

**EFFECT OF TAX INCENTIVES ON FOREIGN DIRECT
INVESTMENTS INFLOWS IN KENYA**

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DECLARATION

I, the undersigned, declare that this is my original work and has not been presented to any institution or university other than KESRA and Moi University for examination.

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This research project has been submitted for examination with our approval as the University Supervisors.

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Dr. David Kosgei

DEDICATION

This project paper is dedicated to family, who have always encouraged and supported me throughout my life. They have been, and still are, the pillar of strength in my life. I thank you.

To my friends, finishing this project would have been impossible if it were not for your constant impetus in concluding this project. Also for your wonderful support and great input, you are much appreciated.

ABSTRACT

The study sought to determine the effect of tax incentives on foreign direct investments inflows in Kenya. The objectives were: to determine the effect of farm work deductions, Industrial building allowances, investment deductions and wear and tear allowances on foreign direct investment inflows in Kenya. The study was conducted at the macro level and therefore was looking at tax incentives and foreign direct investment inflows for the country annually. Secondary data was collected for a period of 10 years (2008 to 2017) on an annual basis. The study employed an explanatory research design. The researcher also conducted inferential statistics specifically correlation and regression analysis. A multiple linear regression model was used to analyze the relationship between tax incentives and foreign direct investment inflows. Statistical package for social sciences version 22 was used for data analysis purposes. F test and t test were applied to test the significance of the overall model and individual parameters respectively. Diagnostic tests were carried out on the collected data to ensure it is reliable and stable for the analyses. From the results, the R-square value was 0.633 which can be translated to mean that 63.3% of the variations in foreign direct investment inflows in Kenya are attributable to the four selected independent variables and the 36.7 percent remainder are attributable to other factors beyond the scope of this research. The study also revealed a strong connection of predictor variables and foreign direct investment inflows ($R=0.796$). Analysis of variance (ANOVA) results at 5% significance level show an F statistic of 2.160 which was less than the critical value and hence the model was found not statistically significant. Additionally, the results showed that, industrial building allowances and investment deductions are statistically significant factors affecting foreign direct investment inflows while farm works deductions and wear and tear allowances do not substantially determine foreign direct investment inflows in Kenya. The recommendation made by the study was that more focus should be placed by policy makers to the current levels of industrial building allowances and investment deductions since they have a significant influence on foreign direct investments inflows in the Kenya. The study recommends the need for further studies to focus on the other variables that determine foreign direct investment inflows in Kenya.

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LIST OF ABBREVIATIONS & ACRONYMS

CBK	Central Bank of Kenya
EAC	East African Community
EPZ	Export Processing Zone
FDI	Foreign Direct Investments
GDP	Gross Domestic Product
IMF	International Monetary Fund
KNBS	Kenya National Bureau of Statistics
KRA	Kenya Revenue Authority
MNC	Multi-National Corporation
NSE	Nairobi Securities Exchange
SPSS	Statistical Package for Social Sciences
UNCTAD	United Nations Conference on Trade and Development
USD	United States Dollar

OPERATIONAL DEFINITION OF TERMS

Export Processing Zones (EPZs): are areas in developing countries that aim to spur economic growth through attraction of FDI for export oriented production by offering incentives (Mangieri, 2006).

Foreign Direct Investment (FDI): is the long-term investment reflecting a lasting interest and control by a foreign direct investor (or parent enterprise), of an enterprise entity resident in an economy other than that of the foreign investor (Hill, 2005).

Tax Incentives: Refers to the exclusion, exemption or deduction from tax liability offered so as to encourage engagement in a specified investment activity (Mutua, 2011).

Taxation: Refers to the means by which governments finance their expenditure by imposing charges on citizens and corporate entities (Morisset & Pirnia, 2001).

CHAPTER ONE: INTRODUCTION

1.0 Overview

This chapter discusses the context of the project, the problem statement, the research objectives, and the research hypotheses, justification of the study and the scope of the analysis.

1.1 Background of the Study

Foreign Direct Investment (FDI) is an investment made in a business by an interested party from another country through which the company is owned by a foreign investor (Hill, 2005). This transaction would lead to a perpetual relationship among the host and mother country investors (Olson, 2008). According to Ismaila and Imoughele (2010), FDI is a representation of a perpetual allegiance to the host country. The reason why it is preferable is that this type of investment holds no obligation to the host country. UNCTAD (2002) defines three forms of FDI: reinvested earnings, equity and capital consisting of intercompany loans. Employment opportunities are created by FDI since when businesses set up in the host country, transfer of skills to the locals of the country is enabled through recruitment and training. Apart from new skills, the host country also benefits from technological advancements.

Kariguh (2014) capital, managerial skills, technology, and human capital formation. It also mentions that the crucial source of FDI in many economies is capital flows since connections cap the creation of an environment in which business competition thrives. Voorpijl (2011) however noted that consequences exist in increasing the inflow of FDI such as exploitation of the local communities by the multinationals more freely. Another issue arising from this is that private investment is promoted by international

investors at the expense of public investments hence leaving little to the hosting companies in case the donors decide to leave.

According to Easson (2004) there are various factors which influence foreign investments which include political stability, good communication, good infrastructure network, tax and other investments incentives, free repatriation of profits, satisfactory dispute settlement mechanisms, skilled labour force, lack of bureaucratic obstacles and investments protection agreements that alleviate the risks associated with nationalization. FDI takes a variety of forms: Greenfield investments (real developments in manufacturing or assembly plants), collaborative partnerships (creating multinational corporate alliances), brownfield investments (acquiring established production facilities to launch a new assembly line) and cross-border mergers and acquisitions (Zolt, 2015). Each of the four types of FDI mentioned above can pursue any of the following four key strategies, namely: strategic objective-oriented assets, utilization of natural resources, the quest for productivity and, finally, those associated with business growth (Dunning, 1977).

Generally, the calculation of FDI is based on the stock of FDI, which is expressed as a percentage of the GDP of the region. It is usually issued at the end of the year, with its elements being foreign direct investment capital, which comprises international equity investments and international foreign investors' foreign direct investment capital, foreign equity investments and host country loans. The issue with this approach is that developed countries do not have the infrastructure and resources to capture these data effectively. Along with international FDI, FDI flows are also a measure of FDI, but its unpredictable existence makes foreign direct investment stock an adequate measure of

FDI, since FDI shares reflect shifts in the market, such as inflation and exchange rates (Nunnenkamp, 2002).

Various scholars have come up with different definitions of tax incentives which is also referred to as fiscal incentives. Klemm (2010) points out that all types of special tax dealing are aimed specifically at individual industries or practices, unlike the common tax treatment applicable to all. Tax incentives are sometimes alluded as fiscal rewards. Bolnick (2004) argues that these are fiscal actions which the government takes to lure both domestic and international investment. Tuomi (2011) defines tax incentives as a government facility that grants investors a favorable opportunity beyond normal tax legislation. Globalization has increased the importance of tax incentives because investment locations are increasingly becoming more and more similar and competitive (Munongo, 2015). Lodhi (2017) argues that fiscal incentive policies are founded on two principles: Firstly, enhanced investment is necessary for quick economic growth and secondly, greater investment will be stimulated when fiscal measures are employed.

Developing nations use fiscal incentives to entice FDI, hoping that increased FDI will boost development in the host country. These states use fiscal measures as a counterweight to business disincentives that are prevalent in their economies (Brodzka, 2013). Zee, Stotsky and Ley (2002) point out how fiscal incentives help in reducing tax burden of specific investment projects while Wilson (1999) opines that escalation of tax rate in a state will lead to relocation of mobile capital to other destinations with a lower tax rate. Therefore, tax incentives effectively lead to attraction of FDI since they reduce tax rates. This leads to accrual of attendant benefits such as development of worldwide export and import networks, increased revenue, social benefits such as creation of jobs, signaling effects, and positive externalities like skills development,

infrastructure development, and technological transfer (Kinda, 2010). However, provision of fiscal incentives can lead to revenue loss especially where the realized investments would have been made even without granting the incentives. The cost of providing fiscal incentives goes beyond revenue losses to include other costs such as administrative costs, trade distortions and rent seeking costs (James, 2013).

Tax incentives are in various forms. United Nations Confederation of Trade and Development (UNCTAD) claims that tax benefits come in various ways: savings exemptions, tax holidays, losses carried forward, discounted corporate income tax rate, savings tax credits, deductions for eligible investments, value-added tax credits and zero or discounted taxes (UNCTAD, 2000). Provision of a tax holiday is a condition where new foreign investment is exempted, either in part or in full, from the paying of corporate income tax for a predetermined period of time (UNCTAD, 2000). Despite criticism from numerous areas of tax holidays, it continues to be very popular globally (Cleeve, 2008). The success of tax holidays stems from the fact that they are easy to enforce and would not require the direct cash outflow expense by the host country. However, there are some drawbacks. James (2013) listed some of the risks associated with the tax holiday. In the first case, it is a general gain without the requirement on how much one might have spent. Secondly, companies with subsidiary companies abuse the transfer pricing practice of the provision of tax holidays, that is to say, the channeling of profits from a different jurisdiction into where you have a tax holiday. Third, businesses have a bad habit of relocating to other jurisdictions after the latest tax holiday has expired. So they are going to leave and move to another country to start celebrating a fresh tax holiday.

Investment allowances are packaged in different ways such as capital deductions, special zones investment allowances, investment deductions, accelerated depreciation, buildings allowances, timing difference, wear and tear allowances and investment tax credit (Klemm & Parys, 2012; James, 2013). There are various advantages to investment allowances. Firstly, they are given only after the initial spending has happened, which is the real purpose of having fiscal motivation in the actual context. They were however criticized because they distort the existing investment from new investments (Klemm, 2010).

Period of losses carried forward is a tax incentive method used by governments to lower effective tax paid by investors. Investors are allowed to spread business losses forward for a stipulated period time. The losses spread forward will be deductible against future taxable income. It is helpful and very much valued by investors, particularly those who are likely to make losses in their early formative years when they are penetrating the new market (UNCTAD, 2000).

Tax policies have been shaped around the world by the desire for countries to remain competitive in a progressively globalized economy (Klemm, 2010). Provision of tax incentives has led to international tax competition, which can technically be defined as a race to the bottom. This is a phenomenon where countries (especially neighbors) with roughly the same investment climate compete with each other in giving generous fiscal incentives thereby leading to massive losses of revenue (James, 2013). According to Klemm and Parys (2012) tax competition through provision of tax incentives in developing countries has only succeeded in attracting footloose investments, which relocate to other tax favored jurisdictions upon expiry of tax incentive period. Tax competition leads to loss of much needed revenue especially by developing countries.

Berkhout (2016) observes that the corporate tax revenue to total tax revenue ratio is twice as important in developing and poor countries as compared to rich countries. Therefore, it is imperative that developing countries collect as much revenue as possible to advance their development agenda. Hence, an analysis of how much benefits the host country receives against the cost incurred due to provision of tax incentives is vital (Fleinkman & Plekhanov, 2005).

Fiscal policies formulated for attracting business are highly recommended as one way of improving international competitiveness of a nation by being able to influence location of globally mobile capital (Eyraud & Lusinyan, 2013). Tax incentives will be of benefit if they will lead to investments that would not have been made in the host country were it not for the fiscal incentives. The new investments will result in increased revenue and improvement of general wellbeing. Foreign exchange earnings will also be enhanced by increased FDI. Improvement of local skills will also be expected alongside technological transfer. Notwithstanding the noble intentions, use of fiscal measures to attract business is controversial. It brings along expenses like foregone revenue, welfare, administrative expenses and spillover costs. Furthermore, the degree of effectiveness of the fiscal measures in attracting FDI is not known (Parys & James, 2010)

Administratively there are two different forms of fiscal incentive regimes: Automatic fiscal incentive regimes and discretionary tax incentive regimes (Morisset & Pirnia, 2001). In an automatic tax incentive regime, criteria is established where a firm qualifies automatically upon meeting set conditions. This is a very objective method, which is less costly administratively. A discretionary fiscal incentive regime is subjective since it involves decisions that are made at the discretion of government

officials. Tax incentives granted will depend on the outcome of a case-by-case evaluation exercise. One of the disadvantages of this regime is that it can encourage rent seeking. Additionally, it is costlier and time consuming. Another cost of tax incentives is the revenue lost, which can also be viewed as a tax expenditure. The costs are more pronounced in instances where the costs due to provisions of tax incentives lead to spillover costs. Due to tax incentives, revenue is lost, inevitably leading to opportunity cost. The government of the host country either will reduce public spending/benefit or be forced to tax other sectors of the economy to plug the hole left by the tax expenditure (Easson, 2004).

