



Tax incentives: A panacea or problem to enhancing economic growth in developing countries

Favourate. Y Sebele-Mpofu^a Delight Gomera^b Bonface Sibanda^c

^a University of Johannesburg, Post-Doctoral Research Fellow, School of Accounting. Orcid ID 0000-0002-6309-1697. fmpofu@uj.ac.za

^b National University of Science and Technology, Student - Department of Accounting delightgomera@gmail.com

^c National University of Science and Technology, Lecturer- Department of Accounting, bonface.sibanda@nust.ac.zw

Keywords

Tax incentives, effectiveness, economic growth, developing countries, tax base.

Jel Classification

H20, H21.

Paper Type

Research Article

Received

03.02.2022

Revised

05.03.2022

Accepted

14.03.2022

Abstract

Purpose: The study sought to review literature on tax incentives in developing countries, with the objective of assessing whether tax incentives were a problem or a solution to fostering economic growth and development in developing countries. The research sought to explore the controversy surrounding the offering of incentives in developing country contexts in order to contribute to the ongoing debate on the desirability and non-desirability of tax incentives.

Methodology: This study was a critical literature review, therefore used literature review as a stand-alone methodology. Literature was collected from databases that include the Google Scholar database and. Thematic analysis was used to guide the analysis of the findings from the review. These were grouped into two major themes and these were the arguments in favour of tax incentives and those against. Several sub-themes were explored under each main theme as they emerged from the literature review.

Findings: The revealed the controversy and contradiction surrounding offering incentives, their effectiveness and their influence on economic growth, spill over gains, the revenue mobilisation efforts (tax base) and future tax compliance. The review accentuated the research gaps that emanate from the lack of consensus among scholars on the effect of awarding tax incentives in developing countries.

Originality or Value: Developing countries continue to offer tax incentives yet the outcry on their relevance; contribution and effect on the tax base continue to be debatable among researchers. This study sought to contribute to this body of knowledge on the effect of tax incentives in developing countries.

Introduction

Globally, policymakers are focused on constructing policies that enhance economic development and accelerate improvement of the welfare of their country's citizens (Hansson, 2021). Governments have commonly awarded tax incentives as measures to boost economic growth (Hanson & Brokelind, 2014). Tax incentives are largely employed in developing countries to promote and foster competitiveness, though the outcomes may deviate from expectations (Daude, Gutiérrez, & Melguizo, 2014). There is no agreement among researchers on how to define a tax incentive. There is controversy surrounding the term (Cogazon & Calderon, 2018). Zee, Stotsky, and Ley (2002) describe them, as advantageous specific tax treatments that are awarded to a certain category of taxpayers. These normally include tax holidays, credits, investment allowances, exemptions, allowable deductions and other special tax rates as well as postponement of tax liability. Contention also surrounds the desirability and effectiveness of employing tax incentives as a fiscal policy tool to stimulate economic growth in developing countries. The general employment of tax incentives has been substantiated by the need to: (i) correct market inefficiencies associated with the externalities of certain economic activities; (ii) target new industries and mobile investments that are subject to tax competition; (iii) generate a form of agglomeration economies, or concentration externalities, and (iv) subsidize companies during their sector's downturn (Klemm, 2010). In fact, developed countries commonly award tax incentives to encourage research and development initiatives, enhance export activities, and boost the competitiveness of their companies as they compete in the global market. On the other hand, developing countries award them to lure foreign investment and improve the performance and growth of national industries (Gravelle, 1992; Klemm & Van Parys, 2009; Mbethe, 2019) or to reduce the withdrawal of investments (Oguttu, 2018).

Despite the fact that the majority of developing countries offer tax incentives with the objective of encouraging investments and facilitating economic development, the effects of these tax policy initiatives have remained debatable among scholars and

economists (Padilla, Biyani, Jaiswal, Buenaventura et al., 2020). Nidheesh (2014) asserts that special economic zones were aimed at motivating exporters, boosting creation of employment opportunities and mobilisation of both domestic and foreign investments. The researchers allude to a significant positive relationship between tax incentives and the growth in exports as well with employment generation and increased investment. Researchers have failed to come to a consensus on the question whether these incentives weaken or enhance economic development in these countries. Questions persist the effect of these incentive policies (Chirinko & Wilson, 2008; Zolt, 2014). There are disagreements on the causal impact of these incentives. Contention surrounds whether they facilitate or impedes economic growth. Controversy also surrounds whether these incentives attract foreign direct investment that is fundamental to economic growth. There is no concurrence among researchers on whether costs of giving these tax incentives outweigh the benefits. The difficult issue is the lack of information about the real costs and benefits of implementing tax incentives into the tax systems due to problems with data availability (Brodzka, 2013). Munyanyi and Chiomba (2015) further add that the abundance of government tax incentives raises this important empirical question whether these tax incentives are effective in increasing investment and other forms of economic activity within a country.

Arguments also emanate from the attainment of the spill over gains from the attracted investments. These spill over benefits include additional investment, shared technology, skills and knowledge, which contribute to improved productivity and growth (Stausholm, 2017)

Rationalisations or justifications for awarding tax incentives has leaned more on the argument of attracting investment, but empirically backed submissions allude to the inefficiency and ineffectiveness of these tax incentives (Oguttu, 2018; Zelekha & Sharabi, 2012). Evidence has supported the perspective that these tax incentives unwarrantedly erode tax bases of developing countries, robbing them of public revenues to fund public goods and services as well as infrastructural development.

The tax incentives compromise government efforts to mobilise domestic tax revenues, crippling efforts to address inequality, poverty alleviation, service delivery provision and the propensity to achieve sustainable development goals (SDGs) (Padilla, Biyani, Jaiswal, Buenaventura et al., 2020). Tax incentives have been linked to poor governance, corruption, lack of transparency, heightened inequality and complex tax structures that become porous and lead to increased tax evasion and avoidance. Tax incentives are connected to increased illicit financial flows in Africa, especially due to corruption and transfer pricing abuse (Padilla et al., 2020).

The contradictions, convergences and inconsistencies in findings and conclusion drawn among various studies have led to several questions in relation to incentives. Do tax incentives really attract investments? Do these incentives lead to the attainment of the short term and long-term envisaged outcomes? Are the resultant economic and social costs justifiable or commensurate with the benefits derived? Are these incentives necessary or just redundant? Studies evaluating the cost and benefits of tax incentives in developing countries are few (Stausholm, 2017). Bodies such as the World Bank, the OECD, and IMF have raised concerns on the need for developing countries to revisit the justification, relevance, costs and benefits of awarding tax incentives to aid in informed analysis and effective policy construction. Studies have focused on the rationale and prevalence of incentives in developing countries. The controversies in research outcomes prompted this critical literature review article. This paper adds to discussion and literature on the controversial effect of tax incentives on economies.

Research Methodology

The article is a review article, employing literature review as a stand-alone method. The review type adopted is a critical review. The main purpose of the article is to provide a recapitulation of tax incentives offered by developing countries, assessing whether they are beneficial or harmful to these economies as well as whether they are a fundamental component of developing countries' tax systems. Incentives are a

practical, topical and important issue to tax authorities, governments, investors and policymakers in developing countries, therefore a critical review was considered appropriate for the article. A critical review allows one to combine descriptive and evaluative analysis. This is affirmed by Snyder (2019) who asserts that a critical review is essential in carrying out a critical evaluative analysis of existing literature on a subject area. The comprehensive evaluative review of literature seeks to reveal consistencies and inconsistencies in previous studies (Mpofu, 2021; Paré, Trudel, Jaana, & Kitsiou, 2015). According to Grant and Booth (2009), in addition to showing strengths and weaknesses as well as contradictions in available knowledge and literature in the area, critical reviews bring to light important information on methodologies adopted, theories as well as divergences in findings. This article brings forward an analytic synopsis and synthesis of the studies on tax incentives in developing countries, the arguments for and against incentives as well as possible ways to address the policy and research gaps identified.

