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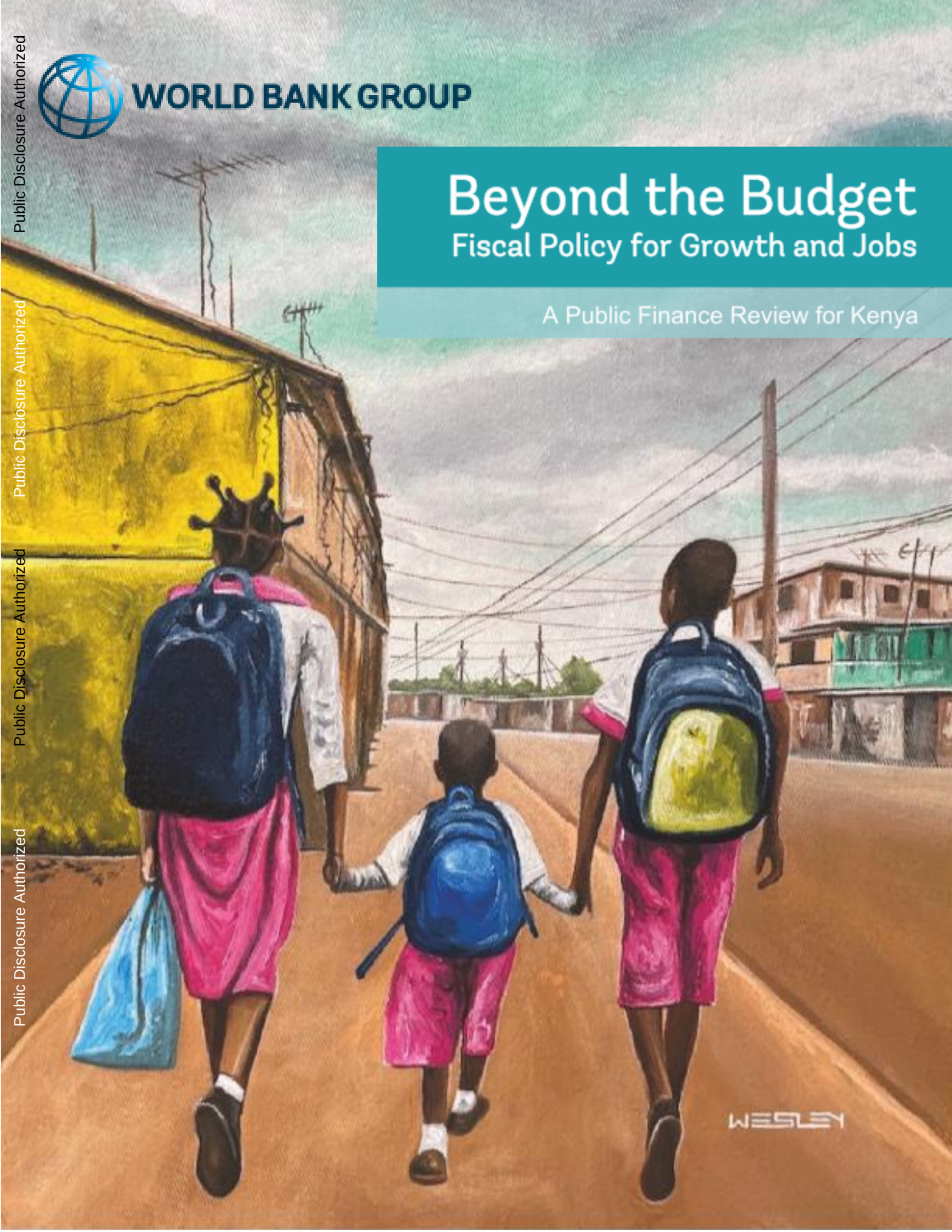
Beyond the Budget

Fiscal Policy for Growth and Jobs

A Public Finance Review for Kenya



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Kuna njia nyingine
There is another way
- Swahili saying

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List of Acronyms

AfCFTA
African Continental Free Trade Area
AML/CFT
Anti-Money Laundering/Combating the Financing of Terrorism
ASALs
Arid and Semi-Arid Lands
BRS
Business Registration Service
CAD
Current Account Deficit
CCDR
Country Climate and Development Report
CG
County Government
CIT
Corporate Income Tax
CT-OVC
Cash Transfer for Orphans and Vulnerable Children
DOD
Department of Defense
DSA
Daily Subsistence Allowance
EAC
East Africa Community
EACC
Ethics and Anti-Corruption Commission
ECCIF
Emergency, Chronic, and Critical Illness Fund
e-GP
Electronic Government Procurement
e-TIMS
Electronic Tax Invoice Management System
EPZ
Export Processing Zone
FDI
Foreign Direct Investment
FY
Fiscal Year
GDP
Gross Domestic Product
GDPU
Government Digital Payments Unit
GoK
Government of Kenya
HRIS-Ke
Human Resource Information System-Kenya
HSNP
Hunger Safety Net Program
IFMIS
Integrated Financial Management Information System
IMF
International Monetary Fund
KALRO
Kenya Agricultural and Livestock Research Organization
KIPPRA
Kenya Institute for Public Policy Research and Analysis
KNBS
Kenya National Bureau of Statistics
KRA
Kenya Revenue Authority
Ksh.
Kenyan Shillings
MDAs
Ministries, Departments, and Agencies
MSME
Micro, Small, and Medium Enterprises
MTRS
Medium Term Revenue Strategy
NAAIAP
National Agricultural Inputs Access Programme
NASEP
National Agricultural Sector Extension Policy
NCDs
Non-Communicable Diseases
NESP
National Extension Services Policy
NFSP
National Fertilizer Subsidy Programme
NG
National Government
NHIF
National Health Insurance Fund
NPLs
Nonperforming loans
NSNP
National Safety Net Program
NSSF
National Social Security Fund

NT
National Treasury
NWSS
National Water Services Strategy
NVSP
National Value Chain Support Programme
OPCT
Older Persons Cash Transfer
OSR
Own Source Revenue
OVC
Orphans and Vulnerable Children
PAYE
Paye As You Earn
PEPFAR
President's Emergency Plan for AIDS Relief
PIM
Public Investment Management
PHCF
Primary Health Care Fund
PFM
Public Financial Management
PFR
Public Finance Review
PIT
Personal Income Tax
PPOs
Public Policy Obligations
PPP
Public Private Partnership
PSC
Public Service Commission
PWSD-CT
Persons with Severe Disabilities Cash Transfer
RBF
Results-based Finance
SEZ
Special Economic Zone
SHIA
Social Health Insurance Act
SHIF
Social Health Insurance Fund
SOE
State-Owned Enterprise
SRC
Salaries and Remuneration Commission
SSB
Sugar-Sweetened Beverages
TADAT
Tax Administration Diagnostic Assessment Tool
TFP
Total Factor Productivity
TOT
Turnover Tax
TSA
Treasury Single Account
TSC
Teachers Service Commission
UN
United Nations
UNCTAD
United Nations Conference on Trade and Development
UNODC
United Nations Office on Drugs and Crime
VAT
Value Added Tax
VIN
Vehicle Identification Number
WDI
World Development Indicators
WGI
Worldwide Governance Indicators
WRA
Water Resources Authority
WRUAs
Water Resources Users Associations
WSPs
Water Service Providers
WSS
Water Supply and Sanitation

Executive Summary

This Public Finance Review (PFR) for Kenya aims both to ensure that every tax shilling benefits the Kenyan taxpayer and to inform the development of a fiscal policy that fosters job creation, poverty reduction, and equity. Kenya's fiscal situation is precarious: public debt stood at 68 percent of gross domestic product (GDP) in 2024, and the risk of debt distress is high. Years of expensive public debt accumulation, the recent tightening of global credit conditions, and ballooning interest costs—which absorb over one-third of Kenya's public revenues—are shaping Kenya's current fiscal imbalances and prompting unpopular fiscal adjustment measures. The ambitious Finance Bill 2024 led to unprecedented protests and a social backlash that required its subsequent withdrawal; the Finance Bill 2025 is currently under review. Coupled with an economic slowdown and stalled poverty reduction, Kenya's fiscal outlook places the country at a crossroads. This PFR explores options for Kenya that look beyond the national budget to leverage fiscal and structural policies that can promote macroeconomic stability, economic growth, job creation, and poverty reduction, while improving governance.

Kenya is at a crossroads and can select from various options to shape its fiscal policy. The first option is to adopt a business-as-usual approach: continue on the current pathway, which is more recently characterized by fiscal slippage and prolongs the risk that a liquidity problem turns into a solvency issue that could affect debt sustainability. The second option relies on the implementation of severe austerity measures, which have distributional consequences and have shown mixed results. Yet a third pathway is possible. This PFR proposes as the way forward a fiscal consolidation strategy that combines interventions to simultaneously address fiscal imbalances and weak governance, low progressivity of the budget, and productivity and jobs challenges. Beyond tackling key fiscal policy challenges—such as domestic revenue mobilization, debt sustainability, and resource allocation—fiscal policy in Kenya needs to be part of a broader policy agenda for inclusive and sustainable economic development.

This PFR explores policy measures that could reduce Kenya's debt-to-GDP ratio by about one-third within 10 years, returning the country to a position closer to its debt level of the 2010s, when the debt buildup began. This scenario takes into consideration increasing economic growth, real wages, and consumption across society. Under this scenario, it is estimated that Kenya's debt-to-GDP ratio would fall to about 44 percent of GDP by 2035, close to the mid-2010s figure. Real wages and consumption could rise by about 4 percent if all reforms are implemented, and GDP growth and labor productivity by 7.1 and 6.4 percent respectively.

The current fiscal situation reflects two underlying constraints. First, fiscal imbalances reflect Kenya's unsustainable growth performance since the beginning of 2010s coupled with inefficient and distortive fiscal policies. Past economic growth relied heavily on debt-financed infrastructure investment. Yet many of those investments did not yield sufficient returns as productivity remained flat, generating macroeconomic imbalances and debt overhang. Moreover, fiscal policy also generated distortions. Inefficient tax incentives resulted in an uneven 'playing field' for businesses, further aggravated by an increasing proliferation of state-owned enterprises (SOEs), which, in many cases, operate in competitive sectors and have often become a fiscal burden. Given shallow domestic financial markets, government borrowing risks crowding out credit to the domestic private sector. Kenya's devolution agenda adds additional complexities.

The second constraint is that insufficient provision of public services and concerns about governance have weakened the social contract. Afrobarometer data show that trust in public institutions, a reflection of the social contract, has eroded in recent years, with less than 50 percent of the Kenyan population having trust in most political and government institutions. Kenya currently ranks in the bottom third of countries on Transparency International's Corruption Perceptions Index. In 2024, 60 percent of the Kenyan population believed that corruption had worsened, according to Afrobarometer. Public resources are perceived to be diverted toward rent-seeking activities rather than essential public services: there is dissatisfaction with the Kenyan government's management of the economy. Since public resources are not considered well spent, there is little social support for higher taxes. Any fiscal consolidation strategy must, therefore, consider how to rebuild trust, including by improving the efficiency of spending and public policies that support jobs

and higher incomes. This requires deficit reduction to be placed within a broader vision of stable and sustainable development, where fiscal policies reinforce macroeconomic stability while promoting equity, efficiency, and inclusion.

As a result of these two constraints underlying the current fiscal situation, Kenya's fiscal policy has contributed to the continuous decline of tax revenues. Weak income tax performance and, overall, Kenya's overly narrow tax base is the country's Achilles' heel in terms of its ability to tackle ongoing macroeconomic imbalances. Tax rates in Kenya are not low vis-à-vis international peers, but the country has seen a continuous decline in its tax base since at least 2013. Kenya's main drivers of growth and biggest sectors of the economy—the agricultural and nontradable services sectors—are hard to tax and thus tax productivity is low. Exports as a share of GDP have halved since the beginning of last decade, Kenya's manufacturing sector has shrunk in GDP terms, and the overall competitiveness of the economy has dropped. The share of wage employees has fallen, real wages have declined, and youth entering the labor market struggle to find productive jobs. Many businesses' profits have come under pressure, and several international businesses have exited the country citing an unfavorable business environment. Tax exemptions and trade barriers have further narrowed the tax base and hampered the competitiveness of the economy. Thus, personal and corporate income taxes, as a share of GDP, have also fallen.

The Kenyan government has been implementing overarching reforms to increase revenues, contain the budget, and address systemic inefficiencies. In response to the revenue shortfall due to the rejection of the Finance Bill 2024, the government announced a reduction in the 2024/25 budget of approximately 12 percent. With the Tax Laws (Amendment) Act, 2024, the government introduced changes to the computation of pay-as-you-earn, a reduction in the capital gains tax rate, and amendments to the Income Tax Act, among others. Several cost-cutting and efficiency measures have been enacted and are being implemented, including the rollout of the Treasury Single Account and e-Procurement, dissolution of 47 state corporations, and elimination of certain allowances for public sector workers. These steps contribute positively toward a sustainable fiscal consolidation path.

A reduction in capital expenditure has supported fiscal consolidation, but budget inefficiencies and fiscal slippages, high interest payments, and weak governance are hampering service delivery, while pending bills are soaring. The fiscal deficit has reduced from its peak of 8.1 percent of GDP in 2016/17 to 5.1 percent in 2023/24—the government expects a similar outturn for 2024/25. Pending bills (arrears) have been increasing as spending needs, spending inefficiencies, weak cash management systems, and fiscal consolidation objectives clash.

The budget has also become more rigid. Increased public debt coupled with recent increases in global and domestic interest rates have pushed up debt servicing costs. Interest payments now crowd out spending on many important public services, including social protection for the poorest members of society, and flagship government programs, like universal health coverage, are inadequately funded. Inefficiencies in public investment management, procurement, and practices around public–private partnerships generate further unnecessary costs—and some programs, like the current fertilizer program, can be both regressive and inefficient. Although the wage bill has significantly consolidated, there is scope to strengthen human resource management, especially at the county level, and rationalize excessive allowances, to make room for productivity-enhancing public investment.

Structural policies need to complement fiscal policies to increase the tax base and funding for service delivery. This is, however, challenging in the context of Kenya's low tax productivity, rigid budget, and weak governance, which calls for a holistic fiscal consolidation strategy. Low tax productivity implies that increasing taxes will yield limited revenue gains. Overall, it is hard to tax personal incomes when the economy is not generating sufficient formal jobs and when real wages are falling, or to further tax corporate incomes when profits are under pressure and the economy is losing competitiveness. Reducing expenditure is tough with 53 percent of total revenues already allocated to interest payments and county transfers. Adding public wages, salaries, and pensions increases this to 86 percent of revenues, leaving little fiscal room for development and capital spending. Moreover, any further cuts in capital spending could damage provision of basic services and counteract the reforms. Finally, there are severe governance challenges that result in leakage of public funds and weak project implementation.

There is room to increase the progressivity of the national budget. A progressive budget ensures that public resources are allocated in a way that promotes equity, reduces poverty, and supports inclusive growth. It expands access to essential services and builds human capital. It also enhances social cohesion and stability by reducing inequality and enabling broader participation in economic opportunities, focusing on those interventions with the highest social returns. Kenya's fiscal system is already relatively progressive, but there is significant potential to enhance its contribution to poverty reduction.

A range of policy options can make fiscal policy a driver of prosperity in Kenya, by promoting welfare and equity while enabling fiscal consolidation in a challenging context. In certain cases, there are opportunities to raise the productivity and equity of taxes and the efficiency of spending. In other instances, the challenges are more complex and may be better addressed by integrating tax and expenditure measures with structural reforms. These include structural reforms aimed at expanding the size of the economy to reduce the number of individuals adversely affected. Such measures can make the reforms more progressive and socially acceptable. The recommendations of this PFR focus on measures that (1) strengthen fiscal sustainability; (2) enhance equity; and (3) remove distortions, reviving economic growth, raising productivity, and increasing real wages—a measure of jobs quality.

This PFR recommends revenue policies focused on enhancing the efficiency and equity of the tax system while reducing tax exemptions and distortions that further narrow the tax base and repress growth. In certain areas, especially leasehold rents and property taxation, there are clear opportunities to raise additional revenues. While land- and property-based taxes are generally nondistortionary and have the capacity to provide stable, predictable long-term revenues, they are administratively complex and require significant upfront and notable ongoing investments in systems and training. They also rely on a commitment to enforce nonpayment. In addition, the current property tax system in Kenya would benefit from legislative reform, which has a significant lead time and no guarantee of success. The narrow tax base, insufficient progressivity, and numerous exemptions—which distort the market and reduce revenues—limit the space for additional taxes, however. Key reforms, summarized in table ES.1, include the following:

- Promote the progressivity of the tax system and formalization by reforming personal income tax (PIT) and payroll levies; simplifying the tax regime for micro, small, and medium enterprises; and phasing out mortgage interest rate deductions (*to contribute about 0.25 percent of GDP in additional revenues per year*).
- Strengthen the efficiency of income tax incentives and broaden the income tax base by rationalizing tax exemptions in PIT and corporate income tax (CIT), which tend to be inefficient and regressive (*up to 2.2 percent of GDP in additional revenues per year*).
- Strengthen the efficiency of value added tax (VAT) exemptions and broaden the tax base by removing VAT exemptions with limited progressivity. (*To minimize adverse effects on poverty and consumption, VAT reform should focus on regressive exemptions and be considered only as part of a broader package of policies.*)
- Better capture the value of real estate at the national and county level by raising leasehold rents and reforming county-level property taxes respectively (*at least 0.14 percent of GDP in additional revenues per year, split between the national government and county governments*).
- Correct for externalities (that is, input use and consumption that hurt society), including through a carbon tax on fuel and higher excise taxes on alcohol, tobacco, and sugar-sweetened beverages (*0.18 percent of GDP in additional revenues by 2030 from a carbon tax on fuel, including revenue recycling to protect poor members of society; and up to 0.6 percent of GDP in additional revenues per year from health excise taxes*).
- Strengthen tax compliance through better enforcement mechanisms, better taxpayer education, and simplified tax procedures (*up to 0.6 percent of GDP in additional revenues per year*).

Table ES.1. Summary of Recommendations for Revenue Policy, and Impacts on Productivity, Equity, and the National Budget

Objective	Policy recommendation	Impacts		
		Productivity	Equity	Budget Revenues*
Promote formalization and progressivity by reforming personal income tax (PIT)	Adjust tax rates for top and bottom decile earners to reduce the average PIT rates and levies on low-wage workers	+	+++	Up to +0.2 per year
	Phase out mortgage interest rate deductions	++	+++	Up to +0.05 per year
	Align capital income tax (CIT) rates more closely with PIT rates	+	+++	Positive
	Implement a single tax rate of 15 percent on dividends	+	+++	Positive
Promote formalization and progressivity by reforming the tax regime for micro, small, and medium enterprises	Reform the turnover tax (TOT) by increasing the value added tax (VAT) registration threshold and aligning it with a reduced TOT maximum threshold, and align the TOT filing and payment period with the assessment of the exemption threshold	++	++	Neutral to positive
Strengthen the efficiency of tax incentives	Phase out CIT exemptions, including: (1) for collective investment schemes; and (2) from capital gains tax	++	++	Up to +1.2 per year (combined)
	Remove capital gains exemptions on: (1) transfers to immediate family members; (2) companies with a 100 percent family shareholding; (3) private residences occupied for three years; and (4) any capital gains realized as a result of internal group restructurings Repeal the tax exemption on dividend payments made by special economic zone (SEZ) enterprises	++	+++	Up to +1.0 per year
	Place a moratorium on new incentives for SEZs and export processing zones (EPZs), pending a review on the rationale for and practice of incentives, and revisit and grandfather existing incentives pending the review outcome	+++	+	Positive
	Reform VAT to eliminate certain regressive exemptions as part of a set of policy packages (see table ES.3)	+	-	Up to +3.4 per year (extreme scenario)
Capture value of real estate	*National level.* Improve coverage of properties; make improvements to the area-based valuation methodology of the ground rent calculation; strengthen enforcement and communications; and raise rates	+++	++	At least +0.05 per year
	County level. Update and simplify the property rate's legal system; streamline and standardize valuation methodologies; invest in property tax administration systems; and raise rates	+++	++	At least +0.09 per year
Correct for externalities (harmful effects on society)	Introduce a carbon tax on fuel at point of entry, and recycle revenues	+	+	+0.18 by 2030
	Raise excise taxes on alcohol, tobacco, and sugar	+	+	+0.3 to 0.6 per year
Strengthen tax compliance	Register all VAT taxpayers on e-TIMS, automate tax exemptions, and expand scope of e-Citizen platform	+	+	Up to +0.6 per year

Source: Original table for this report, based on chapter 2 of the report.
Note: A + symbol indicates a fiscal saving, reduced distortion, or improved progressivity; a - symbol indicates higher funding needs, increased distortion, or reduced progressivity. Additional symbols denote relatively stronger effects (as determined by a World Bank staff assessment).
*Percentage points of gross domestic product [GDP].

Moreover, this PFR recommends a range of measures to improve expenditure efficiency and equity, while creating fiscal space for development policies. A relatively large wage bill, transfers to SOEs, weaknesses in public financial management, and inefficiencies in expenditure across various sectors undermine adequate service delivery for citizens. In some cases, spending claims remain unsettled, as the government has accumulated pending bills that amount to more than 4 percent of GDP. Key reforms, summarized in table ES.2, include the following:

- Strengthen the efficiency and compliance of the public wage bill, bringing it in line with the requirements of the Public Financial Management Act by fully rolling out the Human Resource Information System – Kenya (HRIS–Ke) to enhance payroll control while reducing the travel budget and enforcing compliance with allowance-related directives (*to contribute about 0.4 to 0.5 percent of GDP in expenditure savings per year*).

- Limit liabilities from SOEs by accelerating divestment, particularly of commercial SOEs in the competitive sector, and advancing ongoing efforts to rationalize and merge entities to improve efficiency and reduce fiscal risks. In addition, enhance the effectiveness of transfers, subsidies, and grants by linking them to measurable performance outcomes (performance-based contracts), and prioritizing them based on socioeconomic impact and delivering on public policy obligations. At the same time, privatization processes must be transparent, open, and accompanied by competition safeguards and sectoral reforms to avoid the creation of privatized entities with undue market power (*up to 0.26 percent of GDP in expenditure savings per year*).

- Improve public financial management by (1) strengthening public investment management through regular monitoring of the project portfolio and improved contract management: (2) strengthening public procurement through the rollout of e-GP; (3) strengthening the public–private partnership framework; and (4) rolling out the Treasury Single Account (*for a total of up to 1.0 percent of GDP in expenditure savings per year*).

- Raise efficiency in health, education, social protection, water supply and sanitation, and agriculture through sectoral reforms. (*To improve service delivery, it is necessary over the next five years to raise spending on health by 3 percent of GDP, education by 1 percent of GDP, and social protection funding by at least 0.3 percent of GDP. Also needed are the adjustment of water tariffs and the resolution of legacy debt in county water utilities. Raising the efficiency of fertilizer subsidies through better targeting, eliminating public procurement, and improving distribution can yield expenditure savings of up to 0.1 percent of GDP per year.*)

Table ES.2. Summary of Recommendations for Expenditure Policy, and Impacts on Productivity, Equity, and the National Budget

Objective	Policy recommendation	Impacts		
		Productivity	Equity	Budget Savings*
Strengthen efficiency and compliance of the public wage bill	Adopt a temporary hiring freeze for nontechnical positions to allow for a review of the efficient allocation of existing public servants; and strengthen establishment controls, including through implementation of HRIS-Ke	+	+	Up to +0.4 per year
	Reduce the budget for domestic and international travel budget by half and improve compliance, including through the use of an operationalized travel management module in IFMIS that interfaces with HRIS-Ke	+	+	+0.07 per year
Limit liabilities from state-owned enterprises (SOEs)	Divestment of SOEs in commercial and competitive sectors	+++	+	Up to US$1.2 billion
	Discontinuation of transfers to commercial SOEs and prioritization of transfers to SOEs that deliver on public policy obligations	++	+	+0.26 per year
Improve public financial management	- *Public investment management.* Strengthen project preparation and selection; accelerate PIMIS rollout and integration; enhance cross-government coordination - *Public–private partnerships (PPPs).* Ensure competitive biddings, and ensure investments follow the least-cost planning approach; ensure suitable technical design, clear terms, risk allocation, and performance standards; establish clear performance benchmarks and monitoring - *Procurement.* Fully implement electronic government procurement - *Cash management.* Fully transition to the Treasury Single Account	+++	+	Up to +1.0 per year
Improve service delivery	*Education.* Prioritize allocation of funds to underserved regions; implement results-based financing; adjust capitation grants for equity; strategically invest in infrastructure and leverage PPPs; expand digital and distance learning; and hire teachers	+++	+++	At least –1.0 per year
	Health. Strengthen capacity and equity (staffing, resources, and service delivery gaps); improve governance and efficiency (national–county coordination, pooling of procurement of medicines, and linking of funding to improved budget execution) and ensure sustainable financing; consider removing Social Health Insurance Fund contributions for low-wage earners	+++	+++	Up to –3.0 per year
	Water supply and sanitation. Raise tariffs to cost-recovery levels and recycle the fiscal savings into expansion of water supply and sanitation; resolve legacy debt in county water utilities	++	++	Neutral
	Social protection. Increase benefit levels from 2,000 to 3,000 Kenyan shillings per month for all current beneficiaries; strategic expansion of poverty-targeted cash transfer programs to cover a larger share of the population in the 10 poorest counties; strengthen shock-responsiveness of the National Hunger Safety Net Program	+	+++	–0.3 per year

	Social insurance. Reform National Social Security Fund to reduce costs and improve data accuracy through automation, while extending social insurance for informal workers via enhanced processes, awareness programs, and collaborative savings efforts	+	++	Neutral
	Agriculture. Reform the fertilizer subsidy program to target poor smallholder farmers, eliminate public procurement of fertilizer, and include agro-dealers in distribution	+++	+++	Up to +0.1 per year

Source: Original table for this report, based on chapter 3 of the report.
Note: A + symbol indicates a fiscal saving, reduced distortion, or improved progressivity; a - symbol indicates higher funding needs, increased distortion, or reduced progressivity. Additional symbols denote relatively stronger effects (as determined by World Bank staff assessment). HRIS–Ke = Human Resource Information System – Kenya. *Percentage points of gross domestic product [GDP].

Strengthening governance is critical. Weak governance results in the inefficient use of fiscal resources, which harms the economy in various ways. For example, energy tariffs in Kenya are among the highest in Africa, which is partly due to poor governance in power purchasing agreements with independent power producers. Another example relates to the police, the public institution that enjoys the lowest trust among the Kenyan population. This PFR estimates that bribes to traffic police result in potential forgone revenue of 88 billion Kenyan shillings (or 0.5 percent of GDP) per year. Considerable constraints are exerted on efficient service delivery by the public financial management system, from public investment management, procurement, and cash management to the public–private partnership framework. Improving governance will play a central role in improving service delivery and strengthening social support for reform.

The social acceptability of any fiscal consolidation strategy also hinges on its ability to increase the number of winners and minimize the number of losers, which requires not only fiscal interventions but also structural interventions and a focus on governance. The PFR analysis therefore proposes several policy packages that combine revenue, expenditure, governance, and structural measures to enhance the overall policy benefits and minimize any negative impacts. These packages are designed to leverage complementarities across different policy areas, creating synergies that enhance their overall effectiveness and political feasibility. They focus on rebalancing the relationship between (1) the state and its citizens (policy package 1); (2) the public and private sectors (packages 2 and 3); and, consistent with the Kenyan government's strategic focus, (3) consumption and investment (packages 4 and 5). Modeling identifies significant impacts of the policy packages on economic growth (by removing distortions and raising productivity), jobs (through equity and productivity gains), and public debt (through fiscal savings and higher economic growth), as summarized in table ES.3.

- Policy package 1: From rents to public services

  This package focuses on strengthening governance and tackling rent-seeking (corruption) to rebuild trust in the government. Key components include strengthening the public financial management system, complemented by a strong conflict of interest framework, improved Anti-Money Laundering / Countering the Financing of Terrorism provisions, enhanced accountability of the traffic police, and stronger governance in business licensing. The impact of this package is expected to be a 3.0 percent increase in GDP over the next 10 years, relative to business as usual; an increase in real wages by 0.5 percent; and an 11.2-percentage point reduction in the debt-to-GDP ratio. Fiscal savings could be used to fund critical public services and build further social support for the adjustment path.

- Policy package 2: From a defensive to a competitive private sector

  This package focuses on improving the productivity of the economy by removing inefficient distortive measures, including by leveraging fiscal and structural policies, and is embedded in the broader context of implementing the African Continental Free Trade Area. Fiscal measures in this context include reducing CIT while tightening dividend taxation and rationalizing corporate tax exemptions. The 10-year impacts for the fiscal reforms within this package, relative to business as usual, include GDP growth of 1.9 percent, real wage growth of 1.5 percent, and a reduction in the debt-to-GDP ratio of 7.6 percentage points.

- Policy package 3: From public to private firms

This package focuses on reforming the role of SOEs in the economy, promoting divestiture in competitive sectors and improving corporate governance in the remaining SOEs. Competition policy measures should accompany divestitures to level the 'playing field' and raise productivity, thus maximizing the gains from divestiture. The potential proceeds from privatizing SOEs in competitive sectors reach US$1.2 billion, while the broader reform package could generate GDP growth of 1.0 percent, real wage growth of 1.2 percent, and a reduction in the debt-to-GDP ratio of 4.6 percentage points, relative to business as usual.

- Policy package 4: From subsidizing consumption to supporting the poor

This package addresses the challenges of inefficient and regressive consumption and production subsidies. It suggests removing VAT exemptions that barely benefit poorer members of society, complemented by the introduction of additional pro-poor revenue measures, as well as reforming the fertilizer subsidy program to raise its efficiency and target poor smallholder farmers. This package reduces aggregate demand and therefore GDP; however, the effect is cushioned by the capacity to pay down particularly distortive government liabilities—pending bills—in addition to other government debt. Although economic growth slows, agricultural growth increases, which, together with higher social transfers, promotes food security as well as poverty reduction and equity. The 10-year effects relative to business as usual include a 0.1 percent decline in GDP, a 0.4 percent reduction in real wages, and a reduction of 5.9 percent in the debt-to-GDP ratio. The fiscal gains of this package could be realized quickly, but its adverse effects on growth, consumption, and wages call for this package to be combined with one or more other packages.

- Policy package 5: From consumption cities to production hubs

This package leverages property taxation and savings from the public sector travel budget to promote productivity growth in Nairobi and Naivasha while lowering the cost of living and reducing pressures on the public sector wage bill. This will help these cities to depend less on public consumption and become engines of growth and jobs for the whole country. The 10-year impacts of the package, relative to business as usual, for all of Kenya include GDP growth of 1.2 percent, real wage growth of 1.2 percent, and a reduction in the debt-to-GDP ratio of 1.3 percentage points.

Table ES.3. Summary of Policy Packages, and Impacts on Growth, Jobs, and Public Debt

Objective	Policy recommendation	Impacts		
		GDP (%deviation from baseline in 2035)	Real wages (% deviation from baseline in 2035)	Debt to GDP ratio*
Policy package 1: From rents to public services	Conflict-of-Interest and Anti-Money Laundering/Combating the Financing of Terrorism policies; public financial management measures; instant fines/business regulations; reduced public domestic borrowing	+2.98	+0.46	-11.19
Policy package 2: From a defensive to a competitive private sector	Competitiveness and competition measures; reduction in the corporate interest tax rate (to 25%) and increase in the dividend tax rate	+1.86	+1.46	-7.6
Policy package 3: From public to private firms	Promote a level playing field while divesting of SOEs in competitive sectors	+0.96	+1.23	-5.47

Policy package 4: From subsidizing consumption to supporting the poor	Reform VAT (remove value added tax exemptions for goods with low consumption by the poorest members of society) and excise taxes on environmental and health externalities, while raising social protection transfers and paying down pending bills	-0.11	-0.43	-5.88
Policy package 5: From consumption cities to production hubs	In Nairobi, leverage property taxes to reduce the distortive effects on prices in Nairobi, increasing housing supply and supporting densification. In Naivasha, recycle one-quarter of savings from the public travel budget to leverage private finance to promote tourism	+1.23	+1.16	-1.33

Source: Original table for this report, based on chapter 4 of the report.

Note: Individual effects are per year and combined effects are by 2035. GDP and real wage figures indicate the deviation relative a fiscal slippage scenario, while public debt figures show the percentage point change in the debt-to-gross domestic product (GDP) ratio. *Percentage point deviation from baseline in 2035

Successful implementation of these policy recommendations requires a carefully sequenced approach that considers their political economy and potential social impacts. Prioritizing reforms that generate quick wins and build public support is crucial to create momentum and foster a sense of shared ownership. Eventually implementing all measures, including the full suite of the five policy packages, will have the largest impact. Regular monitoring and evaluation are essential to track progress, identify challenges, and enable necessary adjustments. Strong stakeholder engagement and communication are also vital to ensure that the reforms are transparent, and that the government is held accountable for policy implementation.

The first and immediate priority is to restore the credibility of the national budget and ensure that the fiscal accounts remain sustainable. Currently, Kenya's fiscal policy lacks credibility owing to slippage of fiscal targets for both revenue and expenditure, leading to frequent tax policy changes that undermine confidence and investment. Social support for fiscal tightening is weak, as fiscal policy is perceived as unfair and undermined by rent-seeking behaviors, while service delivery remains inadequate and does not support job creation. In the short term, to be considered for the FY2025/26 budget or the first supplementary budget of FY 2025/26 (next one to three months), a focus on governance interventions (policy package 1), consumption taxes (policy package 4), and additional tax measures that promote equity can generate social support for revenue measures by reducing fiscal leakage while raising substantial revenue. This could be complemented by expenditure-side measures that can be speedily introduced, such as halving the public sector travel budget, or reducing the budget for fertilizer subsidies as a first step toward reforming the fertilizer subsidy program. Ensuring adequate funding for social protection remains also a short-term priority. Governance measures such as the introduction of strong legislation on conflicts of interest (along with implementing regulations) and county licensing regulations could also be put in place almost immediately. Various other institutional reforms that are already quite advanced and could be accelerated over the next six to 12 months to yield results include the rollout of e-Procurement, the Treasury Single Account, and instant fines, all of which will generate savings while improving service delivery.

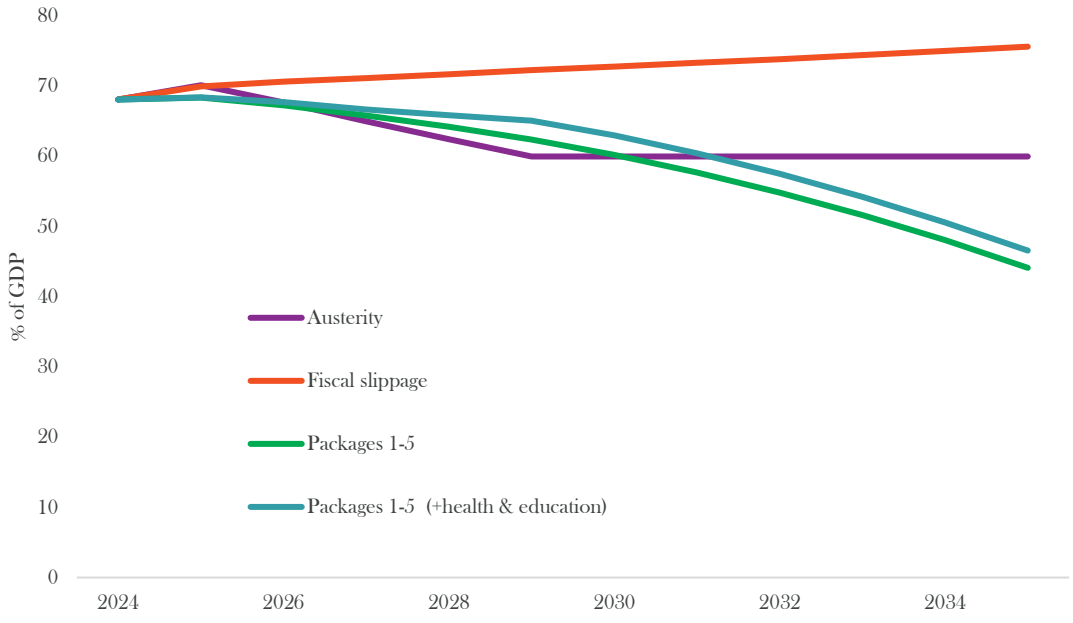
The second priority, for the short to medium term, is to strengthen fiscal policy through the addition of structural and governance measures that can deliver equity, productivity, and jobs, and further build fiscal space. This involves reforming fiscal policy to be less distortionary and more equitable, complemented by structural measures; significant progress could be achieved over the next 12 to 24 months. It is also critical to address Kenya's structural fiscal and governance challenges, which include public financial management, management of the wage bill (including allowances), and revenue administration. Removing distortions that undermine job creation, such as the current structure of PIT and levies, can promote equity and broaden the tax base. Policy packages 2, 3, and 5 advance fiscal and structural policies to enhance growth, job creation, and revenue mobilization. A review of the current system of tax incentives—to ensure that it delivers the intended benefits, such as additional investment and jobs—will be essential to lift any moratorium on new tax incentives that may be put in place.

The third priority is to raise additional revenues to adequately fund efficient public services. Many public services in Kenya are inefficient and underfunded, a situation that necessitates key reforms to raise efficiency and equity, especially in sectors like health, education, water supply and sanitation, social protection, and agriculture. Kenya's current domestic resource mobilization of less than 15 percent of GDP is insufficient for adequate service delivery, with health and education alone estimated to collectively require an additional 4 percent of GDP. Implementing reforms to raise spending efficiency will improve standards of living and create support for better funding. As revenues rise with improved economic growth, tax buoyancy, and tax productivity over the next two to three years, more and better public services can be funded, facilitating compliance with legal obligations under the Public Financial Management Act to keep wage bill growth in line with revenue benchmarks.

It is possible to promote equity, jobs, growth, and fiscal and debt sustainability in Kenya. Combining all policy packages and comparing them to business as usual (fiscal slippage) and to an austerity scenario makes it possible to evaluate the power of the abovementioned reforms to promote development in Kenya (figure ES.1). The business-as-usual scenario, which incorporates fiscal slippages would eventually result in unsustainable debt. Austerity would reduce the public debt burden to the 2029 target of 55 percent of GDP in net present value terms, but with limited growth and jobs results and uncertain social costs. The five policy packages presented in this PFR can also help Kenya meet its debt target—but inclusive of growth, jobs, and social dividends. Moreover, combining the five packages creates the necessary funding to increase social spending in health and education.

Looking beyond the budget, by implementing fiscal, governance, and structural reforms, Kenya can achieve fiscal sustainability while creating jobs and generating services. This PFR provides a range of policy options for the country to achieve these outcomes in the shorter and longer term.

Figure ES.1. Public Debt to GDP ratios under the Kenya Public Finance Review Scenarios



Source: Original figure for this report, based on chapter 5.

Chapter 1.
The Case for a New Approach to Fiscal Policy in Kenya

The current fiscal imbalances in Kenya reflect an unsustainable growth path, coupled with inefficient and distortive fiscal policies. The public sector-driven and capital-intensive investment growth during the 2010s yielded suboptimal dividends to Kenya's citizens. It failed to significantly crowd in private investment, build sufficient buffers to stabilize the economy, or ensure adequate productivity gains that drastically raise real wages and create more quality jobs. It did, however, create fiscal vulnerabilities that now challenge the country. It also tilted the economy toward nontradable services, hurting the formal sector and particularly merchandised tradable sectors such as commercial agriculture and manufacturing. This imbalance eroded Kenya's tax base as most firms and workers operate in informal nontradable sectors.

In pursuit of recapturing the tax base—without activating adequate social safety nets and control systems—Kenya's fiscal policy created additional distortions, which were accompanied by an increase in the size and footprint of the state. Managing the economy and the public administration seems to have become more complex, including the management of the wage bill, public infrastructure, procurement, and state-owned enterprises (SOEs). As efficiency and governance issues become more prevalent, fiscal policy may also have created an environment where rent-seeking behaviors become easier, undermining both the progressivity of the fiscal system and trust in public institutions.

Kenya needs more progressive and efficient public finances that not only allows to adequate finance spending for fiscal consolidation but also support businesses and households in creating jobs and strengthen the social contract. This chapter explains the motivation behind the Kenya Public Finance Review and presents a framework to evaluate fiscal policy considering the challenges facing the economy.

1.1. Kenya's Recent Macro-Fiscal Performance

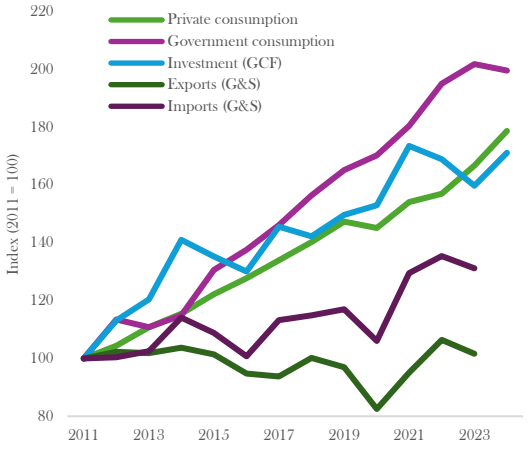
From 2010 and up until the onset of the COVID-19 pandemic, Kenya seized opportunities presented by the global low-interest environment to invest in its infrastructure. During the 2010s, an ambitious infrastructure development agenda spurred growth in construction, public consumption, and investment, creating demand for domestic services. Through high public sector investment and spending, the Kenyan government aimed to lay the foundations for strong long-term economic growth, anchored in the Kenya Vision 2030. The country invested in new infrastructure projects, fueling public investment spending. Moreover, Kenya introduced changes in its governance structure by introducing a devolved system of government that was enshrined in the 2010 constitution. The first county governments were thereafter elected to office in 2013 and given the mandate to promote social and economic development. Between 2005/06 and 2011/12, government investment more than doubled as a share of gross domestic product (GDP)— only falling since 2017/18— and government consumption expenditure growth averaged 6.5 percent per year from 2011 to 2019 (figure 1.1 and figure 1.2). The resulting 4.6 percent average real GDP growth during the 2010s initially translated into rising incomes, poverty reduction, and improved standards of living.

