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**THE IMPACT OF TAXATION ON ECONOMIC
GROWTH IN KENYA: (1979 – 2015)**

BY

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ABSTRACT

The study was motivated by the worrying trend of sharply increasing public debt in Kenya which has a multiplier effect of draining the economic growth through high debt servicing charges. The study therefore purposed to collect and utilize secondary data for 37 years (1979- 2015) in order to investigate the impact of taxation on economic growth in Kenya against the belief that taxes are the major sources of financing government expenditure. Specifically, the study investigated the impact of income tax, taxes on internal trade transactions and VAT on import goods and services on economic growth alongside the impacts of gross domestic savings and imports. Unit root tests confirmed the presence of non-stationarity of the macroeconomic variables used in the analysis while cointegration trace test showed that the cointegrating equations had long-run relationships. This called for employment of the Vector Error Correction Model (VECM) estimation method for data analysis.

The estimated results showed that a 1% increase in previous two year's GDP, holding all other factors constant, leads to a 0.24 percent increase in the current year's GDP. A 1% increase in previous year's and previous 2-years income tax was found to increase current year's GDP by 0.19% and 0.35% respectively. Also, it was found that, a 1% increase in previous year's taxes on international trade transactions, holding all other factors constant, leads to a 0.21 percent decrease in economic growth in Kenya. Imports were also found to have a positive significant impact on economic growth while gross domestic savings were found to be insignificant. The error correcting term showed that 42.71% of a shock in equilibrium position in the previous year will be corrected in the present year.

The study therefore recommends to policy makers to design optimal income tax codes, creation of free trade areas and provision of subsidy on import substituting industries in the economy to promote economic growth.