

**THE IMPACT OF TAX INCENTIVES ON THE GROWTH OF THE
KENYAN ECONOMY.**

BY

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DECLARATION

I hereby declare that this research project is my own original work. It is not a duplication of similarly published work of any scholar for academic purpose nor has it been presented to any other institution of higher learning for award of any academic degree also declare that all materials cited in this study which are not my own have been dully acknowledged.

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SIGN

DATE

SUPERVISOR

This proposal has been submitted for examination with my approval as the university supervisor.

NAME

SIGN

DATE

DEDICATION

I dedicate this work to my friends for helping me with some of the resources and moral support.

My parents who committed themselves to provide me with good education.

ACKNOWLEDGEMENT

I first give thanks to God for giving me strength and guidance throughout the project proposal. I would also appreciate the assistance I received from friends. I would also like to thank my lecturers for making it easier to do the project proposal for their guidance all through. I also would like to acknowledge my parents help and moral support to finish this project.

ABSTRACT

Taxation is the key source of revenue that the government of Kenya uses to provide public goods and services to the citizens. Revenue collections have increased over the last decades, though the collections have not been enough to fund the proposed budgets. This results to budget deficits. Raising efficient tax revenues in the country is the main objective for the government, thus it balances the increasing competing development needs and its desire to encourage investments through tax incentives. Budget deficit of a government shows that there is a form of negative saving. Reduction in deficit positively influences the national savings more than the changes in tax policies and encourages savings within the economy thus stimulating investments. It is vital for the government to raise adequate revenue for the country through taxation to meet its development plans.

Individual tax incentives are prominent form of incentives and include deductions, exemptions, and credits. Some of the examples are mortgage interest deduction, individual retirement accounts and hybrid tax credit. Cooperate tax incentives can be raised at federal, state and local government levels. Cooperate tax is mostly directed at individual companies involved in cooperate site selection project.

My objective of this study is to establish the effects of tax incentives on economic growth in Kenya. To achieve this I will use secondary data using descriptive analysis and regression analysis.

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CHAPTER ONE: INTRODUCTION

1.1 Background of the study

1.1.1 “Tax incentives”

Tax incentives simply mean remove part or all the burden of the tax from whatever market transaction is taking place. This is because almost all taxes imposed create an excess burden or deadweight loss. Deadweight loss is the difference between the amount of economic productivity that would occur absent the tax and that which occurs with the tax imposed. This can be seen where if savings are taxed, people would save less than otherwise. Tax non-essential goods and people buy less. Taxing activities like entertainment and travel reduces consumption as well. When a tax incentive is spoken of, it usually mean removing the tax thereby lessening the burden. A tax incentive is an aspect of a country’s tax code designed to incentivize or encourage a particular economic activity.

There have been debates on whether and to what extent the government should use the tax system for policy goals other than raising tax revenue. Raising tax revenue is a key objective of Kenyans tax system and therefore, the government must strike a balance between the ever increasing completing development needs and the desire to encourage investments through low tax regimes. It is in the consideration of the latter that has seen the government of Kenya, like other countries implement tax incentives on the assumption that taxation is an appropriate policy instrument in attract investments (IEA 2012).

Tax is a compulsory contribution of resources from the private to the public sector or government levied on a basis of predestined criteria and without reference to any specific benefits received by the tax payer Governments levy different types of taxes at varying tax rates to distribute the tax burden among persons involved in taxable activities or to redistribute resources within the society. In additional taxes are levied by the government to influence the macroeconomic performance of the economy through its fiscal policy-more specifically the taxation policies and to adjust patterns of consumption or employment within an economy by making certain transactions more or less attractive (Goode, 1984). Taxation is necessary because it is neither feasible nor desirable for governments to finance their projects solely through charging for services and benefit the majority of the population and

social development-Taxes are the price of civilization (Holmes, 1904). The view that deomacy legitimizes taxation is rejected by those people who argue that all forms of governments policies or laws are opposite and therefore taxation is viewed a producing the same result as theft, the difference between government and thievery being mostly a matter of arguments about taxation around revolved the degree and method of taxation and associated government spending not taxation itself.

1.1.2 Economic Growth

Economic growth refers to increase in the capacity of the economy to produce goods and services compared from one period to another. The growth of an economy is thought of not only as an increase in productive capacity but also as an improvement in the quality of life to the people of that economy and it is also associated with technological improvements.

Fiscal policies are concerned with governments spending and taxation policies. The burden of resource mobilization to finance essential public development projects must be focused on how the government will raise adequate revenues for its development efforts. In the long run the government can only rely on the efficient and equitable collection of taxes as a more sustainable way to raise revenue to meet its development goals. The main question however is whether huge tax incentives in developing nations like Kenya have been able to increase investments to the extent of increasing economic growth rates and improving the welfare of its citizens. Studies shows that tax incentive is an inefficient way of encouraging investments and expensive.

Therefore for the government to be effective in its role of providing quality public goods or services to its citizens and also fund its development projects which are the main determinants of investment location decisions. The Kenyan government mainly raises its revenues through taxation and through the years it has been difficult for KRA to meet its revenue targets.

1.1.3 Effects of tax incentives and economic growth

Business output, value added, wealth, personal income, or employment is used in assessing economic impact of an economic policy. They are used to indicate improvements in the economic wellbeing of people in a country. It's stated that most countries have budget deficits since they adopt balanced budget requirements instead of ex-post balanced budget

requirements. BBR requires legislature to pass while ex-post require governments to balance their budgets by the end of the year which may ensure a government takes measures to collect sufficient revenues to meet its targets.

1.1.4 Tax incentives in Kenya

Tax incentives in Kenya can be grouped into either investment promotion incentives or export promotion incentives. Investment promotion incentives include investment deduction allowance which highly encourages investment in physical capital such as industrial buildings, machinery, and equipment. Export promotion incentives program has three main schemes which include the Export Processing Zones (EPZs) and Tax Remissions and Exemption Office (TREO). The objective of the EPZs is to generate and encourage economic activity and foreign direct investments while TREO is meant to encourage manufacture for export within the country.

1.2 STATEMENT OF THE PROBLEM

Tax incentives are any incentives that reduce the tax burden of any party in order to induce them to invest in particular projects or sectors. They are expectations to the general tax regime and may include reduced tax holidays, accounting rules that allow accelerated depreciation and loss carry forwards for the tax purposes, and reduced tariffs on imported equipment, components, and raw materials, or increased tariffs to protect the domestic market. KRA defines tax incentive as a provision of the tax legislation.

The government is sometimes unable to raise adequate revenues and meet budgetary requirements yet they still offer a wide range of tax incentives. Due to globalization it has also become extremely easy for multinational companies to do international tax planning and reap maximum economic benefits for the period they enjoy the tax incentives yet most of them remain in a net tax credit position due to huge incentives or after the expiry of the incentive period they close down, start a new company in the same locality, doing similar business or they move to another country offering similar tax structures and continue enjoying the tax-free status thus denying the government of the much needed revenue to fund its economic projects. Many multinational companies in Kenya pay little to no tax to the

Kenyan government for many years they have operated in this country and for those that operated in the exporting zone. Most of them close down after ten year tax holiday period and move to other countries that introduce similar programs.

Lipsey and Crystal 2007 stated that the government plays an important role in the growth process and apart from the expenditure it incurs, it can employ policies including favorable tax treatment of savings, investment, capital gains, research and development tax incentives to encourage investments and innovations.

However, studies show that tax incentives offered have not resulted into an increase in the FDI into the country. A report released by action aid showed that KRA losses 100 billion Kenyan Shillings in tax revenue through a wide range of tax exemptions mainly to the MNCs yet these incentives do not translate to substantial returns. Uganda and Tanzania which gives far less incentives than Kenya have a better flow of returns. Tax incentives have a negative effect on the exchequer revenues.