To finance this growth agenda, the country drew in public and foreign savings in the form of wider fiscal and current account deficits, backed by external inflows. External borrowing—bilateral, private, and concessional—provided major foreign exchange inflows to finance Kenya's growth; at the same time, the fiscal and current account deficit widened (figure 1.3). As a result, Kenya's public debt burden grew sharply, and the stock of debt more than doubled to 73.2 percent of GDP by end-2023, from 35.7 percent of GDP in 2011. Further, the share of expensive non concessional borrowings increased, with spending on interest as a share of government revenue almost tripling between 2014 and

2023 (figure 1.4). Kenya's total investment exceeded the amount of private domestic savings in the economy and thus financed itself by running twin deficits—domestic and external.

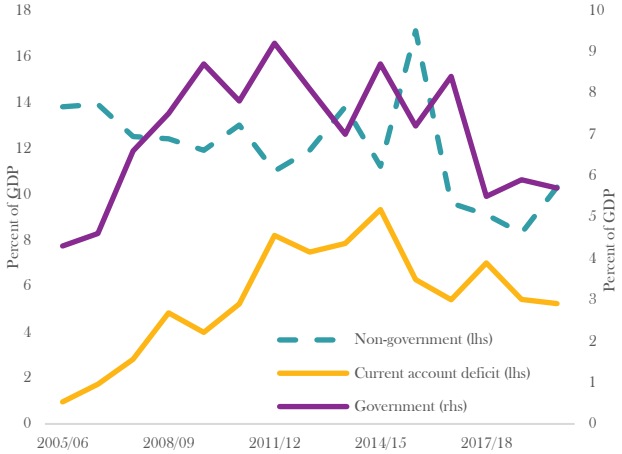
Kenya's economic growth has been driven mostly by the public sector, at the same time the fiscal and current account deficits expanded

Figure 1.1. Real Gross Domestic Product Growth by Expenditure Category (Index 2011=100)



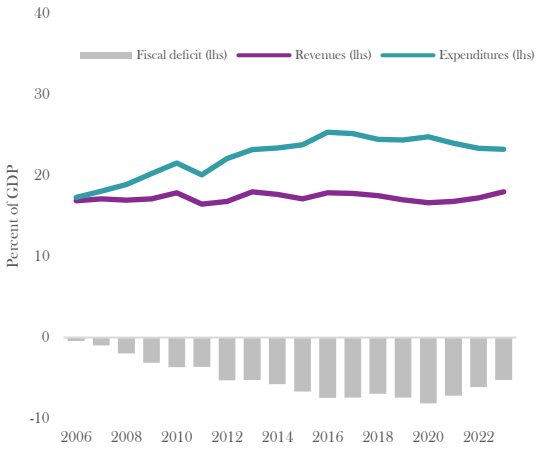
Source: Kenya National Bureau of Statistics, 2025.
Note: Exports and imports data is shown until 2023 and do not reflect revisions made in the Kenya Economic Survey of 2025.

Figure 1.2. Government and Nongovernment Investment, and Current Account Deficit as a Percentage of Gross Domestic Product, FY2006/07–2019/20



Source: IMF, from Article 4s.
Note: The current account deficit is in calendar years, for example, 2005/06 = 2005.

Figure 1.3. Government Fiscal Accounts, 2006–23



Source: National Treasury of Kenya, Kenya National Bureau of Statistics, and International Monetary Fund data.

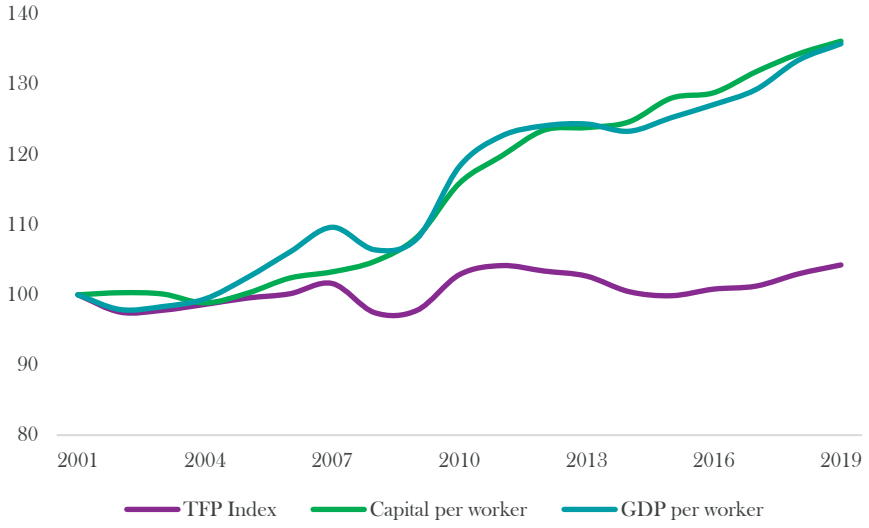
Figure 1.4. Interest Payments (% of Revenues) and Government Gross Debt (% of Gross Domestic Product), 2024

Source: World Bank *World Development Indicators* and IMF *World Economic Outlooks.*
Note: Global sample of 93 countries with available data for 2022.

The construction and public sector driven boom, however, generate limited growth and jobs dividends. The construction and public sector boom supported infrastructure development and capital per worker growth in the economy, which had positive changes in several sectors and regions of the country. However, total factor productivity—which measures the efficiency in using both capital and labor—grew little, just 0.3 percent per year, between 2001 and 2010, and not at all between 2011 and 2019 (figure 1.5). This accounts for much of the growth differential between Kenya and aspirational

peers, such as Bangladesh or Ghana (World Bank 2023a). New jobs were created—International Labour Organization (ILO) estimates suggest that total employment grew at an average rate of 2.7 percent per year between 2011 and 2019[1]—and on average, 800,000 people are joining the labor market every year (World Bank, 2024). Growing numbers of young workers joined the labor force, and while still most Kenyans live in rural areas, urbanization rates increased (World Bank 2023c). Labor force participation rates rose by 10 percentage points between 2006 and 2016, and unemployment decreased from 10 percent to 3 percent. Most new entrants to the labor market, however, found low-productivity, informal jobs in agriculture and low-productivity services, with the number of new formal jobs created annually amounting to less than 100,000 (prior to the onset of the COVID-19 pandemic).

Figure 1.5. Total Factor Productivity, Capital per Worker, and Gross Domestic Product per Worker Index (2001=100), Kenya



Source: Penn World Tables, 10.01.

At the same time, large public spending failed to significantly crowd in private investment and hindered Kenya's domestic firms. Public sector investment had limited crowding-in effects in the private sector, with multipliers particularly low compared with peer countries and even lower for foreign direct investment (FDI) (figure 1.6).[2] Given the productivity trends, it seems that public infrastructure investment did not substantially expand the country's production possibility frontier. On the contrary, as public domestic borrowing also increased, funds available to the domestic private sector became relatively scarcer (figure 1.7), pushing up real interest and appreciating the real exchange rate. An immediate effect was that foreign goods became cheaper relative to domestic goods, steering the economy toward the nontradable sectors—which are also dominant in the job creation trends—and damaging the competitiveness of the domestic private sector. At the same time, because of the accumulation of pending bills and arears by the government, domestic firms and suppliers have been experiencing cash flow issues, which contributed to rising nonperforming loans (NPLs) in the banking sector, which reached 17.2 percent by February 2025.

[1] International Labour Organization-modeled estimates (November 2022) are used in this section to describe employment dynamics and to calculate yearly productivity trends at the sectoral level. Although the number of jobs and sectoral shares differs from KIHBS 2005/06, KIHBS 2015/16, and KCHS 2019, as used in the *Kenya Jobs Diagnostic* series (World Bank 2023c), the trends follow a similar path and thus conclusions are similar.

[2] Kenya's structural and aspirational peers were selected through a data-led approach using the World Bank's available tools, in addition to conversations with stakeholders. Regional peers comprise Ethiopia, Ghana, Senegal, Tanzania, and Uganda, while aspirational peers include Bangladesh, Morocco, South Africa, Thailand, and Vietnam.

Figure 1.6. Foreign Direct Investment Inflows (Averages for 2011–19 and 2021–23), % of Gross Domestic Product

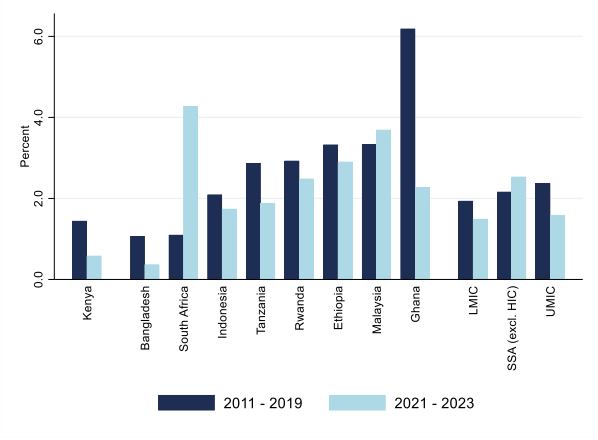
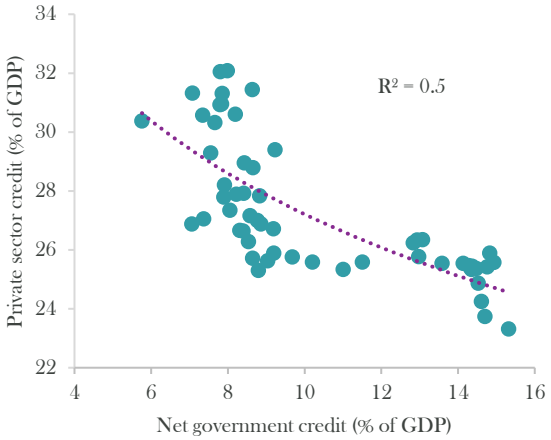


Figure 1.7. Private and Government Credit (% of Gross Domestic Product), 2010 (Q1) to 2023 (Q4)



Sources: World Bank staff calculations based on National Treasury of Kenya, Kenya National Bureau of Statistics, Central Bank of Kenya, and International Monetary Fund data.

Expensive debt accumulation without the associated returns generated macroeconomic imbalances that became evident after global economic conditions changed, calling for a new approach for Kenya's fiscal policy. Kenya's ability to access global financial markets was restrained following the COVID-19 shock, particularly between 2022 and 2024. Rapid interest rate hikes in advanced economies and uncertain global monetary conditions led to a substantial increase in borrowing costs for the country, leading to questions around its ability to successfully repay its obligations at a reasonable cost. This created a debt overhang situation and, in a context of limited external inflows, Kenya experienced severe liquidity challenges between these years given its large external financing needs—including for external debt repayments—which were met by increasing domestic borrowing. The stock of foreign reserves fell continuously, and the exchange rate depreciated until early 2024. These trends were only reversed after the macroeconomic outlook had improved through stronger macroeconomic policies, multilateral support, and better global market conditions.[3] Fiscal policy challenges and risks remain high, however.

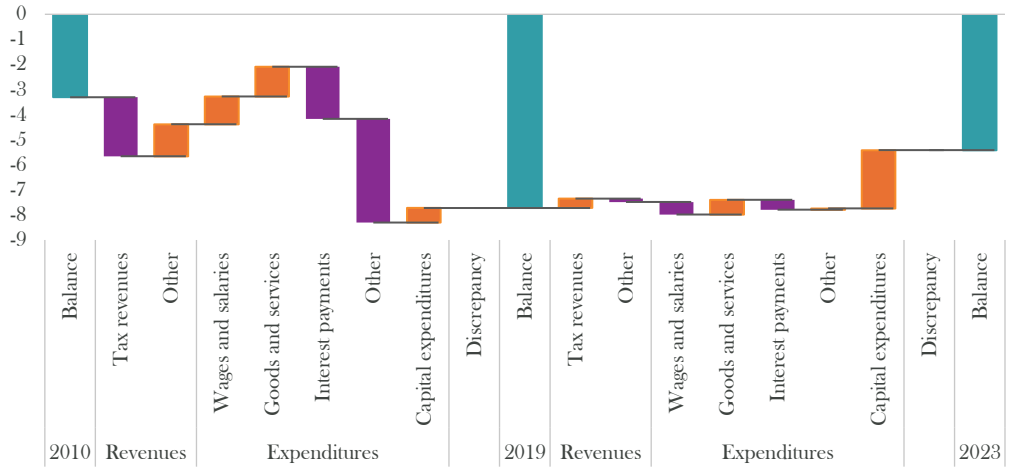
1.2. Kenya's Fiscal Policy Performance and Associated Risks

Kenya's fiscal balance worsened during the 2010s, largely due to decreasing tax revenues, capital expenditure pressures, rising interest payments, and transfers to SOEs (figure 1.8). Tax revenues fell from 16.2 percent of GDP in 2016/17 to 14.2 percent of GDP in 2023/24, while total expenditure, averaging 23.8 percent of GDP, peaked at over 26 percent of GDP in 2016/17 on account of the construction of the Mombasa–Nairobi Standard Gauge Railway. The fiscal deficit has remained above 5 percent of GDP since FY2012/13, hitting 8.2 percent in 2016/17. Fiscal consolidation efforts started in the mid-2010s but were hampered by the outbreak of the COVID-19 pandemic, which necessitated emergency response spending owing to unmet revenue targets and socioeconomic impacts.[4]

[3] In February 2024, when Kenya was benefiting from an improved macroeconomic outlook, stronger multilateral support, and improved global market conditions, the Kenyan government issued a US$1.5 billion Eurobond and bought back almost 75 percent of the Eurobond maturing in June 2024, but at a higher cost. Initially, this helped to ease market concerns, and the domestic currency appreciated by almost 20 percent in the weeks following this event.

[4] Fiscal measures included, among others, increased spending estimated at 40 billion Kenyan shillings (or 0.4 percent of GDP) to strengthen the health system's capacity, support the most vulnerable households, and ease businesses' liquidity constraints. Parliament also approved the Taxation Laws (Amendment) Act of 2020, providing income tax relief to low-income earners (less than 28,000 Kenyan shillings [equivalent to US$264] per month); reduction of corporate and individual income tax rates from 30 percent to 25 percent; reduction of turnover tax rate on all micro, small, and medium enterprises from 3 percent to 1 percent; and a reduction in the value added tax (VAT) rate, from 16 to 14 percent.

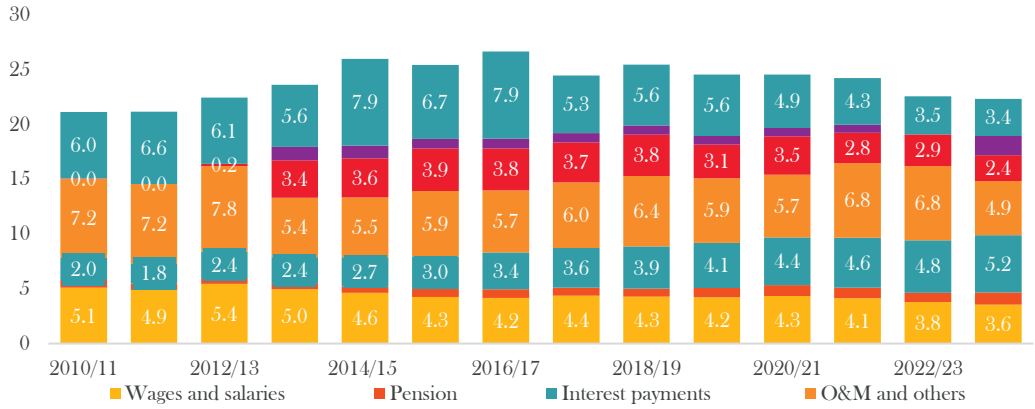
Figure 1.8. Drivers of Change in Kenya's Fiscal Balance (% of Gross Domestic Product), 2010–19 and 2019–23



Source: World Bank *World Development Indicators* and IMF *World Economic Outlook*.
Note: Purple represents a negative yield to the fiscal balance, while orange indicates a positive yield; both sum to the green.

More recent expenditure rationalization measures have been containing capital expenditures, but recurrent expenditures and high interest payments continue to challenge fiscal balances and create rigidities in the budget. Following the COVID-19 emergency, total expenditure decreased as capital expenditures (development expenditures) fell (figure 1.9). Interest payments fueled by expensive borrowings continued to rise, however, and by FY2023/24 had reached 5.3 percent of GDP and about a third of total revenues, restricting fiscal space for spending on social and productive sectors. Despite it's the non-discretionary nature of many recurrent expenditures, efforts to contain public wages and benefits were also implemented, including a mandate to freeze wages and hirings, reflected in spending on public wages and benefits falling to 3.6 percent of GDP in FY2023/24, down from a high of 5.4 percent in 2012/13.

Figure 1.9. Expenditures as a Share of Gross Domestic Product, by Category

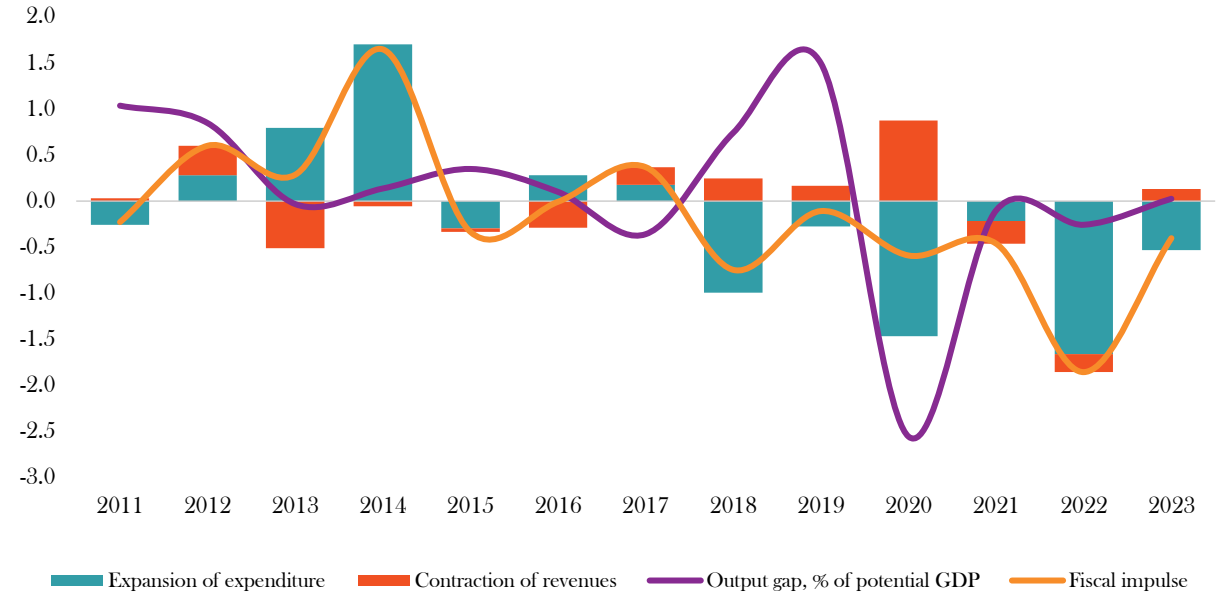


Source: National Treasury of Kenya.

Fiscal policy was procyclical for most of the 2010s, influenced by the global low-interest rate environment (Amra et al. 2019). Generally, fiscal policy should stabilize short-term output and be symmetrical (countercyclical), with debt accumulation during weaker periods balanced by debt reduction during upswings (World Bank, 2020). Owing to the low-interest rate environment and the commodity super cycle, Kenya's fiscal policy did not consistently aim for output stabilization. Figure 1.10 shows the cyclicality of fiscal policy relative to the output gap. The fiscal impulse measures how expansionary or contractionary the government's budget is for a specific year relative to the previous year. The figure

highlights that fiscal policy is often loosened during growth periods and tightened during weaker periods, rather than fiscal policy *systematically* leaning against the economic cycle. Public expenditure also appears procyclical, positively correlating with GDP at a higher coefficient than that of most peer countries.[5]

Figure 1.10. Fiscal Impulse and Output Gap (2011–23)



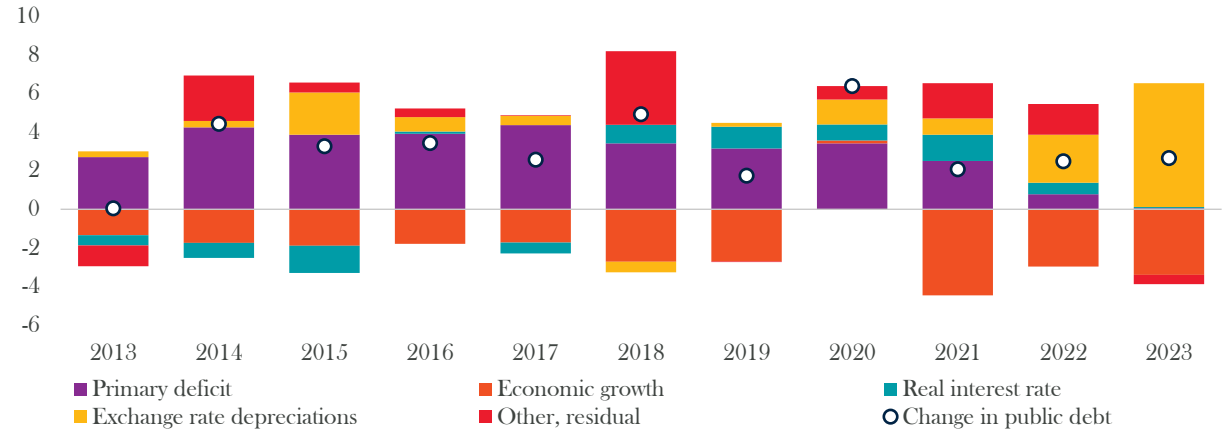
Source: World Bank staff estimates.

Debt-creating flows were primarily driven by persistent primary deficits, with public borrowing slowly switching from external to domestic debt over the years. Debt-creating flows were positive throughout the studied period, primarily driven by the country's expansionary balance sheet. Real interest costs started to add pressures from 2018 onwards; at the same time, there was a more gradual shift toward domestic debt, away from external debt, to finance the budget (figure 1.11 and figure 1.12). Between 2020 and 2023, the annual average real interest rate on domestic debt reached 6.4 percent; on external debt, it was 1.2 percent. In 2022 and 2023 especially, the exchange rate depreciation drove public debt upwards, but more recently it declined following exchange rate appreciation of about 20 percent between February and March 2024, and by end-2024 public debt stock stood at 65.8 percent of GDP. Yet even if recent Eurobond issuances are supporting short-term liquidity challenges, they come at a higher cost and are mostly paying for interest expenses rather than financing development investments.[6] Other critical non-debt creating inflows to finance the current account deficit, such as FDI, have been low (figure 1.6).

[5] The coefficient of the correlation between GDP and public spending cyclical components for Kenya is about 0.16 between 2011 and 2023, lower than for Bangladesh (0.6) but higher than for the rest of Kenya's peers: Ghana (0.13), Tanzania (0.04), Ethiopia (-0.07), Vietnam (-0.09), Uganda (-0.18), Senegal (-0.44), Thailand (-0.53), South Africa (-0.58), and Morocco (-0.67).

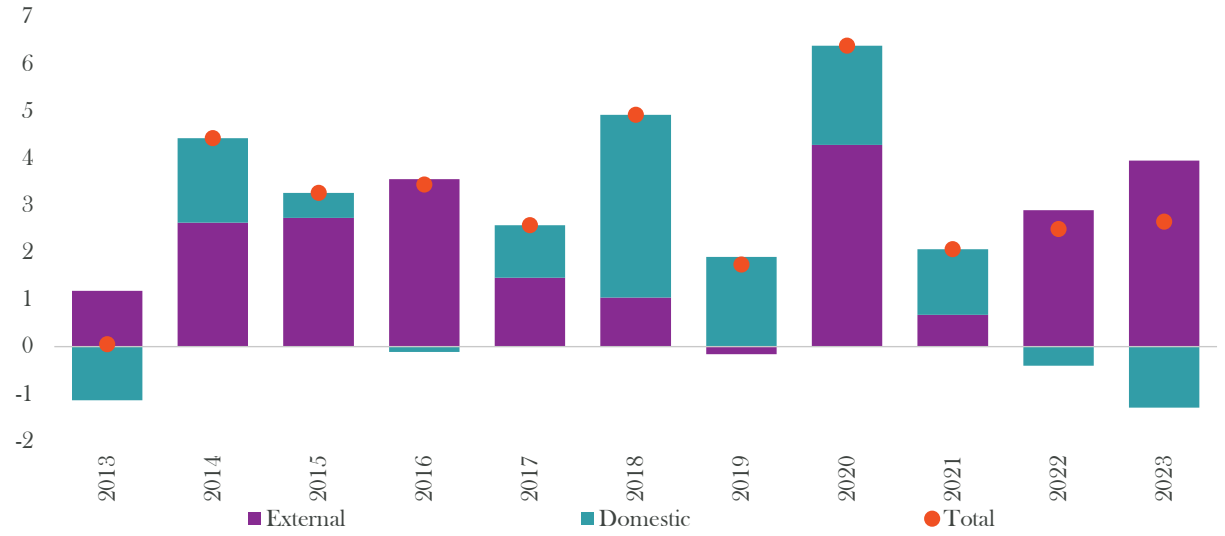
[6] The US$1.5 billion February 2024 Eurobond was issued at a 9.75 percent coupon rate and 10.375 percent yield and was used to partially buy back a 2014 Eurobond with a 6.785 percent coupon rate. In February 2025, Kenya issued another US$1.5 billion Eurobond for liability management, with a coupon rate of 9.5 percent and a yield of 9.95 percent. The plan was to buy back US$900 million of a Eurobond maturing in 2027, with investors accepting 64.4 percent of the total (about US$580 million).

Figure 1.11. Debt-Creating Flows (Percentage Points)



Source: World Bank staff estimates.
Note: The real interest rate effect includes the effect of changes in the nominal interest rate and inflation rate.

Figure 1.12. Changes in Debt, by Source (Percentage Points)

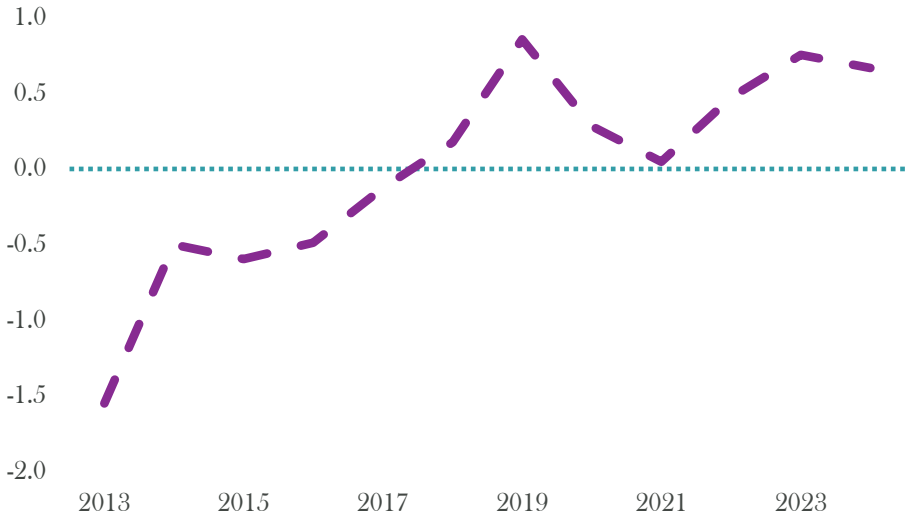


Source: World Bank staff estimates.

As a consequence of these dynamics, debt vulnerability risks increased. Following Doemeland et al. (2022), we estimate a risk index that captures liquidity, solvency, and institutional risks, and combines them into a single (normalized) debt vulnerability number that assesses the most important indicators of what makes debt vulnerable (Doemeland et al, 2022). For Kenya, we see that the risks associated with debt vulnerabilities have increased over time as debt accumulation has increased, now to a figure above its historical average (figure 1.13).[7]

[7] The standardized variables captured by the risk index are external debt (private, nonguaranteed); short-term external debt; external debt service; external debt stock; international reserves; dollar-denominated debt; amortization (PPG); the governance effectiveness indicator from the World Governance Indicators; nonperforming loans; external financing needs; and external amortization.

Figure 1.13. Risk Index Score (2013–24)



Source: World Bank staff estimates based on Doemeland et al. (2022).

Currently, the risk of external debt distress is assessed as high. The latest joint World Bank–International Monetary Fund low-income country debt sustainability analysis (November 2024) classifies Kenya at high risk of debt distress, with pressures on the external debt indicators highlighting significant challenges from exports and revenues (World Bank and IMF 2024). Under the baseline scenario, the external debt service-to-revenue and external debt service-to-exports ratios exceed the indicative thresholds, signaling that Kenya's external repayment obligations are large relative to its fiscal revenue and export earnings respectively. Although the maturity profile has improved, rising nonconcessional borrowing costs could further elevate the risk by increasing rollover and liquidity pressures.

Additional sources of fiscal risk in Kenya, especially from contingent liabilities, remain latent. Contingent liabilities stemming from SOEs and public–private partnerships (PPPs) constitute a significant fiscal risk to the country. With the government guaranteeing 100 percent of the due principal, interest, and other charges on loan guarantees to SOEs, materialization of these liabilities could pose fiscal challenges in the budget year when they occur. Although public guaranteed debt has declined from 1.8 percent of GDP in FY2016/17 to 0.6 percent in FY2023/24, it remains significant. In addition, several state corporations face liquidity challenges due to unfavorable revenue and economic performance and could face difficulties in servicing their short-term liabilities. In addition to guaranteed debt, 21 SOEs reported nonguaranteed debt collectively amounting to 0.5 percent of GDP (as at June 2024). This too represents a potential source of fiscal risk to the extent that the government implicitly backstops this debt and may find itself liable for it. Contingent liabilities from PPPs may arise from various sources including litigations, guarantees, indemnities, letters of support, and insurance. As at June 2024, over 140.7 billion Kenyan shillings (about 0.9 percent of GDP) in private capital had been mobilized through PPPs, with an additional projection of 120 billion Kenyan shillings (about 0.8 percent of GDP) for the next two years.[8]

Fiscal risks from climate-related shocks, which have already led to significant economic losses, stem from the country's vulnerability to climate change. Estimates suggest that more than 70 percent of natural hazard-induced disasters in Kenya are attributable to extreme climatic events, especially floods and droughts (World Bank 2023b). The repeating patterns of climate hazards in the country have had devastating socioeconomic impacts and given rise to associated fiscal risks. For example, the 2008–11 drought is estimated to have cost Kenya US$12.1 billion: US$0.8 billion from the destruction of physical and durable assets and US$11.3 billion from losses across all sectors of the economy (Republic of Kenya, 2012). Reducing greenhouse gas emissions and steering the economy toward a green development path, including through the implementation of green fiscal policies, is a key component in Kenya's ongoing development (World Bank

[8] A billion is 1,000 million.

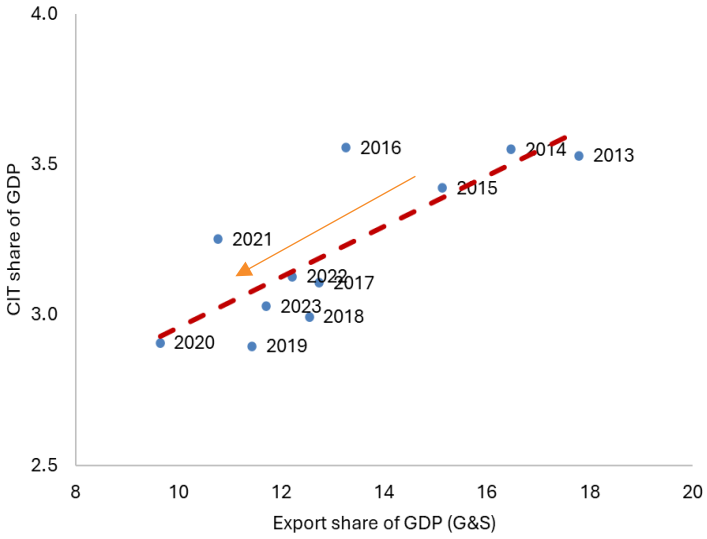
2023b). The susceptibility to climate-related shocks of Kenya's agricultural sector—which currently contributes over 30 percent of total employment in the country and 20 percent of GDP poses additional challenges.

Kenya's transition to a devolved system of government introduced fiscal risks arising from the financial demands of supporting the new county governments. To run the county governments, the 2010 Constitution of Kenya guarantees unconditional budgetary transfers from the nationally collected revenues to the county governments. This is in addition to each county's own source revenues from select taxes (for example, property and entertainment taxes), and fees and charges, to ensure that the county governments have the means and autonomy to provide public services. A potential fiscal risk arises from a mismatch between the funding allocated to the county governments and their service delivery obligations, which can lead to underfunding of essential services.

1.3. What Explains Kenya's Weak Fiscal Policy Performance?

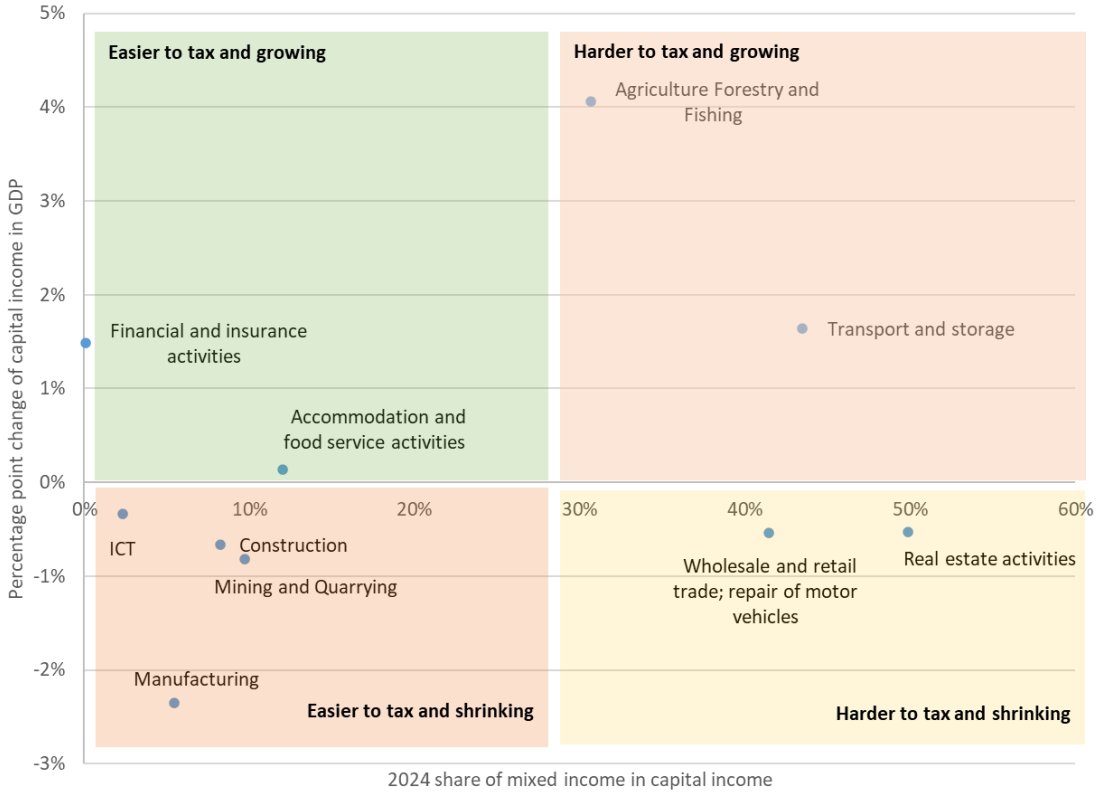
The continuous decline in tax revenues in Kenya is primarily associated with the declining competitiveness of the economy. First, the 2010s saw a continuous decline in corporate income taxes (CIT) as a share of GDP; at the same time, the competitiveness of the economy shrank. As tradable—that is, exporting—sectors fell as a share of GDP, so too did corporate income tax revenue (figure 1.14); much of this is explained by the falling share of the manufacturing value added, which fell from around 12 percent of the total in 2011 to 7 percent in 2021, its biggest recorded fall since the 1960s.The share of the manufacturing sector in GDP was largely absorbed by agriculture and services. Figure 1.15 shows that with this transformation, the share of mixed income rose in capital income, especially in sectors like agriculture and logistics. Mixed income tends to be harder to tax as it includes activities that tend to be associated more with the informal sector. A relatively uncompetitive and informal economy is sheltered by trade protections: high trade costs, now equivalent to a tariff of 100 to 200 percent, are raising both the price of exports and imports. The costs of internationally traded goods are therefore double or triple that of domestic goods. This not only has welfare implications for consumers but also requires firms to operate in a more inefficient environment.

Figure 1.14. Exports and Corporate Income Tax, Shares of Gross Domestic Product (2013–23*)*



Source: National Treasury of Kenya and World Development Indictors.
Note: Years for corporate income tax shares correspond to fiscal years, for example, 2023 = FY2023/24. G&S = Goods and services

Figure 1.15. Share of Mixed Income in Capital Income (2024), and Percentage Point Change of Capital Income in Gross Domestic Product (2014-24)

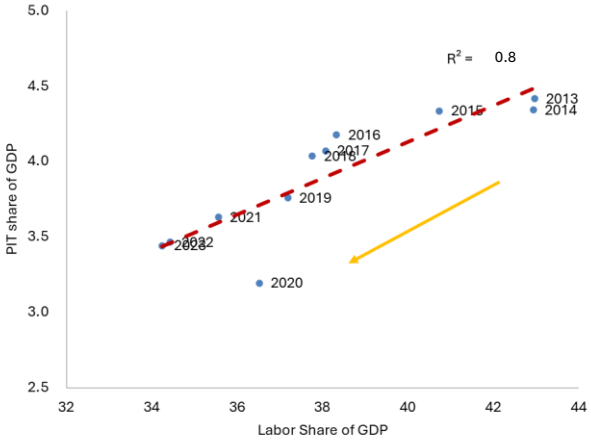


Source: World Bank staff estimates based on KNBS data.

Moreover, the strong association between declining labor shares in the economy and personal income taxes further emphasizes that poor quality job creation—mostly in hard-to-tax sectors—hinders the revenue base. While employment grew across Kenya's various sectors, most jobs were created in sectors where informality is high and taxation difficult, such as agriculture, commerce, and hospitality. The share of wage employment in total nonfarm employment declined from 21 percent in 2005 to 16 percent in 2023.[9] In addition, real wages in the formal sector have been on a declining trend since 2005, except during the expansionary period 2012–19, when a surge in debt-financed government spending facilitated several public sector wage hikes. Taken together, sluggish employment growth in the formal sector and declining real wages have resulted in a sharp decline in the labor share of national income and, in turn, personal income tax collections (figure 1.16 and figure 1.17). High-productivity services subsectors—for example, business and finance—have contributed to important gains in the economy, but these subsectors have grown from a low base and have limited capacity to absorb the majority of Kenya's workforce.

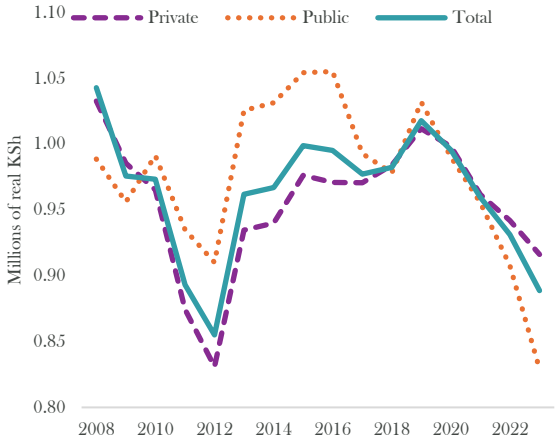
[9] Kenya Economic Survey, 2005-2023. Kenya National Bureau of Statistics.

Figure 1.16. Labor Share and Personal Income Tax, Share of Gross Domestic Product (2013–23)



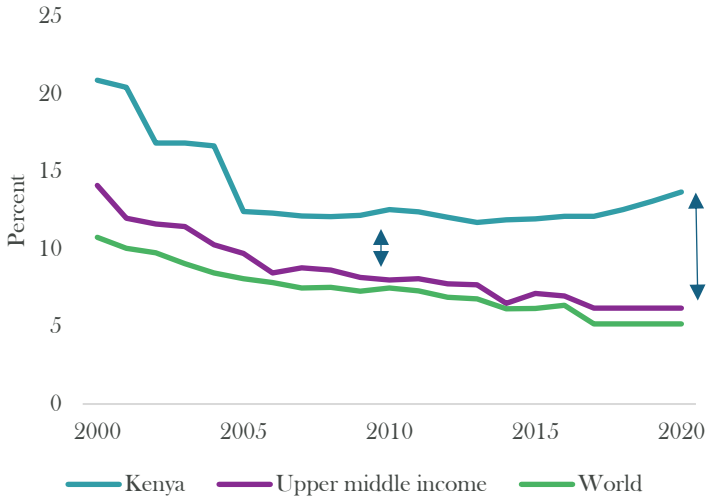
Source: National Treasury of Kenya and World Development Indicators.
Note: Years for personal income tax shares correspond to fiscal years, for example, 2023 = FY2023/24.

Figure 1.17. Real Annual Wages in the Formal Sector in Kenya (2023 Kenyan shillings)



Source: Kenya Economic Survey, 2005-2023. Kenya National Bureau of Statistics.

Figure 1.18. Applied Tariffs: Kenya vs World



Source: World Bank (2023c), cited from World Development Indicators.

