EFFECTIVENESS OF FISCAL INCENTIVES IN FDI PROMOTION IN ZANZIBAR

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A DISSERTATION SUBMITTED IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER IN BUSINESS ADMINISTRATION OF THE OPEN UNIVERSITY OF TANZANIA

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CERTIFICATION

The undersigned certifies that he has read and hereby recommends for acceptance by the Open University of Tanzania, a dissertation titled: ***"****Effectiveness of Fiscal Incentives in FDI Promotion in Zanzibar****",*** in partial fulfilment of the requirements for the Degree of Master in Business Administration (MBA) of the Open University of Tanzania.

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(Supervisor)

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DECLARATION

I, **Amour Haji Mkombe**, do hereby declare that this dissertation is my own original work and that it has not been submitted and will not be presented to any other University for similar or any other degree award.

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Signature

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Date

DEDICATION

This work is especially dedicated to the memory of my beloved parents, and the whole family.

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ABSTRACT

The study aspired to investigate the effectiveness of fiscal incentives in FDI promotion in Zanzibar. It was conducted in Urban-West region Zanzibar, using a descriptive survey based on cross-sectional design. A total of 60 respondents formed the study sample taken from ZRB, TRA and ZIPA. The methods of data collection included focus group discussion, structured interview and documentary review. The instruments used in data collection were interview schedule and interview guide, while information was analysed through editing, coding, classification and tabulation. In general, the study has found that fiscal incentives such as tax holiday, corporate tax, and investment allowance played greater roles to the promotion and attraction of FDI in the study area. In the issue of the impact of FDI in the economic development in the study area, it is highly agreed that FDI significantly affected the economic development of the Isles. It provided employment opportunities, technology transfer; developed and expanded the business in the region and internationally. Zanzibar FDI also led to the improved government revenue. For example in the period of ten years till 2014, Zantel alone paid a total of Tshs. 118.3 billion to the Zanzibar government in the form of VAT, ED, SDL and PAYE. Lastly on the matter of the policy change of (FDI) toward economic development of the host country, frequent policy review and amendment, regulations and control of reasonable time limit of investment have been explained as proper policy change. The study recommended that the government should attempt to review its development and economic policies periodically to ensure attraction of appropriate FDIs and retaining of such investments in order to reduce the poverty on the isles.

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LIST OF ABBREVIATIONS

DOESs	Domestic Owned Enterprises
DAHACO	Dar es Salaam Airport Handling Company
ED	Exercise Duty
EPZ	Export Processing Zone
EPZs	Export Processing Zones
FDI	Foreign Direct Investment
FOEs	Foreign Owned Enterprises
GDP	Gross Domestic Products
IMF	International Monetary Fund
IPC	Investment Promotion Centre
LCDs	Lest Developed Countries
M&A	Mergers and Acquisitions
MIDP	Motor Industry Development Program
MNE’s	Multinational Enterprises
PAYE	Pay As You Earn
SD	Stem Duty
SDL	Skill Development Levy
SEZs	Special Economic Zones
SSBs	Small Scale Business
OECD	Organisation for Economic Co-operation and Development
TIA	Tanzania Investment Act

TIC	Tanzania Investment Centre
TNCs	Transnational corporations
TOT	Transfer of Technology
TTO	Technology Transfer Office
UNCTAD	United Nations Conference on Trade and Development
UNECA	United Nations Economic Commission for Africa
VAT	Value Added Tax
WHT	Withholding Tax
ZANTEL	Zanzibar Telecommunication Company
ZIP	Zanzibar Investments Policy
ZIPA	Zanzibar Investment Promotion Authority
ZPRP	Zanzibar Poverty Reduction Plan
ZRB	Zanzibar Revenue Board

CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Several international and regional development institutions and bodies such as the International Monetary Fund (IMF), World Bank, United Nations Development Programmer (UNDP) and United Nations Economic Commission for Africa (UNECA) have been advocating the importance of foreign direct investment (FDI) in the development of a country. The belief has been that the inflow of FDI would result in enormous benefits to host countries.

Some scholars advocated that FDI creates o new job opportunities, technological transfer and know-how, increased the earning of foreign exchange through trade, improved efficiencies of domestic industries, between the domestic economy and the rest of the world and supporting human capital formation in the home as well as host countries. To obtain these perceived benefits and spillovers associated with FDI, coupled with the commitment to develop their countries, developing countries have been looking for ways to attract and increase the flow of FDI. Various initiatives have been taken in the process, including improving their investment environments (such as infrastructure), liberalising their economies and providing various incentives to potential investors (Tessama, 2008; Khalfan, 2002).

Generally though, offering foreign investors investment incentives in general and tax incentives in particular to attract FDI has been a debatable issue. Based on the above mentioned perceived benefits associated with FDIs, some economists have been in favor of the provision of incentives and have argued that governments should do everything possible to attract FDI. Others have either argued against the provision of incentives and have advanced views as to why governments should not offer tax incentives to attract foreign investment.

Amongst others, the following arguments summarised by Wells, Allen et al (2001) have been advanced: that FDI may have a negative impact on the productivity of local firms; that the cost to the public for incentives may exceed the additional benefits created by the investment; that there is a great possibility that the decision made by investors on the selection of locality does not only depend on incentives but on many other factors that might weigh higher than incentives.

They also argue that incentives have had little (if any) effect on the total foreign investment made worldwide; and that in the aggregate, incentives create a net transfer from taxpayers to investors. They have further argued that in the case of foreign investors in developing nations, this transfer would be primarily from a poor country to a richer one. Countries have, despite the above arguments, continued offering incentives to attract FDI.

Over the past few decades, most Governments have been actively promoting their countries as investment locations to attract scarce private capital and associated technology, as well as managerial skills in order to help achieve their development goals. They have increasingly adopted measures to facilitate the entry of foreign direct investment (FDI). Such measures include liberalizing the laws and regulations for the admission and establishment of foreign investment projects; providing guarantees for repatriation of invest profits; and establishing mechanisms for the settlement of investment disputes. Tax incentives are also part of these promotional efforts.

Some researchers Maxwell (2007); UNCTAD (1998) and DTI (2008) insist that as a factor in attracting FDI, tax (fiscal) incentives are secondary to more fundamental determinants, such as market size, access to raw materials and availability of skilled labor. In addition, governments can quickly and easily change the range and extent of the tax incentives they offer.

However, changing other factors that influence the foreign investment may be more difficult and time consuming, or even outside government control entirely. For these reasons, investment expert's promotion agencies, view incentives as an important policy variable in their strategies to attract FDI for economic development.

1.2 Statement of the Problem

Following Zanzibar economic liberalization decision in mid 1980s, the Zanzibar government has undertaken several ambitious steps aimed at improving and liberalizing the island economy and promoting development of its resources aiming at economic growth and poverty reduction among its citizens. A series of government plans have followed in order to focus on education, health, agriculture, tourism, infrastructure, trade, and good governance to help reduce poverty. Spearheading economic development initiatives were trade liberalization and direct investment promotion (Khalfan, 2002).

In 1992, the Government of Zanzibar established the Zanzibar Investment Promotion Agency (ZIPA), the Commission for Tourism, and the Free Economic Zones Authority. Few years later, in 1998, Zanzibar's Free Ports Authority joined the team. ZIPA was later a merge of three institutions dealing with direct investments in the Isles; Investment Promotion Agency, Free Economic Zones Authority and Free Ports Authority. According to ZIPA, so far 519 projects with a proposed capital of USD3.2bn have been approved to invest in Zanzibar.

Among those attracted by Zanzibar investment environment with its incentive package was the Zanzibar Telecom Ltd (Zantel), which in 1999 became a joint venture between the Zanzibar Government (18%), ETISALAT (65%) and Meeco International of Tanzania (17%). Zantel has its own international gateway and was the first to reduce rates on international calls by 60%.

Other benefits realized by presence of Zantel are improvement in both urban and rural livelihoods, reduction in poverty by providing rural households with fast and easy modes of employment and communication, thereby increasing their ability to access livelihood assets, undertakes diverse livelihoods strategies, and overcome their vulnerabilities. It is also claimed that, up to year 2012 Zantel was the largest tax payer to Zanzibar authorities (the Guardian, 12 Nov. 2012)

Despite being the largest tax payer, little is known on the actual facts that attracted Zantel to come and invest in Zanzibar. Nor is it known whether the fiscal sacrifice made by the Government and extended to the Company has optimally drawn the anticipated returns from the investment undertaken. Knowledge of this type assists in the knowledgeable implementation of the investment policies with their derived benefits to local economies.

1.3 Objectives of the Research

The overall objective of this research is to find out the potential effectiveness of fiscal incentives in FDI promotion on economic development in Zanzibar, with its implications to the ongoing efforts to poverty reduction.

1.3.1 Specific Objectives

The specific objectives of this study are,

(i) To explore the role of fiscal incentives in attracting FDI in Zanzibar

(ii) The impact of fiscal incentives to foreign direct investment on Zanzibar economic development especially in employment creation, technology transfer and revenue collection

(iii) Policy changes needed to make FDI contribute more to the Zanzibar economic development.

1.4 Research Questions

1.4.1 General Question

What is the effect of tax incentives offered to FDI in promoting economic growth of Zanzibar?

1.4.2 Specific Research Questions

(i) What is the role of fiscal incentives in attracting FDI in Zanzibar?

(ii) What is the impact of fiscal incentives to FDI on Zanzibar economic development in employment creation, technology transfer and revenue collection?

(iii) Which changes are needed to make FDI contribute more to the Zanzibar's economic development?

1.5 Significance of the Study

The issue of tax exemptions to Foreign Direct Investments as a measure to persuade more inflows of FDI to Zanzibar has become a matter of concern to the public. Indeed, little is known in this area to assess the quantitative impact of granted tax exemptions on business performance of FDIs in Zanzibar.

This study will provide insights in the effect of fiscal incentives on performance of FDI and contribution to Zanzibar economic growth. Specifically, and perhaps most importantly, results of this study will be useful in improving policy-designing concerning to FDI regarding Government revenue collection, employment opportunities and services delivery to its citizens. Finally, the academicians may use the study findings as an additional source of knowledge to what is already available in the existing literature.

1.6 Limitation of the Study

This study has the limitations as follows:

Firstly, the study required some important information from revenue authorities, which was obtained due to corporate confidentiality.

Secondly, the data were collected in Unguja only where the headquarters of TRA, ZRB and ZIPA are available.

Finally, some of the respondents could not provide accurate information during the interviews as they regarded some of the questions sensitive. However, this group was small and did not affect the overall results and conclusions.

1.7 Area and Scope of the Study

This research work was conducted in Unguja, where the head quarters of ZIPA, TRA and ZRB are situated, also the researcher decided to concentrate on Unguja due to availability of the information required. The study focused on the period from 2004 to 2014.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This chapter presents the review of literature related to this study. The chapter is divided into three parts. The first part presents operational definitions. While the second part, will present theoretical framework and the empirical studies on incentives in general and tax incentives in specific which are mostly used as strategy by Government of developing countries on attracting more FDI as reflected in different literatures. The last part gives conceptual framework and research gaps in the reviewed literatures to mark the rationale for conducting this study.

2.2 Operational Definitions

Operational definition in a common language refers to the process of establishing a conceptual definition that is explicitly stating what a concept means in the context of a particular study (Singleton, 1999). Cozby (2007) gives the meaning of the term as defining a concept in terms of operations or techniques the researcher uses to measure or manipulate it. He further argues that operational definition forces researcher(s) to discuss abstract concepts in concrete terms. Operational definition helps to avoid misconception to the users of a particular study.

Based on the above elucidation, the key concepts which are brought into operation for the present study includes foreign direct investment (FDI), tax incentives and determinants for investment.

2.2.1 Foreign Direct Investment (FDI)

Bjorvatn (2000) defines FDI as an investment made to acquire a lasting interest in a foreign enterprise with the purpose of having an effective voice in its management. The literature distinguishes between horizontal and vertical FDIs.

Horizontal FDIs, as seen in Markusen (1984), Markusen (1992); Markusen (1996, 1998) is the type of FDI undertaken to place production closer to foreign markets. In this case, production of goods and services in the host economy takes the place of exports and FDI can substitute trade.

Vertical FDIs, as seen in Helpman (1984); Krugman (2005) is undertaken to exploit lower production costs in order to serve both foreign and home market. In this case FDI can be a complementary to trade when a part of the production in the host economy is exported back to the home country.

