that production function is fixed and the factors of production cannot be substituted for each other, which is not possible for the steady growth of the economy. In fact, technological and organisational changes bring out the shifts in production function to a greater extent. Thus, these assumptions are not in the tune of economic development.

Yeager (1954) raised objection against the use of the concept of “natural growth rate” (G_n) in Harrod's model. He was of the opinion that ceiling limit to growth is not only determined by the available labour and natural resources as suggested by Harrod but also by the production techniques employed. Even if it is assumed that labour and natural resources are fixed, output can be raised by combining these resources with better techniques of production. It is quite possible to increase output by organisational and technological improvement even though the resources are fixed.

So, Harrod's contention that there is a ceiling on potential output put by the fixity of resources does not hold good. Yeager (ibid) has also pointed out that cumulative upward and downward movements are merely theoretical exercises which have not been supported by empirical statistical data.

The various variables used in Harrod and Domar models, are non-monetary in character. Due to this, effect of monetary factors on investment, saving and demand cannot be studied properly. In fact, investment, saving and productivity of capital variables serve as a useful tool in growth process if they are expressed in monetary terms. The operation of trade cycle depends upon these monetary factors. Therefore, the study of growth models becomes insignificant in case these variables are expressed only in real terms.

Harrod-Domar models stress the importance of economic parameters only. These models have not provided due place to the non- economic parameters such as social, political, religious factors etc. The economic factors (saving, investment, capital formation etc.) can initiate the process of economic development and non-economic factors provide the necessary stimulus for the maintenance of stable growth. Meier and Baldwin (1957) aptly remarked, "The psychological and sociological requirements of development are as important as the economic requirements."

2.2.2 Neoclassical Theory – The Solow Growth Model

It was named after Robert (Bob) Solow and Trevor Swan and was meant to demonstrate why the Harrod-Domar model was not a good model to adopt. The model states that economic growth is derived from an increase in capital and labour inputs, ideas and new technology.

He observed that a sustained rise in capital investment increases the growth rate only to a certain level then the growth rates start declining because of the law of diminishing returns that is, as the ratio of capital to labour increases, the marginal product of additional units of capital decreases and hence the economy will adjust back to a steady state growth path, with real GDP growing at the same rate as the

growth of the workforce plus a factor to reflect improving productivity (Begg et al, 2005).

A steady state of growth refers to a situation where output, capital and labour are all growing at the same rate, so output per worker and capital per worker are constant. Neo-classical theorists state that to raise the rate of economic growth, an increase in the labour supply and a higher level of productivity of labour and capital are fundamental. They further state differences in the levels of technological advancements between countries explain the variations in growth rates observed in the world today. Technological advancements not only increases incomes due to increased production but also transform lives through new product and process inventions (Lipsey and Chrystal, *ibid*).

While the Solow Growth Model is an upgrade on the The Harrod-Domar Model the model still has its weaknesses. There is the absence of an investment function in Solow's model and once it is introduced, the Harrodian problem of instability quickly reappears by the Solow model. Thus, according to Sen (1970), the assumption of substitutability between labour and capital does not seem to be a key difference between neo-classical and neo-Keynesian studies of growth, and the main difference seems to lie in the investment function and the consequent failure to assign a major role to entrepreneurial expectations about the future.

Solow assumed flexibility of factor prices which may bring difficulties in the path towards steady growth. For instance, the rate of interest may be prevented from falling below a certain minimum level due to the problem of liquidity trap. This may, in turn, prevent the capital-output ratio from rising to a level necessary for attaining the path of equilibrium growth.

The Solow model is based on the unrealistic assumption of homogeneous and malleable capital. As a matter of fact, capital goods are highly heterogeneous and thus pose the problem of aggregation. Consequently, it is not easy to arrive at the steady growth path when there are varieties of capital goods. Furthermore, Solow

leaves out the causative of technical progress and treats the latter as an exogenous factor in the growth process. He thus ignores the problems of inducing technical progress through the process of learning, investment in research, and capital accumulation.

2.2.3 Structural Change and Patterns of Development Theory – Chenery Model

The structural-change theory focuses on the mechanism by which underdeveloped economies transform their domestic economic structures from reliance on traditional subsistence agriculture to a modern, urbanized, and industrial diverse manufacturing and service economy. He observed that increased savings and investment are necessary but not sufficient conditions for economic growth.

Both human and physical capital accumulation and changes in the economic structure of a country are required for the transition from a traditional economic system to a modern one. Changes in production, consumer demand patterns, international trade, and use of available resources, urbanization, growth, and distribution of population were all considered to be necessary (Todaro and Smith, 2003).

Structural-change theorists observed that differences in development levels among developing countries are largely dependent on both domestic and international constraints. Domestic factors include economic factors such as a country's resource endowment and its physical and population size and institutional factors such as government policies and objectives.

International factors include access to external capital, technology, and international trade. He observed that to a great extent, it is the international factors that create a difference between developing and industrialized countries. The higher the ability to developing countries to access opportunities presented by the industrial countries as sources of capital, technology, and manufactured imports as well as markets for exports, the faster they can increase their economic growth rates (Todaro and Smith, *ibid*).

Although, Chenery's approach better explains the structural change model, it also has its limitations. One of the criticisms against the Chenery's structural change model is that it short-changes critical valuables judgement. Areas of market failure emanating from exploitation of static comparative advantage inferior for less developed countries to a more protective or interventionist approach which merely focuses on producing dynamic comparative advantages have been identified in Chenery's theory (Krueger, 1997).

This observation bears some relevance to the protection mechanism established under the 'Common Exchange Tariff (CET)' mechanism for ECOWAS member countries. Here, there is clause in the CET that allows Nigeria to use tariffs to protect some local industries (Echenin, 2015). In spite of these limitations, Chenery's model is useful for economic growth where different countries with varying economic systems are able to support each other in terms of economic relations. On this note, this model suits the economic development efforts of developing countries against the backdrop of globalization (Greider, 1997).

2.5 Empirical Studies

Various studies have been concluded by many researchers on tax breaks and their impact on investments and economic growth of a country that is, whether they are an effective tools for economic growth. Studies done developed countries and developing countries suggest that most countries are competing against each other in giving more attractive tax breaks so as to attract more foreign direct investments to their countries but whether or not they are meeting the intended objectives is another issue (Tax Justice Network [TJN – Africa], 2013).

In its policy studies, the U.S Treasury policy studies department (2002) observed that the effects of tax policies should be analysed within a general framework where one explicitly recognizes the effects of tax policies on the level of services demanded from the government. Tax policies affect factor prices and the allocation of resources

by the private sector and in the long run, the quantity of services demanded from the government by its citizens.

Hungerford (2012) plots the annual real per-capita GDP growth rate against the top marginal income tax rate and the top capital gains tax rate from 1945 to 2010 a period that spanned wide variation in the top rate. The fitted values suggest that higher tax rates are not associated with higher or lower real per-capita GDP growth rates to any significant degree. In multivariate regression analysis, neither the top income tax rate nor the top capital gains tax rate has a statistically significant association with the real GDP growth rate. An obvious caveat to this result is that the share of households facing the top rate is generally quite small. However, historically, the highest several marginal tax rates were moved together, so that changes in the top rate per se proxy for changes in a broader set of higher tax rates that do affect many taxpayers.

