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Unpacking Finance Bill 2024/25: Strengthening Fiscal Policy Alignment, Revenue Mobilization, and Public Engagement for Sustainable Economic Development in Kenya

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1.1 Executive Summary

Kenya's current revenue-to-GDP ratio stands at around 14%, significantly below the target range of 24-25% set by various economic frameworks. To achieve this target, critical inefficiencies in tax collection must be addressed, alongside reducing tax leakages, improving compliance, and expanding the tax base. A major challenge is the largely untaxed informal sector, which, despite its considerable contribution to the economy, exacerbates the revenue shortfall. Additionally, the country faces escalating fiscal challenges, including increasing public debt and inefficient resource allocation.

The fiscal challenges are further compounded by inefficiencies in tax administration, the absence of effective digital infrastructure for tax collection, and unclear tax policies affecting the growing digital and gig economies. Public debt, including those associated with state-owned enterprises (SOEs), is on the rise, with privatization offering potential solutions, though requiring careful management to ensure transparency and optimize resource use. Furthermore, the lack of public participation in fiscal decision-making erodes trust, making it difficult to build consensus around fiscal policies. The disconnect between the Finance and Appropriation Bills further complicates resource allocation, while expenditure management inefficiencies deepen the fiscal strain.

This document examines these challenges in detail and offers actionable recommendations to improve tax collection, enhance public financial management, and stimulate economic growth. These recommendations include strengthening public participation, aligning fiscal measures, improving tax equity, and reevaluating current tax policies to ensure they are more effective and inclusive. By adopting these measures, Kenya can move toward a more sustainable fiscal framework, fostering economic stability and growth.

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1.2 Background

The University of Nairobi recently convened an academic forum to examine the Finance Bill 2024, following its deliberation in Parliament. The forum brought together experts from diverse sectors to evaluate the fiscal and tax implications of the bill, alongside its broader socio-economic impact. This brief synthesizes the key insights from the forum and proposes policy recommendations aimed at improving public engagement, aligning fiscal policies, and fostering sustainable economic growth in Kenya.

1.3 Context and Challenges

Kenya faces several fiscal challenges, including a low revenue-to-GDP ratio due to inefficiencies in tax collection and a largely untaxed informal economy. The tax administration system is hindered by poor digital platforms and lack of coordination between agencies. Public debt is a growing burden, with state-owned enterprises contributing to the strain, while privatization is seen as a potential solution. The digital and gig economies offer untapped revenue, but unclear tax policies and high compliance costs discourage participation. Additionally, the lack of inclusive public participation in fiscal decision-making undermines transparency and public trust.

1.3.1 Low Revenue-to-GDP Ratio

The tax-to-GDP ratio measures a nation's tax revenue relative to the size of its economy. A tax-to-GDP rate is a gauge of a nation's tax revenue relative to its economy's size as measured by (GDP). The ratio provides a useful look at a country's tax revenue because it reveals potential taxation relative to the economy. It also enables a view of the overall direction of a nation's tax policy. The Tax-to-GDP ratio represents the size of a country's tax kitty relative to its GDP. The higher the tax to GDP ratio, the better financial position the country will be in. A lower tax-to-GDP rate constrains the government to spend on infrastructure and puts pressure on the government to meet its fiscal deficit targets (Carneo & Vergallia, 2016). Kenya's revenue-to-GDP ratio lags significantly behind the target due to inefficiencies in tax collection, extensive underreporting, and the prevalence of an informal economy. The informal sector, which contributes significantly to GDP, remains largely untapped for tax purposes.

1.3.2 Inefficiencies in Tax Administration

Tax collection in many low-income countries is costly and inefficient (Crook, 2003). As Moore (2020) articulates, many African tax administrations face particular challenges in taxing "economies characterized, to a greater extent than most of the world, by low incomes, small scale enterprise, rurality, subsistence agricultural production, and the dominance of cash transactions". Huang, et al. (2017) posit that efficiency assessments of the public sector are more complicated than such assessments of the private sector, as the products and services in question cannot be based on market values. These evaluation issues can be overcome by using data envelopment analysis (DEA), which requires input–output information for performance assessments. DEA can process multiple inputs and outputs of different measurement units without the need to assume a production function relationship. Kenya's tax administration has inefficiency challenges such as poor usability of digital tax platforms, frequent system changes, and lack of integration across tax agencies hinder effective revenue collection.

