

Investment Incentives Influencing Foreign Direct Investments Among East Africa Community Member Countries

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Abstract

Foreign direct investment remains a critical driver of economic transformation, industrialization, and capital formation in developing regions, particularly within the East African Community. Despite the region's efforts to attract foreign capital, disparities in FDI inflows persist across countries, raising concerns about the effectiveness of investment incentives as a policy tool. This study examined the influence of investment incentives, specifically tax incentives and custom incentives, on FDI inflows among selected East African Community member countries, namely Kenya, Rwanda, Tanzania, and Uganda, over the period 2015 to 2024. The study adopted a quantitative research approach utilizing panel data analysis, with random-effects generalized least squares regression applied to evaluate the relationship between the variables. Descriptive statistics revealed substantial variability in FDI inflows and incentive structures across the selected countries, suggesting uneven implementation and outcomes of investment promotion strategies. The findings indicated that tax incentives have a positive and statistically significant effect on FDI inflows ($\beta = 0.889, p < 0.05$), implying that increased fiscal concessions are associated with higher levels of foreign investment. Similarly, custom incentives were found to exert a positive and significant influence on FDI inflows ($\beta = 0.911, p < 0.05$), highlighting the importance of trade facilitation measures in attracting foreign investors. The results support the argument that well-structured investment incentives play a pivotal role in enhancing the investment climate and stimulating capital inflows within the region. The study concludes that investment incentives are effective instruments for attracting FDI when appropriately designed and implemented. The findings provide valuable insights for policymakers seeking to strengthen investment frameworks and enhance competitiveness in attracting global capital.

Key Words: Foreign Direct Investment, Investment Incentives, Tax Incentives, Custom Incentives, East African Community

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I. Introduction

Foreign direct investment (FDI) has remained a key driver of economic growth, industrialization, and structural transformation in developing economies. It contributes to increased capital formation, technology transfer, and employment creation, thereby enhancing productivity and competitiveness in host countries (Hamid et al., 2021). In capital-constrained regions, FDI plays an even more significant role by supplementing domestic savings and enabling investment in critical sectors of the economy (Pavlović et al., 2021). Additionally, FDI has been associated with increased household income and expansion of economic activities through multiplier effects (Voica et al., 2021). These benefits have made FDI a central component of development strategies in emerging regions such as East Africa (Nguyen, 2022).

Governments have increasingly relied on investment incentives as a strategic tool for attracting foreign investors. Investment incentives refer to deliberate policy measures designed to reduce the cost of investment and enhance expected returns for investors (Aldy et al., 2023). These incentives commonly include tax-related benefits and customs-related concessions aimed at lowering production and operational costs (Fan & Liu, 2020). Tax incentives reduce fiscal obligations on investors, while customs incentives facilitate the importation of capital goods and inputs by lowering or eliminating duties (Aksoy et al., 2020). Such incentives are particularly important in competitive investment environments where countries seek to attract multinational enterprises by improving their relative attractiveness (Cason et al., 2023).

Within the East African Community (EAC), investment promotion has increasingly been prioritized as a mechanism for enhancing economic integration and growth. The region has demonstrated strong economic potential, supported by expanding markets and ongoing structural transformation (Latif, 2023). However, despite the implementation of various investment incentive schemes, FDI inflows across EAC member countries have

remained uneven. Differences in incentive structures, policy frameworks, and implementation effectiveness have contributed to variations in investment outcomes across countries (Murungi et al., 2023). This has raised important questions regarding the extent to which specific investment incentives, particularly tax incentives and custom incentives, influence FDI inflows within the region.

Research Problem

In theory, well-designed investment incentives are expected to stimulate foreign direct investment by reducing the cost of doing business and increasing the profitability of investment projects. Effective incentive structures should enhance a country's competitiveness and attract higher levels of foreign capital inflows. This, in turn, would support industrial expansion, job creation, and economic growth in host countries (Aksoy et al., 2020). Furthermore, within a regional bloc such as the East African Community, efficient and well-coordinated incentive frameworks would be expected to promote balanced investment distribution and strengthen the region's position in the global investment landscape (Musil & Hedija, 2020).