To be clear, many factors affect economic growth rates. Nonetheless, if taxes were as crucial to long-term growth as is sometimes claimed, the large historical increases in tax burdens and marginal tax rates that occurred between World War I and the end of World War II, as well as the historic reduction in top marginal income tax rates that has occurred since then, might be expected to affect the aggregate growth rate of the economy. Among developed countries (Slemrod 1995). Countries vary, of course, not just in their level of revenues and spending, but also in the composition of taxes and outlays. Nevertheless, a large literature has developed aiming to compare tax effects across countries.

Evidence shows that pooling data from developed and developing countries is inappropriate because the growth processes differ (Garrison and Lee 1992; Grier and Tullock 1989) and that taxes have little or no effect on economic growth in developed countries. Mendoza et al. (1997) and Garrison and Lee (1992) find no tax effects on growth in developed countries. Padovano and Galli (2001) find that a 10 percentage point reduction in marginal tax rates raises the growth rate by 0.11 percentage points in OECD countries. Engen and Skinner (1992) find significant

effects of taxes on growth in a sample of 107 countries, but the tax effects are tiny and insignificant when estimated only on developed countries.

Piketty, Saez, and Stantcheva (2014) look at evidence from 18 OECD countries on tax rates and economic growth for the 1960-2010 time periods, taken from their study, conveys the idea that there is little correlation between growth in real GDP per capita and the drop in the top marginal rate for the 1960-2010. Their regression analysis confirms this result. Thus, a reasonable summary from the simple correlations of economic growth and income tax policy over long periods is that the presence of strong tax effects on economic growth is hard to reconcile with observations from the U.S. historical record and international comparisons.

Ultimately, the impact of specific tax changes on the size of the economy is an empirical question. Rigorous empirical studies of actual U.S. tax changes are relatively rare, however, for several reasons. First, the U.S. has only had a few major tax policy changes over the past 50 years. Second, most major tax changes alter many features of the code simultaneously. Third, it is difficult to isolate the impact of tax changes relative to other changes in policy and the economy, an issue addressed directly in the following section.

In this section, we review studies of specific tax policy changes. It is worth noting that historical reforms do not represent pure textbook tax reform efforts, since they all took place in the real world, subject to the compromises that the political process imposes. However, future tax reforms will also be affected by political factors, so the history of reform efforts and their effects is relevant. Several studies have aimed to disentangle the impact of the major tax cuts that occurred in 1981, 2001, and 2003, as well as the tax increases that occurred in 1990 and 1993. The Economic Recovery Act of 1981 (ERTA) included a 23 percent across-the-board reduction in personal income tax rates, a deduction for two-earner families, expanded IRAs, numerous reductions in capital income taxes, and indexed the income tax brackets for inflation.

Many features of ERTA, particularly some of the subsidies for capital income, were trimmed back in the 1982 and 1984 tax acts. Feldstein (1986) provides estimates indicating that all of the growth of nominal GNP between 1981 and 1985 can be explained by changes in monetary policy. Of the change in real GNP during that period, he finds that only about 2 percentage points of the 15 percentage point rise cannot be explained by monetary policy. But he also notes that the data do not strongly support either the traditional Keynesian view that the tax cuts significantly raise aggregate demand or traditional supply-side claims that they significantly increase labor supply. He finds, rather, that exchange rate changes and the induced changes in net exports account for the small part of growth not explained by monetary policy. Feldstein and Elmendorf (1989) find that the 1981 tax cuts had virtually no net impact on economic growth. They find that the strength of the recovery over the 1980s could be ascribed to monetary policy. In particular, they find no evidence that the tax cuts in 1981 stimulated labor supply.

A Center on Budget and Policy Priorities study looks at the relationship between the 1993 tax hikes and the 2001 tax cuts with respect to employment and GDP growth over the periods following the respective reforms (Huang 2012). Job creation and economic growth were significantly stronger in the years following the marginal income tax increases enacted in 1993 (the top marginal tax rate went up from 31 percent to 39.6 percent) than they were following the 2001 tax cuts (described below). While correlation does not imply causation, and while the 1993 and 2001 tax changes occurred at different times in the business cycle, making comparisons between the two of them more difficult, the evidence presented above at the very least discredits the argument that higher growth cannot take place during a period of higher tax rates.

The tax cuts in 2001 (The Economic Growth and Tax Relief Reconciliation Act of 2001, or EGTRRA) reduced income tax rates, phased out and temporarily eliminated the estate tax, expanded the child credit, and made other changes. The 2003 tax cut (The Jobs and Growth Tax Relief Reconciliation Act of 2003 or JGTRRA) reduced rates on dividends and capital gains. A variety of forms of evidence suggest that the

impact on growth of these changes was negligible. A cursory look at growth between 2001 and 2007 (before the onset of the Great Recession) suggests that overall growth rate was both mediocre – real per-capita income grew at an annual rate of 1.5 percent during that period, compared to 2.3 percent from 1950 to 2001 – and was concentrated in housing and finance, two sectors that were not favored by the tax cuts. There is, in short, no first-order evidence in the aggregate data that these tax cuts generated growth.

Gale and Potter (2002) estimate that the 2001 tax cut would have little or no net effect on GDP over the next 10 years and could have even reduced it; that is, they find that the negative effect of higher deficits and the decline in national saving would outweigh the positive effect of reduced marginal tax rates. The intuition behind these results is noteworthy. Gale and Potter (2002) do not show that reductions in tax rates have no effect, or negative effects, on economic behavior. Rather, the improved incentives of reduced tax rates analysed in isolation increase economic activity by raising labor supply, human capital, and private saving.

Indeed, these factors are estimated to increase the size of the economy in 2011 by almost 1 percent. But EGTRRA and JGTRRA were sets of tax incentives financed by increased deficits. The key point is that the tax cut reduced public saving (through higher deficits) by more than it increased private saving. As a result, national saving fell, which reduced the capital stock, even after adjusting for international capital flows, and lowered GDP and GNP. Thus, the effects on the deficit are central to the findings.

Based on analysis in Gale and Potter (2002) and Gale and Orszag (2005), the 2001 tax cut raised the cost of capital for investments in residential housing, sole proprietorships, and corporate structures because the higher deficits raised interest rates. By contrast, the cost of capital for corporate equipment fell slightly because the tax act also contained provisions for bonus depreciation that more than offset the rise in interest rates. It might also be thought that the 2003 tax cut would have more beneficial effects on investment, since it focused on dividend and capital gains tax

cuts, but Desai and Goolsbee (2004) argue that the effects were likely to be small and Yagan (2015) presents empirical evidence that the 2003 tax cuts had little impact on investment or employment.

An admittedly less than fully scientific source of evidence is simply asking economists what they think. In a survey of 134 public finance and labor economists, the estimated median effect of the Tax Reform Act of 1986 on the long-term size of the economy was 1 percent (Fuchs et al. 1998). Note that TRA 86 did not reduce public saving, so the growth effect was entirely due to changes in marginal tax rates and the tax base. The median response also suggested that the 1993 tax increases had no effect on economic growth.