FDI differs from foreign portfolio investment where a stake is taken in an overseas business without operational control, but with the view to acquiring an investment income stream through dividends, capital gains and so on. FDI is furthermore, defined as a situation where a foreign company creates a subsidiary to provide goods and services. Thus a firm undertakes FDI in a foreign market if it possessed an ownership advantage over the local competitors.

The ownership of the foreign investment usually remains in the investing (home) country. FDI represents the primary means of transfer of private capital (i.e. physical or financial), technology personnel and access to the brand names and marketing advantage (Khalfan, 2002; Makola, 2003). Recently, Standard propositions of the neoclassical theories suggest that FDI is likely to be an engine of host economic growth, because firstly inward FDI may enhance capital formation and employment augmentation; Secondly FDI may promote industrial restructuring through competitive pressures or bring new activities or industries to host countries and then increase manufacturing export competitiveness;

Thirdly by its very nature, FDI may bring into host economies special resources such as management know-how, the access of skilled labor to international production networks, and established brand names: and lastly FDI may result in technology transfers and spill-over effects (Khalfan, 2002; Markusen, 1999).

Moreover, FDI inflows has crucial economic development role for host countries. There are some inherent advantages for development: risk sharing, market discipline, export orientation, and the transfer of technology and managerial expertise. Recent trends show that FDI can be an important and stable source of private capital for developing economies, particularly countries that are able to create a friendly environment for new foreign investment (Singh and Kwang, 1995).

The factors that create the investment climate in one country and determine its attractiveness for foreign direct investment are numerous and complex. There are a large number of literatures examining the determinants and constraints on FDI inflows. The most important have been identified as a country's political and economic stability; geographic location; market size; membership and status in regional integration; legislation; infrastructure and telecommunications; availability of skilled labor; fiscal incentives, and FDI promotion. Obviously, many factors other than market size, particularly the policy and institutional framework, are important in determining a country's attractiveness to FDI.

The quality of the policy regime is an important determinant of the allocation of FDI follows among developing counties. Macroeconomic stability, corruption, rule of law, and effectiveness of the regulatory regime has been shown to be significant determinant of the locations of foreign investment, after controlling for other variable. Time series analysis underlines the importance of governance and institutional quality for the allocation of FDI.

Countries with better investment climates – indicated by the level of corruption, voice (political openness). Rule of law, quality of the regulatory regime, government effectiveness and political stability – tended to receive an increasing share of total FDI over Beyond this, there are three categories of 'investment promotion' expenditures that are regularly associated with host efforts to attract foreign direct investors. They are: providing information to MNCs (host country provides "information externalities" that the market does not supply in its own); effective SEZs; fiscal incentives (tax breaks and direct subsidies) (Moran, 2005).

2.2.2 Tax Incentives

The term incentives has been interpreted in Tanzania Investment Act (TIA) 1997 (3) as "…tax relief and concessional tax rates which may be accessed by an investor under the Income Tax Act, 1973, the Customs Tariff Act, 1976, the Sales Tax Act, 1976 and any other for the time being in force, and includes additional benefits that may be accessed by an investor under section 19 and 20”. In many studies the role of incentives has been the subject in promoting FDI, but they did not clearly establish its relative advantages and disadvantages.

In some cases, and with some types of investment, however, their impact may be more pronounced. For some foreign investors, such as footloose, export-oriented investors, tax incentives can be a major factor in their investment location decision, for these and other reasons investment experts, particularly from investment promotion agencies, view incentives as an important policy variable in their strategies to attract FDI for economic development (UNCTAD, 2005).

The most common tax incentives offered by several countries in FDI promotion are; Reduced corporate income tax rate; Loss carry forwards, Tax holidays, Investment allowances, Investment tax credits, Reduced taxes on dividends and interest paid abroad, Preferential treatment of long-term capital gains, Deductions for qualifying expenses, Zero or reduced tariffs, Employment – based deductions, Tax credits for value addition, Tax reductions/credits for foreign hard currency earnings (UNCTAD, 2005).

Among the approaches taken by Zanzibar trough Zanzibar Investment Authority (ZIPA) to attract more FDI include a general improvement in the investment environments like improvement of infrastructure, liberalization of the economy and granting of various incentives like tax incentives, (Corporate tax relief, Investment allowances and import duty on capital expenditure, Reinvestment allowances on capital expenditure, Infrastructure allowances on infrastructure expenditure, Preferential tax rates for withholding tax on dividends, royalties and interest, Preferential rates on indirect taxes, Double deductions of approved and/or specified costs and expenses).

2.2.3 Determinants of Foreign Direct Investment (FDI)

These are some of the factors that determine FDI inflows into a given geographical region, or country other than tax incentives. They give investors the confidence needed to invest in foreign markets. The list of these determinants may be very long, but not all determinants are equally important to every investor in every location at all times. Some determinants may be more important to a given investor in a given location at a given time than to another investor (UNCTAD World Investment Report, 1998).

A given determinant may be a necessary and satisfactory factor by itself for FDI inflow in one location but not in another. For the most part, they form a complementary set. It is difficult to determine the exact quantity and quality of FDI determinants that should be present in a location for it to attract a given level of FDI inflows. What is clear is that every location must possess a certain critical minimum of these determinants before FDI inflows begin to take place. UNCTADs 1998 World Report presents some host country determinants of FDI. These include the following:

2.2.3.1 Policy Framework for FDI

This includes economic, political and social stability; rules other regulating entry and operations of FDIs; standard of treatment of foreign affiliates; policies on functioning and structure of the market; international agreement on FDIs;

privatization policy; trade policy (tariffs and non-tariff barriers and coherence of FDI and trade policy; and tax policy (UNCTAD World Investment Report, 1998).

2.2.3.2 Economic Determinants

These include business facilitation; investment promotion (including image-building and investment-generating activities and investment-facilitating services); investment incentives; hassle costs (related to corruption and administrative efficiency); social amenities (for example quality of life); and after investment services (UNCTAD World Investment Report, 1998).

2.3 Theoretical Literature Review

Over the last few decades, foreign direct investment (FDI) is said to have dominated economic literature, especially in the area of development economics. Further with globalisation of the international economy in the 1990s, the importance of FDI increased and was considered by many economists to be one of the leading motivations for its dominance (Massoud, 2003). A general view in literature on FDI has been that FDI plays a major role in the economic development of the host country through the benefits associated with it (Hanson, 2001).

According to Hanson, these include, amongst others, the creation of new employment, technological transfer and know-how, increased trade integration with the rest of the world. This has led countries of the world; emerging economies in particular, to engage in FDI attraction efforts in order to meet their investment and development needs. Increased integration into the world economy that FDI is deemed to offer, is believed to result in potential economic growth (Massoud, 2003).

According to Massoud (2003), FDI can take a number of forms; and although generally perceived as investment in a country by a new foreign entrant, the majority of FDI actually occurs within established foreign affiliates. Hartman indicates that the most explicit is the transfer of funds abroad by a parent firm, either as loans to or equity investments in subsidiaries; and that the retention of earnings abroad by foreign subsidiaries also raises the subsidiary stake of the parent firm in a similar manner.

Generally though, the subject of FDI is a complex one. Issues of why FDI exists and what motivates FDI have been debatable, such that there has not been a unified theoretical explanation for FDI (Denisia, 2010). Various theories have been developed aimed at explaining the existence of and motivation for FDI.

Denisia (2010) and Khalfan (2002) pointed out these to include *the Production Cycle Theory* developed by Raymond Vernon in 1966, which analyses the relationship between the product life cycle and possible FDI flows; *the Theory of Exchange Rates on Imperfect Capital Markets* by Cushman 1985 that looks at the relationship between FDI flows and exchange rate changes; *the Internalization Theory* by Buckley and Casson brought to the fore in 1976 that aims to answer the question of why firms do not just sign contracts with a subcontractor in a foreign country instead of making FDI and the *Eclectic Paradigm Theory* originating from Dunning's work in 1976, referred to as the OLI theory.

The OLI theory is a mix of three different theories of FDI which analyse the investing firm's decisions on the basis of ownership advantages (O), localisation advantages (L) and internalisation advantages (I). The author has considered the Internalisation Theory and the Eclectic Paradigm Theory to be the most relevant to the subject matter of this study and they are therefore summarised below. The summary borrows from the work by (Denisia, 2010; Khalfan, 2002).

2.3.1 Direct Investment Theory

A theory of direct investment explain capital flow from one country to another according to the marginal productivity of capital (Curdiff and Hilger, 1988 cited from Khalfan, 2002). The theory explains that capital will flow to where the expected rate of return on investment is highest.

Difference in the rate of return between countries (or region) are said to result from the relative endowment of productive factors (Daniels et al, 1979 cited from Khalfan). Thus, where capital is abundant in relation to the labour, the return will be normally be lower than where capital is in short supply relative to the amount of labour. Hence, it is expected that funds will tend to flow industrial to less developed countries.

2.3.2 Pro-foreign Approach

According to Khalfan (2002) Pro-foreign approach argues that national and foreign private sectors enterprises, if permitted to operate in the competitive market conditions, offers developing countries the best prospect of speedy economic growth. Thus the local and foreign investors can deliver more economic benefits to the country when they are allowed to operate competitively.

This approach is direct link with product circle theory. This theory focused on the structure of market oligo policies and impacted competition, as these determine the behavior of firm with specific advantages in term of costs, innovation, economies of scale and product differentiation. When such advantages can be transferred to other counties, firm can be seek to extend the benefits at home and abroad altering the structure of supply (Khalfan, 2002).

2.3.3 The Internalization Theory of FDI

This theory intends to answer the question of why firms do not just sign contracts with a subcontractor in a foreign country instead of making FDI. Denisia (2010) explains that transnational companies organise their internal activities so as to develop specific advantages, which they then can exploit.

The main issue of this theory is the fact that contracting out is risky, i.e. transferring specific capital outside the firm and revealing the proprietary information might result in a problem for the firm, especially in cases where the contracted agent decides to interrupt the contract and use the technology to compete with the mother company or in the case where the agent through its operations damages the brand reputation of the firm. As such, the firm could be more comfortable with engaging production activities itself in a foreign country and hence invests in that country.

This theory therefore aims to explain the growth of transnational companies and their motivations for achieving foreign direct investment by recognizing the existence of the aspect of market imperfection. The above aspects covered by this theory are relevant to this study which aims to assess the extent at which tax incentives have induced investors to invest in Namibia.

2.3.4 The Eclectic Paradigm Theory of FDI.

The Eclectic Theory is explained by Denisia (2010) as a mix of three different theories of foreign direct investments and analyses FDI based on the following: ownership advantages (O), localisation advantages (L) and internalisation advantages (I). It is therefore referred to as the OLI theory. Denisia provides the essence of each of the three components as summarised below.

Ownership advantages (O) postulates that some firms have firm-specific intangible assets (such as human capital, patents, brands, technologies, etc.) which can be replicated in different countries at low costs, and which might yield higher incomes at reduced costs; hence the motivation for entering other countries in the form of FDI. However because additional cost might be faced by the investing company, there is a need for the company to have some specific characteristics to be able to enter a foreign country successfully.

According to Denisia; these characteristics might be in the form of certain monopolistic advantages, technology to contain innovation as amongst others such as economies of scale and greater access to financial capital. The Location (L) component of the theory advances that location advantages of different countries are key determinant factors of host countries for FDI of transnational corporations (TNCs). Country specific advantages can range from economic benefits such as factors of production, transport costs, telecommunications and market size; political factors including government policies on FDI flows, and social factors such as the appreciation for cultural diversity and attitude towards strangers. However, it is important to mention that the ability of investing firms to take advantage of various location advantages is affected by their specific characteristics. As such, specific location advantages may have different values for specific firms and hence location choices by various firms are affected accordingly, i.e. they cannot be identical across all TNCs.

The third component of the Eclectic Theory, the internalisation (I), on the other hand, looks at ways in which the firm can exploit its powers. It explains that the firm would want to engage in foreign production instead of franchising or licensing if cross-border market internalisation benefits are higher. What is important to note with regards to the Eclectic Paradigm Theory is that OLIs are different from company to company, and also depend on context and reflect the economic, political and social characteristics of the host country. As such, the objectives and strategies of firms, the magnitude and pattern of production will depend on the challenges and opportunities offered by different types of countries.

Nevertheless, Kusluvan (1998) concludes that the OLI theory is a better framework and can form a single general theory of MNEs as it has features encompassing all other theories as well as the analytical power for examining the motivation for firms going abroad, the reasons for different forms of investment abroad and why firms investing abroad are able to be successful. All these factors underlying the OLI theory are thus relevant aspects to consider in the process of determining whether or not Namibia has attracted FDI because of the tax incentives offered or because of other factors, which is the intention of this study as highlighted above.

