

The GLOCEPS

Weekly Influential Brief

Research Focus: Development and Innovation

Rebalancing Fiscal Policies to Enhance Kenya's Regional Trading Competitiveness

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Executive Summary

The 2024/2025 Finance Bill has elicited substantial debate among Kenya's economic sector stakeholders over its potential ramifications on the country's economic landscape and competitiveness in the region. Since 2017, tax-raising measures in Finance Acts have retarded investment and job creation, reduced earnings, and lowered incentives for informal businesses to formalize. The 2024/2025 Bill will continue this trend, impacting Kenya's trade relations and positioning within the EAC and COMESA trading blocs. While Kenya's GDP has shown resilience amid global economic

challenges, the Treasury's ambitious increases in revenue collection raise concerns about over-taxation. Comparative to the projected economic growth of 5% in 2024, the 12% increase in revenue collection is expected to burden businesses and households that are grappling with high production and capital costs and reducing disposable incomes respectively. The proposed fiscal measures, like an increase in RDL, EIPL, and eco levy levies, will worsen the uncompetitive agricultural and manufacturing sectors. This will resultantly accelerate the relocation of investment and production firms to



to neighboring EAC and COMESA countries where the investment environments are more conducive. To this end, Kenya's budgeting process must evolve from being a predominantly political exercise to one that is guided by social, economic, and regional trading realities. A balanced fiscal approach coupled with constructive and formalized dialogue with the private sector will spur the local operating environment, making it attractive to investors and job creators. Leveraging trade agreements with AGOA and the EU is important in diversifying the market of Kenyan products from the vulgarities of regional trade dynamics and competition. Moreover, harmonization and enactment of the tax policy, and encouraging investment in production infrastructure are essential strategies to enhance Kenya's competitiveness in the local, regional, and continental marketplace.

Context

The 2024/2025 Finance Bill has stirred considerable debate from economic sector actors like agricultural producers and the Kenya Association of Manufacturers (KAM) regarding its potential effect on Kenya's economic landscape. Concerns have been raised regarding the country's trade relations and competitiveness with neighboring East Africa Community (EAC) countries and those in the Common Market for Eastern and Southern Africa (COMESA).

In 2023, Kenya's Gross Domestic Product (GDP) showcased considerable resilience amid global economic challenges like the post-COVID operating environment and conflict in Eastern Europe. However, the ambition to increase revenue collection by 12% in the 2024/2025 financial year raises concerns of over-taxation. Kenya's Treasury's revenue-raising measures are considered ambitious and idealistic as businesses and households are already grappling with high production costs and

dwindling disposable incomes in the aftermath of previous Finance Acts. The resulting costs have made agricultural production lower in Tanzania and Uganda compared to Kenya. Local agricultural actors have shifted their farming and value-addition expertise in maize production to Malawi and Zambia. The resulting maize is later imported into Kenya under COMESA trade rules. Equally, Kenyan egg producers rely on imported feed components from Uganda due to lower costs. Likewise, the uncompetitive nature of Kenya's agricultural production informs the decline in coffee production from around 52,000 tonnes in 2022 to 49,000 tonnes in 2023.

The proposed finance bill will have a significant impact on Kenya's trade within the EAC and COMESA markets. This is due to the continued impartation of new taxes and levies. As a result, neighboring countries like Uganda have become attractive alternatives for Kenyan manufacturers. For example, Kenya manufacturers were the fourth largest foreign direct investors (FDI) in 2022 with estimated investments amounting to \$7.5 billion.

Comparatively, Kenya's manufacturing sector has been experiencing a decline, despite Vision 2030's vision of manufacturing contributing 20% to the GDP. In 2019, manufacturing contributed 8.4% to Kenya's GDP compared to 7.2% in 2023. This reduction is partly attributed to high production

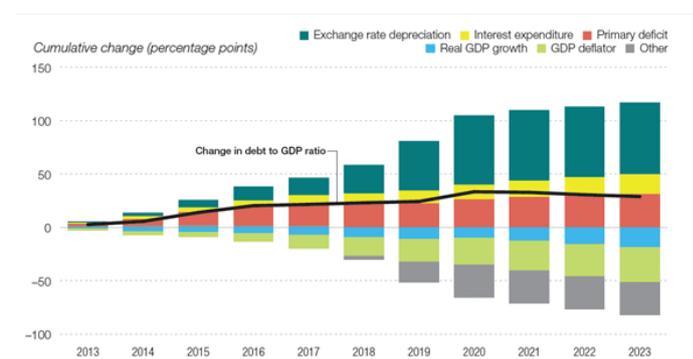


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costs coupled with stiff competition from cheaper imports from EAC and COMESA member states and China. In contrast, Vietnam's manufacturing contributes over 15% to its GDP, demonstrating the potential of a supportive business environment. Moreover, Vietnam's government has encouraged significant investment in electricity production to 94,000 megawatts, compared to Kenya's 3,000 megawatts.