The 1993 act raised tax rates on the highest income households, but also reduced the deficit and thereby increased national saving. One strong finding from all of the analysis is that not all tax changes will have the same impact on growth. Reforms that improve incentives, reduce existing subsidies, avoid windfall gains, and avoid deficit financing will have more auspicious effects on the long-term size of the economy, but in some cases may also create trade-offs between equity and efficiency. These findings illustrate both the potential benefits and the potential perils of income tax reform on long-term economic growth.

A study by Inter American Centre of Tax Administrations [CIAT] (2011) on tax and development established that inadequate attention has been paid to the cost effectiveness of the various tax breaks offered in terms of the overall impact on tax revenues lost, credibility and economic sustainability of the tax system and therefore the tax policy and risks of corruption. It established that improved transparency in the provision and delivery of tax breaks for investment may help increase governments fiscal accountability and rationalize the use of such incentives.

This will also help in improving investor and taxpayer confidence in the system, support good governance, reduce lobbying pressures for increased or new incentives, and promote economic development.

An investment policy study conducted in Botswana by the OECD (2003) on its investment policy supports the view that tax breaks are not a major FDI attraction factor. Botswana was one of the poorest countries of the world but after few decades it had one of the fastest economic growth rates in the world and its now an upper middle-income developing economy with its growth progress catalysed by the discovery of rich and profitable deposits of diamonds in 1967, which initiated a process of structural change that is, from an economy heavily dependent on low productivity in agriculture to an economy dependant on mining and services sectors.

Its growth performance is owed to the good management of natural resources and good governance which have created a good and stable political and economic environment. Most of its mineral revenue, as well as foreign aid, was invested in health, education and infrastructure which created proper foundations for long-term growth and also a strong saving culture was established for any excesses and this has ensured a long-term macroeconomic environment conducive to a sound investment climate, a rare fete for any developing country.

The Financial Assistance Policy was the main incentive that the Botswana government offered to investors which provided financial grants to encourage investment and employment in non-traditional sectors. Initially, the scheme focused on manufacturing and non-traditional agriculture but expanded over the years to include tourism, small-scale mining and related service businesses. This program was, however, abolished in the year 2000, following a highly critical evaluation of its rationale, effectiveness, and administration.

It was established that fewer than 40% of medium and large-scale projects receiving grants were either 100 percent foreign-owned or joint ventures and that the scheme was too generous and was bound to attract unscrupulous investors who could not be identified through evaluation procedures. Evaluation of the incentive scheme found little evidence that the FAP grants were a crucial factor in attracting foreign investors although one investor found the scheme to be very helpful in providing working capital during a period of rapid growth (UNCTAD, 2003).

A study done by Graduate Institute for Policy Studies-GRIPS (2006) on Public Finance Policy in developing nations showed that although MNCs contribute to government revenue in form of taxes, they generally tend to pay much less than what they ought to pay due to long tax concession periods, transfer pricing practices, huge investment allowances, disguised public subsidies and tariff protection from the government.

These companies use their economic power to lobby for policies that are unfavourable for development and they can avoid local taxation and shift profits to affiliates in low tax jurisdictions. This has a negative effect on the revenues collected by the government from taxation and therefore developing countries are unable to effectively fund their development goals.

A study done by GRIPS (2006) on Public Finance policies in Ethiopia showed that countries which strive to be self-sustaining and focus on growing their economies can achieve excellent results in growth and development. A study showed that in contrast to donor- driven decentralization of investment programs, the country has developed clear internally determined policies defined by the government and supported by the constitution which has provided for clear regional responsibilities, revenue bases and enhanced capacity building to spur economic growth.

This has ensured that although functions have been decentralized to all regions, the revenue base is well expanded and there are clear guidelines in revenue collections hence it is possible to meet financial requirements for development agenda set for each region. This has definitely helped as the country has one of the fastest growing economies in the world.

The OECD (2007), research on tax breaks and FDI performance in the Middle East and North Africa (MENA) region showed that there is various tax breaks offered in MENA countries. The research established that tax breaks were not very effective in attracting investment but rather, investors preferred transparency, simplicity, stability

and certainty in taxation policies. The ability of tax breaks to attract foreign investment is relatively low compared to the possible negative effects.

There are more efficient and effective alternative ways to increase investments and achieve economic growth rather than focusing on tax breaks like increase spending on human capital in a country (Beardshaw et al, 2001). The Inter American Centre of Tax Administrations (CIAT) task force on Tax and Development suggested that tax breaks erode the revenue base for developing countries reducing significantly the resources available for public investment on infrastructure, education and security, factors that are considered to be key drivers in making decisions on the location of investments. The report established that developing countries are responding to pressure from investors and other competing nations in giving tax breaks and the result is often a race to the bottom, in which countries in a region are made collectively worse off, possibly to the benefit of investors, findings also supported by Irish, (1978).

In its research on Tax breaks for investments in MENA and Non- MENA countries, The OECD (2007), established that generous tax breaks cannot compensate for a poor business environment. Where in particular, there is a lack of good infrastructures such as transport, unreliable and expensive electricity supply, and poor education, economic growth is bound to be very slow and most tax breaks offered will mainly erode the tax base, resulting in low tax revenues rather than increase the flow of investments to a country.

Mauritius, Costa Rica, Ireland and Malaysia were examples of countries which were able to attract investments without giving tax breaks and instead focused on ensuring stable economic and political conditions, a well-educated labor force, good infrastructure, open trade for exporters, dependable rule of law, and effective investment promotion systems to attract investors. This also has been supported strongly by policy reviews done in countries which have been able to change their investment strategies and spur economic growth a good example being Botswana.

Mozambique has long used tax breaks as a tool to promote national investment and attract foreign investors with the most notable investment incentive being the reduced corporate tax rate given to Mozal Aluminium Smelter in the late 1990s which included a one per cent tax on turnover instead of the standard 32% tax on income and a full exemption from custom duties, sales and circulation tax. A study by UNCTAD (2012) revealed that the government had initiated measures to rationalize tax breaks, broaden the tax base and improve tax administration.

This strategy seemed to work as the country succeeded in increasing the tax to GDP ratio from 12.2% in 2005 to 17.5% in 2010, which compared relatively well with other similar countries. The Government initiated the review of the tax policy in order to provide an enabling tax regime for investment and rationalize tax breaks. It intends to do strict cost –benefit analysis when offering tax breaks and use tax breaks selectively as a means to achieve well-defined industrial policies objectives and meet development goals. The large number of sector- based incentives has the potential to distort market mechanisms and investment decisions.

A study conducted by the Action aid group (2012) in Zambia on The human cost of a British sugar giant avoiding taxes in southern Africa proved that Zambia was a mirror of a problem present across Africa and beyond, where countries both rich and poor, are struggling to tax globally mobile profits and capital and giving special tax breaks to investors, and as a result they are losing tax revenues that might otherwise be available for the fight against poverty.

The study stated that Zambia grants large capital allowances which allow major investors to deduct much of the value of the new plant, buildings, and equipment from their taxable profits. An example was the giant Zambia sugar Factory which over the years has tripled its sugar exports since 2010, its revenues have risen 250% in the past five years, and its operating profits have increased significantly yet the company pays very little in corporate taxes.