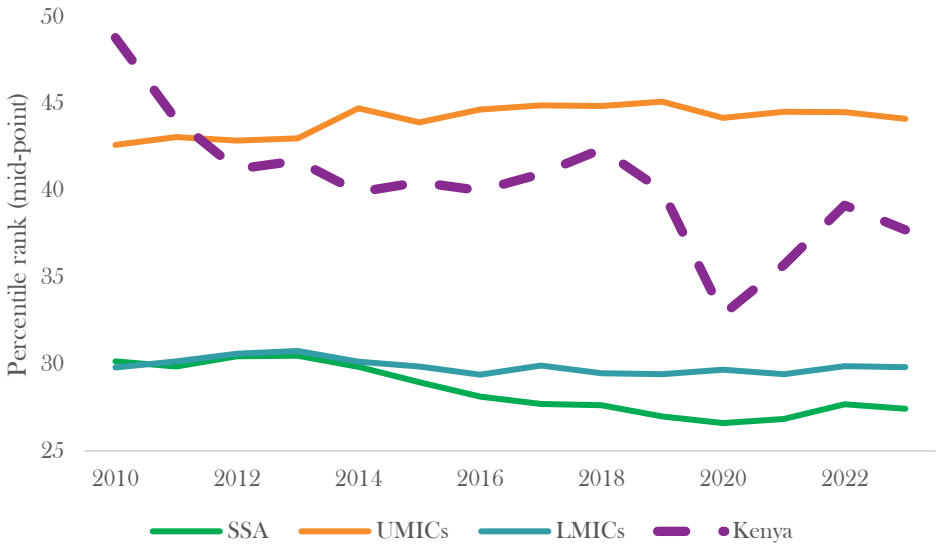
The strong involvement of the state in the economy and in fiscal policy itself created distortions that are further hindering the tax base and worsening fiscal outcomes. A diverse range of fiscal instruments—including levies, new taxes, and exemptions—were introduced to make up for falling income taxes, raise more revenues, and protect firms from losses in competitiveness. For example, for tradable sectors, applied tariffs increased in line with those of the East African Community, while export promotion levies were implemented to support firms, thereby further increasing distortions in private markets (figure 1.18).[10] In 2015, Kenya adopted the Special Economic Zones (SEZ)Act, granting firms reduced

[10] Kenya applies export levies on a series of products that are listed in the Miscellaneous Fees and Levies Act, 2016. This act has been amended several times since its adoption, most recently by the Tax Laws (Amendment) Act, 2024 (Act No. 12 of 2024). Full alignment with the East African Community's Common External Tariff on imports from non-East African Community countries has not been yet achieved.

corporate tax rates in an effort to support formal firms, but further narrowing the tax base and distorting incentives in private domestic markets. Additional tax wedges levied on formal incomes (for example, the housing levy) to fund public services have had uncertain results and have favored the taxing of labor relative to capital.[11] This implies that taxes promote a substitution in the production function and thus may be creating fewer incentives for businesses to hire formal workers. Finally, the real appreciation of the Kenyan shilling—apparently a consequence of increased domestic borrowing and the country's fiscal policy strategy—further favored sectors with limited capacity to generate quality jobs for most of the Kenyan workforce or more productive firms and added to the decline in competitiveness of the tradable sectors. Already, several labor-intensive manufacturing firms have exited Kenya, citing high operational costs and an unfavorable business environment as a result of the introduction of new levies and regulatory overreach. Notable exits in the last two to three years include Proctor and Gamble, Reckitt Benckiser, Colgate–Palmolive, Cadbury, Johnson and Johnson, and GlaxoSmithKline.

Pressure on state capacity rose as the state grew in size faster than its capabilities to manage a more complex economy, creating governance and efficiency challenges that undermine the impact of fiscal policy. The economy and the state seem to have grown faster and more complex than the original scope of the public administration. From the private sector side, the increased footprint of the state was accompanied by a continual decline in the quality of the country's regulatory environment, with Kenya's percentile rank falling by about 16 percentage points in the Regulatory Quality Index from 2010 to 2023 (figure 1.19).[12] Increasing intervention in private markets and competition from SOEs, which benefit from public support, further hurt product markets. From the public sector side, rising number of projects and contracts, coupled with low state capacity, derived in slow and inefficient public financial management systems that amplify expenditure wastage at various levels of government Kenya's devolution agenda, which transferred public service provision responsibilities to counties, created additional complexities at the subnational level. Moreover, the public sector wage bill grew, along with complex new regulations to deal with it. These regulations are often unenforced, however, leading to repeated breaches of the payroll ceiling. Suboptimal budgetary planning increased pending bills and arrears to private firms and government workers, adding to the distortions created by state interventions

Figure 1.19. Regulatory Quality Index, Percentile Rank



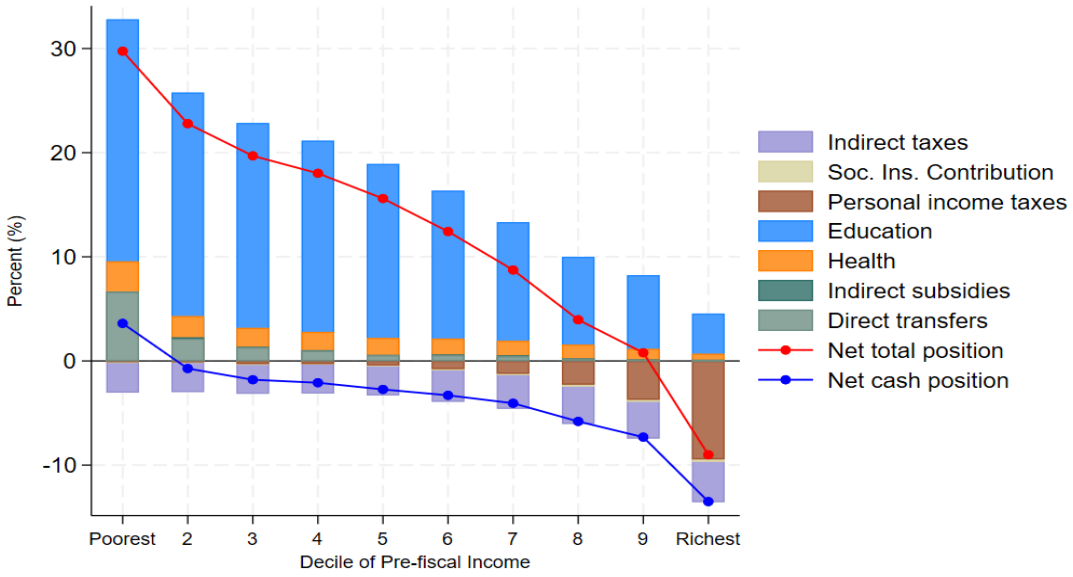
Source: World Governance Indicators, World Bank.
Note: Associated numbers show the percentile rank of the aggregate indictor.

[11] This includes, among others, housing levies and health contributions.
[12] The Regulatory Quality Index captures perceptions of the government's ability to formulate and implement sound policies and regulations that permit and promote private sector development.

Public service delivery that remain weak and corruption undermine citizens' trust in public institutions, damaging the country's social contract. Public officials with large private sector interests seem to influence public policy outcomes, benefiting from weak governance capacity. These challenges manifest in inflated costs of goods and services, low quality of government-funded projects, inefficient sectoral subsidies—for example, for agriculture—or payments made for nonexistent goods and services, all of which contribute to significant losses (World Bank 2024a). For example, in the energy sector, weaknesses in public investment management and in PPP frameworks contribute to the high cost with independent power producers. This is one reason why Kenya's electricity costs are among the highest in Africa, hurting competitiveness. From the Afrobarometer's report for 2024, over 50 percent of the Kenyan population have little trust in their political and governance institutions, including the Presidency, Parliament, Electoral Commission, County Assemblies, ruling and opposition political parties, and police. Kenya ranks 121 out of 180 in Transparency International's 2024 Corruption Perceptions Index—effectively in the bottom third of index countries globally. Almost 60 percent of the Kenyan population perceive that corruption has increased since 2024 and almost 70 percent of people believe that corruption is not being handled adequately (Afrobarometer 2024). Both this and the aforementioned trends are the basis for citizens' significant resistance to support for fiscal consolidation through revenue measures or cuts to public services—as demonstrated during the mid-2024 protests against Kenya's Finance Bill 2024.

A progressive fiscal system is key for a strong social contract. Although Kenya's fiscal system seems progressive, there is scope for further improvement. The recent World Bank fiscal incidence analysis shows that the fiscal system reduces inequality overall (figure 1.20). The key equalizing factor, however, is spending on health and education: improving spending efficiency in these areas therefore has high dividends for poorer people in Kenya, and the government is pursuing ambitious reforms in both sectors. In net cash terms, only the poorest 10 percent of the population is benefiting from Kenya's redistributive policies. And even though major staples consumed by the poor are value added tax (VAT) exempt—such as maize, rice, and wheat—so too are many other products that lack a progressivity rationale. Thus, there are opportunities to further strengthen the progressivity of Kenya's fiscal system, including in social protection, as discussed later in this public finance review.

Figure 1.20. Fiscal Incidence, 2022



Notes: The net cash position corresponds to all direct and indirect taxes, transfers, and subsidies. It excludes in-kind transfers such as health and education. The total net position refers to all components, including in-kind transfers.
Source: World Bank staff estimates based on the 2022 KCHS survey. World Bank

1.4. Toward a New Approach to Fiscal Policy in Kenya

To support sustained and inclusive growth, Kenya needs to have more progressive and efficient public finances that not only allow adequate spending for fiscal consolidation but also support businesses and households in creating jobs and strengthen the social contract. Policy makers in Kenya are facing interrelated challenges and vulnerabilities that need to be addressed in parallel for fiscal policy to achieve its intended objectives. In particular, the country faces: (1) macroeconomic vulnerabilities—Kenya is at high risk of debt distress, and thus there is a need for fiscal consolidation; (2) productive vulnerabilities—the economy has been losing competitiveness over time and productivity is too low; and (3) social vulnerabilities—Kenyan citizens are demanding that the country's fiscal policy delivers social outcomes, including better public services, jobs, and higher incomes. Thus, Kenya's growth performance and its weak fiscal policy performance are intertwined in a pattern that needs to be changed.

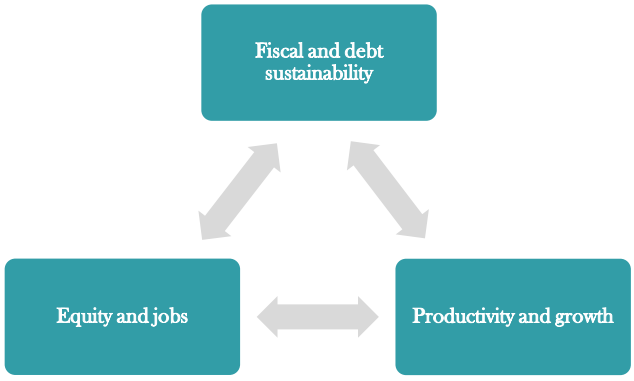
As Kenya's resources are constrained, fiscal policy must be more progressive in order to do more with less. Given the constraints to growth caused by the current fiscal, debt, and regulatory aspects, there is an opportunity to reform fiscal policy so that it becomes less distortionary, more efficient, and more focused on equity. Fiscal policy can deliver more growth and greater poverty reduction using fewer resources and with less government involvement in the economy.

Fiscal policy reform in Kenya should do the following:

- *Build fiscal buffers through fiscal consolidation and debt sustainability.* Addressing Kenya's short-term macroeconomic vulnerabilities will lead to increased fiscal savings that can support the country to meet its debt obligations (debt sustainability), respond to economic shocks (output stabilization), and provide essential public services (allocative efficiency).
- *Strengthen the social contract through a more equitable and redistributive fiscal policy.* Enhancing the progressivity of the budget will support the reduction of poverty and inequality, enhance human capital, and promote social and political cohesion.
- *Put productivity, jobs, and poverty reduction at the forefront by reducing distortions.* Increasing productivity by removing market distortions generated by fiscal policy will support economic growth for job creation. This approach will further guarantee that the much-needed fiscal consolidation is growth-friendly and supports sustained and inclusive growth that benefits the entire Kenyan population.

The proposed policy framework for the Kenya Public Finance Review thus involves evaluating Kenya's fiscal instruments and policy proposals in terms of their ability to generate fiscal savings, reduce distortions for productivity growth, and increase progressivity (figure 1.22). Together, this approach will contribute to the government's Bottom-Up Economic Transformation Agenda, supporting production while generating jobs, enhance, and reducing debt vulnerabilities.

Figure 1.21. Policy Framework for the Kenya Public Finance Review



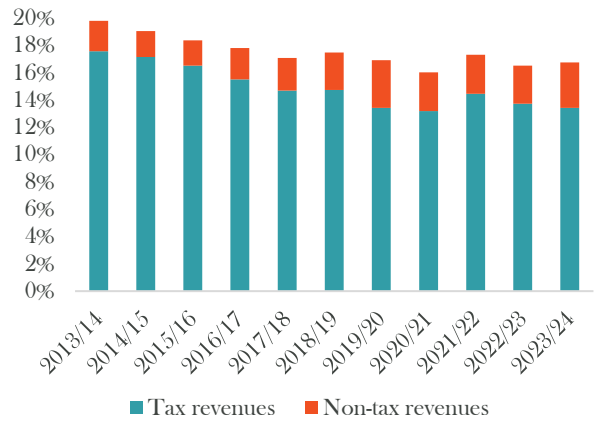
Source: World Bank staff, 2025

Chapter 2.
Strengthening Domestic Revenue Mobilization and Tax Progressivity

2.1. Toward a More Efficient and Equitable Tax System

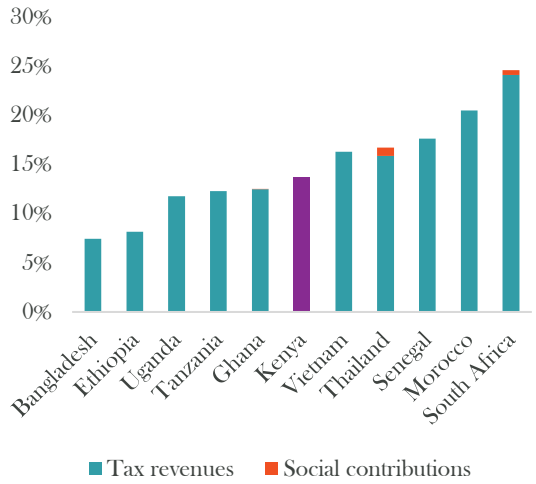
Kenya's tax revenues have dropped below 15 percent of gross domestic product (GDP), an international minimum standard necessary for providing quality public services. Despite Kenya's sustained economic growth, tax revenues have declined by more than 4 percentage points of GDP, falling behind its peers (figure 2.1 and figure 2.2). The highest reduction in tax revenues coincided with the onset of the COVID-19 pandemic (2020/21), but tax revenues have not yet recovered to their pre-pandemic level, despite economic recovery. Kenya's tax system is unable to efficiently and effectively capture economic gains. Averaging 13.7 percent of GDP annually from FY2019/20 to FY2023/24, tax revenues in Kenya are insufficient to fund even essential public services (Choudhary et al. 2024; Gaspar et al. 2016).

Figure 2.1. Kenya: Fiscal Revenues, % of Gross Domestic Product



Source: National Treasury of Kenya.

Figure 2.2. Tax Revenues, 2019–23 Average, Kenya and Peers (% of Gross Domestic Product)

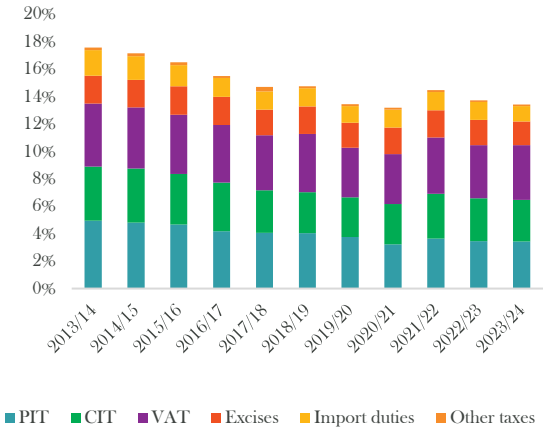


Source: National Treasury of Kenya, World Bank Macro Fiscal Model (MFMOD) and World Bank Fiscal survey.

The decline in Kenya's tax revenues has been primarily driven by falling shares of income taxes. While all tax components recorded a decline over the last 10 years, the downward trend in tax revenues was primarily driven by income taxes—which fell by about 4.2 percentage points between 2013/14 and 2023/24 (figure 2.3). Almost two-thirds of that reduction can be attributed to personal income tax (PIT); corporate income tax (CIT) had the next biggest effect. Income taxes represented more than half of Kenya's tax revenues until FY2018/19, but this changed in favor of taxes on consumption (value added tax [VAT], excises, and taxes on international trade) (figure 2.4). Thus, an inability to raise revenue from taxes resulted in a shift toward consumption-based taxes, reducing the overall progressivity of Kenya's tax system.[13]

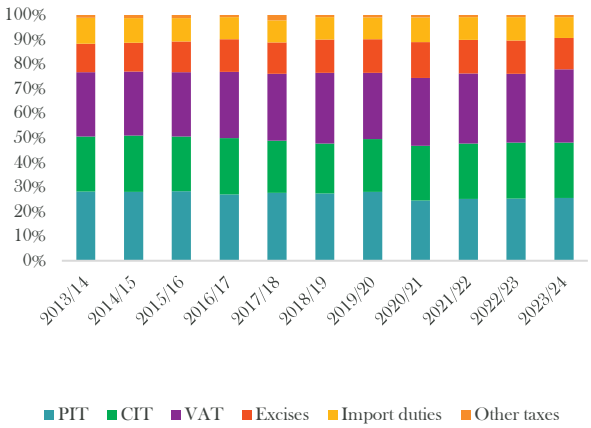
[13] Personal income tax (PIT) is one of Kenya's most progressive tax instruments, while VAT and excise taxes are only mildly progressive and have regressive indirect effects.

Figure 2.3. Tax Revenues by Component, % of Gross Domestic Product



Source: National Treasury of Kenya.

Figure 2.4. Composition of Tax Revenues, % of Total



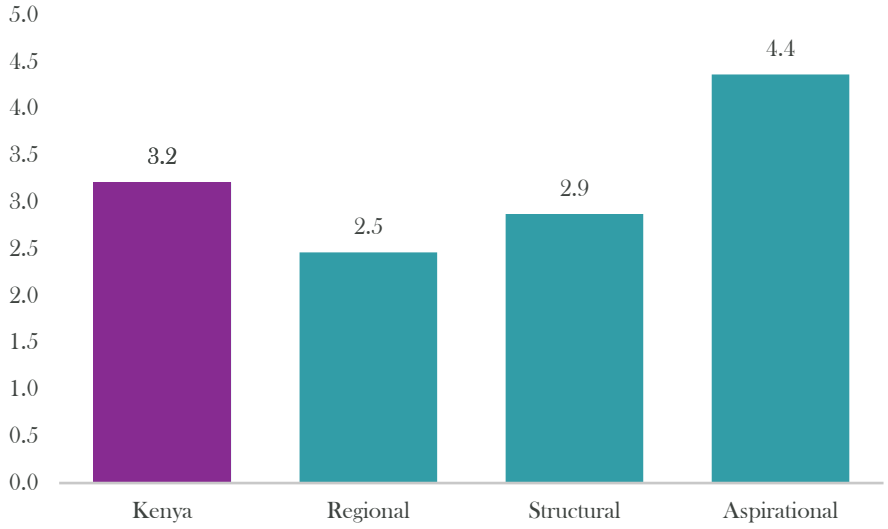
Source: National Treasury of Kenya.

Changes in Kenya's economy have increased the share of GDP hard-to-tax sectors—such as the informal sector which contributed to reducing the tax base. As discussed in chapter 1, trends in PIT and CIT revenues are affected by low levels of productivity and high levels of informality across the economy. Kenya has experienced an increased contribution to GDP by the hard-to-tax sectors, including those where informality is prevalent. Over the last decade, the agricultural sector's contribution to GDP increased by more than 3 percentage points, rising from 18.6 percent in FY 2013/14 to 21.8 percent in FY 2023/24, while the contribution of the manufacturing and industry sector shrank (Source: World Development Indicators). Most workers and businesses in the services sector also operate in the informal sector, and their share in total employment increased during the same period.

The tax base is also narrowing owing to numerous tax exemptions. Government estimates suggest that Kenya's forgone tax revenues reached 3.2 percent of GDP in 2023 (figure 2.5). This exceeds the averages for its regional peers (2.5 percent) and structural peers (2.9 percent) and is about 1.2 percentage points below the average of its aspirational peers (4.4 percent).[14] VAT accounts for the majority of revenue forgone (65 percent) from tax expenditures, followed by income taxes (18.6 percent) and import duties (12.4 percent). The exemptions/reduced rates included in the country's benchmark tax system are quite extensive, suggesting that the actual revenue forgone could be higher. The benchmark tax system for Kenya has certain features that reduce the reported revenue forgone.

[14] These data are from the Global Tax Expenditures Database, Tax Expenditures Lab (accessed May 19, 2025), https://gted.taxexpenditures.org/data-download/. Peers in this section are described as follows: regional are Sub-Saharan African countries, structural lower-middle income countries, and aspirational upper middle income countries.

Figure 2.5. Revenue Forgone from Kenya's Tax Expenditures, Versus Peers



Source: World Bank from GTED.

Kenya's tax buoyancy is low, which is concerning.[15] Figure 2.6 shows Kenya's short- and long-term tax buoyancy, both of which are low relative to its peers. Short-run tax buoyancy is an indicator of the tax system's ability to stabilize the economy, while long-run buoyancy indicates the tax system's ability to ensure fiscal sustainability. A few factors at play in Kenya may be driving such a low short-run tax buoyancy, including low progressivity of the overall tax system and high tax evasion, exemptions, and avoidance.[16] In addition to closing potential loopholes in policy design, tax buoyancy could be increased by reducing tax evasion through improved efficiency of tax administration.

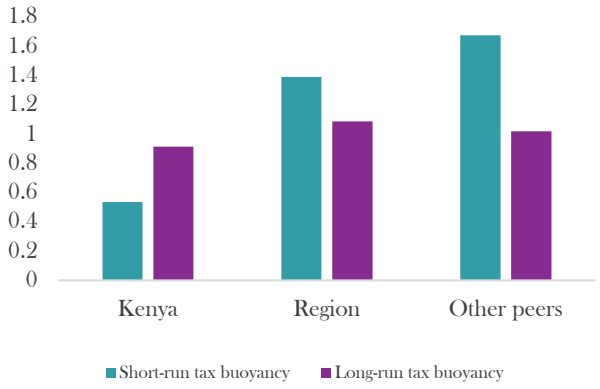
Raising taxes will not yield much additional revenue owing to Kenya's economic structure; the evidence also points to high levels of tax avoidance and evasion. Kenya's tax productivity is low, meaning that the ability of the current system to generate more revenues by further increasing tax rates is limited (figure 2.7). Both tax productivity and C-efficiency (a measure of VAT efficiency) measure how much additional tax revenue can be generated by a 1 percentage point increase in the statutory tax rate, should the tax design, implementation capacity, and size of the economy remain constant.[17] Low tax productivity and low C-efficiency reflect Kenya's narrow tax base and low tax compliance, which may signal high levels of tax avoidance and evasion, coupled with a low taxpaying culture. For Kenya, both CIT productivity and C-efficiency are the lowest among its regional, structural, and aspirational peers.

[15] Tax buoyancy measures the total response of tax revenues both to automatic changes to national income and to discretionary changes in tax policy. The tax system is buoyant if tax revenues increase one-to-one with changes in national income.

[16] In addition, low short-run buoyancy of PIT and VAT may be driven by wage rigidity and consumption smoothing respectively.

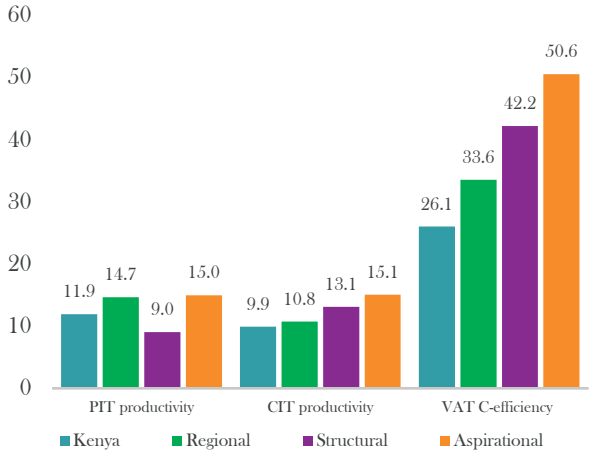
[17] CIT productivity is calculated as [actual CIT revenues / (statutory CIT rate*GDP)]. Similarly, PIT productivity is calculated as [actual PIT revenues / (statutory PIT rate*GDP)]. VAT C-efficiency is [actual VAT revenues / (standard VAT rate*final consumption expenditures)]. The C-efficiency ratio shows the actual VAT collections relative to the theoretical VAT revenues under a perfectly enforced tax levied at the standard rate on all final consumption without any exemption.

Figure 2.6. Kenya: Tax Buoyancy, 2005–23



Source: World Bank staff estimates.

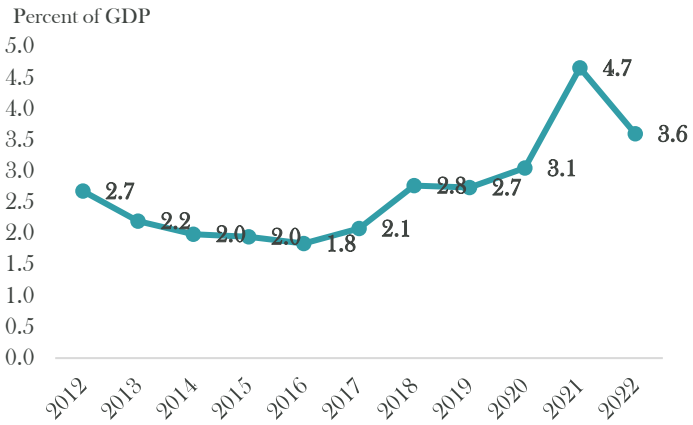
Figure 2.7. Tax Productivity and Efficiency (%)



Source: World Bank staff estimates.
Note: Corporate income tax productivity is calculated as the ratio of CIT revenue (as a percentage of GDP) to the CIT rate. Personal income tax productivity is computed as the ratio of PIT revenue (as a percentage of GDP) to the top marginal PIT rate. The VAT C-efficiency ratio is defined as the ratio of actual VAT collections to the potential revenues that could be derived from applying the standard VAT rate to consumption expenditure in the national accounts.

Kenya's tax revenue collection, however, remains below its potential; there is space to increase collection through more efficient taxation. World Bank staff estimates from a stochastic frontier analysis suggest that Kenya's tax potential is about 18 percent of GDP, indicating a tax gap of around 3.6 percentage points (figure 2.8).[18] Although Kenya's tax collections are nearly at par with those of its regional and structural peers, the country's tax revenues have been on a decreasing trend, leading to a widening tax gap and a decline in revenue effort.

Figure 2.8. Kenya's Tax Gap, 2012–23



Source: World Bank staff estimates.

[18] A stochastic frontier analysis was performed to estimate the maximum tax-to-GDP ratio (potential tax collection/tax capacity) the country could reach, considering structural characteristics such as per capita GDP, share of trade in GDP, agriculture value added in GDP, age dependency ratio, and time invariant country specific characteristics. The tax gap is the difference between potential and actual tax collections, and the tax effort is the ratio of actual to potential tax revenues. For further details on the methodology, please refer to Namunane and McNabb, 2025; Benitez et. al, 2023; McNabb et. al, 2021; Musharraf et.al, 2013.

More recently, uncertainty around investment incentives in Kenya risks affecting businesses' investment decisions, further damaging wage and revenue growth. Kenya is seeing continued announcements and changes in tax policy.[19] Tax policy uncertainty risks undermining business confidence and discourages long-term investment decisions, making businesses more cautious about hiring, expansion, or innovation. This hesitancy directly affects workers through slower job creation and potentially lower wage growth. At the same time, when businesses reduce or delay their activities, tax revenue growth stalls, constraining the government's ability to fund essential services.

Increasing Kenya's tax effort is critical for domestic revenue mobilization. Rationalizing tax expenditures, expanding the tax base in hard-to-tax sectors, and ensuring a fair and equitable tax system can significantly bolster domestic revenue mobilization in the country. The narrow tax base, caused by extensive exemptions and incentives, limited tax progressivity, and low productivity in the formal sector, significantly erodes the country's ability to capture economic gains.

Moreover, the progressivity of the tax system needs to be enhanced. More than 50 percent of tax revenues are collected from VAT alone, indicating that the progressivity of the tax system needs to be improved. Overall, fiscal incidence analysis results, as shown in chapter 1 (figure 1.20), indicate that only the lowest decile of the income distribution benefits from Kenya's fiscal system in cash terms, and thus most of the population are net cash contributors.

This chapter revisits many of the tax measures set out in Kenya's Medium-Term Revenue Strategy (MTRS) and makes some additional recommendations.

2.2. Efficiently and Equitably Taxing Personal Income

Personal income tax rates, levies, and contributions

Kenya has a progressive personal income tax (PIT) system with a top marginal tax rate of 35 percent and five tax brackets. Taxable employment income in Kenya includes all cash payments and noncash benefits exceeding 5,000 Kenyan shillings per month. The individual income tax statutory rates are progressive, with five brackets ranging from 10 to 35 percent as per the Finance Act, 2023. The top marginal tax rate increased from 30 to 35 percent on July 1, 2023.

In addition to PIT, there are several levies on wages, including the housing levy. The housing levy is a statutory contribution introduced under the Affordable Housing Act, 2024, requiring employees and employers alike to each contribute 1.5 percent of their gross monthly earnings to a central fund aimed at financing the construction of affordable homes. The housing levy had a long genesis. It is relatively unpopular and civil society organizations have taken the Kenyan government to court over it. The housing levy is a payroll tax that raises the relative cost of labor and thus reduces formal employment. The levy was established following a 2023 High Court ruling that declared a previous version of the levy unconstitutional owing to the absence of a legal framework. This prompted the government to enact a dedicated law to support its ambitious public housing agenda and address the country's growing urban housing deficit. The funds are managed by the Affordable Housing Board, with a variety of housing support programs under consideration. Other additional costs to the wage bill include individual contributions to the Social Health Insurance Fund and National Social Security Fund (NSSF), both of which are paid by employers and employees (see further discussion in chapter 3), and a small industrial training levy.

PIT is one of the largest revenue contributors, yet the relatively large PIT burden on lower-income individuals encourages informality, contributing to a shrinking tax base. Kenya's tax wedge is high for a low-income household and relative to peer countries. Figure 2.9 illustrates the average tax wedge for a one-earner married couple with two children, earning 50 percent of the average wage. The average tax wedge is broadly defined as the ratio between the amount of

[19] Changes in tax policy include, for example, digital economy taxation, proposed capital gains tax increase, expanded withholding tax, affordable housing incentives, turnover tax adjustments, and repatriated income tax, among others.

taxes paid by a worker and the corresponding total labor cost for the employer.[20] In other words, the tax wedge is the difference between the total labor cost and the take-home pay. This indicator measures the extent to which taxation of labor income discourages formal employment. Kenya's tax wedge of 19 percent is estimated to be higher than in many countries—and is more than double the tax wedge of Austria, the Netherlands, and Belgium, among others. Such a high tax wedge discourages workers in Kenya from seeking formal employment, and employers have fewer incentives to formally hire low-wage workers, potentially leading to more informal work in the economy.

Figure 2.9. Average Tax Wedge (%) for Single-Earner Married Couple with Two Children, Earning 50 Percent of the Average Wage

Source: OECD, 2013; World Bank staff analysis.
Note: Kenya's estimated tax wedge includes the sum of both the tax on labor income and social security contributions, adjusted for tax credit and other assumptions as detailed in the annexes.

The tax burden disproportionally affects low wage earners and does not rise significantly for higher earners when accounting for contributions. Even though the PIT structure exhibits progressivity, the average tax wedge increases steeply for low-income earners: the extra shillings they earn have a tax burden identical to that of a higher-income earner. For example, an individual earning near the minimum wage has a tax wedge (including employer social security contributions) of about 15 percent, which nearly doubles to 27 percent for those earning closer to the average wage (figure 2.10). Beyond this, the increase is modest, with individuals earning five times the average income facing a 32 percent tax wedge. Marginal tax wedge calculations show a flat rate for those earning between half and seven times the average income (figure 2.11). This is evident from the current structure of tax brackets. The lowest tax bracket, for annual incomes up to 288,000 Kenyan shillings, effectively has a zero percent tax rate owing to the annual tax relief of 28,800 Kenyan shillings. The marginal tax rate then rises sharply, with the second bracket subject to a 25 percent tax rate. In the third bracket, covering a broad range of earnings from half to seven times the average income, the tax rate increases more modestly, to 30 percent. This indicates that the tax burden does not rise significantly for higher earners, resulting in a less steep progression in tax rates for higher income brackets and a substantial tax burden for lower earners.

[20] This indicator is measured as a percent of labor costs. The broad formula is defined as the final tax payable plus employee social security contribution plus employer social security contribution, divided by the gross income given to the employee (their salary) plus the employer-only social security contribution. The tax wedge can be estimated with reference to the wages of an average single worker or married couple, with earnings compared to the average wage in a country (for example, 67 percent of the average wage, or 100 percent of the average wage), with or without children.

Figure 2.10. Average Tax Wedge for Single Earner with No Children, %

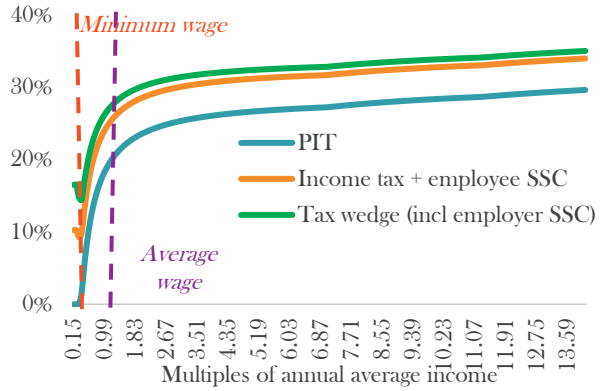
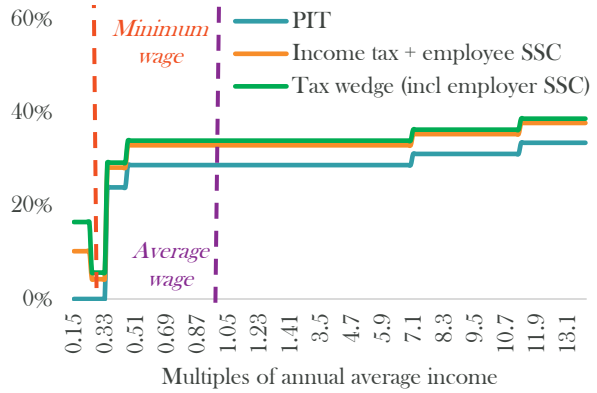


Figure 2.11. Marginal Tax Wedge for Single Earner with No Children, %



Source: World Bank staff analysis.

Note: The tax rules include a monthly tax credit of 2,400 Kenyan shillings and mandatory social security contributions. For the mandatory contributions, both employer and employee contribute 6 percent to the National Social Security Fund, and both contribute 1.5 percent to the housing levy; only employees contribute 2.75 percent to health insurance. The figures report the case of a representative single earner without children. Minimum wage is about 20 percent of average annual income. The break on the x-axis figure 2.10 reflects the change in scale and reference point for better visualization of changes in marginal rate. The industrial training levy was omitted owing to its small size.

An alternative tax rule with revised structure can reduce the burden on low-income earners while maintaining revenue neutrality by slightly increasing the effective rate for the top decile. Table 2.1 models a scenario that introduces changes to PIT to increase its progressivity while keeping it revenue neutral (scenario 1). As shown in table 2.2, the tax rate for the second bracket is lowered to 15 percent, and the third bracket is divided into two—the first part, a 25 percent rate on earnings up to 2,000,000 Kenyan shillings, and the second, a 32.5 percent rate for earnings up to 6,000,000 Kenyan shillings, replacing the previous 30 per cent rate for this bracket in its entirety. The rates for the last two brackets are revised upwards. Household survey data indicate that the top decile is likely to include earners with incomes of more than seven times the average wage (figure 2.12), while the average wage falls in the fourth decile.[21] This reform results in a decreased average tax wedge for all earners except those in the top decile, with a neutral net revenue impact. Such policy reform suggests there is potential to redistribute the tax burden to make the system more progressive. This proposed bracket does not necessarily represent the optimal tax structure, however, and further improvements in design may be feasible.

Table 2.1. Simulated Impacts of the Personal Income Tax (PIT) Rate and Social Security Contribution (SSC) Reform Options

	Average tax wedge (incl. employee and employer SSC), %			Estimated revenue impact (% of PIT + SSC revenues)			
	Below-average earners	Above-average earners (excl. top decile)	Top decile	Below-average earners	Above-average earners (excl. top decile)	Top decile	Net impact
Baseline	21.0	31.5	34.0				
Scenario 1	18.7	29.5	34.8	-0.2	-1.54	1.76	0.02
Scenario 2	20.0	31.5	34.0	-0.08	-	-	-0.08
Scenario 3	17.7	29.5	34.8	-0.28	-1.54	1.76	-0.06

Source: World Bank Staff calculations.

Note: Scenario 1 assumes revision of the tax brackets and tax rates, as presented in table 2.2 . Scenario 2 assumes removal of the housing levy and the industrial training levy for employees with an annual wage of up to 388,000 Kenyan shillings. Scenario 3 assumes scenario 1 and scenario 2 combined.

[21] A caveat to this analysis is the reliance on household survey data, which may suffer from underreporting and lack of representativeness.

Table 2.2. Current and Alternative PIT Brackets and Marginal PIT Rates to Reduce Tax Burden for Low Earners (Revenue Neutral)

Current system		Proposed system	
PIT brackets, by annual wage (K Sh)	Marginal PIT rate (%)	Pit brackets, by annual wage (K Sh)	Marginal PIT rate (%)
0–288,000	10.0	0–288,000	10.0
288,000–388,000	25.0	288,000–388,000	15.0
388,000–6 million	30.0	388,000–2 million	25.0
		2 million–6 million	32.5
6 million–9.6 million	32.5	6 million–9.6 million	35.0
Above 9.6 million	35.0	Above 9.6 million	38.0

Source: World Bank Staff calculations.

Figure 2.12. Average Annual Wage (K Sh, on left) and Concentration of Income by Decile (%, on right)

Source: Original figure based on Household Budget Survey 2022 data.

An adjustment to the PIT structure to exempt low-wage earners from the housing levy would also improve progressivity with minimal revenue impact, but enforcement reforms are needed to broaden the tax base effectively. A reform that solely repeals the housing levy for low earners—those earning less than half the average wage—without altering tax rates (table 2.1, scenario 2) would have a minimal effect on average tax rates, leading to a marginal revenue decline of 0.08 percent of total PIT and social security contribution revenues. Conversely, combining the PIT rate reform with exempting low earners from the housing levy (table 2.1, scenario 3) would further reduce the average tax rate for below-average wage earners, while increasing the burden on top earners to 34.8 percent, as seen in scenario 1, to maintain revenue neutrality. Given the small contribution from below-average earners, shifting the tax burden from low-income earners to the top income deciles is expected to have a minimal impact on revenues, yet would make the tax system more progressive. Notably, the average tax wedge decreases for all earners except those in the top decile, where it increases only marginally (figure 2.13a). Reducing the tax wedge for low earners could potentially expand the tax base by enhancing incentives for formalization. It is important to note, however, that reducing the tax burden alone is unlikely to encourage formalization if enforcement is not strengthened. Administrative reforms must therefore accompany policy changes to have a positive impact on the broadening of the tax base.

Figure 2.13a. Average tax wedge (incl. employer social security contributions), in %

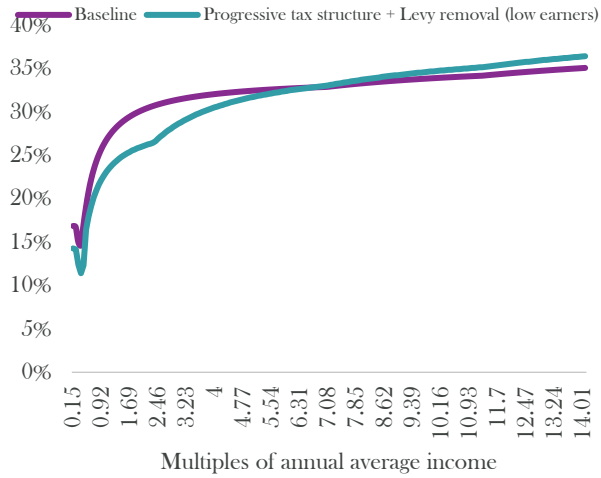
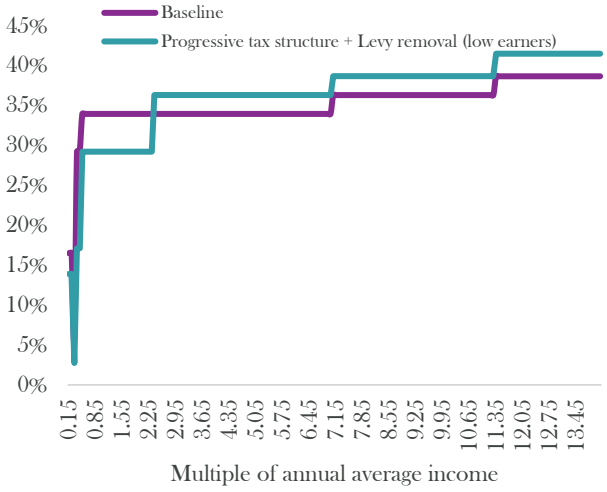


Figure 2.13b Marginal tax wedge (incl. employer social security contributions), in %



Source: World Bank Group staff calculations.
Note: Refer to table 2.1 for underlying assumptions. Only scenario 3 is compared against the baseline in the above figure.