Due to the major world capital inflows as well as financial and policy transformations in the developing economies (Adam & Tweneboah, 2009), FDI has been growing dramatically. For a developing economy, FDI is important if it can effectively absorb their spill-over effects. FDI is a major source of capital inflows with beneficial impacts on the host country's economy, including knowledge transfer, financial, skilled human resources, foreign trade growth and a sustainable economic climate (OECD, 2002). However, the home country's fiscal-policy climate must be conducive for attracting foreign investors. Because of its potential advantages, many policymakers have adopted different ways of rewarding investment to enable foreign-owned firms to spend within their expertise (Loyford & Moronge, 2014).

In addition to government, policymakers and academic research, the determining factors of foreign direct investments have been an important topic (Mahiti 2012). Both the theory and empirical literature suggest that development in a country has a direct relation with the economy, which consists of several variables such as GDP, monetary policies, exports, FDI, interest rate, ID, currency exchange and other outlets. These

variables form the foundation of every economy (Mitullah, 2010). The flows to a nation from foreign direct investment are impacted by changing several economic factors and the potential expectations of these basic factors change. Countries need to search for new ways to draw FDI stock, as investors' intentions vary. Analysis is thus critical for investment decision-making, and the predictability of FDI inward stock is indispensable.

The importance of tax benefits to manufacturing can potentially be explained in terms of reimbursement externalities and support policies of the host government for the infant industry. UNCTAD (2012) states that corporate investment practices both generate revenues by selling produced goods and create positive externalities based on factors such as increasing employment, disseminating new knowledge and economies of scale. However, a corporation cannot be sufficiently paid for creating these externalities due to inconsistent business dynamics, which requires a justification for the benefits. This means that farmers cannot take advantage of the externalities they produce that generate a tension between private and social returns. Ochumbo, (2009) argues that the incentive of a private investor that counterbalances them could be warranted for such incentives.

As a step towards attracting FDI, their corporate tax rate has fallen in recent years from one country to another. Germany lowered the corporation tax rate (federal tax and basic tax rates) from 25% to 15% in January 2008, lowering the overall corporate tax rate from approximately 39% to approximately 30%. Britain slashed the income tax rate in April 2008 from 30 per cent to 28 per cent. The effective corporate tax rates currently hover around 30 per cent in the major European countries. The second-tier European countries, including the Netherlands, Finland and Denmark, lowered corporate tax rates

between 2005 to 2007 and have now hit an average corporate tax rate of about 25 percent. Between 2004 and 2008 the Czech Republic, Poland, Slovakia, Hungary and other countries which joined the EU reduced corporate tax rates by about 20 percent. In Asian countries Hong Kong and Singapore as well as other countries they have also lowered their corporate tax rates, introducing an international perspective to the corporate tax rate reduction pattern. However, it should be noted that many countries have expanded their tax bases in conjunction with a reduction of their corporate tax rates. Germany and Britain, for example, expanded their tax bases by revising their depreciations regulations to limit the fall in tax incomes as a result of the corporate tax rate reduction. (Chaves, 2010).

In 1989, with the assistance of the IMF and the World Bank, the Washington Convention of the International Financial Institutions (IFI) laid down new standards to help emerging countries enter the developing world. They drew up a list of ten proposals that included elements such as trade liberalization, stricter economic control, government sector reduction, and internal FDI liberalization. These initiatives were aimed at reducing government intervention and growing private sector dependence. Although at least some of these economic policies were implemented by several developed countries with a problematic outcome (Westerberg, 2011).

UNIDO (2008) has estimated that FDI's global production has hit an all-time peak of US\$ 1.3 trillion in 2000. The UNO is a pioneer in the field of industrial growth. Investment support companies (IPAs) have seen high business volumes and continued success in attracting new investments to countries throughout the world, in particular in highly developed economies of Europe and North America, and also in flourishing Asian economies of China (UNIDO, 2008).

However, much of the flow of investment is concentrated in the highly developed areas of the European Union, the USA and Japan where 71 percent of FDI 's world influxes were created together by beneficial tax incentives (UNIDO, 2008). Malesky (2010) and Jensen noted the majority of US states had offered lucrative tax encouragement to attract investment, despite broad skes about the benefits of globalization. The African share of global investment has thus fallen from its previous 1% to just another 0.67% (UNIDO 2008). Therefore, African countries were urged to create "business" their attractions and establish a one-stop shop to ease the way forward for incoming investment. Instead, investment development agencies (IPAs) were created.

Over the years, several LDCs have made attempts to strengthen the investment climate, for example by lowering taxes, setting up an investment promotion agency to properly support international investors and abolishing FDI-related restrictions (UNCTAD, 2011). In addition, many LDCs have paid more attention to policy proposals at bilateral ,regional and multilateral level to improve foreign coordination and/or participation in FDI-related matters. These policy measures are as follows: the introduction in 2001 of the New Alliance for Africa's Growth (NEPAD) to raise the available resources to US\$ 64 billion through a mix of changes, resource mobilization, tax cuts, the creation of an investment promotion agency to properly assist foreign investors, the elimination of FDI-related constraints and a favorable climate for FDI. To this end, the Nigerian authorities have sought to draw FDI by numerous changes (Funke & Nsouli, 2003).

Kenya has a long-standing rich past, with multinational companies since the 1960s. Kenya has long been known as an enticing location for foreign investors to invest in East and Central Africa. In Kenya a host of multinationals, such as Procter & Gamble, General Motors, Microsoft, Google, Coca-Cola Citibank, Ogilvy andMather, still act

as the East African market center of choice. Notice that foreign investment accounts for approximately 51 percent of the country's total banking assets (CBK, 2015). Thanks to its integration with global hubs and its trained and skilled staff, fiscal benefits, advanced financial structures, built infrastructure and regional trade strategic memberships and cooperation agreements, Kenya is considered a productive hub for the country (Ryan, 2006).

Kenya unveiled its 2030 vision in 2008 with the goal, among other things, of achieving global competition for FDI and economic growth. Incoherent FDI inflows have occurred in Kenya since the 1970-1980s. In response to structural shifts and industry trends, Net FDI was extremely unpredictable and generally diminishing in the 1980s and 1990s (UNCTAD 2015). The purpose of this research is to determine whether Kenya's current tax incentives are effective in attracting foreign direct investment inflows.

1.2 Statement of the Problem

Kenya has a long running rich tradition with international companies dating back to the 1960s. Kenya has been seen for years as a desirable location for international investors looking to invest in the broader region of East and Central Africa. However, the country has also seen multinational corporations with well-developed country leaving operations in unpredictable circumstances and this has adversely affected FDI inflows into the region. In 2014 Eveready East Africa shut down its Nakuru factory for importing batteries from its Egyptian branch after strong competition from cheap illegally imported goods. Two weeks later Cadbury Kenya declared it a halt on the Kenyan market. Their factory was decreed to be decrying inexpensive and subsidized imports in September 2016. Bridgestone, Unilever, Procter and Gamble, Reckitt

Benckiser, Johnson and Johnson and Colgate Palmolive are other companies which have since left Kenya in alternative markets. Experts have linked these exits to fiscal policy and this analysis would aim to examine if actually tax incentives which are part of fiscal policy affects FDI inflows.

The effects from tax incentives on foreign direct inflows are largely inconsistent and varied in empirical evidence. Klemm and Parys (2009) explored how efficient tax incentives encourage investment. This was achieved in observational research. The findings have demonstrated that relatively low corporate income tax rates and longer tax holidays are effective in attracting FDI, but not in stimulating aggregate private fixed capital investment or growth. Sebastian (2009) explored the use of tax incentives for attracting investment in developed countries in particular. The study concluded that tax benefits on spending alone had no impact. In order to encourage investment, a good investment environment is also important.

Locally, Kenya's FDI was influenced by human capital, economic openness, ID, the FDI in the preceding periods and the real exchange rate, as was found in the time series analysis (2006). Otieno (2012) studied FDI locations in Kenya. He found that FDI has a long-standing relationship to exchange rates, direct taxes, GDP, the establishment of fixed capital, and economic openness. The impact of various variables on foreign direct inflow in Kenya was mostly clarified through empirical evidence, and others were still studying the effects of direct foreign investment in economic growth. However, few studies have been carried out, if any, regarding the effects of tax incentives on foreign direct investment in Kenya, which is the void the current study aimed at filling. International direct investment has an important role to play in the global economy's growth. This is why the government of Kenya has offered numerous tax incentives to

draw FDIs. However, the best impact of these benefits on FDI influxes to the nation is not clear.

1.3 Objective of the Study

The general objective of this study was to determine the effect of tax incentives on foreign direct inflows in Kenya. The specific objectives of the study were:

- i)** To determine the effect of farm works deduction on foreign direct investment inflows in Kenya
- ii)** To establish the effect of industrial building allowances on foreign direct investment inflows in Kenya
- iii)** To determine the effect of investment deductions on foreign direct investment inflows in Kenya
- iv)** To establish the effect of wear and tear allowances on foreign direct investment inflows in Kenya

1.4 Hypotheses of the Study

- i)** H_0 : Farm works deduction have no significant effect on foreign direct investment inflows in Kenya
- ii)** H_0 : Industrial building allowances have no significant effect on foreign direct investment inflows in Kenya
- iii)** H_0 : Investment deductions have no significant effect on foreign direct investment inflows in Kenya
- iv)** H_0 : Wear and tear allowances have no significant effect on foreign direct investment inflows in Kenya

1.5 Justification of the Study

Students, researchers and researchers who may wish to conduct further research in the same area will use the results of the study in future. The study will also be useful in identifying further research fields in other related areas with topics requiring further examination of the empirical literature, so that study gaps are identified. The results of this study can be useful to the government and other policy-making bodies as a guide for the formulation of economic sector-related growth policies. The government as the regulator will benefit from the results of this report, as it will shed light on the impact of tax incentives on FDI inflows in Kenya. The results of the study would aid foreign investors in taking informed decisions on the Kenyan market. An accurate assessment of the impact of fiscal incentives on foreign direct investments in the country will be made by investors with an interest in the Kenyan markets.

1.6 Scope of the Study

The analysis looks at the effects of tax incentives on foreign direct investments in Kenya. The tax incentives considered are farm works deductions, industrial building allowances, investment deductions and wear and tear allowances. The tax incentives are the independent variables while FDI inflows in Kenya are the dependent variable. Research was carried out for 10 years (2008-2017) on a yearly basis.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This section discusses the theoretical framework used in the research and reviews previous studies on tax incentives and foreign direct investment. It comprises a theoretical review, tax incentives and foreign direct investment, an empirical review, conceptual framework and a summary of the literature.

2.2 Theoretical Framework

This section reviews the relevant theories that explain the associations between tax incentives and foreign direct investments. The theoretical reviews covered are; Neoclassical investment theory, internalization theory, eclectic paradigm theory, the product lifecycle theory, consumer and producer surplus theory, theory of tax competition, monopolistic power theory and new economic geography theory.

2.2.1 Neoclassical Investment Theory

Neoclassical investment theory has been a dominant lens of analysis in management research on the influence of fiscal policy framework and FDI in developing countries. Jorgenson (1963) developed the theory. According to the theory, the relationship that exists between fiscal incentives and investment is positive. Tax incentive reduces cost of capital hence increasing the return on capital, which will lead to increased investment (Parys & James, 2010). The main attraction of the model is the use of tax parameters in determining capital costs of business production and ascertaining the tax cost on returns on investments (Gemmell, Kneller & Sanz, 2013). The theory was preferred because it incorporates tax parameters directly into the investment model. The study thus tested the assumption by neoclassical investment models that tax incentives reduce user cost of capital, thereby improving investments in an economy.

The neoclassical investment model calculates the percentage tax cost emanating from fiscal policy adjustments and compares the same with different countries. At the end the effects of tax reforms on investments is estimated by combining empirical estimates with the percentage change on tax liability measures (Eyraud & Lusinyan, 2013). Nevertheless, the theory ignores some of the factors affecting the tax cost on FDI. For example, power for administration to decide on tax liabilities and ignoring the effect of tax planning and other taxes omitted from the model. The assumption by the theory of declining marginal productivity of capital can also be challenged. For instance, business concentration may increase rates of return instead of decreasing as the model assumes leading to different policy implications (OECD, 2007).

2.2.2 Internalization Theory

Casson and Buckley introduced this hypothesis in 1976. Hennart (1982) further evolved the theory and learned from subsequent works by Casson (1983). The principle outlines the development and inspiration of multinationals. It reveals that multinational companies plan their internal operations in order to obtain unique advantages and leverage them to improve their productivity. According to Hymer (1976), FDI can only occur where the utilization of a firm-specific benefit supersedes the marginal cost of foreign investment. In short, he suggests that FDI happens in unstable markets, and it is actually a firm-level policy judgment rather than a capital-market financial decision.