1.3.3 Public Debt and Privatization

State-owned enterprises (SOEs) have become a fiscal burden in Kenya, with privatization identified as a potential solution to reduce fiscal pressures. However, this process must be carefully managed to ensure transparency and attract credible private sector investments. Baum, et al. (2020) emphasize that ensuring state-owned enterprises (SOEs) are efficient and managed prudently is important for economic and social reasons. It is also crucial to contain fiscal risks and reduce the burden on taxpayers from recurrent and large bailouts. Governments need to develop stronger capacity to monitor and mitigate the risks from SOEs.

1.3.4 Tax Compliance in the Digital Economy

The digital and gig economies in Kenya present an untapped revenue stream. However, high compliance costs and unclear tax policies for digital platforms discourage businesses and freelancers from participating in formal tax systems. Thomas (2018) posit that Technology is revolutionizing the way we do business. Online platforms now efficiently connect service providers and other workers with willing consumers. This new mode of transacting has transformed the landscape and because majority of Gig workers use online platforms to supplement wages or otherwise earn part time income, they are commonly thought of as independent contractors rather than small business owners. Online platforms treat gig workers as contractors rather than employees for tax purposes. The employee/ contractor distinction is however a hotly contested issue. But from a tax perspective, if an individual earns income from services outside of the traditional employee- employer relationship, that individual is a business owner for tax purposes. The profile of the gig worker is somewhat different from the traditional small business owner. The former tend to be younger, less financially sophisticated, work fewer hours, often supplementing traditional employment with gig work and make less income.

1.3.5 Public Participation in Taxation and Budgeting

Ebdon and Franklin (2006) attempted to aggregate the citizen participation literature where common elements deemed critical to structuring budget participation emerged which include; the governmental environment, the design of the process, the mechanisms used to elicit participation and the goals and outcomes desired from participation in budgetary decision making. According to the summary by Ebdon and Franklin (2006), Variables for the Environment include; structure and form of government, political culture, legal requirements, population size and density. Variables of Process design include; Timing, Type of budget allocation (by program, or earmarked funds, operating, capital), Participants (selection method, numbers, representativeness) and sincere preferences or willingness to pay. Variables of Mechanisms include; Public meetings, Focus groups, Simulations, Advisory committees and surveys. The goals and outcomes are noted as; reduce cynicism, educate participants about the budget, gain support for budget proposals, gather input for decision making, change resource allocation, enhance trust and create a sense of community. In Kenya, there is a perceived lack of inclusive public participation in fiscal decision-making which erodes the transparency and legitimacy of tax policies, undermining the public's willingness to comply.

1.4 Key Issues Discussed

The budget process in Kenya plays a critical role in shaping the nation's fiscal and economic landscape. However, several challenges persist, ranging from issues in public participation and policy alignment to concerns over expenditure management and tax measures. These challenges have significant implications for fiscal sustainability, economic growth, and public trust in governance. This section explores key issues, including public awareness and engagement, the predictability of the tax environment, the disconnect between revenue and expenditure planning, inequitable tax policies, and the ongoing struggle to broaden the tax base.