Tax expenditures refer to revenue loses that a government incurs by providing tax exemptions, deductions or allowances, tax credits, perennials tax rates or deferral of tax payments legally to any party in the economy (Gruber, 2005). The budget deficit of a government is a form of a negative saving and a reduction in the deficit can positively influence the net national savings more than any feasible changes in tax policies and encourage savings within an economy which will then stimulate investments (Goode, 1984)

1.2 PURPOSE OF THE STUDY

To determine the effect of tax incentives to the growth of the Kenyan economy.

1.3 OBJECTIVES OF THE STUDY

- I. To determine the effect of tax incentives to the economy of Kenya.
- II. To bring out how tax incentives drive investments decisions
- III. To find out ways in which tax incentives are collected

- IV. To evaluate how tax incentives so far has brought about improvement in the economy of Kenya

1.4 RESEARCH QUESTIONS

- i. What are the effects of tax incentives?
- ii. What are benefits of tax incentives on investments?
- iii. State examples of tax exemptions in Kenya?
- iv. How do tax incentives affect investment decisions?

1.5 SCOPE OF THE STUDY

The study will seek to investigate the role of tax incentives applied to Kenyans in the Kenyan economy. It will be carried out In the KENYA REVENUES AUTHORITY (KRA). It will target the department of Commissioner of Domestic Tax Office.

1.6 VALUE OF THE STUDY

- I. To the researchers and academicians, the study adds to the existing literature in this field which will form a good base of literature for review by researchers in the future. Researchers may use the study as a foundation to carry out any further research in this area.
- II. To investors and citizens, this study provides an insight into Tax incentives and their impacts on economic growth. Investors need to establish business strategies putting into consideration the long term effects of their decisions on the business and the economy.

1.7 LIMITATIONS OF THE STUDY

- i. The researcher will face lack of corporation from heads of departments and various employees during the research process. The researcher will have to convince them that it is for studying purpose only.
- ii. Tight schedule for workers will be left to be filled by the workers during their free time
- iii. Lack of finance to cater for transport and typing costs thus the researcher will have to find own means to raise finance needs.

CHAPTER TWO: LITERATURE REVIEW

2.1 INTRODUCTION

This chapter presents a review of literature. A methodological review of past literature is important for any academic research. The need for uncovering what is already known in the body of knowledge before initiating any search study should not be underestimated. This chapter reviews literature on tax incentives and various aspects on economic growth.

2.2 Theoretical framework

The theoretical approach defines and explains the various economic theories or models that economists have used to explain the factors that really drive economic growth in a country. Taxation policies are studied for their macroeconomic effects on the economy. These theories attempt to explain what is important or necessary to improve the economy. Exogenous theories are based on constant returns to accumulation that is, choices on investments and savings affect the long run growth rates while neoclassical theories assumes that actual output equals potential output and therefore only technology can explain the differences in the economies of various countries. Examples of economic growth theories are discussed below:

2.2.1 The Harrod-Domar Model

This model was used in development economics to explain an economy's growth rate in terms of the level of saving and capital productivity. It was developed by Sir Roy F. Harrod and Evsey Domar in 1946.

The model suggests that in the absence of government interventions, the growth rate of national income will directly be related to the savings ratio therefore, the more an economy is able to save and invest , the greater the growth in GDP . It further states that the growth rate of national income will be inversely related to the economic capital-output ratio - the higher the capital is, the lower the GDP growth rate (Friedland & Sanders, 1985).

According to the model, there are two possible problems which can be experienced in an economy. First, the relationship between the actual and natural (population) growth rates can

cause disparities between the two, as factors that determine actual growth are separate from those that determine natural growth. Factors such as birth control, culture, and general tastes determine the natural growth rate. However, other effects such as the marginal propensities to save and consume influence actual output. There is no guarantee that an economy will achieve sufficient output growth to sustain full employment in a context of population growth. The second problem is the relationship between the actual and warranted growth. If output is expected to increase then investments will increase to meet the extra demand but when actual growth either exceeds or fails to meet warranted growth expectations, attempts to meet the actual demand will be exaggerated causing economic instability (Todaro & Smith, 2003).

Exogenous theorists observed that countries which were able to save 15% to 20% of GDP could grow at a much faster rate than those that saved less; this growth was self-sustainable. They stated that the mechanism of economic growth and development is a matter of increasing national savings and investment (Todaro & Smith, 2003). A good example of a country which has achieved economic growth by encouraging savings is Singapore

2.2.2 Neoclassical Theory – The Solow Growth Model

It was named after Robert (Bob) Solow and Trevor Swan and was meant to demonstrate why the Harrod-Domar model was not a good model to adopt. The model states that economic growth is derived from an increase in capital and labor inputs, ideas and new technology. He observed that a sustained rise in capital investment increases the growth rate only to a certain level then the growth rates start declining because of the law of diminishing returns that is, as the ratio of capital to labor increases, the marginal product of additional units of capital decreases.

The economy will adjust back to a steady state growth path, with real GDP growing at the same rate as the growth of the workforce plus a factor to reflect improving productivity (Begg et al, 2005)

A steady state of growth refers to a situation where output, capital and labor are all growing at the same rate, so output per worker and capital per worker are constant. Neo-classical theorists state that to raise the rate of economic growth, an increase in the labor supply and a higher level of productivity of labor and capital are fundamental and differences in the levels of technological advancements between countries explain the variations in growth rates observed in the world

today. Technological advancements not only increases incomes due to increased production but also transform lives through new product and process inventions (Lipsey & Chrystal, 2007).

2.2.3 Structural Change and Patterns of Development Theory – Chenery Model

Structural-change theory focuses on the mechanism by which underdeveloped economies transform their domestic economic structures from reliance on traditional subsistence agriculture to a modern, urbanized, and industrial diverse manufacturing and service economy. He observed that increased savings and investment are necessary but not sufficient conditions for economic growth. Both human and physical capital accumulation and changes in the economic structure of a country are required for the transition from a traditional economic system to a modern one. Changes in production, consumer demand patterns, international trade, and use of available resources, urbanization, growth and distribution of population were all considered to be necessary (Todaro & Smith, 2003).

Structural-change theorists observed that differences in development levels among developing countries are largely dependent on both domestic and international constraints. Domestic factors include economic factors such as a country's resource endowment and its physical and population size and institutional factors such as government policies and objectives. International factors include access to external capital, technology, and international trade. He observed that to a great extent, it is the international factors that create a difference between developing and industrialized countries. The higher the ability of developing countries to access opportunities presented by the industrial countries as sources of capital, technology, and manufactured imports as well as markets for exports, the faster they can increase their economic growth rates (Todaro & Smith, 2003).

2.3 Types of Tax Incentives in Kenya

Kenya offers various types of tax incentives as provided for in the Income Tax Act CAP 470, The VAT Act CAP 476 and the EPZs Act CAP 517. These incentives are mainly fiscal incentives and they determine the fiscal policy adopted to affect macroeconomic activity in a country (UNCTAD, 2000). Tax incentives are mainly offered to encourage some favored economic activities by increasing the after-tax rate of return on the investments (Goode, 1984) and to compete favorably with other countries offering the same. Incentives offered in Kenya include the following:

2.3.1 Exemptions, Zero -Rating and Remissions

Tax exemption refers to a case where a good or service is not chargeable to tax under the law while zero rating refers to a case where the tax rate applicable for the good or service is zero.