When setting the threshold for employee contributions to the housing levy, several critical factors must be carefully considered. From an administrative perspective, to ensure efficiency and accuracy, it is essential to assess how straightforward it will be to screen contributors based on their income level. Given the lengthy process involved in passing the initial law, the feasibility of amending current coverage of the housing levy and updating it annually to reflect changes in average income must also be evaluated. Additionally, establishing a single cutoff point may create a significant disparity between individuals just below and just above the average income—the so-called cliff effect. An alternative approach could involve setting the cutoff point based on a multiple of the minimum wage level, a common practice in Latin America. Although Kenya does not have a single minimum wage, using a dynamic benchmark that adjusts over time could make the process more manageable and equitable.

A case can also be made to fund health care through the national budget rather than through a levy on payroll. This is discussed in chapter 3.

Additional exemptions and deductions

Kenya's PIT system includes various additional deductions and exemptions. Additional deductions from taxable income include contributions to a postretirement medical fund (up to 15,000 Kenyan shillings per month), to the Social Health Insurance Fund, to registered pension or provident funds (up to 360,000 Kenyan shillings per year), and also mortgage interest (up to 360,000 Kenyan shillings per year).[22]

Exemptions exist on certain types of capital gains. Specific provisions can lead to significant unrealized capital gains, for example, those capital gains exemptions on transfers to immediate family, on companies with a 100 percent family shareholding, on private residences occupied for three years, and on internal group restructurings. These exclusions reduce potential revenues and allow businesses to undervalue property within a group to avoid or minimize their capital gains tax liability. The complexity of implementing and monitoring these exclusions can further lead to tax evasion and avoidance, undermining the integrity of the tax system. Excluding some capital gains from taxation encourages tax planning and undermines tax revenue efforts.[23] Potential revenue gain from streamlining the exclusions is high, but it is conditional on administrative improvements to ensure that the property registry and property values are up to date.

[22] Self-employed professionals are subject to the same PIT rates as employees. Unlike employees, however, they are also entitled to deduct business expenses (such as travel expenses, marketing costs, legal fees) from their taxable income, which is a common practice.
[23] Tax planning happens when a taxpayer makes use of the tax law to pay the least amount of tax possible.

Exempting dividend payments made by a special economic zone (SEZ) enterprise, which already enjoys numerous exemptions, narrows the tax base further and undermines revenue effort. The exemption creates an uneven playing field, giving SEZ enterprises an undue advantage over businesses operating outside these zones, thereby distorting market competition. This preferential treatment can also result in significant revenue losses for the Kenyan government, as dividends are a key source of PIT. Moreover, such exemptions can encourage profit shifting and tax avoidance strategies, in which enterprises may artificially inflate dividends to minimize their tax liabilities. In the interest of fairness, dividend payments made by SEZ enterprises should be taxable.

While the mortgage interest deduction is justified by an objective to encourage homeownership, the policy tends to be an inefficient and regressive way to support the housing market. The larger the borrower's loan, the larger the relief obtained by the borrower. In practice, the annual relief does not represent an exorbitant amount (up to 360,000 Kenyan shillings annually), especially for low earners. Relief of up to 7.2 percent (up to 25,800 Kenyan shillings) is available to taxpayers in the bottom two income tax brackets, while those in the top three income tax brackets can obtain relief of between 30.2 percent (up to 108,800 Kenyan shillings) and 35.2 percent (up to 126,800 Kenyan shillings). This illustrates the regressivity of the mortgage interest deduction. In addition, the deduction has limited impact on homeownership rates[24] given the relatively small size of the mortgage market in Kenya (only about 0.1 percent of adults have a mortgage),[25] despite the growing number of mortgages available.[26] The average mortgage size has been gradually increasing over the last decade (from 6.9 million Kenyan shillings in 2013 to 9.4 million Kenyan shillings in 2023), resulting from the persistently high borrowing cost (average mortgage interest rates rose from 12.4 percent in 2018 to 14.3 percent in 2023), inflationary pressures, and increasing property values. This trend is concerning as it reduces housing affordability for lower-income households. Gradually phasing out the policy would enhance the progressivity of the PIT system, while bringing in about 0.05 percent of additional government revenues. If it is maintained, it is recommended that the relief be extended to those obtaining mortgages from savings and credit cooperatives, which are currently excluded from the list of eligible loan institutions where mortgage interest tax relief can be obtained.

Inconsistencies across tax rates

To limit tax avoidance, it is important to align personal taxes paid on labor and capital income. Kenya's PIT system adopts a scheduler approach,[27] which has both advantages and drawbacks. On the one hand, even though there are multiple withholding tax rates, allocated according to the source of income, tax collection through final withholding is simple and efficient. On the other hand, the scheduler tax system has many weaknesses that reduce its efficiency, equity, and productivity, such as lower taxation of capital income versus labor income. Transitioning to the dual income tax system, where all capital income is taxed at a single rate, while labor income continues to be taxed at the progressive rate, would improve the efficiency of the tax system. To ensure neutrality, the optimal harmonized rate on all capital income should be set based on the CIT rate and PIT rate structure.[28]

The differential tax treatment of other forms of income, especially personal capital income—which includes dividends, capital gains, and rental income—may undermine revenue mobilization and the progressivity of the system. Taxing personal capital income at a 15 percent withholding rate—well below the top PIT rate of 35 percent—creates horizontal inequity, as individuals with similar total incomes are taxed differently depending on the source. This disproportionately benefits wealthier individuals, who earn more from capital than labor, and weakens vertical equity by allowing high-income earners to pay less tax on significant portions of their income. It also undermines the progressivity of PIT as it shifts the tax burden toward wage earners and may exacerbate income inequality. Further, it also opens avenues for tax avoidance through income shifting, as the large gap between PIT and capital income tax rates incentivizes reclassification

[24] However, empirical evidence from several (mostly developed) countries illustrates that the mortgage interest deductions either do not increase homeownership (Bourassa et al. 2013) or even have a negative effect (Sommer and Sullivan 2018).
[25] This does not include mortgage loans obtained through employers, at interest rates lower than the market rate (which is a fringe benefit subject to the fringe benefit tax paid by the employer).
[26] The contribution of the mortgage finance market to the economy has declined over the same period—from 2.85 percent of GDP in 2015 to 1.86 percent of GDP in 2023 (KMRC 2024).
[27] A scheduler tax system is one in which different types of income are separately taxed under different tax schedules.
[28] Neutrality of taxation of labor and capital income is achieved when the total tax burden on capital income (that is, combined burden of CIT and tax on dividends) is in line with the top marginal PIT rate.

of income. Aligning capital income tax rates more closely with PIT rates would enhance both equity and revenue mobilization, supporting a fairer and more efficient tax system.

The PIT system can be further improved by taxing dividend income from both Kenyan residents and nonresidents at the same rate of 15 percent. Currently, the withholding tax rate for dividends paid to Kenyan residents or East African Community citizens is 5 percent; for nonresidents, it is 10 percent. Dividends from publicly listed companies are taxed at the same withholding rates. Lower withholding tax rates may apply under double taxation agreements, provided the recipient qualifies under the limitation of benefits provisions. Multiple tax rates not only complicate tax administration and undermine revenue collection but also create perceptions of an unfair tax system. Implementing a single tax rate on dividends of 15 percent, along with a moratorium on negotiating new double taxation agreements and a request to review existing ones, will not only improve PIT revenues but also enhance the progressivity and fairness of the tax system.

Policy recommendations:

- *Revisit income brackets and tax rates for top and bottom earners.* This would involve reducing the average tax rate (PIT + social security contributions) to 18.7 percent for below-average earners, while raising the rate for top earners by 0.8 percentage points.
- *Revisit the housing levy, especially for employees with wages up to 388,000 Kenyan shillings.* The resulting decline in revenue would be minimal and can be offset by a marginal levy increase of 0.05 percentage points for above-average earners.[29]
- *Revisit the Social Health Insurance Fund levy.* See chapter 3.
- *Revise PIT exemptions.* This includes capital gains exemptions on transfers to immediate family, on companies with a 100 percent family shareholding, on private residences occupied for three years, on internal group restructurings, and on dividends from SEZ enterprises.
- *Phase out mortgage interest rate deductions.* This would enhance the progressivity of the PIT system.
- *Align personal capital income tax rates more closely with PIT rates.* By setting capital income tax rates closer to PIT rates, tax liabilities better reflect each individual's total economic capacity, and the tax system becomes more progressive. At the same time, this alignment can broaden the tax base and enhance revenue mobilization, helping governments fund social programs and infrastructure.
- *Implement a single tax rate on dividends of 15 percent.* This should be accompanied by a moratorium on negotiating new double taxation agreements and a request to review existing ones.

Potential fiscal impacts:

- Adjusting PIT bands and exempting low earners from the housing levy could promote formalization, which could result in up to 0.2 percentage points of GDP in additional revenue annually (conditional to administrative reform) over the medium and long term.
- Removing PIT exemptions would yield an estimated 0.2 percent of GDP as a short-term impact, with a larger long-term impact of 1 percent of GDP, conditional on administrative modernization (per year).
- Phasing out mortgage interest rate deductions could yield 0.05 percent of GDP in revenues.
- Additional, hard-to-estimate impacts would be expected from aligning personal capital income tax rates with PIT rates and implementing a single tax rate on dividends.
- **Thus, 0.45 percent of GDP could be considered a minimum yield from implementing this list of recommendations over the long term.**

Implications for equity: The main aim of these reforms is to make the PIT system more progressive by shifting the burden to the top income deciles and removing from low earners the heavy contributions that are regressive in nature

[29] For brevity, we do not consider potential behavioral responses to the tax rate changes. These responses are likely to be minimal, especially for the rate increases, as we are only considering small adjustments.

and which disincentivize formalization. In the long run, the potential increase in formal employment will benefit mostly the lower deciles of the income distribution.

Implications for productivity: The reduction of labor market wedges, overall, increases the efficiency of labor markets in Kenya. By removing these distortions, wages will be closer to the real marginal productivity of workers, enabling businesses to increase their hiring capacity and overall productivity. Adjusting rates for labor and capital income reduces opportunities for tax avoidance while addressing a bias toward capital over labor.

2.3. Efficiently and Equitably Taxing Corporate Income

2.3.1. Corporate Income Tax

Corporate income tax rates

Even though Kenya's corporate income tax (CIT) rates are comparable to those of regional peers and higher than structural and aspirational benchmarks, collected revenues are relatively small. Higher CIT rates do not necessarily translate into more tax revenues, since there are multiple reduced rates and exemptions, which may explain the low productivity, raise equity concerns, and undermine revenue generation. Resident businesses in Kenya are taxed at 30 percent on both local and international income, while nonresident businesses are taxed at 30 percent on profits from Kenyan operations. Special rates apply, with CIT rates for: (1) export processing zone (EPZ) enterprises at 0 percent for the first 10 years, 25 percent for the next 10 years, and 30 percent thereafter; (2) SEZ enterprises at 10 percent for the first 10 years and 15 percent for the next 10 years; (3) companies listed on the securities exchange at 25 percent for the first five years; and (4) local motor vehicle assembly businesses, businesses operating carbon market exchanges, or shipping businesses at 15 percent for the first 10 years. Nonresident businesses' income from communication services is taxed at 5 percent, while their income from ship and aircraft operations, as well as demurrage charges, is taxed at 2.5 percent. Additional incentives are provided to EPZ and SEZ enterprises, including exemptions from import duties and VAT.[30]

Kenya's Medium-Term Revenue Strategy recommendation of lowering the CIT rate from 30 to 25 percent has advantages and drawbacks. One positive is that the reduced rate may attract direct foreign investment, stimulate growth of domestic businesses, and potentially boost job creation. Lowering the tax rate could also promote tax compliance, as the incentive to engage in tax planning diminishes. As CIT reduces the shareholders' after-tax returns, it gives them incentives to shift some of their investments out of the corporate sector. Some of these investments may shift abroad, however, and no longer be subject to Kenya's CIT. A more significant drawback of a CIT reduction is the immediate reduction in government revenue, which could further hamper Kenya's much-needed revenues to invest in critical development spending. Moreover, if the overall investment climate remains weak, the cut in CIT may not generate the expected boost in private investment, meaning the lost revenue would not be recovered in the form of growth and new jobs. Reducing the CIT rate as part of a broader policy package is discussed in chapter 4.

Exemptions

A more urgent matter is the growing number of SEZ enterprises, which is eroding Kenya's tax base and undermines tax productivity. Kenya's Special Economic Zones Act, 2015 aimed to promote economic growth by attracting investments. Since then, the number of SEZs has risen consistently, raising concerns about eroding the tax base and stagnating or declining tax revenues. Goods produced by SEZ and EPZ enterprises compete in the local market and avoid the standard tax regime, but several of the incentives for such enterprises undermine revenue collection and provide an

[30] The fiscal incentives granted to beneficiary businesses in SEZs include full exemption from VAT, excise duty, import duty, import declaration fee, stamp duty, advertisement fees, and business service permit fees. Additionally, these businesses benefit from a corporate tax rate of 10 percent for the first 10 years, followed by 15 percent for the next 10 years, and then 30 percent for subsequent years. They also receive a 100 percent investment deduction allowance on capital expenditure for buildings and machinery. Businesses in EPZs enjoy several benefits, including a 10-year corporate income tax holiday followed by a 25 percent tax rate for the next 10 years, and a 10-year withholding tax holiday on dividends and remittances to nonresidents. They also receive perpetual exemptions from VAT and customs import duty on various inputs, VAT exemption on local purchases, and stamp duty exemption on legal instruments. Additionally, there is a 100 percent investment deduction on new investments in EPZ buildings and machinery, applicable over 20 years.

unfair advantage. This encourages the so-called mutation of businesses, whereby production moves to SEZs or EPZs primarily to exploit tax benefits while still targeting domestic consumers, undercutting the original goal of export-focused development. Moreover, ongoing global SEZ-related tax reforms under the Organisation for Economic Co-operation and Development and the United Nations Conference on Trade and Development, to which 133 jurisdictions are already signatories, are prompting countries to move toward a unified CIT rate of 15 percent for SEZ enterprises. Consequently, it is essential to assess whether these incentives truly spur greater investment, growth, employment, and profitability among SEZ enterprises compared with ordinary Kenyan businesses located outside SEZs, or whether they simply weaken the domestic tax base.

Moreover, exempting collective investment schemes/unit trusts from CIT erodes the tax base as income generated by these trusts bypasses corporate-level taxation. In Kenya, unit trust income is tax-exempt, but tax is payable upon distribution if the trustee is not exempt. Tax systems designed to tax income at both the entity and individual levels aim to minimize leakages due to compliance issues at the individual level. Entity-level taxation serves as a backstop to prevent such leakages. Inadequate taxation at the individual level results in significant economic activity escaping taxation, narrowing the tax base and potentially leading to higher taxes elsewhere or cuts in public services. This undermines the equity and efficiency of the tax system, distorting economic behavior and resource allocation as individuals/entities may prefer to hold their income in unit trusts than engage in productive economic activity.

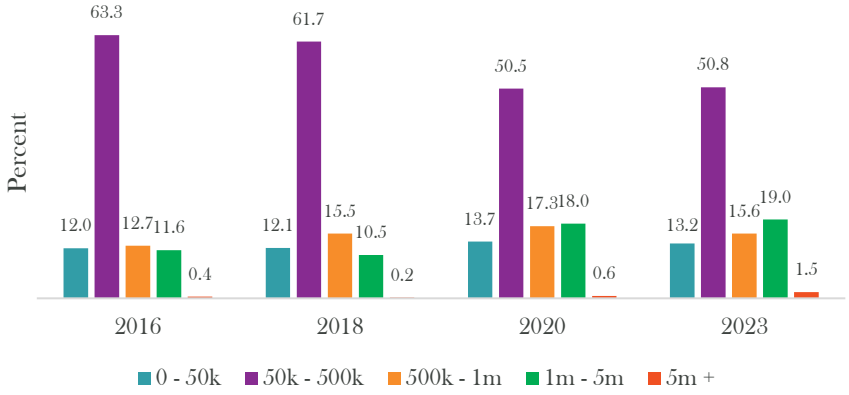
Reduced rates for shipping and motor vehicle assembly businesses further undermine Kenya's revenue potential. The 15 percent reduced rate for these businesses, aimed at stimulating economic growth and attracting investment, has contributed to low revenue collection, affecting public services and infrastructure projects. This is particularly challenging given Kenya's strained budget. Reduced rates create market distortions, giving unfair advantages to specific industries and undermining fair competition and market efficiency. Beneficiary businesses may engage in riskier practices, potentially harming the economy in the long term. Favoring certain industries can also lead to public discontent, perceptions of favoritism, and erosion of trust in government institutions, causing social and political tensions.

2.3.2. Turnover Tax on Micro, Small, and Medium Enterprises

Current misalignment between the turnover tax (TOT) thresholds and VAT undermines revenue mobilization from micro, small, and medium enterprises (MSMEs). Kenyan MSMEs are exempt from CIT and are instead subject to a simplified TOT. MSMEs with an annual turnover of 1 million to 25 million Kenyan shillings are subject to a tax rate of 1.5 percent of turnover. Introduced to simplify tax processes and reduce recordkeeping for MSMEs, TOT ensures that these businesses contribute to national revenue. There is a misalignment between TOT and VAT thresholds, however, as the maximum threshold for TOT is set at five times the current registration threshold for VAT, which is 5 million Kenyan shillings. This results in a requirement for TOT-registered taxpayers with a turnover exceeding 5 million Kenyan shillings to also register for VAT.

Aligning the maximum TOT threshold with an increased VAT threshold could enhance production efficiency and have a positive impact on revenue by reducing the incentive for businesses to limit turnover to avoid VAT registration. In general, a business capable of accounting for VAT should also be able to file a CIT return and be subject to the CIT rate. Data show that very few businesses over the years have reported an annual turnover exceeding the VAT registration threshold (Hoy et al. 2024). Specifically, in 2023, only 258 businesses (1.5 percent of all businesses operating in Kenya) exceeded this threshold (figure 2.14).

Figure 2.14. Distribution of Businesses Paying Turnover Tax, by Turnover Bracket and Year



Source: Hoy et al. (2024) using monthly administrative records of turnover tax (TOT) filing and payments.
Note: The figure shows the distribution of businesses paying TOT across the various turnover brackets. The total percentage for each year sums to 100 percent.

Further, increasing the VAT threshold reduces the administrative burden on both small businesses and the tax authorities. The VAT threshold, unchanged since 2007, does not account for inflation. Increasing the threshold would allow the tax authorities to focus their resources on larger businesses that contribute more significantly to VAT revenues, thereby improving administrative efficiency. Even with a higher VAT threshold, small businesses (below the potential revised VAT threshold) that can comply with the registration requirements can voluntarily register for VAT and benefit from VAT refunds (assuming the refund mechanism works well). This approach can foster a more cooperative environment between government and the private sector. Importantly, the current situation may be creating a distortion or perverse incentive for businesses to stay small.

Misalignment between monthly TOT filings and annual assessments leads to more than 70 percent of tax-exempt microbusinesses paying TOT, creating regressivity in the system and disproportionately affecting women. The minimum TOT threshold of 1 million Kenyan shillings is intended to exempt microbusinesses from paying TOT. While TOT filings and payments are made monthly, however, the exemption threshold is assessed on annual revenues, with no opportunity to reconcile payments at the end of the year. As a result, the minimum exemption threshold for TOT is not enforced in practice, leading to more than 70 percent of tax-exempt microbusinesses paying TOT and contributing about 24 to 39 percent of aggregate TOT revenue annually (Hoy et al. 2024). The administration of TOT therefore results in a de facto regressive system, in which microbusinesses that are intended to be exempt end up filing and paying taxes. This highlights the need to enhance taxpayer education campaigns to ensure that the tax system is understood by taxpayers and enforced fairly.[31] Since women are more likely than men to run microbusinesses, they may be disproportionately affected by the administration of TOT.

Policy recommendations:

- *Consider reducing CIT to 25 percent, but **only** as part of a broader policy package.* See chapter 4.
- *Phase out CIT exemptions.* This includes: (1) removing exemptions for collective investment schemes; and (2) reviewing the exemptions for SEZs and EPZs, with a view to rationalizing the inefficient provisions.
- *Place a moratorium on new incentives for SEZs, EPZs, and sector tariffs.* This should be done pending a study on whether the beneficiaries from the existing incentives are meeting the intended objectives. Keeping the incentives for existing beneficiaries could be considered to ensure predictability in the business environment.

[31] Survey evidence suggests that taxpayers' lack of knowledge about the exemption threshold, or the desire to pay something to avoid being audited by Kenya Revenue Authority are the main reasons for taxpayers' payment of TOT (Hoy et al. 2024).

- *Review VAT and TOT thresholds.* Increase the VAT registration threshold, align it with a reduced TOT maximum threshold, and align the TOT filing and payment period with the assessment of the exemption threshold.

Potential fiscal impacts: The potential fiscal impacts of CIT reforms—not including a reduction in the CIT rate—could in total yield up to 1.2 percent of GDP per year in additional revenues. This number reflects only the direct effects of phasing out CIT exemptions and does not account for the associated increased private investment and growth potentially derived from such a change. As TOT collections are very small (about 0.002 percent of GDP in 2023), any losses from the proposed TOT reform would be relatively insignificant. The reform would, however, reduce the administrative burden on both small businesses and the tax authorities. It would allow the tax authorities to focus their resources on larger businesses that contribute more significantly to VAT revenues, thereby improving administrative efficiency.

Implications for equity: The efficient use of exemptions promotes fairness in business by ensuring that all businesses, regardless of size, sector, or political connections, pay taxes under the same rules. Moreover, these policy recommendations would increase progressivity in those areas where lower-income groups currently bear a heavier relative tax burden. The TOT reform would be equitable as it would support MSMEs, whose owners are often low income earners single proprietors—many of them women, who would thus disproportionately benefit from the reform. Increased tax revenue achieved by rationalizing exemptions could finance essential public services (health, education, social protection), which disproportionately benefit low-income and vulnerable populations.

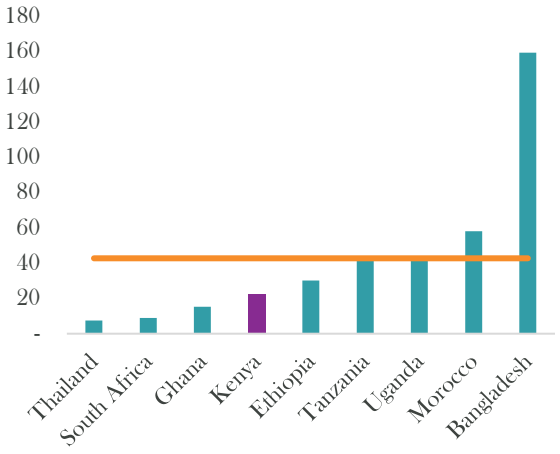
Implications for productivity: Rationalizing exemptions ensures that all businesses compete on a leveled 'playing field', which leads to more efficient allocation of capital and labor across the economy. When businesses respond to tax incentives rather than market fundamentals, investments flow into less productive or more politically favored sectors. Moreover, a simpler, broader tax base reduces these behaviors and lowers enforcement costs for the Kenyan government.

2.4. Efficiently and Equitably Taxing Consumption (VAT)

The standard rate of VAT in Kenya is 16 percent. VAT registration is mandatory for businesses making taxable supplies of more than 5 million Kenyan shillings annually, excluding capital asset sales, with voluntary registration available for those below the threshold. Nonresident businesses supplying services electronically to consumers in Kenya must register for VAT regardless of whether they meet the threshold. Input tax can be deducted within six months if the supply was for taxable purposes and proper records are kept. From July 1, 2023, suppliers must declare sales invoices in VAT returns for input tax recovery. Taxpayers can claim VAT refunds on bad debts after three years have elapsed (and within 10 years of the debt falling due).

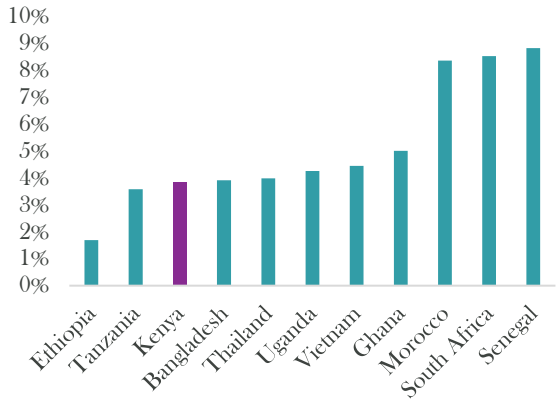
Kenya's VAT efficiency ratio is only 0.26 and it lags behind that of its peers. C-efficiency is the ratio of actual VAT collections relative to the theoretical revenues if compliance were perfect, and all final consumption, with no exemptions, taxed at the standard VAT rate. Kenya's C-efficiency ratio (0.26) is the lowest when the country is compared with the average of its regional peers (0.34), structural peers (0.43), and aspirational peers (0.51). Since Kenya's VAT rates are relatively in line with most of its comparable peers (figure 2.15 and figure 2.16), the low C-efficiency ratio may indicate low compliance levels. Tax design issues, such as VAT exemptions for government investment spending, and granting of VAT exemptions if supplies are used for specific purposes, may encourage mis-invoicing of supplies and undermine VAT performance.

Figure 2.15. VAT Threshold per Gross Domestic Product per Capita, 2019



Source: World Bank estimates.

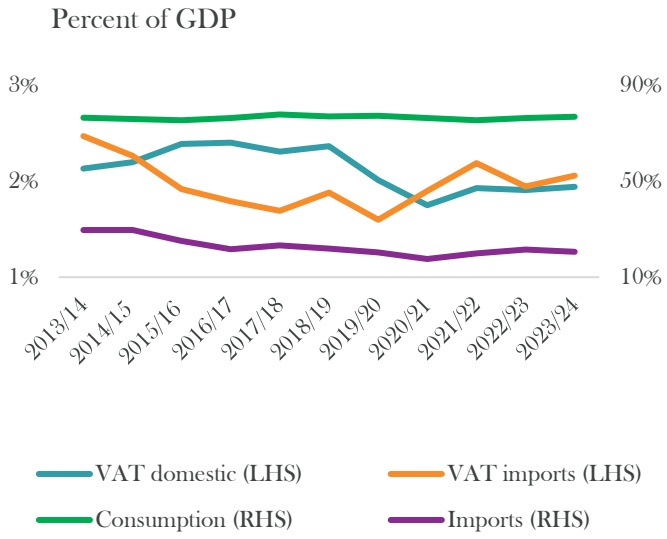
Figure 2.16. VAT Revenues, 2019–23 Average (% of Gross Domestic Product)



Source: World Bank estimates.

Macroeconomic conditions and numerous VAT exemptions are the main causes of the declining trends in VAT collections. Despite private consumption contributing a stable share of GDP, the share of GDP contributed by domestic VAT collections has vastly declined since the late 2010s (figure 2.17). The declining trend in import VAT collections follows a weak overall performance by imports since the beginning of the 2020s decade. Opposite trends in consumption VAT and overall consumption in the economy may be caused by increased VAT exemptions, as well as increases in the size of the informal economy. Kenya has several VAT-exempt goods and services, as detailed in the first schedule of the VAT Act, 2013, and in subsequent amendments to the act. VAT-exempt goods and services include agricultural and food products (for example, maize, rice, wheat, and beans), health services, medical supplies and equipment (for example, medicines, syringes, catheters, and diagnostic kits), and education materials and services, among others.

Figure 2.17. VAT Trends by Component, 2013/14 to 2023/24 (% of Gross Domestic Product)



Source: National Treasury of Kenya; and World Development Indicators Database.
Note: lhs = left-hand side; rhs = right-hand side

Kenya could raise significant revenue by reforming its VAT system. Removing VAT exemptions is key to the Kenyan government's aim to reduce the standard VAT rate in the medium term; otherwise, significant revenue losses would accrue. VAT reform needs to be considered jointly, however, with potential adverse impacts on poverty, inequality, and consumption, as current exemptions make the VAT system mildly progressive. In a hypothetical case and as an exercise, removing all VAT exemptions would raise poverty by more than 3.3 percentage points and slightly increase inequality (a 0.1-point increase in the Gini coefficient), while generating fiscal revenues of about 3 percent of GDP annually. The effects of increasing the standard VAT rate from 16 to 18 percent would increase poverty by less than 0.5 percentage points and slightly increase inequality, while resulting in a 0.3 percent gain in government revenue—the relatively small revenue gain from this increase comparing it to a removal of all exemptions is symptomatic of the very large volume of exemptions on consumption. The large effects on poverty and inequality from the removal of exemptions calls for VAT policies to be implemented in addition to measures to protect the poor and Kenyan citizens from such removals.[32]

Policy recommendation:

- *Consider reforming VAT system.* This should be done as part of a broader policy package that mitigates adverse impacts on poverty, inequality, and consumption. See chapter 4.

Potential fiscal impacts: Removing all VAT exemptions would yield 3 percent of GDP in additional revenues annually; however, this reform is unfeasible given its negative impacts on poverty, inequality, and consumption.

Implications for equity: Unless packaged with other policies, adjusting VAT rates or removing exemptions would raise poverty and reduce equity.

Implications for productivity: Exemptions distort the principle of tax neutrality by favoring some goods or services over others. Removing VAT exemptions therefore ensures that all consumption is taxed equally, leading to more efficient decision-making by consumers and businesses. Moreover, all sectors would receive uniform treatment, reducing artificial incentives for overconcentration in VAT-exempt areas. A broader VAT base simplifies the system, making it easier for businesses to comply and for the tax authorities to enforce.

2.5. Correcting for Externalities: Reducing Harm to Society

2.5.1. Climate-Related Externalities

Fiscal policy instruments can help correct negative externalities that harm society— underpricing of carbon, for example, contributes to climate change. Usually, green fiscal instruments will adjust price signals so that polluters bear more of the true social cost of their actions. By internalizing negative externalities, these instruments could encourage reduced emissions, stimulate innovation in cleaner technologies, and create revenue streams that can fund climate adaptation and mitigation measures. Ultimately, green fiscal instruments aim to foster a more resilient and equitable economy while combating climate change. Kenya has already reduced its VAT exemptions on fuel, as stimulating fuel consumption is harmful to the climate.

Carbon taxation can help Kenya meet its commitments under the Paris Agreement and further curb climate change externalities. Kenya's Medium-Term Revenue Strategy identifies the potential for a dedicated carbon tax. Modeling carried out for the latest Kenya Country Climate and Development Report (World Bank 2023b) confirms this, suggesting that a carbon tax on fuel could be considered to internalize the carbon externality. Various options exist for a fuel-based carbon tax including, for example, various vehicle taxation options. Vehicle taxation is part of Kenya's current policy

[32] Microsimulation—anchored in the Commitment to Equity (CEQ) framework for fiscal incidence—is used to model the removal of selected VAT exemptions based on the 2022 Kenya Household Budget Survey (KCHS) and administrative data. The analysis first estimates household welfare under the current tax and transfer system by imputing VAT from reported consumption to establish baseline poverty at consumable income. In the policy simulation, VAT is applied uniformly across all goods and services, including those previously zero-rated and exempt (e.g., staple foods, health, education), raising the tax burden on poorer households that consume a higher share of exempt goods. The poverty rate is then recalculated to assess the impact of increased VAT payments on household welfare. For further reference, please see: World Bank. (2025). Kenya Economic Update #31.

dialogue on fiscal consolidation and features in the Medium-Term Revenue Strategy. Table 2.3 shows the trade-offs between efficiency in addressing the carbon externality, and the simplicity, equity, and administrative complexity of different options for vehicle taxation.

Table 2.3. Options for Vehicle Taxation

Vehicle tax option	Pros	Cons
Taxing the value of the vehicle	Relatively simple to implement, generates significant revenue (especially useful for fiscal consolidation), and acts as a luxury tax, potentially targeting wealthier individuals who can afford more expensive vehicles.	Might not fully incentivize reduced vehicle use; it could disproportionately affect lower-income households and hinder their access to newer or more efficient models.
A tax based on car engine size/number of axles/weight	Relatively simple to administer and uses readily available information.	Poorly targets externalities, as engine size, number of axles, and vehicle weight are not strong indicators of emissions or pollution. Ineffective in promoting climate-friendly behavior.
CO_2 emissions tax (based on CO_2/km)	Directly addresses the climate change externality by incentivizing the purchase and use of low-emission vehicles. Data could be readily available via the vehicle identification number, making it effective in promoting climate-friendly behavior.	High administrative cost to link kilometers driven to emissions data by vehicle. Easy to implement, however, as a lump sum tax at time of import.
A tax on the vehicle age	A practical proxy for pollution in countries with weak emissions control systems. Older vehicles are often poorly maintained and lack functioning pollution control equipment.	Does not directly address emissions or incentivize the purchase of newer, cleaner vehicles and may disproportionately affect lower-income households.

Source: World Bank Staff.

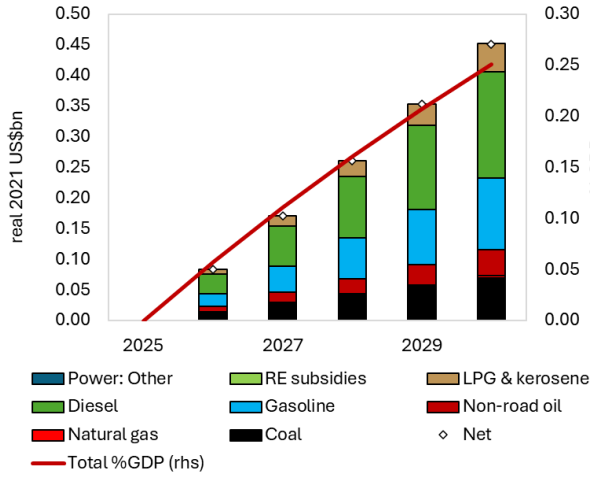
Policy recommendation:

- **Rather than implement vehicle taxation, taxing fuels at the point of entry into the country would also attain its intended objectives and could be adjusted to Kenya's current implementation challenges.** In contrast to a vehicle tax, this option is efficient, reaches all types of fuel consumption across the economy—including all types of transport and industry that burn fossil fuels—and is administratively simple. The fiscal impact of introducing a carbon tax on imported fuels, raising this gradually to US$25 per ton of CO_2 by 2030, would yield additional revenues of about 0.25 percentage points of GDP by 2030 (figure 2.18a).

Potential fiscal impacts: Implementing a carbon tax at the point of entry is anticipated to bring in additional revenues of about 0.25 percentage points of GDP annually by 2030 (revenue recycling would reduce this to 0.18 percentage points, as described below).

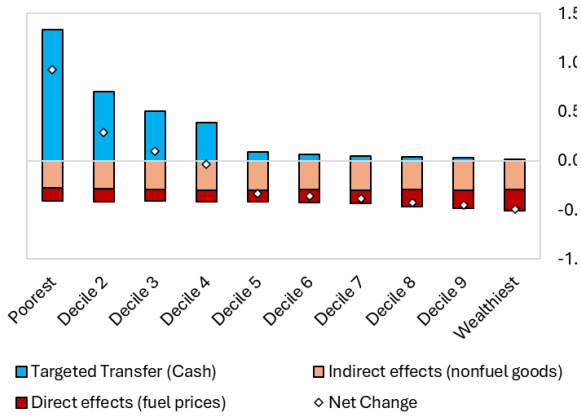
Implications for equity: There are climate co-benefits associated with carbon taxes, including less air pollution and, in the transport sector, fewer road traffic accidents, saving lives and reducing health costs. About two-thirds of the tax would fall on the transport sector. Direct impacts on consumption related to transport costs and inflation would be regressive, however, because poorer households spend proportionately more on transport than wealthier households do. This can be addressed through higher social transfers to poorer households. If 30 percent of the total revenues from the carbon tax were used for lump-sum cash transfers to the poorest deciles (bottom 40 percent of the income distribution), implementation of the tax would not hurt the poor (figure 2.18b) but would still correct for environmental distortions and still yield around 0.18 percent of GDP in fiscal revenues.

Figure 2.18a. Fiscal Impact of Carbon Tax (US$25/Ton of CO_2) by 2030



Source: World Bank using the Climate Policy Assessment Tool.

Figure 2.18b. Impact on Households of Carbon Tax (US$25 per Ton of CO_2), % of Total Consumption by Decile



Source: World Bank using the Climate Policy Assessment Tool.

Implications for productivity: A carbon tax would internalize the cost of CO_2. Prices would rise since they do not currently include the cost to society associated with global warming (meaning that present prices are artificially low—or distorted). To reduce adverse impacts on the competitiveness of some sectors, the carbon tax could be coupled with other measures to raise competitiveness and be part of a broader policy package (see chapter 4).

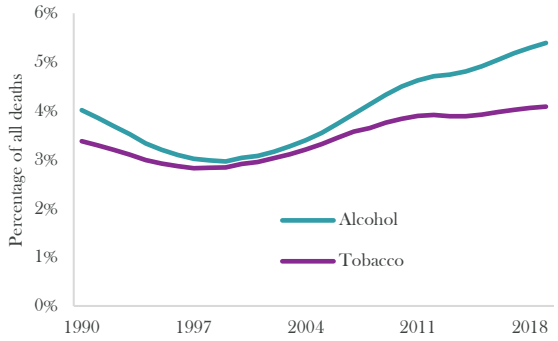
2.5.2. Health Externalities

Fiscal policy tools can also help ensure that the societal costs of health practices are more accurately reflected in prices. Measures that make harmful products costlier and incentivize healthier behaviors can reduce the burden on health systems, improve population well-being, and promote a more sustainable, health-conscious society.

In Kenya, consumption of tobacco, alcohol, and sugar-sweetened beverages is a considerable and growing contributor to mortality and morbidity. Collectively, consumption of these products accounted for 9.7 percent of all deaths in Kenya in 2019 (figure 2.19). This is a significant increase on the 7.5 percent of deaths in Kenya in 1990 attributable to consumption of these products. It is also significantly higher than the regional average for 2019 of 7.4 percent. Of the three products, alcohol is the largest contributor to mortality, its consumption accounting for 5.4 percent of all deaths in Kenya in 2019, and its use has also increased more rapidly in the country than tobacco use. While sugar-sweetened beverages are a significantly smaller contributor to mortality, deaths due to their consumption are also rising rapidly—having accounted for 0.10 percent of all deaths in Kenya in 1990, increasing to 0.18 percent of all deaths in 2019.

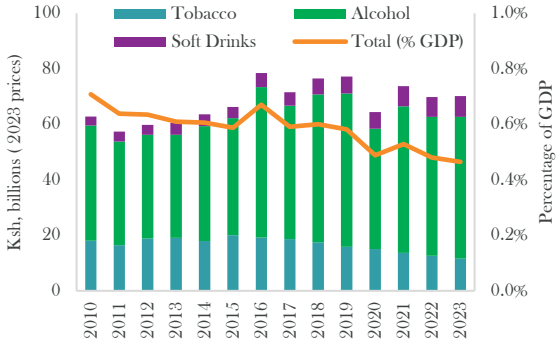
Currently, health taxes generate meaningful—but declining—tax revenues in Kenya. Alcohol and tobacco tax revenues have declined by 6 and 39 percent respectively, in real terms, between 2016 and 2023 (figure 2.20), while soft drink tax revenues increased by 47 percent over the same period, albeit from a much lower base. Trends in alcohol tax revenues are inconsistent across products, with beer revenues declining by 15 percent and spirits and wine revenues increasing by 15 percent. Alcohol generates the bulk of health tax revenues (73 percent), while tobacco and soft drinks generate significantly lower shares of the total revenues (17 and 10 percent respectively). The decline in health tax revenues is steeper and more concerning when the revenues are measured as a share of GDP, with the combined share declining from 0.67 to 0.46 percent of Kenya's GDP between 2016 and 2023, about half the global average of 0.9 percent of national GDP (World Bank 2023c).

Figure 2.19. Deaths Due to Tobacco and Alcohol Consumption in Kenya (1990–2019)



Source: IHME (2019).

Figure 2.20. Health Excise Tax Revenue in Kenya (2010–23)



Source: Kenya National Bureau of Statistics; World Development Indicators Database; and World Bank Macro Poverty Outlook.

Kenya has a well-established system of health taxes, with specific excise taxes applied to tobacco, alcohol, and soft drinks. In Kenya, several reforms have been implemented in health taxation, including reforms of tax structures and increases in tax rates.[33] The most recent was implemented in late 2024, resulting in substantial changes in the tax structures and rates of alcohol and tobacco excise taxes, with no changes to excise taxes applied to soft drinks (table 2.4).

Table 2.4. Health Excise Taxes in Kenya, Late-2024 Reform

	2024		2025		
	Rate (K Sh)	Base	Rate (K Sh)	Base	Effective rate (K Sh per L)
Alcohol					
Beer	142.44	per L	22.50	per cL of AA	112.50
Wine	243.43	per L	22.50	per cL of AA	292.50
Spirits	356.42	per L	10.00	per cL of AA	400.00
Tobacco					
Cigarettes (filtered)	4,067.03	per 1,000	4,100	per 1,000	n.a.
Cigarettes (plain)	2,926.41	per 1,000	4,100	per 1,000	n.a.
Soft drinks					
Fruit juices	14.14	per L	14.14	per L	14.14
Waters	6.41	per L	6.41	per L	6.41

Source: World Bank staff estimates based on the Tax Laws (Amendment) Act, 2024.
Note: AA = absolute alcohol; cL = centiliter; L = liter.

[33] The tax structure refers to the type of tax (specific or ad valorem), tax base, and other characteristics and attributes of the tax.