1.4.1 Public Awareness and Engagement in the Budget Process

Public participation is the process through which citizens actively contribute their views and inputs to influence public policy decisions (Malanilo, 2014; Roberts, 2002). While often used interchangeably with citizen involvement, public participation specifically ensures that citizens have a direct voice in decision-making processes (Irvin et al., 2004; Hardin, 1982). In Kenya, the roots of public participation and accountability in public finance can be traced back to decentralization efforts, such as the District Focus for Rural Development initiative in the 1980s and the rise of decentralized funds in the late 1990s (Oyugi & Kibua, 2006). The Constituency Development Fund (CDF) Act of 2003 further institutionalized public participation by enabling communities to engage in project identification at local levels. The promulgation of the Constitution of Kenya (CoK) in 2010 reaffirmed the importance of public participation, embedding it within the Public Finance Management Act (2012) to enhance accountability and inclusivity in fiscal processes. In recent years, public engagement with the Finance Bill has significantly increased, with public submissions driving critical amendments, such as the removal of VAT on bread and vehicle taxes. Despite these advancements, concerns remain regarding the transparency of how public feedback is incorporated into final legislation, raising questions about accountability and eroding public trust.

1.4.2 Unpredictable Tax Environment

According to the World Bank (2013), tax administration is one of the top eleven constraints to business operations, while high tax rates rank among the top five. Elevated tax rates are strongly linked to reduced investment, lower foreign direct investment (FDI), diminished entrepreneurial activity, and the expansion of the informal sector (Djankov et al., 2010; Lee & Gordon, 2005; Fisman & Svensson, 2007). Equally critical to fostering a conducive business environment is the improvement of tax administration. In developing countries, tax monitoring and enforcement are often weaker compared to developed nations, largely due to tax evasion or corruption among taxpayers and collectors (Bird, 2003). Tax-related corruption typically thrives under three conditions: discretionary power, the presence of economic rents, and weak institutional frameworks (Aidt, 2003). In Kenya, the inconsistent application of the National Tax Policy as well as the Medium – Term Revenue Strategy (MTRS) has further exacerbated these challenges, creating uncertainty and making it difficult for businesses to plan effectively. A predictable and transparent fiscal policy is essential to enhance economic confidence, attract long-term foreign direct investment, and foster sustainable economic growth.

1.4.3 Disconnect Between the Finance and Appropriation Bills

Appropriations are more than just a budgetary tool; they can serve as a powerful mechanism for policy implementation, although few systematic empirical studies have explored this potential. Appropriations specifically refer to bills that allocate funds and are handled through the Appropriations Committees in the House and Senate. The appropriations process is particularly appealing for policy change due to its annual and mandatory nature, which creates a reversion point of zero funding for specific programs or policies if action is not taken (Ryan & Minkoff, 2023). However, in Kenya, a recurring issue is the misalignment between the Finance Bill, which outlines revenue measures, and the Appropriation Bill, which specifies government expenditure. This disconnect has resulted in inefficiencies, particularly in the allocation of funds to priority areas, such as addressing pending bills. Bridging this gap is essential for enhancing fiscal efficiency and ensuring that resources are effectively allocated to meet national priorities.

1.4.4 Expenditure Management Concerns

In Kenya, a growing imbalance between efforts to increase tax revenue and the absence of corresponding measures to curb excessive government expenditure poses a significant threat to fiscal sustainability, particularly in light of the country's Eurobond refinancing challenges. As Wawire (2020) observes, taxpayers are more willing to comply when they see efficient use of public resources and value for their money. To address this, the government must conduct thorough cost-benefit analyses (CBAs) to evaluate project viability before implementation, while also scrutinizing and prioritizing budgets and projects to eliminate waste. However, expenditure efficiency is often undermined by political interference, as budget and spending decisions are primarily approved by politicians in Parliament rather than by technocrats who might objectively assess value for money. According to Maina (2019), intense lobbying by politicians and influential actors within the economy fosters corruption, compromising the quality of government services. This misalignment of priorities often leads to critical projects being abandoned or left incomplete, while less deserving projects receive funding. Furthermore, political influence and connections frequently derail public spending efficiency, as individuals involved in corrupt practices may hold political office or maintain ties with the political elite. To ensure fiscal sustainability, Kenya must address these systemic issues by prioritizing transparency, accountability, and the depoliticization of public expenditure decisions.

