Effect of Taxation on Economic Growth in Kenya

Abdulmalik Omar[1], Mulandi Victor Musyoki[2], Musyoki Irene Muliwa[3], Race Muthoni Wangechi[4]

Dennis Mbuthia[5], Sammy Mbolu[6], Dr. Robert Ombati[7]

[1,2,3,4,5,6]*School of Business and Economics, South Eastern Kenya University*
[7]*Lecture, School of Business and Economics, South Eastern Kenya University*

***Abstract*: The study was motivated by the increasing levels of taxation in Kenya as a result of the Increasing size of the Public Budget between over the years. The Study Period was between the years 2011 and 2020. The choice for the period was guided by the availability of Data and the increasing size of Kenya's public budget which has made it necessary to increase the level of Taxation to counter the Budget deficit. The government of Kenya uses taxes as a means to generate revenue for its development objectives and provision of public goods like security and education. The main problem was that while the government uses taxes as a means to generate revenue they in turn generate both positive and negative impacts to the economy. In addition, money collected as a result of charging taxes always fall short of government expenditure necessitating the need for the government to borrow money. Various reforms have been made on tax policies in Kenya such as the recent Finance act 2021that was gazetted on 1st July 2021 which has broadened the coverage VAT tax increasing the prices of commodities therefore raising the standard of living. The general objective of the study was to investigate the effect of taxation on economic growth in Kenya while the specific objectives were to investigate the effect of income tax on economic growth in Kenya, to investigate the effect of VAT on economic growth in Kenya, To establish the effect of import duty on economic growth in Kenya and to investigate the effect of Excise duty on Economic growth as they are the four main forms of taxes the government of Kenya charges. The research aimed at answering the following research questions: Does income tax affect Economic growth in kenya? What is the effect of VAT on economic growth in Kenya and what is the effect of import duty on economic growth in Kenya? The study adopted the benefit theory, diffusion theory of tax incidence and endogenous growth theory and various previous researches like Nguluu (2017), Maingi (2010) and Murithii (2013) to show how economic growth in Kenya is impacted when Income tax, VAT, import duty and Excise duty are levied. Quantitative research design was applied with secondary data collected from C.B.K, K.N.B.S and K.R.A from the period 2011-2020 u. A Time series ARIMA regression model was then used to identify the relationship between the dependent and the independent variable and how the variables relate among themselves using STATA and SPSS. The estimated results showed that a 1% increase in Income tax leads to an increase in GDP by 0.678% holding all the other variables constant. A 1% increase in VAT leads to an increase in GDP by 1.480% holding all the other variables constant. A 1% increase in import duty leads to a decrease in GDP by 0.663% holding all the other variables constant and a 1% increase in Excise Duty leads to an increase in GDP by 2.783% holding all the other variables constant.The study concluded that that total Tax has a statisticaly significant relationship with economic growth with a P-value of 0.00. The study recommended that policy makers in the country should induce optimal and enabling tax policies that promote Economic growth and at the same time reduce leakages that happen in the tax system through evasions and avoidance by enacting tough laws against evaders and embracing an Online tax system for all tax payers.**

I. INTRODUCTION

This chapter covers the background of the study. Problem statement, general research objective, specific research objectives, research questions, significance of the study, scope of the study and limitation of the study.

1.1 Background of the study

Anyanwu (1997) defines tax as a mandatory payment made to the government by individuals and corporations to generate revenue for its operations and its fiscal policy objective of redistribution of income and wealth. According to Nguluu (2017), the major objective of any nation is to improve the welfare of her citizens by providing social goods. To finance the government spending, the government needs revenue, which is primarily collected through taxes. According to Duncan (2019), the revenue generation role of taxes for both developing and developed countries has been given much attention than the fiscal role of income and wealth redistribution due to the increasing fiscal budget deficits. Marina et al (2002) argues that the only practical way the government can collect revenue to finance its expenditure is through taxation. Musgrave and Musgrave (1989), taxation leads to growth retardation due to the disincentive effects it generates to the economy. Although taxation is the most preferred tool of government revenue collection as it is easily assessed in terms of equity, fairness and simplicity, taxation as a method of revenue collection creates disincentives in the economy by generating contractionary effects. Taxation reduces consumption by households by reducing their disposable income and motivation to invest in physical or human capital and innovation. Taxation also crowds out the private sector. A higher tax burden on businesses and corporations increases the cost of doing business and reduces profits creating distributional consequences' like increase in unemployment levels (Maingi 2010). There are a variety of ways that the government can use to levy taxes on its citizens and this can either be through direct or indirect taxes. Direct and indirect taxes further fall into three classes and these are: the tax base, tax incidence and tax rate. Taxes classified based on the tax base include income tax and corporation tax while taxes classified based on tax rate include progressive tax, regressive tax, digressive tax and proportional tax. Income