The article focused on contemporary literature on tax incentives, but it was also important to compliment it with old literature from the early years in order to give a contextual background to the contentious nature of tax incentives in developing countries. Therefore, literature search was limited to the years from 2010 to date to give a 10-year range. Literature was gathered through database searches. Searches were done through Google scholar, ProQuest, Econpapers, EBSCO host to exploit the diversity of literature found in the different databases. The initial search was done using the Google scholar database. The search phrases used include “tax incentives in developing countries”, “effectiveness of tax incentives in developing countries”, “costs and benefits of tax incentives in developing countries”. The initial search yielded 80 papers. The papers retrieved were assessed for their appropriateness to the review by reading through, the title, abstract and introduction. The exclusion of some of the papers that did not focus on the effect of tax incentives or tax incentives in developing countries or those that were outside the dates focused resulted in 36 papers being considered relevant. Snowballing and citation mining was further

conducted on the selected articles in order to complement those already found relevant. While conducting back and forward snowballing on some of the papers and prominent authors in subject area, the researchers found themselves searching in the econopapers, EBSCO host and ProQuest databases. The final papers reviewed were 47 in total. However, the chosen articles were not limited to published and peer reviewed articles, but the bulk of them were peer-reviewed and published. This was a way to enhance the validity of review findings, through gathering reliable information. The peer review process by experts in taxation before the article is accepted and eventually published increases the reliability of information and knowledge contribution of the article. The data emanate from the review was analysed thematically as guided through the work of Braun and Clarke (2006).

1. Literature review

1.1 What are tax incentives?

There is no consensus on defining tax incentives. Researchers have given varying definitions and explanations. A synopsis of these definitions is given in Table 1. Incentives might be in form of Special Economic Zones (SEZs), tax holidays, capital allowances, carried forward losses, investment allowances, reduced tax rates, exemptions, allowable deductions, investment tax credits and other preferential treatments and advantageous tax computations (Cotrut, Munyandi, Choi, Ferreira, & Rienstra, 2018). What is fundamental is the advantageous treatment that the incentives give to those who enjoy them. This can be either the maximisation of the value of the investment through reduced tax liability or improvement of the return on investment through reduced costs and risk level of the investment. Abramovsky et al. (2018) describe tax incentives as measures that give more clear-cut beneficial tax treatment to isolated companies, industries, sectors, regions or investments. This distinct tax treatment is more advantageous, comparative to prevailing conventional tax regime applicable to broad sectors, industries or regions in the economy. Tax incentives can be grouped into two main categories. Cost base incentives and profit based ones. The former includes tax credits, accelerated depreciation or capital

allowances and investment allowances. The tax benefit is linked to capital expenditure incurred. The latter encompasses tax incentives that minimise the tax rate or taxable income or fully or partially waiver the tax liability. For example, tax holidays (Abramovsky et al., 2018). While developed economies' tax incentives take the form of accelerated depreciation, investment tax credits and advantageous tax treatments for funds spent on research and development activities, in developing countries tax incentives normally take the shape of SEZs, reinvestment incentives and tax holidays (Zolt, 2014).

Table 1: Summary of the definition of incentives

Studies	Articulation/Definition
Ogazon and Calderon, 2018	<p>Defined incentives in terms of characteristics exhibited such as speciality, exceptionality, favourability, effectiveness, economic measure and being a tax expense.</p> <p>Incentives explained as economic instruments that gives exceptions to ordinary tax measures and give an advantage to particular sectors or investments</p> <p>These are often aimed at boosting the return on investment or minimising its costs or risks, with the objective of encouraging both domestic and foreign investment. The other reason is to make the situation less burdensome for existing investment projects and investors.</p>
(Zolt, 2014)	Distinctive tax provisions that award exemptions, credits, tax liability deferment or other special tax rates or unusual tax treatments
(Munongo, Akanbi, & Robinson, 2017)	Fiscal instruments to induce investments from both domestic and foreign investors to certain important sectors of the economy. These measures are often granted to certain identified investments or qualifying groups of investment to minimising the tax burden.
(Klemm, 2010; Tavares-Lehmann, Toledano, Johnson, & Sachs, 2016)	These are tax provisions that deviate from the commonly applied provisions or principles of neutrality. The departure from the general rules is aimed at attracting investment, maximise the return on investment or minimise the risks and costs of the investments by lowering the accompanying tax liability.

Authors' compilation from various sources

Types of Corporate Tax incentives

The article focused on reviewing corporate tax incentives, as these are the most prevalent ones and prone to abuse by domestic corporates and multinationals in their activities that result in base erosion and profit shifting (Oguttu, 2018). These normally include investment incentives, tax holidays, economic processing zones and reduced tax rates among others. Oxfam (2019) and Abramovsky et al. (2018) identify the following as the prevalent corporate tax incentives that have been offered by most developing countries.

Tax holidays: These are non-permanent or shorter exemptions of new companies or investments taxes, mostly from corporate tax. In some cases, these companies are not expected to fulfil tax administration and compliance obligation such as submission of tax returns. Tax holidays can fully or partially exempt tax liability. These normally range for between 1 to 5 years. According to Abramovsky et al. (2018) some can go around 10 to 15 years.

Special Zones: Firms meeting set criteria operate, while enjoying a variety of tax exemptions in these demarcated geographical areas. These companies are often relieved of certain administrative obligation relating to tax compliance. Examples include export-processing zones and special economic zones. It is important to note that in some countries the location is not important as companies can be considered zones regardless of where they operate.

Reduced tax rates: Companies or investments are offered reduced tax rates especially corporate tax rates. For example, in Zimbabwe we have the build own operate and transfer (BOOT) arrangements.

Investment tax credits: Investors are allowed to deduct a particular a particular fraction or percentage of the investment from the tax payable to reduce the tax liability. When after effecting the deduction there is a tax refundable position, it varies with tax jurisdictions on how this treated. While for others, the excess is refunded, other carry it forward and others just write off the excess.

Investment allowance: In this case, investors or companies are given an allowable deduction, which is a portion or percentage of the investment in addition to its normal depreciation.

Accelerated depreciation: This a situation where certain companies or investments are awarded rates of depreciation or capital allowances that ensure that the capital assets depreciate at a faster rate than the commonly available in the mainstream tax system. The rate can be such that it is higher in initial year of purchase and use, then lower in the next years. For example, in Zimbabwe for investing at growth points special initial allowance is 50% in the first year and then accelerated wear and tear for the next two years at 25% whereas for the rest of the economy its 25% first year then accelerated wear and tear for the next three years (Tapera, 2021).

Economics Arguments Around Tax Incentives in Developing Countries

Tax incentives can stimulate investment, particularly for projects that could be viable in several alternative locations where non-tax conditions are reasonably similar. Researchers submit that institutional market and infrastructural weaknesses as well as political instability put off investors from investing in developing countries as they are not willing to risk their investments (Zolt, 2014). In an attempt to compensate for these deficiencies in the investment, climate governments offer tax incentives and other investment incentives to lower the cost of investments. The question is what if the compensation is unnecessary for investments that care very little about incentives and are interested in developing countries for their natural resources. At times governments overcompensate for the deficiencies in the investment environment especially where tax competition is stiff, thus these tax incentives become harmful to the economy. If the tax incentives do not yield the targeted investment and development then developing countries are unnecessarily putting at risk their long-term sustainability of revenue mobilization. There is a possibility that even if investment is attracted, the costs might still negatively affect development and compromise government's ability to fund education and health. There is still

disputation on the effect of incentives among studies. Stausholm (2017) found out tax holidays have a negative correlation with tax revenues. Tax holidays lead to decreased tax revenues and have an overall negative effect on sustainable development. The researcher concludes that the effect of tax holidays on economic growth and development are not certain and unfavourable at worst (Stausholm, 2017).