The recent reform modified the tax base on alcohol, resulting in significant changes to the effective tax rates by beverage and to the overall tax revenues. The tax base was modified from a volumetric system to an alcohol content-based system, meaning that the tax is now applied per centiliter of absolute alcohol rather than the volume of the beverage. For example, beer was previously taxed at 142.44 Kenyan shillings per liter but is now taxed 22.50 Kenyan shillings per centiliter of absolute alcohol. This means that the effective tax on a liter of beer with an alcohol content of 5 percent is now 112.50 Kenyan shillings per liter—a decrease of 25 percent. Moreover, the effective tax on wine and spirits increased by 14 and 7 percent respectively, assuming alcohol content of 40 and 13 percent respectively. The changes are likely to generate a significant decline in tax revenues: the tax increases on wine and spirits are unlikely to offset the decrease in beer revenues as beer dominates the market, accounting for 54 percent of total alcohol sales and 63 percent of health tax revenues. The recent reforms are expected to have a significant negative impact on tax revenues, which are expected to decline to 0.21 percent of GDP Although the major objective of these taxes should be to dissuade consumption rather than generate revenue, these trends signal unintended consequences of the late-2024 reform, warranting a revision of the tax rates upwards to preserve and improve tax revenues.

Reform of tobacco taxes has unified the tax structure of different products. Prior to the reform (before late 2024), a tiered tax was applied, with the rate on plain/unfiltered cigarettes 28 percent lower than the rate on filtered cigarettes. The World Health Organization recommends that all cigarettes are taxed uniformly as health consequences do not vary by type of cigarette (WHO 2021). The reform resulted in only a 1 percent increase in the tax on filtered cigarettes but a 40 percent increase in the tax on plain cigarettes.[34]

The recent reform removed the inflation indexation of alcohol and tobacco taxes. An optional indexation to inflation has been available since 2015, but it has not always been exercised. Its use allowed excise taxes to maintain their real value over time without the need for parliamentary intervention. While the optionality of the inflation indexation was suboptimal, the complete removal of this provision presents risks of consumption dissuasion and risks to tax revenue generation (World Bank 2023c).

Kenya has a well-regarded excise tax administration system that has generated strong results in improving tax compliance and increasing tax revenue, but challenges remain (see, for example, Ross 2017). Excise administration includes a track-and-trace system that is applied to excisable goods. Yet challenges remain, including unrecorded alcohol, and concerns that the effectiveness of the track-and-trace system has declined, particularly for tobacco. Cigarette sales have declined despite taxes and prices not increasing in real terms, suggesting declining tax compliance. Unrecorded alcohol has been well described in the literature and mostly comprises traditional home-brewed alcohol (see Mkuu et al. 2018; Mkuu et al. 2019). While this presents significant public health challenges, the implications for tax policy and tax administration are less clear. In other areas of excise tax, like tobacco taxes, tax evasion is most often the result of pernicious actors evading tax.

Policy recommendations:

- *Raise health taxes on alcohol and tobacco.* Both taxes need to be adjusted to account for inflation and economic growth to reduce consumption and prevent losses in the revenue base. Increases of 117 percent on alcohol and 50 percent on tobacco will return tax rates to 2016 levels adjusted for inflation and economic growth and have the potential to return revenue to 2016 levels, resulting in an increase in tax revenues from 0.27 to 0.60 percent of GDP. Further, taxes should continue to be adjusted annually for inflation—or the tax rates should be increased—to ensure that tax increases account for both inflation and economic growth. Larger tax increases have the potential to increase tax revenues on alcohol and tobacco to the global average of 0.90 percent of GDP.

[34] World Bank staff estimate that more than 80 percent of the Kenyan tobacco market is filtered cigarettes. This estimate is based on sales data from private sector sources and needs to be verified with tax-paid sales data.

- *There is scope to reform the tax on soft drinks since it applies to both sugar-sweetened beverages and healthier alternatives, like water*. Removing the tax on healthier alternatives such as water will increase their affordability and incentivize substitution from drinks with a high sugar content. The loss of tax revenues can be offset by increasing taxes on sugar-sweetened beverages.
- *Focus greater attention on tax administration on tobacco and on broadening the tax base on alcohol.* Assess the effectiveness of tobacco tax administration to ensure that declining sales are the result of tax policies and public health interventions rather than poor tax compliance. Promote public health and regulatory interventions to reduce the use of home-brewed and other illicit alcohol.

Potential fiscal impacts: Aligning Kenya's health tax rates with historical benchmarks is expected to raise at least 0.3 percent of GDP in the short term and 0.6 percent in the longer term. Additional fiscal savings, although hard to quantify, would derive from the reduced pressure on the health system.

Implications for equity: International evidence shows that the long-term effects of increases in health taxes are progressive, once reductions to health care costs, including out-of-pocket payments, and increased labor productivity are considered (Fuchs and Pierola 2022). Estimates from a wide range of countries consistently show that poorer households see greater benefits from reductions in health care costs and increased labor productivity, offsetting the direct effects of the tax.

Implications for productivity: Health taxes disincentivize harmful consumption and raise revenue to finance externalities such as associated costs to the public health system.

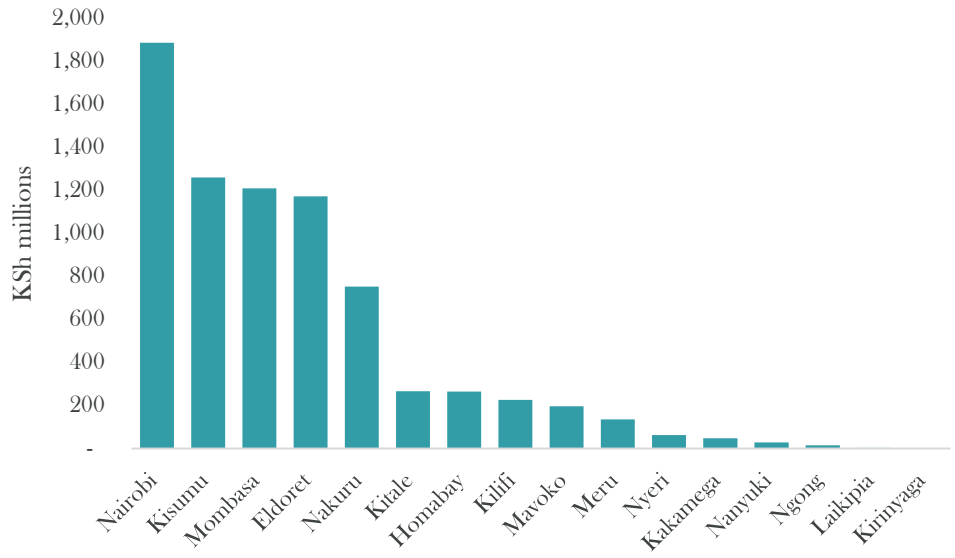
2.6. Capturing Value from Real Estate

Land rents (national level)

Land rents are rental income that a national government levies on leaseholders at the national level; they tend to be low in Kenya. Based on leasehold land databases from the Nairobi leasehold registry and 15 other leasehold land databases (including Mombasa and Eldoret), there is significant potential to increase revenues raised through ground rents. There are two primary drivers of this potential. First, data from the leasehold databases show that land rents in Nairobi account for only a fraction of land parcels captured in the system, indicating significant potential to expand coverage and capture a larger number of eligible properties in the system. Second, many of the rents have been set at nominal 'peppercorn' (very low) nominal levels that bear little relation to the current market value of the land.

Estimates suggest that revenues from land rents could increase by a factor of 50 were the rents to properly reflect the value of the public land being made available via leasehold arrangements. A market valuation-driven approach that considers the differences between urban and rural markets and the differing land valuations within urban areas would help increase the revenue yield. At the same time, such an approach would also lower the rents charged on less attractive parcels and improve the allocative efficiency of land resources. This approach would incentivize a more efficient use of land, potentially increasing supply and possibly even supporting densification in some areas where market conditions are conducive. Further, it allows for the collection of public revenue from rapidly appreciating land values in the face of rapid urbanization, redistributing unearned private gains to the populace at large, via Government expenditure. Figure 2.21 shows the revenue potential, applying the 5 percent rental yield assumption that was used for this analysis.

Figure 2.21. Potential Revenue (KSh, millions), Assuming a 5 Percent Rental Yield



Source: World Bank estimates using data from the Ministry of Lands, Public Works, Housing and Urban Development of Kenya.

Policy recommendations:

- *Improve coverage of properties.* This includes improvements to the area-based valuation methodology of ground rent calculation. Currently, only 31,354 properties are in the leasehold database, against an estimated total of 150,500 properties across Kenya.
- *Strengthen the underlying valuation methodology to improve revenue potential.* It is estimated that the current rents from the 31,354 properties are about 2 percent of market rents. The true potential of ground rents, assuming a 5 percent yield, is estimated at 7.5 billion Kenyan shillings. Adding more properties to the system by improving coverage would have an even higher impact.
- *Strengthen enforcement and collection measures.* This will be key to capturing the potential revenue and minimizing revenue leakages. Current estimates suggest that up to 60 percent of ground rents are not collected. Digital payment systems can help simplify collections processes.
- *Organize public awareness campaigns to generate awareness of land rents.* Linking revenue increases to improved infrastructure and services, and a phasing-in of increases may be necessary to make the reforms more successful.

Property taxes (county level)

Property taxes (referred to as property rates) are one of the largest own-source revenue streams for Kenya's county governments. Between 2017 and 2020, property rates—the annual land value-based tax levied by counties—ranked as the third highest own-source revenue generator across 40 counties, contributed 10.8 percent of own-source revenues on average. Despite property rates' criticality to county budgets, their actual collection lags behind their revenue potential. A World Bank (2020) study showed that Kenya's counties have the potential to collectively generate about 14 billion Kenyan shillings annually, up from 5.1 billion Kenyan shillings. Nairobi City County alone is currently collecting only 35 percent of its estimated property tax revenue potential (estimated at 3.8 billion Kenyan shillings), having the highest among counties. In absolute terms, the revenue potential is significantly larger in urban centers and in areas with high estimated property values. Properties in the top counties (for example, Nairobi City, Kiambu, and Mombasa) account for more than half the total value of properties in the country, while the combined total value of properties in the bottom

ten counties is much lower, accounting for only 2 percent of the total property values in the country. Consequently, own-source revenue collection is dominated by those counties with the largest urban areas. Property tax reforms in Kenya could help improve own-source revenue collection at the county level and reduce the counties' reliance on intergovernmental fiscal transfers.[35]

Policy recommendations:

- *Improve property coverage in the tax system.* This should include complete digitization of land records and strengthening of land information management systems, prioritizing Nairobi City, Kiambu, and Mombasa.
- *Update and simplify the legal and regulatory framework for property rates.* Streamline and standardize valuation methodologies for both commercial and residential properties. Streamline access to the most up-to-date valuation rolls that can be used to identify the economic base and explore their potential.
- *Invest in property tax administration systems to enhance collection efficiency.* This includes modernizing payment systems and ending amnesty programs, particularly in larger urban counties.
- *Create buy-in for the reforms.* Ensure effective communication, stakeholder engagement, and strong political leadership to support the reforms.
- *Improve zoning of permitted development.* This should be backed by improved enforcement.
- *Change the tax base to improved value from solely land value.* Consider this potential policy in order to reduce market distortions and improve equity outcomes by spreading tax collection over a wider tax base.

Potential fiscal impact:

- *Land rents (national level).* Based on the available data, improving the ground rent yield to a 5 percent rental yield could raise 7.5 billion Kenyan shillings. This represents a potential increase of 7.4 billion Kenyan shillings (0.05 percent of GDP). The true potential for revenue increase may be even higher as the underlying data are incomplete. For example, the leasehold registry system contains only about 21 percent of parcels and 23 percent of the total ground rent in Nairobi.
- *Property taxes (county level).* A World Bank (2020) study showed that Kenya's counties have the potential to collectively generate about 14 billion Kenyan shillings (0.09 percent of GDP) annually. Nairobi City County alone is currently collecting only 35 percent of its estimated property tax revenue potential. Additional revenue potential could emerge from land value capture mechanisms linked to urban densification, which requires strong zoning and enforcement of permitted development.

Implications for equity: Property values are supported and enhanced by public expenditure on infrastructure and municipal services and increasing revenue from property, and the unearned increases in value of both freehold and leasehold land have an important role in promoting fairness and equity. Since property tax is a wealth tax, it tends to have positive impacts on equity—accordingly, its proper collection is equitable. For a small portion of the population that may be asset-rich but cash-poor (such as pensioners), it will likely have a negative impact. Additional reforms will be needed to increase coverage for leaseholders in the system who are paying the land rents. Without improvements in coverage, an increase in the revenue yield would pose a greater burden on those who are already compliant, which could, in turn, lead to worsening equity outcomes for those who are currently captured in the system. Reforms to increase coverage could, therefore, help improve equity outcomes and create an environment where other reforms, including a potential increase in revenue yields, may become easier to implement. On balance, the proposed reforms are expected to be progressive.

Implications for productivity: Differential property tax rates for vacant land can help discourage land speculation by making it more financially viable to develop land rather than leave it idle. Even without differential rates, assessing urban land at or close to market value incentivizes denser development as property owners seek to maximize their return on

[35] Please see: Commission on Revenue Allocation. (2022). Comprehensive own source revenue (OSR) potential and tax gap study. https://cra.go.ke/download/comprehensive-own-source-revenue-osr-potential-and-tax-gap-study/

outlay (including land-based taxes)—urban density is associated with higher productivity. A dense urban form can be further supported by spatial planning regulations and by the efficient operation of property markets. Informal transactions of uncovered properties distorts the property market, and improving coverage will also discourage this practice.

2.7. Strengthening Revenue Administration

Despite recent improvements in revenue administration, Kenya continues to face challenges. Inefficiencies in processing VAT collections, refunds, and exemptions result in unrealized revenue. The 2022 launch of the Tax Administration Diagnostic Assessment Tool highlighted issues such as inaccuracies in the taxpayer register, low rates of on-time filing and payment, and low usage of electronic payments. Large unpaid VAT refunds and the absence of a risk-based audit plan further complicate compliance. Other factors include incomplete integration across tax systems, outdated technology, and lack of business continuity protocols, leading to occasional system downtimes.

A recent audit report by the Auditor-General of Kenya identified irregularities and accountability issues with the eCitizen platform for non-tax revenue collection (Auditor-General 2025). The report revealed several inconsistencies in revenue data recorded through the eCitizen platform. According to the audit report, about 144 million Kenyan shillings collected using the platform could not be traced in government financial records. The report exposed potential manipulation or serious weaknesses in the integration of the payment and accounting frameworks, as well as limited government control of the system. The eCitizen platform is reportedly managed by a private technology vendor whose identity and contract details have not been publicly disclosed, raising accountability concerns. The data security framework of the platform was also called into question. Despite handling sensitive personal and financial data from millions of Kenyan residents daily, the Government Digital Payments Unit is neither registered as a data controller nor a data processor under the Office of the Data Protection Commissioner. This omission violates Kenya's Data Protection Act and raises concerns about potential data misuse or exposure. The issues highlighted by the Auditor-General point to a broader systemic failure in managing digital government services. As the eCitizen platform undergoes reengineering, it is crucial to ensure the platform's seamless integration with the treasury's information technology (IT) systems and to embed robust accountability mechanisms throughout the tax administration system.

Kenya Revenue Authority (KRA) has recently initiated reforms to strengthen revenue administration. KRA aims to close significant tax gaps in VAT, PIT, and CIT by enhancing voluntary compliance through modern tax systems, data analytics, and a redesigned service delivery model. The Electronic Tax Invoice Management System (e-TIMS) will streamline VAT compliance and facilitate the filing of returns for businesses. By December 2024, 69.4 percent of VAT-registered taxpayers were registered with e-TIMS. These were mainly large and medium VAT taxpayers, which together account for 70 percent of VAT revenues. Challenges remain, however, particularly with onboarding smaller taxpayers to e-TIMS, with only 38 percent of these taxpayers in the system by December 2024. KRA is conducting taxpayer education and outreach initiatives focused on small taxpayers and exploring avenues to bring additional businesses into the VAT ecosystem. To address the issue of underreporting of VAT, KRA plans to activate VAT auto-assessments, a system that detects inconsistencies between purchase and sales invoices declared on VAT returns and penalizes noncompliant taxpayers. KRA's efforts to simplify tax processes for businesses are starting to yield results, as domestic VAT collections reached 314.2 billion Kenyan shillings in 2023/24, surpassing the target of 307.8 billion Kenyan shillings and marking a 15.3 percent year-on-year increase in collections.

Automation is also being used to enhance tax services and processing of tax exemptions. The National Electronic Single Window System streamlines the application and approval of tax exemption requests, significantly reducing the typical processing time from weeks to days. Applicants can now apply for VAT exemptions upfront and receive real-time status updates. This system provides a consolidated view of all exemption requests, facilitating tax expenditure analyses and informed decision-making regarding the impact of tax exemptions on the economy. Further efficiency improvements are expected from the implementation of KRA's station-less service delivery model, which envisions a digitally driven, one-stop tax service system. This model aims to eliminate the inefficiencies of the current system, accessed using a

personal identification number (PIN), where taxpayers are assigned to a specific tax service office based on their postal address, often leading to delays and inconvenience. This approach eliminates the need to refer taxpayers from one tax station to another. By adopting a program-based strategy, KRA can transition away from the traditional PIN- and domicile-based approach, enhancing the efficiency and accessibility of its service delivery.

Policy recommendations:

- *Register all VAT taxpayers on e-TIMS to increase domestic VAT collections.* This initiative is expected to improve compliance, reduce tax evasion, and streamline the VAT administration process, leading to increased fiscal efficiency and higher revenues. KRA plans to have 70 percent of all registered VAT traders connected to e-TIMS (and issuing electronic fiscal invoices and receipts from the system) by December 2025. The expected increase in revenues is approximately 0.2 percent of GDP annually.
- *Process all tax exemptions through the automated tax exemption system to increase efficiency.* The automation of tax exemptions is expected to generate efficiency gains by reducing the time and effort required by both taxpayers and tax officials. It minimizes human errors and ensures consistent application of exemption criteria, leading to more accurate and fair tax administration. Overall, automation can enhance transparency and accountability, improving trust in the tax system.
- *Expand the scope of the eCitizen platform to handle a higher volume of transactions and ensure seamless integration with the treasury IT ecosystem.* By enhancing the eCitizen platform's capacity to handle more transactions, the government can streamline the collection of non-tax revenues, reducing leakages and improving overall efficiency. Integrating the eCitizen platform with the treasury IT ecosystem can reduce administrative costs associated with manual processing and oversight. With better data integration and real-time transaction processing, the government can gain more accurate insights into revenue flows, thereby improving fiscal planning and budgeting.

Potential fiscal impacts: The abovementioned revenue administration measures are expected to yield up to 0.6 percent of GDP in revenue collection per year.

Implications for equity: A well-administered tax system collects more revenue without the need to raise rates, enabling the Kenyan government to fund progressive social programs. Moreover, tax morale will increase: when taxpayers see that everyone is being treated fairly, they are more likely to comply voluntarily with tax law. Finally, improved administration (for example, digital systems, simplified procedures) makes it easier for informal businesses to enter the formal sector, broadening the tax base and promoting inclusive growth.

Implications for productivity: Improved tax administration 'levels the playing field', ensuring that all businesses and individuals follow the same rules, which leads to more efficient competition and investment decisions. Moreover, the ongoing implementation of digital systems has the potential to reduce discretionary practices, fostering a more neutral and predictable environment for economic activity.

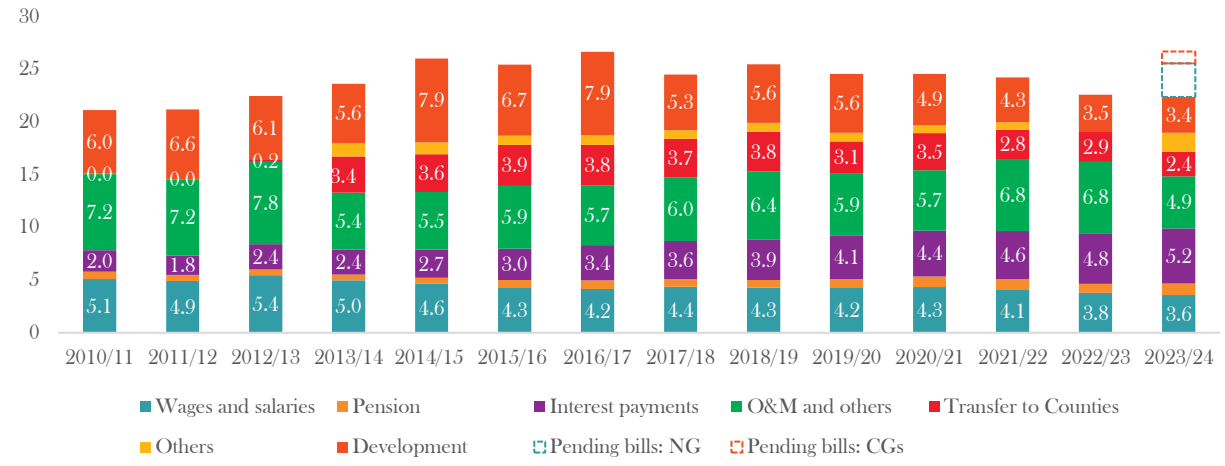
Chapter 3.
Enhancing Public Expenditure Efficiency and Equity

3.1. Toward More Efficient and Equitable Public Spending

Kenya's public expenditure has been on a declining trend. On a cash basis, spending fell from 26.1 percent of gross domestic product (GDP) in 2016/17 to 22.3 percent of GDP in FY 2023/24. This conceals spending that would appear if Kenya used accrual accounting: Kenya has been accumulating considerable pending bills (or arrears) (figure 3.1). Although expenditure consolidation has been on its way – especially after the COVID-19 pandemic -, its extent was less than the headline numbers suggest.

The decline in public expenditure is primarily driven by cuts in development expenditure, in favor of increases in recurrent spending. Development spending has declined from 7.9 percent of GDP in 2016/17 to 3.5 percent of GDP in 2023/24, following the completion of several major infrastructure projects. Although needed, this reduction in spending could significantly limit public investment in critical sectors, undermining long-term growth prospects and job creation if not carefully planned. Meanwhile, recurrent expenditure has increased rapidly—from 14.4 to 16.6 percent of GDP from 2016/17 to 2023/24 —driven by growing interest payments, as well as increased grants and subsidies to state-owned enterprises (SOEs). Despite the K[36]'s introduction of austerity measures, including the Supplementary Budget I for FY 2024/25, efforts to curb expenditure growth have faced significant implementation challenges.

Figure 3.1. Trends and Composition of Total Expenditure (2010/11 to 2023/24) (% of Gross Domestic Product)

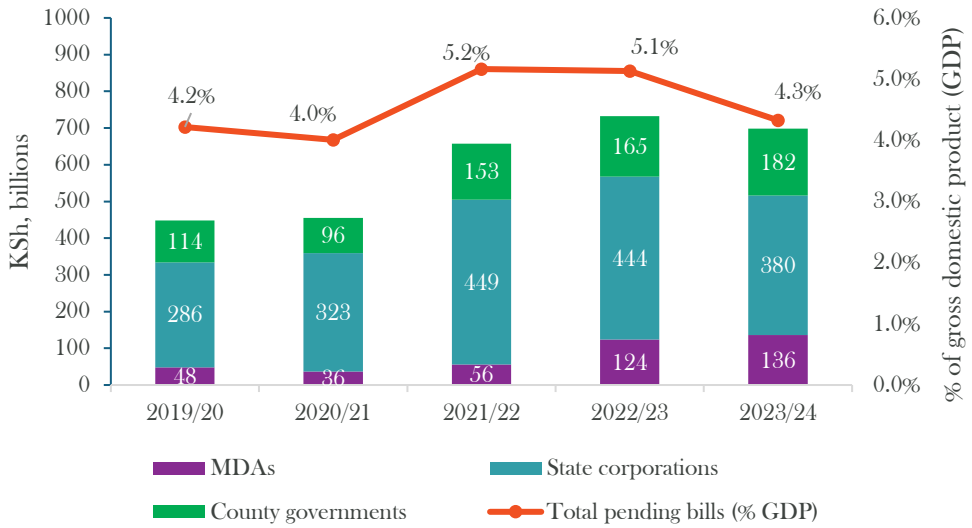


Source: National Treasury of Kenya; World Bank staff calculations.
Note: Pending bills, presented as a stock figure, are added to total expenditure to illustrate the full fiscal burden. NG = National Government; CGs = County Governments.

[36] Austerity measures include a reduction of 156.4 billion Kenyan shillings overall, about 78 percent of which (122.4 billion Kenyan shillings) comes from development expenditure and about 22 percent (34 billion Kenyan shillings) from recurrent expenditure. (http://www.parliament.go.ke/index.php/node/22201)

The accumulation of pending bills has effectively shifted a portion of public expenditure to "below the line," amounting to indirect borrowing from the private sector. Total pending bills rose from 448 billion Kenyan shillings in 2019/20 to 698 billion Kenyan shillings in 2023/24, marking an increase of approximately 56 percent (figure 3.2). The pending bills are primarily concentrated in SOEs (63 percent), followed by county governments (24 percent) and ministries, departments, and agencies (MDAs) of government (13 percent). Pending bills amounted to 3.2 percent of GDP at the national level and 1.1 percent of GDP at the county level in 2023/24. If all pending bills were now settled within one year (for example, in the last fiscal year), they would raise Kenya's fiscal deficit to more than 9 percent of GDP, significantly above the fiscal outturn of 5.1 percent of GDP. These unpaid obligations reduce liquidity in the private sector, delay payments to suppliers and contractors, and create uncertainty, particularly for small and medium enterprises (SMEs), which are more vulnerable to cash flow disruptions. Clearing outstanding pending bills is critical for restoring fiscal discipline, enhancing public spending efficiency, and supporting private sector growth.

Figure 3.2. Accumulation of Pending Bills, 2019/20 to 2023/24 (KSh, billions, and % of Gross Domestic Product)

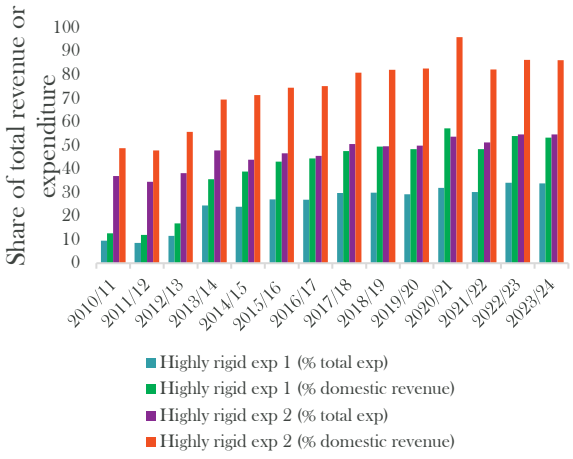


Source: National Treasury of Kenya and World Bank staff calculations.
Note: MDAs = ministries, departments, and agencies.

These trends reveal an increasingly rigid national budget, mostly due to rising statutory expenditure and, in particular, interest payments.[37] High budget rigidities limit fiscal space and flexibility, lower spending efficiency, and may force cuts in discretionary spending such as public investment (Herrera and Olaberria 2020). In Kenya, rigid expenditures have risen sharply, especially interest payments and constitutionally mandated transfers to county governments,[38] which together have increased substantially in size—from 10 percent to 34 percent of total expenditure, or from 13 percent to 53 percent of domestic revenue, between 2010/11 and 2023/24 (figure 3.3). Interest payments alone have increased significantly, rising from 2 percent to 5.2 percent of GDP (or from 12.7 percent to 36.7 percent of domestic revenue) over the same period. This implies that over one-third of total spending, or more than half of domestic revenue, is precommitted to statutory spending. When a broader definition of rigid expenditure is used—one that includes wages and salaries, and pensions—rigid expenditure grew from 35 percent to 55 percent of total expenditure, or from 48 percent to 86 percent of domestic revenue between 2010/11 and 2023/24, leaving limited space for development and discretionary spending (figure 3.4).

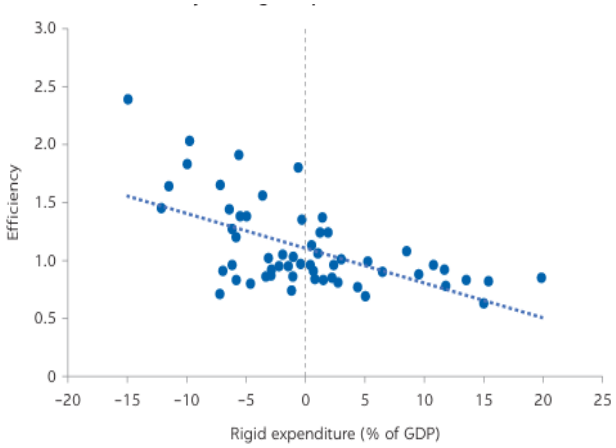
[37] Budget rigidities are institutional, legal, contractual, or other constraints that limit the ability of governments to change the size and composition of the public budget, at least in the short term. They originate, among other things, from demographic factors such as an aging population and rules that predetermine the level of certain types of expenditure.
[38] Article 203(2) of the Constitution of Kenya 2010 provides that for every financial year, the equitable share of revenue allocated to county governments shall be not less than 15 percent of all revenue collected by the national government. This amount is calculated on the basis of the most recent audited accounts of revenue received, as approved by Kenya's National Assembly.

Figure 3.3. Precomitted Budget as a share of Revenues and Expenditures



Source: National Treasury of Kenya and World Bank staff calculations.
Note: Highly rigid expenditure 1 includes: interest payments and transfers to county governments. Highly rigid expenditure 2 includes: interest payments, transfers to county governments, wage bill, and pensions.

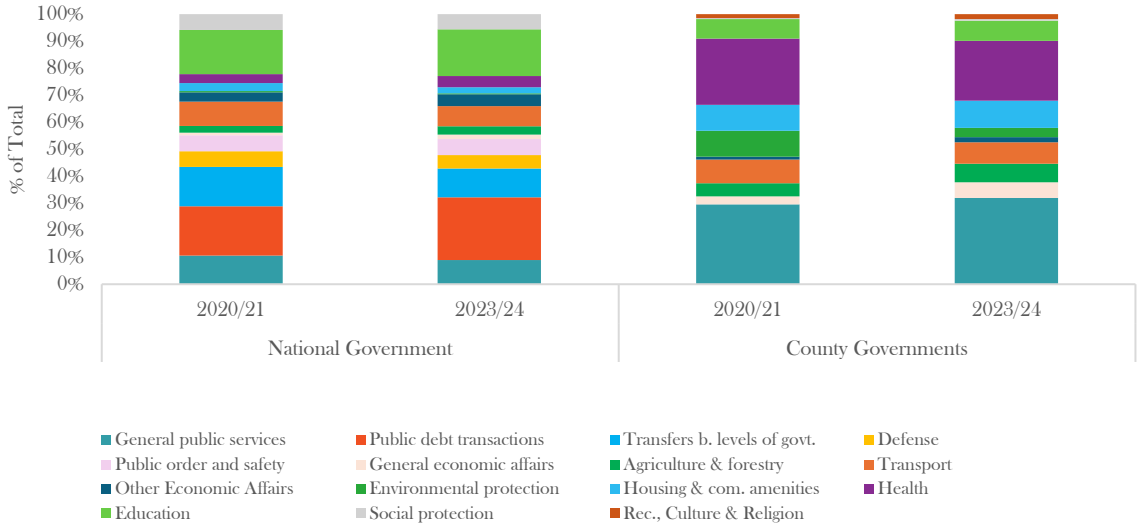
Figure 3.4. Public Sector Efficiency and Rigid Expenditure



Source: Herrera and Olaberria (2020).

A rising proportion of rigid expenditure has increasingly crowded out spending on development priorities, constraining fiscal space for key sectors such as health, education, social protection, infrastructure, and agriculture. Between 2019/20 and 2023/24, spending on core social and development sectors remained modest at the national level—with the exception of education, which consistently accounted for about 20 percent of total expenditure annually. In contrast, allocations to health, social protection, and infrastructure have been limited. At the county level, public administration consumed the largest share of spending, averaging 34 percent per year, followed by sectors like health (23 percent), agriculture and urban development (13 percent), infrastructure (9 percent), and education (8 percent), all of which received comparatively less (figure 3.5).

Figure 3.5. Composition of Expenditure of National and County Governments (% of Total)

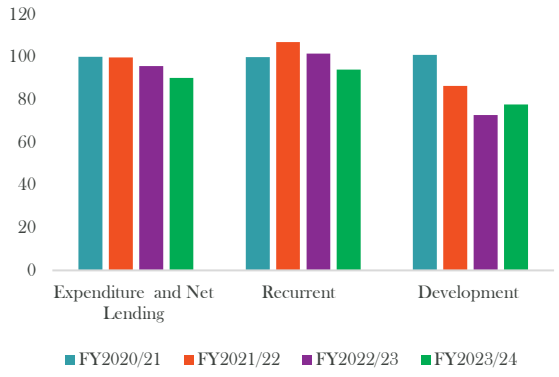


Source: KNBS and World Bank staff estimates.

These low allocations, combined with systemic inefficiencies, have adversely affected service delivery and equitable development in Kenya. In health, rural areas suffer from inequitable workforce distribution, high absenteeism, and shortages of medicines and equipment. In education, investment is skewed toward secondary and tertiary levels, with underfunding in early years education and teacher shortages in rural counties. Social protection programs offer limited coverage and low benefit adequacy, compounded by fragmentation and poor targeting. Similarly, in agriculture, overreliance on untargeted fertilizer subsidies has been at the expense of more impactful investments in irrigation, research, and extension services.

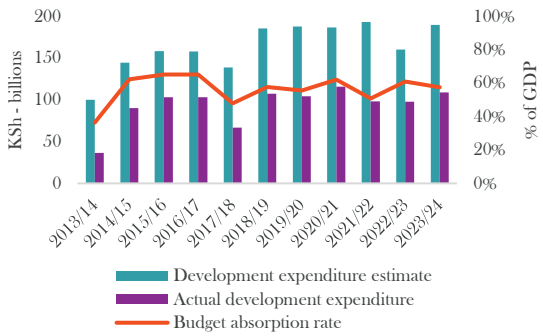
Poor budget planning and execution further exacerbates the challenges posed by budget rigidities. At the national level, the execution of development expenditure reached 73 percent and 78 percent of the approved budget in 2022/23 and 2023/24 respectively. At the county level, the execution of development spending was even lower, at 61 percent and 58 percent of the allocated funds in 2022/23 and 2023/24 respectively. Several factors contributed to these shortfalls, including overly optimistic revenue projections, weak planning and budget preparation, and a tendency to prioritize new projects over completing ongoing ones. At the county level, additional challenges include delays in the disbursement of equalization funds and late budget approvals, which have also hindered effective and timely execution (figure 3.6 and figure 3.7).

Figure 3.6. Budget Execution of National Government Expenditure (Actual vs Printed Estimates, %)



Source: National Treasury of Kenya; and World Bank staff calculations.

Figure 3.7. Budget Execution of County Development Expenditure



Source: National Treasury of Kenya; and World Bank staff calculations.

Moreover, the progressivity of Kenya's public spending has likely declined as a result of the tightening fiscal space. While there are opportunities to improve the progressivity of spending in key sectors, limited fiscal resources constrain allocations to equity-enhancing programs. In social protection, most cash transfer programs are effectively targeted toward poorer households. Other programs, however, require better targeting—for example, the Kenya Cash Transfer for Orphans and Vulnerable Children program disproportionately benefits higher income groups. Subsidy programs remain largely regressive. The fertilizer subsidy program shows mild regressivity, partly reflecting its low initial uptake among poor farming households. In education, in-kind public spending is pro-poor at early education levels but becomes less equitable at the tertiary level, where attendance and access to quality education favor wealthier households. Health spending is more progressive, with the lowest income groups receiving a larger share of services relative to their income, especially in primary care.

Realizing efficiency gains is essential to increase budget flexibility and create fiscal space to raise progressivity, improve service delivery, and address pending bills. These efficiency gains need to be achieved in key areas such as the wage bill, transfers to SOEs, sectoral expenditures, and public financial management.

3.2. Toward a More Sustainable Wage Bill at the National and County Levels

Public employment and wages

Kenya's public sector wage bill remains above the threshold set by Kenya's Public Finance Management Act, 2015. Kenya's wage bill represented 31 percent of total public expenditure in FY 2023/24.[39] This translates into a wage bill-to-revenue ratio for FY2023/24 of 40.5 percent, well above the 35 percent threshold set by the Public Finance Management Act, 2015. Wage bill dynamics are driven by a gradual increase in public sector employment over recent years; public service headcount has increased about 15 percent, from 842,900 individuals in 2018 to 968,452 in 2024. While the wage bill has increased in nominal terms, it has decreased as a share of GDP, declining from 9 percent of GDP in FY2019/20 to 7 percent of GDP in FY2023/24.

Figure 3.8. Public Sector Wage Bill (% of Gross Domestic Product)

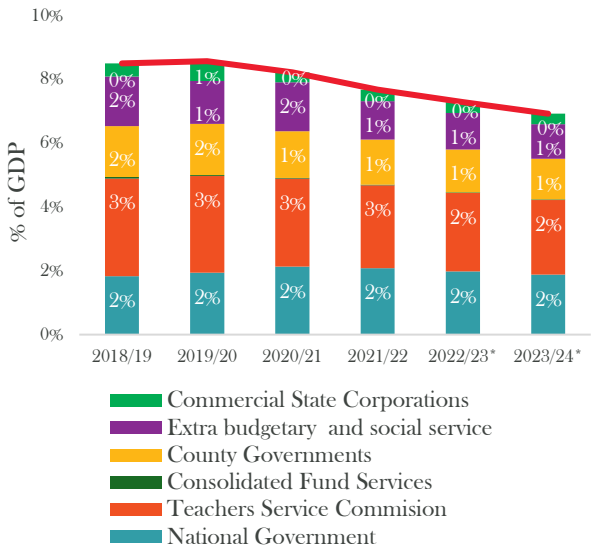
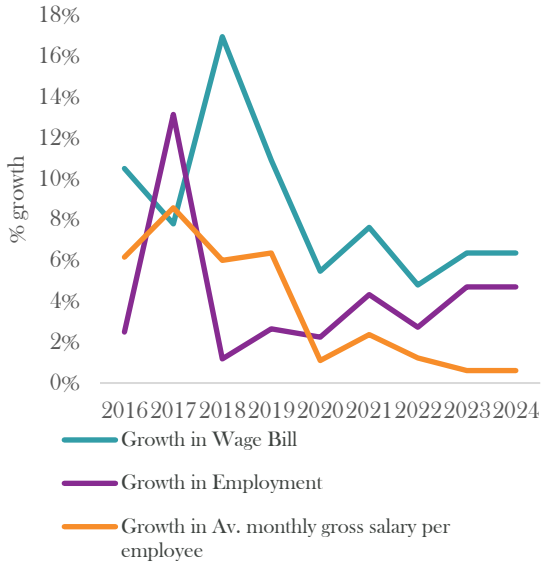


Figure 3.9. Public Sector Wage Bill Trend

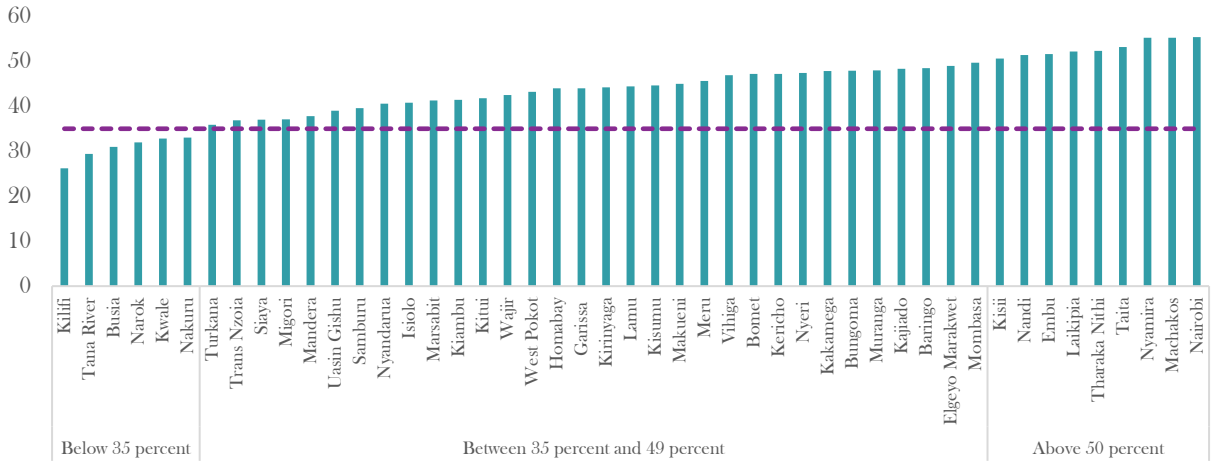


Source: SRC Second Quarter Wage Bill Bulletin, January 2025.

While the national government has generally kept the wage bill steady, many county governments struggle to meet the fiscal responsibility targets set by the 2015 Public Finance Management Regulations. County governments account for about 22 percent of total public sector employment and have been the main drivers of public sector employment growth in recent years, with their combined headcount increasing from 178,700 employees in 2018 to about 221,400 in 2023/24 (an increase of 23.9 percent). In FY2023/24, the aggregate ratio of the wage bill to revenue for county governments—that is, equitable share plus own-source revenue (excluding that from natural extractives)—was about 44.2 percent. Only six out of 47 counties met, or were below, the target ratio of 35 percent of the total revenue that year, while nine counties had ratios of 50 percent or more. A rising wage bill among counties also crowds out investment or development expenditure—violating another Public Finance Management Act target of 30 percent minimum investment. The challenge that some counties face in meeting wage bill ratio targets is partly due to low own-source revenue mobilization (figure 3.10).

[39] Fourth Quarter Wage Bill Bulletin, July 2024. Salaries and Remuneration Commission (SRC).

Figure 3.10. Wage Bill-to-Revenue Ratio, by County, 2024.



Source: SRC Second Quarter Wage Bill Bulletin, January 2025.