There are various exemption and zero rating regimes in Kenya. Certain goods, services, and individuals have the tax exemption or zero rated status under the VAT Act. The ITA also exempts certain classes of incomes from corporation tax. A party either individual or institution can also apply to the National Treasury for tax exemption or tax remission on specific circumstances and the Minister has the power to grant such requests if there is adequate justification. However the current constitution provides that all persons should pay taxes and the Government seeks to scrap these provisions. Companies that import raw materials and manufacture goods for export can also get tax remission status for the exports under the Tax Remission Exemption Office (TREO) arrangement. These companies already have a tax advantage since the materials imported usually do not attract any customs duty or value added tax except industrial sugar which is taxed at a low rate of 10% as customs duty. The disadvantages of giving tax exemptions, remissions and zero rated status for exports is that it results in substantial leakage of untaxed goods into the domestic market.

2.3.2 Tax Holidays – Special Economic Zones

SEZs are designated areas in a country that possess special economic regulations that are different from other areas in the same country. The regulations tend to contain measures that are conducive to foreign direct investment including tax incentives and the opportunity to pay lower tariffs. In Kenya companies operating in EPZs enjoy a 10-year tax holiday and a reduced corporate tax rate of 20% for the next 10 years (ITA, 2010). Tax holidays have many disadvantages if not designed and controlled properly. First, it attracts short term projects because once the period for the tax holiday is over, businesses soon wind up and move out to invest elsewhere (Blackwell, 2009). It also encourages tax avoidance by allowing businesses to move from high tax regions to low tax regions – tax avoidance is not illegal but it certainly is unjust and administration costs to ensure compliance with all laws and accurate reporting may be high (Irish, 1978).

2.3.3 Capital Allowances / Deductions

The law, under the income Tax Act provides for various capital allowances. These incentives are mainly intended to encourage investments in the country and since the year 2010, the government even sought to encourage investments outside the main cities by giving higher incentives to businesses setting up in such areas. Though the main goal is to increase investment and improve economic standards, the system is prone to abuse and requires constant monitoring to ensure its efficiency.

2.3.3.1 Investment Deduction

This is given to companies upon construction of a building and on the purchase and installation of new machinery used for the purposes of manufacture or for the following ancillary purposes: generation, transformation and distribution of electricity; clean-up and disposal of effluents and other waste products; reduction of environmental damage; water supply or disposal; and workshop machinery for the maintenance of the machinery. Currently companies claim ID at 100% and those who invest outside the three cities in Kenya claim at 150%. (ITA, 2010)

2.3.3.2 Industrial Building Deductions

The ITA (2010) provides for IBD deductions at a rate of 2.5% or 10% for hotels. The cost includes capital expenditure incurred on the construction of an industrial building used for business and any civil works or structures if they relate or contribute to the use of the building including: roads and parking areas; railway lines and related structures, water, industrial effluent and sewage works; communications and electrical posts and pylons, other electricity supply works; and security walls and fencing.

2.3.3.3 Farm Work Deductions

The owner or tenant of agricultural land is allowed 33.3% capital expenditure on the construction of farm works for three years. Expenditure considered includes costs the on a farm-house and any asset used for the purpose of husbandry (ITA, 2010).

2.3.3.4 Shipping Investment Deductions

A resident person who is a ship-owner is allowed 40% in the first year and 10% in subsequent years for capital expenditure incurred on the purchase of a new and unused power driven ship of more than 495 tons gross; or on the purchase, and subsequent refitting of a used power-driven ship of more than 495 tons, used for business (ITA, 2010).

2.3.3.5 Mining Allowance

The ITA (2010) provides for a deduction equal to 40% in the first year and 10% in each of the following six years of income for expenditure incurred by a person carrying on a business of mining. The cost includes expenditure incurred in searching for or in discovering and testing deposits of minerals, or in winning access to those deposits, the acquisition of rights over minerals, provision of mining machinery and construction of a building or works specifically for the purpose of the mines; costs of development, general administration and management prior to the commencement of production or during a period of nonproduction.

2.3.4 Tax Credits and Double Taxation Treaties

The ITA, 2010 provides for deduction of foreign tax payable in respect of income derived by a person resident in Kenya as a credit against tax chargeable in respect of that income if Kenya has a double taxation agreement with that foreign country. Currently Kenya has double taxation treaties with many countries including United Kingdom, South Africa and India. However, most double taxation treaties are structured in a manner that gives more advantage to the developed countries as compared to developing countries like Kenya in terms of tax revenue due to exemptions on the basis of source versus the residence principle (Irish, 1978). The World Bank, IFC and the OECD have however come out to assist developing countries in capacity building to enhance their negotiation abilities and effectiveness and they have also issued guidelines on how double taxation agreements are to be drawn to assist in developing agreements that are fairly balanced.

2.3.5 Reduced Corporate Tax Rates

This refers to a case where the law allows a party to apply a tax rate lower than the normal stipulated rate. In Kenya, the corporate tax rate is 30% for resident and 37.5% for non – resident branches or permanent establishments. EPZs however, in the past have been taxed at 25% for the 10 year period succeeding the tax holiday period (CAP 470/517 laws of Kenya). Private companies listing on the CMA also enjoy reduced corporate tax rates. Companies listing at least 20%, 30% and 40% of the issued share capital are taxed at 27% for three years, 25% for five years and 20% for five years respectively (ITA, 2010). Although meant to encourage listing of companies on the stock markets, this incentive tends to be biased against other companies operating in the same market.

2.4 Determinants of Economic Growth

Economic growth theory is concerned with explaining the determinant of the long term trend in potential GDP. Economic growth is the economy's most powerful engine for generating long-term increases in living standards. Continued annual growth has a big impact in the long run – what may appear as modest growth rates have a powerful effect in raising the living standards because its effects accumulate over time. Every macroeconomic policy must be tested on whether it will achieve its main goal or have unfavorable effects on the economy. If it does not pass the test, it is not sufficient to abandon it but its sufficient reason to rethink the policy (Lipsey & Chrystal, 2007). Economic growth refers to an increase in the real GDP of a country which is measured by changes in the national aggregate output. GDP is used to measure economic growth within the boundaries of a country because it only considers the value of goods and services produced within that country.

Economic growth is determined by the stage of development in which the country is, the quality and quantity of investments, population size and structure, level of education and training of the population and how liberalized the market is in a country. Several economic theories also give a different view on what affects economic growth in a country. Adams Smith, and Cheney both stated the importance of resources in economic growth, Harrod- Domar stated the importance of policies such as tax incentives while Solow explained the importance of technical progress in economic growth (Beardshaw et al, 2001).

2.4.1 Stages of Economic Growth

Attempts have been made to classify the pattern of economic growth as a passage through a number of defined stages. Marx classifies societies as passing through primitive, communism, slavery, feudalism, capitalism and finally socialism and communism. However, in recent times, countries do not necessarily go through these stages sequentially a good example being China. Rostow classifies these stages differently from an early stage up to the takeoff time when the economy can experience self – sustaining growth. Development of markets and accumulation of capital are therefore necessary for economic growth (Beardshaw et al, 2001).

2.4.2 Level of Investments

Initially, increasing the rate of investment reduces consumption of goods and services as resources are diverted to investment industries but increased growth rate results in a higher

consumption of goods and services in future which also increases the growth rates. The two main factors that influence the relationship between investments and economic growth rate are the differences between gross and net investment and the quality of investments. It is only the net investments that increase the wealth of a nation and not investments meant to replace obsolete 17 equipment. Investments have also to be of the right kind to contribute strongly to economic growth (Beardshaw et al, 2001). It is therefore important to consider the two main roles of investment that is; as a component of aggregate demand and as an addition to the stock of productive resources which is the objective of the Harrod- Domar model of Economic growth (Hardwick et al, 1994).