In comparison, Kenyan businesses with high turnover are faced with an annual corporate tax of 30%, alongside various indirect taxes. It is estimated that indirect taxes in Kenya account for around 40% of production costs, which is comparatively higher than those in neighboring EAC and COMESA countries. Even the UK has a favorable corporate tax regime of 18%. The KAM has voiced concern that the proposed eco-levy, road development levy (RDL), export and investment promotion levy (EIPL), and excise levies either being introduced or expanded to all categories of raw and intermediate materials and finished goods will further diminish competitiveness.

The comparative analysis with other EAC countries highlights Kenya's precarious position. Neighboring countries are leveraging low nominal budgets with low production, labor, and regulatory costs. While Kenya's budget for 2024/2025 stands at \$31 billion, Uganda and Tanzania have modest budgets of \$19.2



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billion and \$18.9 billion respectively, yet they are equally implementing strategies to enhance domestic financing and reduce reliance on external borrowing. For example, Tanzania's focus on expanding its tax base, improving voluntary compliance, and leveraging ICT for tax collection offers a model for sustainable fiscal policy.

The Finance Bill 2024/2025 presents a critical phase for Kenya's economic and trading policy. It is imperative to adopt a balanced approach that



encourages both investment and production while mainstreaming fair and predictable taxation. Collaborative policy-making involving the private sector will foster a more conducive and practical business environment. Moreover, trade dynamics under the EAC and AfCFTA frameworks necessitate that Kenya align its fiscal policies with regional realities to remain competitive. Reducing recurrent expenditure, enhancing infrastructure, and creating a fair and predictable tax regime are essential steps towards economic development and improved trade relations in the region.

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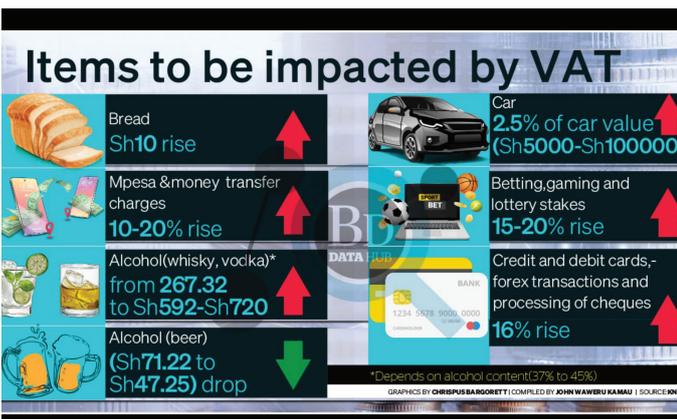
that Kenya align its fiscal policies with regional realities to remain competitive. Reducing recurrent expenditure, enhancing infrastructure, and creating a fair and predictable tax regime are essential steps towards economic development and improved trade relations in the region.

Key Issues

The paper addresses three key thematic issues including the 2024/2025 budgetary statement, regional trade and manufacturing realities, and the critical consideration of the political economy of balanced budgeting approach. These key issues highlight the ambitious revenue targets and fiscal deficits, the high production costs and shifting investment trends, and the need to enhance Kenya's competitiveness. Collectively, they impact the country's trade capabilities, investment climate, and long-term economic sustainability.