Ogazon and Calderon (2018) point out that despite tax incentives being aimed at inducing positive developments in terms of investments, they also result in a cost in the form of lost revenues. James (2016) who acknowledges that tax incentives are commonly applied by governments affirms this and points out they reflect these governments' efforts to enhance economic growth as well as to attract novel skills and technology to the economy. The researcher further avers that despite these noble efforts to bring diversification to investments in the economy and new avenues to growth, these incentives often lead to unintended outcomes, such as abuse of discretionary powers given to awarding bodies and revenue authorities. Furthermore, these tax incentives promote increased tax evasion and avoidance; heighten rent-seeking opportunities and behaviours. In concurrence, Redonda et al. (2018) argue that some incentives policies are often weakly constructed and not effective; hence, their contribution to increasing investment inflows is often trivial. These incentives in some cases result in loss of revenue for the government, while certain benefiting individual businesses and sectors that enjoy them. Other researchers raise concerns on the environmental costs of these incentives and call for government to urgently review them or drop them. Castaneda (2018) and Van Kommer (2018) point out to inefficiencies and tax injustices as unintended consequences that arise from the tax incentives, due to abuse and political exploitation. Chikova (2021) contends that tax incentives risk compromising the effectiveness and efficiency of tax systems; convolute the tax system, compromise horizontal equity and results in production efficiency distortion. Ultimately, the incentives fail to achieve either redistributive justice or economic growth.

There are legitimate reasons to favour the use of investment tax incentives, but also strong reasons to believe that the fiscal and economic costs may be comparatively higher than benefits. In some countries like Botswana, incentive programs been successful in attracting FDI and increase tax revenue in the economy in the end (AfDB, 2012; KPMG, 2012). In other countries such as Zimbabwe, Angola, Swaziland, Democratic Republic of Congo, Tanzania and Nigeria among others, they failed to stimulate the required investment (Basdevant et al., 2011; Fjeldstad, Jensen, & Orre, 2012; Fossat & Bua, 2013). The ineffectiveness of tax incentives in these countries is linked to the weak legal institutions. This compounded by fragile tax administration capacities as well as rampant corruption and lack of transparency and accountability in awarding the tax incentives (Fossat & Bua, 2013; Heggstad, Ustvedt, Myhrvold-Hanssen, & Briseid, 2011). In some limited cases, the tax incentives have been abandoned, without significant harmful impact to investment inflows. The outcomes have been divergent depending on the settings. Generally, research points to the cost outweighing the benefits.

Why, then, are tax incentives so widely used in developing countries? Other researchers argue that some tax incentives are largely driven by special interest groups that benefit from them and often advocate for their continued use. Nevertheless, this cannot explain the sincere belief in many quarters that tax incentives are an essential and constructive component of development policy. While the possible benefits are easy to comprehend, fiscal and economic costs are complicated to unpack. Policy decisions on tax incentives sometimes anchor on a cost and benefit evaluation that exaggerates the probable benefits and significantly under-approximate the probable costs. (Brodzka 2013) argues that developing countries introduce tax incentives in order to attract capital and support economic growth or as counterweight to investment dissuading factors found in their tax systems. In addition, Munongo, Akanbi and Robinson (2017) argue that Governments will seek to correct investment decisions of the private sector using tax incentives and harness investment that would have not occurred without tax incentives, perhaps because governments want the economy to enjoy the benefits of foreign

capital, which include technological transfer, skills transfer, employment creation and economic growth and development.

Brauner (2012) notes that if tax incentives are standardized, prevalent and applied universally they create a predictable set of encouragements for multinational enterprises (MNEs), searching an optimal location for their investment and often using tax optimization practices. In analysing the issue of such fiscal instruments man usually takes the natural order of deduction: tax incentives enhance foreign direct investments and as such have a positive influence on economic growth, which strengthens development (Brodzka, 2013). This way of thinking is currently criticised by international economic organization such as, IMF, OECD, UN and World Bank, which perceive tax incentives both inefficient. The international institutions observe that tax incentives are probably detrimental to development efforts in developing countries as investors and those in charge of their governance and administration abuse them (OECD, 2008). The ineffectiveness of tax incentives is further compounded by weak administration, corruption, lack of training and poor remuneration among tax officers, which lowers their motivation to enforce incentives aggressively (Brodzka 2013). To enhance the effectiveness of tax incentives, the IMF (2015) recommends that tax incentives need to be properly target and based on a clear qualifying criterion in order to ensure they address the needs of the economy in any economic manner that minimizes the costs of offering and administering them.

All those constraints have to be overcome, as they now constitute large obstacles to emerging economies, (Owens, 2012). The impact of tax incentives on tax compliance also needs to be tested. McKerchar and Evans (2009) in their studies concluded that taxpayer non-compliance is a continual and growing global problem. Many indications suggest that developing countries, many of them in Sub-Saharan Africa, are the hardest hit (Fuest & Riedel, 2009). Mobilising revenue is a way for governments to create fiscal space, provide essential public services, and reduce foreign aid and single resource dependence. However, the domestic tax bases in most

African countries are undermined by widespread tax avoidance and evasion (IMF, 2011).

Munongo et al. (2017) note that tax incentives are a vital instrument that allows the state to influence the financial and investment activities of companies, the development of social sphere, research and innovations hence reduced taxation may not always lead to the expansion of production or perspective development of business. In practice, it is quite common for taxpayers to use tax incentives simply to minimize their tax liabilities (Munongo et al, 2017). It destroys the multiplication effect from these incentives and reduces revenues to the budget.

Positive implications/ Viewpoints in favour of tax incentives

Just like the costs of tax incentives that is transparent, often understated and hard to quantify, the benefits of tax incentives are not easily quantifiable, budgeted or even published (Daude et al., 2014). Despite the controversy surrounding offering tax incentives, the AfBD (2012) and KPMG (2012) point out favourable outcomes emanating from tax incentive policies in Botswana. These institutions acknowledge that the success story is because of a strong legal institution in the country, low rates of corruption and fair remuneration, which are fundamental pillars to effective administration, and monitoring of incentives. The arguments in favour of tax incentives anchor on the role of tax incentives as a tool to attract FDI, enhance economic growth, and stimulate employment generation and to bring other positive spillover effects to the economy. According to Stausholm (2017), tax incentives would ideally help increase capital inflows, transfers of skills, knowledge and technology, increase job opportunities and attract development to underdeveloped areas. The validity of these submissions has been critiqued by other researchers such as (Oguttu 2018).

Table 2: Summary of selected studies on the positive implication of tax incentives in developing countries

Studies	Area of focus	Methodology	Findings	Implications
(Olaniyi, Oyedokun, & Ajayi, 2019)	Nigeria	Regression and correlation methods on data collected from the central bank of Nigeria database	Focused on corporate tax incentives, VAT and customs duty	Recommended a revisit of the VAT and customs duty on imported goods to attract more FDI
(Munongo, 2015)	SADC countries	Trend analysis and System generalized method of moments	Tax important in attracting FDI but the key is to strive for a productive mix that ensures efficient use of tax incentives to mobilise enough tax revenues and foster sustainable FDI inflows	SADC to improve on the initiatives of attracting FDI through good governance of tax incentives
(Appiah-Kubi et al., 2021)	40 African countries	Economic model with four proxies of tax incentives	FDI responds to lower corporate tax rate. Countries with longer tax holidays and lower withholding taxes were predominantly FDI destination. Researchers also acknowledge the possible negative impact of tax incentives	Recommended need for proper restructuring as their poor structuring could rob African countries of public revenues. This could lead to failure to failure to attain vital goals such as poverty reduction, sustainable growth, women empowerment and infrastructural development.
(Gitonga, 2017)	Kenya	Used time series data and regression analysis	Wear and tear allowances had a significant positive relationship with FDI, attracting FDI, while investment deductions and industrial building allowance had no significant relationship with FDI inflows	Re-evaluate the incentive policy especially in relation to investment deductions and industrial allowances, as they appear to bring redundancies.
(James Ike, 2018)	Nigeria, Ghana and South Africa	Performed descriptive and inferential statistics using secondary data	Found a positive relationship between tax incentives and FDI. Results also showed no significant effect on FDI on exports in the three countries	There is need to look at the tax incentives in relation to stimulating exports as these are also key to economic growth
(Ugwu, Okwa, & Inyang, 2020)	Nigeria	Used ex post facto research design and times series on data collected from the	Findings showed significant and positive relationship between tax policy incentives and capital formation	Despite the notable favourable impact of income tax allowance and investment