Literature has, however, also identified the existence of weaknesses in all of the FDI theories, in that each of them (i.e. the ones discussed above and others) could only partly explain some of the aspects pertaining to the existence and motivation of FDI, and thus the existence of no unified theory (Denisia, 2010). However, the importance of FDI to the economies has generally been agreed upon. The question is what the countries should do and how they should go about attracting FDI while ensuring that they derive maximum benefit and reduce inherent costs. Countries have been providing various incentives to attract FDI, but this study aims to limit itself to the extension of tax incentives.

2.4 Empirical Literatures

2.4.1 Effectiveness of Tax Incentives

Some authors indicates that investment incentives were not a marginal or geographically-limited phenomenon and that on every continent, multiple levels of governments use location subsidies to try and promote investment. He is also of the opinion that investment incentives were mainly the tool of *industrialised countries*, though increasingly developing countries have recently adopted incentives in an attempt to counter their use by the developed countries. Following below are some of the country specific cases, borrowed from Thomas' work, which reviewed the issue of offering investment incentives. It was found that the U.S. federal government permitted for accelerated depreciation, considered as an incentive to attract investment into the United States. This incentive was directed machinery and equipment was estimated to have cost of US$ 44.7 billion in economic year 2004.

The author also found that in Canada, the incentives game was being played at the provincial level and that they were much more highly centralised than in the United States. For large incentives, such as those in the automobile industry, he indicated that there was often federal as well as provincial participation in the awarding of subsidies. (GAO, 2005 as cited in Thomas, 2007).

In terms of fast developing countries, Thomas found that China was attracting substantial investment with its low labour costs and large number of skilled workers. This, he explains, was in addition to providing a full five-year tax holiday and another five years with 50 percent tax liability, while cities and regions also gave incentives to investors.In the case of India, he is of the view that the country’s 2005 Export Processing Zone (EPZ) legislation led to the approval of 200 EPZ businesses by March 2007, while tax breaks, labour law and regulatory concessions had been the main drawback (Thomas, 2007).

South Africa’s investment incentives were found to have included a 30 percent grant for so-called Critical Infrastructure, a 15 percent foreign investment grant and a free trade zone program. The study revealed that the South African Government introduced location subsidies in March 2007 for call centers of up to approximately US$8,570 per seat, with a total of US$154 million having been budgeted through March 2011. Thomas indicated that the Motor Industry Development Program of South Africa further provided substantial benefits to the industry, including a 20 percent investment grant. Efforts have been made to measure the effectiveness of FDI incentives in many other countries of the *developing world*. (Country Finance Select, 2006 as cited in Thomas, 2007).

Also the author did some work on measuring the benefits and costs of FDI in Namibia. Though he was unable to “matter-of factly” prove many of the costs associated with FDI in Namibia (as he put it), given data and other limitations; he could reveal some positive effects and some costs by employing a single equation approach, using available macro and micro data as well as a simplistic cost-benefit analysis technique. The main conclusion of his work was that FDI is supposed to act as a supplement to domestic investment and not as a substitute; that the economic benefits of FDI are real and in most cases outweigh the costs; but they do not accrue automatically.

Jensen and Malesky (2010) remarked that despite broad skepticism about the benefits of globalisation, the majority of U.S. states had offered lucrative tax incentives to attract investment. They indicate that the size of these incentives was generally considered too large to be welfare enhancing, and that many economists were skeptical of the effectiveness of those policies. Yet despite the mounting evidence to the contrary, the incentives offered by the U.S. have continued and have actually increased in their generosity over time.

This shows that even the US has been extending tax incentives to attract investment, and that foreign investment is important regardless of the level of development. From the above literature review it is clear that countries around the globe have engaged the process of attracting FDI through various means and instruments, including tax incentives.

However, it has been doubtful in most cases if the provision of investment incentives were backed up by any quantifiable evidence as Lall, (2009) write: "it is nowadays well accepted that both economic growth and development are highly dependent on improving not just the availability of capital, but also access to technological capabilities, infrastructure and resources. This has gone hand-in-hand with an increasing economic liberalisation of most developing countries.

The role of the MNE as a viable source of both capital and technology is one of the key features of this new openness. In the process of embracing FDI as a solution to the myriad of economic ills - something even the World Bank has begun to do - little attempt is made to understand the rationale and the costs associated with this policy stance. Simply put, FDI is not a condition *sine qua non* for development. Too much emphasis has been placed on attracting FDI, and not on understanding how to optimise the benefits for the host economy".

2.4.2 Profitability or Economic Value Added (EVA) Performance

It is clear that every business operate in order to earn profit. In most cases the main goal of a business is making profit. A business may have other goals but if they do not make profit in the business then they will have to end the business (Lall, 2009). Profitability measure was developed by the Stern Stewart Corporation as an overall measure of financial performance; It is both a specific performance measure and the basis for a longer performance means a financial performance is most directly linked to the increase or decrease on shareholder value over time (Lall, 2009). Profit is net operating profit less an appropriate charge for the opportunity cost of all-capital invested in an enterprise.

Profitability gives managers better information and motivation to make decisions that will create the greatest shareholder wealth. The profitability measurement framework is typically used as a manager incentive plan. Since EVA is a single metric (although it can flow down and cross an enterprise to evaluate the performance of specific investments) it is complementary to the balanced scorecard and can be included in one (Osterloh, 1999).

2.4.3 FDI and Employment Opportunities

Most of scholars said that workers in foreign owned enterprises (FOEs) are more productive than workers in domestic owned enterprises (DOESs). This is supported by Gunna (1997) who analyzed differences in labor productivity between FOEs and locally owned firms in Morocco and Cote d'Ivoire. Shah (1998) also report that added value per worker is 59% higher for wholly owned foreign enterprises than for local firms in Kenya, 178% higher for FOEs in Zimbabwe and 1,422% higher for FOEs in Ghana. The worker productivity gap may be partly explained by the difference in training opportunities for workers in FOEs and DOEs.

The increase of FDI to China has been remarkable. From being non-existent as late as in the early 1980s, inward FDI increased to about 3.5 billion US in 1990, 41 billion in 2000 and 69 billion in 2006 (UNCTAD, 2008). China is today among the four largest receivers of FDI and the largest among developing countries. There are reasons to expect that the large inflows of FDI to China will continue. One reason is that they are still relatively modest in relative terms.

For instance, China's FDI inflow as a share of GDP was about 11 percent in 2006 (UNCTAD, 2008). This is considerably lower than the average for the world (25 percent) and East Asia (29 percent). Looking at the share of FDI in total capital formation (about 8 percent in China) gives a similar picture of relatively modest inflows to China when it is related to the size of the economy.

Lall (2009) assessed the impact of Italy's outward foreign direct investment (FDI) on local (domestic) employment growth between 1996 and 2001 for 12 manufacturing industries and 103 administrative provinces. Their main result was that, controlling for the local industrial structure and area fixed effects, FDI is associated with faster local employment growth, relatively to the national industry average. They also found that employment in small plants was not negatively influenced by higher levels of FDI. Their findings didn't support the idea that FDI was detrimental to local employment growth in the home country.

2.4.4 Government Revenue Mobilization

The last two decades of the 20th century have seen major shifts in the size of cross-border capital flows. FDI flows to developing countries and economies in transition have proved to be the source of economic growth. FDI remain a major source of external finance for developing countries and economies in transition. Foreign companies may also contribute to fiscal revenue through their operation. For the foreign companies involved in the acquisition of the former state owned companies through the privatization process they can, for example, generate a lot of revenue through the sale of the privatized companies. However, on the other hand the revenue impact is still ambiguous as the governments lose a lot of revenue through fiscal incentives extended to the foreign companies.

Government revenue contribution is also very important for economic development through tax revenue. In Tanzania between 2001 and 2003 privatized companies contributed about 6.7, 9.1 and 9.2 percent of total tax revenue in 2001, 2002 and 2003 respectively. However, there have been some policy conflicts between revenue generation and FDI attraction through tax incentives. Tax incentives can cost the government a lot of money. For example, if you consider the companies which have privatized in 2000, such as Carnaud Metal Box, and DAHACO, a three year tax holiday given to the companies, could have cost the country loss of about 0.2 and 0.4 percent of total tax revenue during the 2001-2003 (Tanzania Investment Centre).

The introduction of VAT in a number of developing countries has been successful in raising more revenue. But it is important to complement the VAT with either exemptions and/or excise duties to make it less regressive, thereby reducing the burden on poorer households. Excise duties have received less attention in the reform agenda compared to other instruments, but they can raise substantial revenue and at the same time be distributional friendly. However one needs to have realistic rates so as to avoidance and corruption and they should be seen as long-term opportunity for raising revenue as the economy develops and the consumption of luxury commodities rises (Levin, 2004).

2.5 Research Gap

There are a number of studies that have been undertaken on the effectiveness of tax incentives but not concentrated in Zanzibar. The researcher believes that the previous studies are not detailed to such degree and are outdated given current development in the FDI spectrum. This study will try to fill in the gap of the study by looking into the effectiveness of tax incentives to Zanzibar FDI activities.

2.6 Conceptual Framework

From the figure below it is shown that Independent variables (tax incentives) are expected to lead to increased FDI inflows in to Zanzibar.

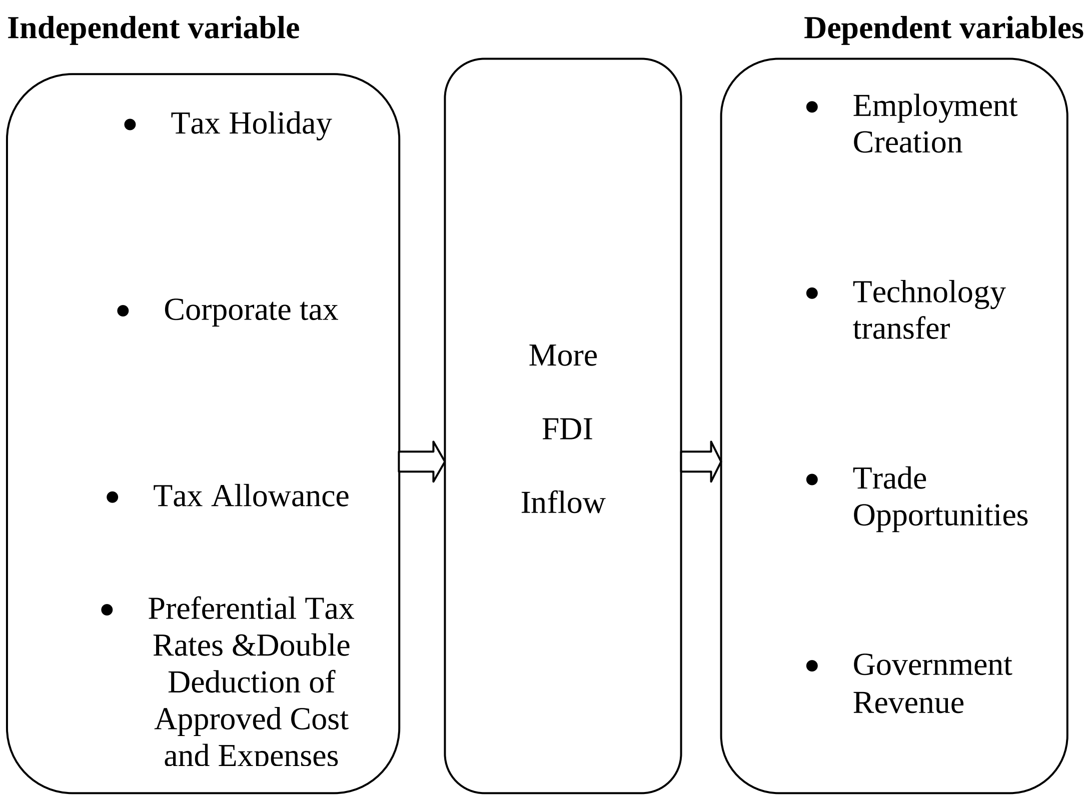

Figure 2.1: Conceptual Framework

Source: Researcher (2014)

Following more FDI inflows that are due to the tax incentives provided more employment opportunities, technology transfer, trade opportunities and increase of government revenue will be realized.