However, the observed pattern of FDI inflows within East Africa does not fully reflect these expectations. Despite the widespread use of investment incentives, FDI inflows have remained uneven and, in some cases, relatively low compared to global trends (UNCTAD, 2022). Some countries have consistently attracted higher levels of foreign investment, while others have experienced volatility or stagnation. This disparity suggests that the effectiveness of investment incentives may vary across countries, raising concerns about their design, implementation, and overall impact on investment decisions within the region.

Empirical studies have examined the determinants of FDI across different contexts, but many have focused on broad macroeconomic and fiscal variables rather than isolating the specific role of investment incentives. Some studies have explored taxation policies and FDI without explicitly incorporating incentive structures (Dumiter, 2023). Other studies have considered incentives but have not examined their direct effect on FDI inflows within a regional framework (Da Fonseca & Jucá, 2022). Additionally, several studies have focused on single-country contexts, limiting the generalizability of their findings (Evans et al., 2022). These limitations have created a conceptual and contextual gap in understanding how tax incentives and custom incentives influence FDI inflows. This article addressed this gap by examining the effect of tax incentives and custom incentives on FDI inflows among selected East African countries, namely Kenya, Rwanda, Tanzania, and Uganda, over the period 2015 to 2024.

II. Literature Review

Theoretical Foundation

The theoretical foundation of foreign direct investment is largely anchored on the Eclectic Paradigm Theory, which explains FDI decisions through ownership, location, and internalization advantages. The location component is particularly relevant in explaining how host-country conditions influence investment decisions. Investment incentives such as tax and customs concessions form part of these location advantages by reducing operational costs and enhancing expected returns for multinational enterprises (Aberu, 2023). The theory therefore suggests that countries offering favorable incentive structures are more likely to attract foreign investors due to improved investment attractiveness.

The Neoclassical Investment Theory further provides insight into how firms evaluate investment opportunities. According to this theory, firms make rational decisions based on the comparison between expected returns and the cost of investment (Calcagnini et al., 2019). Investment incentives directly influence this decision-making process by lowering the cost component, thereby increasing the net present value of investment projects. Consequently, tax incentives and customs incentives can enhance the attractiveness of a host country by improving the profitability of foreign investment projects and influencing capital allocation decisions by multinational corporations (Emmanuel & Kehinde, 2018).

Additionally, the Internalization Theory explains why firms choose to undertake FDI rather than rely on external market transactions. The theory posits that firms internalize operations to minimize transaction costs and exploit firm-specific advantages. Investment incentives can reduce the cost of establishing and operating foreign subsidiaries, thereby encouraging firms to internalize production activities within host countries (Dragoi, 2019). This implies that favorable incentive regimes can increase the likelihood of FDI by lowering the costs associated with cross-border operations and enhancing efficiency in resource utilization.

Empirical Review

Empirical evidence has consistently shown that fiscal and investment-related policies play a significant role in influencing foreign direct investment decisions. Studies have demonstrated that taxation policies and investment incentives affect the cost of doing business and the expected profitability of investments, thereby shaping investor behavior (Shafiq et al., 2021). However, while taxation has been widely examined, the specific contribution of investment incentives has often been less clearly isolated, particularly in developing regions. This

has limited the ability to draw definitive conclusions regarding the effectiveness of incentives as independent drivers of FDI inflows.

Some studies have examined the combined effect of taxation policies and investment incentives on FDI inflows. Dumiter (2023) found that both corporate tax rates and tax incentives significantly influence foreign direct investment in OECD countries. The study focused primarily on corporate taxation and did not consider other forms of incentives such as customs incentives. This limited its conceptual scope. Da Fonseca and Jucá (2022) also established that taxation policies significantly affect FDI decisions across countries. Their analysis did not explicitly evaluate the direct role of investment incentives. This left a gap in understanding their standalone impact.

Evidence from developing economies provides further insights but also reveals methodological limitations. Evans et al. (2022) examined fiscal policy and FDI in Kenya and found a significant relationship between fiscal variables and investment inflows. The study did not incorporate investment incentives as a key explanatory variable. This omission overlooked their potential contribution to attracting foreign investment. It also highlighted the need for studies that explicitly model the influence of incentives on FDI within emerging economies.