		central bank of Nigeria and the Federal Inland Revenue services. Performed ordinary least square estimation and regression analysis	Low corporate tax attracts higher private investment and increases gross capital formation. There is degree of co-variability between investment allowance incentive and gross fixed capital formation.	allowance on gross capital formation, policy reform could look at other ways to attract investment.
(Klemm & Van Parys, 2009)	40 developing countries from Latin America, Caribbean and Africa	Employed spatial econometric technique on panel data and dynamic panel data econometrics as well as descriptive statistics	Larger tax holidays and lower corporate income tax rates were effective in driving FDI in Latin America and the Caribbean counties but not in Africa. The tax incentives were not effective in enhancing gross fixed capital formation in Africa.	The awarding of tax incentives must be contextualized to the needs of the economy as well as administration capabilities. Out comes differ for countries
(Olaleye, Riro, & Memba, 2016)	Nigeria	Correlation and regression analysis	Strong positive linear relationship between the income tax incentive (reduced income tax rates) and FDI inflows to listed manufacturing companies	The study implies that tax incentives are effecting in encouraging investment in listed companies
(Haiyambo, 2013)	Namibia	Secondary data and a survey with foreign investors	Incentives had a positive effect on FDI inflows. The incentives attracted foreign companies to invest in the country	Considering the business environment is evolving there is need for periodic reviews and monitoring of the incentive system
(Olaleye, Memba, & Riro, 2015)	Nigeria	Descriptive analysis and regression analysis of data collected using questionnaires	Significant positive relationship between capital allowances and FDI inflows	Tax incentives linked to capital expenditure attracts investors as it lowers their tax liability
(Musyoka, 2012)	Kenya	Correlation and regression analysis	While acknowledging the positive impact of tax incentives attracting FDI, the researcher pointed out that they are can equally have unfavourable impact on revenues.	Impact of tax incentives on attracting investment and promoting economic development is both positive and negative

Source: Authors' compilation from various sources

Tax incentives as a tool for development

All countries strive to increase their revenue base in order to improve their economy represented by the growth in their Gross Domestic Products (“GDP”)

(Siyanbola et al., 2017). Economic growth and development is a goal pursued by all African countries (Munongo, 2015). According to ActionAid International and Tax Justice Network Africa (2015), most African countries have a weak investment climate, partly due to political and macroeconomic instabilities. As such, governments appear to consider tax incentives as a necessary tool to attract investments that would otherwise not have happened. Munongo (2015) further states that the lack of investment in a country creates socioeconomic problems mainly centered on unemployment and poverty therefore tax incentives have become the most common tool amongst African countries to attract investments. Given the role of foreign direct investment in the development process, one of the most important challenges facing Africa is how to attract foreign direct investment ("FDI"). Could tax incentives be the answer? FDI is actively sought by almost all Sub Sahara African countries, due to the contribution that it can make to their economies (Cleeve, 2008).

On the other hand, other studies seem to contradict the fact that tax incentives are crucial in attracting FDI. In 2010, the United Nations Industrial Development Organization conducted a business survey of 7,000 companies in 19 sub-Saharan African countries active in agriculture, mining, manufacturing, and utilities, construction, and services sectors. Investors were asked to rank the importance of twelve location factors and to assess how they might have changed, improved and worsened, in the last three years. The results suggested that tax incentives packages ranked 11th out of 12 in importance; and this importance fell over time. For comparison: transparency of the legal framework ranked fifth in investors' concerns and grew in importance. Investors thus seem to care much more about deficient legislation and onerous regulations than about the availability of tax incentives (UNIDO, 2011). Investor Motivation Surveys in Tanzania, Rwanda, Uganda, and Burundi showed that over 90 percent of investors would have invested even if incentives were not provided (WBG 2013). In South East Europe investors indicate that rather than encouraging FDI, special tax incentives either were not taken into account or operated to discourage investment – provisions were difficult to track,

understand or comply with and/or invited corrupt behaviour on the part of tax officials, tending to increase project costs and uncertainty (OECD 2009).

Tax incentives as a tool to achieve international competitiveness and correcting market failure

As noted by the OECD (2011) report entitled 'Corporate tax incentives for FDI', tax incentives are introduced by many developed, transitional and developing countries with the aim of achieving international competitiveness, addressing market failures, boosting regional development and improving income distribution. Low corporate taxes increase FDI flows by attracting new investors, retaining existing investors and encouraging reinvestments of returns accrued by existing enterprises (Onyeiwu & Shrestha, 2015).

International competitiveness tax incentives are regarded as a strong factor in attracting internationally mobile capital, encouraging research and development initiatives by multinational companies and improving the competitiveness of the export sector of the host nation (OECD, 2001). Thus, tax incentives are viewed as critical in the locational decisions of the multinational companies. Tax incentives act as a relief to locational costs of foreign business and increase the competitiveness of an economy against other neighboring jurisdictions with similar locational factors.

The market mechanism is inherently socially sub-optimal, thus tax incentives are also used in instances where socially optimal investment has not been achieved by the market system (OECD, 2001). In this case, tax incentives are used as government intervention mechanisms in achieving socially acceptable investment levels. Due to the positive externalities characterising investment, the private sector normally under-produces investment, hence the socially desirable level of investment is established through government intervention in the form of subsidies and tax incentives. Tax incentives are also used by economic regional groupings to address the regional unemployment and poverty problems. OECD (2001) notes that tax incentives are also important in improving the host nation's macro-economy. By moving investment into their countries, nations reduce the problems of cyclical

unemployment, balance-of-payments (BOP) deficits and, in some cases, help to control inflation.

Tax incentives as a tool to attract FDI and increase capital inflows

Klemm (2010) notes that tax incentives are constantly developing, and they are an eminent feature of various tax systems in both developed and developing countries. This is not surprising considering the notion that they are an instrumental tool for developing economies that are vulnerable to structural shortfalls (Klemm, 2010). Empirically supported propositions on the cost effectiveness of incentives as a tool to attract FDI are inconclusive. Despite the skepticism by many scholars on the effectiveness of tax incentives, countries continue to offer tax incentives as a means of attracting domestic and foreign investment (Lent, 2010). The process of globalisation has increased competition and establishment of production units in different locations has increased the amount of internationally mobile capital, which can be lured into different locations with tax incentives (Owens, 2012). Tax incentives can lure the investors to a preferred destination and supply to markets that do not offer investment incentives but share a common market and common tariffs with the preferred location. While worthwhile submissions on the increased use of tax incentives and the corresponding growth in FDI inflows, it cannot be established with certainty whether tax incentives yield an increase in investment. This is linked to the difficulty in directly attributing additional investment to tax incentives or to prove that had it not been for the tax benefits the investment would not have occurred. The validity of the supposition is questionable. Secondly, considering tax incentives are not the only incentives targeted at attracting FDI, how does one link the incremental investment to tax incentives and not the other investor-targeted initiatives. Tax incentives are rarely considered in the selection of investment destinations. The contribution of tax incentives to overall decision on whether to invest in a country or not is minimal. Fundamental factors for assessment in investment appraisal include the state of infrastructure, the level of economic and political stability, trade policies, skills levels, presence of natural resources as well as

human capital. The availability of tax incentives consideration is not a main factor, it is not an important criterion, and otherwise what matters is the quality of the investment climate.