2024/2025 budgetary statement

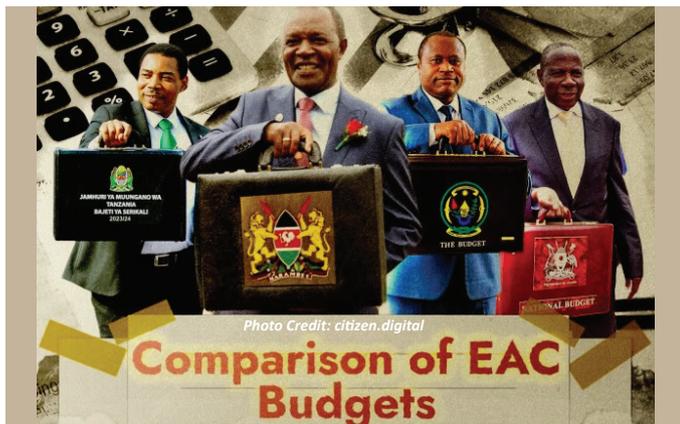
Kenya's 2024/2025 budgetary statement set ambitious revenue targets amidst challenging economic and social environments. The National Treasury aims to raise Ksh 3.342 trillion, composed of Ksh 2.91 trillion in ordinary revenue, Ksh 426 billion in appropriations in aid (AIA), and Ksh 51.8 billion in grants. This revenue projection is intended to support a total expenditure of Ksh 3.992 trillion. Of this, Ksh 2.984 trillion will be allocated to recurrent expenditure, Ksh 774 billion for development spending, and Ksh 401 billion for equitable share to the country government. The difference between the revenue and expenditure components of the budget results in a fiscal deficit of Ksh 597 billion. The government plans to finance this deficit through external and domestic borrowing of Kshs 333.8 billion and Kshs 263.2 billion respectively. While the proposed fiscal deficit represents a significant reduction from Ksh 920 billion contained in the 2nd supplementary budget of 2023/2024, these targets





are based on optimistic revenue assumptions that KRA has historically struggled to meet. This portends to increased borrowing or future taxation to cover the shortfall.

Kenya's budgetary context compared to other EAC member states reveals significant concerns. With a budget of \$31 billion, Kenya's fiscal plan dwarfs those of Uganda at \$19.2 billion, Tanzania at \$18.9 billion, Rwanda at \$4.4 billion and Burundi at \$1.5 billion. Similar to Kenya, many of the EAC budgets have been made on the backdrop of rising public debts, high fuel costs, declining household and business incomes, and global geopolitical tensions. While neighboring finance ministers face the task of



balancing revenue-raising measures without exacerbating debt distress, they are making efforts not to discourage trade and investment through punitive taxes.

It is against this backdrop that the proposed tax measures have been unfavorably received by businesses and households. High production costs due to new taxes, such as the Ksh 7 increase in RDL and eco-levy on all imported finished products, threaten to increase the prices of goods and services and production costs. This will make essential items unaffordable with the potential rising consumer demand for counterfeit goods. East African Breweries Limited (EABL) has reported a rise in counterfeit alcoholic products. The counterfeit

situation is likely to be worsened with the new and higher excise on spirits and tobacco products. Likewise, KAM warns that the increased cost of production will force businesses to pass these costs to consumers. This will further strain household budgets.

The implication of the previous and current fiscal propositions on Kenya's trade and investment has been significant. The proposed Finance Bill of 2024 will accelerate businesses, especially in the manufacturing sector, to relocate to neighboring countries that have more favorable tax regimes. Most evaluations by business associations deem it profitable to produce in EAC member countries and import into Kenya under EAC and COMESA frameworks. This will lead to job losses and decreased tax revenues. Moreover, the exodus of business will weaken Kenya's competitive edge and value of the shilling, harm the balance of trade, and exacerbate the prevailing economic conditions. Likewise, the perception of a hostile tax environment will deter FDI which is essential for economic growth and job creation. This is because investors seek stability and predictability which previous and current fiscal policies have been unable to deliver.

Resultantly, the Finance Bill of 2024 risks triggering a vicious cycle of job losses and economic decline. Businesses struggling with high taxes will either downsize, shut down, or re-orient operations to an





import-led business approach. The Bill will increase unemployment and reduce household incomes. In turn, this will lead to further reductions in consumer spending and more business closures, potentially devastating the economy.

Regional trade and manufacturing realities

Kenya's 2024/2025 budgetary measures should be considered against the backdrop of regional trade and manufacturing dynamics within the EAC, COMESA, and AfCFTA. The proposed measures have drawn concerns from traders and manufacturers who argue that the increased taxation that is required to fund the ever-rising budget estimates, amid debt servicing and a slowing economy, will hamper the country's competitiveness in the region. For example, previous revenue and tax administration measures are already affecting top taxpayers and increasing refund arrears as traders, farmers, and manufacturers contest the remittance of value-added tax (VAT).