At the national level, the government has enforced the wage bill principle through the budget process, but unless revenues pick up, further consolidation is needed to comply with the Public Finance Management Act target. When applying a definition of the wage bill ratio of national government wages to revenues that excludes the 15 percent transferred to counties, the national government wage bill remains above the 35 percent target, reaching 38 percent in FY2023/24 (figure 3.11). *Under this definition, were the national government to meet the 35 percent rule, this would amount an estimated 0.4 percent of GDP.* This suggests there is still room to improve wage bill management at both the national and county level (figure 3.12). The National Treasury of Kenya requires prior approval for resources allocated for new recruitment, interns, or promotions. Ministries must substantiate their wage bill budget requests with documentation from the payroll database.

Figure 3.11. National and County Government Wage Bill-to-Revenue Ratios

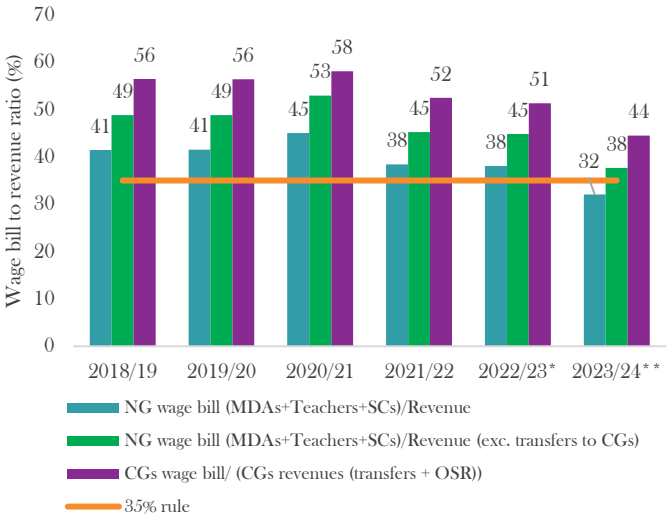
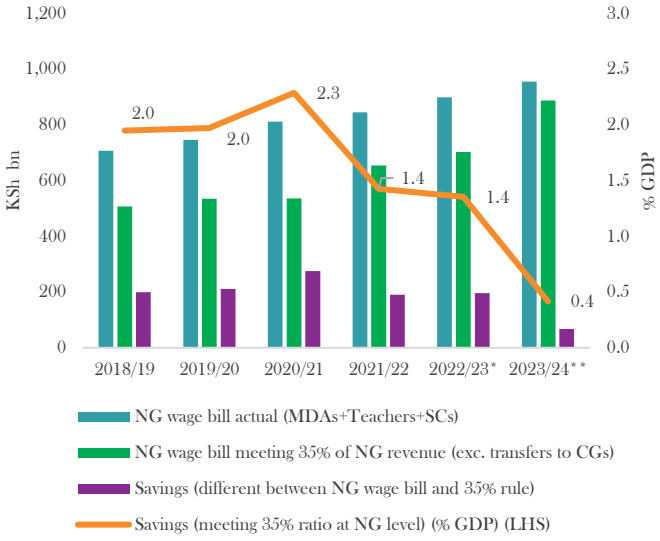


Figure 3.12. Savings from National Government Meeting Target Wage Bill-to-Revenue Ratio of 35 Percent



Source: SRC and World Bank staff estimates.
Note: CGs = county governments, MDAs = ministries, departments, and agencies; NG = national government; OSR = own-source revenue; SCs = state corporations (state-owned enterprises). * provisional, ** budget

To reach the mandatory wage bill ratio threshold, it is important to reevaluate the structure of public sector wages. The average monthly gross salary per public sector employee has steadily increased by about 2 percent annually, from 67,038 Kenyan shillings in FY2019/20 to 73,540 Kenyan shillings in FY 2023/24, driven mainly by state corporations and county governments.[40] Public sector workers in Kenya earn more than their private sector counterparts when accounting for remunerative allowances (figure 3.13). In 2015, the public sector wage premium was estimated at 50 percent relative to the private sector. By education level, public employees with secondary education earned 18 percent more—and those with tertiary education earned 15 percent more—than their private sector peers (figure 3.14).[41] This reflects an overconcentration of highly educated workers in the public sector, which could affect the private labor market.

Figure 3.13. Wage Bill Premium, by Occupation

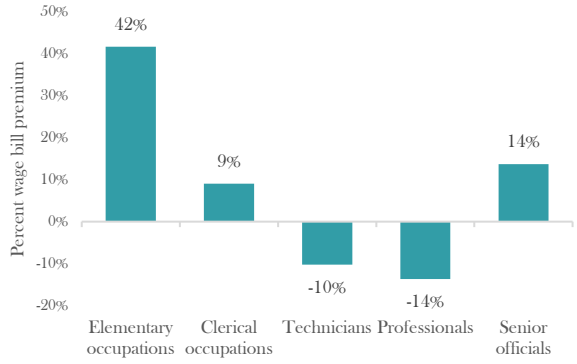
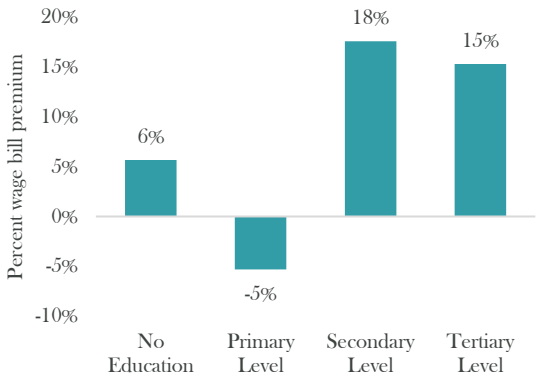


Figure 3.14. Wage Bill Premium, by Level of Educational Attainment



Source: Worldwide Bureaucracy Indicators (database).

Kenya's high wage bill also stems from systemic inefficiencies in human resource management and payroll control. Weak establishment controls have led to recruitments beyond approved levels, while inconsistencies between payroll data and human resource records and an absence of robust frameworks to guide staffing needs have compromised payroll integrity. The extensive use of manual payrolls, prone to manipulation, and ineffective succession management, delaying the retirement of eligible civil servants, further exacerbate the problem. Moreover, the lack of integration across public sector payrolls complicates decision-making on wage bill-related issues, hindering comprehensive efforts to address these challenges.

Several Kenyan public institutions lack approved staff establishments or operate with significant discrepancies between authorized and actual staffing levels, leading to inconsistent allocation of staff across institutions and government.[42] An authorized staff establishment in the public service is based on comprehensive human resource plans guided by workload analysis, which public organizations are expected to undertake to inform their structure and staffing needs. A recent study by Kenya's Public Service Commission reveals that only 4 percent of the country's public institutions have established a human resource management and development plan. While 91 percent of public institutions operate with approved staffing levels, only 33 percent have conducted a workload analysis (table 3.1).[43]

[40] SRC Second Quarter Wage Bill Bulletin, January 2025.
[41] World Bank. 2024. Worldwide Bureaucracy Indicators version 3.1.
[42] Staff establishment refers to the approved jobs and number of posts created for the normal and regular requirements of an organization. The Constitution of Kenya, 2010 mandates the Public Service Commission the authority to establish and abolish offices.
[43] PSC Values and Principles Report 2023-2024.

Table 3.15. Status of Staff Establishments in the Public Service

Service Sectors	Number of Organizations	Organizations with AE	Organizations with AE %	Approved Staffing Levels	Staff in Registers	Vacancies Filled	Staff Registers to AE %
Constitutional Commissions & Independent Offices	10	9	90%	7,413	4,622	4,564	62%
Ministries & State Departments	52	47	90%	127,767	105,539	93,004	83%
Public Universities	39	35	90%	43,273	28,359	26,072	66%
State Corporations and SAGAs	210	191	91%	147,261	99,704	95,146	68%
Statutory Commissions and Authorities	8	7	88%	4,755	1,942	1,913	41%
Total	**319**	**289**	**91%**	**330,469**	**240,166**	**220,699**	**73%**

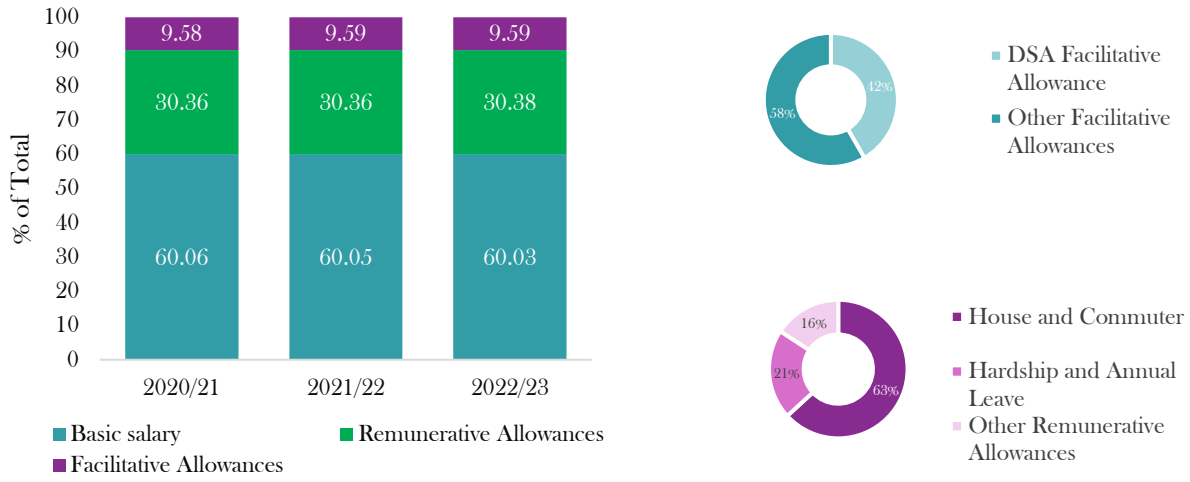
Source: Public Service Commission Annual Values Report 2023.
Note: AE = authorized staff establishment; SAGAs = semi-autonomous government agencies.

Allowances

Another inefficiency in the public sector wage bill is related to the lack of coherence among allowance policies. About 60 percent of wage expenditures are directed toward base salaries for permanent employees and elected or appointed officials, while 30 percent are allocated to remunerative allowances and 10 percent to facilitative allowances. Allowances accounted for 14 percent of total expenditures in FY2022/23. Lack of standardization and control, as well as inadequate adherence to Salaries and Remuneration Commission guidelines on remuneration and allowances, have contributed to the overuse of allowances (figure 3.15).

A critical issue in the current remunerative allowance practice is the market adjustment component that is potentially leading to double compensation. The original intent of the market adjustment was to ensure that compensation reflected prevailing market rates for specific skills until these rates could be incorporated into the basic salary (SRC 2021). This adjustment is now being captured in both the market adjustment and basic salary, however, leading to potential double counting.

Figure 3.15. Composition of Wage Bill by Category, % of Total

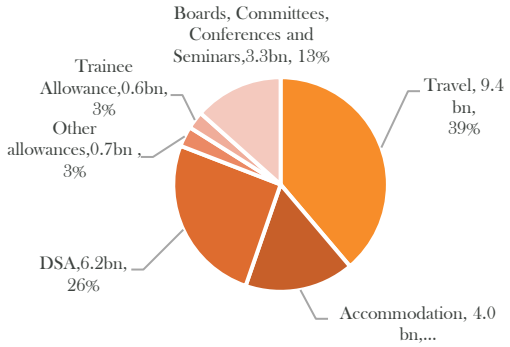


Source: SRC End of Term Report FY 2018/19 – FY 2023/24.

The overuse of facilitative allowances in the public sector leads to significant inefficiencies in both the wage bill and the civil service. These allowances have been used to supplement basic pay rather than as rewards for specific jobs or work performance. This undermines productivity as staff are frequently absent from their duty stations since the system creates incentives to seek per diems (figure 3.16). In the fiscal year 2022/23, spending on the Daily Subsistence Allowance (DSA) amounted to 6.2 billion Kenyan shillings, about 32 percent of the total 19.6 billion Kenyan shillings directed to

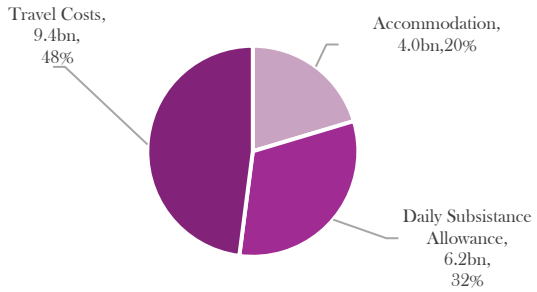
travel-related expenditures (figure 3.17). Audit findings from the Office of the Auditor-General indicate widespread overuse of the DSA, which fails to meet value-for-money standards.[44] The per diem practice has led to the proliferation of committees, meetings, and delays in administrative processes and decision-making. Additionally, technical outputs that would ordinarily be produced by a consultant and validated by government teams end up being produced at very high costs by large numbers of staff through numerous workshops away from the duty station and over extended periods of time. To enhance efficiency, travel frequency and in-country workshop locations should be regulated, budget ceilings for travel and conference expenses reviewed, and DSA rates standardized across job grades to the extent possible.

Figure 3.16. Share of Major Allowances (K Sh, billions, and % of Total), 2022/23



Source: National Treasury of Kenya.
Note: bn = billion

Figure 3.17. Travel Expenditure (K Sh, billions, and % of Total), 2022/23



Source: National Treasury of Kenya.

Standardization of DSAs with international rates—such as those of the United Nations Development Programme (UNDP)—could yield some savings. The Salaries and Remuneration Commission uses the UNDP DSA rates as a benchmark for its own foreign travel DSA. When Kenyan civil servants from various job groups undertake an official overseas trip to the United States, the current government rates lead to an average expenditure of US$513 per day per person (table 3.2). If the per diem and accommodation rates are standardized across all job groups using rates from MDAs, the average daily cost per officer drops to US$326, a saving of US$187 per day. Alternatively, if the rates are standardized across all job groups using the UNDP rate, the average daily cost per officer is US$460, a saving of US$53 per day relative to the current average expenditure.[45]

Table 3.2. Standardization of Kenya's Daily Subsistence Allowance (Foreign Travel), Considering Various Scenarios

Job group	Current per diem rate for travel to United States (US$)	Standardized rate across all job groups, using example from MDAs (US$)	Standardized rate across all job groups, using UNDP rate (US$)
F4	724	326	460
U-V	658	326	460
S-T	527	326	460
P-R	462	326	460
K-N	425	326	460
F-J	405	326	460
A-E	393	326	460
Total	3,594	2,282	3,220
Average	513	326	460

Source: SRC Circular on Allowances, World Bank (2024d), and World Bank staff calculations.
Note: Rates include accommodation and per diem; job groups A–U are equivalent to state officer gradings D4–F2. MDAs = ministries, departments, and agencies; UNDP = United Nations Development Programme.

[44] World Bank. (2024d).
[45] Ibid.

The Kenyan government has recently undertaken several initiatives to enhance wage bill management, but further efforts are needed to achieve significant improvements. Ongoing reforms include the rollout of the Human Resource Information System – Kenya (HRIS-Ke) in all government ministries and in the 47 county governments, the phasing out of certain allowances, and the enforcement of compliance with establishment controls. Key achievements of the HRIS-Ke rollout to date include the migration to HRIS-Ke of all integrated payroll and personnel database sites (except for the Teachers Service Commission and the Ministry of Defence payroll sites) and of some county government staff originally on manual payrolls. Additionally, over 500 system users have been trained to use HRIS-Ke effectively, and the system has been aligned with new pension and tax rules that took effect in January 2025.

It is recommended that the government continues to prioritize the enforcement of compliance with the use of the automated payroll systems, as well as limits for allowances. Implementing a unified human resource information system to manage the entire hire-to-retire process across the public sector is essential. Additionally, auditing and cleaning payroll registers at both national and county levels, and standardizing and enforcing the payment of all allowances through the Integrated Financial Management Information System (IFMIS), will enhance payroll integrity and efficiency. Harmonizing the DSA across job groups, automating travel management systems, and integrating travel expenditure into IFMIS and HRIS-Ke for better financial consolidation can significantly contribute to the management of travel-related expenses.

All in all, effective wage bill management in Kenya requires a comprehensive approach that focuses on automation, compliance, and rationalization of personnel expenditures. By addressing these key areas, the government can achieve significant fiscal savings and ensure sustainable public expenditure management. Moreover, reducing institutional fragmentation could help streamline the civil service.

Policy recommendations:

- *Implement a hiring freeze for two years, conduct a skills audit, and redeploy existing staff across the public service.* Adopting a temporary hiring freeze can make space for the government to review the compensation structures and assess the efficient allocation of existing civil servants. As a significant number of civil servants will retire in the coming years, there is an opportunity to reassess staff allocations across institutions. Alongside other savings, as outlined below, some roles can be automated to reduce the number of staff in routine administrative roles. In turn, this can allow for staff numbers to be increased in service delivery roles in health, education, or better water management in a context of growing climate impacts, enabling service delivery improvements in a fiscally neutral way. Additionally, rigorous exercise to redeploy skills across the civil service, both at the national and county levels of government, should be undertaken rather than prioritizing new hires. Certain priority sectors with growing staffing needs, such as education (see section 3.4.2), would need to be exempted from the freeze.
- *Enhance human resource management and payroll controls.* This should be done through implementation of HRIS-Ke.
- *Phase out the market adjustment component of current remunerative allowance practice and instead incorporate the appropriate compensation for skills into the basic salary.* To address the issue of double compensation, it is recommended that the market adjustment be phased out as initially envisioned, while ensuring that the basic salary adequately compensates for the required skills. Additionally, a comprehensive review of public sector salary structures should be conducted to ensure competitiveness and sustainability, aligning public sector wages more closely with the private sector to reduce the wage premium and encourage a balanced distribution of skilled labor. Implementing performance-based pay systems can incentivize productivity and efficiency, while enhancing transparency and accountability through regular audits and reviews will ensure compliance with established guidelines.
- *Reduce the travel-related budget, estimated at 19.6 billion Kenyan shillings, by 50 percent.* This should be combined with measures to address abuse of allowances. Additionally, DSA rates should be harmonized across all job groups and levels of government.

Potential fiscal impact: Depending on revenue performance, ensuring the national government's compliance with the 35 percent wage bill rule could create fiscal space equivalent to approximately 0.4 percent of GDP (as at 2023/24). Part of these savings could derive from addressing payroll system weaknesses. Halving the travel-related budget would generate about 10 billion Kenyan shillings in savings, with significant room for further efficiency gains by tackling irregular allowances (table 3.3). The majority of the adjustment would, however, need to come from restraining hiring and wage growth. The wage bill at both national and county level exceeds the 35 percent target. Reducing the wage bill at the national level would generate fiscal space, while reducing it at the county level would increase room for county-level public investment.

Table 3.3. Potential Savings To Be Realized by Addressing Payroll System Weaknesses

Payroll system weaknesses	2019/20	2020/21	2021/22	2022/23	Total
Irregular domestic travel and foreign travel allowances	706	1,527	920	202	3,354
Irregular allowances (personal, special duty, bonuses, extraneous, acting, commuter, sitting, leaving, mileage, etc.)	583	716	353	60	1,712
Ghost workers: employee records with missing or shared personal data, Kenya Revenue Authority PINs, double payments, or bank account numbers	197	4,172	1,013	-	5,382
Unapproved remuneration structure, salary scale, recruitment, or appointments	210	59	62	601	932
Unexplained instances/variances and overpayments of basic salary or compensation of employees	502	402	177	970	2,051
Noncompliance with allowances or allowances unsupported by the Salaries and Remuneration Commission	14	273	3	216	507
Total (K Sh, millions)	**2,212**	**7,149**	**2,527**	**2,049**	**13,938**
% of gross domestic product (GDP)	*0.021*	*0.059*	*0.019*	*0.014*	*0.082*

Source: Office of the Auditor-General.

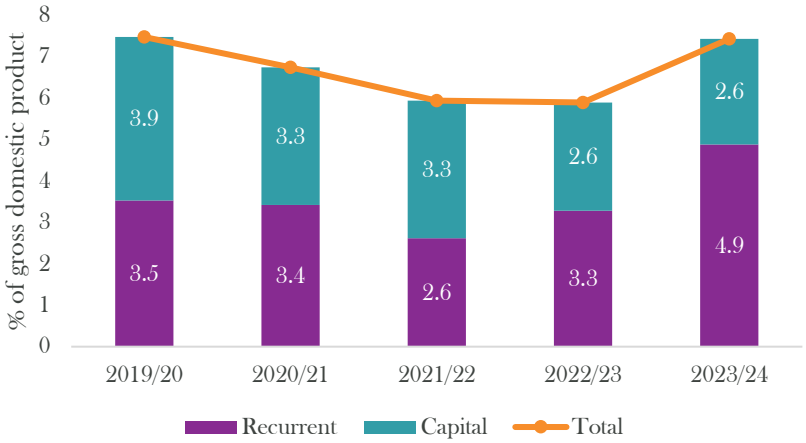
Implications for equity: Reducing Kenya's public sector wage bill could have implications for equity, especially if revenue performance is weak and strict wage bill management measures are needed for fiscal sustainability. Streamlining the civil service and removing allowances may lead to job losses and effective pay cuts, hitting lower earners the hardest. Additionally, rightsizing institutions without proper staff assessments can lead to understaffing and lower quality in essential services like health and education. If, however, these wage bill reductions are combined with efficiency improvements and strategic resource reallocation to social programs, they can free up funds for infrastructure, social protection, and poverty alleviation, ultimately enhancing equity and supporting long-term economic growth.

Implications for productivity: The growing wage bill has been crowding out critical public investments, especially at the county level. Reducing the wage bill in counties especially would help meet another Public Finance Management Act target: minimum investment spending of 30 percent of county revenue. This would promote investment and productivity growth. In addition, raising the productivity of the government workforce through human resource interventions will improve the efficiency of government interventions and the quality of public goods.

3.3. Containing Transfers to State-Owned Enterprises

Government transfers to SOEs through grants and subsidies are substantial.[46] This support has become a significant burden on public finances, amounting to about 6–7 percent of GDP annually between FY2019/20 and FY2023/24 (figure 3.18), with nominal transfers increasing by 50 percent to reach 1,199 billion Kenyan shillings. Compared with international benchmarks, this level of support is high (World Bank 2021). For instance, in Tanzania—which has an SOE portfolio that is comparable in size—such subsidies account for 1.5 percent of GDP. Further, in Kenya, transfers in the form of recurrent expenditures to ensure the continued operation of essential public services, covering operational costs, salaries, and other expenses, have more than doubled in nominal terms between 2019/20 and 2023/24, rising from 3.5 percent to 4.9 percent of GDP, or from 47 percent to 66 percent of total transfers. In contrast, transfers in the form of capital spending—to enable SOEs to build, upgrade, and maintain public assets—have declined over the same period, both as a share of GDP, decreasing from 3.9 percent to 2.6 percent, and as a proportion of total transfers, falling from 53 percent to 34 percent.

Figure 3.18. Government Transfers to State-Owned Enterprises (FY2019/20 to FY2023/24) (% of Gross Domestic Product)



Source: Kenya National Treasury and World Bank staff calculations.

Noncommercial SOEs and government-managed funds receive the bulk of the transfers owing to their economic nature and public policy obligations. According to a World Bank (2021) study, noncommercial SOEs received 96.5 percent of total transfers in FY2019/20, while commercial SOEs received just 3.5 percent. By sector, transport received the largest share of total transfers (42 percent), followed by education (13.8 percent) and social protection (13.2 percent). The study also found that subsidies and grants constitute 78 percent of total revenue for noncommercial SOEs (and 68 percent for government-managed funds), underscoring their heavy dependence on government support. Sectors such as water supply and sanitation, social services, and education are particularly reliant on public funding, with government support representing more than 60 percent of total revenue in each case.

Fiscal exposure and associated risks from both commercial and noncommercial SOEs have continued to rise.[47] World Bank (2021) indicates that total liabilities from Kenyan SOEs increased from 21.9 percent of GDP in FY2015/16 to 23.4 percent in FY2019/20, exceeding the Sub-Saharan Africa average of about 20 percent. When including liabilities

[46] Kenya has 247 state corporations: 46 commercial enterprises and 201 noncommercial entities. Most commercial SOEs are concentrated in the transport and energy sectors. In 2019/20, these commercial enterprises accounted for 85 percent of total revenues and 89 percent of total liabilities in the state corporation sector. Noncommercial SOEs, which include universities and vocational training colleges, water development agencies, and national hospitals, perform social mandates to deliver core public services to citizens and are heavily dependent on government transfers.

[47] Fiscal risks from SOE liabilities can be grouped into explicit and implicit liabilities. Explicit liabilities are those backed by legal or contractual obligations, either direct (for example, on-lending, subsidies) or indirect/contingent (for example, guaranteed loan defaults). Implicit liabilities arise from political or moral obligations, even in the absence of formal contracts, and include direct responsibilities (for example, absorbing SOE pension obligations) or contingent ones (for example, bailouts following bankruptcies of nonguaranteed SOEs).

from Kenya's semi-autonomous government agencies and other public funds not categorized as SOEs, this figure rises to 24.1 percent of GDP. Government exposure through on-lent loans has also grown significantly, largely due to the Kenya Standard Gauge Railway project led by Kenya Railways Corporation. In 2019/20, on-lent loans accounted for 8.38 percent of GDP, with total direct and on-lent loans to SOEs reaching 8.86 percent of GDP, more than double the level in 2015/16. Similarly, government-guaranteed debt has risen from 0.8 percent to 1.52 percent of GDP between 2015/16 and 2019/20, with nearly half of this debt linked to Kenya Airways and the remainder primarily involving Kenya Electricity Generating Company and Kenya Ports Authority.

These growing issues highlight the urgent need for structural reforms to enhance the financial sustainability, governance, and accountability of Kenya's SOEs. This includes accelerating divestment, particularly of commercial SOEs that operate in the competitive sector, advancing ongoing efforts to rationalize and merge entities to improve efficiency and reduce fiscal risks.

Policy recommendations:

- *Enhance the governance, accountability, and performance linkages of transfers to SOEs.* Improve the effectiveness of subsidies and grants by tying them to specific public policy objectives and measurable performance outcomes. In general, there should be a separation of commercial functions from public service delivery obligations to ensure that transfers do not cross-subsidize commercial activities or distort pricing mechanisms in markets. Use of performance-based contracts—such as the results-based financing model in the water supply and sanitation sector—should be expanded to other strategic SOEs, including transport entities. These should include development of key performance indicators that reflect both financial performance (for example, return on equity and equity/assets ratio), and operational and efficiency measures (for example, quality and accessibility of service, labor productivity, and utilization of production capacity). It is also important to strengthen oversight and accountability by the National Treasury of Kenya and the Office of the Controller of Budget, through rigorous monitoring and evaluation frameworks; through mandatory public audits by the Office of the Auditor-General; and by acting on audit reports that flag issues—in some cases, relatively significant issues.[48]
- *Discontinue transfers to commercial SOEs and improve targeting and prioritization of transfers based on socioeconomic impact and need.* Prioritize and align subsidies and grants with national development priorities by focusing on SOEs that deliver public policy obligations, such as critical services to underserved populations, or high-impact infrastructure. This can be implemented through a needs-based allocation formula that considers financial viability, service coverage, and regional disparities—for instance, providing higher grants to water utilities in arid counties than to revenue-generating urban utilities. For commercial SOEs, transfers should be removed, and requirements should be put in place to generate rates of return comparable to similar private businesses (over a reasonable period) and thus minimize distortions in competing with the private sector.
- *Strengthen legal and regulatory frameworks governing SOE loan guarantees by establishing and enforcing clear eligibility criteria for approval.* These criteria can include financial health assessments, performance benchmarks, and comprehensive risk mitigation plans to ensure that guarantees are granted only to creditworthy and well-managed entities, and for projects corresponding to specific and agreed public policy goals and priorities. In parallel, improved transparency and accountability in the reporting of contingent liabilities can be achieved by aligning disclosure practices with international standards. This will enhance fiscal oversight and support better risk management.

Potential fiscal impacts: The reforms will potentially generate fiscal savings of 0.26 percent of GDP per year and enhance the efficiency and sustainability of public spending. Through improving governance, accountability, and performance linkages—for example, by tying subsidies to measurable outcomes (performance-linked and needs-based transfers to

[48] For example, state audit reports from 2023 for companies such as Kenya Railways Company and Kenya Port Authority have flagged as an issue the accuracy of financial reporting, even as it relates to government grants to the companies; have identified issues where management was "in breach of the law"; and have identified issues related to staff wage bill and staff promotions.

SOEs) and strengthening oversight and accountability—the Kenyan government can significantly reduce leakages and misappropriation of transfers. This approach supports fiscal sustainability by avoiding blanket subsidies and ensuring that resources are directed to where they will yield the highest economic and social returns.

Implications for equity: The reforms (for example, performance- and needs-based allocation) will likely improve equity in public spending by prioritizing support for SOEs that serve marginalized and underserved regions, or markets with limited private sector participation. This promotes fairer access to essential services like safe water, transport, and energy. By incorporating indicators such as service coverage and regional disparities, the fiscal system ensures a more just and transparent distribution of public funds, helping close service delivery gaps.

Implications for productivity: The proposed reforms could reduce economic distortions by discouraging inefficiency and rent-seeking behavior among SOEs. Performance-based transfers introduce market discipline, encouraging SOEs to operate more like commercially viable entities and focus on delivering results. This can also foster competition and innovation, particularly if subsidies are carefully targeted to avoid displacing private sector providers operating in similar markets.

3.4. Enhancing the Provision of Public Services in Selected Sectors

More efficient and equitable spending is critical in various priority sectors.[49] Given the constrained fiscal environment—a reflection of the fact that 15 percent of GDP in revenue is insufficient to properly fund key services—a focus on efficiency critically complements a focus on progressivity, so that better services can be provided until the fiscal envelope increases.

3.4.1. Health

Kenya has made important health gains, but major challenges persist. From 2000 to 2021, life expectancy rose from 54 to 67 years, and overall mortality dropped from 1,052 to 357 deaths per 100,000 population. Infant and under-five mortality also fell significantly, largely because of better management of childhood illnesses and communicable diseases. Progress has, however, lagged in reducing maternal mortality, neonatal mortality, malnutrition, and noncommunicable diseases. In Kenya today, noncommunicable diseases are now the leading cause of death, while HIV/AIDS, malaria, and respiratory infections remain among the top 10 killers. Rural and marginalized populations continue to face the greatest health inequities.

Health system capacity has grown, but key gaps remain. Health spending per capita increased by 75 percent between 2001 and 2019, and the Kenyan government now contributes about 47 percent of total health spending. The health workforce nearly doubled to 190,000 health workers by 2020, and health infrastructure has expanded nationwide. Yet government health spending remains low—about 2 percent of GDP—and out-of-pocket costs remain at 24 percent of total costs, limiting access. Many facilities remain under-resourced and understaffed, with health worker shortages and uneven distribution. Devolution improved access to health services but exposed coordination and autonomy issues between counties and the national government.

Kenya's 2023 health reforms introduced a new health financing architecture to advance universal health coverage.[50] Four landmark laws—the Primary Health Care Act, Facility Improvement Financing Act, Digital Health Act, and Social Health Insurance Act—aim to transform health service delivery, financing, and governance. These laws created three national pooled funds: the Primary Health Care Fund (PHCF) to support community and health facility-level services; the Emergency, Chronic, and Critical Illness Fund (ECCIF) to cover high-cost care; and the Social Health Insurance Fund

[49] The following subsections draw heavily from the recently completed and ongoing sectoral public expenditure reviews, including the: (1) 2023 Kenya Public Expenditure Review for the Health Sector 2014/15–2019/20; (2) 2023 Kenya Social Protection and Jobs Public Expenditure Review; (3) 2023 Unblocking Sector Financing for Universal Access to Water Supply and Sanitation in Kenya; and (4) 2024 Agriculture Public Expenditure Review, updated using more recent available information and analysis.

[50] Universal health coverage means that all people have access to the full range of quality health services they need, when and where they need them, without financial hardship.

(SHIF), which replaced the National Health Insurance Fund as Kenya's main health insurance mechanism. The PHCF and ECCIF are intended to be fully publicly funded but are significantly under-resourced, receiving just 4.1 billion Kenyan shillings and 2 billion Kenyan shillings respectively in 2024/25 against estimated needs of 61 billion Kenyan shillings and 107 billion Kenyan shillings.

SHIF's sustainability is undermined by Kenya's largely informal labor market. SHIF is a contributory scheme financed through mandatory payroll deductions (2.75 percent) from employees in the formal sector. Workers in the informal sector, who account for up to 80 percent of the national workforce, are mandated to contribute 2.75 percent of their household income, but the majority do not contribute. As a result, SHIF is projected to collect only 67 billion Kenyan shillings per year—far below the target 157 billion Kenyan shillings. The government plans to subsidize contributions only for indigent households, leaving a large unfunded population. Moreover, the payroll tax design discourages formalization, particularly for low-wage workers and small employers who face higher costs when joining the formal sector. This creates a structural contradiction: SHIF depends on formalization to succeed yet actively undermines it.

Implementation of the 2023 reforms faces serious operational and financial barriers. The sustainability of the Community Health Promoters initiative, which is central to the primary health care model, is questionable since the national government made a commitment to support the initiative for only three years from 2023. Facility financial autonomy, as called for by the Facility Improvement Financing Act, requires political will and enabling laws at the county level. The success of the Digital Health Act hinges on the creation of a national health information system, estimated to cost 104 billion Kenyan shillings. SHIF has encountered system failures, challenges in transitioning from the National Health Insurance Fund, weak coordination with providers, and limited capacity to enforce payment of contributions from informal sector workers. Further, the SHIF benefit package is ambitious and currently unlikely to be affordable. Without stronger public financing and better administrative systems, the full benefits of these reforms may not materialize.

Kenya's transition to domestic health financing is increasingly urgent. As a lower middle-income country since 2014, Kenya has experienced a steady decline in development assistance for health. Most of the remaining aid—over 90 percent of which comes from just four donors—is concentrated in vertical programs such as HIV/AIDS, malaria, tuberculosis, and immunization programs. The recent withdrawal of US government funding, which accounted for 60 percent of Kenya's HIV/AIDS program funding, leaves a major gap. The Kenya Health and HIV/AIDS Financing Transition Roadmap 2022–2030 outlines the country's path to domestic financing, but its implementation remains fragile and underfunded.

Policy recommendations:

- *Strengthen capacity and equity.* Address staffing gaps and resource shortages (medicines, equipment, and supplies) to enhance the functionality of health facilities. Address gaps in health service delivery in underserved regions and among vulnerable groups.
- *Improve governance and efficiency.* Strengthen national–county government coordination to ensure harmonized implementation of priority programs and grant greater autonomy to hospitals. In addition, prioritize pooling of procurement of medicines through the Kenya Medical Supplies Agency to avoid the current fragmentation; link funding to improve budget execution and rationalize the SHIF benefit package to better reflect available resources.
- *Ensure sustainable financing.* Fully cover funding of the PHCF and ECCIF as well as gaps created because of the accelerated donor transition, giving priority to US government-supported initiatives and the immunization program supported by Gavi, the Vaccine Alliance. Focus SHIF collections on formal sector workers; the government should finance contributions for informal workers and poor populations.
- *Consider removing SHIF contributions for low-wage formal workers.* This potential reform could encourage formalization and reduce labor market distortions, as well as cover SHIF services for poor and informal workers and low-wage formal workers, funding the gap through the budget.

Potential fiscal impacts: Universal health coverage will require an additional 2–3 percent of GDP in health spending. Kenya needs about 193 billion Kenyan shillings (1.3 percent of GDP) more per year to sustainably fund the ECCIF, PHCF, and SHIF. Specific additional funding needs for counties and SHIF require further study, and funding needs may further increase as donor support diminishes.

Implications for equity: The poorest members of society will benefit most from universal health coverage. Since poor people face the worst health outcomes and financial barriers, reforms toward universal health coverage can significantly reduce health disparities.

Implications for productivity: Universal health coverage will address underinvestment in human capital, which undermines productivity growth in Kenya. Shifting health financing from payroll taxes to general taxation supports formal job growth. Moving away from contributory schemes for formal low-wage employees makes formalization more attractive and aligns with long-term labor market and health goals.

3.4.2. Education

Kenya has made impressive progress in education the 2000s decade. Since the introduction of fee-free schooling policies (since 2003 at primary level and since 2008 at secondary level, among day schools) access has improved dramatically, with Kenya reaching almost universal access to basic education. The country has recently shifted focus to improving quality and expanding access to post-basic education (Government of Kenya 2023). The country is implementing very ambitious reforms and has sustained high levels of investment in education. Among others, these reforms include a new competency-based curriculum, which has drastically changed the structure of the system and teaching and learning; new textbook policies, which aim for a 1:1 ratio of textbooks to students; support for teachers in the classroom; and strengthening of school-based management. Implementation of the 100 percent transition policy has resulted in more than 90 percent of students transitioning from lower to senior secondary school. Even with significant external disruptions like COVID-19, the rollout of the reforms has been relatively smooth, especially considering their ambition. The reform agenda has been rolled out at primary and lower secondary level and the focus is now turning to senior secondary and tertiary level education. This next stage of reforms will be crucial to support economic transformation and job creation in Kenya.

These recent efforts have made Kenya a leader in education in the Sub-Saharan Africa region, but large inequities persist and are holding the system back. Kenya has the highest expected years of schooling in the region: a child enrolled in school in Kenya today is expected to complete 12 years of schooling, compared to the Sub-Saharan Africa average of eight years. The results are even more impressive when adjusted for quality using learning-adjusted years of schooling (LAYS).[51] Kenya has the highest LAYS in continental Africa. Yet large geographic disparities in results are preventing Kenya from accelerating progress. While a student in Nairobi is expected to complete nearly 12 years of effective learning (LAYS), a student in Garissa is expected to complete fewer than five LAYS. These disparities are particularly pronounced in Kenya's arid and semi-arid counties and other lagging subregions: the average primary net enrollment rate in 2022 for lagging counties[52] (63.2 percent) was 23 percentage points lower than the national average (86.2 percent), while the secondary net enrollment rate for lagging counties[53] (26.5 percent) was 22.3 percentage points lower than the national average (48.8 percent). These disparities are particularly large for girls in lagging counties. Disparities by household income level are also stark, starting in secondary education.

[51] The learning adjusted years of schooling (LAYS) measure adjusts the expected years of schooling measure by the learning outcomes of Kenya relative to those of other countries.

[52] Primary net enrollment rate for lagging counties, from lowest to highest rate: Turkana (44.0 percent), Garissa (48.8 percent), Mandera (55.1 percent), Tana River (57.1 percent), Wajir (57.4 percent), Samburu (58.6 percent), West Pokot (67.1 percent), Marsabit (69.9 percent), Isiolo (76.9 percent), Kwale (78.9 percent), and Narok (81.1 percent).

[53] Secondary net enrollment rate for lagging counties, from lowest to highest rate: Tana River (17.1 percent), Kilifi (19.1 percent), Turkana (20.6 percent), Garissa (20.9 percent), Kwale (24.0 percent), Mandera (24.8 percent), Narok (25.9 percent), Samburu (32.5 percent), Lamu (33.8 percent), Marsabit (35.7 percent), and West Pokot (39.0 percent).

Despite these challenges, increased investment to address educational inequities in arid and semi-arid areas has shown encouraging results. The primary net enrollment rate in arid and semi-arid areas improved from 68.22 percent in 2020 to 76.53 percent in 2022, and counties in the lowest quartile saw the rate improve from 71.5 to 82.2 percent. The disparity between higher- and lower-performing counties narrowed from 18.8 percentage points in 2020 to 9.3 percentage points in 2022 for primary education, and from 43.2 to 18.8 percentage points for secondary education over the same period. This 18.8-point range between quartiles remains significantly high, however, indicating that substantial work still needs to be done to achieve equity.

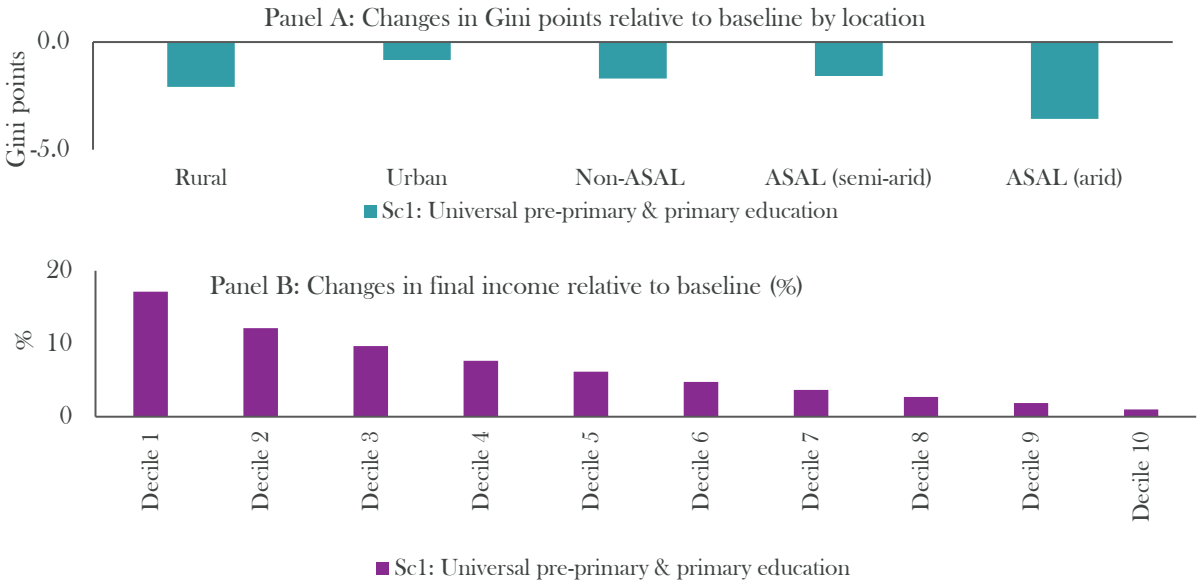
While Kenya is a top performer in primary and secondary education, it severely underperforms in tertiary education (technical and vocational education and training, and university). The gross enrollment rate for tertiary education in Kenya was 20.5 percent in 2022, similar to the average among low-income countries. Access to tertiary education is also highly inequitable. Individuals in the richest income quintile are six times more likely to attend tertiary education than those in the lowest quintile.