Casson and Buckley (1976) claim that an FDI is desirable only if the requirements of possession, place, and internalization (OLI) are satisfied. Firstly, the company would have a competitive edge over the ownership of the local business. This could be in the context of the corporate or technical expertise unique to the multinational. Government regulations that are likely to change the advantages of investment in a given host

country are also important. In some situations, the host government can lay down rules on the existence of foreign ownership. In addition, such constraints limit the inward FDI inflows that would be followed by technology. Second, manufacturing in the home country would be beneficial for multinationals as well as other buyers if they can take advantage of any competitive locational advantage. Instead of renting or purchasing from other businesses, it should be appropriate to carry out the operations within the host countries.

2.2.3 Eclectic Paradigm Theory

This theory, a combination of three distinct but correlated hypotheses, was developed by Dunning (1993). These theories are control, location and internalization (OLI) that are used to explain how the variables lead to increases in foreign direct investment. Intangible properties are the owner-related privileges. However, these properties may be treated as an exclusive ownership and control by the corporation and may be sold to other companies at price discounts, or the corporation may record high return prices. These properties are not restricted to the company's ownership. Dunning (2005) suggests that while all other conditions remain stable, a business with a higher degree of competitive advantages than its rivals has a greater chance of increasing its total performance and therefore increasing its global footprint.

Place advantages, as described by Denisia (2010), are used to compare the strengths and prospects of the various economies. The final outcome of this study is that the most fitting country is chosen to be the host country for the operations of multinational corporations. The link between location and ownership advantages is that, as a global company is able to host itself in the most effective environment, it is now in a position

to participate in the development of its property-related resources and hence to involve the business in foreign direct investment.

Internalization creates the need for a corporation to be able to develop a market in of of the markets in which the organization offers its goods or services. The company must find forms in which it can further benefit from foreign production in contrast to the limited fees received in international trading practices such as export and franchising. Instead of expanding the manufacturing rights to other nations, Dunning (2005) notes that companies are more likely to earn better profits. Therefore, the diverse model encourages the development of a corporation's output markets by leveraging its economic advantages and choosing desirable locations. In doing so, companies not only participate in foreign direct investment, they also reap much more than their rivals.

2.2.4 Product Life Cycle Theory

Vernon (1966) describes the production life cycle as a process consisting of four phases of development, including invention, growth, maturity and decline. First, a company develops an idea of a product or a service. The substance or concept then goes through a developmental period and finally reaches maturity. It then begins to worsen. The commodity downturn is mainly due to market uncertainty and the company's failure to innovate. Companies who are directly engaged in foreign direct investment carry manufacturing machinery to foreign countries in order to be close to the target market and maintain a competitive market share (Dunning, 1993).

The production life cycle described by Vernon is typically used in countries that produce and export products. The countries sometimes lose market share to competitors that imitate the products, and eventually become the main exporters of the product. The hypothesis explains why the dissemination of technical progress is significantly higher.

As a consequence, variations in manufacturing processes used by different countries are expected to emerge. It is important to note, however, that the life-cycle of production referred to by Vernon applies only to certain types of goods, in particular those for high income earners and goods with alternative sources of labor and capital. Analysts have argued that Vernon's theory of technical progress is mute, which is crucial to turn technologies that need a lot of income in order to expand (Dunning, 1993).

Vernon's evaluation of foreign direct investment based primarily on commodities. A definition of the process indicates that the product was first invented in the home country. The country in which the foreign investor lives has benefits in terms of technology and technological capability. First, the innovator produces a product for the local market. At a later stage in the production cycle, the commodity is exported to other countries that lack the resources or innovative power to manufacture equivalent products. Subsequently, the commodity becomes developed and gradually matures. At this point of product growth, labor becomes a vital input into manufacturing. As a result, the investor would obtain demand input from local resources and citizens in the foreign world. As a consequence, foreign direct investment is seen as a crucial stage in the life cycle of product production (Chen, 1983).

2.2.5 Theory of Tax Competition

Tiebout (1956) developed the theory. Tiebout (1956) argues that provision of different tax rates by various states leads to efficiency by allowing firms and individuals to enjoy different tax rates and eventually choosing which fits them best. The theory explains that some countries will choose to charge low taxes and provide modest common goods, while on the other hand, some will charge high taxes and provide comprehensive public

facilities and services. According to the theory, MNEs will decide where they maximize profits and accrue their capital by moving to the countries that best serve their interests. This theory therefore, could be the best to explain the interphase between tax incentives and explain how countries and regions compete for FDI through provision of tax incentives, which reduces cost of investments (Wellisch, 2000).

According to Onyeiwu and Shrestha (2005), theory of tax competition provides a tradeoff and a good mix between loss of revenue due to tax expenditure on provision of tax incentive and provision of public goods. This is because FDI will want to locate in countries with enhanced public goods provisions and low taxes. Hence, provision of tax incentives may lead to compromising of public goods provisions.

Oates (1972) asserts that the desire to lower taxes due to fiscal competition among countries produces leads to poor local service provision. Low taxes lead to low revenue for the governments, this ultimately affects the capacity of the government to provide better local services. However, in the tax competition literature, there is disagreement on the effect of tax competition. Janeba (2002) opines that tax competition results in low taxes on investments while some studies disagree.

The theory of tax competition however fails to capture the fact that in the international context, it is not easy for foreign investors to move from one state to another looking for favorable tax jurisdictions, there are other restrictions as well. The theory argues in support of tax competition; however, tax competition has led to harmful tax practices in some regions especially in developing countries.

2.2.6 Consumer and Producer Surplus Theory

User and producer surplus principle suggests that government allows businesses to invest in their countries to generate jobs and increase revenue for the local market.

Potential investors are judged on the basis of their potential to enhance the quality of life of their people (Chen, 1983). The role of FDI in the local market for inputs and outputs leads to the economic development of the host country. In most cases, the government demands the employment of local citizens in the industries. The upward slope of the labor demand curve indicates that the existence of the company is favorable to the society. The downward trend in the market demand curve indicates that customers profit from the products and services of companies (Glaeser, 2001).

When making a decision on tax incentive to offer, the government should consider benefits created by the presence of the investor. The size of the tax incentive should be proportional to the surplus produced by the customer or manufacturer. This is inferred by the buoyancy between supply as well as demand. There would be no local excess while the flow of labor to the company is elastic. The government should not offer tax incentives unless labour supply is inelastic. On the other hand, highly elastic demand generates little consumer surplus. However, an inelastic demand to the firm's products generates higher surpluses and government should offer tax incentives. Another factor that can generate consumer surplus is that, if the firm has large fixed costs and prices of its products are set close to marginal costs then the surplus goes to the consumer (Glaeser, 2001).

2.2.7 Monopolistic Power Theory

The monopolistic power theory was advanced by Kindleberger (1969). The theory holds that multinational firms could enjoy the monopolistic power benefit in an imperfect market condition as they are majorly progressive in technology has superior managerial skill, they tend to be in the situation to invest in the business opportunity and generate numerous profits (Onyinyechi & Ekwe, 2016). The theory explains that

in the name of the interest of the nation, there is unwillingness by the host Government to permit foreign firms, free entry into the nation (Nayak & Choudhury, 2014).

The Kindleberger's (1969) monopolistic power theory describes the several forms of benefits normally enjoyed by multinational firms not enjoyed by the local firms for example intangible assets or specialist knowledge that make them competitive globally. These are firm specific advantages (Denisia, 2010). These benefits usually give motive to a firm to invest internationally to take advantage of them rather than distributing them to rivals in the foreign market. The encouragement of companies becomes even more if there is a possibility of the firm to make huge monopoly profits (Nayak & Choudhury, 2014).

The monopolistic theory however does not describe the benefit a firm should focus on since apart from monopolistic advantages (Nayak & Choudhury, 2014). In this study, the monopolistic power theory explains that when MNCs engage in FDI they enjoy various benefits including tax incentives offered by the local governments thereby increasing the MNCs profits.

2.2.8 New Economic Geography Theory

It is one the most appropriate models which explains the determinants of FDI location (Lee, 2012). NEG was developed by Krugman (1991). It holds that business location tends to be influenced by demand for products or by large markets, which help them to minimize transportation costs. The theory postulates that locational advantage is a key factor which makes a country attractive and most multinationals will seek to invest in a country with locational advantages which are favorable for investments. Further, in support of the NEG model, Devereux and Mifflin (2007) posit that tax incentives will

have more impact in countries with already established foreign investments compared to countries with fewer or no foreign investments.

The New Economic Geography Theory contradicts the central assumption of the neoclassical investment theory as to the value of taxation to affect expenditure. The model indicates that lower taxes foster the growth of FDI among international business entities. Thus, the distribution of FDI can be calculated by a country's geographical position and not simply by tax incentives, which may be inconsistent. This according to Venables (2005) gives NEG theory a holistic approach to spatial economics that explains the movement of FDI. These clattering forces, due to FDI flows generate uneven allocation of economic activities among countries. This leads to emergence of regional disparities, new cities and this eventually brings in international inequalities. The theory demonstrates that easy access to the market creates incentives to firms because of reduction in transport costs and as such determines international competitiveness of a country (OECD, 2008).

According to Ottaviano (2003), the power of regional policy will depend on the level to which trade integration has taken place. Therefore, there is a need to reduce trade barriers in order for fiscal policies to be effective. Globalization has made cross border trading easy and MNEs are able to sell their goods across boundaries. The theory may therefore, not be sufficient in explaining movement of FDI in the advent of globalization and regional community integrations.

2.3 Tax Incentives and Foreign Direct Investment Inflows

Changes in controls including abolition of international trade and privatization of government services are impacted in the country's request for FDI. Economic growth is also due to a country's appeal for FDI, as states with high economic growth potential

can allow firms to take advantage of the growth by establishing business there. Exchange rates along with tax rates also influence an FDI appeal by a government. Low-level corporate income tax rates are highly likely to draw FDI while companies tend to allocate FDI to countries where local currency is projected to increase against their own currency (Olson, 2008).

Although FDIs face many restrictions, the absence of well-structured and lucrative tax incentives emerges invariably in previous surveys as a major obstacle to achieving growth in FDIs. Globally, Tax incentives constitute the promotion strategies of the government. Different countries have adopted a variety of tax incentives so as to boost growth, attract Foreign Direct Investment (FDI), promote technological transfer and diversify production. Taxes influence the net return on capital and most policymakers consider it to have great impact on capital movements between nations (Morisset & Pirna, 2001).

Tax incentives proponents point out that investors earn a higher rate of return as a result of tax lower tax burdens which enables them to re-investment using the additional income obtained. The Host Country thus raises its income, benefits from the technology transfer and attracts increased FDIs. It is also argued that investors need to be provided with tax benefits in Less Developed Countries (LDCs), considering that such countries generally have very bad investment climates such as dilapidated infrastructure, policy turbulence, macroeconomic uncertainty and rising market costs (Basu & Srinivasan, 2002).

The African Development Bank and IMF produced a report in 2006, examining the tax incentives in East Africa confirmed that the contribution of tax incentives in promoting FDIs in the region was negligible. Another report by the IMF further indicated that,

majority of the countries with huge FDIs have not necessarily offered large incentives and Tax incentives and that incentives do not encourage FDI without other considerations, such as low operating costs in setting up and maintaining enterprises, infrastructure of high quality, stable macroeconomic policies and political stability (Basu & Srinivasan 2002).

2.4 Empirical Review

This subdivision examines the relevant analysis regarding tax incentives (farm works deductions, industrial building allowances, investment deductions, wear and tear allowances) and FDI. It also offers a basis for assessing the study's significance, as well as a benchmark for contrasting the outcome with other results. It gives an overview of the literature showing the research gap to be filled.

2.4.1 Farm Works Deductions and Foreign Direct Investments

Fiscal measures were found to increase FDI in China by an empirical research carried out by Tung and Cho (2000). The study observed before 1991 fiscal measures in China were only offered to joint ventures which made more FDI inform joint ventures to come in comparison with other forms of FDI. The period subsequent to 1991 after offering fiscal measures to all kinds of FDI, showed improved growth in FDI in types of businesses. Hence, the conclusion was fiscal measures were key to investments. However, a study by Cleeve (2008) carried out in Sub Saharan Africa, found that tax allowances and repatriation of earnings, the attractiveness of FDI in sub-Saharan Africa was statistically negligible.