2.7 Theoretical Framework

This frame work includes all fiscal incentives stipulated by Zanzibar Investment Policy (ZIP) as inducement to FDI inflow but this study detailed on only three of them namely Tax Holiday, corporate tax and Tax Allowance. The fiscal incentives which do not detailed are preferential tax rates and double deductions of approved cost and expenses

2.7.1 Tax Holiday

Probably the most frequently used tax incentive is a tax holiday, whereby new firms are allowed a period of time during which they are relieved from the burden of income tax. A tax holiday thus eliminates tax on revenues from investment projects over the holiday period, which tends to encourage investment. This incentive is likely to reward the establishment of a new company rather than the expansion of an existing company and is thus more focused on the creation of enterprises than on the level of investment (OECD, 2001).

Although this type of incentive has a tendency to encourage new investment, taxpayers may use this measure to evade taxation of income from other sources. Existing companies may be tempted to start a new company that qualifies for a tax holiday and transfer its existing business and capital to the new company, resulting in a gain for the company and pure revenue loss for the treasury. Another disadvantage of attracting “footloose” investments (companies that relocate easily) by way of temporary benefits such as a tax holiday is that the companies may exit the country quickly once the benefit period ends (OECD, 2001).

2.7.2 Investment Allowance

Investment allowances permit companies to write off a percentage of qualifying investment costs from their taxable income and are usually allowed in the acquisition year or the first year of use of an asset. They provide tax benefits that are additional to the capital allowances deductible for the asset, resulting in total tax deductions exceeding the acquisition cost (OECD, 2001; UNCTAD, 2000). This type of incentive is mainly offered in respect of capital expenditure incurred by industrial enterprises (Ngowi, 2000). Investment tax allowances promote new investment rather than giving owners of old capital extra gain (as a reduction in corporate tax rates would do).

However, investment allowances also have limitations and drawbacks, especially for projects with long gestation periods – where the incentive is received upfront, but the benefits for the economy are only realised in future years, as well as where companies are not able to benefit from the incentive until income is earned (Ngowi 2000; Viherkentta, 1991).

2.7.3 Corporate Tax

Morisset (2000) recognised that “a low corporate tax rate is, in itself, an incentive… [and]… investors look favourably on a country offering a low statutory tax rate”. The benefit of this type of incentive is that investors are allowed to retain most of the company's profits, while governments are also able to minimise tax revenue losses by limiting aggressive tax planning. This is made possible by the simplicity of the tax system, which provides a reduced tax rate only, in stead of numerous incentives.

Developed and developing countries often use this tax incentive to attract investment. The rate reduction may be implemented in two different ways: A low standard rate which uniformly applies to all profitable business activities without biasing the allocation of capital, the choice of production technology or the form of financing; or a preferential tax rate reduction that applies to designated sectors (such as manufacturing or agriculture), or to selected beneficiaries based on discretionary screening criteria (such as small business corporations) (OECD, 2001). Lowering the tax rate can be very effective.

For example, the Government of Indonesia found that reducing the tax rate from 45% to 35% was equally attractive to most investors as the complex system of incentives that were previously in place (Miles 2009). For many years, Hong Kong (China) has also opted for a low effective corporate tax rate for all companies while providing limited or no incentives (UNCTAD, 2000; Miles, 2009).

2.7.4 Foreign Direct Investment

Buckley (2000) defines foreign direct investment (FDI) as a term used to denote the acquisition abroad of physical assets, such as plant and equipment, with operational control ultimately residing with the parent company in the home country. FDI may take different forms such as the establishment of new enterprises in an overseas country either as a subsidiary or branch, the expansion of overseas branch or subsidiary and the acquisition of overseas business enterprise or its assets.

FDI differs from foreign portfolio investment where a stake is taken in an overseas business without operational control, but with the view to acquiring an investment income stream through dividends, capital gains and so on. FDI is furthermore, defined as a situation where a foreign company create a subsidiary to provide goods and services. Thus a firm undertakes FDI in a foreign market if it possessed an ownership advantage over the local competitors. The ownership of the foreign investment usually remains in the investing (home) country. FDI represents the primary means of transfer of private capital (i.e. physical or financial), technology personnel and access to the brand names and marketing advantage (Makola, 2003).

2.7.5 Employment Creation

Foreign Direct Investment expected to result more employment opportunities, as a result of tax incentives, Government and all stake holders expect speedily expansion of FDI operations and result direct and indirect employment opportunities of Zanzibaries, if that is the case, researcher will measure the impact of tax incentives offered to FDI and informal employments resulted by the company during the covered period.

There exists some statistics to support the argument of employment creation by FDIs. UNCTAD (1999) gives the number of foreign employees employed by each of the world’s top 50 MNEs in 1997. The aggregate number is 2,324,300. On a global scale MNEs employed about 45 million persons in 1970s, (Enderwick, 1985). In 1986 the figure was 65 million, which is 3% of the total world labour force of 2,160 million (Dunning, 1992). In countries like Liberia, Zaire (Now Democratic Republic of Congo), Taiwan, Malaysia, Singapore, Fiji, Columbia and Argentina, MNEs employed directly 15% of the labour force. About 73 million people were employed directly by MNEs in 1993 (UNCTAD, 1999). Indirect FDI employment effect is said to be at least twice as much as the direct ones.

But when FDI takes the form of acquisition of existing companies there is a possibility that no new jobs are created but lost through retrenchments. It is also possible for FDI to lead into unemployment due to the MNEs' effects on market structure. Trans-nationalism increases the degree of monopoly, which leads to weaker competition and therefore stagnation followed by unemployment

The fact that MNEs are largely capital intensive makes it questionable whether they will actually create substantial amount of new jobs than a corresponding local establishment in developing countries. Arguably the indirect impact on employment through multiplier effects may still make FDIs good sources of employment their capital intensity notwithstanding. But to the extent that the figures of persons employed by MNEs given above are correct, there is no doubt on the role of FDIs as creators of employment.

2.7.6 Technology Transfer

Technology transfer, also called transfer of technology (TOT), is the process of transferring skills, knowledge, technologies, methods of manufacturing, samples of manufacturing and facilities among governments or universities and other institutions to ensure that scientific and technological developments are accessible to a wider range of users who can then further develop and exploit the technology into new products, processes, applications, materials or services. It is closely related to (and may arguably be considered a subset of) knowledge transfer.

Horizontal transfer is the movement of technologies from one area to another. At present transfer of technology (TOT) is primarily horizontal. Vertical transfer occurs when technologies are moved from applied research centers to research and development departments. Many companies, universities and governmental organizations now have an Office of Technology Transfer (TTO, also known as "Tech Transfer" or "TechXfer") dedicated to identifying research which has potential commercial interest and strategies for how to exploit it. For instance, a research result may be of scientific and commercial interest, but patents are normally only issued for practical processes, and so someone not necessarily the researchers must come up with a specific practical process.

Another consideration is commercial value; for example, while there are many ways to accomplish nuclear fusion, the ones of commercial value are those that generate more energy than they require to operate. There has been a marked increase in technology transfer intermediaries specialized in their field since 1980, stimulated in large part by the Bayh-Dole Act and equivalent legislation in other countries, which provided additional incentives for research exploitation.

2.7.7 Trade Opportunities

On trade opportunities, FDI can promote international trade by providing opportunities to expand and improve the production of goods and services. Particularly, the efficiency-seeking and export-oriented FDI can create exports of finished products to the investing countries, at the same time increasing imports of components and processed materials from the investing countries or other countries (UNCTAD, 1999).

With respect to FDI's impact on home and host countries imports, the report maintains that existing evidence suggests a positive but weak relationship between FDI and both home and host countries imports. The report re-affirmed that most empirical studies have concluded that there is a complementary relationship between home country exports and FDI, and that there is an overall positive correlation between host country exports and inward FDI. The report also noted that there was an increasing overlap of the determinants of investment and trade as firms determine simultaneously where to invest and from where to export.

In particular, the evidence indicates that foreign investment abroad stimulates the growth of exports from originating countries (investing countries) and, consequently, that this investment is complementary to trade. An analysis of 14 countries demonstrated that each dollar of outward FDI produces about two dollars' worth of additional exports.

Conversely, in host countries, short-term foreign investment most often tends to increase imports, whereas an increase in exports appears only in the longer term. However, in the short term, host countries enjoy many benefits from foreign investment (technology transfers, job creation, local subcontracting, etc.).

2.7.8 Government Revenue

It is the expectation of all countries engaged on accepting FDI that on future, central Government revenue will be increased as a result of expanding and increase sources of revenue, the researcher in this study is more interested to measure at what extent

FDI full fill this government expectation. Researcher will apply trend analysis on measurement of tax revenue collected by Zanzibar Government through Value Added Tax (VAT) and Pay as You Earn (PAYE) for the covered period.

For a host economy like that of Tanzania to benefit from this potential FDI role of increasing government revenues, a number of conditions have to be fulfilled. Among others, to benefit from privatization proceedings, royalties and dividends it takes good valuation, negotiation and contractual capabilities as well as a sense of broader national interest. For FDI-based taxes to contribute meaningfully in social-economic transformation and by extension to poverty reduction, adequate collection of taxes is needed.

This takes adequate tax estimation and collection techniques. Inter alia, it calls for sector specific (for example mining, gas, oil, hotel) knowledge, skills, and experience12. It also takes adequate knowledge on the way MNEs operate within the host economy and with parent companies as well as other affiliates in various tax jurisdictions including in tax havens. This is very important in the context of various tax evasion and avoidance techniques by MNEs. The techniques include but are not limited to tax planning and capital flight.

When the various revenues have been collected from MNEs undertaking FDIs in Tanzania, proper social-economic transformation and poverty reduction will be conditional to prudent expenditure of the collected revenues. From the discussion above it is clear that the theoretical FDI roles in the social-economic transformation and poverty reduction process are not automatic. It takes a number of conditions to be fulfilled if these potential roles are to be actualized.

2.7.9 Economic Development

It is important to understand that economic development in a nation is a slow process whereby the people's standards of living are improved as a result of increase in income, leading to a shift from low income to a high income economy (Spar, 2003). To accomplish economic development, the government needs to ensure a favorable environment for investment especially allowing foreign capital movement in to the economy. For this to be accomplished, the political environment has to be conducive for FDI who might be scared by investing their capital in a volatile economy.

In many less developed economies, population growth is usually high, leading to a large labor force with few opportunities for work. This is because there are few local industries to provide employment. Foreign investment comes in handy. It supplements the local industries generating employment for skilled and unskilled labor. This contributes to economic growth, as people are capable of coping with the increasing cost of living (Obstfeld and Rogoff, 1996).

Economic development is accomplished when an economy has a capable workforce to maintain competitiveness in the local industries. Knowledge and technology transfer are significant in economic development. Moreover, the establishment of foreign industries locally leads to the development of other enterprises (Feenstra, 2003). For example, small and medium enterprises providing goods and services to the employees of foreign companies are major income earners for the local population. Foreign investors are also major consumers of products manufactured locally. They use most of the products generated locally as raw materials such as agricultural products, which benefits the local producers since they have a ready market for their commodities (Houston, 2007). On the other hand, the byproducts from industries owned by foreign investors are used for local industries, which is important in lowering the price of commodities locally. The host government also earns through taxes paid by the foreign investors, as well as the increased income taxes from the employees of these companies. Increased foreign investment in a particular country indicates the presence of a favorable environment created by the country's regime (Bowles, 2004).

Other economies tend to reciprocate by offering their local resources to be exploited for economic development. The host nation is also likely to enjoy foreign markets for the locally produced commodities. Infrastructure is developed where the foreign industries are established, which is beneficial to the economy. For example, roads are developed for transportation of raw materials, airports are developed for landing and exportation of finished products and many other developments in infrastructure. In general, the local economy benefits to a large extent from foreign investment.

However, it is important to note that there are several disadvantages regarding foreign investment to the host economy. There is a likelihood of dependence on foreign companies in many aspects such as employment and government revenue through taxes to the extent that if the foreign investors withdraw, the economy is likely to collapse (Pritchard, 1996). On the other hand, the influx of foreign investors in a country leads to a rise in demand of particular services such as housing, leading to the increase in prices of the services, suppressing the local people who are unable to purchase the services. This deficit lowers the standards of living of the population.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

The foregoing chapter has embarked on operational definition, theoretical framework, and other related issues to FDI. This chapter was on methodological aspect of the study. It will be on research design, study area, population, sample and sampling techniques. The section proceeded with the research tools, data collection methods and validity and reliability.

3.2 The Research Design

According to Bryman (2008), research design entails the detail exploration of the specific case, which could be community, person or organization. Generally, research design is a framework for collecting and analyzing data. Kothari (2004) and Koda (2006) define research design as the arrangement of conditions for collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure. The research design is very important in doing research as it plays major task to define the research problem.