Tax incentives help correct market externalities or inefficiencies

Incentives can be used to attract investments, incentivize certain target geographic areas and industries or sectors and to iron out market externalities. Tax incentives are argued to attract FDI, and new investments that help stimulate economic growth, infrastructural development and employment creation to underdeveloped areas. The challenge is how to maintain a balance between the potentially positive and likely pervasive effects of awarding tax incentives (Munongo, 2015). Offering tax incentives can crowd out domestic investment replacing it with foreign investment and not stimulating economic growth. The effects of incentives and FDI on economic growth and development are contested. Researchers allude to significant negative impact on public revenues and increasing donor and aid dependence of developing countries. Furthermore, tax relief given to certain sectors or industries may create perceptions of unfairness and unequal treatment lowering tax morale and ultimately tax compliance.

Bring positive spillover effects and promote economic growth

Tax incentives can result in spillover advantages from the FDI attracted. Additional benefits to those linked directly to the investment projects. These benefits include employment creation, increased demand for raw materials from companies in the area, provision of services such as being distributors, marketers, wholesalers and retailers for the new companies or investors. Economic growth could be further enhanced due to increased economic activity. Employment generation can also lead to the rise in demand for goods and services. These spillover effects can indirectly increase tax revenues. Employment generation could increase income tax collections, increased spending might increase VAT or sales tax and the heightened demand for goods and services could boost corporate tax and VAT collections. If the new investments stimulate demand for imports, then customs duty and VAT could be increase. Increase tax revenues. The spillovers could also include knowledge and

skills sharing, learning of new production methods, marketing techniques as well as new managerial skills. These positive additional outcomes could in turn aid in boosting productivity and economic growth (Stausholm, 2017). The investment attracted could lead to strengthening of the industry and economic base, infrastructure improvement, improved standards of living and attract more investment. Notwithstanding the validity of the spillover arguments, the spillover effects are still considered problematic. They cannot be directly linked to the investments attracted. In the case where the investment would still have been made without tax incentives being availed, the argument on unnecessary loss of revenues and incurring of administration costs still make sense. Johnson, Toledano, Strauss, and James (2013) argue that spillovers from investments are usually minimal. Sometimes the investments do not really bring unique skills and resources to the economy. In cases where the skills and resources are not very responsive to the needs of the economy, this weakens the impact of tax policy, as spillover gains attracted might not yield any additional advantages. Daude et al. (2014) assert that there are very little welfare or spillover gains from tax incentives.

Compensating for Other Deficiencies in the Investment Climate

A common argument in less developed countries is that attractive fiscal benefits are essential to gain the interest of investors who would otherwise not consider investing because of problems, such as unreliable or high cost of infrastructure, macroeconomic instability, or a weak legal and judicial system. It is easier for developing countries to provide tax incentives than to remedy deficiencies in the institutional, economic, political and legal environment because there is no direct expenditure involved. It is critical to note that the expenditure may not be direct but there is indirect expenditure in the form of foregone revenue (opportunity cost), a portion of the budget is lost in indirectly financing the companies awarded incentives. The question is whether in practice, these tax incentives really compensate for the inadequacies in the investment environment. Researchers have argued that the incentives cannot substitute for weaknesses in the tax system and institutional environment or other inadequacies in tax system structures such as high

tax rates, low depreciation allowances or the absence of tax holidays to boost startup businesses (Stausholm, 2017; Zolt, 2014). The cost of tax incentives is less visible than that of investment promotion policies that involve explicit budget outlays. This argument is rarely uttered aloud, but it undoubtedly contributes to the political attraction of tax incentives, compared to alternatives that have a direct budgetary impact, such as subsidies or infrastructure development for industrial zones (Shaw 2015). Incentives are viewed as a poor rejoinder to political and economic challenges experienced by developing nations. It would be important to address the problems affecting the investment climate such as weak legal systems, lack of protection of property rights and failure to uphold the rule of law as opposed to resorting to awarding incentives to compensate for the deficiencies. Issues such the conduciveness of the investment setting, effectiveness of legal institution as well as the reputation of the revenue authorities in upholding these incentives also contribute to the effectiveness of tax incentives

Revenue Gains.

As explained earlier, the central purpose of tax policy is revenue mobilization. The claim that tax incentives have no adverse impact on revenue assumes that the investments that benefit from tax incentives are additional to what would take place in the absence of the incentives. The additional increase on investment may indeed occur in two cases. Firstly, where an investment is fundamentally viable in the host country but could earn a higher risk adjusted rate of return in another location, and the profit differential is small enough that a tax break reverses the location advantage. Secondly, where an investment is not viable under the normal tax code, but becomes so due to the tax break. Investments in this category are inherently those of low productivity. Aside from these special cases, tax incentives do cause a loss of revenue.

According to Emmons, et al. (2019), if it is likely that investors would take their investment to another destination in the absence of getting special tax breaks, then there is no direct revenue loss from awarding such incentives. The indirect revenue

impact can be favorable, because the new investments that materialize through the tax incentive program will create jobs and linkage effects that generate tax revenue.

Unfavourable implications of tax incentives

(Zolt 2014):3 portends that tax incentives especially those targeting to induce FDI inflows “are both bad in theory and bad in practice”. The former being reflected in that, they result in distortions in the investment choices. The latter being due to the fact they are considered practically “ineffective, inefficient and prone to abuse and corruption” (Zolt, 2014:3). Van Kommer (2018) points out several possible risks that can emanate from offering tax incentives. These include under and/or incorrect declaration of incomes, an increase in the number of operators in the sector or industry awarded incentives, manipulation of the life span of investments in order to access incentives; transferring incomes to other businesses (through for example, manipulative transfer pricing strategies). There is also the general misuse of tax incentives. Daude et al. (2014) asseverate incentives have invisible costs, thus increasing social burdens and leading to underestimation of their impact on lost revenues. Munongo et al. (2017) argue that unfavourable outcomes of awarding tax incentives include disproportionate distribution of resources, loss of revenue, increased tax administration and compliance burdens, complexity of tax systems. Tax incentives also lead to an increase the corrupt behavior, due to lack of transparency and unclear concession of incentives. While agreeing that tax incentives might lead to increase in FDI and improved welfare of communities, points out that they can also result in harmful effects such as tax competition, and negative implications for jurisdictions with or without tax incentives leading to a reduction in overall welfare of citizens. Daude et al. (2014) adduce that tax incentives are normally not only economically driven but also politically motivated. This political motivation leads to them lacking transparency and becoming non-public, thus increasing their discretionary nature and government’s lack of accountability on the significant costs that arise due to offering incentives. The political criteria for offering incentives leads to a loss of comparative advantages that would accrue if the incentives given purely basing on economic merit. While focusing on Zimbabwe, Chikova (2021:1)

asserts that “it is baffling to observe that tax exemptions are generously granted to mining companies who engage in harmful and aggressive corporate behavior that undermine tax revenue mobilization efforts of governments”.

This section discusses main arguments about costs and problems associated with tax incentives, particularly selective incentives. Most of these arguments are familiar to tax specialists and public finance economists, but they are not well understood by other stakeholders. For that reason, they merit a critical review and discussion.

Table 3: Summary of Selected Studies on the negative implications of tax incentives