Aldaba (2006) studied the effects of investment incentives programs instituted by a country to attract foreign investors and foreign direct inflows. A comparative investigation of the Philippines and other countries within the Asian region was

undertaken. The study factored variables like operation cost, the level of competitiveness and availability of infrastructure. The findings established that the absence of key factors like economic growth, tax incentives, and political climate alone did not have a substantial effect on FDI. Zhang (2005) looked at association of foreign investments inflows and export performance. It was established that FDI positively influenced export performance in China. A study by Sharma (2000) done in India revealed that FDI did not influence exports

Klemm and Parys (2009) performed an observational analysis to determine how beneficial tax incentives are in encouraging investors. Data were obtained from over 40 Latin Caribbean, American and African countries between 1984 and 2004. FDI and private total fixed capital development have been considered as contingent expenditure factors and tax as a discrete variable. As a result, the relationship between tax incentives and FDI was strongly positive.

Njeru and Ndimitu (2015) assessed the influence on productivity of tax incentives among export processing firms (EPZs) in Kenya. The research has followed a descriptive style. The results of the study found that investment in EPZ businesses improved with an increase in revenue, benefit and tax benefits. However, the impact of tax incentives on spending in the EPZ was negligible. The analysis showed that the extent at which EPZ gained from the following tax benefits: grants or loan guarantees; corporate income tax concessions; tax exemptions or lowered tax rates; acquisition allowances; exemption from import tariffs; exemption from purchases, revenue from employment or property taxes and subsidized funding.

Yanikkaya and Karaboga (2017) explored the relationship between investment incentives on employment levels, labour productivity in various sectors and capital

intensity in the Turkish manufacturing sector. Data from 16 manufacturing firms from 1981 to 2009 was used. Data was analysed using the panel dataset system estimation technique GMM. It was established that investment incentives had no influence on productivity of labour, employment levels and capital intensity.

Mutisya (2019) aimed to examine the impact of tax incentives that include investment depreciation allowances, factory construction allowances and export promotion incentives on foreign direct investment in Kenya. This thesis followed a 32-year time series predictive analysis methodology from 1985 to 2016. In this analysis data from secondary time series were used. Owing to the objective aspect of the data and the usage of informative and inferential statistics analysed it. The frequency, mean, standard deviation, and percentages are used in the descriptive statistics. Correlation analysis and multivariate regression analysis were used in the inferential statistics. The findings showed that the deduction allowance on foreign direct investments in Kenya had a favorable and substantial effect. Furthermore, business funding for constructions has had a significant and positive impact on Kenya's foreign direct investments. In addition, the opportunity to subtract farm work had a positive and significant impact on foreign direct investment in Kenya. The report suggests that benefits to subtract agricultural activities have the greatest effect on foreign direct investment and factory production budget and expenditure deduction budget.

2.4.2 Industrial Building Allowances and Foreign Direct Investments

An industrial building includes buildings used for purposes such as manufacturing, mineral extraction, fishing, agricultural contracting and working foreign plantations. It must be used for the purposes of a company, industry, service, industry or occupation to apply for the building or structure (or part of a building or structure) (Alegana, 2014).

Both arrangements for which the health of employees or the accommodation of manual workers working in a specific profession, corporation or sector are to be paid for and in operation shall also be liable for allowances. According to the Malaysian Inland Revenue Board (2012), in compliance with Schedule 3 of the ITA 1967, Real Estate Investment Trusts / Property Trust Funds (REITs / PTF) deriving rental income from an industrial building can be awarded industrial building allowance (IBA), deductible against the calculated company income from the rented source. IBA only allows REITs / PTF renting out their properties if the occupant uses the property as an industrial site. The industrial building is used for a particular reason in compliance with subsections 63 and 64 of Schedule 3 of the ITA 1967. These objectives are restricted to certain forms or classes of trades and the building needs to be used for some of the specified certification ways.

In Kenya, the allowances are given on qualifying expenditure at 4 per annum and this has been done on a straight line basis for 25 years. However, the government announced the abolishing of industrial building allowances in 2008 but it faced major withdrawals. A business is liable for the IBA as regards buildings used as warehouses for production and re-export handling of goods. The IBA is a special allocation of 10 percent of the building's qualified capital spending. Gumo (2013) used the secondary data to perform an analysis on the impact of tax benefits on foreign direct investment, and followed the descriptive test style. The findings showed that the Industrial Building Allowance for capital spending on the construction of an industrial building contributed to building growth.

Wafula (2010) aimed to determine the numerous tax incentives provided to encourage house development by building firms and individuals' ownership of the residence, an

exploratory concept was used to achieve the study goals. The research population has been taken from a list of Kenya Private Developers Association members. Using a simple random sampling procedure, a sample size of 30 was obtained. For research purposes both primary and secondary data were obtained. The primary data was obtained using a questionnaire that was self-administered. Data was evaluated using mean scores and analysis of regression to link tax benefits to the growth of the housing. The type of questionnaire used for the study was quantitative which included closed questions only. This study showed that government benefits, if any, were limited. The study also found that there are no financial-resource government benefits. Creation of facilities, favorable legal and political climate, provides minor rewards.

Kransdorff (2010) examined competitiveness of South Africa tax policy using an empirical study. The study found that South Africa tax policy competitiveness compared to those of its FDI rivals affects its attractiveness to foreign investors. The study compared two indexes the UNCTAD inward FDI potential index where it ranks 72nd and inward FDI performance index where it dismally ranked position 103. UNCTAD inward FDI potential index uses generally accepted FDI determined such as real per capita income, infrastructure capacity, macroeconomic factors, political stability, natural resources availability, and skilled availability leaving out taxation. Therefore, the degree of the difference in the countries FDI potential and its actual FDI performance is attributed to competitiveness of tax policy.

Gumo (2013) carried out an analysis to assess the impact of tax incentives on the output of Kenyan manufacturing companies. The thesis was descriptive and applied a research style similar to it. Primary sources such as the Kenya revenue authority were used to gather secondary data on (tax benefits and Foreign Direct Investment). The research

further gathered primary data to collect quantitative data through standardized questionnaires. The study reveals that Kenya had numerous tax benefits including capital expenditure allowances that were given to citizen firms such as the Industrial Construction Allowance (IBA). Also, Kenya's government has a subsidy on investments made where certain deductions are made for each investment made and aimed at stimulating the manufacturing sector's growth. There were other incentives levied on farm works to the tune of up to fifty percent per year for a duration spanning twenty-four months. Munongo (2015) studied the effectiveness of fiscal incentives in luring foreign business in the Southern African Development Community (SADC) Tax incentives were found to be crucial to attracting FDI. A Lee (2012) analysis found that tax incentives affect investor position decisions. The study showed that corporate tax and value added tax investors were drawn to invest in the manufacturing industry sector in Taipei, China and Hong Kong.

Devereux, Maffini and Xing (2015) concentrated on corporate tax benefits and firm efficiency. The research used data from proprietary annual return reports combined with financial statements for a UK group of firms operated from the 2001/2002 – 2009/2010 fiscal years. The review of the report was based on data on secret tax returns at business level in the United Kingdom. There have been extensive linkages in the corporate tax rate plan that have led to a reduction in the company's marginal tax rates, and has also provided the leading recognition technique. In order to achieve a favorable and significant long-term impact of tax on the competitive financial benefit of the firms, a complex adaptation model was used that engrossed capital structure.

Thuita (2017) investigated the influence of tax holiday and capital deductions in attracting and retaining FDI on the Kenyan export-promoting sector (EPZ). Using

descriptive survey design and questionnaires, the findings revealed the length of tax holiday was key in the luring and retaining of FDI inflows compared to the extended capital allowances which were offered to the sector. The study made the conclusion that tax incentives should be enhanced so that they can boost the expansion and growth of the EPZ sector in Kenya.

2.4.3 Investment Deductions and Foreign Direct Investments

It is a tax credit or reduction on the capital spending on buildings and equipment used for the development of some hotels (Oleyeye, 2015). Just once in the year of first use of certification materials is the tax charged. Any party sustained expenses for construction, purchasing and constructing a construction or a machinery shall have the right to sue, whether both the building and the machinery are employed for the development or hotel as applicable. Where an industrial property is constructed by a taxpayer and is rented to another taxpayer who installs qualified machinery in the same property, the capital benefit for the building owner is extended and the landlord is extended an income deduction in favor of the machinery (Tirimba, Muturi & Sifunjo, 2016). Although if a taxpayer builds an industrial facility and subsequent equipment and then leases both the buildings and the machines for another entity, the lessor (owner) is allowed an income deduction for both the building and the equipment which were licensed for manufacturing purposes. If the lessee installs machinery in the leased building and uses the machinery for manufacturing purposes, the investment is permitted on the equipment owned by the lessee (Olaleye & Riro, 2016).

Anastassopoulos (2007) investigated whether international competitiveness of a country was connected with FDI inflows in European Union (EU)-15members countries between 2003 and 2006. The study found varied response of FDI toward the

two region of EU-South Member Countries (SMCs) and North Member Countries (NMCs). The results revealed that governments played a greater role in pushing for international competitiveness in SMCs than in the NMCs leading to more FDI in SMCs.

Substian (2009) conducted a survey in which three parameters were considered in four different countries as tools for decision-making on the importance of tax incentives as a tool for investment: duty-free imports, tax incentives, etc. 27% of Mozambique's 60 firms considered duty-free imports, 17% considered fiscal incentives and 12% considered moving to another area. The industries listed in Jordan were 61, 36% tax free imports, 38% tax incentives and 33% relocations, 61 businesses in Serbia, 16% increase in tax-free goods, 29% tax incentives, and finally 93% duty-free imports in Nicaragua, 76% of tax incentives and 40% of other nations. All the study showed that investment-related factors, such as ease of export, local supplier availability, regulatory framework, geographical location of infrastructure and countries, were more than tax incentives. In case of an incentive tax, the government should ensure that it is: - affordable; simple, targeted and periodically reviewed. It also needs to take initiatives to promote the lobbying and transparency of incentive costs in order to ensure that businesses benefit from the tax incentive in order to help shape future policy.

Teraoui, Kaddour, Chichti and Rejeb (2011) focused on corporate performance and tax incentives in general without being specific on the type of tax incentive involved. The context of the study was however in the African setting in Tunisia. It is well known that incentives are a widespread method in the world that promotes investment. The main target was exporting firms operating in Tunisia, the subsectors of mechanical as well as electric engineering sub sectors of the economy and thus contributed to the literature that investment is widely promoted through the adoption of incentive enhancing

strategies. The study sampled 60 firms to conduct an empirical analysis and established a number of key findings. The result showed that an increase in the tax negatively affects the financial criteria of performance when the benefit and output are examined. Similar results were established and confirmed by other approaches based on an investigation by questionnaire on temporal data.

Githaiga (2013) sought to explore the influence of tax incentives on performance of firms listed at the NSE. The main focus of this study was on the following variables that included the influence of wear and tear allowances on attracting inflows of FDI into the firms listed at NSE, the impact of investment deductions on attraction of FDI to the firms as well as industrial building deductions directed at attracting FDI inflows into all those firms listed at the NSE during the study period. The study made use of time series data that was collected on investments as well as tax incentives from a sample of 10 firms listed at the NSE between years 2008–2011. The relationship between FDI inflows and tax incentives variables was established by the use of regression analysis to provide a basis for generalization of the findings and also make any necessary recommendations. The results of the study showed a strong relationship between FDI inflows and wear and tear allowances. Industrial construction deductions and deductions for investment have not been found to be significantly linked to FDI influses.

In 2001 and 2010, Ahmed (2015) conducted research on taxation and FDI in Bangladesh. Inflation, GDP and the exchange rate were used as control variables. Ahmed (2015). FDI and corporate tax rate were found to be negatively associated. FDI and exchange rate were statistically insignificant in their relationship. Additionally, FDI

had a positive and statistically insignificant association with GDP, while FDI had a crucial inflation association.

Olaleye, Riro and Memba (2017) investigated the impact of income tax benefits on results by listed manufacturing firms in Nigeria. Descriptive research design has been implemented in this particular review. The target population of the study was 174 manufacturing firms. The total number was 176. The findings revealed strong positive causal ties between decreased income tax benefits for businesses and foreign direct investment. The strong and statistically beneficial link between decreased corporate income tax benefits and foreign direct investment has ensured that foreign investors will increase their investment by taking advantage of current government fiscal benefits to create a sustainable business climate.

Gebremedhin and Saporna (2016) assessed the influence of tax holiday on investments in Ethiopia through an experimental design, which in the form of a case study. The study sampled 70 construction and manufacturing firms and used both primary data collected via questionnaires. It was found that Tax holidays significantly influenced investment in the construction and manufacturing sectors in Ethiopia. It was established that the period of tax holiday lured investors in Ethiopia.