According to Kothari (2004), there is some significance of research design in doing research, research design stands for advance planning of methods to be adopted in collecting the relevant data, helps to time and money, helps to test hypothesis. Generally, it is a logical model of proof that allows the researcher to draw inference concerning the causal relationship among the variable under investigation.

This study used descriptive survey because this method has been used by Bitrina, et al (2011) in their study “The Role of Foreign Direct Investment (FDI) in Local Technological Capability Building: The Case of Tanzania” which resemble the topic of this study. Gupta (2001) depicts that descriptive survey involves gathering data that describe events and then organizes, tabulates, depicts, and describes the data, using both quantitative and qualitative data. It also uses description as a tool to organize data into patterns that emerge during analysis. The design had been used since data were collected at one point in time from a sample selected to represent a larger population.

The author added three other characteristic features of descriptive survey under cross-sectional design; first it has the ability to reach large number of people across a wide geographic area at short time, second it provides ease and low cost of distribution and third it often uses visual aids such as graphs and charts to aid the reader (Gupta, 2001).

3.3 Study Area

This study was conducted in Zanzibar at Zanzibar Investment Promotion Authority (ZIPA), which is one stop centre for the promotion and facilitation of investment and trade in Zanzibar.

3.4 Target Population

According to Bryman (2003), *Population*-basically is the universe of units from which the sample is to be selected. The term ‘units’ is employed because it is not necessarily people who are being sampled-the researcher may want to sample from a universe of nations, cities, regions, firms, etc. Thus, population has much broader meaning than the everyday use of the term, whereby it tends to be associated with a nation's entire population.

The targeted population for this study were officials from ZIPA who were largely provide us the situations of foreign direct investment (FDI) in Zanzibar, some officials from ZRB who were mainly provide us with the data tax collection from foreign direct investors and TRA officials who were mostly provide us with the data tax collection from foreign direct investors.

3.5 Sample Size

According to Cohen, et al (2001), a sample is a representative group drawn from the population in such a way that the findings from the sample can be generalised on population. Kusluvan (1998) defined sample as the analysis of large population where bias is minimized and the chance of inclusion of every member.

This study used the sample of 60 peoples. This sample was selected from three (3) institutions. Whereby, from each institution twenty (20) people will be selected to form a sample size of sixty (60). This going hand-to-hand with what Hogg and Tanis (1977), said, 25 to 30 observations are enough for analysis and reporting purposes.

3.6 Sampling Procedures

The sample was selected using both probable sampling procedures and non-probable sampling procedures. In probable sampling procedures, stratified sampling procedure was used. Stratified random sampling is a sampling technique whereby the total population was divided into different groups or layers before selection of the representatives (Kothari, 2008). This sampling procedure was directed to the three (3) institutions namely ZIPA, ZRB and TRA. This helped to ensure that every item in the population has an equal chance of inclusion in the sample, since the population does not constitute a homogeneous group. Thus, this design helped to obtained representative sample.

The main advantage of this method is that, it gives appropriate weighing to particular groups, which is small but more important to the study. The strata were formed on the basis of common characteristics, such as gender, education, position and age which will be found in each institution. In each stratum, items will be selected through simple random sampling so as to avoid biasness by the researcher. However, some key informant from each stratum will be selected purposefully so as to get intended data on that specific area where the sample found.

3.7 Research Tool

Cohen (2000) described research tools as the range of approaches used in gathering information, which are to be used as a basis for inference and interpretation, for explanation and prediction. This research used two different instruments namely: questionnaire and interview guide. These instruments generated the wide range of data which were both qualitative and quantitative. Questionnaire was targeted to the directors, coordinators and some officials. On other side, interview guides was targeted to some other officials, since there were high concentrations of respondents from different socio-economic background. Both provided different dimensions of the data on the subject. The instruments can be found on: (*Appendix II)* questionnaire and Interview Guide *(Appendix III)*.

3.8 Data Collection Methods

Data collection methods will fall under two categories. These will be those that were used during the field (in the field) and those after the field. Those during the field include structured interviews and focus group discussions were used. While after the field the researcher was collect the data through documentation in various libraries and departments.

3.8.1 Focus Group Discussions (FGD)

The focus group discussion is the method that used to elicit some in-depth information from the respondents. Basing on Corlien, et al (2003) and Morgan (1998) a focus group discussion should be constituted by six to twelve persons, three groups of discussion of respondents were conducted and each group comprised ten respondents.

The researcher facilitated the discussion in such a way that all group members (household members) during the discussion were left to talk freely and spontaneously about the different subtopics which emanated from the main topic. The discussion was guided by the group discussion guide lines (interview guide). The group discussions involved the key informants from ZIPA, ZRB and TRA. Keys informants were found in Unguja, there was high concentration of respondents from different socio-economic background. The groups were deliberately formed so as to elicit a diversity of experiences on the operations of higher education contribution.

This will be done by the help of the people who are familiar on that institution who were invited the researcher to deliver their presentation and then at the end of the presentation keys informant will be asked to volunteer for one hour group discussion on their convenient time.

3.8.2 Structured Interviews (S I)

A structured interview is sometimes called a standardized interview. The same questions are asked of all respondents. Corbetta (2003) states structured interviews are "interviews in which all respondents are asked the same questions with the same wording and in the same sequence." It would be ideal if questions can be read out in the same tone of voice so that the respondents would not be influenced by the tone of the interviewer (Gray, 2004).

Bryman (2001) explains structured interview entails: The aim is for all interviewees to be given exactly the same context of questioning. This means that each respondent receives exactly the same interview stimulus as any other. The goal of this style of interview is to ensure those interviewees "replies can be aggregated …"

Gender, employment and knowledge were given special consideration in this process. The interview was structured in such a way that it looks more as normal conversation. Before proceeding to the specific question related to the study, the interview started by asking general questions about daily life in the household. The aim was to create friendly environment for developing trust between the interviewers and respondents, it also provided chance to get more required information and clarification on some issues.

This procedure is supported by Kothari (2005) by saying that familiarising with the research environment minimizes barriers in data collection and in some instances allows the researcher to develop mutual trust that allows for smooth flow of information.

3.8.3 Document Reviews

Documentary analysis has been considered by many researchers as potential source of data for research Mason (1996). Providing the meaning of a document in research context, Bryman (2004) says that, it is any written material that can be read, have not been produced specifically for the purpose of social research, are preserved so that they become available for analysis and are relevant to the concerns of a social researcher. In this study, documents have been used to complement other sources of information with the idea that documents corroborate and augment evidence from other sources Yin, (1994). Various published and unpublished working documents and record from libraries of various departments and higher education institutions were used in collecting secondary data. This helped to obtain various information related to the study.

3.9 Data Collection Procedures

Before the actual operation of the research, a pilot study was conducted to insure the validity and reliability of the information. The pilot study helps the researcher to gain insight into which questions pose problems, which terms are misunderstood, and where questions might be inappropriate, insufficient or formulated in a way which induces misunderstandings (Noël, et al, 2005). After the pretest, the interview questions were adjusted for the necessary changes and the smooth of research. This led to revision of the instruments (for instance interview guide and interview schedules) to suit participants. Then, the instruments were fully administered to the rest of the subjects in order to give out the required information.

Also triangulation of methods was employed (interview, focused group discussion and documentary review). In the social sciences, triangulation is often used to indicate that more than two methods are used in a study with a view to double (or triple) checking results. This is also called "cross examination" (Cheng, 2005). These two measures were taken to maintain the validity and reliability of the findings of the study.

3.10 Reliability and Validity of Data

3.10.1 Validity of Data

Validity refers to the extent to which concept one wishes to measure is actually measured by particular scale or index. That is, the extent to which an account accurately represents the social phenomena to which it refers (kusluvan, 1998). Internal Validity in this research was achieved through proper identification of research problem, building a theoretical perspective on the various motivation programs, as well as using secondary information.

External Validity achieved through proper identification of the research problem, following the scientific research process, and the use of different research methods. Constructs validity was concerned with the validity of relationships between theoretical constructs variables operationalization and conclusion to be drawn

(Kothari, 2005). In order to achieve it, the scientific research process adopted from designing the research problem, and undertaking the research process.

3.10.2 Reliability

Reliability refers to the consistency with which repeated measures produce the same result across time and across observers. Reliability denotes to how consistent a research producer or instrument. Reliability concerns with the question of whether the results of a study are repeatable. So, Reliability implies stability or dependability of an instrument or procedure in order to obtain information (Bryman, 2001). Again proper study have to regards to reliability, consistency, stability and predictability (synonyms for reliability), whether the result is replicable.

Therefore the stability and equivalence aspect of reliability of this research study was achieved or increased by carefully replicating the research methods. This can be conducted by pre-testing of different data collection methods such as focus group discussion, questionnaire and interview, as well as conducting pilot study in the field before the actual study.

The researcher of this study used these methods to ask the same question so as to check the reliability of the data. Again the researcher used these different data collection methods on asking the alike questions from different organization (which are ZIPA, TRA and ZRB). Furthermore, the researcher conducted pilot study on data collection methods on the field to check the reliability of the data. He used to provide the sample question to all ZRB, TRA and ZIPA.

The researcher of this study used to apply different data collection methods such as interview and focus group discussion in different organizations (ZIPA, TRA and ZRB) before actual study. This also insured the reliability of the data collected in this study. Finally the result obtained from the secondary data of Zantel as an example of Foreign Direct Investors, which its contribution in percentage determined in relation to the Zanzibar GDP, tax exempted to investors, and the contribution of the company to social security fund as welfare of its employee *table 4.15,* supported the field data by providing the same results.

3.11 Data Analysis

Data analysis refers to examining what has been collected in a survey or experiment and making deductions and inferences, (kulsuvan, 2008). Indeed, Kothari (2005) said that research data are processed through editing, coding, classification and tabulation. In this dissertation, data were analysed and processed through editing, coding, tabulation and pictorial presentation. Data analysis method is normally dependent on the types of data the study aims at collecting. Even though this study is qualitative in nature, it became necessary that the methods of data analysis contained both qualitative as well as quantitative forms of data.

3.12 Ethical Issues

There are a number of ethical principles that should be taken into account when performing quantitative research. At the core, these ethical principles stress the need to do good and do no harm. In practice, these ethical principles mean that as a researcher, you need to obtain informed consent from potential research participants;

minimise the risk of harm to participants; protect their anonymity and confidentiality; avoid using deceptive practices; and give participants the right to withdraw from your research (Panter, 2011).

On the other hand, in qualitative research ethical consideration involves certain principals such that informed consents, confidentiality, privacy, free from harm and right to withdrawal from the study (Stevens, 2013). In the looking of these two school of thought. It found that most of these ethical principles are common. Thus this article discusses these five ethical principles. This research regarded the ethical issues in the following aspects;

Firstly, it was voluntary participation of the respondents in the sense that they were not compelled to participate. Secondly, they were free to express there feelings by giving them sufficient time to respond. Thirdly, the method used to collect the data was not associate the names and other individual addresses which are immaterial in the context of this research.

Finally, it is argued by Creswell (2003) that during research the researcher is compelled to develop an informed consent form for participants to sign before they engage in the research. This form acknowledges that the participants' rights have been protected during data collection. The informed consent form is found in *Appendix I.*

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

4.1 Introduction

In the preceding chapter, the methodological aspect of the study was presented. This chapter puts forward data presentation and findings of the study. It includes the profile of the respondents, followed by the presentation, analyses and discussion of the results with the experience to the first objective, second objective and third objective of the study.

4.2 Profile of Respondents

This research involved sixty (60) respondents from the study area. Most of the respondents were TRA officials, ZRB officials, and ZIPA officials. All were interviewed in their offices. The profile of the respondents that covers their age, gender, education and employment is shown below.

4.2.1 Respondents' Composition by Age

Age of the respondents ranged from twenty to over fifty years. Grouping the respondents based on their age at the interval of ten years, four groups were obtained. The number of respondents whose age ranged between 30 to 39 years was 16 (26.7%), while those respondents whose age ranged between 40 to 49 years was 28 (46.7%). 16 responses (26.7%) were aged above 50 years. This distribution is as presented in Table 4.1.

Table 4.1: Distribution of Respondents by Age

Age Group	Frequency	Percentage (%)
30-39	16	26.7
40-49	28	46.7
50-59	16	26.7
Total	**60**	**100**

Source: Field Survey, (2014)

The data implied that most of the respondents were in the group of 40-49 years. The group was mostly matured, active, energetic and powerful to perform both office and manual works. The group also was capable to perform various duties and responsibilities that if they were maintained and given special consideration they would contribute to the socio-economic development of their nation.