1.4.5 Inequitable Tax Measures

Equity theorists examine whether existing laws ensure equal treatment for equals (horizontal equity) and appropriately differentiate among unequals (vertical equity). To assess whether taxpayers or groups of taxpayers are equals or unequals, equity theorists typically compare their pretax economic incomes (Bittker, 1978). In Kenya, proposed taxes on essential goods, such as bread, as well as VAT on banking services, Excise duty of Financial and Telecommunication services, taxes on amateur sports associations, expansion of the Pay as You Earn (PAYE) bands for salaried employees with high income, Eco Levy on certain products, have faced widespread criticism for disproportionately burdening vulnerable populations. Such measures not only exacerbate economic inequality but also hinder broader economic growth by reducing disposable income, raising the costs of essential goods and limiting access to essential services for low-income groups. Ensuring equitable taxation is therefore critical to fostering social justice and sustainable economic development.

1.4.6 Challenges in Expanding the Tax Base

Base broadening is a strategy to increase government revenues without raising marginal tax rates, but it often faces significant challenges. Many groups lobby for special treatment under the tax system, seeking deductions or credits for specific activities, referred to as "tax expenditures." Coined by Harvard Law Professor Stanley Surrey in the 1960s, the term highlights how such deductions function like government spending, where taxpayers receive support in the form of reduced taxes. However, these tax expenditures narrow the tax base, creating pressure to raise rates on other sectors to compensate for lost revenue (Poterba, 2010). In Kenya, efforts to broaden the tax base—particularly by taxing the informal sector and agricultural income—have met strong resistance. This sector presents significant challenges due to its unique characteristic and structure, many activities are carried without fixed location or in places that are not visible to the authorities such as small shops, stalls or home - based operations. Furthermore, the lack of targeted support for manufacturing and foreign direct investment (FDI) has constrained economic growth, limiting the potential for a more equitable and expansive tax system.

1.5 Policy Recommendations

This section outlines strategies to improve Kenya's fiscal framework by enhancing public participation, aligning revenue and expenditure measures, adopting predictable policies, and promoting equity in taxation. It also highlights the need to foster SME and digital growth, ensure transparency, and implement sustainable debt management to drive inclusive and sustainable economic development.

1.5.1 Strengthen Public Participation and Transparency

Strengthening public participation and transparency in budgeting requires institutionalizing continuous feedback loops to ensure public input directly shapes legislative decisions. Enhancing transparency builds trust, inclusivity, and accountability while transitioning to activity-based budgeting allows citizens to evaluate the impact of government programs. Public involvement in budgeting entails accessible information and active engagement by citizens, grassroots organizations, enterprises, and NGOs in discussions on taxation, resource allocation, and state asset management (Fölscher & Gay, 2012). This engagement is critical to public fiscal oversight, influencing accountability, transparency, and governance. The level of citizen participation during budget formulation determines their understanding of the budget process and its outcomes (Hansen & Mowen, 2000). Furthermore, socialization among personnel during budget preparation mitigates gaps in implementation, highlighting the crucial role of human factors in effective budgetary processes (Dahana & Ermwati, 2020).

1.5.2 Align the Finance and Appropriation Bills

To enhance fiscal efficiency in Kenya, the Finance Bill should precede and inform the Appropriation Bill, ensuring alignment between revenue measures and expenditure plans. This alignment minimizes inefficiencies in resource allocation, strengthens fiscal discipline, and ensures expenditure priorities are adequately funded (International Monetary Fund, 2019). Furthermore, linking expenditure management to realistic revenue projections further strengthens fiscal planning by preventing budget deficits and promoting financial sustainability (World Bank, 2021). Such measures also build public confidence in government budgeting processes by demonstrating a commitment to responsible and transparent fiscal governance (Fölscher, 2007).

1.5.3 Adopt Predictable Fiscal Policies

Advocates for government intervention argue that it can drive long-term economic growth by ensuring efficient resource allocation, regulating markets, stabilizing the economy, and resolving social conflicts. They highlight the government's role in fostering endogenous growth through knowledge accumulation, research and development, productive public investments, human capital development, and maintaining law and order (Easterly and Rebelo, 1993; Chrystal and Price, 1995; Mauro, 1995; Folster and Henrekson, 1999). However, critics contend that government activities are often bureaucratic and inefficient, potentially hindering rather than promoting growth (M'Amanja and Morrissey, 2005). In Kenya, fully implementing the National Tax Policy and engaging stakeholders in the formulation of long-term, development-oriented tax strategies are essential for enhancing tax administration and supporting sustainable growth.