2.4.4 Wear and Tear Allowances and Foreign Direct Investments

The impact of tax incentives on Nigeria's operation has been assessed by Jiakponna (2012). In this study, three selected industries (small scale) were specifically identified. These were Industrial Promoters Nigeria Limited Aba, Nigeria Springfield, Deluz Paints Industrial Limited, and Enugu. The findings from the study showed that small-scale tax incentives industries have increased their productive assets, their investment in capital, and their training in working capital. Furthermore, tax incentives were not

only a stimulus to small-scale industries but also a signal to the industries for their decision to invest, a particular sector of the economy. The results also included the effect of the incentives on the level of employment. These incentives had a positive influence on investment development which resulted in diversified jobs.

Mutwiri and Okello (2015) discussed how VAT incentives have affected the decisions on capital structures of companies listed on the exchange of securities in Nairobi. The study adopted a descriptive research design that facilitated the achievement of its aims. The architecture mainly contributed to the development of a causal link between the researches variables. The study also adopted the correlational research design which helped it to collect data at the same time over various companies. The study relied primarily on the correlation and regression analysis with the inclusion of descriptive results with data analysis. The results of the analysis showed that value-added tax incentives did not have a significant impact on the decisions of the companies listed at NSE regarding the capital structure.

Thuita (2017) investigated the influence of tax holiday and capital deductions in attracting and retaining FDI on the Kenyan export-promoting sector (EPZ). Using descriptive survey design and questionnaires, the findings revealed the length of tax holiday was key in the luring and retaining of FDI inflows compared to the extended capital allowances which were offered to the sector. The study made the conclusion that tax incentives should be enhanced so that they can boost the expansion and growth of the EPZ sector in Kenya.

Sari, Dewi and Sun (2015) carried an investigation in Indonesia to assess how policies on tax holiday influenced tax collection and investments. It was established that period of tax holiday positively influenced investments and it did not have any adverse effects

on tax revenue losses. The study concluded that tax holidays in Indonesia positively enhanced investment activities and enhanced tax revenue growth with the period of the tax holiday.

Zwick and Mahon (2016) estimated the effect of temporary tax incentives on the performance of the firm equipment. Two investment stimulus episodes and a different methodology were used in this study to investigate the effect of tax on investment and the variety between businesses. The policy studied, –bonus average depreciation, accelerated the schedule for companies being able to deduct investment purchase costs from taxable income. Bonus changed the timing but not the amount of deductions, so that the economic incentive produced by the bonus worked, as future deductions are less than the current deductions. Data from more than 120,000 companies have been analyzed to show that depreciation of bonuses has a significant effect on investment. Averaging 10.4 percent between 2001 and 2004, and 16.9 percent between 2008 and 2010 is the relative investment response across companies with differential bonus exposures.

2.5 Conceptual Framework

Although the FDIs face many constraints, in past surveys the absence of well-structured and attractive fiscal incentives is always a major obstacle to achieving FDI progress. Globally, fiscal incentives are a key component of the government's investment promotion strategies. In order to draw FDI, encourage technology transition, diversify development and improve economic growth, countries have implemented numerous incentive tax schemes (Morisset & Pirna, 2001).

This predicted relationship between the research variables is seen in the conceptual model described below. Tax incentives and foreign direct investment are hallmark

considerations here. The independent variable composed of wear and tear allowances (WTA) tax credits, factory development allowances (IBAs), depreciation of farms (FWD) and deductions from income (ID). The dependent variable that the study sought and measured by FDI inflows is foreign direct investment.

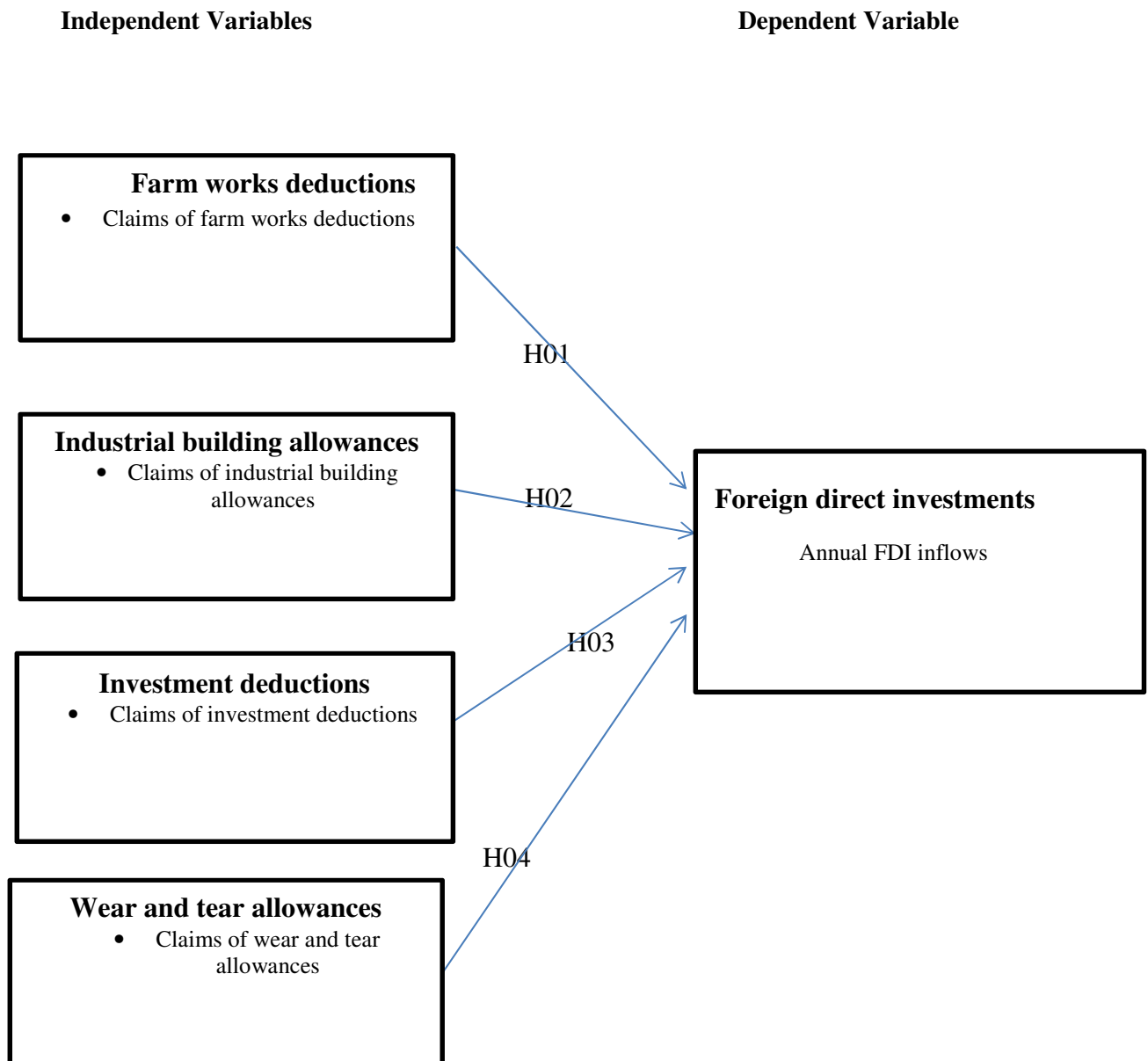


Figure 2.1: The Conceptual Model

2.6 Summary of the Literature Review and Research Gaps

The definition of tax incentives and foreign direct investment has been clarified in different analytical contexts. In this theoretical review, four theories were discussed. Theory includes: theory of surplus demand and production, internalization theory, the theory of multicultural models and the theory of the commodity lifecycle. In this section, we have also addressed the potentially anticipated relations between fiscal incentives and foreign direct investment. Several longitudinal research on tax benefits and foreign direct investment were carried out both globally and locally. This chapter also addressed the results of these research.

The lack of agreement among numerous scholars on the effects of tax incentives on foreign direct investment is sufficient justification to carry out a further analysis on the subject. The World Bank (2006) found that a major effect on final decisions on FDI inflows can be observed in tax variables. An important positive correlation between fiscal rewards and FDI was identified by Klemm and Parys (2009). Njeru and Ndimitu (2015) found a marginal association in Kenya between tax benefits and the output of EPZ companies. Githaiga (2013) found that some tax benefits have a positive impact on FDI inflows while others have a negative effect. Moreover, much of the current empirical literature has explored the effects of various variables on foreign direct inflows in Kenya, while others have studied the influence of FDI on other variables. There are few reports however on the effect of tax benefits on direct foreign investment inflows. Thus, by answering the issue, this study aimed to fill this research gap; what is the impact of tax incentives on foreign direct investment inflows in Kenya?

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter explains the research methods used to systematically assess the effect of tax incentives on foreign direct inflows. It also demonstrates the requirements for the target population, research design, data collection, and analysis.

3.2 Research Design

Study design is characterized as the blueprint of the procedures implemented by a researcher to assess the relationship between dependent variables and independent variables (Khan, 2008). Explanatory analysis attempts to create a causal association between variables (Saunders, Lewis, & Thornhill, 2009 & Robson, 2002). According to Kerlinger & Lee (2000), an informative non-experimental study method is acceptable when the researcher tries to clarify how the process works by defining the fundamental causes that cause change in it, in which case the independent variable is not manipulated. Accordingly, this analysis was. Quantitative analysis involves structures, methods and interventions that yield discrete numerical results, and some of the structures used may include experimental designs, causal-comparative and correlational analysis.

3.3 Target Population

Population refers to all observations of interest in the entire collection, such as people or events described by a researcher (Burns & Burns, 2008). This research does not have a target population because of the nature of the study. The study was carried out at the macro level and thus examined tax incentives as well as foreign direct investment throughout the country.

3.4 Data Collection

Data was acquired predominantly from a secondary source. Annual data were gathered and analyzed over a span of 10 years (January 2008 to December 2017). The data collected included FDI inflows and the four selected tax incentives; farm works deduction, Investment Deductions, Wear and Tear Allowances and Industrial Building Allowances during the sample period. Secondary data was collected from KNBS and KRA reports.

3.5 Data Analysis

For swift analysis the data obtained were classified, identified, encoded and tabulated. Descriptive and inferential measures have been used to analyze the data obtained. The research has used version 22 of the SPSS programming software because it is easy to use. The data were entered and analyzed using classification, correlation and regression. In the descriptive statistics, the study used standard deviation and dispersion charts. For quick analysis, the data obtained was sorted, sorted and tabulated. The data collected was evaluated using logical and inferential techniques. The analysis included version 22 of the SPSS program, since it is more user-oriented. The data were entered and analyzed in the SPSS using analytical methodology. In descriptive statistics, the study used mean, standard deviation and dispersion.

3.5.1 Analytical Model

The researcher conducted a regression analysis using the data collected to assess the extent of the correlation between tax incentives and foreign direct investment inflows. The study will follow the following form of regression:

$$Y = \beta_0 + \beta_1 X_{1t} + \beta_2 X_{2t} + \beta_3 X_{3t} + \beta_4 X_{4t} + \varepsilon.$$

Where: Y = Sum of FDI inflows every year

β_0 = y intercept of the regression equation.

β_1, \dots, β_4 , = are the slope of the regression

X_{1t} = Amount of farm works deductions on an annual basis.

X_{2t} = Amount of Industrial Building Allowances on an annual basis

X_{3t} = Amount of investment deduction incentives on an annual basis

X_{4t} = Amount of Wear and Tear Allowances on an annual basis

ε =error term

3.5.2 Hypothesis Testing

Arendt and Matthes (2017) describe the hypothesis testing an act in statistics by which the researcher checks the population parameter statement. Hypothesis research is used to predict the outcome of a hypothesis based on survey evidence from a broader population. In the hypothesis test, the researcher tests a statistical study with the goal of supporting or denying a null hypothesis. The evaluation tells the researcher whether or not his primary hypothesis is correct. If this is not the case, the researcher shall propose a new theory to be tested, replicate the experiment before the proof indicates the right conclusion.

It involves determination of the basis of sample data on whether a proposition about the population is true or false. Researchers use several hypothesis tests which may be grouped as either parametric tests or non-parametric tests. The use of inferential statistics was used in this analysis to assess the existence and strength of the association between variables and to evaluate the causal relation. The Pearson's Coefficient of

Correlation and the bivariate correlation such as multiple regression analysis was applied in this study.

Table 3.1: Hypotheses

Hypotheses	What is expected	Remarks
H ₀₁	Farm works deduction have no significant effect on foreign direct investment inflows in Kenya	When the P Value > significance level, we fail to reject H ₀₁
H ₀₂	Industrial building allowances have no significant effect on foreign direct investment inflows in Kenya.	When the P Value > significance level, we fail to reject H ₀₂
H ₀₃	Investment deductions have no significant effect on foreign direct investment inflows in Kenya.	When the P Value > significance level, we fail to reject H ₀₃
H ₀₄	Wear and tear allowances have no significant effect on foreign direct investment inflows in Kenya.	When the P Value > significance level, we fail to reject H ₀₃

Source: Researcher, (2020)

3.5.3 Tests of Significance

The F- and t-tests were used with 95 percent confidence for checking their statistical significance. The statistics from F have been used to evaluate a statistical value of the regression equation, while the statistical importance of the research coefficients has been checked.