It was established by the same study that the company had paid to the Zambian Revenue Authority on average taxes of about 0.5% of its pre-tax profits – an average of less than ZK450 million (US\$90,000) a year which is significantly less than the 35% corporate tax rate. Between 2008 and 2010 Zambia Sugar Plc made no corporate income tax payments at all, although it continued to report tax liabilities. The company did further state that it was due to its expansion projects and the availability of substantial capital allowances that led to virtually no corporate tax being paid.

The company had also negotiated for two special tax breaks which entitled them to huge tax refunds, and for years to come will actually bring the Zambian tax rate applied to this highly profitable company below the tax rate even in some tax havens. The government has, however, initiated policies to limit its revenue losses by reducing extreme generous capital allowances, particularly in the mining sector which is the first step in its review of tax breaks and tax breaks granted to big companies across all sectors. Considering the poverty levels in the country, the revenues could go a long way in enabling the country to meet some of its development goals (Action aid group, *ibid*).

A study by the TJN– Africa (*ibid*), on tax completion in East Africa indicated that Kenya, offered more tax breaks than its neighboring countries, however, it still received less FDI flows than any of those countries. Furthermore, the study established that the Kenyan government is losing over Kenyan Shillings 100 billion (US\$ 1.1 billion) a year from tax breaks and exemptions with trade-related tax breaks accounting for at least Kenya Shillings 12 billion (US\$ 133 million) in 2007/08.

TJN's study indicated that the country is, therefore, denied resources urgently needed to reduce poverty and improve the general welfare of its citizens. In 2010/11, the government spent more than twice the amount on providing tax breaks (using the figure of Kenya Shillings 100 billion) than on the country's health budget. This is a serious situation when 46% of Kenya's 40 million people live below the poverty line.

It is important for a country to pay attention to other factors that affect the flow of investments rather than focusing only on tax breaks.

Just as it was established that Kenya lost billions annually because of tax breaks, in Tanzania too it was established that in 2009/10 alone, 2.3 percent of GDP or TZS 695 billion was granted in tax breaks. In 2005/06 it lost TZS 772 billion (Osoro et al., 2009). It is the opinion of the researcher that the sheer size of the amount involved should raise questions about the purpose these tax breaks serve. Could it be that tax exemptions are too high for a country that is struggling to collect sufficient resources to finance its budget? Could it be that Tanzania would be better off if fewer tax exemptions were granted and more money was spent on health, water or education? And why is information on who benefits not publicly available?

The use of tax breaks will continue in most developing because many countries feel that failure to offer them will have an adverse effect on FDI flows because the same incentives are also widely available in other developing countries and also because tax breaks appear to offer the simplest feasible way of attracting foreign investments irrespective of the cost implications (Irish, 1978).

However, the Kenyan government has recognized that the current level of tax breaks present a problem and has committed to rationalize and reducing them. This is best demonstrated by recent amendments to the VAT Act which removed most of the tax breaks except on some machinery, agricultural produce, basic commodities, and exports. This definitely is a good place to start just as it was the case when VAT was first introduced into law with very few zero-rated items as it will enable the government seal the many loopholes in revenue collection and increase the tax base and revenue collections (Action Aid, 2013).

One should hope that all the other developing African countries including Tanzania takes a hint of what Kenya has introduced, so that to model it and seal loopholes that keep draining the country rather than enriching it. If countries are to eradicate poverty and hunger, then they will need to do so by increasing their own public

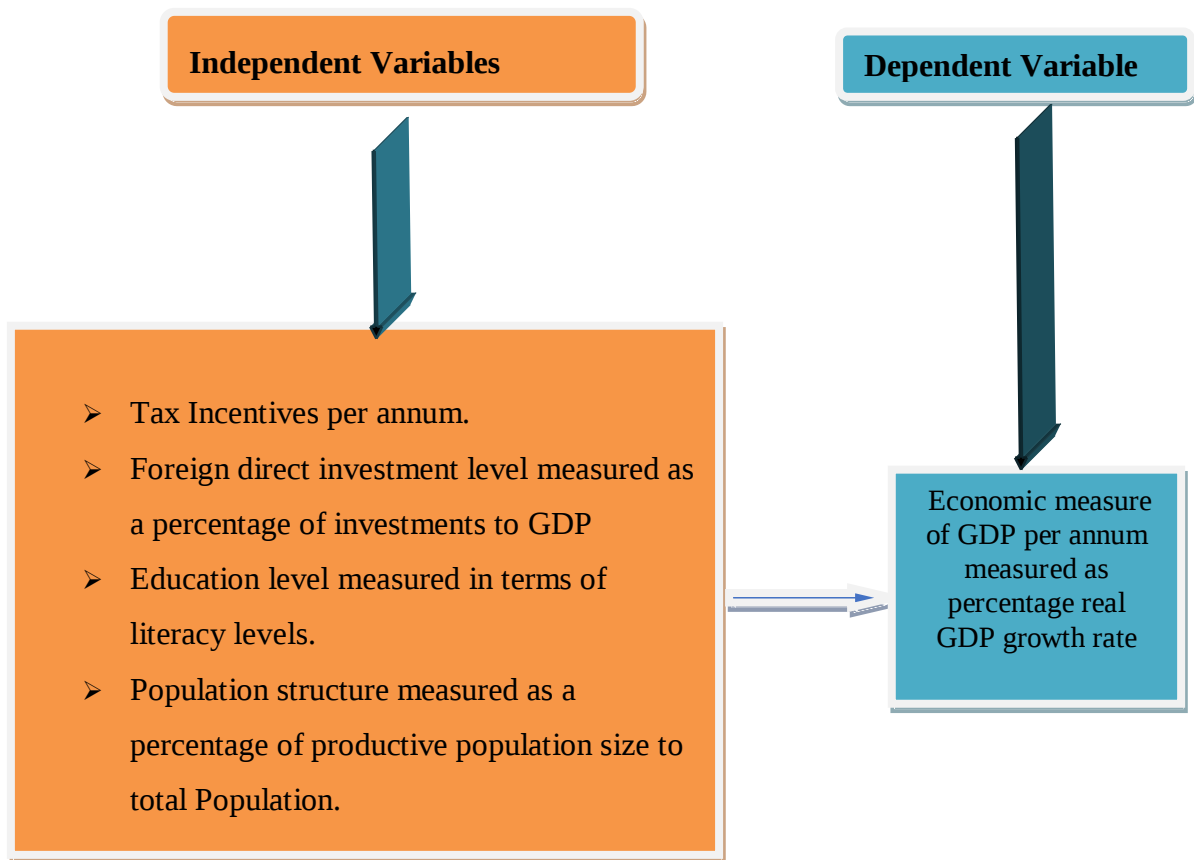
finances mainly through increased tax revenues. Poverty cannot be eradicated if developing countries are unable to raise adequate revenues to provide for the needs of their own citizens and drive economic growth in their own countries (Action aid, *ibid*).

2.6 Conceptual Framework

A conceptual framework is an analytical tool with several variations and contexts. It is utilized to make conceptual qualification and compose thoughts (Kenneth, 2005). It is an abstract indication of how fundamental ideas and constructs are relied upon to collaborate in the real setting, and the encounters that shape the establishment of the exploration. It is concerned about the way thoughts are sorted out to accomplish an undertaking reason. The point of this segment is to build up an incorporated reasonable model to break down the variables of the investigation.