Other studies have attempted to integrate investment incentives into broader investment frameworks but have not fully explored their interaction with FDI. Bhupatiraju (2020) found that favorable tax conditions combined with incentives enhance foreign investment across countries. The study treated incentives as complementary factors rather than independent determinants. This limited the understanding of their direct effect. Additionally, many empirical studies have focused on single-country contexts. This has made it difficult to generalize findings to broader regional settings such as East Africa.

Overall, existing empirical literature confirms that fiscal measures influence foreign direct investment, but significant gaps remain. Most studies have not isolated the effects of specific investment incentives such as tax and customs incentives within a multi-country framework. Additionally, limited use of panel data across multiple countries has constrained the ability to capture cross-country variations in investment behavior. This article addressed these gaps by examining the direct effects of tax incentives and custom incentives on FDI inflows among selected East African countries, namely Kenya, Rwanda, Tanzania, and Uganda, over the period 2015 to 2024.

III. Research Methodology

This article adopted a quantitative research approach grounded in a positivist research philosophy. Positivism assumes that relationships between variables can be objectively measured and analyzed using empirical data and statistical techniques (Cooper & Schindler, 2021). This approach was appropriate because the study focused on examining measurable relationships between investment incentives and foreign direct investment inflows. A descriptive research design was utilized to systematically analyze trends and relationships across countries and over time without manipulating the study variables (Creswell & Creswell, 2023). The design enabled the study to capture patterns in FDI inflows and investment incentives within the selected East African countries.

The study focused on four East African countries, namely Kenya, Rwanda, Tanzania, and Uganda. These countries were selected due to data availability and their relevance in the regional investment landscape. The study utilized a balanced panel dataset comprising 40 observations over a ten-year period spanning from 2015 to 2024, with each country contributing 10 observations. Secondary data was collected from revenue authorities for tax and custom incentives, while data on foreign direct investment inflows was obtained from central banks, national bureaus of statistics, and international databases such as the World Bank. The use of secondary data was appropriate as it provided reliable and consistent longitudinal information necessary for panel data analysis.

Data analysis was conducted using both descriptive and inferential statistical techniques. Descriptive statistics, including means, standard deviations, minimum and maximum values, were used to summarize the characteristics of the study variables. Inferential analysis was performed using panel data regression techniques, specifically the random-effects generalized least squares (GLS) model, to examine the relationship between investment incentives and FDI inflows. The random-effects model was appropriate as it accounted for both cross-sectional and time-series variations across countries. Hypothesis testing was conducted using coefficient estimates, z-statistics, and p-values to determine the significance of the relationships. The results were presented in tables and interpreted in line with the study objectives.

IV. Findings And Discussion

A. Descriptive Results

Table 1 presents the summary of descriptive statistics for the key study variables, namely foreign direct investment inflows, tax incentives, and custom incentives across selected East African countries, namely Kenya, Rwanda, Tanzania, and Uganda, over the period 2015 to 2024. The statistics include the number of observations,

minimum and maximum values, mean, standard deviation, median, and standard error of the mean. These measures provide an overview of the distribution, central tendency, and variability of the variables, thereby offering preliminary insights into the behavior and patterns of FDI inflows and investment incentives within the selected countries.

Table 1: Summary of Descriptive Statistics of Study Variables

stats	N	Min*	Max*	Mean*	SD*	Median*	se(mean)*
FDI inflows (USD)	40	182.9492	17200	3605.5	5601.353	499.9363	885.6516
Tax incentives (USD)	40	110.923	9215.3	2237.7	3582.113	245.1532	566.3818
Custom incentives (USD)	40	48.50702	3418.5	857.73	1351.84	109.7924	213.7446

Note: * figures in “000”

The results indicate that FDI inflows exhibited substantial variability across the study period and countries. The mean FDI inflow was USD 3,605,500 (in ‘000), with a relatively high standard deviation of USD 5,601,353, suggesting notable fluctuations in investment inflows. The minimum value of USD 182,949 and the maximum value of USD 17.2 million indicate that while some periods recorded relatively low investment inflows, others experienced significantly higher levels. The large difference between the mean and median (USD 499,936) suggests a positively skewed distribution, where a few country-period observations recorded disproportionately high inflows relative to the majority. This pattern implies that FDI inflows were unevenly distributed across the selected countries and over time.