2.4.3 Population Growth and Structure

The effects of population growth on economic growth depends on the how developed a country is and the participation rate in the economy. In developed countries, stagnation in population growth may negatively affect economic growth as it is the case in Western Europe while countries with faster growing populations like Australia have maintained higher economic growth rates. On the other hand, population growth rates have been known to be an inhibiting factor in increasing GDP per Capita in developing countries hence major advances in living standards for many people in such countries depends on limiting the sizes of their families. The age, sex and geographical distribution of the population are also an important aspect to consider. A country with a higher percentage of a dependent population means that more resources will be devoted to caring for these people hence diverting necessary resources for investments (Beardshaw et al, 2001). Also, one must consider the participation rates that is, the proportion of the population which is economically active and the age of the population. A rise in this rate increases the size of the labor force. It is determined by the extent to which the different age groups and sexes in the population are by law, customs, tradition and labor regulations and the attitudes within a society, allowed to participate in the labor market activities (Hardwick et al, 1994).

Since population growth causes an increase in the number of consumers and an expansion in the labor force, the rate of economic growth caused by population growth must exceed the rate of population growth if output per head is to be increased and hence the potential to improve on the social welfare of the society (Hardwick et al, 1994).

2.4.4 Level of Education and Training

It is said that the wealth of a nation lies in the skills of its population. A country must therefore, ensure that it has adequate skills it needs to advance its economy. An investment in human capital is therefore a priority for the economic wellbeing of a country. Education is also a component in the quality of life thus those receiving higher education consume an economic product which will improve their standard of living by improving their quality of life (Beardshaw et al, 2001).

2.4.5 Market Liberalization and Trade

A country benefits immensely by allowing free markets and by taking measures to increase international trade hence promoting liberalization. Competition in the market place encourages specialization and creates efficiency which encourages trade and investments. A government may take measures to increase the proportion of exports to imports and also employ taxation policies that will encourage market liberalization (Beardshaw et al, 2001).

2.4.6 Conclusions on Economic Growth

Economic growth is a powerful weapon in the fight against poverty. It leads to a transformation in the lifestyles and living standards of ordinary citizens and the technological advancements made enhance the production of new and more superior products which improves the living standards of the citizens. Economic growth requires heavy investment of resources both in physical capital and human capital and these investments do not yield returns immediately. Due to the scarcity of resources, sacrifices have to be made in the current period to make provision for better goods and services in the future and therefore, consumers must be willing to consume less and invest more now so as to reap greater benefits tomorrow. This is the opportunity cost and the main cost of economic growth (Lipsey & Chrystal, 2007).

The government has the responsibility of developing the framework for the economy, provide infrastructure that will support the economy and invest in capacity building. It is also responsible for designing favorable fiscal policies that will enhance economic growth and reduce poverty rates. It is debatable whether the government should intervene directly in the market in order to boost sectors of the economy. Studies have shown that in certain instances such interventions have yielded positive results such as the Japan automobile sector, Taiwan's electronic sector and the US semiconductor industry (Lipsey & Chrystal, 2007). 19

2.5 Empirical Studies

Various studies have been concluded by many researchers on tax incentives and their impact on investments and economic growth of a country that is, whether they are effective tools for economic growth. Studies done in Africa suggest that most countries are competing against each other in giving more attractive tax incentives so as to attract more foreign direct investments to their countries but whether or not they are meeting the intended objectives is another issue(TJN – Africa, 2013).

In its policy studies, the U.S Treasury policy studies department (2002) observed that the effects of tax policies should be analyzed within a general framework where one explicitly recognizes the effects of tax policies on the level of services demanded from the government. Tax policies affect factor prices and the allocation of resources by the private sector and in the long run, the quantity of services demanded from the government by its citizens. A study by CIAT (2011) on Tax and development established that inadequate attention has been paid to the cost effectiveness of the various incentives offered in terms of the overall impact on tax revenues lost, credibility and economic sustainability of the tax system and therefore the tax policy and risks of corruption. It established that improved transparency in the provision and delivery of tax incentives for investment may help increase governments fiscal accountability and rationalize the use of such incentives. This will also help in improving investor and taxpayer confidence in the system, support good governance, reduce lobbying pressures for increased or new incentives, and promote economic development.

An investment policy study conducted in Botswana by the OECD (2003) on its investment policy supports the view that tax incentives are not a major FDI attraction factor. Botswana was one of the poorest countries of the world but after few decades it had one of the fastest economic growth rates in the world and its now an upper middle- income developing economy with its growth progress catalyzed by the discovery of rich and profitable deposits of diamonds in 1967, which initiated a process of structural change that is, from an economy heavily dependent on low productivity in agriculture to an economy dependent on mining and services sectors. Its growth performance is owed to the good management of natural resources and good governance which have created a good and stable political and economic environment Most of its mineral revenue 20 as well as foreign aid was invested in health, education and infrastructure which created

proper foundations for long-term growth and also a strong saving culture was established for any excesses and this has ensured a long-term macroeconomic environment conducive to a sound investment climate, a rare feat for any developing country. The Financial Assistance Policy was the main incentive that the Botswana government offered to investors which provided financial grants to encourage investment and employment in non-traditional sectors. Initially the scheme focused on manufacturing and non-traditional agriculture, but expanded over the years to include tourism, small-scale mining and related service businesses. This program was however, abolished in the year 2000, following a highly critical evaluation of its rationale, effectiveness and administration. It was established that fewer than 40% of medium and large-scale projects receiving grants were either 100 per cent foreign-owned or joint ventures and that the scheme was too generous and was bound to attract unscrupulous investors who could not be identified through evaluation procedures. Evaluation of the incentive scheme found little evidence that the FAP grants were a crucial factor in attracting foreign investors although one investor found the scheme to be very helpful in providing working capital during a period of rapid growth (UNCTAD, 2003)

A study done by GRIPS (2006) on Public Finance Policy in developing nations showed that although MNCs contribute to government revenue in form of taxes, they generally tend to pay much less than what they ought to pay due to long tax concession periods, transfer pricing practices, huge investment allowances, disguised public subsidies and tariff protection from the government. These companies use their economic power to lobby for policies that are unfavorable for development and they can avoid local taxation and shift profits to affiliates in low tax jurisdictions. This has a negative effect on the revenues collected by the government from taxation and therefore developing countries are unable to effectively fund their development goals.

A Study done by GRIPS (2006) on Public Finance policies in Ethiopia showed that countries which strive to be self-sustaining and focus on growing their economies can achieve excellent results in growth and development. A study conducted on Ethiopia showed that in contrast to donor-driven decentralization of investment programs, the country has developed clear internally determined policies defined by the government and supported by the constitution 21 which has provided for clear regional responsibilities, revenue bases and enhanced capacity

building to spur economic growth. This has ensured that although functions have been decentralized to all regions, the revenue base is well expanded and there are clear guidelines in revenue collections hence it is possible to meet financial requirements for development agenda set for each region. This has definitely helped as the country has one of the fastest growing economies in the world.

The OECD (2007), research on Tax Incentives and FDI performance in the MENA region showed that there are various incentives offered in MENA countries. The research established that tax incentives were not very effective in attracting investment but rather, investors preferred transparency, simplicity, stability and certainty in taxation policies. The ability of tax incentives to attract foreign investment is relatively low compared to the possible negative effects. There are more efficient and effective alternative ways to increase investments and achieve economic growth rather than focusing on tax incentives like increase spending on human capital in a country (Beardshaw et al, 2001). The CIAT task force on Tax and Development suggested that tax incentives erode the revenue base for developing countries reducing significantly the resources available for public investment on infrastructure, education and security, factors that are considered to be key drivers in making decisions on the location of investments. The report established that developing countries are responding to pressure from investors and other competing nations in giving tax incentives and the result is often a “race to the bottom,” in which countries in a region are made collectively worse off, possibly to the benefit of investors, findings also supported by Irish, 1978.