4.2.2 Respondent's Composition by Gender

Male respondents who were 35 (58.3%) outnumbered female respondents who were only 25 (41.7%). This is due to the reason that most of the male populations were the one who were the crux of this study in the offices. Table 4.2 demonstrates the data.

Table 4.2: Distribution of Respondents by Gender

Gender	Frequency	Percentage (%)
Male	35	58.3
Female	25	41.7
Total	**60**	**100**

Source: Field survey, (2014)

The results indicate that majority of respondents were male, who are over fifty percent (58.3%) compared to 41.7% female respondents. This implies that there is high concentration of male employees in the visited organizations compared to the female. However, the special efforts should be taken by the government to increase the qualified female employees across the departments of the organizations so that to benefit from their contributions.

4.2.3 Respondent's Composition by Education

Education of respondents ranged from primary education to college and university education. Out of 60 respondents, twenty eight (28) respondents (46.7%) had University education. While sixteen (16) respondents (26.7%) had college education and the remaining sixteen (16) respondents (26.7%) had secondary education. The results are as shown in Table 4.3.

Table 4.3: Distribution of Respondents by Education

Education	**Frequency**	**Percentage (%)**
University	28	46.7
College	16	26.7
Secondary	16	26.7
Total	**60**	**100**

Source: Field Survey, (2014)

Since the majority of respondents have university education level, the results implied that they are well professional with respect to their departments, meaning that they are resourceful and important to the development of their department on the FDI attraction and flow in the study area, this could develop policy that can favour mutual benefit between the FDI and the host country. They could also have high ability to adopt and cope with new technology. In addition, they could contribute more to the government revenue and national income at large as a result the individual and social welfare of home country and host country would be promoted.

4.3 Fiscal Incentives Attracting FDI in Zanzibar

The first objective of this study was to explore the role of fiscal incentives in attracting FDI in Zanzibar. To be able to show that seven important items were found, namely the contribution of fiscal incentives, the position of corporate tax, part of tax holiday incentive, investment allowance, reinvestment allowance and position of preferential tax rates and double deductions of approved cost and expenses. This study observed four items including three fiscal incentives namely the contribution of fiscal incentives, the position of corporate tax, part of tax holiday incentive and investment allowance. The section responds to the question: fiscal incentives attract more FDI in the study area?

4.3.1 Contribution of Tax Incentives

The study findings indicate that large proportion of respondents 43.3% out of the total responses agreed that fiscal incentives attract more FDI in the study area. However, twenty five (25) respondents which is equal to 41.7% out of the total respondents indicated that non fiscal incentives attract more FDI in the study area. The rest of responses (9) responses, which are equal to 15% out of the total responses, depicted that they not know which determinants attract more FDI in the study area. Table 4.4 revealed the findings.

Table 4.4: Contribution of Tax Incentive

Tax Incentives	Frequency	Percentage (%)
Fiscal Incentives	26	43.3
Non Fiscal Incentives	25	41.7
Don’t Know	9	15.0
Total	**60**	**100.0**

Source: Field survey, (2014)

The results implied that fiscal incentive contribute in large extent to the FDI flow and attraction in the study area which means that the it increases the Government revenue, the creation of job opportunities, the technology transferred to the host country which results to the rise of development of the country.

Also, when observing the tax relief provided by the government such as corporate tax relief and capital allowance relief which are provided by ZIPA, more FDI were retained in the study area. However, other non fiscal determinants such as security, political atmosphere contribute to the FDI flow in the study, which is an additional qualification contributing in the attraction of FDI.

4.3.2 Corporate Tax Relief

The data indicate that large proportion of respondents, above fifty five percent (55%) of the total responses depicted that corporate tax relief increase FDI flow in the study area. Meanwhile, eighteen point three percent (18.3%) out of the total responses believed that corporate tax relief increase FDI flow. The rest of responses, sixteen respondents (26.7%) showed that the presence of corporate tax only did not result to more FDI flow in the study area.

Table 4.5: Corporate Tax Relief

Corporate Tax Relief	Frequency	Percentage (%)
More FDI Flow	11	18.3
FDI Flow	33	55
Less Flow	16	26.7
Total	**60**	**100.0**

Source: Field Survey (2014)

The results implied that since large percent of respondents agreed that corporate tax increase FDI flow in study area, employment opportunities increases, and individual's income increases the technology transferred to the host country which results in economic development. Also, the results show that the country to have more FDI inflow the Government should use other determinants to induce them to invest in the country. Therefore, the corporate tax relief should be affordable and competitive enough to assure profits and thus stimulate more investments (FDI) in Zanzibar (Table 4.5).

4.3.3 Tax Holiday Incentive

The study findings indicate that large percentage of responses (56.7%) out of the total responses complained that tax holiday is less encouraging the FDI in the study area. Meanwhile, twenty eight point three percent (28.3%) of the total responses explained that tax holiday encouraged FDI in the study area; and the remains of the responses that are nine (9) responses, which is equal to (15%) were encouraged by this incentives.

Table 4.6: Tax Holiday Incentive

Tax Holiday Incentive	Frequency	Percentage (%)
More Encouragement	9	15.0
Encourage	17	28.3
Less Encouragement	34	56.7
Total	**60**	**100.0**

Source: Field Survey (2014)

The majority indicates that tax holiday relief alone has to contribution on FDI flow in the study area. The findings are as indicated in table 4.6 above.

4.3.4 Investment Allowance

In Table 4.7 the result indicates that sixteen responses (16) which are equal to 26.7% out of the total responses conveyed that investment allowance promotes more FDI flow in the study area. Fifty percent (50%) out of the total responses explained that investment allowance just promotes the FDI flow. However, the rest of the responses complained that investment allowance promoted less FDI flow in the study area.

Table 4.7: Investment Allowance

Investment Allowance	Frequency	Percentage (%)
More Promotion	16	26.7
Promotion	30	50.0
Less Promotion	14	23.3
Total	**60**	**100.0**

Source: Field Survey (2014)

This implied that the investors (FDI) are of greater interest in investment allowance. Thus, the expenditure on new capital assets should be encouraged by various kinds of allowances and annual depreciation so that to promote more investors in the study area.

4.3.5 Discussion of the Findings

Generally, study findings show that out of the total respondents from the study area, large proportion of respondents, (43.3%) agreed that fiscal incentives attract more FDI in the study area. However, twenty five (25) respondents which are equal to 41.7% out of the total respondents claimed that non fiscal incentives attract more FDI in the study area. The rest of responses (9) which are equal to 15% out of the total responses depicted that they do not know which determinants attract more FDI in the study area. This result implied that fiscal incentives attract more FDI in the study area. As one of ZRB official puts:

> *"It is open and undeniable to say that one amongst the major determinants of FDI flow is fiscal incentives. However there are other determinants of FDI flow in our country such as political climate, infrastructure and market."*

This statement is supplemented by a study done by Tanzi and Zee (2001) on tax policies for developing countries. It indicated that while granting tax incentives to promote investment was common in countries around the world, evidence suggested that its effectiveness in attracting investments above and beyond the level that would have been reached had no incentives been granted, was often questionable.

However there are other factors, these include business facilitation; investment promotion (including image-building and investment-generating activities and investment-facilitating services); investment incentives; hassle costs (related to corruption and administrative efficiency); social amenities (for example quality of life); and after investment services (UNCTAD World Investment Report, 1998).

According to Ngowi (2000), FDI inflows to a country depend largely on the presence of economic, political and social stability, and rules regulating entry and operations of businesses. Others are standards of treatment of the foreign affiliates; business facilitation (including, inter-alia, investment incentives; market size, growth, structure and accessibility; raw materials, low cost but efficient labor force and physical infrastructure in form of ports, roads, power and telecommunication).

Concerning the corporate tax relief, large proportion of respondents, over fifty percent (55%) of the total responses depicted that corporate tax relief increase FDI flow in the study area. Eighteen point three percent (18.3%) out of the total responses claimed that corporate tax relief in the study area increase more FDI flow and the rest of responses, sixteen respondents (26.7%) out of the total responses showed that the presence of corporate tax only in the study area result to less FDI flow in the study area. This means that corporate tax relief increased FDI flow in the study area. The data revealed that:

> *"Corporate tax provides more chance to FDI flow in our country. The inflow of foreign direct investors in this island is influenced by the number of factors. However corporate tax is one among the leading influencing factor in the attraction and promotion of FDI in this world of competition".*

Table 4.6 indicates that large percentage of responses (56.7%) out of the total responses complained that tax holiday is less encouraging the FDI in the study area.

While twenty eight point three percent (28.3%) of the total responses explained that tax holiday encourage FDI in the study area; and the remains of the responses nine (9) responses which is equal to (15%). One among the TRA official puts:

> *"……..actually the most frequently used tax incentive is a tax holiday, tax holiday play greater role in attracting foreign investors in our country. Look for instance in this globalize world, multilateral companies who are the FDI look more influencing factors to invest in a particular nation. Thus having many competitive determinants including tax holiday could attract more FDI in to our nation".*

Probably the most frequently used tax incentive is a tax holiday, whereby new firms are allowed a period of time during which they are relieved from the burden of income tax. A tax holiday thus eliminates tax on revenues from investment projects over the holiday period, which tends to encourage investment. This incentive is likely to reward the establishment of a new company rather than the expansion of an existing company and is thus more focused on the creation of enterprises than on the level of investment (OECD, 2001).

Above all, Table 4.7 indicates that sixteen responses (16) which are equal to 26.7% out of the total responses revealed that investment allowance promotes more FDI flow in the study area. Fifty percent (50%) out of the total responses explained that investment allowance just promotes the FDI flow. However the rest of the responses complained that investment allowance less promote the FDI flow in the study area. As explained:

> *"As my fellows explained about fiscal incentives, it's quite true for me to say that more new foreign investors in our country are attracted as the result of investment allowance. Several new foreign companies are investing because of the availability of the investment allowance during investment".*

Investment tax allowances promote new investment rather than giving owners of old capital extra gain (as a reduction in corporate tax rates would do). However, investment allowances also have limitations and drawbacks especially for projects with long gestation periods – where the incentive is received upfront, but the benefits for the economy is only realized in future years, as well as where companies are not able to benefit from the incentive until income is earned (Ngowi, 2000; Viherkentta, 1991).

4.4 Impact of FDI on Zanzibar Economic Development

The second objective of this study was to find out the impact of foreign direct investment on Zanzibar economic development. To be able to show that four important impacts were found, namely; employment creations, technology transfer, trade opportunities and government revenue. The section responds to the question: What are the impacts of FDI on Zanzibar economic development?

4.4.1 Employment Opportunities

The study findings indicate that thirty percentage (30%) out of the total responses explained that FDI create more employment opportunities in the study area. While thirty five percent (35%) out of the total responses puts that FDI create the employment opportunities in the study area. Even though the remains responses

(35%) out of the total responses complained that FDI create less employment opportunities in the study area.

Table 4.8: Employment Opportunities

Employment Opportunities	Frequency	Percentage (%)
More Employment	18	30.0
Employment	21	35.0
Less Employment	21	35.0
Total	**60**	**100.0**

Source: Field Survey (2014)

The results suggested that FDI can provide employment opportunities and exports, but also indirectly through promoting human capital, so as to increase capability of productivity, hence provide more employment opportunities to the local people; thus it is important to open the door for more FDI inflow. The findings are as indicated in Table 4.8.

4.4.2 Technology Transfer

The data indicate that fourteen (14) responses which are equal to twenty three point three (23.3%) portrayed that FDI lead to more technology transfer in the study area. While eighteen (18) responses which are equal to thirty percent (30%) of the total responses explained that FDI have influence technology transfer in the study area.

Table 4.9: Technology Transfer

Technology Transfer	Frequency	Percentage (%)
More Technology Transfer	14	23.3
Technology Transfer	18	30.0
Less Technology Transfer	28	46.7
Total	**60**	**100.0**

Source: Field Survey (2014)

However the rest of respondents protested that FDI have less influence on technology transfer in the study area. The data indicate that there is moderate rate of technology transfer in the study area because of the FDI policy needs to be adjusted so that to increase the transfer of technology. This due to the fact that transfers of advanced technology are not provided in sufficient amount the countries cannot accelerate the acquisition of knowledge, experience and equipment related to advancement, innovative industrial products and development.

4.4.3 Trade Opportunities

The study results indicate that twenty (20) respondents which are equal to thirty three point three percent (33.3%) out of the total responses explained that FDI create more trade opportunities in the study area. While twenty two (22) responses which are equal to thirty six point seven (36.7%) of the total responses depicted that FDI create trade opportunities. Even though, eighteen (18) responses which are equal to thirty percent (30%) out of the total responses complained that FDI create less employment opportunities in the study area.