Tax incentives also displayed considerable variation, with a mean value of USD 2,237,700 and a standard deviation of USD 3,582,113. The wide range between the minimum value (USD 110,923) and the maximum value (USD 9.2 million) indicates notable differences in the magnitude of tax incentives provided across the selected countries. The median value of USD 245,153, which is substantially lower than the mean, further confirms the presence of skewness in the data, suggesting that a few observations recorded significantly higher tax incentives compared to others. This variation indicates differences in fiscal strategies adopted by the selected countries in their efforts to attract foreign investment.

Similarly, custom incentives exhibited variation, though at relatively lower levels compared to tax incentives. The mean value of custom incentives was USD 857,730, with a standard deviation of USD 1,351,840, indicating moderate dispersion. The minimum value of USD 48,507 and the maximum value of USD 3.4 million suggest that while some observations recorded minimal customs-related support, others provided relatively higher levels of incentives. The median value of USD 109,792, which is lower than the mean, indicates a positively skewed distribution. Overall, the observed variability in both tax and custom incentives suggests differences in the design and implementation of investment incentive policies across the selected countries, which may influence their effectiveness in attracting foreign direct investment.

B. Hypothesis Testing

Table 2 presents the results of the random-effects generalized least squares (GLS) regression analysis examining the effect of tax incentives on foreign direct investment (FDI) inflows among selected East African countries, namely Kenya, Rwanda, Tanzania, and Uganda, over the period 2015 to 2024. The model was based on 40 observations, with each country contributing 10 observations. The results show an overall R-squared value of 0.4772, indicating that approximately 47.72% of the variation in FDI inflows is explained by tax incentives. The Wald chi-square statistic of 141.09 with a probability value of 0.000 confirms that the model is statistically significant.

Table 2: Tax Incentives and Foreign Direct Investments

Random-effects GLS regression		Number of obs		=	40	
Group variable: CountryID		Number of groups		=	4	
R-sq:		Obs per group:				
within = 0.2643		min		=	10	
between = 0.493		avg		=	10	
overall = 0.4772		max		=	10	
		Wald chi2(1)		=	141.09	
corr(u_i, X) = 0 (assumed)		Prob > chi2		=	0.000	
FDI inflows	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Tax incentives	0.889032	0.074847	11.88	0.000	0.742334	1.03573
cons	2.197918	0.987641	2.23	0.026	0.262178	4.133658

The findings indicate that tax incentives have a positive and statistically significant effect on FDI inflows. The coefficient for tax incentives is 0.889032, with a p-value of 0.000, which is less than the conventional significance level of 0.05. This implies that an increase in tax incentives is associated with an increase in foreign

direct investment inflows within the selected countries. The positive coefficient suggests that tax incentives reduce the cost of investment and improve expected returns, thereby enhancing the attractiveness of host countries to foreign investors. The z-statistic of 11.88 indicates a strong statistical relationship, while the confidence interval does not include zero, confirming the robustness of the findings.

The within R-squared value of 0.2643 indicates that variations in tax incentives over time within countries explain a moderate portion of the variation in FDI inflows. The between R-squared value of 0.493 suggests that differences in tax incentives across countries also play a meaningful role in explaining variations in FDI inflows. This implies that both cross-country differences and temporal changes in incentive structures influence foreign investment decisions. Overall, the results confirm that tax incentives are a significant determinant of foreign direct investment inflows within the selected East African countries.

Table 3 presents the results of the random-effects GLS regression analysis examining the effect of custom incentives on foreign direct investment (FDI) inflows among the selected East African countries. The model was based on 40 observations across 4 countries. The overall R-squared value of 0.4278 indicates that approximately 42.78% of the variation in FDI inflows is explained by custom incentives. The Wald chi-square statistic of 133.68 with a probability value of 0.000 shows that the model is statistically significant.