In its research on Tax incentives for Investments in MENA and Non- MENA countries, The OECD (2007), established that generous tax incentives cannot compensate for a poor business environment. Where in particular, there is a lack of good infrastructure such as transport, unreliable and expensive electricity supply and poor education, economic growth is bound to be very slow and most tax incentives offered will mainly erode the tax base, resulting in low tax revenues rather than increase the flow of investments to a country. Mauritius, Costa Rica, Ireland and Malaysia were examples of countries which were able to attract investments without giving tax breaks and instead focused on ensuring stable economic and political conditions, a well-educated labor force, good infrastructure, open trade for exporters, dependable rule of law and effective investment promotion systems to attract investors. This also has been supported

strongly by policy reviews done in countries which have been able to change their investment strategies and spur economic growth a good example being Botswana.

Mozambique has long used tax incentives as a tool to promote national investment and attract foreign investors with the most notable investment incentive being the reduced corporate tax rate given to Modal Aluminum Smelter in the late 1990s which included a one per cent tax on turnover instead of the standard 32% tax on income and a full exemption from custom duties, sales and circulation tax. A study by UNCTAD in 2012 revealed that the government had initiated measures to rationalize incentives, broaden the tax base and improve tax administration. This strategy seemed to work as The country succeeded in increasing the tax to GDP ratio from 12.2% in 2005 to 17.5% in 2010, which compared relatively well with other similar countries. The Government initiated the review of the tax policy in order to provide an enabling tax regime for investment and rationalize tax incentives. It intends to do strict cost –benefit analysis when offering tax incentives and use tax incentives selectively as a means to achieve well-defined industrial policies objectives and meet development goals. The large number of sector- based incentives has the potential to distort market mechanisms and investment decisions.

A recent study conducted by the Action aid group (2012) in Zambia on The human cost of a British sugar giant avoiding taxes in southern Africa proved that Zambia was a mirror of a problem present across Africa and beyond where countries, both rich and poor, are struggling to tax globally mobile profits and capital and giving special tax breaks to investors, and as a result they are losing tax revenues that might otherwise be available for the fight against poverty. Zambia grants large capital allowances which allow major investors to deduct much of the value of new plant, buildings and equipment from their taxable profits. An example was the giant Zambia sugar Factory which over the years has tripled its sugar exports since 2010, its revenues have risen 250% in the past five years, and its operating profits have increased significantly yet the company pays very little in corporate taxes. It was established that the company had paid to the Zambian Revenue Authority on average taxes of about 0.5% of its pre-tax profits – an average of less than ZK450 million (US\$90,000) a year which is significantly less than the 35% corporate tax rate. Between 2008 and 2010 Zambia Sugar Plc made no corporate income tax payments at all, although it continued to report tax liabilities. The company did further state that it was due to its expansion projects and the availability of substantial capital allowances that led

to virtually no corporate tax being paid. The company had also negotiated for two special tax breaks which entitled them to huge tax refunds, and for years to come will actually bring the Zambian tax rate applied to this highly profitable company below the tax rate even in some tax havens. The government has however, initiated policies to limit its revenue losses by reducing extreme generous capital allowances, particularly in the mining sector which is a first step in its review of tax breaks and incentives granted to big companies across all sectors. Considering the poverty levels in the country, the revenues could go a long way in enabling the country meet some of its development goals.

A study by the TJN – Africa (2013), on Tax completion in East Africa showed that Kenya, despite the fact that it offers more tax incentives than its neighboring countries, received less FDI flows than any of those countries. The study established that the Kenyan government is losing over Kenya Shillings 100 billion (US\$ 1.1 billion) a year from all tax incentives and exemptions with trade-related tax incentives accounting for at least Kenya Shillings 12 billion (US\$ 133 million) in 2007/08. The country is therefore, denied of resources urgently needed to reduce poverty and improve the general welfare of its citizens. In 2010/11, the government spent more than twice the amount on providing tax incentives (using the figure of Kenya Shillings 100 billion) than on the country's health budget. This is a serious situation when 46% of Kenya's 40 million people live below the poverty line. It is important for a country to pay attention to the other factors that affect the flow of investments and not to concentrate on tax incentives only. Governments should not therefore assume that if they fail to match their benefits to those of their neighboring countries then new companies and investors will opt for the neighboring country and reduce FDI flow into their country.

The use of tax incentives will continue in most developing because many countries feel that failure to offer them will have an adverse effect on FDI flows because the same incentives are also widely available in other developing countries and also because tax incentives appear to offer the simplest feasible way of attracting foreign investments irrespective of the cost implications (Irish, 1978). However, the Kenyan government has recognized that the current level of tax incentives presents a problem and has committed itself to rationalizing and reducing them and this is best demonstrated by the recent amendments to the VAT Act which removed most of the tax incentives except on some machinery, agricultural produce, basic commodities

and exports. This definitely is a good place to start just as it was the case when VAT was first introduced into law with very few zero rated items as it will enable the government seal the many loopholes in revenue collection and increase the tax base and revenue collections. If countries are to eradicate poverty and hunger, then they will need to do so by increasing their own public finances mainly through increased tax revenues. Poverty cannot be eradicated if developing countries are unable to raise adequate revenues to provide for the needs of their own citizens and drive economic growth in their own countries (Action aid, 2013).

2.6 Summary of Literature Review

Many previous studies done on tax incentives in African countries show that the tax incentive programs do not necessarily increase the flow of FDIs into the countries and therefore do not deliver on the intended purposes. Most developing countries are unable to raise adequate revenues to meet their budget income needs and invest in their infrastructure and development projects that will improve their economies. While many governments are aware of the fact that they are losing more resources due to the incentive regimes, many are slow or reluctant to change their taxation policies towards better practices and seal revenue loopholes in the economy because of stiffened competition for investors among the developing nations. All stakeholders including academicians, regulators and industry players agree on the importance of effective tax policies in any economy and as such countries across the globe must work hard towards adopting international best tax practices and the government, citizens and investors must make sacrifices and invest in our economy to spur higher economic growth rates.

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

This chapter discusses the research methodology adopted in the study. It explains the methodology that was used in selecting the population, sampling data, collecting data, and gathering, coding, classifying and analyzing the data as well as reporting the results of the study. The researcher aimed at applying methods, tools and techniques that were relevant and reliable to ensure that the data obtained was relevant and accurate for the study.

3.2 Research Design

Both the diagnostic and explanatory approaches were adopted for the study. The diagnostic approach shows the association between the variables while the explanatory approach studies the causal relationship between the variables (Kothari, 2004). The descriptive approach provided the foundation to the study by clearly giving an in-depth profile and understanding on the two issues of tax incentives and economic growth while the explanatory approach was adopted to estimate how and to what extent tax incentives offered in Kenya affect economic growth. The study adopted the archival research strategy because government records and documents were used as the main source of data (Saunders et al, 2009).

3.3 Data Collection

Secondary compiled data was used for the study. The data was collected from the Export Processing Zone Authority, Kenya Bureau of Statistics, World Economic Forum database, World Bank Database and the Kenya Revenue Authority. Data was mainly obtained from past published statistics, financial and economic reports and budget reports. Data collected was checked for reliability, validity and measurability to ensure that it was feasible to draw valid conclusions from the data (Saunders et al, 2009).