Studies	Area of focus	Methodology	Findings	Implications
(Lakuma, 2019)	Uganda	Study uses estimated marginal tax rates as well as the effective average tax rates to evaluate the effectiveness of tax holidays.	Concludes that tax holidays and preferential income tax rates encourage individual tax avoidance strategies and promote high profit short-lived investments with less than 5-year span.	The question is how beneficial these short-term investments to the economy are and whether offering the tax holidays is economically justifiable.
(Abramovsky et al., 2018)	Middle- and low-income countries	Case studies of Ethiopia and Ghana	Incentives have a controversial effect on revenue mobilization efforts of developing countries. Some countries benefit from tax incentives as a tool for investment and revenue generation, while some lose significant revenues through offering tax incentives. Cost based incentives encouraged as opposed to profit-based ones.	Countries to improve on the design, governance and administration of tax incentives, reduced rates for the extractive industrial detrimental to economic development in these developing countries.
(Siyabola, Adedeji, Adegbe, & Rahman, 2017)	SSA countries	Linear regression model was tested using the Ordinary Least Square technique on data from World Bank Data Index (WDI), Federal Inland Revenue Services (FIRS), Ghana Revenue Authority (GRA), Nigerian Investment Promotion Commission (NIPC), Ghana Investment Promotion Centre (GIPC) and Action-	Found that there is a 0.529:1 relationship between tax incentives and GDP. The result also indicated positive effect of tax incentives on industrial and economic growth, suggesting that increasing tax incentives to productive and priority sectors of African economy will increase the continent’s gross domestic products.	Sub-Sahara African States should grant more incentives to those sectors and monitor closely the administration of such incentives

		aid International (AAI) for 4-year period between 2011 and 2014.		
(Nnubia & Obiora, 2018)	Nigeria	Adopted the ex post facto research design, using data sourced from the CBN Statistical Bulletin. They also used the Ordinary Least Square Method in their data analysis.	Results show that annual allowance was positive and has significant impact on economic growth in Nigeria while investment allowance was negative and has significant impact on economic growth in Nigeria	There need for re-assessment of the objectives of offering investment allowance and the outcomes
(Adamu, 2014)	Nigeria	Adopted survey and content analytical method. Data was analysed using chi-square test and statistical package for social sciences (SPSS.)	Significant relationship between tax incentive and economic growth	government should formulate fiscal policies that would increase tax incentives granted to companies especially to small and medium scale businesses, in order to enhance the micro and macro-economic growth and development
(Alegana, 2014)	Kenya	Descriptive analysis, correlations and regression analysis	Inverse relationship between GDP growth rate and tax incentives	Tax incentives must be evaluated for their benefit to the economy as well as how they support economic growth before they are awarded. After the implementation of the tax incentives policy, there is need for continuous review and amendment.
(Abille, Mpuure, Wuni, & Dadzie, 2020)	Ghana	Distributed lag bound technique	Corporate tax incentives have significant negative impact on FDI inflows	Re-evaluate corporate tax incentives and administration
(Nwidobie, 2020)	Nigeria	Used secondary data to perform statistical analysis and regression analysis	Tax incentives have no impact on Nigeria's GDP. GDP was found to be static. Supposed growth in GDP as a result of tax incentives being a paradox	The impact of tax incentives on economic growth remains unclear

Source: Authors' compilation

Lost or foregone revenues

The biggest criticism of tax incentives is on increased erosion of the tax base without significant increase in investment levels. Revenue losses due to offering tax incentives are estimated at 1% of GDP (Lakuma, 2019). Researchers argue that the

tax expense or foregone revenues are often higher than the tax revenues generated additional (Abramovsky et al., 2018; Daude et al., 2014). While Munongo (2015) points out the erosion of the tax base in SSA countries, Daude et al. (2014) allude to significant erosion of the tax base in Central America and the Caribbean due to tax incentives. Easson and Zolt (2002) suggest that tax incentives are difficult to administer and enforce which leads to huge losses in revenue to governments that operate them. Some investments could still have been made without tax incentives being awarded, thus the foregone revenue in the form of reduced tax liability due to incentives becomes lost revenue. Revenue loss could be through tax liability being reduced partially or completely on a temporary or permanent basis. The uncollected revenue lost is effectively a loss of part of the public budget Revenue can be lost also through abuse of tax incentives. Through the claiming of the tax incentives or income shifting from taxable firms to those eligible for tax incentives. This further compounded by the displacements effects of some of the investments attracted by the incentives. Chikova (2021) argues that developing countries like Zimbabwe lose significant tax revenues through awarding of tax incentives in the mining sector. The research argues that in addition to already ongoing problem of poor revenue mobilization in the sector, due to weak regulatory frameworks and fragile administration of royalties, tax incentives given to the mining sector represents lost revenue. Whether firms increase, the rate of return of investments remains contested. Whether firms financed by tax incentives perform better, survive and succeed in the longer run better than those not accessing the tax incentives, remains empirically unproven. Ideally, it would be more fruitful to award incentives only to firms who would in the absence of tax incentives possibly opt for other more favourable investment destinations. However, the determination of investment preferences and likely decisions in the presence or absence of incentives would be a challenge task to accomplish.

Increase in revenue leakages due to tax avoidance and evasion

Revenue losses can increase many-fold through an entirely different channel. Tax incentives often create opportunities for businesses and individuals to engage in

“aggressive tax planning (a tactful description of tax avoidance). Tax incentives can result in heightened tax evasion and avoidance as well as competitive unfairness. Tax evasion and avoidance leads to erosion of the tax base. Lakuma (2019) submits that in Uganda tax holidays and special income tax treatments minimized the effective tax rate and encouraged tax avoidance schemes and activities. Taxpayers or companies can either change or camouflage their operations to suit the profile and/or sector targeted for incentives. Local firms can disguise themselves as foreign firms or vice-versa if incentives are awarded to foreign firms or local firms depending on the incentives policy. If awarded to startup companies, firms can re-incorporate or incorporate new affiliated entities to benefit from the tax incentives. Revenue can also leak through the exploitation of tax incentives to claim for non-qualifying business activities. Companies can undertake other extra or separate activities under the disguise of the main activity that qualifies the company to access the tax incentive especially in case of tax holidays. This is further enabled by the fact that developing countries suffer from financial, human resources and technical constraints that make monitoring of the activities of companies enjoying incentives very challenging. According to Laukkanen (2018), special economic zones are often exploited by MNEs to reduce overall tax liability through abusive transfer pricing arrangements. These exploitative TP strategies result in BEPS in the high tax jurisdiction (Sebele-Mpofu, Mashiri, & Schwartz, 2021). OECD (2013) further adds that even when targeted at new investors, tax incentives are always sought by businesses outside the target group. Existing firms attempt to reconstitute themselves as “new” ones towards the end of their holiday periods so that they can continue to be tax-exempt. It further notes that tax incentives enable opportunities for profits and deductions to be artificially shifted across entities with different tax treatments either domestically or internationally. Chikova (2021) adduces that mining companies can continuously carryover losses not pay any taxes or generally ensure that they speed up the rate of production to produce and sell more during the tax holiday period. These tax-planning opportunities are commonly exploited by both developed and developing countries; however, their ill effects are especially pronounced in developing

countries that have limited capacity to detect and counter the detrimental tax avoidance techniques.

Increase in tax administration, enforcement and compliance burdens.

(Daude et al. 2014) argue that due to tax incentives, tax systems become intricate and opaque, weakening the ability of citizens to hold government accountable. Incentive programs encumber tax administration in several ways. Firstly, selective incentives require applying different rules to different taxpayers, which inherently complicates the system. Secondly, preventing and controlling the abuse of loopholes absorbs needs highly skilled administrative resources. Thirdly, senior tax administrators should be and generally do participate in designing tax incentives, screening applicants, and monitoring performance. Therefore, highly trained officers are diverted from mobilizing tax revenue to managing programs designed for other social and economic purposes. As emphasized by Zee, et al. (2002:1501): "The more scarce resources are devoted to administering tax incentives, the more other important administrative tasks would be impaired thus jeopardizing tax collection as a whole." The costs of ensuring adherence to tax rules, monitoring costs as well as legal costs in cases of tax disputes. Brodzka (2013) notes that tax incentives introduce complexity into the tax system, as tax authorities add the special rules to the regular ones. The complexity of tax systems is argued to be directly linked to enforcement and compliance costs. The broadness and narrowness of the category of taxpayers targeted for incentives has an effect on the costs as well. The wider the net of taxpayers captured by the tax incentives the higher the enforcement efforts and costs. The limited resources facing developing countries makes the monitoring of tax incentives not a priority or even the auditing of such entities (Zolt, 2014), thus opening room for abuse of the incentives and increased revenue losses.