Despite significant investments, budget pressures continue in the education system. Education spending has averaged almost 5 percent of GDP and 20 percent of the budget per year over the last decade, meaning that Kenya meets international benchmarks for education spending.[54] Recently, the 2024/25 budget allocated to education 656 billion Kenyan shillings (or 27.6 percent of the total government expenditure on ministries and departments), which is above regional averages—a clear sign of Kenya's commitment to education even in the face of fiscal consolidation. Despite these large investments, successful implementation of reforms has increased pressures on the budget, leaving core programs like Free Day Secondary Education underfunded. The rollout of the competency-based curriculum has created acute staffing needs, with a current shortage of 72,000 teachers in lower secondary and similar shortages expected in senior secondary as new learning areas and pathways are introduced. The Teachers Service Commission estimates that an additional 162,000 teachers will be needed by 2028 to meet reform requirements. At an average teacher salary of about 40,000 Kenyan shillings per month, this represents an additional annual requirement of 77.8 billion Kenyan shillings for salaries alone. As more children and young people progress through the education system and as reforms turn to tertiary education, which is more expensive to deliver, budget pressures are likely to increase.

Expanding equitable access to primary and secondary education would bring in enormous economic gains, particularly for the poorest segments of the population. Fiscal incidence analysis confirms that universal access to preprimary and primary education could dramatically reduce inequality (figure 3.19). The poorest income decile could see a 17 percent income gain, and arid and rural counties could reduce inequality by up to 3.6 Gini points. Achieving universal access would, however, require enrolling about 2.8 million out-of-school children, based on current net enrollment rates for primary and secondary education; registering learners from refugee camp-based schools under the Shirika Plan; and keeping up with population growth. These additional enrollments would require substantial investment in capitation grants (currently 1,420 Kenyan shillings per primary student and 22,244 Kenyan shillings per secondary student annually), in infrastructure, and to recruit and retain the 162,000 additional teachers needed by 2028. While there is room for increased efficiency in spending in primary and secondary education, the needs surpass these potential efficiency gains.

[54] World Bank, 2023f.

Figure 3.19. Change in Inequality by Income Decile, through Achieving Universal Preprimary and Primary Education



Source: World Bank.
Note: ASAL = arid and semi-arid lands.

Improving equity in outcomes requires efficient delivery models (focusing on day school at secondary level where feasible, using technology to support instruction), prioritizing teacher deployment and support to underserved areas, targeted infrastructure investments, and more equitable formulas for capitation grants. Incentivizing teachers to work in underserved counties, alongside continuous professional development, can improve education outcomes and reduce staff turnover. Investment in teacher housing, career progression, and rural hardship allowances should form part of this targeted strategy.

Expansion of tertiary education to support opportunities for young people, increased employability, and job creation will further increase budget pressures. Bringing the gross enrollment rate for tertiary education to the level of upper middle-income countries (raising it from 20.5 to 51 percent) would increase enrollments by an additional 833,000 students. Public funding alone cannot cover this cost. The current financing system in tertiary education brings additional challenges. Financing is currently mostly input-based and relies on student loans with very low repayment rates. Universities and technical and vocational education and training centers have few incentives to diversify sources of income or to align programs with job market needs. To drastically increase access, equity, and the relevance of tertiary education, the financing system needs to be reformed.

Results-based financing can enhance efficiency and accountability. Results-based financing links funding to measurable outcomes such as literacy, numeracy, graduation rates, and research output. In basic education, this would encourage performance improvements; in higher education, it would reward research productivity and student completion. Incorporating results-based financing into Kenya's budget framework would align funding with performance, especially in lagging counties.

Public–private partnerships (PPPs) offer critical support for resource mobilization. Engaging the private sector in financing infrastructure, digital platforms, and learning materials can ease fiscal pressure and accelerate modernization—particularly in higher education and in remote areas. PPPs can fill gaps in capital investment while promoting innovation and cost-sharing.

- **Policy recommendations:**

- *Continue to implement reforms while prioritizing funding to underserved regions.* Prioritize infrastructure and teacher recruitment in rural and arid areas.
- *Adjust capitation grants for equity and to incentivize results.* Include school size and student socioeconomic status in funding formulas.
- *Strengthen teacher training and deployment.* Improve teacher quality and ensure equitable distribution.
- *Strategically invest in infrastructure and leverage PPPs to build more schools and education infrastructure.* Phase capital investments, prioritizing rural schools. Supplement public funding with private investment in education.
- *Expand digital and distance learning.* This will support increased access to higher education in marginalized regions.
- *Reform tertiary education financing to focus on incentivizing results, relevance, and collaboration with industry.* Incentivize improved outcomes in schools and universities.
- *Reduce and consolidate the number of semi-autonomous government agencies under the Ministry of Education.* There are currently 18 such agencies besides universities (which have the same status).

Potential fiscal impacts: Efficiency reforms, PPPs, and better targeting of resources can reduce waste and direct funding to where it will achieve the greatest impact. Results-based financing ensures accountability and better performance per shilling spent. Any additional resources directed to education should be accompanied by efforts to increase efficiency. According to a report by the Presidential Working Party for Education (2023), the fiscal gap for education was about 140 billion Kenyan shillings (roughly 1 percent of GDP), with the largest resource requirements for primary education, secondary schools, and universities.

Implications for equity: Focused investments and reforms in underserved areas can significantly reduce regional and socioeconomic disparities, promoting inclusive national development. Improving equity in access to tertiary education is key to reducing inequities in outcomes in the job market.

Implications for productivity: Kenya needs to expand access to and improve the relevance of tertiary education to support economic transformation and job creation (particularly the creation of good quality jobs). Reforming tertiary education financing can bring large productivity gains if it complements reforms to improve aggregate demand and productivity.

3.4.3. Social Insurance and Social Protection

Social insurance

The formal sector of Kenya's economy, which employs less than 20 percent of those who work, has separate pension plans for workers in the public and private sectors.[55] The civil service pension scheme (public sector workers) is transitioning to a defined contribution plan, while private sector workers must enroll in a provident and pension fund plan with the National Social Security Fund (NSSF) and can choose, in addition, to participate in occupational plans. Self-employed and informal sector workers—who account for the bulk of Kenya's workforce—fall outside the purview of formal sector social insurance schemes and remain vulnerable to shocks and at risk of falling into poverty. In 2021, only 20 percent of workers were part of the formal economy, covered by labor market legislation and hence covered by social security.

As at June 2022, only about 4.6 million Kenyan residents had some form of social insurance, while 2.6 million were contributing to the mandatory NSSF scheme for the formal sector, according to NSSF data, comprising 12 percent of all employed persons (18.1 million). This leaves about 23.7 million people (nonpoor, and not covered by social

[55] Formal sector refers to individuals working in the civil service or in the private sector. The remainder of the total workforce are self-employed or work in the informal sector.

assistance), including a mixture of informal sector workers and adults outside the labor force, uncovered. In Kenya, workers not covered by formal insurance schemes are not required to join the NSSF but can contribute voluntarily, through mainly the Haba Haba scheme. The savings plan, administered by the NSSF, was launched as a pilot in 2019. By providing some income in old age, these types of social insurance scheme for the informal sector can help individuals maintain a basic standard of living and reduce their dependence on social assistance—as long as participants make meaningful and sustained contributions during their working years. Additionally, such schemes promote a culture of saving and can contribute to increased financial inclusion. Evidence shows that the success of these schemes hinges partly on including flexible contributions, options for early withdrawal, and the availability of fiscal incentives (see, for example, Guven 2019). Informal sector workers earn relatively low and irregular incomes, and it has been shown that permitting contributions of varying amounts and on an irregular schedule can make a difference.

While Kenya has been successful in ensuring good social insurance coverage of formal sector workers, concerns around the adequacy and sustainability of these plans remain a concern. The NSSF has been operating as a provident fund plan, to which individuals contribute during their working lives and from which they receive lump sum payments at the time of retirement, or invalidity, or death. There has been a tendency for such lump sum benefits to be poorly applied, resulting in inadequate protection against poverty in old age. Also, given the current extremely low contribution rate, a decent pension benefit from the plan cannot be expected on retirement. In addition, the high administrative costs (due to overstaffing and operational inefficiencies) and ad hoc returns on contributions further contribute to the inadequacy of the benefit at the time of retirement.

Given these challenges, reforms of the pension agenda had been discussed for many years. In 2020, to limit its pension expenditure and the extent of defined benefit obligations, the Kenyan government closed the current civil service scheme to future accrual of benefits for public service employees ages 45 years and below, as well as to all new entrants. A new defined contribution pension scheme for future accrual of benefits was established.

For formal workers in the private sector, the National Social Security Fund Act No. 45 of 2013 transforms the NSSF from a provident fund to a pension scheme, to which every Kenyan resident with an income shall contribute a percentage of their gross earnings. The NSSF scheme requires 12 percent of average wage pensionable earnings (with employers and employees each contributing 6 percent). The contributions are split into two tiers, with tier 1 contributions going toward providing a minimum pension and tier 2 contributions used to provide income replacement.[56] Its implementation has not been enforced, however. The act establishes two funds—a pension fund and a provident fund—to provide for contributions to and payment of benefits. The NSSF scheme provides for a higher level of mandatory contributions, with a corresponding increase in the range and level of benefits; a partial opt-out of mandatory contributions is permitted to enable contributions to alternative schemes, such as employer-sponsored pension plans or private retirement savings. This possibility was introduced by the act for tier 2 contributions to be directed to a contracted-out scheme of choice, which may result in better returns for employees. The act also provides for the bulk of the benefits to be paid in the form of a regular income (either as an annuity or phased withdrawal), thus addressing the challenge of lump sum benefits under the previous NSSF being poorly applied and not delivering effective retirement security. The National Social Security Fund Act aims to correct for the shortcomings in the design of the NSSF, but its implementation is being delayed by legal disputes.

Policy recommendations:

- *Reform the NSSF by addressing administrative shortcomings and inefficiencies and automating the system to reduce administrative costs.* The use of manual processes has led to data inaccuracy (data duplication, missing data, and so on), creating obstacles to operating the fund in an efficient and cost-effective manner, as well as to safely and accurately maintaining member and financial information (for example, tracking overdue payments accurately). This has also raised trust issues for the broader population. The NSSF is in the process of

[56] Tier 1 contributions will include pensionable earnings up to the average statutory minimum monthly wage, defined as the lower earnings limit in the National Social Security Fund Act. Tier 2 contributions will include pensionable earnings between the lower earnings limit and the upper earnings limit (for higher earners).

enhancing its engagement strategies, supporting fund growth, and delivering competitive benefits/pension and social security solutions by switching to a comprehensive, digitally integrated system that leverages innovative technologies (such as artificial intelligence, machine learning, blockchain, and biometric identification) to enhance service delivery, improve compliance, and strengthen operational efficiency. The NSSF should accelerate these concrete steps to reduce its administrative costs and provide stable and competitive returns that win back the trust of its members.

- *Extend and improve social insurance schemes for informal sector workers.* The NSSF lacks adequate resources and capacity to provide quality customer experience for the Haba Haba scheme. Investments in strengthening the NSSF business processes and systems, in large-scale targeted awareness programs to encourage savings among informal workers, and in building trust through transparent payments and easy registration are needed to help scale up the incipient plans. Low levels of financial and retirement literacy are another important barrier, and promoting voluntary long-term savings by millions of informal sector workers requires a collaborative effort by multiple stakeholders, including government, regulators, financial services providers, informal sector groups, and the media. To ensure the Haba Haba scheme's sustainability it is necessary to target the expansion of its coverage for informal sector workers to organized groups in specific industries, which are more likely to have the ability to save regularly in the short term, and to encourage dedicated savings habits among workers.

Potential fiscal impacts: The reform of the public sector pension scheme is aimed at limiting government pension expenditure. This scheme is noncontributory, so benefits are paid from general revenues. The 2.5 percent accrual rate[57] used in the previous scheme is among the most generous in the Sub-Saharan Africa region.[58] Hence, the long-term sustainability of the civil service pension scheme was improved with the reform in 2021, switching from a noncontributory defined benefit scheme to a defined contribution scheme. Government expenditure under the new pension plan will increase in the short to medium term, owing to transition costs, but will eventually decrease. If new and existing civil servants under 45 years of age were all to switch to the defined contribution plan, the expenditure would rise to 1.2 percent of GDP per year in the medium term, but would fall to just 0.4 percent of GDP per year by 2080 (World Bank 2023f). Regarding the NSSF, the National Social Security Fund Act has introduced important measures to strengthen the corporate governance of the NSSF, including controls on the maximum expenditure that the NSSF can incur and requirements for additional disclosures and reporting. It is currently unclear how the transition between pension schemes will happen,[59] hence its fiscal impact is unknown. The impact on funding levels is expected to have net positive effects in the short term, however, as the higher liabilities under the new act will only materialize at a later stage. It is crucial that pension contributions generated by the increased contribution rate are prudently invested to prevent a deficit when these new liabilities fall due.

Implications for equity: Since civil service pensions are paid from general revenues, ballooning pension expenditure also raises concerns of equity, since taxes collected from a broad range of residents are used to pay benefits to a small proportion of the population. In fact, spending on civil service pensions in Kenya has been disproportionately higher than spending on safety nets, education, or health if considering the number of people receiving benefits from each sector. Improving equity was among the reasons given for reforming the civil service pension scheme. Regarding the NSSF, an increase in the contribution rate from the average of 0.8 percent to 12.0 percent would significantly improve the benefit at the time of retirement, increasing equity for workers, since low and irregular contributions combined with ad hoc returns and high administrative costs result in inadequate income on retirement for most private sector workers. The requirement for the benefits to be taken in the form of a regular income rather than as a lump sum will likely improve the long-term retirement security of contributors. About 14 million Kenyan workers participate in the informal

[57] The pension benefits were calculated based on the years that civil servants spend in service, their final basic salaries, and the accrual rate, as per the law.
[58] It is higher than either the Organisation for Economic Co-operation and Development average of 1.20 percent, or the 1.33 percent for each year of service recommended by the International Labour Organization.
[59] Those in the middle of their careers are often given the option to switch, while older civil servants are typically excluded from new defined contribution plans, as they are unlikely to accumulate sufficient savings before retirement—unless, as in Chile, past contributions under the defined benefit system are recognized through mechanisms like recognition bonds.

sector and lack pension/social insurance coverage, raising concerns about equity between workers in the formal and informal sectors. Extending social insurance to informal workers would increase equity by providing a safety net that helps them manage financial risks and ensures a more secure retirement. Expanding coverage to the informal sector would also ensure that benefits are more equitably distributed across different segments of the workforce.

Implications for productivity: The dualism in pension provision for public and private sector workers creates inequities and labor market distortions, which the reforms are likely to limit. In addition, the phasing in of the higher mandatory contributions by the NSSF over a five-year period helps mitigate the cost of the higher contributions for employers and the impact on take-home pay for employees whose employers made no supplementary voluntary provision. A gradual increase in contributions will ultimately contribute to improved pension adequacy while reducing adverse impacts on formalization of the economy due to the relatively high (12 percent) contribution rate.

Social protection

Kenya's social protection and social insurance system has expanded significantly since 2012. The National Safety Net Program (NSNP), also known as Inua Jamii, includes the Older Persons Cash Transfer, the Cash Transfer for Orphans and Vulnerable Children, the Hunger Safety Net Program, and Persons with Severe Disabilities Cash Transfer, and reached nearly 2 million households in 2024. Despite a recent expansion, NSNP coverage remains below 50 percent of households living in poverty. In addition, benefits are too small to significantly reduce poverty, covering only 12.2 percent of poor households' consumption and having declined in real terms by 34.2 percent since 2012. Targeting is also inefficient, with transfers reaching only 59 percent of beneficiaries from the poorest two income quintiles. Improved targeting could enhance the impact of existing spending, potentially eradicating extreme poverty. Increasing benefit levels would improve the NSNP's effectiveness in poverty reduction and resilience building.

Policy recommendations:

- *Increase benefit levels from 2,000 to 3,000 Kenyan shillings per month for all current beneficiaries.* An increase to 3,000 Kenyan shillings would bring Kenya's benefit level roughly in line with the global benchmark of 25 percent of the average monthly expenditures of poor households.
- *Strategic expansion of poverty-targeted cash transfer programs to cover a larger share of the population in the 10 poorest counties.* A commitment to provide social assistance to 75 percent of all households living below the poverty line in the 10 poorest counties in Kenya could significantly improve the efficiency and impact of the NSNP by ensuring that limited resources are directed toward the poorest members of society, where they can have the greatest impact.
- *Strengthen the shock-responsiveness of the NSNP by adopting a risk financing strategy for emergency cash transfers.* While the Hunger Safety Net Program already has a world-class mechanism and strong track record for providing cash transfers for up to 750,000 preregistered households in the event of a shock, its effectiveness is hampered by the lack of a national disaster risk financing strategy. Kenya previously had such a strategy but it was allowed to lapse without replacement in 2018.
- *Improve the efficiency of the NSNP through improved targeting and recertification to ensure that at least 80 percent of its beneficiaries are below the poverty line.*[60] A recertification, along with a dynamic system for the continuous exit and replacement of beneficiaries once they no longer qualify for assistance, would improve the share of beneficiaries who fall below the poverty line and ensure that limited social assistance spending is directed toward the poorest households.

Potential fiscal impacts: Additional annual budget allocation of 0.2–0.3 percent of GDP by the national government for social protection would be needed to implement the reforms: (1) adjusting the benefit value of NSNP cash transfers to 3,000 Kenyan shillings (and thereafter linked to inflation) is estimated at 32 billion Kenyan shillings per year; (2) the

[60] Three out of four NSNP programs have never been recertified, meaning that beneficiary eligibility has not been reassessed following their initial entry to the program. The government has had a plan for recertification since 2019, but it has not been implemented.

strategic expansion of the program to the poorest counties requires an additional 5.6 billion Kenyan shillings per year; and (3) approving and operationalizing robust risk layering mechanisms—including, but not limited to, the existing National Drought Emergency Fund and sovereign drought insurance—to build the long-term sustainability of shock-responsive social protection in Kenya would cost about 1.4 billion to 2.1 billion Kenyan shillings per year.

Implications for equity: Even though another 0.3 percent of GDP spent on the NSNP would double the fiscal envelope from current levels, it would still not bring Kenya's total social assistance spending up to the global benchmark of 1.0 percent of GDP for lower middle-income countries. Improved targeting combined with an increase in benefit levels could, however, eradicate extreme poverty in Kenya, as less than 5 percent of the population are classified as extremely poor and the current NSNP covers nearly 17 percent of Kenyan residents. Replacing nonpoor beneficiaries with poor beneficiaries through improved targeting would not raise the total cost of NSNP cash transfers.

Implications for productivity: Kenya's social protection and insurance programs do not reduce the Kenyan population's willingness to work (the "reservation wage"), as nearly all cash transfers are targeted to people with limited capacity to work (for example, elderly people, orphans, people with severe disabilities). As such, the NSNP does not generate substantial distortions in the labor market—and any distortions will decline further as targeting improves. Instead, the NSNP contributes to aggregate demand, multipliers, and local growth and job creation in poor communities. Based on a combination of survey data (Beegle, Coudouel, and Monsalve 2019) collected from among households and businesses in local communities, for each dollar equivalent transferred to beneficiaries, nonbeneficiaries also see increases in real income ranging from US$0.03 to US$0.83.[61]

3.4.4. Water Supply and Sanitation

Spending on Kenya's water supply and sanitation (WSS) sector has increased but nevertheless remains low and is inadequate to meet Kenya's WSS needs. Spending has been averaging just 2.9 percent of total public spending between FY 2015/16 and FY 2020/21 (an average of 63 billion Kenyan shillings per year). More than half of water sector spending (52 percent) was allocated to WSS. The fiscal constraints arising from broader economic pressures have, however, been limiting the available fiscal space for more robust investment in WSS services. This prevailing level of expenditure is insufficient to meet the scale of needs and address the water access gaps that persist across urban and rural populations. Without reforms, meeting universal access to safe drinking water by 2030 is estimated to require an additional 100 billion Kenyan shillings per year (World Bank 2023g). By implementing sector reforms, this could be reduced to 50 billion Kenyan shillings per year. These reforms include: (1) reducing nonrevenue water; (2) increasing collection rates; (3) raising real tariffs to achieve operation and maintenance cost-recovery levels recommended by Kenya's Water Services Regulatory Board; and (4) raising commercial finance on the strength of improved operating cash flows. Further, deploying cheaper forms of sanitation management for 60 percent of the population would reduce the additional financing to just 10 billion Kenyan shillings per year (World Bank 2023g).

Planning and budget execution are one reason for slow investment in the WSS sector. Execution of budgets in the sector has faced significant challenges, with the overall execution rate from 2015/16 to 2020/21 averaging 77 percent per year, which is relatively low compared with other sectors, like energy and health. Specifically, the WSS sector has faced even lower budget execution, with an average rate of 67 percent during the same period. This underperformance is mainly due to inadequate planning, delays in fund disbursement, slow procurement processes, and issues with land acquisition and resettlement. The uneven execution rates across counties, with some counties achieving high execution rates while others lag significantly, point to systemic inefficiencies and a lack of coordination in resource management. This budget execution inefficiency exacerbates disparities in service delivery, particularly in marginalized regions that require targeted investments to meet their WSS needs.

Kenya's approach to setting water tariffs and subsidies is inefficient and inequitable, contributing to the misallocation of resources. Current tariff revenues are insufficient to cover operation and maintenance or debt repayment costs,

[61] For example, in Zimbabwe, for every dollar transferred to beneficiaries of the Zimbabwe Harmonized Social Cash Transfer Program, an additional US$0.36 resulted as a multiplier. Evidence from Ethiopia shows that for every dollar transferred by a social assistance program, about US$1.50 was generated for the local economy.

necessitating a significant increase in average tariff revenue from the current 95 Kenyan shillings per cubic meter to 163 Kenyan shillings per cubic meter for full cost recovery—in other words, water tariffs are currently subsidized by the national government. A benefit incidence analysis reveals that water tariffs and subsidies are not well-targeted, with wealthier urban households benefiting disproportionately. Poorer households, including both those living in unplanned urban areas (informal settlements) and those living in rural areas, pay a higher share of household income for water services. They also receive less in both operational expenditure and capital expenditure subsidies. This misalignment between spending and needs creates further challenges to ensuring equitable access to safe water and sanitation. To address these fiscal inefficiencies, Kenya must prioritize improvement of budget execution, better target subsidies, and ensure that funding reaches the most underserved populations.

Kenya's water utilities face an unsustainable debt overhang, with about US$2 billion in outstanding debt. This is 10 times the total annual tariff revenue collected by all regulated water service providers. The debt, originating from multilateral, bilateral, and private institutions, was on-lent by the National Treasury of Kenya to water works development agencies and then handed over to water service providers, creating legally binding debt service obligations under the Water Act, 2016. With the peak debt service period that started in 2022, liquidity amortization pressures from legacy debts will be about 7.5 billion Kenyan shillings for the next five years. The standoff between the national government and counties over debt repayments, with many counties unwilling or unable to repay inherited debt, has exacerbated the situation. Factors include inadequate financial capacity, perceived lack of responsibility for pre-devolution loans, and inadequate information about the loans. As a result, few loans are being serviced, leading to the accumulation of significant interest and penalties. If the repayment issue is not addressed, the debt burden will continue to grow, further straining the financial viability of water service providers.

Policy recommendations:

- *Remove the implicit subsidy from urban water tariffs.* At the same time, implement operational measures to raise the efficiency of urban water utilities.
- *Recycle the saved national fiscal resources to invest in the expansion of WSS services.* This should include WSS services for poor urban areas and rural WSS services.
- *Resolve the legacy debt of county utilities.* There are four possible options: (1) forgive interest and penalties on arrears (interest and penalties are estimated at significantly above 6 percent of the total outstanding debt); (2) write off debt that fell due for repayment prior to devolution (these loans were taken out in the 1960s and amount to 9 percent of the outstanding debt); (3) restructure and transfer debt that has fallen due since devolution to counties (provide a moratorium of three years for debt that has fallen due since devolution in 2016, and put on hold the application of penalties and interest; this amounts to 15 percent of the outstanding debt); or (4) transfer loans falling due in future to counties (repayments for the remaining 70 percent of the loan portfolio, which will fall due in future—2025 onwards—should be transferred to counties, allowing them time to ensure that tariffs allow for the repayment of the loans).
- *Support a WSS sector financing strategy.* The strategy needs to: (1) demonstrate the consequences of not moving to cost-reflective tariffs; and (2) develop a strategy to match finance to sector business models (for example, grants for WSS services in arid and semi-arid areas versus commercial finance for urban WSS services).

Potential fiscal impacts: Removing the water tariff subsidy to achieve full cost recovery and repurpose it for investment is expected to be fiscally neutral (about 0.014 percent of GDP). This would free up just under 20 billion Kenyan shillings per year. Along with the other abovementioned reforms, this could plug the investment gap for the WSS sector and help finance some of the additional investment needed in water storage and interbasin transfers.

Implications for equity: Water tariffs, when unsubsidized, would no longer be regressive, and poorer households will benefit from better access to WSS services. Data indicates that poorer households spend more on WSS services as a

share of their total household expenditure. The benefit incidence analysis shows that poorer households have received only 22 percent of all water supply subsidies.

Implications for productivity: The current tariff structure encourages overuse of water by wealthier households connected to the utility network and underuse by poorer households that are not connected to the utility network.

3.4.5. Agriculture

The Kenyan government has implemented various public support programs in agriculture, with input subsidies—particularly for fertilizers—playing a central role. Kenya's agricultural sector accounts for 20 percent of GDP and employs about one-third of the labor force. Yet it mostly grows along the extensive margin: productivity remains low, with average cereal yields over the period 2000–22 of 1.5 tons per hectare, compared with 1.9 tons per hectare and 2.1 tons per hectare in Ethiopia and Uganda respectively. This suggests inefficient use of inputs, including the utilization of fertilizer (FAOSTAT). Moreover, stagnating yields suggest that past agriculture support programs have not generated the desired outcomes.

Key programs to raise productivity include the National Accelerated Agricultural Input Access Program (2007–2015) and the National Fertilizer Subsidy Program (NFSP-1) (2008–2019). Together, these programs benefited 4.36 million farmers in Kenya. Across these programs, the focus shifted heavily toward fertilizers, for which the share of input subsidies rose from 33 to 98 percent per year, while support for less distortive on-farm capital investments fell from 60 percent to just 1 percent. On-farm services support averaged only 5 percent per year. Fertilizer subsidies also grew as a share of total producer support, rising from 33 percent in 2007 to 62 percent in 2018, as other forms of support to producers declined, including subsidies for on-farm capital formations, income support, on-farm subsidies, and other payments.[62]

Introduced in 2020, the National Value Chain Support Program (NVSP), also known as the e-voucher program, offered a more efficient, targeted, and transparent alternative. Aligned with the Agricultural Sector Transformation and Growth Strategy (2018–2028), the NVSP aimed to reach 1.4 million smallholder farmers by 2025 with bundled input packages (seeds, fertilizer, agrochemicals, and post-harvest tools). Under the NVSP, farmers paid 60 percent of input costs in year 1, with government subsidies declining to 30 percent in year 2 and 10 percent in year 3—eventually transitioning farmers to market prices. Inputs were distributed through prequalified private agro-dealers, reimbursed in real time by commercial banks acting as fund managers. Key success factors included comprehensive registration of both farmers and agro-dealers; assignment of agro-dealers to specific catchment areas for targeted distribution; seamless, timely reimbursements ensuring liquidity, efficiency, and transparency; strong coordination between national and county governments; and active private sector participation. Early evaluations showed positive impacts on access, productivity, and market engagement (Vutukuru 2022).

The NVSP was discontinued in 2022 and replaced by a second National Fertilizer Subsidy Program (NFSP-2), but the new program is inefficient, poorly targeted, and negatively affects the private sector by crowding out agro-dealers. Introduced following the 2020 fertilizer crisis—which was driven by COVID-19-related disruptions, external conflicts, and rising global input costs—NFSP-2 marked a return to a centralized subsidy model. Budgetary allocations to NFSP-2 have risen sharply, from 2 billion Kenyan shillings in FY 2021/22 to more than 12 billion Kenyan shillings in FY 2023/24. Fertilizers are distributed through National Cereals and Produce Board stores, with farmers redeeming e-vouchers via Short Message Service (SMS) texts. Implementation faces challenges, however. In 2023, while 46 percent of households registered for SMS notifications, only 32 percent received the notifications, and just 19 percent obtained subsidized fertilizer.[63] Unlike its predecessor, the NVSP, which used a decentralized distribution system driven by private agro-dealers, the NFSP-2 centralizes procurement and distribution through a limited number of fertilizer companies and National Cereals and Produce Board outlets. This has resulted in the crowding out of agro-dealers, reduced market competition, and weakened distribution networks. The program has reduced commercial fertilizer use by 22 percent,

[62] Food and Agriculture Organization of the United Nations. (n.d.), accessed in December 2024.
[63] Ricker-Gilbert, J., Mather, D. L., Maredia, M. K., Olwande, J., & Bin Khaled, N. (2024, October).

and the domestic fertilizer industry came under pressure, threatening jobs in the sector. At 1.11, the benefit–cost ratio of the NFSP-2 is lower than the ratio when the private sector distributes the subsidized fertilizers (1.22), reflecting the better returns with reduced financial losses for private-sector fertilizer suppliers.

Policy recommendations:

- *Reinstate the NVSP and phase out the NFSP-2.* This will include: (1) ceasing public procurement of fertilizer; (2) onboarding remaining agro-dealers; and (3) providing e-vouchers to poor farmers, to be redeemed with agro-dealers or the National Cereals and Produce Board outlets.
- *Adopt a holistic productivity strategy.* Move beyond fertilizer-centric interventions to improve overall soil health and productivity; e-vouchers will provide farmers the choice to select the inputs they need and to experiment with new inputs to raise productivity.
- *Focus the government's role on facilitation and equity.* Focus public efforts on regulation, quality control, and safeguarding vulnerable farmers—while allowing private markets to drive efficiency and innovation.

Potential fiscal impacts: Through better targeting and more efficient private sector-led procurement, the budget allocation could be reduced closer to the original allocation, with potential fiscal savings of up to 10 billion Kenyan shillings per year or 0.1 percent of GDP.

Implications for equity: Better targeting of small farmers will have a large positive impact on the progressivity of the program. Broadening the distribution network from the 110 National Cereals and Produce Board outlets to the 30,000 or so agro-dealers in Kenya will also reduce travel distances for remote smallholders, ensuring that the value of the e-voucher is not eroded by transportation costs.

Implications for productivity: The NVSP would remove distortions associated with public intervention in the competitive private fertilizer market, by providing farmers with the choice to buy the inputs they consider best. This will result in the use of better-fit fertilizers, raising soil quality and long-term agricultural productivity. Finally, better targeting will raise the efficiency of spending, directing scarce fiscal resources to more productive activities (for other examples, see chapter 4).

3.5. Strengthening Public Financial Management

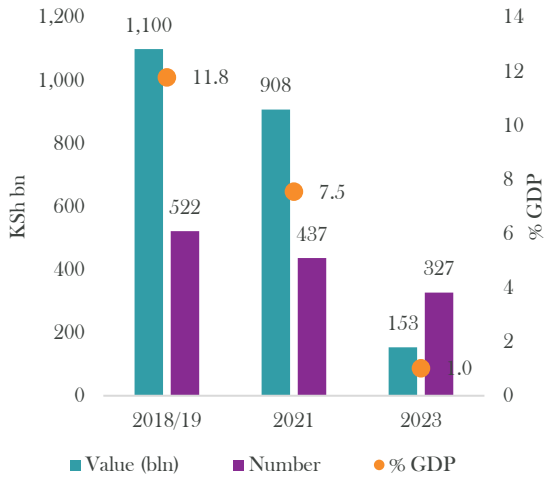
3.5.1. Public Investment Management (PIM)

Several challenges hinder the successful completion of public investment projects in Kenya. Project proposals by ministries, departments, and agencies (MDAs) of government are often inadequately designed and costed, resulting in a high number of projects stalling due to procurement delays, faulty construction, and cost overruns during implementation. There are no coherent and transparent criteria applied during the budget preparation cycle for the selection, prioritization, and inclusion in the budget of projects—yet, ideally, inclusion of projects should be based on objective economic viability and return analysis, in line with expressed public policy objectives. Coordination challenges between MDAs involved in projects spanning multiple sectors cause implementation bottlenecks, necessitating interventions from higher levels of government to unlock progress. There is a lack of information regarding the status of planned and ongoing investments, making it difficult to track, monitor, and evaluate expenditure for public investments.

The Kenyan government is strengthening public investment management and has made progress in monitoring stalled projects. The government is enhancing public investment management by standardizing and automating the project cycle through new regulations and implementation of the Public Investment Management Information System (PIMIS). The National Treasury of Kenya is rolling out public investment management regulations across the public sector, establishing frameworks and criteria—including cost–benefit analyses, feasibility studies, and selection standards—for prioritizing economically viable infrastructure projects within available financing. PIMIS, a digital platform integrated with other public financial management systems such as IFMIS, will centralize all public investment projects, providing a consolidated view of portfolio composition and performance. By automating workflows, PIMIS will improve the efficiency of project preparation, execution, and monitoring, while enhancing data quality and transparency. Currently being piloted in the roads, infrastructure, health, and education sectors, PIMIS is expected to launch sector-wide in July

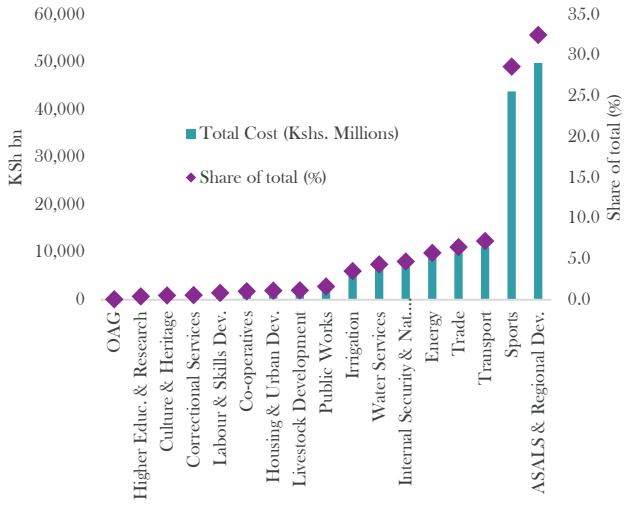
2025. Additionally, significant progress has been made in reducing the number of stalled projects, from 522 projects valued at 1.1 trillion Kenyan shillings in 2018/19 to 327 projects worth 153.47 billion Kenyan shillings (1 percent of GDP) in 2023. Implementing PIMIS will enable systematic, real-time monitoring of project execution, eliminating the need for costly and inefficient periodic reviews (figure 3.20 and figure 3.21).

Figure 3.20. Value and number of Stalled Projects



Source: National Treasury of Kenya and World Bank staff calculations.

Figure 3.21. Distribution of Stalled Projects across Ministries, Departments, and Agencies, 2023



Source: National Treasury of Kenya and World Bank staff calculations.

Policy recommendations:

To enhance the effectiveness, efficiency, and impact of public investment in Kenya, an integrated approach is required. The following actions are recommended to support a more robust and accountable public investment management framework:

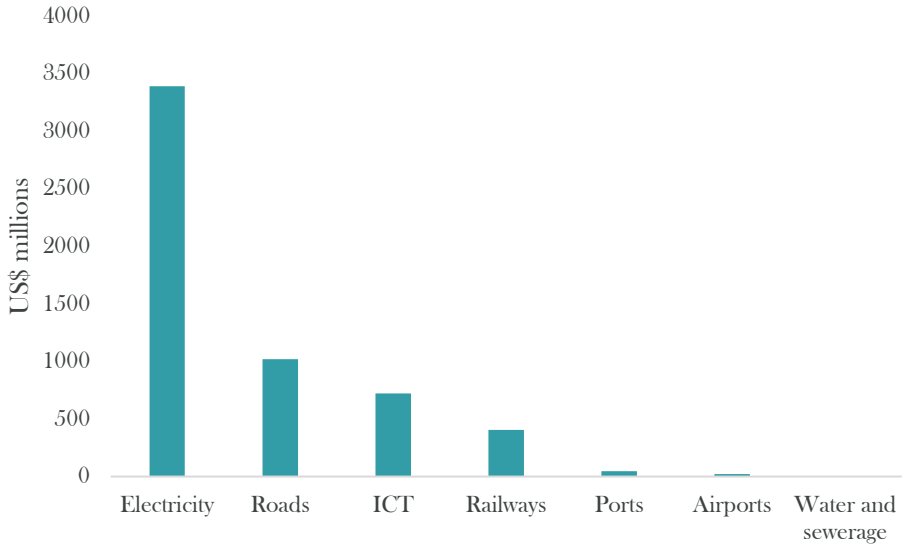
- *Strengthen project preparation and selection.* Improve the quality of project preparation and appraisal by institutionalizing rigorous, evidence-based screening processes. Mandate cost–benefit analysis, feasibility studies, and alignment with sectoral strategies as prerequisites for budget inclusion. Link capital budgeting explicitly to the National Development Plan and the Medium-Term Expenditure Framework to ensure that projects are economically viable and aligned with national priorities.
- *Accelerate PIMIS rollout and integration.* Expedite the full rollout of PIMIS and ensure its seamless integration with IFMIS and public financial management systems. Establish PIMIS as the central platform for project registration, documentation, real-time performance tracking, and postcompletion evaluations. Ensure interoperability with procurement and accounting systems to enhance financial oversight and reduce data fragmentation.
- *Enhance cross-government coordination.* Strengthen institutional coordination mechanisms for cross-sectoral and intergovernmental projects by establishing formal interagency working groups or steering committees. These units should facilitate joint planning, streamline implementation processes, and ensure accountability in multistakeholder initiatives.
- *Leverage PPPs.* Fully operationalize the PPP framework to attract private capital and expertise in infrastructure development. Ensure PPP projects are subject to robust project appraisal, risk assessment, and value-for-money analysis prior to approval. Strengthen institutional capacity in PPP units and provide clear guidelines for project

structuring, procurement, and contract management. Foster transparency and competitive bidding to safeguard public interest and build investor confidence.

3.5.2. Public–Private Partnerships

Kenya has made notable progress in advancing PPPs to meet its infrastructure development goals. The enactment of the Public–Private Partnerships Act, 2021 marked a key milestone, streamlining project approval processes and enhancing transparency compared with the previous 2013 law. The establishment of the Public–Private Partnerships Directorate under the National Treasury of Kenya has helped centralize oversight and improve coordination. Yet, most PPP projects are in the electricity sector (figure 3.22), which, in many cases, means they are associated with high costs. As at March 2025, Kenya has 35 PPP projects under preparation and implementation—27 in the pipeline and eight under implementation—across sectors like energy, transport, agriculture, water and irrigation, housing, urban development, education, and health (table 3.4).

Figure 3.22. Public–Private Partnership Projects in Kenya, 1990–2023 (US$, millions)



Source: WB PPI database.

Table 3.4. Public–Private Partnership (PPP) Projects in Kenya, by Stage in the PPP Project Cycle, March 2025

Stage of PPP project	No. of national government projects	No. of county government projects	Total number of projects per stage
Projects in operation and maintenance phase	5	0	5
Projects in construction phase	3	0	3
Projects at commercial close (PPP contracts signed)	1	0	1
Projects at contract negotiations (contracts not yet signed)	2	0	2
Projects in tender/procurement of private party	1	0	1
Projects ready for tender	1	0	1
Projects at feasibility study/project development phase stage (ongoing studies)	15	1	16
Projects at proposal stage, awaiting procurement of transaction advisor	5	1	6
TOTAL	33	2	35

Source: NT PPP Directorate, Government of Kenya.

While public investment and PPPs in Kenya have shown promise, several challenges remain. The upfront costs and time needed to prepare a PPP project can seem prohibitive to implementing agencies. This preparation involves technical studies to identify risks, which may relate to technology, materials supply, insurance, long-lead items, critical path issues, construction costs, input supply, staffing needs, operating costs, environmental, and/or social risks. Financial advice and modeling are necessary to identify the best type and sources of capital, address financing gaps, prepare for refinancing, and create a risk management framework to reduce the weighted average cost of capital. This includes assessing the direct or contingent financial support needed from the government. Additionally, contractual and legal advice is required to ensure balanced risk sharing through clear yet flexible corporate and contractual arrangements, with conflict resolution arrangements in place and flexibility for additional capital contributions, sell-down of positions, and/or refinancing.

The disadvantages of not properly structuring PPPs far outweigh potential short-term benefits, and ill-structured PPPs have the potential to cause severe problems. Poorly structured PPPs lacking clear terms, risk allocation, and performance standards typically lead to financial challenges, increased costs, procurement delays, operational inefficiencies, and reduced incentives for service delivery. Ineffective risk allocation can exacerbate construction delays, risk management difficulties, and even lead to project abandonment. Additionally, financing challenges can arise, resulting in higher costs of capital, funding gaps, and potential government bailouts. Insufficient performance benchmarks and inadequate monitoring can lead to underperformance by private partners, negatively affecting public services and infrastructure. Unclear legal terms frequently result in disputes, regulatory noncompliance, and project delays. Ultimately, failed PPPs undermine public trust and satisfaction, increase government financial burdens, and can escalate public debt because they are contingent liabilities. Effective structuring of PPPs requires clear contracts, appropriate risk sharing, and clearly defined roles and responsibilities for both public and private sectors to ensure project success and value for money.