3.4 Data Analysis

Data collected was simplified, organized and tabulated to make it easier to understand and analyze the data. The data was then analyzed using the Statistical package for social sciences. Measures of central tendencies, standard deviations and percentages were applied in analyzing the data. Correlation analysis was used to show whether and how strongly tax incentives and

economic growth are related while regression analysis was used to measure the nature of relationship between Tax incentives and economic growth. The quantitative reports obtained from the analysis were presented using tables. The model that was applied in data analysis is given below. Y is the dependent variable, X1 to X4 are the independent variables where X2 to X4 were controlled variables.

Regression model:

$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \mu$ Where Y = Economic measure of GDP per annum measured as percentage real GDP growth rate

X1 = Tax Incentives per annum

X2 = Stage of development measured as per the global competitiveness index or ranking

X3 = Investment level measured as a percentage of investments to GDP

X4 = Population structure measured as a percentage of productive population size to total

Population

$\beta_0, \beta_1, \beta_2, \beta_3, \beta_4$ = the parameters that were estimated

μ = the random error term

The F-Statistic for the multiple linear regression models was computed to determine the significance of the model that is, to what extent the variation in the independent variable explains the changes in the dependent variable.

$$F = [SSR / (k)] / [RSS / (n-k-1)]$$

Where SSR = the regression sum of squares (SSR)

RSS = the error sum of squares or the residual sum of squares.

CHAPTER FOUR: DATA ANALYSIS AND PRESENTATION OF FINDINGS

4.1 Introduction

The research objective was to establish the effect of tax incentives on economic growth in Kenya. The study was conducted for the period 2003 to 2012 where data on GDP growth rates, tax incentives, stage of development (global competitiveness index), levels of investment, and percentage of productive population and was obtained from relevant sources. This chapter presents the analysis and findings with regard to the objective and discussion on the same. To analyze the data descriptive, correlation and regression analyses were used.

4.2 Data Presentation

4.2.1 Descriptive Statistics

Table 1: Descriptive Statistics

	Minimum	Maximum	Mean	Standard Deviation
Tax incentives per annum	39.00	222.000	122.4000	63.17559
Global competitiveness ranking	3.19	3.84	3.5760	0.22945
Investments to GDP as a percentage	16.48	20.54	18.833	1.3844
Production population as a percentage	54	54.99	54.768	0.2474
Real GDP growth rates	1.50	7.45	4.18	1.978

From the findings above, it shows that the GDP growth rate between 2003 and 2012 was 4.18% and the mean tax incentives given over the period when the Kenyan Shilling was 122 Billion, the mean productive population was given as 54.76%. The highest real Gross Domestic Product was 7% while the lowest was 1.5%. This data show that the highest amount of tax incentives stood at Kenyan Shilling 222 Billion with the lowest being 39 Billion. The highest global competitiveness index is at 3.8 and lowest 3.19 and the highest production population being at 54.99% and lowest at 54.

4.2.2 Correlation analysis

	Real GDP growth rates	Tax incentives per annum	Global competitiveness rating	Total investments (%)	Population productivity (%)
Real GDP growth rates	1	0.231	0.0842	0.373	0.482
Tax incentives per annum	0.231	1	0.818	0.920	0.909
Global competitiveness rating	0.0841	0.818	1	0.865	0.828
Total investments (%)	0.3723	0.9201	0.8655	1	0.962
Population productivity (%)	0.4823	0.909	0.8288	0.962	1

- Correlation is significant at the 0.01 level.
- Correlation is significant at the 0.05 level.

A correlation coefficient denoted by r enables one to quantify the strength of the linear relationship between ranked or numerical variables. This coefficient takes the value between -1 and +1. There is no statistically significant relationship between the Gross Domestic Product rate and tax incentives ($r=0.231$, $p \geq 0.05$), the relationship between GDP growth rate and global competitiveness index ($r=0.084$, $p \geq 0.05$).

4.2.3 Regression analysis

Model	R	R ²	Adjusted R ²	Std. error of the estimate
1	0.865	0.748	0.433	1.48953

From the finding in the above table the adjusted R² is the coefficient of determination which shows the variance in revenue collected due to changes in tax incentives, global competitiveness index, levels of investment, and percentage of productive population. As shown in the table above, is 0.433, which means that 43.3% of the total variance in GDP growth rate has been explained by the independent variables. The R² is 0.748 which means that 74.8% of variation in the GDP growth rate was explained by the changes in tax incentives, global competitiveness index, levels of investment and percentage of productive population.

Table 4.2.4 Anova

ANOVA

MODEL	Sum of squares	DF	Mean square	F	Sig.
Regression	26.336	5	5.272	2.376	0.211
Residual	8.875	4	2.219		
Total	35.235	9			

a. Predictors: global competitiveness ranking, percentage of productive population to total population, Total investments to GDP as a percentage, Tax incentives per annum.

b. Dependent Variable: Real GDP growth rates

To determine the goodness of fit of the model ANOVA analysis was done. From the above table the significance level of the model is 0.211 which shows that the model is not statistically significant.

4.2.4 Regression Analysis (part 2)

Model	Unstandardized coefficients		Standardized coefficients		
	B	Standard error	B	t	significance
Constant	-828.662	367.084		-2.26	0.087
Tax incentive per annum	-0.88	0.60	-2.822	-1.15	0.214
Global competitiveness	-1.939	6.600	-0.225	-0.029	0.78
Total investments to GDP %	-0.111	1.551	0.078	0.071	0.95
%population productivity to total population	10.582	7.487	1.461	1.413	0.23

From the findings the following regression model was established;

$$Y = -828.662 - 0.088X_1 - 1.939X_2 + 0.111X_3 + 10.582X_4$$

From the findings of the regression analysis, it was found that holding Tax incentives, global competitiveness index, level of investment, and productivity levels at constant zero the GDP growth rate would be -828.662%. The model further reveals that a unit increase in tax incentives would lead to a decrease in GDP growth rate by a factor of 0.088, a unit increase in the stage of development would lead to a decrease GDP growth rate by a factor of 1.939. A unit increase in investment levels would lead to an increase in GDP growth rate by a factor of 0.111, a unit increase in the percentage of the productive population levels would lead to an increase in GDP growth rate by a factor of 10.58. The finding indicate that the y- intercept and GDP, Tax incentives, global competitiveness index, levels of investment, percentage of productive population are all statistically insignificant at 5% level of confidence.

4.2.5 GDP and Tax incentives per year

YEAR	REAL GDP GROWTH RATE %	%GROWTH IN TAX INCENTIVES
2003	1.5	2646.28
2004	2.2	48.34
2005	5.8	11.17
2006	5.7	34.58
2007	7	7.57
2008	1.7	47.84
2009	2.6	5.68
2010	5	20.51
2011	5	11.26
2012	5.3	12.64

The findings in the table above show the percentage growth in GDP against the percentage growth in tax incentives for each year. It shows that growth in tax incentives have been increasing at a higher rate than the growth in GDP for the period under review.

4.3 Summary and Interpretation of the Findings

The correlation analysis revealed that there is no statistically significant relationship between the GDP growth rate and Tax incentives ($r= 0.231$, $p>0.05$), the relationship between GDP growth rate and global competitiveness index ($r= 0.084$, $p>0.05$), GDP growth rate and level of investments ($r= 0.373$, $p>0.05$), GDP growth rate and percentage of productive population ($r= 0.482$, $p>0.05$), and GDP growth rate.

The adjusted R^2 is the coefficient of determination which shows the variance in GDP growth rate due to changes in tax incentives, global competitiveness index, levels of investment and percentage of productive population. The R^2 was 0.748 which means that 74.8% of variation in the GDP growth rate was explained by the changes in tax incentives, global competitiveness index, levels of investment, and percentage of productive population.