Table 3: Custom Incentives and Foreign Direct Investments

Random-effects GLS regression		Number of obs		=	40	
Group variable: CompanyID		Number of groups		=	4	
R-sq:		Obs per group:				
within = 0.2619		min		=	10	
between = 0.5438		avg		=	10	
overall = 0.4278		max		=	10	
		Wald chi2(1)		=	133.68	
corr(u _i , X) = 0 (assumed)		Prob > chi2		=	0.000	
FDI inflows	Coef.	Std. Err.	z	P>z	[95% Conf.	Interval]
Custom incentives	0.911106	0.078803	11.56	0.000	0.756656	1.065557
cons	2.685023	0.972587	2.76	0.006	0.778788	4.591259

The regression results reveal that custom incentives have a positive and statistically significant effect on FDI inflows. The coefficient for custom incentives is 0.911106, with a p-value of 0.000, indicating strong statistical significance. This suggests that an increase in custom incentives is associated with an increase in foreign direct investment inflows. The positive relationship implies that reducing import duties and facilitating access to capital goods and intermediate inputs enhances the attractiveness of host countries to foreign investors. The z-statistic of 11.56 further confirms the strength of this relationship, while the confidence interval excludes zero, supporting the reliability of the findings.

The within R-squared value of 0.2619 indicates that changes in custom incentives over time within countries explain a moderate portion of the variation in FDI inflows. The between R-squared value of 0.5438 suggests that differences in custom incentives across countries account for a slightly larger share of the variation in FDI inflows. This indicates that both country-specific differences and temporal variations in customs-related policies influence investment decisions. Overall, the results demonstrate that custom incentives are an important determinant of foreign direct investment inflows within the selected East African countries.

V. Conclusions

The findings of this article demonstrate that investment incentives play a significant role in influencing foreign direct investment inflows among selected East African countries, namely Kenya, Rwanda, Tanzania, and Uganda. Both tax incentives and custom incentives were found to have positive and statistically significant effects on FDI inflows, indicating that these policy instruments are effective in enhancing the attractiveness of host countries to foreign investors. The results suggest that by reducing the cost of investment and improving expected returns, investment incentives contribute to the creation of a more favorable investment climate that supports increased capital inflows within the selected countries.

The analysis further reveals that both cross-country differences and temporal variations in investment incentives influence FDI inflows. This indicates that countries with more attractive and well-structured incentive regimes are more likely to receive higher levels of foreign investment, while adjustments in incentive policies over time also play a meaningful role in shaping investment outcomes. Overall, the findings confirm that investment incentives are important determinants of FDI inflows within the selected East African countries and underscore the need for strategic design and implementation of such policies to achieve desired investment outcomes.

VI. Recommendations

From a policy perspective, governments in Kenya, Rwanda, Tanzania, and Uganda should strengthen the design and implementation of investment incentive frameworks to enhance their effectiveness in attracting foreign direct investment. There is a need to develop transparent, consistent, and well-targeted tax and custom incentive policies that align with national development priorities. Policymakers should also consider enhancing coordination in investment promotion strategies to improve competitiveness and reduce disparities in incentive structures across countries.

From a practical standpoint, investment promotion agencies and regulatory authorities should focus on improving the administration and accessibility of investment incentives. This includes simplifying procedures, ensuring timely approvals, and providing clear and accessible information to potential investors regarding available incentives. Additionally, there is a need to establish robust monitoring and evaluation mechanisms to assess the effectiveness of incentive programs in generating desired outcomes such as increased investment inflows, employment creation, and economic development. Strengthening institutional capacity will further enhance the credibility and efficiency of incentive regimes.

For further research, future studies should consider incorporating additional variables that may influence foreign direct investment, such as institutional quality, infrastructure development, and sector-specific dynamics, to provide a more comprehensive understanding of investment behavior. There is also a need for firm-level or sectoral analyses to capture variations in how different industries respond to investment incentives. Furthermore, future research could explore nonlinear relationships and threshold effects to determine whether the impact of investment incentives varies at different levels, as well as examine the long-term sustainability and cost-effectiveness of such policies in attracting foreign direct investment.

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