Accordingly, based on what have been understood from theoretical and empirical reviews, the conceptual framework has been developed and was used to guide the study based on the tax-breaks as independent variables and economic growth of Tanzania as a dependent variables.

Figure 2. 1: A Conceptual Framework for the Study



Source: Researcher's Construct (2019)

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

A research methodology is a framework through which the research is carried out, it lays-down the guidelines for data collection and analysis. It is in this chapter where the target population is sample size is defined, an area of the study identified, data collection and analysis instruments chosen, and the research approach in collecting and analyzing the data defined.

3.2 Type of the study

This study adopted both qualitative and quantitative research approach in order to adequately answer the research questions, it employed qualitative since it wanted to capture words such as the types of tax-breaks being granted by Tanzania rather than collecting numbers (Fellows & Liu, 2003). Moreover, the study also employed quantitative approach since it involved collecting quantitative data (numbers) rather than words. In addition the study involved examining the relationship among variables using a model developed from a theory, the variables were measured and the numbers analyzed through a statistical procedure, consistent with what quantitative research is (Fellows & Liu, *ibid*).

Therefore, both qualitative, and quantitative research approaches were connectively applied in light of the fact that when connected together they supplement each other, subsequently, beating the shortcomings that both of the two methodologies may exhibit when used individually (Jonson & Owuegbnzie, 2004).

3.3 Study area

The study area for this research was Dar es Salaam city, Dar es Salaam was selected because the sources of a bulk of the data needed for this study are located in Dar es Salaam. Additionally, because the researcher for this study lives and works in Dar es Salaam it was easier and convenient to schedule data collection activities without

affecting other work related activities, this would not have been the case had the researcher used a different area for the study.

3.4 Study population

This study collected data that were readily documented at TRA, so it did not involve dealing with a specific population.

3.5 Variables and their measurements

3.5.1 Dependent Variable

Economic growth rate; represented by Growth domestic products rate (GDP). GDP is an indicator of the country's economic performance; On average, higher GDP indicates the country is increasing the amount of production that is taking place in the economy and the citizens have a higher income and hence are spending more. A similar measure was used as a representative of economic growth rate in other studies (Otinga, 2009) on the relationship between tax-breaks and economic growth.

3.5.2 Independent Variable

Tax-breaks is measured as the total tax-breaks granted per annum, foreign direct investment level is measured as a percentage of investments to GDP, education level measured in terms of literacy levels, population structure is measured as a percentage of productive population size to total Population,

3.6 Types and sources of data

3.6.1: Types of data

The study collected annual time series secondary data from year 2006 and 2017 on tax breaks granted per annum, foreign direct investment level measured as a percentage of investments to GDP, education level measured in terms of literacy levels, population structure measured as a percentage of productive population size to total Population, and economic growth rate measured as GDP rate per annum. The selection of this period was based on the availability of data.

3.6.2: Sources of Data

The bulk of the time series data collected for this study were from TRA whereby all tax-breaks data were obtained, TIC whereby data on FDI were obtained, NBS whereby data on population were obtained and The BOT whereby data on GDP rate were obtained. However, with the exception of tax-breaks data from TRA, not all data, for each variable in every year could be obtained from the respective sources indicated above as a result the study also used the World Bank database to collect the data that missed in the initial sources.

3.7 Data collection methods

This study only employed desk review in collecting the data needed to answer the research questions. The study used desk research because the data needed for this study were readily documented and could be obtained from the sources identified or through the internet. Because desk review can collect secondary data from sources such as libraries, the internet, published reports and statistics and reviewing relevant documents. Desk research is a quick method of collecting information; this is because some of the most consuming steps of normal researches for example survey researches are significantly reduced as data is already gathered (Doolan and Froelicher, 2009). This method is easier than field research since all the information needed is already published, it is cost-effective and convenient since someone else has already collected the data, and the researcher does not have to devote many financial resources to the collection of data.

3.8 Data analysis

Once the data were edited and coded to make it uniform and easy to analyse, the study employed computer software known as Gretl and Microsoft Excel to analyse the data. Gretl was used since is the best statistical software in reducing/eliminating errors in calculations, decoding variables and providing graphical utilities very efficiently. Graphs and charts derived from the statistical data were used in interpreting the data. Correlation analysis was used to show whether and how strongly tax breaks and economic growth are related while regression analysis was used to measure the nature of relationship between tax breaks and economic growth.

3.8.1 Model Development

Multiple linear regressions were applied to examine whether tax-breaks indeed influence economic growth of Tanzania. The study adopted Solow (1957) growth model for determining the economy's output. The Solow Growth Model is an exogenous model of economic growth that analyses changes in the level of output in an economy over time as a result of changes in labor, capital, and the rate of technological progress.

The model is in the form: $Y = F(K, AL)$.

Whereby,

Y = An economy's gross domestic product (GDP), K stands for its share of capital, L describes the amount of unskilled labor in an economy and A represents a technology level.

It is from the above function that the economic model for this study is derived into the form below;

Regression model: $Y = \beta_0 + \beta_1 \text{TAXIN}_1 + \beta_2 \text{FDI}_2 + \beta_3 \text{EDULV}_3 + \beta_4 \text{POPLN}_4 + \varepsilon$

Where Y (the dependant variable) = Economic measure of GDP per annum measured as percentage real GDP growth rate TAXIN_1 = Tax breaks per annum FDI_2 = Foreign direct investment (FDI) level measured as a percentage of investments to GDP, EDULV_3 = Education level measured in terms of literacy rate, POPLN_4 = Population structure measured as a percentage of productive population size to total Population. $\beta_0, \beta_1, \beta_2, \beta_3$, and β_4 , = the parameters to be estimated ε = the random error term.

3.9 Validity and Reliability

3.9.1 Validity

To measure the degree by which the researcher obtained the relevant variables to strongly answer the research questions, the researcher reviewed several literatures to ensure the right variables were selected as well as the methods used

to get those answers were the correct one; in addition, the researcher collected data over a long enough period to ensure the answers provided are valid.

3.9.2 Reliability

To measure the reliability of secondary data for this research, the researcher made sure to collect data from only reliable and reputable sources which are government institutions of respective countries, i.e. central banks and national statistics bureaus as well as worldwide reliable sources such as the World Bank and world trade organization. Since reliability relates to the consistency of a measure, the study also used the World Bank, the world trade organizations and the like to get data about international trade as well as economic growth, and hence the data obtained from the government institutions were consistent with those from the worldwide organizations such as the World Bank.

3.10 Ethical issues

The main ethical issues with using secondary data are confidentiality and security. For the data obtained from government agencies the researcher hand delivered a request letter to the government agencies (TRA, TIC, NBS) from which most of the data used for the research was collected. The letter assured them of the importance of the study and that the data was not to be abused in any way but rather only be used for the intended academic purpose. However, since this study used desk research to collect data from both the selected sources and the internet. For the data that were obtained from the internet, they are covered by implied permission (implied consent) as long as the original ownership of the data is acknowledged. By implied permission it means the authors by uploading their work online have implied that other people have consent to use the documents (Nijhawan, 2013).