Tax incentives open room for corruption and abuse of discretionary powers

Researchers generally allude to a negative relationship between corruption and tax morale as well as tax compliance (Sebele-Mpofu, 2020). Where poor governance accompanies high level of corruption, tax morale is low, thus increasing tax evasion (Everest-Phillips & Sandall, 2009; Sebele-Mpofu, 2020, 2021). Several scholars have

pointed to a link between corruption and rent seeking tendencies with discretionary awarding of tax incentives (Abramovsky et al., 2018; Daude et al., 2014). Where tax policy is ambiguous and leaves room for discretionary and subjective awarding of tax benefits, opportunities for corrupt behavior are higher. The empirical findings by Zelekha and Sharabi (2012) show that tax incentives may lead to significant corruption, thus compromising tax compliance. Easson and Zolt (2002) in their earlier studies had the same sentiments arguing that tax incentives give bureaucrats the opportunity to engage in corrupt and rent-seeking activities especially in cases where tax incentives give the authorities discretion to determine the qualifying projects and those that do not qualify for incentives. This opinion seems to be upheld by researchers for a very long time as going further back into the 1990s, Tanzi (1998) propounded that corruption is high with tax incentives, due to direct links between investors and government authorities who use their discretion in implementing tax incentives. Lakuma (2019) found out that the awarding of corporate income tax was discretionary. Some companies enjoyed capital allowances assets and tax holidays while others did not. The discretionary tax policies complicated the tax system, obscured the actual tax administration the actual tax effect and resulted in consequential loss of tax revenues. Abramovsky et al. (2018) while focusing on Uganda and Ethiopia pointed to the negative impact of discretionary tax incentives and they fuel corruption. Countries should have transparent and documented guidelines on who benefits from the incentive, the eligibility criteria must be explicit as well as the expectations of government from those benefiting. In addition, the monitoring mechanism should in place. This must be accompanied by clear policy articulation on the penalties and consequences for manipulative access to incentives as well as any deviant behaviour.

Costs outweighing the benefits of incentives

The cost benefit analysis of offering incentives is arguably pointing to the costs exceeding the benefits. This supposition is often fraught with challenges in the approximation of both the costs and benefits as they are difficult to qualify. Foregone revenues are challenging to quantify as well as some of the hidden costs. Matching

costs and value creation is problematic. Incremental investment, its associated costs and benefits are often challenging to estimate. In order to evaluate the costs and benefits estimated four important components to the analysis that are hard to quantify need to be estimated. These are: (1) investment even without tax incentives provided (2) leakages due to erosion of the tax base due to abuse of tax incentive schemes through claiming by those who do not qualify and through income shifting (3) tax revenues generated from investments made because of the tax incentives being awarded (4) tax revenues from spill-over effects (Zolt, 2014). Tax budgets with accompanying expenditure assessments. The lack of coordination and harmonization of the activities of those involved in the designing of investment policies and tax incentives is argued to compound the improper analysis of the cost and benefits of tax incentives. While the role of tax administration, monitoring and auditing tax incentives rests with the revenue authorities, that of designing them is the responsibility of other arms of governments such as ministries of industry and commerce, Investment agencies and Ministry of Finance. This compromises accountability and transparency on the outcomes of the tax incentives. Cooperation and coordination should begin from the construction of incentive policy. There must be clarity and consensus on the target group, sector or region, the objective of the incentive, the methods of measuring the accruing benefits and possible costs as well as the monitoring mechanism and actions to be taken in case of abuse.

Economic distortions and imbalances in the distribution of resources

Tax incentives increase resource distribution costs and bring about unfair distribution of resources in the economy. There can be overinvestment in areas, industries, sectors or regions with favourable tax treatments and underinvestment in those not enjoying tax incentives (Zolt, 2014). It is therefore difficult to conclude whether awarding tax incentives creates imperfections in the economy or is step towards the creation of competitive markets. Tax incentives result in distortion of investments. Tax holidays attract short-term investments as opposed to long-term ones. According to Stausholm (2017), tax holidays have high redundancy rates as they are awarded to investments that would have taken place without them. The

researchers suggest that the largely profitable kind of investments that are attracted by tax holidays would have still occurred without the tax policy compromises, thus making the tax incentives needless. “Round tripping” further heightens the redundancy challenge’.

Harmful tax competition

Tax incentives often lead to tax competition with countries trying to underbid one another to get the investment and the envisaged economic development. The competition might be detrimental to public finances in the long term or undermine public finances and end up resulting in unfavourable effect on development (Oguttu, 2021). The decrease in public revenues could result in government failing to finance public needs such as health, education and security. Chikova (2021:4) portends that as countries try to outcompete each other to attract investments by lowering tax rates or offering favourable treatments, they can overdo it resulting in a race to the bottom, erosion of the tax base and detrimental effects to revenue generation to drive sustainable economic development. The researcher further argues that “simply put, tax incentives discount socio-economic development opportunities”. Investors can take advantage of the unhealthy tax competition to shift profits, avoid tax or even evade it.

Conclusions

Notwithstanding that, tax incentives commonly look like they are costless, in practice they bring about substantial costs in the form of lost revenue, redundancies, more administration and compliance costs, increased tax avoidance and evasion as well as tax system complexity. These costs could lead to negative outcomes such economic inefficiency, stifled economic growth, crowding out of domestic investment as well as erosion of the tax base. It is important to note that the outcomes of awarding incentives differ from country to country. Whereas in some countries tax incentives maybe effective in attracting new investments and consequently contributing to enhancing in economic growth, in some countries the costs of offering the incentives is higher than the benefits and very little investment in any is attracted. When

considering any tax incentive proposals, developing economies need to approach the process with a questioning mind and scrutiny. Tax incentives need to be offered in compelling circumstances, where reasons for awarding them can be supported with collaborative evidence gathered from all policy makers, economic and financial analyst. This will be of paramount importance in protecting countries against adopting generous tax incentives programs that have little or no contribution to the country as a whole. If the tax incentives are not properly evaluated and weighed, they may have negative consequences on revenue collection, increase the burden on administration and lower the standards of living of citizens. A poorly constructed incentive policy can reduce economic efficiency and productivity of the country and promote corruption in some cases. Therefore, proper design of incentive policies, continuous monitoring, re-assessments and amendment, when necessary, cannot be over-emphasised.

References

- ABILLE, A. B., MPUURE, D. M.-N., WUNI, I. Y., & DADZIE, P. (2020). Modelling the synergy between fiscal incentives and foreign direct investment in Ghana. *Journal of Economics and Development*.
- ABRAMOVSKY, L., BIRD, N., HARRIS, T., TYSKERUD, Y., WELDEABZGI, A., BEYENE, Y. A., & ABROKWAH, E. (2018). Are corporate tax incentives for investment fit for purpose? Revisiting economic principles and evidence from low-and middle-income countries: IFS Report.
- ADAMU, S. (2014). The impact of tax incentives on economic growth and industrial development in Nigeria. *International Journal of Advanced studies in Economics and Public Sector Management*, 2(1), 13-14.
- APPIAH-KUBI, S. N. K., MALEC, K., PHIRI, J., MAITAH, M., GEBELTOVÁ, Z., SMUTKA, L., . . . SIROHI, J. (2021). Impact of Tax Incentives on Foreign Direct Investment: Evidence from Africa. *Sustainability*, 13(15), 8661.
- BASDEVANT, O., BENICIO, D., MIRCHEVA, M., MONGARDINI, M. J., VERDIER, M. G., YANG, M. S., & ZANNA, L.-F. (2011). *The design of fiscal adjustment strategies in Botswana, Lesotho, Namibia, and Swaziland*: International Monetary Fund.
- BRAUN, V., & CLARKE, V. (2006). Using thematic analysis in psychology. *Qualitative research in psychology*, 3(2), 77-101.
- BRODZKA, A. (2013). Tax incentives in emerging economies. *Business Systems & Economics*, 3(1), 26-36.
- CASTANEDA, N. (2018). *The politics of tax reforms in Colombia*: Palgrave Macmillan.