From the findings the following regression model was established;

$$Y = -828.662 - 0.088X_1 - 1.939 X_2 + 0.111X_3 + 10.582 X_4$$

From the regression analysis, it was found that holding tax incentives, global competitiveness index, level of investment, and productive population level at constant zero, the GDP growth rate would be -828.662%. The model further reveals that a unit increase in tax incentives would lead to a decrease in GDP growth rate by a factor of 0.088, a unit increase in the stage of development would lead to a decrease GDP growth rate by a factor of 1.939. A unit increase in investment levels would lead to an increase in GDP growth rate by a factor of 0.111, a unit increase in the percentage of the productive population levels would lead to an increase in GDP growth rate by a factor of 10.582. The findings indicate that the y- intercept and GDP, Tax incentives, global competitiveness index, levels of investment, percentage of productive population are all statistically insignificant at 5% level of confidence.

The findings also show that Tax incentives do not determine the GDP growth rate. This is demonstrated by the data in Table 4.2.5 which shows that the amount of tax incentives have been growing steadily while the GDP growth rate has been increasing very marginally for the same period.

Kandie, 2011 in his study on the effects of tax incentives on exchequer revenue a case of the Top 25 taxpayers in the country concluded that tax incentives have negative effects on exchequer revenues. With the constant deficits in the budget financing, the tax expenditures would have gone a long way in filling the revenue gaps and fund development projects. Kinuthia, 2011 analyzed the impact of tax incentives on the flow of FDI in the manufacturing sector in Kenya. He concluded that there was a very weak correlation between tax incentives and FDIs. In his study FDI was a key factor that affects economic growth.

For the government to be effective in its role of providing quality public goods or services to its citizens and also fund its development projects which broadly affect investment location decisions, it needs to implement policies that will enable it raise adequate revenues to meet its budgetary requirements. The burden of resource mobilization to finance essential public development projects should focus on how the government will raise adequate revenues for its budgetary needs. In the long-run, the government can only rely on the efficient and equitable collection of taxes as a more sustainable way to raise revenue to meet its development goals (Todaro & Smith, 2003).

CHAPTER FIVE: SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

The objective of the research study was to establish the effect of tax incentives on economic growth in Kenya. Descriptive, correlation and regression analyses were used.

From the descriptive analysis of the various variables, the study found that the mean of GDP growth rate over the period was 4.18%, the mean tax incentives given over the period was Kenya shillings 122 Billion, the mean of productive population was 54.64%. From the correlation analysis, the study found that the relationship GDP growth rate and tax incentives, global competitiveness index, level of investment, and percentage of productive population was statistically insignificant at significance level of 0.05. The regression analysis was carried out to establish the association between GDP growth rate and the independent variables and it was found that there was a positive association between GDP growth rate and level of investment, and percentage of productive population of the population while there was an inverse relationship between GDP growth rate, Tax incentives and the global competitiveness index. The significance of the model was determined and the processed data, which is the population parameters, had a significance level of 21.1%. The following regression model was established;

$$Y = -828.662 - 0.088X_1 - 1.939 X_2 + 0.111X_3 + 10.582 X_4$$

The model summary found that the value adjusted R^2 is 0.433, which means that 43.3% of the total variance in the GDP growth rate has been explained by the independent variables. The R^2 is 0.748 which means that 74.8% of variation in the GDP growth rate was explained by the changes in the independent variables used in the model.

From the finding, it was shown that Tax incentives have been increasing at a higher rate than the increase in the GDP growth rate. This shows that the Tax incentives have not had its full intended purpose in the economy of encouraging investments and economic growth. This shows that the country is not strongly benefitting from the taxes they give up which could otherwise have been direct tax revenue and injected into the budget for allocation.

5.2 Conclusion

From the results of the findings it can be concluded that Tax incentives alone do not increase GDP growth rate. It was found that there was an inverse relationship between GDP growth rate

and tax incentives. Though tax incentives may encourage investments in a country, they do not drive economic growth. GDP growth rate is affected by so many other factors as it was shown from the correlation analysis that no one particular factor significantly affects economic growth rates. Therefore, though it has benefits to the business community, it is necessary for the Government to rationalize these incentives to ensure that the country is not losing out on needed resources while at the same time not reaping any benefits for the resources given up.

It was noted that the amount of tax incentives given each year has been growing steadily in the years under study while the GDP growth rate has not kept pace at the same level. The marginal GDP growth rate is attributed to the various initiatives the government has put in place towards the achievement of the vision 2030 and therefore the government should consider rationalizing the tax incentives in order to increase its revenue to finance its budget proposals aimed at meeting the 2030 objective.

KRA has also put in place measures to ensure that the provisions of the law and the benefits accruing from the various tax provisions are not misused by taxpayers to enable them reduce their tax base and pay less taxes than required. It is therefore important that the organization remains vigilant to ensure that taxpayers only claim what is due to them to ensure that there is no further leakage of government revenue needed to spur development and growth in the economy.

5.3 Policy Recommendations

The study makes a few policy recommendations that may be effected by the key decision makers. There is need for the government to rationalize the tax incentive schemes in the county. It is important to note that this process has now begun by the government scrapping various tax remission and exemption provisions in the VAT Act, 2013 including the TREO program and it is expected that the intended review of the Income Tax Act will also comprehensively address this issue. This will ensure that the tax incentive scheme is both efficient and beneficial to the economy. As mentioned in the introduction of this study, It is important for the government and policy makers to put in place tax reforms that ensure that its tax system achieve the main three objectives of a good tax system which include raising tax revenue for funding government operations without excessive government borrowing, ensuring equitable distribution of income in a nation and encouraging or discouraging specific activities.

There is need for KRA to improve its systems and procedures to ensure that taxpayers only get the benefit due to them under the stipulated laws and pay taxes due to the government as required ensuring that the law is complied with. Deductions average about 3% of the taxable income declared over the period which is quite high. Given that revenue needs keep increasing annually, all loopholes must be sealed to ensure minimum leakages in the economy.

There is also need for the Government and KRA to put in place proper system to capture accurate data for purposes of monitoring and proper decision making as far as tax incentives or exemptions is concerned. In particular there is no adequate data on the EPZ enterprises. Both KRA and The EPZ authority do not capture adequate or complete financial data on these businesses and therefore it is difficult to review the performance of these businesses. The law should make it mandatory for these entities to file returns even though they are exempted from paying taxes because such data will be useful in decision making and even more important to KRA once the tax holiday period for these entities lapse.

The society in general is ignorant about their tax laws, hence there is need for KRA to sensitize the business community and make it easy for the taxpayers to understand and abide by the tax laws and promote the positive culture of voluntary tax payment among the citizens.

5.4 Limitations of the Study

The study used secondary data sourced from KRA Statistical publication, the World Bank data bank, and from the revenue departments. The study was limited to the degree of precision though the data was sourced from reliable sources. There was lack of uniformity in how the various organizations capture and maintain their data hence the research could not analyze all the variables in details. There was lack of adequate data on some tax incentive schemes. There were data gaps on TREO and MUB programs run under the KRA customs department where only data was available from 2007 when the Simba system was implemented. The researcher was unable to get any accurate data on EPZ as both KRA and EPZ Authority do not capture these data in their systems for the period under review. Therefore, the researcher was unable to accurately analyze all the tax incentive schemes available.

There are so many other factors that affect GDP growth rate some which are quantifiable and others not. As shown in the analysis, no one factor can be said to significantly affect the growth in GDP. This study only focused on a few variables which had been identified for analysis.

There was time limitation to carry out the study which necessitated the use of secondary data from databases. The data from in-depth industry and company analysis may provide more information that would give better information on tax incentives and their specific impact on the economy.