Table 4.10: Trade Opportunities

Trade Opportunities	Frequency	Percentage (%)
More Trade Opportunities	20	33.3
Trade Opportunities	22	36.7
Less Trade Opportunities	18	30
Total	**60**	**100.0**

Source: Field Survey (2014)

The data means that trade opportunities boost the development and reduces the poverty through the reduction of cost of living and facilitate diversification by allowing the developing countries to access new markets of the host country. On the other hand, it contributed in business opportunities expansion to the local companies by opening new markets and expands choice and lower price of commodities to customers. Table 4.10 depicts the results.

4.4.4 Source of Government Revenue

As shown in table 4, nine (9) responses which is equal to fifteen percent (15%) out of the total responses conveyed that FDI is the most sources of government revenue. Twenty five (25) responses which are equal to fourty one point seven percent (41.7%) of the total responses expressed that FDI is the source of government revenue. The rest of responses, fourty three point three percent (43.3%) out of the total responses protested that FDI is the least source of government revenue.

Table 4.11: Source of Government Revenue

Sources of Revenue	**Frequency**	**Percentage (%)**
Most Source	9	15.0
Source	25	41.7
Least Source	26	43.3
Total	**60**	**100.0**

Source: Field Survey (2014)

This means that the existing government policy about FDI does not put more priorities on fiscal benefit but there exist non fiscal benefit which has potential contribution in the economic development of Zanzibar.

4.4.5 Discussion of the Findings

Based on the data shown in Table 4.8, over fifty percent (65%) out of the total responses agreed that FDI provide employment in the study area. However out of this 65%, thirty percent (30%) have said that FDI provides more employment, while thirty five percent (35%) puts that FDI provide employment. Even though, the remains thirty five percent of the total responses complained that FDI provide less employment in the study area.

This means that FDI contributed in creating employment opportunities. It is beyond the scope of this study to include whether the level realized is an optimal one or better results can be achieved. As one of the ZIPA officials puts it;

> *"The investors from abroad reduce the gap of unemployment in our country. Look for example several youth from this county have been employed in the telecommunication companies, these includes ZANTEL, TIGO, VODACOM and AIR TELL.*
>
> *If not enough our youth have been employed in tourism sectors as well as transportation sectors who are the major foreign invested area."*

This is supported by Cao (2003) pointed out that FDI both helps to create more work opportunities for a country and changes the employment structure. The author reported that the effect of FDI on the secondary and tertiary sectors is greater than the effect on the primary sector, and that the inflows of FDI help people move from the primary sector to the secondary and tertiary sectors, thereby changing the proportion of the national economy attributable to each of these three main sectors.

However, Cai and Wang (2004) argued that, although the proportion of employment in foreign investment enterprises is still small, FDI could make a big contribution to employment growth in a nation. In the case of technology transfer, the study findings stipulated that a larger number of respondents (53.3%) explained that FDI is source of technology transfer in the study area. Out of this 53.3% only twenty three point three percent (23.3%) said that FDI provide more technology transfer while thirty percent (30%) puts that FDI just lead to technology transfer in the study area. Contrarily the remains respondents 46.7% out of the total responses protested that FDI provide less technology transfer in the study area. This implied that FDI provide technology transfer in the study area. As official explained:

> *"To initiate new technology in our country is not possible. The major way we develop technologically is through bilaterally and multilaterally companies who are the foreign investors. Thus it is not deniable that FDI provides technology transfer in our country. Therefore we have to create conducive environment so that to attract more FDI in our country."*

A general view in literature on FDI has been agreed that FDI plays a major role in the economic development of the host country through the benefits associated with it (Hanson, 2001). According to Hanson, these include, amongst others, the creation of new employment, technological transfer and know-how, increased trade integration with the rest of the world.

Studies by Rodriguez-Glare (1996) and Blomstrom *et al.* (1992) also suggested that FDI might be able to enhance economic growth of host countries through technology transfer and spillover efficiency. Direct technology transfer from multinational enterprises (MNEs) to local subsidiaries allows host countries to upgrade their industries by absorbing new technology in production.

Meanwhile on trade opportunities, Table 4.10 indicates that thirty three point three percent (33.3%) out of the total responses explained that FDI create more trade opportunities in the study area. While twenty two (22) responses which are equal to thirty six point seven (36.7%) of the total responses depicted that FDI create trade opportunities. This means that 70% of response agreed that FDI create trade opportunities. Even though, eighteen (18) responses which are equal to thirty percent (30%) out of the total responses complained that FDI create less employment opportunities in the study area. This means that FDI create trade opportunities in the study area. This has been explained by one of the ZIPA official:

> *"In fact the lives of trade have been change after the incoming of the foreign direct investors. There are more trade promotion and development in our country. Both local trade and international trade have change. The local entrepreneurs now are in good position to promote their production on the international market. It is good for trade development in our nation".*

This information has been supplemented that FDI can promote international trade by providing opportunities to expand and improve the production of goods and services. Particularly, the efficiency-seeking and export-oriented FDI can create exports of finished products to the investing countries, at the same time increasing imports of components and processed materials from the investing countries or other countries (UNCTAD, 1999).

Above all, on the issues of revenue the data revealed that nine (9) responses which is equal to fifteen percent (15%) out of the total responses conveyed that FDI is the most sources of government revenue. While twenty five (25) responses which are equal to fourty one point seven percent (41.7%) of the total responses expressed that FDI is the source of government revenue. The rest of responses, fourty three point three percent (43.3%) out of the total responses protested that FDI is the least source of government revenue. As ZRB official described:

> *"We do collect revenue from foreign investors and the government earns more from these companies. However we lose the revenue from these companies through the provision of tax incentives to these companies".*

Foreign companies may also contribute to fiscal revenue through their operation. For the foreign companies involved in the acquisition of the former state owned companies through the privatization process they can, for example, generate a lot of revenue through the sale of the privatized companies. However, on the other hand the revenue impact is still ambiguous as the governments lose a lot of revenue through fiscal incentives extended to the foreign companies.

Basing on secondary data (Table 4.12, Table 4.13, Table 4.14 and 4.15) on appendix the secondary data indicate that there is high contribution of FDI on the socio-economic development in the study area. For instance Table 4.12 shows that for the period of ten years from 2000 to 2010, Zanzibar collected tax of 315.2 billion where as the tax exempted was 124.5 billion which is equal two hundred and fifty three percent (253 %) of the tax exempted.

Table 4.12: Tax Exempted and Collected in Zanzibar 2000 – 2010

Year	Tax Exempted (in Billions)	Tax Collected (in Billions)	Percentage
2000 – 2005	28.3	109.0	385.2%
2006 – 2010	96.2	206.2	214.3%
Total	**124.5**	**315.2**	**253.2%**

Source: Zanzibar Revenue Authority Revenue Report 2000 -2010

This implies that the foreign companies contributed to Government fiscal revenue within the defined period, by a profit of one hundred and fifty three percent (153%) of the tax exempted. On determining the reliability of the data the researcher took Zantel as an example of foreign Direct Investors who contributed to government revenue. Table A2 on appendix shows the trend of Tax paid by Zantel as the contribution to Zanzibar government revenue in relation to Tax exempted by the Government to all investors including domestic and foreigners for the period from 2004 to 2014.

Table 4.13: Tax Paid by Zantel to Zanzibar Government in Relation to Tax Exempted Government to Investors (Foreign & Domestic)

Years	Tax Payed By Zantel	Tax Exempted To Zanzibar Investors	Zantel Percentage Contribution
2004/5	1,671,595,670.61	**NA**	**NA**
2005/6	2,216,973,918.41	3,052,267,772	72.63%
2006/7	3,218,754, 983.41	6,743,598,675.10	47.73%
2007/8	6,045,037,940.49	9,725,016,657.06	62.15%
2008/9	8,600,073,420.43	13,451,664,865.10	63.93%
2009/10	16,810,861,184.12	12,409,688,972.60	135.46%
2010/11	10,330,943,917.52	11,153,196,745.80	92.62%
2011/12	14,005,726,702.94	11,093,490,897.80	126.25%
2012/13	19,148,889,514.03	9,686,775,866.80	197.68%
2013/14	20,467,943,671.58	9,397,383,265.70	217.80%
Total (2005 - 2014)	**118,277,175,055.11**	**95609943496**	**112.9%**

Source: ZANTEL Department of Finance & TRA Customer Department Zanzibar Branch, 2015

The trend shows that, excluding the year 2004 which its tax exempted was not available for comparison, only one member of FDI (Zantel) contributed between fourty seven point seven three (47.73%) and two hundred and seventeen point eight (217.8) per year. For that period of ten years till 2014, the government exempted a total amount of shs 95,609,943,496 (95.6 billion) while Zantel only contributed tom Zanzibar Government Revenue a total amount of Tshs. 118.3 billion in the form of VAT, ED, WHT, SD, SDL and PAYE which is equal to an average of 113% based on the exempted tax.

The above implies that if the only one member of FDI paid more than hundred percent of the total tax exempted to foreign and domestic investors, of cause there exist a lot of fiscal benefit if we take in to account Foreign Direct Investors in there totality, in relation to tax exempted to them only.

Table 4.14: Tax Paid by ZANTEL in Relation to Zanzibar GDP at Market (Current) Price

Years	Tax Payed by Zantel	Zanzibar Gdp in Current Prices	Percentage (%)
2004/5	1,671,595,670.61	333,000,000,000.76	0.51%
2005/6	2,216,973,918.41	407,000,000,000.38	0.54%
2006/7	3,218,754, 983.41	517,000,000,000.27	0.62%
2007/8	6,045,037,940.49	735,000,000,000	0.82%
2008/9	8,600,073,420.43	851,000,000,000	1.01%
2009/10	16,810,861,184.12	939,000,000,000	1.79%
2010/11	10,330,943,917.52	1,051,000,000,000	0.98%
2011/12	14,005,726,702.94	1,344,000,000,000	1.04%
2012/13	19,148,889,514.03	1,565,000,000,000	1.22%
2013/14	20,467,943,671.58	1,850,000,000,000	1.10%
Total	**118,277,175,055.11**	**11,726,000,000,001.4**	**1.01%**

Source: ZANTEL Department of Finance & Office of Government Statistician (2015)

On Table 4.14 it shows the contribution of Zantel to Zanzibar GDP in market (current) price for the period of ten years till 2014. The trend shows that only one foreign investor contributed between 0.51% and 1.1% of GDP per year, and for the whole period of ten years, it contributed 118.7 billion out of 11.73 trillion collective GDP, which is equal to an average percentage of 1.01% of the total GDP in current price.

This implies that the contributed percentage even though it seems to be a small amount but compared to the number of sources of income to the Government revenue, it is very big percentage and contributed much. So if we consider all FDI of course they have high contribution to the Gross Domestic Product in the study area. Table 4.15 it shows the contribution of Zantel for the period of ten years till 2014 to Social Security Funds including ZSSF, PSPF, NSSF and PPF, as a welfare to if employee. During this period the company contributed about 8.5 billion.

Table 4.15: Contribution of ZANTEL to Social Security Funds (ZSSF, NSSF &PPF)

Years	Contribution
2004/5	78,824,908.30
2005/6	98,132,657.40
2006/7	152,834,775.00
2007/8	304,427,890.50
2008/9	595,910,647.00
2009/10	878,664,172.57
2010/11	1,285,628,830.06
2011/12	1,584,791,851.72
2012/13	1,697,286,836.43
2013/14	1,788,318,551.12
Total	**8,464,821,120.10**

Source: Zantel Department of Finance, 2015

It is evident that the contribution provided a positive effect in boosting the economy to the study area through individuals themselves and the government as a whole through various means such as paid tax by individuals, business conducted by the funds and so on. That is to say in this aspect Zantel also contributed to the Government Revenue and proved that FDI contributed fiscal incentives direct through taxes and indirect through Social Security Funds and so on.

4.4 Policy Changes towards Economic Development

The third objective was to determine policy changes needed to make FDI contribute more to the Zanzibar's economic development. In order to accomplish this objective three policy changes were examined; namely setting time limit on incentives, policy review and adjustment and number of foreign employee. This section responds to the question: What kind of policy changes are needed to make FDI contribute more to the Zanzibar's economic development?