1.5.4 Reevaluate Tax Measures for Equity and Effectiveness

Modern fiscal theory supports Bird's (2003) principles for an efficient tax system, which advocate for broad tax bases and uniform taxation of consumption to minimize distortions in consumer choices. Tax rates should be carefully calibrated to adequately fund public goods and government functions while remaining as low as possible to avoid excessive burdens on taxpayers. Bejaković (2020) highlights the importance of carefully designing production taxes, as they can significantly impact business locations, production methods, and operational structures. While efficient taxation aims to minimize economic distortions, some level of deadweight loss is inevitable. Achieving equity in taxation, however, remains a more complex challenge due to differing views on fairness. According to the benefits principle, equity is achieved when taxpayers contribute in proportion to the benefits they receive from government services. To support sustainable development in Kenya, policymakers should review proposals such as motor vehicle taxes and eco-levies to ensure alignment with environmental goals while avoiding undue burdens on consumers. Furthermore, sector-specific frameworks are essential to address challenges in implementing e-invoicing, particularly for smallholder farmers and cooperatives, fostering inclusivity and efficiency in tax compliance.

1.5.5 Promote Fiscal Discipline and Expenditure Efficiency

Promoting fiscal discipline and expenditure efficiency is critical for sustainable economic management. Maintaining prudent deficit and debt levels fosters macroeconomic stability by mitigating inflation risks, preventing balance of payments crises, and enabling effective countercyclical fiscal policies. Fiscal discipline also optimizes resource allocation and drives economic growth by supporting efficient tax systems and well-targeted expenditure programs, while providing flexibility to address both predictable fiscal demands, such as public pension liabilities, and unforeseen challenges like contingent liabilities (Hemming, 2003). In the Kenyan context, enhancing fiscal efficiency requires comprehensive audits of public expenditure to identify and eliminate inefficiencies, redirecting resources toward essential services. Furthermore, prioritizing the settlement of pending bills, especially those owed to businesses, is vital for stimulating economic activity, fostering business confidence, and driving economic recovery. These measures would reinforce fiscal stability while ensuring that public resources are utilized effectively and equitably.

1.5.6 Enhance Debt Management Strategies

Over the past decade, developing countries have made notable progress in debt management, bolstered by favorable liquidity conditions and debt relief initiatives that have helped ease their debt burdens. Key reforms in debt management practices and the development of domestic debt markets have further supported this progress. However, recent global market volatility underscores the need for caution, as favorable conditions can rapidly change. The financial crisis has heightened the challenges for debt managers by increasing financing needs and shifting the cost and risk profiles of financing options. Therefore, ongoing reforms are essential to maintain market access and avoid the recurrence of past crises. Given that each country's debt management capacity is shaped by factors such as capital market constraints, exchange rate regimes, macroeconomic policies, and institutional capacity, it is crucial to tailor capacity building and technical assistance to meet specific policy goals and country characteristics (Mustapha & Prizzon, 2015). For Kenya, ensuring long-term fiscal stability requires adopting sustainable debt financing strategies that reduce reliance on external borrowing. Additionally, engaging with international financial institutions to secure favorable debt-servicing terms can alleviate financial pressures and strengthen debt management, promoting a balanced and resilient approach to financing while maintaining fiscal discipline.