- CHIKOVA, R (2021). Should Zimbabweans worry about tax exemptions? African Forum and Network on Debt and Development (AFRODAD). Africa Portal. <https://extraproperty.com>
- CHIRINKO, R. S., & WILSON, D. J. (2008). State investment tax incentives: A zero-sum game? *Journal of public Economics*, 92(12), 2362-2384.
- COTRUT, M., MUNYANDI, K., CHOI, W., FERREIRA, V. A., & RIENSTRA, J. (2018). *Tax incentives in the BEPS era*: IBFD.
- DAUDE, C., GUTIÉRREZ, H., & MELGUIZO, Á. (2014). The political economy of tax incentives for investment in the Dominican Republic: "Doctoring the ball".
- EVEREST-PHILLIPS, M., & SANDALL, R. (2009). Linking business tax reform with governance: How to measure success.
- FJELDSTAD, O.-H., JENSEN, S. K., & ORRE, A. (2012). Taking stock of the tax reform process in Angola, and why tax incentives should be avoided. *Angola Brief*, 1.
- FOSSAT, M. P., & BUA, M. M. (2013). *Tax administration reform in the Francophone countries of Sub-Saharan Africa*: International Monetary Fund.
- GITONGA, F. K. (2017). *The relationship between tax incentives and foreign direct investment inflows of listed multinational corporations in kenya*. University of Nairobi.
- GRANT, M. J., & BOOTH, A. (2009). A typology of reviews: an analysis of 14 review types and associated methodologies. *Health Information & Libraries Journal*, 26(2), 91-108.
- GRAVELLE, J. (1992). *Enterprise zones: The design of tax incentives*.
- HAIYAMBO, E. (2013). *Tax incentives and foreign direct investment: The Namibian experience*.
- HANSSON, Å. (2021). INDUSTRIAL TAX SUBSIDIES: EFFECTIVENESS AND MAGNITUDE. *INDUSTRIAL POLICY*, 67.
- HEGGSTAD, K. K., USTVEDT, T., MYHRVOLD-HANSEN, T. L., & BRISEID, M. (2011). Towards fiscal self-reliance: Capacity building for domestic revenue enhancement in Mozambique, Tanzania and Zambia (Workshop report).
- JAMES IKE, U. (2018). Tax Incentives and Foreign Direct Investment (FDI): Implication for Export Promotion Innigeria, Ghana and South Africa, Post Ifrs Adoption.
- JAMES, S. (2016). 7. Tax Incentives Around the World *Rethinking Investment Incentives* (pp. 153-176): Columbia University Press.
- JOHNSON, L., TOLEDANO, P., STRAUSS, I., & JAMES, S. (2013). Background Paper on Investment Incentives: The good, the bad and the ugly: Assessing the costs, benefits and options for policy reform.
- KLEMM, A. (2010). Causes, benefits, and risks of business tax incentives. *International Tax and Public Finance*, 17(3), 315-336.
- KLEMM, A., & VAN PARYS, S. (2009). Empirical evidence on the effects of tax incentives.
- LAKUMA, P. C. (2019). Attracting Investments Using Tax Incentives in Uganda: The Effective Tax Rates.
- MBETHE, T. (2019). *Tax incentives: are they an instrumental feature of African tax systems?* , University of Pretoria.
- MPOFU, F. Y. (2021). Review Articles: A Critical Review of the Pitfalls and Guidelines to effectively conducting and reporting reviews. *Technium Soc. Sci. J.*, 18, 550.

- MUNONGO, S. (2015). *The effectiveness of tax incentives in attracting foreign direct investment: the case of the Southern African Development Community*. University of South Africa.
- MUNONGO, S., AKANBI, O. A., & ROBINSON, Z. (2017). Do tax incentives matter for investment? A literature review. *Business and Economic Horizons (BEH)*, 13(1232-2017-2411), 152-168.
- MUNYANYI, W., & CHIROMBA, C. (2015). Tax incentives and investment expansion: evidence from Zimbabwe's tourism industry. *AD-minister*(27), 27-51.
- MUSYOKA, K. (2012). *The relationship between tax incentives and foreign direct investment in Kenya*. University of Nairobi.
- NIDHEESH, K. (2014). Relationship between Tax Incentives Offered to Cochin SEZ and Economic Contributions of Cochin SEZ. *Journal of Economic & Social Development*, 10(2).
- NNUBIA, I., & OBIORA, F. (2018). Effect of Tax Incentives on Economic Growth in Nigeria. *International Journal of Social Sciences and Conflict Management*, 3(2).
- NWIDOBIE, B. M. (2020). Tax incentives and economic growth in Nigeria: a paradox? *International Journal of Economics and Accounting*, 9(3), 273-288.
- OGUTTU, A. W. (2018). International tax competition, harmful tax practices and the 'race to the bottom': a special focus on unstrategic tax incentives in Africa. *Comparative and International Law Journal of Southern Africa*, 51(3), 293-319.
- OLALEYE, M., MEMBA, F., & RIRO, G. (2015). Capital allowances and foreign direct investment in listed manufacturing companies in Nigeria. *Research Journal of Finance and Accounting*, 6(24), 109-119.
- OLALEYE, M., RIRO, G. K., & MEMBA, F. S. (2016). Effect of reduced company income tax incentives on foreign direct investment in listed Nigerian manufacturing companies.
- OLANIYI, T. A., OYEDOKUN, G. E., & AJAYI, R. O. (2019). Tax policy incentives on foreign direct investment in Nigeria. *Fountain University Osogbo Journal of Management*, 3(3).
- PARÉ, G., TRUDEL, M.-C., JAANA, M., & KITSIOU, S. (2015). Synthesizing information systems knowledge: A typology of literature reviews. *Information & Management*, 52(2), 183-199.
- REDONDA, A., DE SARRALDE, S. D., HALLERBERG, M., JOHNSON, L., MELAMUD, A., ROZEMBERG, R., . . . VON HALDENWANG, C. (2018). Tax expenditure and the treatment of tax incentives for investment. Economics Discussion Papers, No 2018-57. *Kiel Institute for the World Economy*. <http://www.economics-ejournal.org/economics/discussionpapers/2018-57> Received July, 12.
- SEBELE-MPOFU, F., MASHIRI, E., & SCHWARTZ, S. C. (2021). An exposition of transfer pricing motives, strategies and their implementation in tax avoidance by MNEs in developing countries. *Cogent Business & Management*, 8(1), 1944007.
- SEBELE-MPOFU, F. Y. (2020). Governance quality and tax morale and compliance in Zimbabwe's informal sector. *Cogent Business & Management*, 7(1), 1794662.
- SEBELE-MPOFU, F. Y. (2021). The Sampling Conundrum in Qualitative Research: Can Saturation Help Alleviate the Controversy and Alleged Subjectivity in Sampling? *International Journal of Social Science Studies*, 9(5), 11-25.

- SIYANBOLA, T. T., ADEDEJI, S. B., ADEGBIE, F. F., & RAHMAN, M. M. (2017). Tax incentives and industrial/economic growth of subSaharan African States. *Journal of Advanced Research in Business and Management Studies*, 7(2), 78-90.
- SNYDER, H. (2019). Literature review as a research methodology: An overview and guidelines. *Journal of Business Research*, 104, 333-339.
- STAUSHOLM, S. N. (2017). Rise of ineffective incentives: New empirical evidence on tax holidays in developing countries.
- TAVARES-LEHMANN, A. T., TOLEDANO, P., JOHNSON, L., & SACHS, L. (2016). *Rethinking investment incentives: Trends and policy options*: Columbia University Press.
- UGWU, C. C., OKWA, I. E., & INYANG, E. E. (2020). Tax Incentives and Investment Growth: The Nigerian Perspective. *Journal of Economics and Business*, 3(1).
- ZEE, H. H., STOTSKY, J. G., & LEY, E. (2002). Tax incentives for business investment: a primer for policy makers in developing countries. *World development*, 30(9), 1497-1516.
- ZELEKHA, Y., & SHARABI, E. (2012). Tax incentives and corruption: evidence and policy implications. *International Journal of Economic Sciences*, 1(2), 138-159.
- ZOLT, E. M. (2014). Tax Incentives and Tax Base Protection Issues. *Papers on Selected Topics in Protecting the Tax Base of Developing Countries. Draft Paper*(3).