CHAPTER FOUR

PRESENTATIONS OF FINDINGS

4.1 Introduction

This chapter presents the analysis of the findings with regards to the effect of tax breaks on economic growth of Tanzania. The analysis of the findings presented in this study were dependent on the objectives of the study as laid down in chapter one..

4.2 Tax breaks being granted in Tanzania

The following were identified as tax breaks /breaks that have been granted for the past 20 years in Tanzania.

Tanzania grants a number of tax exemptions to various groups, the beneficiaries of these exemptions are the government institutions, parastatal organizations, religious institutions, Non-Governmental Organizations (NGOs), Foreign Embassies/UN, Military duty free shop, Donor Funded Projects (DFP), private companies and individuals, mining sector, Oil/Gas exploration. Additionally, Tanzania Investment Centre (TIC) also grants incentives in order to attract domestic as well as foreign investors. Furthermore, domestically, there are VAT relief granted under 3rd Schedule – VAT Act Cap 148.

In detail, the tax exemptions and rebates granted in Tanzania include; Goods for the government of Tanzania mainland and Zanzibar, goods for the president of the united republic of Tanzania and president of Zanzibar, materials/equipment for technical assistance projects, goods for personal technical assistance projects, importation of goods for Red Cross, personal effects, such as firearm of a person changing residence to Tanzania, importation of deceased used personal effects, importation by reg. foreign embassies/UN/specialised agencies, imports by high officials of UN/embassies/specialised agencies, importation of Paper/paperboard by manufacturers of Exercise Books under duty imports of MV, controls and equipment for disabled persons, imports of aircraft engine/parts (TRA, 2019)

Others includes; importation of unassembled kits by local approved m/bicycle assembler, importation of goods import duty exempted, imports/acquisition capital good by investors in the priority sectors, imports by mining co's/subcontractors after 1st anniversary of produce, importation of capital goods by investors in the lead sectors, imports of industrial sugar by licenced manufacturing companies, importation of equipment's/inputs for use oil/gas/geothermal exploration, importation of Gap Sugar approved by Sugar Board Tanzania, import of packing materials for export goods where import duty not paid, imports of goods not elsewhere specified all duty/taxes exempt/relief, importation of goods under EPZ Exempt. Facility only imports duty exempt (TRA, ibid)

Furthermore, there is importation of goods under EPZ Exempt. Facility only import duty & VAT exempt. Import of MV/Cycle by public official under TVS, imports of goods by religious under Treasury Voucher System, importation of capital/deemed goods by new TIC investors, importation of goods where ID exempt, and VAT partial relief, mining companies under ESCROW, importation of capital goods by generic description, importation of capital goods/deemed goods by new TIC investors, importation of goods by Non-Government Organizations under TVS, and importation of specially designed and built for transportation tourist (TRA, ibid)

4.3 Descriptive Statistics Summary

The summarized descriptive statistics results of the variables is presented in Table 4.2 below, discussion of the presented results will be done in chapter 5.

Table 4. 1: Summarized Descriptive Statistics of independent and dependent Variables.

Variable	Mean	S.D.	Min	Max
GDPAnnual Rate	6.66	1.11	4.66	8.46
Education Level	73.9	4.09	68.0	80.3
FDI Level	3.43	1.12	1.80	5.70
TaxIncentives Trillions	0.895	0.562	0.201	1.83
Productive Population	23.6M	4.09M	17.8M	30.7M
Note; the observation period is between 2000 - 2018				

Source: Researchers' computations (2019)

As it can be seen from table 4.1 above, the finding shows GDP mean is 6.66%, and standard deviation is 1.11%, the mean of Education or Literacy rate is 73.9%, and the standard deviation is 4.09%, the mean for FDI Level is 3.43%, and the standard deviation is 1.12%. The mean value of Tax incentive/break is 0.895 Trillion and the standard deviation is 0.562. The mean value of productive population is 23.6M, and the standard deviation is 4.09M. The highest GDP of Tanzania was 8.46 and lowest was 4.66, the highest literacy rate was 80.3% while the lowest rate was 68%, the highest FDI level was 5.7% and the lowest was 1.8, the highest tax incentive amounted to 1.83 Trillion and the lowest was 0.201 Trillion, the highest productive population was 30.7 Million and the lowest was 17.8 Million.

4.3 Correlation Analysis

Table 4.3 below, shows the Pearson correlation coefficient as generated from the data.

Table 4. 2: Pearson Correlation Coefficient

GDPAnnualRate	EducationLevel	FDILevel	TaxIncentivesTrillions	ProductivePopulation	
1.0000	0.2367	-0.1017	0.0265	0.1513	GDPAnnualRate
	1.0000	-0.4234	0.4412	0.5576	EducationLevel
		1.0000	0.1104	-0.1446	FDILevel
			1.0000	0.7940	TaxIncentivesTrillions
				1.0000	ProductivePopulation
Note: Correlation coefficients, using the observations 2000 – 2018, 5% critical value (two-tailed) = 0.4555 for n = 19, the correlation coefficient (r) lies between -1 and 1 ($-1 \leq r \leq 1$)					

Source: Researchers' computations (2019), using data from World Bank database, NBS

As shown in table 4.3 in this case GDP, and literacy rate, tax incentive per annum, productive population size, FDI level. The findings presented indicated that tax incentive is weakly positively associated with GDP at 0.03, literacy rate is moderately positively associated with GDP at 0.24, and productive population size is weakly positively associated with GDP at 0.15, and FDI level is weakly negatively associated with GDP at 0.10.

4.4 Panel Data Estimations Findings

While two methods of estimation was run to estimate the data i.e. OLS, and logistic regression, logistic regression was deemed more appropriate since work of literature have shown it to be more appropriate for estimating time series data .

Table 4. 3: Estimation Findings on effect of Tax breaks on GDP in Tanzania.

Regressors	OLS			LOGISTIC		
	<i>Coefficient</i>	<i>Std. Error</i>	<i>p-value</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>p-value</i>
const	0.072	7.147	0.992	-3.831	1.191	0.006 ***
EducationLevel	0.071	0.094	0.465	0.012	0.016	0.460
FDIlevel	0.077	0.308	0.8057	0.016	0.051	0.759
TaxIncentivesTrillions	-0.593	0.912	0.5263	-0.113	0.152	0.471
ProductivePopulation	6.967e-08	1.273e-07	0.5927	1.461e-08	2.12e-08	0.502
Note: Observations time from 2000 - 2018 and Dependent variable is GDP. ***, ** and * shows the statistical significance of the coefficient estimates of that particular variable at 1%, 5% and 10% respectively. Other Important Statistics For OLS, R-squared = 0.084 and Adjusted R-squared = -0.177. and for LOGISTIC R-squared = 0.099 and Adjusted R-squared = -0.157						

Source: Researchers' computations (2019), using data from World Bank data base, NBS

From the table above, the coefficient estimate of tax incentive to GDP being is positive 0.113 and p-value =0.5, this means that there is an insignificant relationship between tax incentive and GDP, whereby for every one unit increase in tax incentive, GDP decreases by 0. 113, or for 100% increase in tax incentive rate, GDP decreases by 11.3%. Furthermore, the table indicate a positive yet insignificant coefficient between FDI and GDP whereby a unit increases in FDI increases the GDP by 0.012.