The imposition of taxes such as a 10% import levy on clinkers, in the 2023/2024 Finance Act, led to a decrease in cement production by 100,000 metric tons in the same financial period. Clinkers are essential for cement production. Similarly, the wholesome increase in the import declaration fee (IDF) from 2.5% to 3% without distinguishing between raw materials and finished products further erodes Kenya's competitiveness. For instance, levies like the EIPL on steel have turned Kenya from an exporter to a net importer of steel-finished products. Equally, the increase in import tax measures has resulted in reciprocation by neighboring EAC economies. For instance, Kenya trucks transporting Irish potatoes to Uganda were halted at the border point after the Uganda Revenue Authority (URA) increased the withholding tax from \$31.49 to \$314.94 per truck. This highlights the

reality that local tax measures can disrupt regional trade and economic activities.

Likewise, fiscal policies have a significant impact on the realization of national development blueprints. For instance, Vision 2030 identified the local manufacturing sectors as a key economic pillar, with a targeted contribution of 20% of the GDP. However, the manufacturing sector has gradually underperformed with a 7.8% GDP contribution in 2023. The preceding imposition of the EIPL on imported raw materials and the introduction of a new eco-levy on all imported finished products will make both locally produced and imported products more expensive. It is therefore imperative for policymakers and legislators to remain cognizant of the tax implications in either spurring or curtailing the growth of key sectors. As such, policymakers should adopt a holistic approach to policy discussions and propositions and actual implementation realities, within the country and region.

Regrettably, the barriers emanating from the Finance Bills inform the shifting of production bases from Kenya to EAC and COMESA countries. In 2022, Kenya was the fourth largest source of FDI in Uganda, with investments primarily in the manufacturing sector. Additionally, Uganda has offered a total of 60,000 hectares of land to Kenyan entrepreneurs for palm oil production. Tanzania is equally cognizant of the bottleneck imposed in



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Kenya, thus informing their measures to make themselves an attractive investment destination for FDIs and relocating businesses from Kenya. This is a replication of Vietnam's positioning in attracting relocating from China due to geopolitical tensions. These measures were undertaken concurrently with prioritizing Vietnam as a favorable investment destination through favorable tax measures and increased infrastructural investment including energy production.

Despite the espoused challenges, Kenya's trading and manufacturing sectors have considerable growth potential, especially in exportation to the United States and the European Union. This is more so in areas like textile and apparel, which has an estimated export to the United States of \$550 million in the 2022/2023 financial year. This is low compared to the annual global trade in textiles and apparel which is estimated at \$2.1 trillion. While this potential can compensate for losses in the regional market, this avenue is largely underutilized. For instance, KAM notes that under the 24 years of implementing the multilateral Africa Growth and Opportunity Act (AGOA) with the United States, Kenya only utilized 6 out of 6000 tariff lines that the country had access to. As such, Kenya should leverage its production potential and strategic location to Europe and America to service the US market under the proposed 16-year extension of the AGOA agreement and the 25-year EU trade agreement for growth and economic expansion. Supportive fiscal legislation will be imperative.

Kenya's 2024/2025 and future budgetary measures pose a significant challenge to Kenya's competitiveness within the EAC, COMESA, and AfCFTA if it proceeds with the current trend of complex taxation. Policymakers must be cognizant of these considerations to reverse this trend and make Kenya a more

favorable investment destination, both regionally and globally.



The political economy of balanced budgeting

Kenya's budgeting process should evolve from a predominantly political exercise to one that is guided by economic and regional trading realities. Currently, the approach is characterized by expanding tax obligations on an already burdened tax base. Reactions from economic actors echo the unsustainable approach of the current revenue-raising measures, which continue to impose considerable and convoluted tax measures. Efforts should be directed at mitigating the negative impacts of fiscal policies on trade and development. To this end, Kenya needs to implement a more balanced fiscal approach and explore alternative revenue generation strategies.