3.6 Diagnostic Tests

The research conducted diagnostic experiments as highlighted below.

3.6.1 Heteroskedasticity

A condition where the difference between the error term and the difference between the numbers of measurements varies is the heteroskedasticity. There is no effect on the impartiality and linearity of the regression coefficient since it only affects the strongest OLS vector, which renders the theory tested invalid (Gujarati, 2004). Therefore, the

study uses the Breusch-Pagan - Godfrey scale to search for heteroskedasticity.

3.6.2 Autocorrelation

Autocorrelation implies a case in which the word misunderstanding is added to its meaning. However, the existence of autocorrelation does not impair the unbiased consistency of performance. Autocorrelation primarily occurs in the findings of time series. The reason is that certain data follow a certain trend over time. The impartiality, linearity and asymptotic existence of estimators are not influenced by autocorrelation. The one thing that undermines the strongest property of the OLS is that the predictive test condition is wrong. Accordingly, this analysis uses Durbin Watson to verify if the data perception is serial autocorrelation (Gujarati, 2004).

3.6.3 Multicollinearity

Multicollinearity is often typical in data from time series, because variables may follow a certain pattern. Multi-linearity applies to a condition under which some explanatory variables are linked. Over time, the variables can increase or decrease. Multicollinearity leaves the regression coefficient indeterminate. Multi-linearity between variables can be normal, but it is the degree that matters (Gujarati, 2004). The research uses the Variance ID Factors Test (VIF) for testing the existence of multicollinearity (Nachtsheim, 2004).

3.6.4 Normality Test

The error term is usually distributed with zero mean and the constant variance denoted by $\mu (0, \sigma^2)$ using one of the assumptions of the classical linear regression model. The error word is used to describe all other variables influencing but not included in the model dependent variable. The excluded variables, however, are assumed to have a slight and at best random effect. The error word must be standard for OLS to function

(Gujarati, 2004). The research used the Shapiro-Wilk test to determine whether the error term was normal or not.

3.7 Ethical Considerations

The researcher was officially approved to perform the present analysis by the university. In situations where objectivity is required or desired, the researcher tried to discourage prejudice in, data modeling, analysis, peer review, staff judgment, writing thesis and other study aspects. Through carefully and objectively reviewing the results, careless errors and neglect were avoided. A good record has been maintained on research activities, including data collection, the design of research and communication with agencies or journals.

CHAPTER FOUR

DATA ANALYSIS, RESULTS AND DISCUSSION

4.1 Introduction

The chapter represents the study results and findings based on the study's objectives. It also gives an analysis of the data collected from the World Bank, KRA and KNBS to determine how tax incentives influence on FDI inflows in Kenya. By use of descriptive statistics, correlation and regression analysis, the study results were presented in tables to simplify the interpretation.

4.2 Descriptive Analysis

Descriptive data shows the average, maximum and minimum variant values used for this analysis in accordance with their standard deviations. The following illustration shows figures for the variables of the study. SPSS software has produced annual analyzes of the variants under study within ten years (2008 to 2017).

Table 4.1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
FDI Inflows	10	95585680	1450474757	684489119	504783441
FWD	10	3749052694	10301479268	6392024110	1893344345
IBA	10	2375716522	42721035736	14329297773	1392261592
ID	10	48389821266	117160473429	77443549151	1973746464
WTA	10	66570919974	205948730103	129410034698	5327651375
Valid N (listwise)	10				

Source: Researcher (2020)

4.3 Trend Analysis

Trend analysis was conducted for FDI inflows; farm works deductions, industrial building allowances, investment deductions and wear and tear allowance. The trend lines are presented in the subsequent sections.

4.3.1 Foreign Direct Investment Inflows

The research aimed at developing the trend in the movement of FDI inflows in Kenya over the study period of 2008 to 2017. The findings were as shown in Figure 4.1. Figure 4 indicates that FDI inflows had been growing on upward trend from the year 2008 to 2011. From the year 2012 to 2016 the FDI inflows were on a decline but started to rise again in 2017.

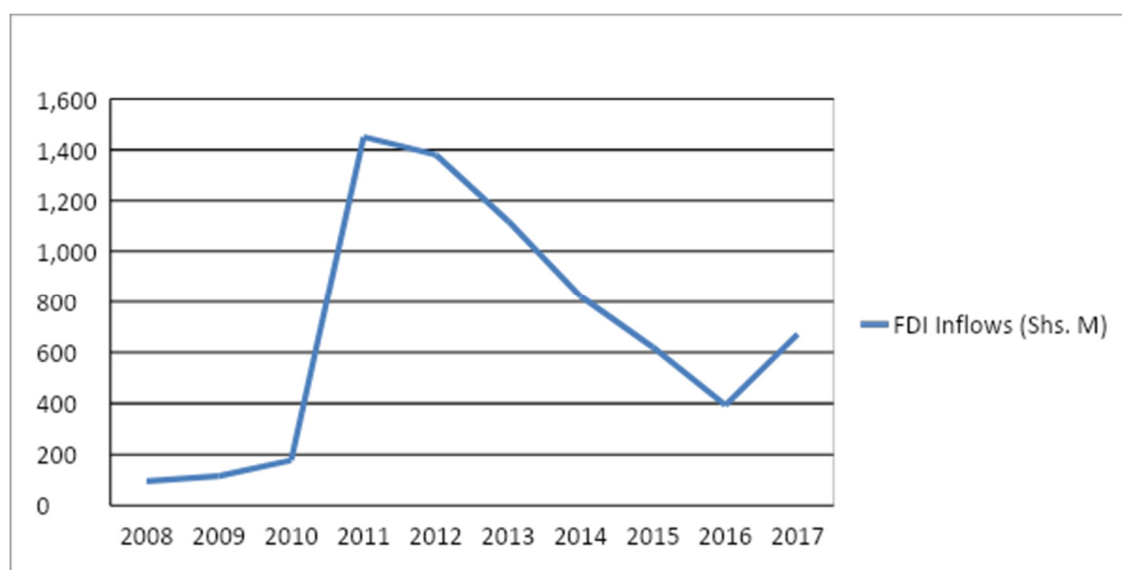


Figure 4.1: Annual FDI Inflows

4.3.2 Farm Works Deductions

The research aimed at developing the trend in the movement of farm works deductions in Kenya over the study period. The findings were as shown in the Figure 4.2. Figure 4.2 indicated that farm works deductions have been gradually rising over the years. From 2008, the farm works deductions have been increasing exponentially but in the year 2009 and 2010 there was a slight decline. The farm works deductions have been on upward trend since then. The highest farm work deductions was recorded in 2017 and lowest in 2010.

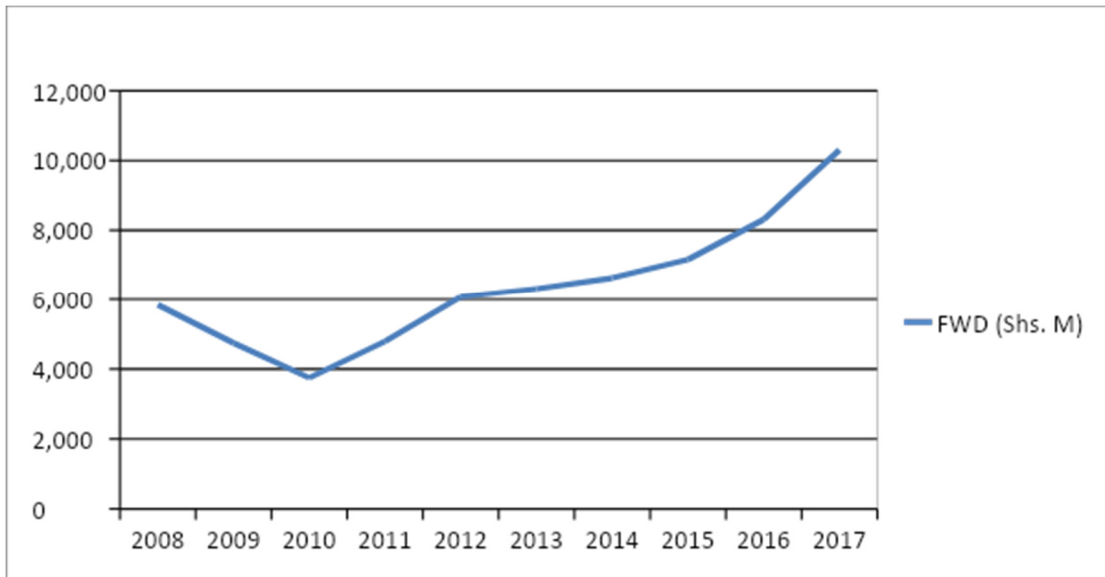


Figure 4.2: Farm Works Deductions

4.3.3 Industrial Building Allowances

The research aimed at developing the trend in the movement of industrial building allowances over the study period. The trend line is as shown in Figure 4.3. Figure 4.3 indicated that industrial building allowances have been increasing exponentially over the years. The increase was recorded from 2008 to 2016 after which a decline was recorded in 2017. In overall the total has been on an upward trend over the years. The highest total industrial building allowances were recorded in 2016 and lowest in 2009.

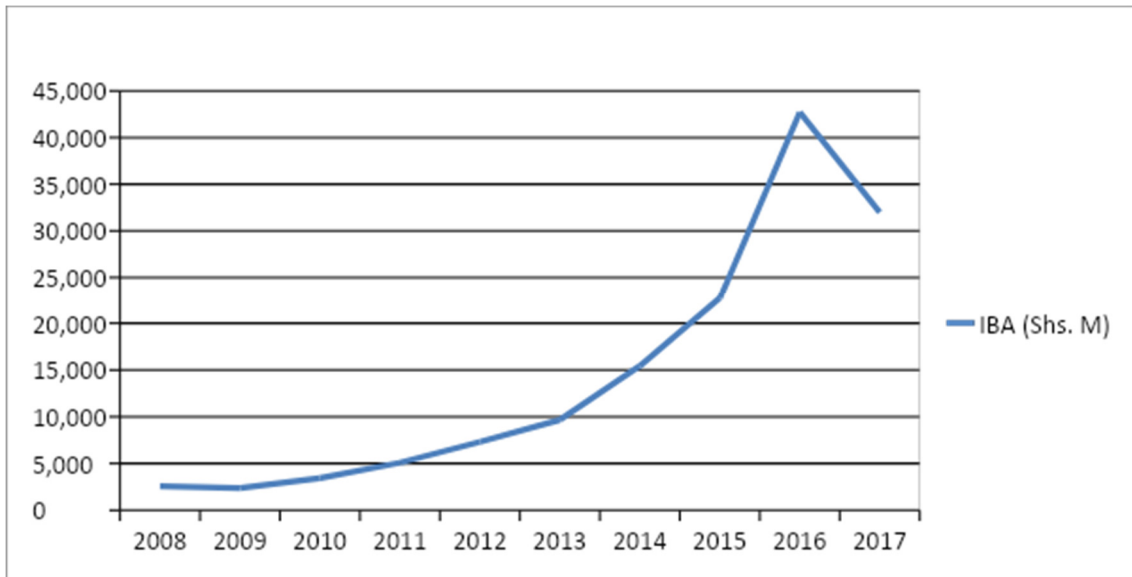


Figure 4.3: Industrial Building Allowances

4.3.4 Investment Deductions

The study sought to establish the trend in the movement of investment deductions measured in Kenya over the study period. The trend line is as shown in Figure 4.4. Figure 4.4 indicated that investment deductions have been fluctuating over the years. The highest investment deductions were recorded in 2016 while the lowest investment deductions were recorded in 2009. The investment deductions have overall been in an upward trend.