The coefficient estimate of education level to GDP is (0.012) and (p-value = 0.46), this means that there is an insignificant positive relationship between tax incentive and GDP whereby for every one unit increase in education level, GDP also increases by 0. 012.

The coefficient estimate of productive population to GDP is (2.12e-08) and (p-value = 0.502), this means that there is an insignificant positive relationship between productive population and GDP whereby for every one unit increase in productive population GDP also increases by 2.12e-08.

CHAPTER FIVE

DISCUSSION OF FINDINGS

5.1 Introduction

While chapter four focused more on the presentation of the findings, this chapter brings forth the discussion of the findings presented in the previous chapter to validate the research objectives.

5.2 Discussions of Major Findings

5.2.1 Tax breaks being granted in Tanzania

Several exemptions being granted by Tanzania were presented in chapter four, Tanzania the main beneficiaries of these exemptions are the government institutions, parastatal organizations, religious institutions, Non-Governmental Organizations (NGOs), Foreign Embassies/UN, Military duty free shop, Donor Funded Projects (DFP), private companies and individuals, mining sector, Oil/Gas exploration, and other investors foreign and domestic who deal with TIC. As it can be seen, most of the exemptions do not even have economic ramifications, so the notion that incentive is for attracting investors with the long term benefits in mind does not hold a lot of weight.

In addition to the fact that an examination of the incentives being granted have revealed a large part of the incentives have no economic impact, studies have revealed that tax breaks is not the very effective means of attracting investment but rather, transparency, simplicity in starting and doing business in a country, political and economic stability and certainty in taxation policies. Furthermore, a study by The Inter American Centre of Tax Administrations (CIAT) task force on Tax and Development reports that tax breaks erode the revenue base for developing countries reducing significantly the resources available for public investment on infrastructure, education and security, factors that are considered to be key drivers for investors in making decisions on the location of investments.

5.2.2 Discussion of Descriptive Statistics Summary

The mean value on Growth Domestic Product is 6.66%, this mean value is within the acceptable level since according to Amadeo, (2019). For developed countries the acceptable level of GDP growth is between 2% and 3%, on the other hand, for developing countries like Tanzania the acceptable level of GDP rate is slightly higher (5% - 8%). The slightly higher GDP rate for developing countries is attributed to the fact that developing countries are starting from a lower base income level than their developed country counterparts.

Then there is also the presence of Official Development Assistance (ODA) from developed to developing countries; higher population growth rates in developing countries; and the general shift of labour from agriculture to faster growing service and industries that's taking place in developing countries. Foreign Direct Investments (FDI) is also growing faster into developing countries than into developed economies. General trade liberalization is also helping developing countries.

The standard deviation for GDP rate is 1.11%, this means most of the observations are spread-out within 0.56% standard deviations on each side of the mean. This shows in line with the average GDP being within the acceptable level, there is also a small difference (dispersion) in GDP from one year to the next, this further, indicates that the economy of Tanzania has been consistently performing at the optimal level, this can further be evidenced by the fact that, the minimum mean of GDP was 4.66 and the maximum was 8.46, showing just a little dispersion from the mean and the standard acceptable level.

The mean value on education level (literacy rate) is 73.9% and the standard deviation is 4.09%, the standard deviation shows there is a minimal dispersion meaning the literacy rate have been consistently around the mean, this further indicate that for the last 20 years the country have not found a permanent solution to truly minimize the illiterate ratio in the country. The mean value for FDI level is 3.43% and the standard deviation is 1.12%, the standard deviation shows there is a minimal dispersion of

about 0.56% on each side of the mean showing that the FDI level have been consistently around the mean, this further indicate that for the last 20 years the country have performed consistently as far as FDI's are concerned with the exception of year 2010 when the maximum FDI level was 5.7%.

The mean value for tax incentive is 0.895 Trillion, and the standard deviation is 0.562 Trillion, the standard deviation shows there is a moderate to large dispersion of about 0.281 trillion from year to year on each side of the mean showing that the tax breaks being granted by Tanzania have varied from year to year, this can also be explained by the huge gap between the highest tax incentive which was 1.83Trillion and the lowest which was 0.201Trillion.

The mean value for productive population is 23.6M and the standard deviation is 4.09M, the standard deviation shows there is a moderate dispersion of about 2.03% on each side of the mean showing that the productive population have been consistently around the mean, the lowest size being 17.8M in year 2000 and the highest size being 30.7Min 2018, meaning with an increase in general population of Tanzania, the productive population also increases.

5.2.3 Discussion of Correlation Findings

Correlation findings enables one to determine the strength or degree of linear association between variables, as shown in table 4.3 in this case GDP, and literacy rate, tax incentive per annum, productive population size, FDI level. The findings presented indicated that tax incentive is weakly positively associated with GDP at 0.03, literacy rate is moderately positively associated with GDP at 0.24, and productive population size is weakly positively associated with GDP at 0.15, and FDI level is weakly negatively associated with GDP at 0.10.

5.2.4 Discussion of Regression Estimation

From the findings presented in chapter four, the regression estimation model evolved to

$$Y = -3.831 - 0.113TAXIN_1 + 0.012FDI_2 + 0.016EDULV_3 + 1.46131e-08POPLN_4 + \varepsilon$$

From the findings as indicated in the above model, keeping all the independent variables employed in this study constant would result into GDP growth rate of -3.83070 . Furthermore, with the coefficient estimate of tax incentive to GDP being (-0.113) and $(p\text{-value} = 0.5)$, this means that there is an insignificant relationship between tax incentive and GDP whereby for every one unit increase in tax incentive, GDP decreases by 0.113 , or for 100% increase in tax incentive rate, GDP decreases by 11.3% . Basically, what this finding shows is that rather than benefit the economy of the country, tax breaks in Tanzania are actually hurting the economy, that is the more tax breaks given the more they hurt the economy.

This findings are in line with findings by OECD (2003 and 2017) and UNCTAD, (2003), who states that tax breaks is not the best way of attracting investors who can in turn lead to economic development, stating that developing countries are granting these huge incentives due to pressure from developed nations and other competitors, this is further reiterated in a study by the TJN – Africa (ibid), on Tax completion in East Africa which showed that Kenya, despite the fact that it offers more tax breaks than its neighbouring countries, received less FDI flows than any of those countries.

The study established that the Kenyan government was losing over Kenya Shillings 100 billion (US\$ 1.1 billion) a year from all tax breaks and exemptions with trade-related tax breaks accounting for at least Kenya Shillings 12 billion (US\$ 133 million) in 2007/08.

TJN's study indicated that the country is therefore, denied of resources urgently needed to reduce poverty and improve the general welfare of its citizens. In 2010/11, the government spent more than twice the amount on providing tax breaks (using the figure of Kenya Shillings 100 billion) than on the country's health budget.

This is a serious situation when 46% of Kenya's 40 million people live below the poverty line. Just as it was established in Kenya of the billions lost annually because of tax breaks, in Tanzania too it was established that in 2009/10 alone, 2.3 percent of GDP or TZS 695 billion was granted in tax exemptions. And in 2005/06 it lost TZS 772 billion (Osoro et al., 2009). The amount has become even higher in recent years.