5.5 Suggestions for Further Studies

After enacting the VAT Act 2013, the government also intends to review other tax laws. The VAT Act 2013 on itself still has areas that are causing debates with the business community pushing for changes on various items that have now been subjected to taxation. A study may be carried out to determine the tax impact on various exemption, zero-rating or remission regimes and analyze their overall impact on the performance of the economy.

There has been an increase in the amounts of tax incentives over the period which is quite high as compared to the revenue targets KRA has to achieve each year. Even with the post-election violence in 2007-2008, the amount of tax incentives still increased. A research may be done to establish how effective the KRA has been in implementing the tax laws and monitoring the tax deductions, remissions or tax refunds claimed by the business entities over the years.

An exploration study on possible future trends on tax incentives may be carried out to determine how the government intends to rationalize the tax incentive schemes in the country, what options are available to the government and the possible impact on the future of the performance of the economy.

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APPENDICES

6.1 Appendix 1 Performance of EPZ industries 2003-2012

Kenyan shillings (millions)	2008	2009	2010	2011	2012
Total sales	31262	26798	32348	42442	44273
Exports	28094	23948	28998	39067	39962
Imports	2536	2214	2389	2553	33223
Investments	16348	12672	16518	21443	24973
Expenditure on local purchases	21707	21507	23563	26468	38535
Expenditure on local salaries	4476	3942	4661	6276	8027
Expenditure on power	3044	3274	3583	3769	4509
Expenditure on telecommunication	575	488	522	707	757
Expenditure on water	88	90	135	61	66
Other domestic expenditure	55	58	71	87	117
Total domestic expenditure	327	3180	4135	4024	4619

- Foreign exchange equivalent injected into the economy.
- Inclusive of exports, domestic sales to EPZ and duty free agencies.

6.2 Appendix 2 Tax incentives data

2003

Turn over SUM	Taxable income SUM	Refund paid SUM	Investments SUM
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333683202	6911639	0	0
95140216	48953	0	0
19490643015	1349050796	289909	271472141
128591410479	26503756835	13215923	1968677447
394266528551	18393858931	69225923	424146819
15010708901	143544704	118308	676897492
386463827	18555071	0	0
36712203710	12620811545	2428216	166119955
159768951679	53955405417	12083849	9273297622
22873182274	9773708664	1563384	16719764
43221750558	16275400402	3097831	70670018
13594894525	1688935695	887973	240244023
45543221522	8894478569	9531681	254041101
304515638	2522633	0	0
356586641871	106781091619	790004734	1577057283
2650358462	132154582	2890095	1501025682

2004

Turnover sum	Taxable income	Refund paid sum	Investment sum
333682202	6911639	0	0
95140216	48953	0	0
19490643015	1349050796	289903	271472141
128591410479	26503756853	13215458	424146819
394266528551	18393855931	62225923	1968677441
15010708901	1443544704	118308	676897492
386463827	18555071	0	0
36712303710	126620811545	2428216	166119955
159768951679	53955405417	12083849	927329762

22873182274	9773708664	1563384	16719764
43221750558	16275400402	3097831	70670081
13594384525	1688935695	887973	240244023
33546058930	13654604870	1646747	34835061
45543221522	8894478569	9531681	254041101
304515638	2522633	0	0
356586651871	106781091619	79004734	1577057283
550734325	166421485	0	0
1580545957	864421869	7460	0
31436321324	1337929397	13724813	58435254

2007

Turnover sum	Taxable income	Refund paid sum	Investment sum
223368481784	121464282740	93731801	772745572
3700934952	21283043844	9044652	34720619
49936848710	6334410924	0	558500079
7105513936	539115003	41424472	118460365
145775057894	78103923283	40556470	106534841
195174390311	37086338066	1261734	694695217
699866092	2582462383	891871	9364770
24273394766	1138398862	0	113643728
0	375566	9708579	0
66818805944	21601361343	2500482	39310720
168479757699	140014742307	53968336	9005055376
48313387525	13417558186	7247738	427461548
8530437257	289587488	547685	823705
184790823	3205410	0	9180366
1006408131	1258455769	1178638	0
94319691933	28789701496	12447115	715289369

7256537381	630946836	513568	4681310
255880891930	25447568631	25572795	1566262528
34342885849	14609348922	7475061	123020884
32726294126	25173518402	11647966	11618646
16645698946	3800584377	2351784	8427765
8889145884	2873279261	1053071	56980573
11719577101	2349681151	1454373	404644086
113347988	191361236	395257	0
2960589556062	548952281482	321343448	15740884064

2009

Turnover sum	Taxable income	Refund paid sum	Investment sum
147699426682	86382040280	57147933	1053979460
202999924000	30053035688	12998703	1517460582
61788656494	7906954060	2943617	1904699554
675675435	82163616	0	0
7448953870	1473473965	1529288	0
153447700	14042841	120541	0
0	2854222	0	0
6556700788	3519348176	3530982	23829341
0	24404939	17936	0
32837070646	29120456646	46777632	24710000
64092690464	25669855279	52602110	585389454
56176075013	15875667165	19937835	711786137
5172998509	2834820829	1754904	24504884
52777884009	3413315671	0	205994836
0	0	0	0
30935038913	17761219778	26403831	236838813

35624180822	22660704016	35622189	27948274
9301357026	773165979	575981	21624991
279882190	614492419	407879	18338
2325585188976	166443927819	134220	39282305871
27829199318	2096769999	1923952	466842753
13500866436	3209896417	4036315	87075571
30595701770	5392365889	419000	78219660
641622818	2036898790	3994930	0
197489195715	45032200472	45301759	813336389
194367893514	135315488	285525534	433507674
82193278482	30580375641	27200530	889780388
356451910080	638746807084	634157634	48389821266

2012

Turnover sum	Taxable income	Refund paid sum	Investment income
7469409233	321535799	0	99574644
66081768015	4505635791	97047	1399509282
235675044615	20935220944	744508	591053959
242598564258	34960902350	1268294	1177265524
24318354186	2745668708	54092	50033469
2545485622	289797685	9319	1920000
0	46460	0	0
177014915561	12837635813	24184318	494581709
2136198043	191929263	0	0
19985872060	4480866425	236048	1610148
3381808141766	269253318092	0	60807672574
170825374307	24437870241	849840	758683291
62682046069	4549988281	104960	531255355
6227098833	830365832	137927	85525514

1661323992	220237115	0	0
10669831122	231651421	6202	17602936
0	3584884	0	484121328
757370351788	1327080367	124004	621393366
57832050159	5210949844	1881	241156107
15074888522	441857470	4854	758141247
32878273509	156849260	0	171676355
35485707921	1912049276	134522	102039719
18745780116	1234730246	0	6619743726
468486367136	30949434221	7056133	0
0	326284	0	0
0	244384	0	0
0	774156	0	0
0	1079736	0	0
0	0	0	0
2399520642	493702634	0	2300000
167964018	63811452	0	0
0	14005146	0	0
5118505688493	435945586	31026916	74954450310
38246919470515	5339549446453	2552762029	473161220207

6.3 Appendix 3:

Data on real GDP growth rates, population structure and investments on GDP levels.

Year	Population structure	Real GDP growth rate	Investment to GDP
2003	54.08	1.5	16.48
2004	54.33	2.2	16.96
2005	54.51	5.8	17.65
2006	54.63	5.7	18.49
2007	54.69	7	19.12

2008	54.73	1.7	19.24
2009	54.77	2.6	19.92
2010	54.52	5	19.76
2011	54.89	5	20.52
2012	54.99	5.3	20.09