1.5.7 Foster Digital and SME Growth

Digital innovation is reshaping economies by shifting traditional business models into a digital realm powered by big data and advanced technologies. Once dominated by software companies, digital innovation now extends across multiple sectors, with leading global businesses emerging from the digital space. For Small and Medium Enterprises (SMEs), however, navigating this complex technological landscape remains challenging. Despite these obstacles, digital technologies present SMEs with opportunities to enhance their business models and technical skills. The success of digital transformation for SMEs largely depends on how they strategically adapt. As essential market players, especially during periods of structural change, SMEs must manage operations sustainably to succeed (North, Aramburu & Lorenzo, 2020). To foster economic growth and innovation in Kenya, it is vital to create tax policies that support digital entrepreneurship and SMEs, which play a key role in job creation. Simplifying tax processes for digital services and promoting financial inclusion will enhance accessibility and efficiency, driving inclusive growth and supporting broader economic development goals.

1.6 Conclusion

Kenya’s fiscal challenges are complex, encompassing inefficiencies in tax collection, public debt management, and a disconnect between fiscal policies and public participation. Although the informal and digital economies make significant contributions to the economy, these sectors remain underutilized for tax revenue due to high compliance costs, unclear regulations, and limited inclusion in fiscal decision-making. The lack of transparent and inclusive participation diminishes public trust in government fiscal policies, further undermining tax compliance. Additionally, the misalignment between revenue and expenditure measures in the Finance and Appropriation Bills results in inefficient resource allocation, deepening the fiscal strain.

The ongoing discussions around the Finance Bill have highlighted critical gaps in Kenya’s fiscal policy framework. Addressing these challenges requires evidence-based, transparent policymaking that builds public trust and supports sustainable economic growth. By aligning the Finance and Appropriation Bills, strengthening public participation, and refining tax policies, Kenya can create a more predictable and equitable tax environment. These measures will not only stimulate economic growth but also contribute to achieving fiscal sustainability and fostering a fairer, more inclusive tax system that aligns with long-term development goals.

To overcome these fiscal challenges, Kenya must embrace a more inclusive, transparent, and efficient approach to fiscal governance. This entails harmonizing tax and expenditure policies, enhancing public engagement in fiscal decision-making, and ensuring tax equity. Additionally, the untapped potential of the digital and gig economies can be unlocked through clearer and more business-friendly tax policies, facilitating compliance and fostering growth in these emerging sectors.

1.7 Call to Action

To address Kenya’s fiscal challenges and ensure long-term economic sustainability, the following actions are critical:

(a) **Increase Public Participation and Transparency**: Establish platforms for ongoing public engagement in the budgeting process to enhance transparency and accountability. This inclusive approach will ensure that fiscal policies reflect the needs of citizens, ultimately improving compliance and trust in government actions.

(b) **Align Fiscal Measures Across Bills**: Ensure seamless coordination between the Finance Bill and Appropriation Bill. This integration will enhance resource allocation efficiency, ensuring that revenue generation supports the funding of key government priorities effectively.

(c) **Commit to Predictable and Transparent Tax Policies**: Strengthen the consistent application of the National Tax Policy to establish stability in the fiscal environment. By involving key stakeholders in shaping long-term tax strategies, the government can encourage investment and business growth, ensuring that the tax system remains responsive and conducive to economic development.

(d) **Foster Equity in Taxation**: Reevaluate tax measures to ensure they do not disproportionately impact low-income groups or vulnerable populations. Expanding the tax base through inclusive and fair taxation will provide the foundation for sustainable and broad-based economic growth.

(e) **Harness the Digital and Gig Economies**: Develop clear, simplified tax guidelines for digital platforms and gig workers to improve compliance and unlock new sources of revenue. This will also promote the formalization of these growing sectors, boosting overall tax collection.

In addition to these steps, it is essential to:

(a) Finalize the implementation of a digital ID system to improve taxpayer tracking and enhance system efficiency.

(b) Simplify tax procedures to make compliance more user-friendly and less burdensome for all taxpayers.

(c) Reevaluate VAT exemptions and assess the impact of recent tax reforms across different sectors to ensure balanced policy outcomes.

(d) Strengthen public-private partnerships to ensure greater transparency and accountability in managing public resources.

By adopting these reforms, Kenya can build a fiscal system that fosters economic growth, attracts investment, and promotes social equity, driving the country toward a more stable and prosperous future.

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