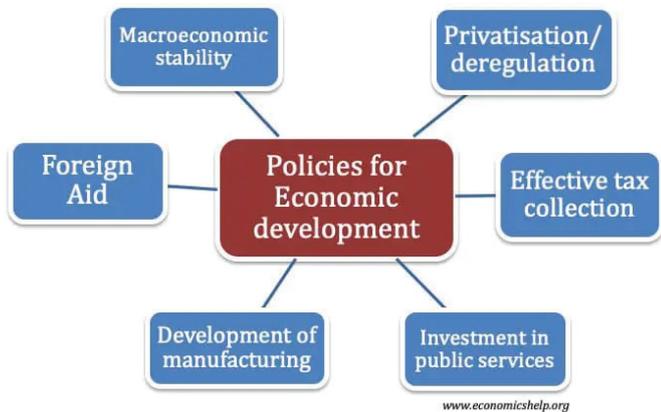
While the government should generate revenue to fund public services and repayment of debt, the current strategy as outlined in the Finance Bill of 2024/2025 runs counter to this. A more balanced strategy that supports the growth of local businesses while ensuring fair taxation should be prioritized. This could include measures such as tax incentives for businesses that invest in local communities, graduated tax rates based on business sizes, and enhanced support for small and medium enterprises. These approaches would help expand the tax base more equitably and sustainably, rather





than repeatedly taxing the same and shrinking pool of business entities.

Constructive dialogue between the government and the private sector is crucial for developing policies that promote economic development. Equally, the government should prioritize and consider fiscal ideas on the wholesome benefit to the country's development rather than from the singular perspective of revenue generation. Engaging businesses in the policymaking process allows the government the challenges businesses and producers face. This will enable the development and implementation of more effective policy solutions. Manufacturers, like those under the auspices of KAM, increasingly advocate for a collaborative



approach to fiscal policy. The partnerships should be prioritized as they help align fiscal strategies with the needs of businesses. This will foster a conducive environment for investment and growth.

The current and future finance legislation should be reevaluated and appraised with a clear focus on enhancing economic resilience and mainstreaming regional and continental trading dynamics. Creating a business environment that supports recovery and growth, especially in the aftermath of COVID-19 and global turbulence is essential. Policies should aim to build a robust and diversified economy capable of adapting to and leveraging external shocks. This involves not only reconsidering and harmonizing tax

measures through a coherent tax policy but also investing in infrastructure, innovation, and human capital development that are requisite for driving long-term growth.

The 2024/2025 poses significant risks in this regard. It threatens an increase in the proliferation of counterfeit goods, drives businesses to downsize, shut down, or relocate, and erodes the competitive edge of local industries. The introduction of new taxes and expansion of old measures including EIPL, eco-levy, RDL, and IDF among others, are leading to the decline of key manufacturing sectors. These include steel and cement production, making Kenyan products more costly than their regional counterparts. It is therefore imperative to prioritize a more balanced and sustainable approach to fiscal policy. By reconsidering current and future fiscal policy instruments, the government and actors in the budget-making process will be able to safeguard national development and prosperity that are mutually beneficial to economic sector actors and the government in its budgeting endeavors.

Conclusion

The 2024/2025 Finance Bill has sparked considerable concerns among economic sector actors, including agricultural producers, traders, and KAM, due to its potential adverse effect on Kenya's economic landscape and trade competitiveness in the regions. Key issues have been highlighted including the overly ambitious revenue targets amidst a challenging economic environment, high production costs, and a shifting investment climate that favors neighboring EAC and COMESA countries. While Kenya's GDP and economy have shown resilience, the proposed tax measures threaten to overburden businesses and households already struggling with high costs and declining incomes respectively. Resulting competitive disadvantages are increasingly evident in the agricultural and





manufacturing sectors. Increasing production costs on the back of tax burdens on raw and intermediate materials, and high energy costs have led to reduced outputs and shifts in production to neighboring countries. Mitigation of these impacts requires a balanced fiscal approach that supports private sector gathering and fair taxation. Likewise, collaborative policy-making, involving the private sectors, is imperative in fostering conducive business environments that mainstream economic resilience with alignments to regional trading dynamics. This balanced approach is crucial for sustaining and improving Kenya's competitiveness

and economic development within the EAC and COMESA markets.



Recommendations

The National Treasury and National Assembly should undertake the following:

1. Harmonize and finalize Kenya's tax code to ensure clarity, predictability, and fairness. This process will involve the consolidation of various taxes into a coherent system, and the implementation of graduated tax rates and incentives that reduce the administrative burden on businesses while preventing the arbitrary annual imposition of new taxes
2. Leverage AGOA and EU trade agreements to maximize Kenya's export potential through the utilization of the full spectrum of available tariff lines
3. Establish a formalized dialogue platform between the government and the private sector for the harmonization and alignment of fiscal policies with business dynamics
4. Prioritize investments in critical infrastructure such as energy, transport, and digital connectivity to reduce production costs and enhance competitiveness





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