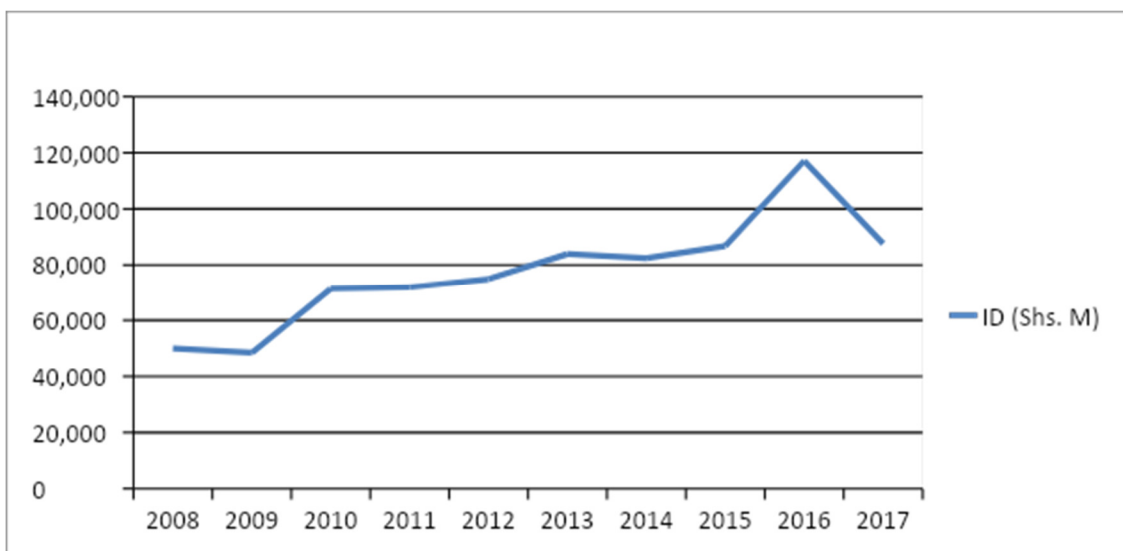


Figure 4.4: Investment Deductions

4.3.5 Wear and Tear Allowances

The study sought to establish the trend in the movement of wear and tear allowance in Kenya over the study period. The trend line is as shown in Figure 4.5. Figure 4.5 indicated that wear and tear allowances have been fluctuating over the years. On average, however, wear and tear allowances have been on an upward trend. The highest wear and tear allowance was recorded in 2017 while the lowest was recorded in 2008.

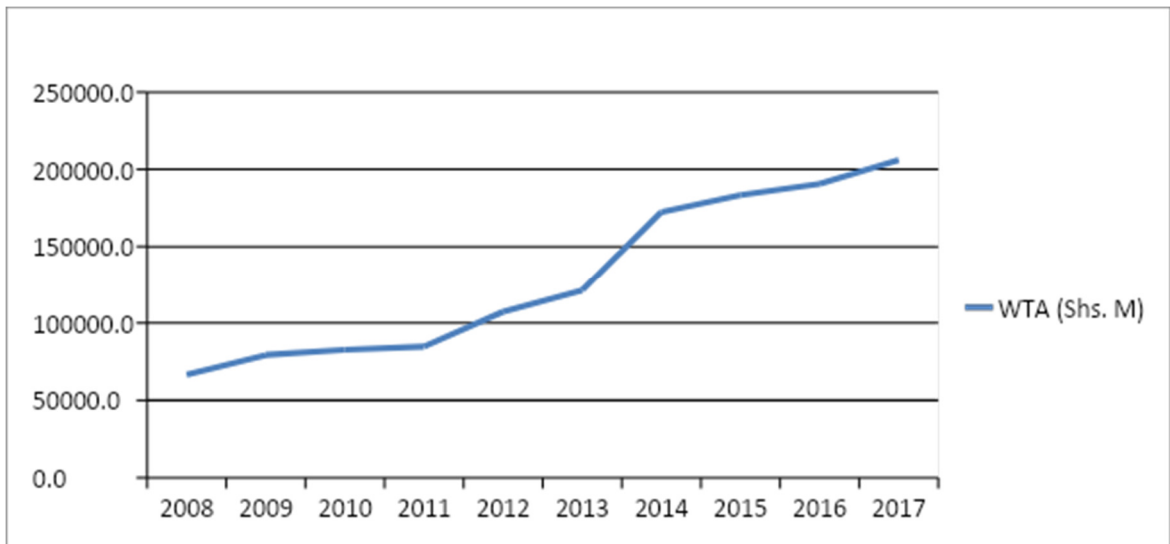


Figure 4.5: Wear and Tear Allowances

4.4 Diagnostic Tests

Diagnostic tests were carried out before the regression model was run. In this case, the tests conducted were Multicollinearity test, normality test, autocorrelation and Heteroskedasticity tests.

4.4.1 Multicollinearity Test

Multicollinearity can be characterized as a statistical situation in which a strong relationship occurs between several predictor variables in a multiple regression model.

The situation is unwanted where there exists a strong correlation among the predictor

variables. A combination of variables is said to be perfectly multicollinear in case there is one or more exact linear relationship among a number of the variables.

Table 4.2: Multicollinearity Test

Variable	Collinearity Statistics	
	Tolerance	VIF
FWD	0.376	2.660
IBA	0.360	2.778
ID	0.392	2.551
WTA	0.372	2.688

Source: Researcher (2020)

VIF value was utilized in the study where a value lower than 10 for VIF meant lack of Multicollinearity. For multiple regressions to be useful, the variables should exhibit a weak relationship. The variables in the study showed a VIF value of <10 as shown on Table 4.2 which could be interpreted to mean that the variables had no statistical significant Multicollinearity among them.

4.4.2 Normality Test

The researcher used Shapiro-Wilk and Kolmogorov-Smirnov experiments to test for normality. As seen below is the null and alternate hypotheses.

H0: the secondary data was not normal.

H1: the secondary data is normal

A p-value greater than 0.05 may have enabled the researcher to reject the null hypothesis and likewise. Table 4.3 displays the test findings.

Table 4.3: Normality Test

FDI inflows	Kolmogorov-Smirnov ^a			Shapiro-Wilk		
	Statistic	Df	Sig.	Statistic	Df	Sig.
FWD	.204	10	.200*	.923	10	.387
IBA	.231	10	.139	.841	10	.046
ID	.199	10	.200*	.874	10	.112
WTA	.150	10	.200*	.953	10	.704

a. Lilliefors Significance Correction

Source: Researcher (2020)

The data revealed a p- value more than 0.05 hence the researcher used only the alternative hypothesis and concluded that the data used in the research was evenly distributed. This data was used to conduct parametric tests and statistical analyses like Pearson's correlation, regression and ANOVA.

4.4.3 Autocorrelation Test

Correlation of error terms in varying time periods were checked by conducting a serial correlation test. The Durbin Watson test for serial correlation was used to assess for autocorrelation in the linear panel which is a major challenge in panel analysis of data and it has to be accounted for so as to get right model specifications. Below are the results.

Table 4.4: Autocorrelation Test

Mod el	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin- Watson
1	.796 ^a	.633	.340	410018.839	2.584

a. Predictors: (Constant), WTA, ID, FWD, IBA

b. Dependent Variable: FDI Inflows

Source: Researcher (2020)

The null hypothesis is that no first order serial /autocorrelation exists. The study used Durbin-Watson to test for autocorrelation. This statistic ranges from 0 to 4 where 0 values are positively auto correlated while values of 4 are negatively auto correlated.

Values of 1 to 3 explain that the data set is not influenced by autocorrelation. The DW statistic was found as 2.584 proving that the data was not auto correlated.

4.4.4 Heteroskedasticity Test

It checked for heteroskedasticity by use of Likelihood Ratio (LR) as indicated in the Table. This test used the alternative hypothesis that the error was homoscedastic. A chi-square value of 26.24 was produced by the likelihood-ratio test with a 0.0000 p-value. The chi-square esteem was significant at 1 percent level.

Table 4.5: Heteroskedasticity Test

Breusch-Pagan / Cook-Weisberg test for heteroskedasticity	
Ho: Constant variance	
Variables: fitted values of FDI inflows	
chi2(1)	= 26.24
Prob > chi2	= 0.0000

Source: Researcher (2020)

4.5 Correlation Analysis

This was done to determine associations between FDI inflows in Kenya and the variables for this research (FWD, IBA, ID and WTA). Findings show, a weak but positive and statistically non-significant correlation ($r = .057$, $p = .876$) between FWD and FDI inflows. ID and WTA also have a positive but not statistically significant correlation with FDI inflows as showed by ($r = .235$, $p = .514$) and ($r = .081$, $p = .824$) respectively. IBA showed a negative correlation with FDI inflows and the relationship was not significant as shown by a correlation value of -0.058 and a p value higher than significance level of 0.05.

Table 4.6: Correlation Analysis

		FDI Inflows	FWD	IBA	ID	WTA
FDI Inflows	Pearson Correlation Sig. (2-tailed)	1				
FWD	Pearson Correlation Sig. (2-tailed)	.057	1			
IBA	Pearson Correlation Sig. (2-tailed)	-.058	.853**	1		
ID	Pearson Correlation Sig. (2-tailed)	.235	.631	.875**	1	
WTA	Pearson Correlation Sig. (2-tailed)	.081	.868**	.904**	.806**	1
		.824	.001	.000	.005	

** . Correlation is significant at the 0.01 level (2-tailed).
b. Listwise N=10

Source: Researcher (2020)

4.6 Regression Analysis

FDI inflows in Kenya was regressed against four predictor variables; FWD, IBA, ID and WTA. It was carried out at 5% level. The summarized statistics are illustrated in 4.7 below.

Table 4.7: Model Summary

Mod el	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin- Watson
1	.796 ^a	.633	.340	41001068.8	2.584

a. Predictors: (Constant), WTA, ID, FWD, IBA
b. Dependent Variable: FDI Inflows

Source: Researcher (2020)

Based on the results on table 4.7 above, R square value was 0.633, a revelation that 63.3% of the deviations in FDI inflows in Kenya are caused by variations in WTA, ID, FWD and IBA. Additional variables outside the model explain the 36.7 percent of the

variations in FDI inflows in Kenya. Additionally, the results showed a strong relationship among the selected predictor variables and the FDI inflows as indicated by the correlation coefficient (R) of 0.796. A durbin-watson statistic of 2.584 showed that there was no serial correlation of the variable residuals since it gave a value greater than 1.5.

Table 4.8: Analysis of Variance

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	145271311759927 3980	4	363178279 399818500	2.160	.210 ^b
	Residual	840543783809108 740	5	168108756 761821760		
	Total	229325690140838 2720	9			

a. Dependent Variable: FDI Inflows
b. Predictors: (Constant), WTA, ID, FWD, IBA

Source: Researcher (2020)

From the statistics, F critical value at the 5% significance level is 5.19. From the findings, it was established that the F calculated was 2.160. For ANOVA interpretation, if the obtained F value is larger or equal to the F critical value, the results are said to be significant at that probability level. From the data shown, the F calculated is lower than the F critical value therefore the model was not statistically significant. The p value found was 0.210 which was higher than the 0.05 level of significance thus it was concluded that the existing relationship between the independent and dependent variables was insignificant.

Coefficients of determination reflected the movement of the relationship between FWD, ID, WTA, IBAs and FDI inflows in Kenya. The p-value under sig. column indicated how significant the relationship was. At 95% confidence level, a p-value

lower than 0.05 is an indication of statistical significance. The table 4.9 below shows this.

Table 4.9: Model Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	
	B	Std. Error	Beta			
	(Constant)	-346495.97	14849.201		-2.334	.067
1	FWD	.311	.183	1.166	1.699	.150
	IBA	-.094	.034	-2.588	-2.722	.042
	ID	.046	.017	1.794	2.683	.044
	WTA	.000	.007	-.038	-.051	.961

a. Dependent Variable: FDI Inflows

Source: Researcher (2020)

The above results prove that IBA and ID substantially determine FDI inflows as evidenced by p values lower than 0.05. IBA has a significant negative effect on FDI inflows as shown by a negative coefficient while ID has a significant positive effect. FWD and WTA are not significant determinants of FDI inflows as evidenced by a p value that is greater than 0.05.

The equation was as below:

$$Y = -3,464,899,896 + 0.311 X_1 - 0.094 X_2 + 0.046 X_3 + 0.000 X_4$$

Where,

Y = FDI inflows in Kenya

X₁ = FWD

X₂ = IBA

X₃ = ID

X₄ = WTA

On the above model, the constant = -3,464,899,896 means that if chosen independent variables (FWD, IBA, ID and WTA) were rated zero, FDI inflows would be -

3,464,899,896. IBA rise by a unit would decrease FDI inflows by 0.094 while a unit increase in ID would cause an increase in FDI inflows by 0.046. A unit increase in FWD would cause an increase in FDI inflows by 0.311 while a unit increase in WTA would result into an increase in WTA by 0.000.

4.7 Hypotheses Testing

The findings in Table 4.9 were used to test the assumptions of the analysis. The acceptance / rejection criterion is that if the p value is greater than 0.05, the null hypothesis is not accepted, but if it is less than 0.05, the null hypothesis is accepted.

4.6.1 H₀₁: Farm works deductions have no significant effect on foreign direct investment inflows in Kenya.

Results in Table 4.9 indicated a p value of 0.150, which was more than 0.05. This resulted to failure to reject of the null hypothesis and therefore, farm works deduction has no significant effect on foreign direct investment inflows in Kenya.