4.4.1 Policy Review and Adjustment

The results indicate that eight (8) responses which are equal to thirteen point three percent (13.3%) of the total responses complained that the policy review and adjustment on cost and benefit of FDI could be the proper policy change needed towards economic development. While sixteen (16) responses which are equal to twenty six point seven percent (26.7%) out of the total responses lamented that the policy review and adjustment on cost and benefit of fiscal incentives (FI) could be the proper policy change of FDI towards economic development. The remaining, majority of responses (60%) out of the total responses agreed that the policy review and adjustment on both cost and benefit of fiscal incentives (FI) and (FDI) could be the proper policy change of FDI towards economic development. This implied that the existing policies on both FDI and FI are not economically friendly in the study area. Thus proper policy review and amendment on both FDI and FI is crucial in the study area so as to make FDI more productive in the study area. The data are as depicted in Table 4.16.

Table 4.16 Policy Review and Adjustment

Policy Review and Adjustment	**Frequency**	**Percentage (%)**
Cost and Benefit of FDI	8	13.3
Cost and Benefit of FI	16	26.7
Both	36	60.0
Total	**60**	**100.0**

Source: Field Survey, (2014)

4.4.2 Setting Time Limit over Incentives

The data indicated that the policy change towards effective FDI to promote economic development is setting time limit on incentives. Large proportion of responses, over fifty percent (58.3%) out of the total responses agreed that setting time limit on incentives could be the proper policy change of FDI towards economic development. While twenty five (25) responses, which is equal to fourty one point seven percent (41.7%) out of the total responses depicted that open time could be the proper policy change of FDI towards economic development. The data are as shown in Table 4.17.

Table 4.17: Time Limit on Incentives

Time Limit	**Frequency**	**Percentage (%)**
Time Limit	35	58.3
Open time	25	41.7
Total	**60**	**100.0**

Source: Field survey (2014)

The data means that there is no time limit on incentives in the study area since FDI take chance on this weakness to exploit the resource of the host country. Thus setting time limit on the incentives could budge the gape and monitor the FDI contribution over the time.

4.4.3 Number of Foreign Employees

The study findings indicate that large proportion of responses (76.7%) out of the total responses accepted that to limit the number of foreign employee could be the proper policy change of FDI towards economic development. While fourteen (14) responses which is equal to twenty three point three percent (23.3%) depicted that Open number of foreign employee could be the proper policy change of FDI towards economic development. Table 4.18 addresses the data.

Table 4. 18 Number of Foreign Employee

Number of Foreign Employee	**Frequency**	**Percentage (%)**
Limit number of employee	46	76.7
Open number of employee	14	23.3
Total	**60**	**100.0**

Source: Field Survey, (2014)

The results implied that there is the problem of employment of native professional workers in FDI in the study area. That is foreign direct investors do employ foreigners rather than the natives of the study area. Majority of top professional in FDI are the foreigners. This eats the employment opportunities of the native with similar professional. Thus limiting the numbers of foreign employees in FDI will create more employment opportunities to the native hence economic development.

What is important is to insure that the natives are educated and trained to be equally or even better qualified than their foreign counterparts.

4.4.4 Discussion of the Findings

Generally the results indicate that large proportion of respondents (60%) out of the total responses agreed that the policy review and adjustment on both cost and benefit of fiscal incentives (FI) and (FDI) could be the proper policy change of FDI towards economic development. Sixteen (16) responses which are equal to twenty six point seven percent (26.7%) out of the total responses lamented that the policy review and adjustment on cost and benefit of fiscal incentives (FI) could be the proper policy change of FDI towards economic development. The remaining eight (8) responses which are equal to thirteen point three percent (13.3%) out of the total responses complained that the policy review and adjustment on cost and benefit of FDI could be the proper policy change towards economic development. This implied that policy review and adjustment on both cost and benefit on fiscal incentives (FI) and foreign direct investment (FDI) could be the proper policy change of FDI towards economic development.

This data is supplemented that the government should show all necessary readiness in formulating and adjusting its regulatory structures in accordance to the policies, laws and regulations governing foreign direct investment. Despite the government intention to increase collection of revenue by reducing tax exemptions there is no a designed mechanism or legislation which has been made to that effect since then (Curtis, Ngowi & Warris, 2012).

Again on the issue of time limit, large proportion of responses, over fifty percent (58.3%) out of the total responses agreed that setting time limit on incentives could be the proper policy change of FDI towards economic development. While twenty five (25) responses which is equal to fourty one point seven percent (41.7%) out of the total responses depicted that open time could be the proper policy change of FDI towards economic development. This means that setting time limit on incentives could be the proper policy change of FDI towards economic development.

Furthermore, findings indicate that large percentage of responses (76.7%) out of the total responses accepted that to limit the number of foreign employee could be the proper policy change of FDI towards economic development. While fourteen (14) responses which is equal to twenty three point three percent (23.3%) depicted that open number of foreign employee could be the proper policy change of FDI towards economic development.

This is supported by Khalfan (2002) who mentioned that importing all necessary expertise to run the hotels and using locals for simple works is among the trend of Foreign Direct Investors in developing countries, which has negative impact to the host country.

CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATION

5.1 Introduction

This chapter presents the summary of the study, conclusion, recommendations and area for further study. Also it provides suggestions for further researches in the problem area. The study intended to respond to the previous study knowledge gap on the effectiveness of fiscal incentives in FDI promotion and attraction.

5.2 Summary of the Study

To summarize the study, one can be mindful on the fact that fiscal incentives are one among the major determinants of foreign direct investment (FDI) promotion and attraction in the study area. Much literature in the study tried to analyse the contributions and effectiveness of fiscal incentives in foreign direct investment in relation to the economic development of the host country. In Tanzania and Zanzibar in fiscal incentives have play grater roles in FDI attraction and promotion.

It was significant and highly noisy that fiscal incentives play greater roles in FDI promotion and attraction in Zanzibar. The roles of corporate tax, tax holiday and investment allowance were evidence to the promotion and attraction of FDI in the study area. In the issue of the impact of foreign direct investment (FDI) in the economic development in the study area, it is highly agreed that FDI was greatly affect the economic development of the host country. Since FDI provide employment creations, it also transfers technology to the host country. FDI develop and expand the business and international trade as well as improve government revenue of the host country.

Lastly on the matter of the policy change of foreign direct investment (FDI) toward economic development of the host country, frequent policy review and amendment is needed so as to make FDI more productive to the economic development of the host country. The issues of labour regulations and time limit have been explained in this area.

5.3 Conclusion

Basing on the findings of this study, it is safe to conclude that fiscal incentives are one among the major determinants of foreign direct investment (FDI) promotion and attraction in the study area; and is directly linked to the economic development in Zanzibar. This is due to the fact that FDI opens the door for study area to transfer technology as well as to expand and develop the international trade and business. Not only that but also FDI created more employment opportunities and have influence to the collection of government revenue.

However, fiscal incentives are not the sole determinants of FDI promotion and attraction in the study area. Other determinants include less corruption, peace and security and loyalty of the people of the study area. Again, on the issue of policy change toward economic development, together with those benefits of FDIs in the host country, it found that there is the need for policy change so as to make FDI contribute more to the economic development of the host country.

5.4 Recommendations

The recommendations of this study focus on the objectives of the study, the first objective of this study was to find out the role of fiscal incentives in FDI promotion and attraction in Zanzibar. Basing on the findings, the study recommends that the government should make an initiative to engage experts in reviewing its development and economic policies for the purpose of harmonizing the objectives of each to remove the existing inconsistency which hamper proper implementation of the tax incentives. All the initiative of economic and development policies should be focused to achieving one or some common major goals.

The second objective of this study was to assess the impact of foreign direct investment (FDI) in the economic development in the study area. Along with the first comment of reviewing development and economic policies to get them in a good alignment, the designing of tax incentives should also be clearly considered. There is a need of high levels of transparency and setting clear criteria that would render a firm eligible for a set of tax incentives.

The last objective on the policy change, the study recommends that there is a need for countries to have FDI-specific policies. Host economies need to have policies that will ensure that there is proper attraction of proper FDIs as well as policies that will retain such investments. Policies should also ensure that once FDIs have flown into host economies they contribute to the maximum into the countries' development process. Policy environment should also assure that the FDI benefits are sustainable beyond the life span of the FDI projects. This will reduce poverty by creating more employment opportunities.

5.5 Area of Further Study

It will not be fair for this study not to mention areas for further studies, since more studies are needed so as to make more FDI flow in Zanzibar as well as socio-economic development among the poor majority of Tanzanians who deserve to get it. Amongst the areas for further study are:

(i) This study consider only three fiscal incentives (tax holiday, Corporate tax and tax allowance) so further studies are needed which will incorporates other incentives such as preferential tax rates and double deductions of approved cost and expenses

(ii) Measures needed to increase number of local employees

(iii) What should be done to attract FDI without using fiscal incentives

(iv) Assessment of the effectiveness governing Regulation of Foreign Direct Investment in Zanzibar.

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APPENDICES

Appendix I: Participation Consent

You are request to consent for your participation into a study that aims at assessing the effectiveness of tax incentives on FDI promotion in Zanzibar with respect to stakeholders' views. The reason for asking you to participate is the fact that you are among the stakeholders and thus a potential respondent in this study.

The study will involve in-depth interviews and focused group discussion. The interviews will involve some officials from ZIPA, some officials ZRB and some officials from TRA. The focused group discussion will involve some officials from ZRB and ZIPA in Zanzibar.

The decision to participate is important and therefore you are requested to respond honestly to a few questions on your knowledge, experience and opinion.

Confidentiality

The information gathered will be treated with confidentiality such that only the researcher will access the given information in their raw form. In any way, the given information will not be linked to your individual name during report writing.

Benefits

There is no direct benefit for your participation in this study. However, your information will contribute to better understanding of the effectiveness of tax incentives in FDI promotion in Zanzibar.

Participation

Participation into the study is voluntary. You have the right to decline to participate or to withdraw from the study at any point of the interview without saying the reason for your withdrawal. Your decisions whether to participate or not will not in any way jeopardize your citizenship, your title or your employment status. If you agree to participate into the study, please, give your signature hereunder.

Signature of the respondent …………………………….. Date ………………………

Signature of the interviewer …………………………….. Date …………………......

Appendix II: Questionnaires

1) Name of Institution………………………………………………………………..
2) Age ☐
3) Gender Male ☐ Female ☐
4) Education
   (i) No education ☐
   (ii) Primary ☐
   (iii) Secondary ☐
   (iv) College/University ☐

5) To what extent do the following investment determinants attract more FDI in Zanzibar?

Determinants of FDI	More Attract	Attract	Less Attract	Not Attract
Fiscal Incentives				
Political Stability				
Availability of Market				
Transparency regulations				
Infrastructures				

6) Which of the followings describe the role of corporate tax relief on FDI flow?

More FDI flow ☐

Less FDI flow ☐

No FDI flow ☐

7) How far investment allowance attracts FDI in Zanzibar?

More attraction ☐

Less attraction ☐

No attraction ☐

8) What is the role of double tax avoidance in encourage FDI investment?

More encouragement ☐

Less encouragement ☐

No encouragement ☐

9) The role of investment allowance promotes FDI. Choose that apply.

More promotion ☐

Less promotion ☐

No promotion ☐

10) Which of the followings describe FDI employment creation?

More employment creation ☐

Less Employment creation ☐

No employment creation ☐

11) FDI technology transfer. Choose that apply.

More transfer of technology ☐

Less transfer of technology ☐

No transfer of technology ☐

12) FDI influence trade opportunity. Choose that apply.

More trade opportunities

Less trade opportunities

No trade opportunities

13) Does FDI have improved government revenue?

Improved

Worsened

Other

14) Setting time limit on incentives

Time limit

No time limit

Other

15) Government revenues from investor could be stable and seasonable

Stable

Not stable

Other

16) Limit the number of foreign employee

Limit

Not limit

Other

THANK YOU FOR YOUR COOPERATION

Appendix III: Interview Guides

1. On you view what are the determinants of attracting FDI in Zanzibar and which contribute more in promoting FDI inflow?
2. To what extent do the Fiscal Incentives, attract more FDI in Zanzibar?
3. What do you understand about the role of corporate tax relief on FDI flow?
4. How far investment allowance attracts FDI in Zanzibar?
5. Do you think double tax avoidance in encourage FDI investment? Explain.
6. Does FDI contribute any thin in resolving problem of employment in the country?
7. Does FDI have improved government revenue? Explain why.
8. What is your observation and advice about setting time limit on incentives?
9. Are we benefited from technology of FDIs? Explain why
10. Is there any problem on the existing policy on FDI? If yes what are they?
11. Is there any importance of limiting the number of foreign employee? Why