It is the opinion of the researcher that rather than focusing on tax breaks as a the main investor attraction criterion, the country should focus on creating a conducive business environment whereby there are good infrastructure such as affordable reliable electricity, transport, high level education, unnecessary bureaucracies due to corruption practices, and political stability. Since other countries such as Mauritius, Costa Rica, Ireland and Malaysia have managed to attract huge number of investors with none or very little tax breaks OECD (2007), the researcher believes that it can also be possible in Tanzania.

Moreover, the findings indicate a positive yet insignificant relationship between FDI and GDP whereby a unit increases in FDI increases the GDP by 0.012. This means foreign direct investments have a small contribution to the economic growth of Tanzania, this finding are in line with Le and Suruga (2005) who reports that FDI has a weaker positive relationship with economic growth especially when there is a huge public investment which is likely to hinder the economic benefits of FDI. On the other hand, the study by Saqib (2013) on the Pakistan's economic performance, reports that economic growth is negatively affected by FDI, Saqib's findings support the dependency theory, that FDI has a negative impact on the host country's economic growth.

It is the researchers' opinion that the effect of FDI on GDP is dependent on several other factors which include the level of technological advancement of the host economy, the economic and political stability, countries investment policy and the degree of trade openness so for the country to truly benefit from FDI's it first have to take care of all those issues that may derail FDI progress.

Furthermore, the coefficient estimate of education level to GDP is (0.012) and (p-value = 0.46), this means that there is an insignificant positive relationship between tax incentive and GDP whereby for every one unit increase in education level, GDP also increases by 0.012.

The coefficient estimate of productive population to GDP is (2.12e-08) and (p-value = 0.502), this means that there is an insignificant positive relationship between productive population and GDP whereby for every one unit increase in productive population GDP also increases by 2.12e-08.

CHAPTER SIX

SUMMARY, CONCLUSIONS, AND RECOMMENDATIONS

6.1 Introduction

This last chapter presents the summary of the study in a short and concise manner, conclusions which were reached, recommendations for stakeholders and their policy implications as well as identifying areas for further research.

6.2 Summary of the Study

The objective of the research study was to establish the effect of tax breaks on economic growth in Tanzania. The research includes six chapters; the first chapter gave the background of tax breaks and economic growth. Developed the gap to be bridged and why it was significant for the gap to be filled, it indicated the scope of the study and lastly developed three (3) specific objectives to be realized by the researches' findings.

The researches' objectives were firstly to determine the tax breaks that have been granted in Tanzania from 2000 to 2018. Secondly, to establish the rate of economic growth of Tanzania from 2000 to 2018, and thirdly, to assess the relationship between tax breaks and economic growth in Tanzania.

To better understand the topic, the second chapter involved the review of several studies on the topic of this research; the review included empirical studies from different authors, while there were studies indicating the existence of a significant relationship between tax breaks and economic growth (UNCTAD, 2012). Others reported no relationship between the two (OECD, 2003). Furthermore, in order to better understand the effect of tax breaks on economic growth the study reviewed several theories which included the Harrod-Domar Model, and Neoclassical Growth Theory - (The Solow Growth Model).

Chapter three developed the research methodology for this study by adopting a quantitative research approach, and causal research design; this is a research design which attempt to reveal a cause and effect relationship between variables (Brüderl, 2015). The study area which is Dar es Salaam city was introduced in this chapter; it introduced the data types and sources as secondary data collected from different reputable sources. It is in this chapter that estimation model and methods for estimating the time series data developed.

In chapter four, the study presented the findings analyzed quantitatively using statistical software, which was Gretl; the study presented the descriptive statistics summary, as well as estimation of the time series data whereby the findings indicated that on average over the period of investigation the GDP growth rate over the period of investigation was 6.67%, the mean tax breaks granted over the period was Tanzania shillings 0.895 Trillion, the mean of productive population was 23.6M, the mean literacy level for the population was 73.9% for the period and the mean FDI level was 3.43%.

The regression analysis was carried out to establish the association between GDP growth rate and the independent variables and it was found that there was an insignificant negative relationship between tax breaks and GDP, a positive yet insignificant relationship between FDI and GDP, a positive yet insignificant relationship between productive population and GDP, and a positive yet insignificant relationship between literacy rate and GDP, and a positive yet insignificant relationship between FDI and GDP. The regression estimation above was derived from the following regression model;

$$Y = -3.831 - 0.113TAXIN_1 + 0.012FDI_2 + 0.016EDULV_3 + 1.46131e-08POPLN_4 + \varepsilon$$

The model summary found that the value adjusted R squared is 0.9, which means that 9% of the total variance in the GDP growth rate was explained by the independent variables.

Chapter five discussed the findings presented in chapter four, starting with the discussion of descriptive statistics summary where by the measure of the central tendency of the variables and their implications was discussed. This included discussion of the minimum and maximum GDP for the period estimated and the reasons for such values.

6.3 Conclusion

From the results of the findings it can be concluded that tax breaks alone does not increase the economy of a country, this study even found an inverse relationship between GDP growth rate and tax breaks.

It is concluded that even though tax breaks may encourage investments in a country, they do not drive economic growth. GDP growth rate is affected by so many other factors as it was shown from the regression analysis that no one particular factor significantly affects economic growth rates.

The study concludes that, even though tax breaks has benefits to the business community, it is necessary for the government to rationalize these tax breaks to ensure that the country is not losing out on needed resources while at the same time not reaping any benefits for the resources given up.

It was concluded that the amount of tax breaks given each year has been growing steadily in the years under study while the GDP growth rate has not kept pace with the growing tax breaks. The marginal GDP growth rate is attributed to the various initiatives the government has put in place towards the achievement of the vision of becoming a second word country.

Conclusively, too many tax breaks are been given, some do not even relate to business or investment of any sort. The government offices and international communities enjoy too much tax breaks. The fact that so many government offices have such benefits could lead to misuse of that privilege leading to the country losing more revenues.

6.4 Recommendations

Following the findings of the study, the following recommendations are made; Since the study could only find a negative relationship between tax breaks and economic growth, it is the study's recommendations that rather than focusing on tax breaks as the main investor attraction criterion, the country should focus on creating a conducive business environment whereby there are good infrastructure such as affordable reliable electricity, transport, high level education, unnecessary bureaucracies due to corruption practices, and political stability. Because other countries such as Mauritius, Costa Rica, Ireland and Malaysia have managed to attract huge number of investors with none or very little tax breaks OECD (2007), so why not in Tanzania.

Since there are other countries which have had a positive economic growth out of granting tax breaks as an investors' attraction strategy (UNCTAD, 2012). This study recommends that the government seeks to learn how others have managed to do it successfully, and then model their success.

6.5 Suggestions for Further studies

Since the findings have indicated that granting tax breaks does not automatically translate to economic growth through attracting potential FDIs, a study should be conducted to determine what real leads to attraction of potential investors so that necessary actions are taken to profitably attract foreign investors.

Although the finding has indicated that tax breaks negatively affect the economic growth in Tanzania, there are other studies which have indicated a positive relationship between the two. Hence, a study should be carried out involving other countries which have successfully used tax breaks to attract FDI with positive results.

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