4.6.2 H₀₂: Industrial building allowances have no significant effect on foreign direct investment inflows in Kenya.

Results in Table 4.9 indicated a p value of 0.042, which was less than 0.05. This resulted to rejection of the null hypothesis and therefore, industrial building allowances have a significant effect on foreign direct investment inflows in Kenya.

4.6.3 H₀₃: Investment deductions have no significant effect on foreign direct investment inflows in Kenya.

Results in Table 4.9 indicated a p value of 0.044, which was less than 0.05. This resulted to rejection of the null hypothesis and therefore, Investment deductions have a significant effect on foreign direct investment inflows in Kenya.

4.6.3 H₀₄: Wear and tear allowances have no significant effect on foreign direct investment inflows in Kenya.

Results in Table 4.10 indicated a p value of 0.961, which was greater than 0.05. This resulted to failure to reject the null hypothesis and therefore, wear and tear allowances have no significant effect on foreign direct investment inflows in Kenya.

Table 4.10: Hypotheses Results

Hypotheses	What is expected	P-Values	Verdict
H ₀₁	Farm works deduction have no significant effect on foreign direct investment inflows in Kenya	p=0.150	Fail to Reject
H ₀₂	Industrial building allowances have no significant effect on foreign direct investment inflows in Kenya.	p=0.042	Reject
H ₀₃	Investment deductions have no significant effect on foreign direct investment inflows in Kenya.	p=0.044	Reject
H ₀₄	Wear and tear allowances have no significant effect on foreign direct investment inflows in Kenya.	p=0.961	Fail to Reject

Source: Researcher, (2019)

4.8 Discussion of Research Findings

The researcher intended to establish the influence of tax incentives on FDI inflows in Kenya. The independent variables were IBA, WTA, ID and FWD. FDI inflows was the response variable that was the main scope of the study and was given by annual FDI inflows in Kenya. The effect of every predictor variables on the response variable was analyzed based on strength and direction.

The correlation coefficients showed a weak but positive and statistically non-significant correlation ($r = .057$, $p = .876$) between FWD and FDI inflows. ID and WTA also have

a positive but not statistically significant correlation with FDI inflows as showed by ($r = .235$, $p = .514$) and ($r = .081$, $p = .824$) respectively. IBA showed a negative correlation with FDI inflows and the relationship was not significant as shown by a correlation value of -0.058 and a p value higher than significance level of 0.05 .

The model description showed that the predictor variables: IBA, WTA, ID and FWD account for 63.3 percent of shifts in the dependent variable as seen in the R^2 estimate, indicating that this model does not contain other factors that explain 36.7 percent of differences in FDI inflows in Kenya. The meaning of the model was tested at 95% confidence level. Although the F -value measured was less than the critical value, we infer that the total result is not statistically important.

The findings are partially in accordance with Klemm and Parys (2009) which conducted an observational study to investigate how efficient tax incentives are in attracting investment. Data were obtained from over 40 Latin Caribbean, American and African countries between 1984 and 2004 . FDI and private total fixed capital development have been considered as contingent expenditure factors and tax as a discrete variable. As a result, the relationship between tax incentives and FDI was strongly positive.

This thesis is also partly related to the Omweri (2013) analysis, which explores factors which have decided an FDI stock in four countries in East Africa. Kenya Uganda, Tanzania, Rwanda, and Burundi, to find out why the area has experienced a very low FDI growth. Panel data collection methods have been used for the analysis. The research used independent variables trade transparency, GDP raise, GDP per population, telephone line (per 100 people); proxy for service services, ID, return on investment and natural resource endowment; and stock of FDI as a dependent variable. Data from 1991 to 2012 were analyzed. The results of the study indicate that the most

significant considerations deciding foreign direct investment for EAC countries are trade transparency, IDs and infrastructure facilities.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

This section is the summary of the results from the research, the conclusions drawn from the study and it makes suggestions for additional studies and policy making. It will also highlight some of the limitations encountered and will include suggestions for future research.

5.2 Summary of Findings

This section gives the summary findings on the effect of the independent variables on the dependent variable.

5.2.1 Farm Works Deduction and FDI Inflows in Kenya

The first objective of the study sought to establish the effect of farm works deduction on FDI inflows in Kenya. Correlation results revealed that there was a weak positive but statistically not significant correlation between farm works deduction and FDI inflows. Further, the regression results indicated that farm works deduction had a positive but not significant effect on FDI inflows in Kenya. This resulted in failure to reject the null hypothesis.

5.2.2 Industrial Building Allowances and FDI Inflows in Kenya

The second objective of the study sought to determine effect of industrial building allowances on FDI inflows in Kenya. Correlation results revealed that there was a weak negative but statistically not significant correlation between industrial building allowance and FDI inflows. Further, the regression results indicated that a negative and

significant effect of industrial building allowance on FDI inflows in Kenya exists. This resulted to rejection of the null hypothesis.

5.2.3 Investment Deduction and FDI Inflows in Kenya

The third objective of the study sought to establish the effect of investment deductions on FDI inflows in Kenya. Correlation results revealed that there was a weak positive but statistically not significant correlation between investment deduction and FDI inflows. Further, the regression results indicated that a positive and significant effect of investment deduction on FDI inflows in Kenya exists. This resulted to rejection of the null hypothesis.

5.2.4 Wear and Tear Allowance and FDI Inflows in Kenya

The fourth objective of the study sought to establish the effect of wear and tear allowance on FDI inflows in Kenya. Correlation results revealed that there was a weak negative but statistically not significant correlation between wear and tear allowance and FDI inflows in Kenya. Further, the regression results indicated that wear and tear allowance had a positive but not significant effect on FDI inflows in Kenya. This resulted in failure to reject the null hypothesis.

5.3 Conclusions

From the regression analysis, it was found that holding the tax incentives at constant zero, FDI will grow at -3,464,899,896. For the variables, IBA was found to have a negative and significant effect on FDI with a coefficient of -0.094 and a p-value of 0.042. WTA was found to have no effect on FDI with a coefficient of 0.000 and a p-value of 0.961. ID and FWA had positive coefficients of 0.046 and 0.311 and significant p-values of 0.044 and 0.150 respectively. A unit increase in ID would increase FDI by

a factor of 0.046 and a unit increase in FWA would increase FDI by a factor of 0.311. The findings showed that only ID and IBA had a significant effect on predicting the foreign direct investment flows in Kenya. ID can increase FDI by a factor of 0.046 while a unit increase in IBA would decrease FDI by a factor of -0.094. The findings also indicated that the y-intercept, WTA and FWA were individually insignificant in predicting FDI while ID and IBA had p values lower than 5% level of significance, therefore, were individually statistically significant in predicting FDI.

This shows that as per the study, offering high industrial building allowances by the Government may be detrimental to FDI in Kenya. The results on the regression coefficients agreed with the study findings of Gumo (2013) on the effect of tax incentives on foreign direct investments in Kenya. He noted that ID and FWA had positive coefficients whereas IBA had a negative coefficient with FDI.

The conclusion of the study therefore is that the predictor variables selected for the study IBA, WTA, ID and FWD influence FDI inflows in Kenya largely since they account for 63.3% of variations in FDI inflows. The realization that the four predictor variables account for 63.3% of changes in FDI inflows imply that the factors beyond the model explain 36.7% of changes in FDI inflows. The non-significance of the model for the study was revealed by the F statistic. Thus, it is correct to state that these variables do not substantially affect FDI inflows as revealed by the p value in ANOVA.

5.4 Recommendations

The government should do a cost benefit analysis for the tax incentives that are available to various economy sectors. Any benefit that is accrued in terms of rise in investments level should exceed the revenue that is foregone through tax allowances, tax holidays and tax exemptions. Further, the government has to ensure that the

environment for investments is highly conducive by improving infrastructure, tax issues, governance, ensuring political stability and security. Since tax incentives erode the tax base, the government should continuously review them to ensure they are relevant, effective and to make an assessment on whether they have achieved the objectives they were set to.

From the analysis it was established that there are other factors that have a greater impact on FDI apart from tax allowances. The government should identify these factors so as to ensure an increase in FDI into the economy. Investment has been noted to be influenced by behaviors of investors. When the behavioral and financial factors are combined, they will provide excellent input for planning the strategies that will attract FDI so that the Kenyan vision 2030 is achieved. The study found that there are some tax incentives that had a positive influence on FDI inflows in the country. The study thus recommends that policy makers should encourage FDI by increasing tax incentives.

Countries have been noted to have tax competition behaviors where they offer lower taxes in order to entice these investments away from their neighboring nations. Since the nations may suffer from this competition, our country is encouraged to be the frontrunner in supporting EAC efforts for regional harmonization of tax. This will phase out needless competition and encourage investments across the board. Nations are encouraged to offer lower but stable tax regimes and provide fewer tax exemptions.

Governments are also encouraged to offer limited tax incentives and to eliminate tax holidays since they result in tax shopping where the foreign companies exit to other nations immediately the holiday expires. The Government should focus on placing

systems that will ensure that the tax incentives are properly recorded and monitored. This is because data is unavailable for tax incentives such as impact of exemptions or tax holidays. This will ensure that proper decision making is made on the tax incentives offered in the country. This will be very important for the KRA as they will be able to identify those firms who are in the country for tax shopping and to tighten revenue leakages.

5.5 Limitations of the Study

The period selected in this study was 10 years that is from 2008-2017. There is no proof that similar results will remain the same for a longer time period. Additionally, it cannot be assessed if the same findings will be beyond 2018. More time would prove more reliable since it will include cases of major economic changes like recessions and booms.

The most significant limitation for this study was the quality of the data. It cannot be concluded with accuracy from this study that the findings are a true representation of the situation at hand. An assumption has been made that the data used in the study is accurate. Additionally, a lot of inconsistency in the measurement of the data was experienced due to the prevailing conditions. The study utilized secondary data contrast to primary information. It took into consideration a few of the determinants of FDI inflows in Kenya and not all factors because of the limit imposed by data availability.

To complete the analysis of the data, multiple linear regression models were used. Because of the limitations involved when using the model like erroneous and misleading results resulting from a change in variable value, it would be impossible for the researcher to generalize the findings with accuracy. In case of an addition of data to the regression model, the model may not perform as per the previous.

5.6 Suggestions for Further Research

The basis of the research was on tax incentives and FDI inflows in Kenya and reliance was placed on secondary data. A similar study that places reliance on primary data collection methods such as in depth questionnaires and interviews extending to all the sectors in Kenya on the influence of tax incentives on FDI inflows would be more revealing since it would complement the current study.

The study did not exhaust all the predictor variables that influence the FDI inflows in Kenya and hence recommends that additional studies be carried out to include additional variables like balance of payments, rate of unemployment, money supply, political stability, interest rates, exchange rates and others. Identifying how each variable influences FDI inflows in Kenya will allow policy makers to identify the best tool for controlling the inflows.

The concentration of the study was on the past ten years because it was the most current and readily available data. Additional studies in the future may cover a much larger range for example from 1970 to date which will be helpful in approving or disapproving findings of the study. The study limited itself making a focus only in Kenya. The study advises that additional studies be done on other contexts such as EAC member countries or other Sub-Saharan Africa countries. Finally, because of the limitations of the regression model, other models such as the Vector Error Correction Model (VECM) may be applied in exploring the various relations between the variables.

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Appendix II: Research Data

Year	Investment Deduction	Industrial Building Allowance	Wear and Tear Allowance	Farm Works Deduction
2008	49,978,244,310	2,586,020,914	66,570,919,974	5,840,887,419
2009	48,389,821,266	2,375,716,522	79,318,999,383	4,747,753,962
2010	71,320,192,507	3,431,758,902	82,688,504,382	3,749,052,694
2011	71,941,041,720	5,083,961,590	84,718,362,795	4,792,327,822
2012	74,954,410,310	7,324,025,285	107,306,230,983	6,072,583,911
2013	83,948,939,547	9,667,713,376	121,256,041,011	6,315,487,267
2014	82,422,737,284	15,431,694,664	172,398,757,483	6,631,261,631
2015	86,760,776,089	22,693,668,623	183,402,933,492	7,161,762,561
2016	117,160,473,429	42,721,035,736	190,490,867,376	8,307,644,571
2017	87,558,855,047	31,977,382,121	205,948,730,103	10,301,479,268

Year	Foreign Direct Investment (Net Inflows, Current US\$)
2008	95,585,680
2009	116,257,609
2010	178,064,607
2011	1,450,474,757
2012	1,380,173,662
2013	1,118,825,000
2014	820,937,598
2015	619,724,470
2016	393,359,421
2017	671,488,393