Kenya's experience underscores the substantial costs of improperly executed PPPs. Selecting independent power producers through direct negotiations instead of competitive bidding weakened the government's negotiating position, limited price transparency, and increased power purchase costs. In the transport sector, privately initiated proposals often bypassed competitive processes, resulting in stalled or inefficient projects and undermining potential efficiency and quality improvements. Globally, evidence consistently shows that competitive procurement significantly reduces costs: solar photovoltaic projects procured competitively were about 47 percent cheaper, and road projects had investment

costs approximately 55 percent lower than directly negotiated deals. Overall, uncompetitive bidding significantly inflates costs and diminishes project value.

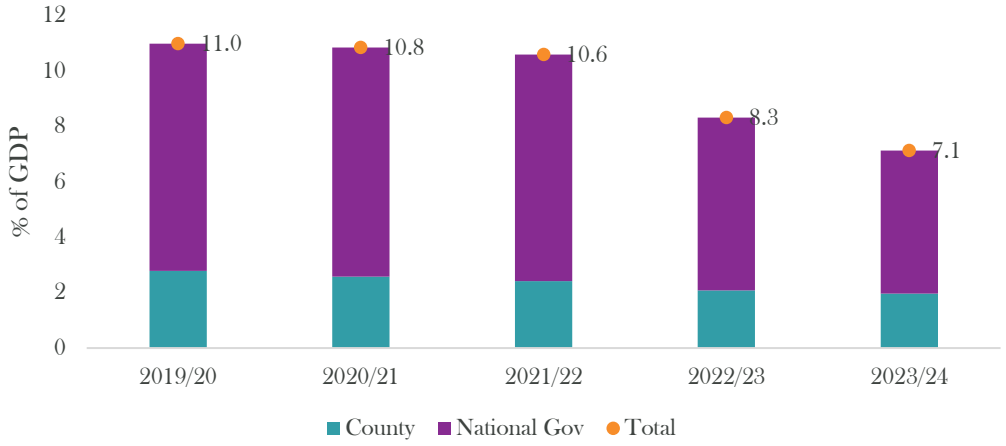
Policy recommendations:

- *Alignment with least-cost plans.* Ensure investments are driven by sector entities and demand for infrastructure services and are aligned to least-cost development plans in each sector. This would allow Kenya to harness its technical capabilities, properly time and sequence investments, and implement more infrastructure investments given its tight financial resource constraints.
- *Competitive bidding.* Avoid uncompetitive bidding, which can inflate project costs by at least 10 to 30 percent, and adopt competitive bidding as the default mode of procurement. Attracting multiple bidders can lead to better value-for-money metrics and lower costs over the project life cycle.
- *Proper structuring, due diligence, and contractual clarity.* Ensure suitable technical design, clear terms, risk allocation, and performance standards. Conduct thorough financial and technical studies to identify risks and create a robust risk management framework. Ensure balanced risk sharing through clear yet flexible corporate and contractual arrangements, with conflict resolution mechanisms.
- *Monitoring, performance, and evaluation support.* Establish clear performance benchmarks and monitoring to ensure that the private partner meets service delivery expectations. Assess the direct or contingent financial support needed from the government to ensure the financial viability and bankability of the project.

3.5.3. Public Procurement

Public procurement constitutes a significant portion of government expenditure in Kenya. The national and county governments allocate between 7 and 11 percent of GDP to public procurement, which accounts for about 60 percent of the national budget, including both development and operations and maintenance expenditures. When SOEs are factored in, total public procurement is estimated to reach 26 percent of GDP, which highlights the need to enhance efficiency and accountability. Information available on the BOOST Open Budget Portal managed by the World Bank indicates that there has been a declining trend in public procurement expenditure in Kenya over recent years (figure 3.23).

Figure 3.23. Estimated Public Procurement Value in Kenya, excl. State-Owned Enterprises (% of Gross Domestic Product)



Source: World Bank BOOST open budget portal.

An efficient public procurement system ensures effective service delivery aligned with the government budget. For FY2022/23, over 50 percent of the procurement budget at the national level was allocated to specific departments (table 3.5). If an electronic government procurement (e-GP) system was installed and used to secure the contracts associated with these budgetary allocations, the digitization would result in savings.

Table 3.5. Procurement Budget at the National Level, FY2022/23

	Leading ministries and departments	Procurement budget (Kenyan shillings)	% of total budget
1	102 Ministry of Interior and Coordination of National Government	50,802,480,074	13
2	107 The National Treasury	22,880,436,190	6
3	101 The Presidency	22,002,850,642	5
4	115 Ministry of Energy and Petroleum	21,158,874,612	5
5	204 Parliamentary Service Commission	18,544,362,170	5
6	108 Ministry of Health	15,201,217,354	4
7	116 Ministry of Agriculture, Livestock, and Fisheries	12,575,995,873	3
8	109 Ministry of Transport and Infrastructure	11,907,680,291	3
9	203 Independent Electoral and Boundaries Commission	10,984,945,834	3
10	105 Ministry of Foreign Affairs and International Trade	9,484,306,688	2
11	106 Ministry of Education, Science, and Technology	9,209,681,612	2
Total procurement budget (KSh) for 11 agencies		204,752,831,339	
Total contribution (%) toward budget for the FY 2022/23			51

Source: World Bank BOOST open budget portal.

Available data and the most recent Auditor-General's report suggest opportunities to increase efficiency in public procurement. Transaction-level procurement data are publicly available through Kenya's Public Procurement Information Portal, an initiative aligned with Open Contracting Data Standards. The data are not exhaustive, however, owing to nonmandatory reporting requirements. Since 2018/19, over 115,900 procurement activities valued at more than 1,753 billion Kenyan shillings have been recorded in the portal. While "request for quotation" accounted for 64 percent of contracts by volume, "open tendering" represented 75 percent of contracts by monetary value. This indicates inefficiencies, suggesting that shifting toward more competitive methods like open tendering could enhance public procurement (figure 3.23 and figure 3.24). Additionally, the Auditor-General's 2023/24 report identifies delays in contract implementation and pending payments, potentially incurring interest costs of up to 16 billion Kenyan shillings, highlighting the need for improved procurement planning and timely execution to avoid significant economic costs (figure 3.26).

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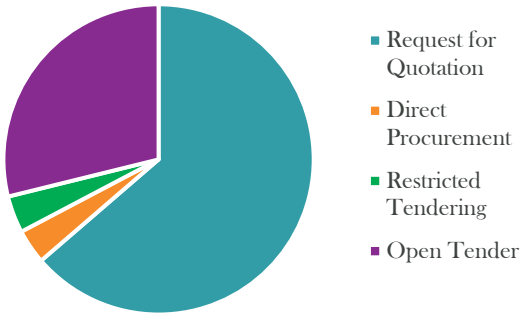
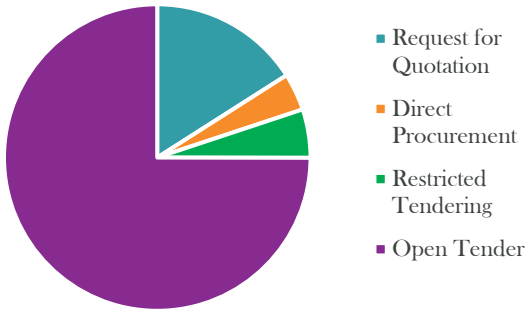
Figure 3.24. Contract Awards (% of Total), by Procurement Method



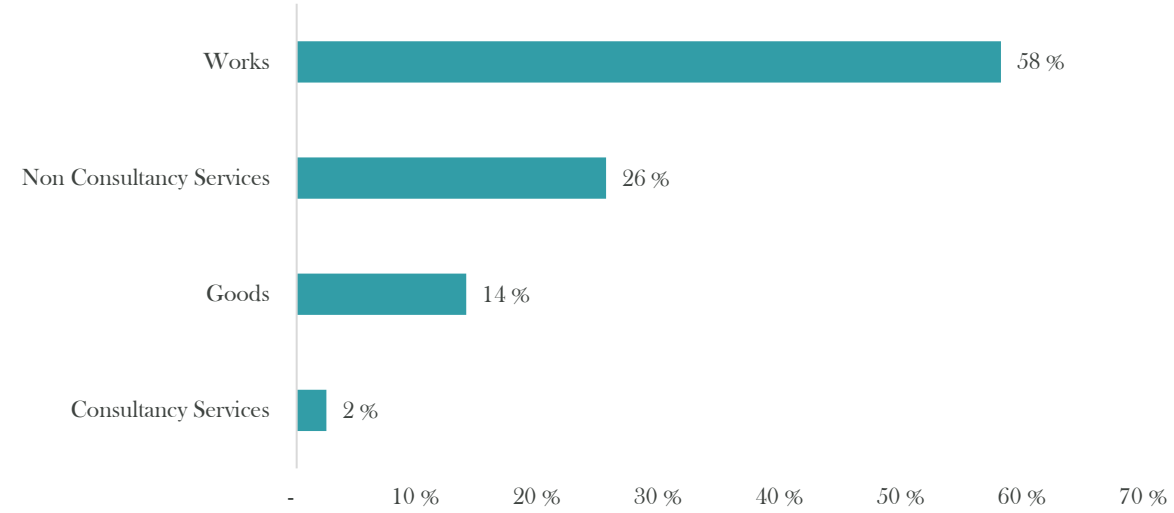
Source: Public Procurement Information Portal, Kenya Public Procurement Regulatory Authority.

Figure 3.25. Value of Awarded Contracts (% of Total Value in Kenyan Shillings)



Source: Public Procurement Information Portal, Kenya Public Procurement Regulatory Authority.

Figure 3.26. Contract Types



Source: National Treasury of Kenya.

Public procurement and contracting systems in Kenya are still widely viewed as lacking transparency and failing to ensure value for money. The main issues arise from the lack of integration of procurement policies and systems, insufficient transparency and enforcement, and limited technical expertise, resulting in delays, cost overruns, and weak accountability. Costs related to corruption in the public procurement process are estimated at 10–25 percent of the contract value awarded. The public perception is that corruption is widespread in public procurement, leading to general mistrust in government tendering. A 2018 survey by Kenya's Ethics and Anti-Corruption Commission (EACC 2018) found that 42 percent of respondents seeking government services in 2018 experienced some form of corruption. Public procurement is performed under the Public Procurement and Asset Disposal Act of 2015. The act mandates the award of contracts within the original bid/proposal validity period; rebidding is required if the period expires. This requirement has a positive impact on the evaluation process, ensuring timely decisions (table 3.6).

Table 3.6. Procurement Metrics of Top 10 Procuring Entities, by Contract Value in 2024

Procuring entity	No. of tenders	Contract amount (K Sh, millions)	Maximum days from advertising to award	Average time for bid evaluation (days)	Maximum time for bid evaluation (days)
Kenya Ports Authority	44	358,829	138	40	115
Kenya Power & Lighting Company	24	18,649	72	17	57
Kenya Revenue Authority	82	14,283	107	14	77
Ministry of Lands and Physical Planning	2	10,002	20	-	7
Busia County Government	37	6,184	42	25	29
Karatina University	16	5,638	61	16	48
Makueni County Government	191	5,364	82	25	74
Kisumu County Government	1	5,104	38	20	20
Kitui County Government	68	3,873	35	5	27
Kenya Medical Supplies Authority	5	3,828	102	14	53
Total	470	431,754			

Source: National Treasury of Kenya, Public Procurement Information Portal.

Kenya has improved corporate transparency, but challenges remain. Advances have been made through beneficial ownership disclosure, with companies required to maintain registers of beneficial owners and an online central registry established in October 2020. Challenges such as noncompliance, misunderstandings, and incomplete data publication persist, however. Concerns about the effectiveness of legislative definitions and the lack of publicly accessible beneficial ownership data, particularly alongside contract award information, highlight areas still in need of improvement. Automatically publishing beneficial ownership data with contract details via an e-GP portal would significantly enhance transparency, reduce corruption risks, and strengthen Kenya's public procurement system.

The adoption of Open Contracting Data Standards and implementation of an e-GP system can substantially enhance transparency, accountability, and efficiency in public procurement. Empirical evidence from global experience demonstrates that e-GP systems can afford significant economic benefits, such as reduced procurement cycle times, increased market competition, lower transaction costs, and improved audit and management capabilities (table 3.7). Effective data sharing and robust implementation of e-GP standards are critical for realizing these potential savings as well as broader transparency and accountability improvements.

Table 3.7. Summary of Electronic Government Procurement (e-GP) System Benefits

Country	System name	Cost savings (% of total costs)	Key benefit areas	Source/reference
Korea, Rep.	KONEPS	10–20	Full integration; reduced cycle time	OECD Report on The Korean Public Procurement Service
Chile	ChileCompra	5–15	Small and medium enterprise access; price competition; transparency	Open Contracting Partnership - Impact in Chile
Philippines	PhilGEPS	9–13	Online visibility; efficiency; audit links	ADB Case Study on the Philippine Government Electronic Procurement System

India	GeM	10–56 (product-specific)	Reverse auctions; price discovery	Ministry of Commerce Press Release on GeM Portal
Ukraine	Prozorro	10–12	Open contracting; competition; anti-corruption	OECD-OPSI Innovation Profile on ProZorro
Indonesia	LPSE/e-Katalog	~10	Tender transparency; increased competition	World Bank Fiduciary Systems Assessment
Bangladesh	Eprocure (e-GP system)	6.5–7.4	Increased competition; tender transparency; higher winning rebates	World Bank Policy Research Working Paper # 10390 Introducing E-Procurement in Bangladesh - The Promise of Efficiency and Openness

Source: World Bank staff compilation of literature.

Efforts are under way to strengthen the public procurement system and enhance transparency and accountability in Kenya. The government has developed an e-GP system that costs approximately 5 billion Kenyan shillings, including its development, rollout, and management over a four-year period. Implementation of the e-GP system spans two phases, the first beginning July 2025. Phase 1 will electronically manage core procurement functionalities such as supplier registration, procurement planning, tender issuance, and evaluations through the central PIMIS, integrated with IFMIS for seamless payment processing. Phase 2 will augment compliance, dispute resolution, and performance management, including through electronic complaints, compliance, appeals, debarment, and auctions functionalities.

Based on observed benefits of e-GP systems, it is anticipated that digitizing Kenya's public procurement process will not only enhance service delivery but also result, over time, in cost savings estimated at 10 percent once mandatory use by procuring agencies is established. By 2027, the e-GP system aims to cover all MDAs (excluding SOEs), delivering considerable cost savings, estimated at over 115 billion Kenyan shillings annually based on the 2023/24 budget. Full benefits, including estimated savings of about 10 percent relative to the current system, are projected to be measurable after three to four years of consistent e-GP usage and adherence to advanced data publication standards.

Policy recommendations:

- *Fully implement e-GP by 2027.* Recent amendment to the Public Procurement Law to include a provision to make use of the e-GP system mandatory among all procuring entities. The e-GP rollout is phased, first targeting the MDAs, followed by all remaining public sector entities, including schools, hospitals, and so on. Interoperability of the IFMIS and e-GP systems will ensure that budget funds are used only for the procurements conducted through e-GP (in other words, if the e-GP system is not used for a specific procurement, budget funds should *not* be used to pay for that contract).
- *Enhance transparency in public procurement systems.* Beneficial ownership information is automatically published, together with the contract award, through the e-GP portal. Publication of public procurement data, including beneficial ownership information and contract awards, on the Public Procurement Information Portal in a format that meets Open Contracting Data Standards will ensure the highest standards of transparency.

3.5.4. Public sector cash management

Challenges persist in the National Treasury of Kenya's capacity to manage cash effectively. In the absence of the ability to consolidate the government's daily cash position, the National Treasury of Kenya resorts to short-term domestic borrowing and overdrafts at the Central Bank of Kenya to finance budget shortfalls, resulting in frequent in-year budget adjustments and idle cash balances at the year-end. Overdraft charges cost the treasury about 6 billion Kenyan shillings annually and have exceeded 10 million Kenyan shillings in the first quarter of 2025. MDAs often retain the allocated

funds instead of spending them in a timely manner for their designated purposes, or redirect the funds partially or entirely to cover other obligations. These practices undermine budgetary discipline, cause the accumulation of pending bills, and contribute to lack of transparency in public financial management.

To address these challenges, the government is implementing the Treasury Single Account. Approved by the cabinet on January 15, 2024, the Kenyan government has adopted a hybrid Treasury Single Account model. This will be used to maintain all MDA accounts at the Central Bank of Kenya, while allowing selected MDAs and SOEs (or state corporations) to keep accounts in commercial banks based on authorized business needs, provided that the National Treasury of Kenya and Central Bank of Kenya have real-time visibility of these accounts. The government is on track to fully implement the Treasury Single Account system across the national government by December 2025.

Policy recommendations:

- *Fully transition to the Treasury Single Account to improve efficiency in treasury management.* Migration to the Treasury Single Account should significantly enhance the government's ability to manage cash, commitment control, fiscal consolidation, and transfers to service delivery MDAs.
- *Implement a robust overdraft management system within the Treasury Single Account model.* This will reduce overdrafts and the balance remaining in bank accounts at the end of the fiscal year, as well as the need for short-term domestic borrowing to cover shortfalls.
- *Ensure seamless integration between the Treasury Single Account and IFMIS to link funds requested from the exchequer directly to payments to beneficiaries.* This "twinning" will prevent funds lying idle in MDA accounts and will ensure that when an invoice is received, the National Treasury of Kenya will release funds to the MDA based on that invoice, further helping to resolve payment arrears.
- *Implement just-in-time invoicing.* This will ensure that invoices are released at the time they are generated, enhancing efficiency of the payment process.

Potential fiscal impacts:

- *Public investment management.* Kenya has already rationalized its public investment portfolio. Strengthening the system further will strengthen the quality of projects and generate additional efficiencies.
- *Public–private partnerships.* Most Kenyan PPP projects are tendered and procured competitively. Assuming that 10 percent of the 120 billion Kenyan shillings allocated to upcoming PPP projects are likely to be procured uncompetitively, *the saving realized by instead observing a competitive bidding process is estimated at 6 billion Kenyan shillings or 0.04 percent of GDP (as at 2024) per year.*
- *Public procurement.* Procurement efficiencies are estimated to *generate savings of about 0.8 percent of GDP per year for the national government and counties*; additional savings are expected for parastatals which are also included under the e-GP system.
- *Treasury Single Account.* The transition to the Treasury Single Account is expected to help resolve penalties and fees associated with pending bills, as well as eliminate overdraft fees and unnecessary domestic borrowing, resulting in *fiscal savings of 0.04–0.09 percent of GDP per year.*

Implications for equity: More efficient management of public resources will generate fiscal space for public services through efficiencies, or by reducing borrowing and associated interest payments. This includes spending that is particularly pro-poor, for example, in health and education, sectors that are currently underfunded.

Implications for productivity: More efficient public financial management will raise the efficiency of public spending, including public investment, reducing the cost of doing business for the private sector. The implementation of the Treasury Single Account, coupled with the introduction of accrual accounting, will contain the buildup of the pending bills that generate liquidity constraints for suppliers and contribute to rising nonperforming loans in the banking sector. Its implementation will also reduce short-term government borrowing, limiting competition for credit with the private sector, and reducing pressure on the cost of capital.

Chapter 4.
Policy Packages for Growth, Jobs, and for Sustainable Public Finances

4.1. Fiscal Policy for Growth and Jobs

The preceding chapters have identified a range of options for fiscal policy to promote development. This chapter proposes policy packages that generate complementarities between the various measures, further maximizing their impact on economic growth, job creation, and strengthening Kenya's social contract. Maximizing the impact of fiscal policy is key to ensuring both fiscal consolidation and social acceptability. This chapter offers examples of policy packages that leverage complementarities across: (1) revenue measures (from chapter 2); (2) expenditure measures (from chapter 3); and (3) structural policies, which are drawn from ongoing policy dialogue. Structural policies are a critical additional ingredient to fiscal policy given Kenya's limited fiscal space, featuring low tax productivity and budget rigidities. These packages therefore recommend a combination of fiscal, structural, and governance measures that jointly support fiscal consolidation, boost equity, and promote growth and better jobs.

This chapter develops five illustrative policy packages. They are informed by the key challenges identified in the preceding chapters. Key dimensions of the policy packages include improving: (1) the relationship between the state and its citizens (package 1); (2) the relationship between the state and the private sector (packages 2 and 3); and (3) trade-offs between consumption and production (packages 4 and 5). To illustrate the complexity of these policy issues, this chapter applies a sectoral lens to package 3 (using an example from the sugar sector) and a spatial lens to package 5 (using the cases of Nairobi and Naivasha).

Policy packages create additional fiscal savings, thereby building additional space for development policy. By removing distortions and improving tax buoyancy, higher gross domestic product (GDP) growth generates fiscal space by reducing the deficit (so long as revenues grow faster than expenditure), in addition to reducing the cost of financing growth. In addition, a higher GDP reduces the denominator of the debt-to-GDP ratio, further improving debt sustainability. Policy packages are thus critical to foster pro-growth fiscal consolidation and would be most effective when implemented jointly.

4.2. Policy Package 1: From Rents to Public Services

A strong social contract between those who govern and those who are governed is the foundation for adequate public policy implementation in modern democracies. There is a large volume of academic literature that highlights the negative consequences of bad governance and corruption, and how they affect public policy implementation (UNODC n.d.). A key characteristic of a weakened social contract is when the population lacks trust in their political and government institutions and perceive that public resources are being used for private interests and rent-seeking—that is, when corruption perceptions are high and could lead to strife and protests. According to the latest Afrobarometer report, more than 50 percent of the Kenyan population have little trust in their political and governance institutions, including the Presidency, Parliament, Electoral Commission, County Assemblies, ruling and opposition political parties, and police (Afrobarometer 2024). Kenya ranks 121 out of 180 on Transparency International's Perceptions of Corruption Index—in the bottom third of countries globally. Almost 60 percent of the Kenyan population perceive that corruption has increased—and almost 70 percent of the population believe that corruption is not being handled adequately (Afrobarometer 2024). Thus, strengthening governance and anti-corruption policy is also key for effective reform implementation.

The Kenyan government acknowledges that tackling corruption is a top priority. Policy package 1 focuses on anti-corruption and complementary governance measures for better public service provision. In 2025, the Kenyan government approved an updated anti-corruption guiding framework for the justice sector. The key issue is now implementation. Currently, about one-fifth of Kenyan citizens consider corruption one of the top three most important problems facing the country (Afrobarometer 2024). Cabinet Secretary for the National Treasury and Economic Planning John Mbadi has estimated that by halving corruption alone, Kenya could service its foreign debt.[64] Policy package 1 adopts a similar logic, bundling anti-corruption interventions that reduce the leakage of public funds and restore trust in government with impactful service delivery. Chapter 3 discussed various measures that can help tackle corruption. These include implementation of e-GP, the Treasury Single Account, a strengthened public–private partnership (PPP) framework, and the reduction of layers of funds across government. A range of additional measures should complement these; jointly, these measures can promote growth and jobs while lowering the fiscal deficit.

4.2.1. Complementary Anti-Corruption Measures

A strengthened conflict of interest framework

Kenya is currently in the process of putting in place new conflict of interest laws and regulations with significant potential to reduce corruption from conflicts of interest. International best practices suggests that such a law should, among other features, lead to the creation of strict, enforceable safeguards to stop public officials from exploiting their positions; mandate full disclosure and ban officials and their associates from contracting with the state; and target collusion across institutions, ensuring transparency and accountability throughout the public sector. Taking these on board, Kenya has ensured that the Conflict of Interest Bill is robust, comprehensive, and in line with international standards, promoting transparency and accountability in public service. Legal enforceability will also be key: as the relevant enforcement agency, the Ethics and Anti-Corruption Commission would require those powers necessary to ensure politically unbiased enforcement.

Strengthened anti-money laundering and countering financing of terrorism provisions

In 2024, the Financial Action Task Force "grey listed" Kenya for weaknesses in its anti-money laundering and countering financing of terrorism (AML/CFT) framework, pointing out areas for reform to limit illicit finance. Kenya has committed to an action plan to address those deficiencies. As at February 2025, remaining actions include strengthening the necessary people, budgets, and technology that supervisors of nonbank financial firms and other high-risk professions need to run tough onsite/offsite checks and to levy sanctions that truly deter misconduct. At the same time, there is still a need for a licensing and oversight regime for virtual-asset service providers and a clampdown on gaps in existing AML rules, to turn paper-based requirements into real-world compliance. Kenya has recently passed amendments to technically comply with beneficial ownership transparency requirements for legal persons and legal arrangements. More needs to be done, however, to demonstrate that remedial actions and/or dissuasive, proportionate, and effective sanctions are in place to ensure compliance with the requirements and deter breaches.[65]

Stronger accountability mechanisms in the traffic police

There are significant governance challenges with the police, that undermine trust and spill into inefficiencies in the justice sector. Over two-thirds of the Kenyan population believe the police are involved in corrupt activities (Afrobarometer 2024). Traffic police are among the state institutions most visible to the public. As even minor traffic offenses are classified as criminal acts, the threat of going to court presents an incentive to motorists to bribe or accept bribe requests

[64] Source: Citizen Digital. (2024, April 15).

[65] Pending measures include: (1) strengthening human, financial, and technical capacities for supervisors of nonbanking financial institutions and designated nonfinancial businesses and professions for effective onsite and offsite supervision, and demonstrated effective, proportionate, and dissuasive remedial action and sanctions, when required; (2) adopting a legal framework for the licensing and supervision of virtual asset service providers (virtual assets include cryptocurrencies and digital tokens); and (3) enforcing existing requirements. Moreover, (4) the Financial Reporting Center of Kenya should increase the quantity and quality of spontaneous disseminations to all relevant law enforcement agencies, and these disseminations lead to more prosecutions; and (5) relevant agencies should improve interagency cooperation at borders to address vulnerabilities identified in the latest risk assessment of money laundering and terrorism financing, such as cross-border cash movements.

from police officers. At the same time, low accountability and perceived low pay in the police force presents incentives to officers to accept bribes. This generates three types of costs: (1) forgone government revenue from fines; (2) negative impacts on investment due to the perception of weak enforcement of the rule of law; and (3) inefficiencies in the judicial system as minor traffic offense cases burden the relevant actors (from enforcement, prosecution, and adjudication). For example, 25 percent of criminal cases (68,126 out of 268,582 cases) filed in Kenya's magistrates' courts in 2024 were traffic-related. This situation continues to contribute to the overall backlog of 278,411 criminal cases in Kenyan courts (Judiciary of Kenya 2024). Concurrently, the national average conviction rate for traffic offenses in Kenya is 93 percent, as most people charged with an offense plead guilty in the first instance. This has been attributed to an overreliance on carceral criminal sanctions in Kenya (Office of the Director of Public Prosecutions 2018). This combination of factors reduces citizens' confidence in state institutions, which has overarching effects on democracy and tax morale.

A range of interventions could improve governance and accountability in the traffic police. The Traffic Act, as amended in 2024, prescribes automated administration of minor traffic offenses (that is, automatic punishment for minor offenses through payment of fines upon admission of guilt). It also allows for the use of any electronic or mobile technology in case management procedures, making the process conducive to digitization. It is, however, emerging that these provisions are yet to be operationalized by the relevant justice institutions. Implementation is now key and will require: (1) implementation of the regulations that clarify which traffic offenses attract which penalties, which requires a high-level commitment to dedicating resources to operationalizing the law and coordinating institutional mandates to manage the procedures and funds across all levels of governance; (2) sensitization of stakeholders, including the police, judicial system, and public; (3) digitization of instant fines to reduce human contact and opportunities for bribery, and their gradual rollout from simpler categories of minor offenses, for example, those catering to private motorists, to more complex scenarios covering public transport service providers; (4) behavioral interventions to increase the risk of being caught in acts of bribery, both for the public and the police (for example, use of body-worn cameras; public campaigns to influence norms; simplified and democratized reporting through secure and accessible quick-response (QR) codes, to promote a "see something, say something" approach; and artificial intelligence modeling to detect hot spots/high-risk scenarios for risk-based auditing).

Moreover, the Ethics and Anti-Corruption Commission estimates that 66.7 percent of interactions with the police result in a bribe; instant fines can ensure that resources will instead support effective policing and trust. As per the Ethics and Anti-Corruption Commission's corruption surveys (Ethics and Anti-Corruption Commission (EACC) 2018)), the average bribe paid in 2022 was 5,039 Kenyan shillings, rising to 7,011 Kenyan shillings in 2023, and falling to 4,127 Kenyan shillings in 2024. Calculations using bribery incidence, average bribe, and Kenya's working age population yields an estimate for total bribes in the economy of 88 billion Kenyan shillings for 2024, or about 0.5 percent of GDP. If such a sum were instead captured by the government through instant fines, it could finance specific interventions to strengthen the efficiency of policing and to generate trust among the population. Further benefits, harder to quantify, could be expected from reducing the caseload in the justice sector and strengthening judicial services.

Stronger governance in business licensing

Corruption in government-to-business service delivery, particularly on licensing, remains a major barrier to private sector growth in Kenya. Discretionary practices, opaque procedures, and fragmented regulatory frameworks—particularly at the county level—create fertile ground for rent-seeking behavior. Yet regulatory reforms anchored on digitization offer a powerful approach to reducing corruption by limiting discretion, automating processes, and enhancing public access to information.[53] While Kenya has made important strides through platforms such as eCitizen, iTax, and emerging county portals, the impact of digitization has been limited where manual processes persist, as implementation remains uneven.[54] Partial automation often shifts rather than eliminates opportunities for illicit payments.

Arbitrary introduction of fees and levies by county governments harms the business climate. The deterioration of Kenya's investment climate, with the proliferation of multiple fees and levies by county governments, has affected domestic businesses across counties. For example, the introduction of multiple levies ("cess") has significantly affected

domestic players in the agricultural sector and their ability to move their agricultural products across county boundaries to access markets.

Recent reforms are beginning to tackle these challenges more systematically. The County Licensing (Uniform Procedures) Act, 2024 and accompanying regulations aim to reduce county discretion by introducing standardized procedures, a harmonized register of fees, and clear institutional responsibilities across all 47 counties. At the national level, the ongoing enhancement of the Business Registry Service offering and the Kenya Investor Portal is streamlining digital applications, e-payments, and data sharing with agencies at the national and county level. These improvements will help reduce delays, limit physical interactions, and eliminate loopholes that have enabled corruption.

To deliver meaningful changes, however, these reforms must be fully implemented and integrated across systems. Key priorities include completing and expanding regulatory reforms, end-to-end digitization of licensing, ensuring interoperability between county and national platforms, and eliminating duplications. Strengthening coordination across different levels of government is also critical. A fully digitized and transparent licensing regime will be key to demonstrating progress—and to building a more accountable and investor-friendly state.

4.2.2. Other Complementary Governance Actions

The Kenyan government's ability to provide public services is hampered by governance challenges in the public financial management system in general and in intergovernmental fiscal transfers specifically. Many of these challenges were laid out in chapter 3. In addition, the transfer of fiscal allocations to counties in Kenya—including funds for externally funded projects/programs using current systems—face several significant challenges. One of the primary issues is the inadequate budget appropriation at the national level and repeated long delays in the approval of the County Government Additional Allocation Acts (CGAAA), which appropriates additional allocations to counties. These challenges affect ministries, departments, and agencies (MDAs) of government, as well as county governments, municipalities, and service delivery institutions, leading to adverse impacts on public service delivery and economic activity. These problems are further compounded by delayed exchequer releases and the multiple layers of fund flow arrangements, which create information gaps and additional implementation delays at both national and county levels. Under the provisions of the Public Financial Management Act, it is a requirement to deposit all resources through MDA development accounts and county revenue funds, which leads to risks of fund diversion and further delays in transferring resources to specific project accounts.

Improving the flow of funds is critical for service delivery. This requires minimizing the layers of fund flow arrangements to reduce delay, information gaps, and corruption risks, and enacting a change to the Public Financial Management Act to reduce the time it takes to approve the County Government Additional Allocation Act. Implementation of the Treasury Single Account will enable the government to consolidate its resources and ensure there is optimum resource allocation for service delivery. Further, the County Government Additional Allocation Act should be approved at the same time as the national allocations, given that this is a key instrument that allows counties to access additional resources. Discussions are ongoing to amend the Public Financial Management Act to reduce at least some of the blockages stemming from the delayed approval of the County Government Additional Allocation Act. Proposed options are to either: (1) stipulate separate bills for funds provided by development partners and domestic development financing for counties; or (2) allow spending of up to 50 percent at the county level prior to approval of the County Government Additional Allocation Act. It is important also to define the standard number days needed to move resources between the various accounts to ensure that resources are availed on time to service providers, until the Treasury Single Account is fully implemented.

4.2.3. Options to Use Savings to Fund Public Services

Chapter 3 identified a range of public services that require additional funding. The largest needs set out in chapter 3 arise from the health sector, given its objective to achieve universal health coverage (which requires additional funding equivalent to 2–3 percentage points of GDP), followed by the education sector (additional funding equivalent to at least 1 percentage point of GDP), and social protection sector (additional funding equivalent to at least 0.3 percentage points

of GDP). Other sectors, such as water and sanitation, are also expected to require additional funding. In addition, the government is exploring additional infrastructure investments, such as the project to connect Kenya's Standard Gauge Railway to Uganda (at an estimated total cost of about US$3 billion).

4.2.4. Overall Fiscal and Jobs Impacts

Anti-corruption measures have significant fiscal and social impacts. Savings from anti-corruption measures are hard to quantify—reducing corruption related to traffic violations alone could release about 0.5 percent of GDP per year. Reducing corruption also has indirect effects, as perceptions about corruption affect investment decisions: corruption raises the hurdle rate, requiring a higher return for investors to make an investment—this can be estimated in a model that improves corruption perceptions to average levels observed in upper middle-income countries. Using these inputs, using the World Bank Standalone Macro Fiscal Model for Kenya (KENMOD – please see technical appendix) points to the following long-run impacts of governance and anti-corruption measures relative to the baseline: **debt to GDP**: -4.9 percentage points; **real wages**: +0.3 percent; **GDP**: +2.0 percent.

Complementary governance interventions would bring additional impacts. Interventions that raise efficiency in public financial management would reduce corruption and increase the value for each taxpayer shilling spent. World Bank modeling suggests that applying the public financial management interventions assessed in chapter 3 to the economy would yield the following long-run (10-year) impacts relative to the baseline: **debt to GDP**: -6.3 percentage points; **real wages**: +0.2 percent; **GDP**: +1.0 percent.

A share of increased fiscal space could finance better services. The savings could easily finance Kenya's additional social protection needs or the Single Gauge Railway connection to Uganda. Increasingly, the savings could also fund universal health coverage, especially when accounting for the positive impacts on productivity that will arise from adequate investments in human capital.

4.3. Policy Package 2: From a Defensive to a Competitive Private Sector

Kenya is stuck in a vicious cycle, where falling competitiveness and defensive actions against competition aggravate one another, damaging revenue growth. Both fiscal and structural policies are needed to break the cycle. Coming under competitive pressures, Kenya is in defensive mode: for as long as Kenya's competitiveness continues to decline, businesses will have the incentive to ask for protection from international competition, whether through tax exemptions, trade tariffs, or sectoral levies. Reforming the corporate income tax (CIT), as recommended in Kenya's Medium-Term Revenue Strategy, can support Kenya's businesses. However, it's unlikely that tax reforms alone will trigger what is needed to boost firm's productivity in Kenya. CIT reform is more likely to succeed —and give rise to fewer risks to fiscal stability or to businesses' bottom line—when it is embedded in a broader structural competitiveness agenda that promotes business growth and, in turn, CIT revenue growth. Policy package 2 thus suggests promoting competitiveness, giving illustrative examples of potential reforms from trade policy. Reforms focused on competitiveness provide a strong backdrop for fiscal reforms to further promote competitiveness and increase the tax base, such as lowering CIT rates, reforming dividend taxes, and reforming tax exemptions. This package would rebalance the relationship between the state and businesses, such that the government enables rather than shelters businesses.

4.3.1. Boosting Competitiveness, Jobs, and Revenue through Trade Policy

Trade policy holds considerable potential for jobs creation and raising revenue. The trade agenda is vast—this section looks at a package of a sample of policies linked to tariffs, nontariff measures, excise duties, and levies as complementary interventions.

Trade agreements (focus on the African Continental Free Trade Area)

Multilateral trade liberalization boosts growth, creates jobs, and can mobilize revenue. Trade liberalization generates efficiencies by strengthening the division of labor across countries, removing distortions in the flow of goods, services, and capital through adjustments to a mix of tariff and nontariff barriers. These efficiencies translate into economic growth and jobs. In addition, trade liberalization creates fiscal space despite lower tariff rates, demonstrating how this approach positively affects public revenue while reducing debt burdens. Empirical evidence shows that a 1-point increase in the

multilateral trade liberalization index generates a 0.06-point decrease in the fiscal space indicator, signifying greater fiscal space (Gnangnon 2019).[66] For poor countries, this impact is even more pronounced, with a 1-point increase in the index of multilateral trade liberalization generating a 0.15-point improvement in fiscal space—nearly seven times the magnitude of the effect observed in richer countries.

Implementing the African Continental Free Trade Area (AfCFTA) is a significant opportunity for Kenya. World Bank modeling suggests that fully implementing the tariff and nontariff measures under AfCFTA would result in a higher tariff revenue collection—a gain of 3 percent in tariff revenues by 2035, relative to business as usual, as a result of an increase in volume of imports from other African countries (World Bank 2022). In Kenya, real GDP is estimated to expand by 10 percent in real terms relative to the baseline by the same year, which would raise additional revenue from across the economy. Revenues would rise alongside formal wages (increase of 23 percent), income (13 percent), and exports (40 percent). Fully implementing AfCFTA, or other trade agreements to which Kenya is a signatory, will support prosperity and revenue generation.

Policy recommendations:

- *Strengthen trade policy negotiation teams.* This should be achieved by developing clear mandates, technical expertise, and well-defined negotiables versus non-negotiables that protect economic interests while maximizing development outcomes from trade agreements. It should be ensured that teams have comprehensive knowledge of global industry trends, market structures, and project economics relevant to the trade sectors involved in the negotiations.
- *Implement monitoring systems for trade agreements, with clearly defined roles and responsibilities.* These roles and responsibilities should include identification of state entitlements, and timing and channels for revenue collection to ensure that the full value of trade agreements is captured. Detailed implementation plans should be developed, containing trigger mechanisms for enforcing specific clauses and with regular progress reviews at predetermined intervals.
- *Clarify institutional roles across government departments engaged in trade negotiations and implementation.* This can ensure proper separation of powers between executive decision-makers and technical negotiators while maintaining effective knowledge transfer between negotiation teams and implementing agencies. Systematic documentation of trade agreements and handover procedures is also required to institutionalize knowledge within government.

Revisiting export and export promotion levies

Export levies are used to raise revenue, encourage value addition, ensure food security, and leverage market power, but they are generally prohibited under most free trade agreements to which Kenya is a signatory. While export levies can serve various purposes, these taxes are typically applied to natural resources, agricultural products, or minerals. Export levies are not explicitly banned by the General Agreement on Tariffs and Trade (GATT 1947) for World Trade Organization signatories; however, most free trade agreements to which Kenya is a signatory prohibit these taxes.

For example, the leather export levy in Kenya has produced limited value addition despite nearly two decades of implementation, potentially harming producers. The tax should be reformed within a broader strategy to strengthen the leather sector. Initially introduced in 2005 at a rate of 20 percent, the leather export levy was increased to 40 percent within months and reached 80 percent by 2012 (though it has subsequently been lowered to 50 percent by the Finance Act, 2023). Despite these measures, Kenya remains a marginal player in higher value-added leather products, ranking 59th globally in leather goods exports despite ranking 12th in herd size (KLDC 2024). The leather sector now employs approximately 17,000 people (about 10,000 of which in the informal sector) across 15 operational tanneries (up from

[66] Fiscal space is calculated as the ratio of outstanding public debt to realized tax collection (the latter being averaged across several years to smooth out business cycle fluctuations). This indicator reflects both a country's ability and willingness to fund fiscal expenditure and transfers. A lower value of this ratio indicates greater fiscal space—meaning a country has more capacity to fund stimuli using its existing tax capacity. Conversely, when this indicator increases, it signals shrinking fiscal space.

five tanneries in 2005), but these tanneries operate at just 30 percent capacity utilization.[67] The levy has hurt poorer producers, such as herders and aggregators, by lowering the prices they receive for raw materials. The leather sector faces numerous challenges, including low-quality raw materials, smuggling, limited investment, and lack of access to finance. The export levy should therefore be reformed as part of a broader strategy that also addresses these underlying issues (similar to suggestions for the sugar sector made in section 4.5.3 of this report).

Import levies on steel and cement, along with export levies on iron ore (known in Kenya as export promotion levies), have had mixed effects and may be increasing costs in ways that counteract affordable housing goals. The Finance Act, 2023 set a rate of 17.5 percent for import levies on steel and cement; an export levy of US$175 per ton of iron ore had already been introduced in 2022. These levies aim to boost the domestic manufacturing sector. The cost of locally manufactured cement and steel products has been rising, however, contradicting the intended impact of the levies. This has led to concerns about the policy's effectiveness, potential monopolies, and the impact on critical development projects like affordable housing. In February 2025, the National Assembly's Committee on Trade, Industry, and Cooperatives called for an investigation into the high cost of cement and steel.[68] Instead, efforts should focus on stimulating local production through improved access to finance, technology adoption, business productivity, and skills development.

International experience offers important lessons. Rwanda recently abolished its leather export levy owing to lack of markets within the SSA region, which had led to stockpiling. It has instead focused on enhancing the production capacities of leather processing small and medium enterprises (SMEs) and capacity building. Ethiopia's experience with a 150 percent export tax on raw hides showed initial positive impacts on domestic processing but failed to sustain growth over the long term, particularly after losing African Growth and Opportunity Act access (AGOA).

Policy recommendations:

- *Leather sector.* Reform the export levy as part of a comprehensive approach to strengthening sector competitiveness through investment in quality improvement, infrastructure, capacity building, and access to finance (see a similar example for sugar in section 4.5.3). Following nearly two decades of protection, the relatively modest scale of job creation achieved by the levy to date may not justify the potential welfare losses to Kenyan herders.
- *Steel, cement, and iron ore.* Review the export promotion levies to ensure that they are not counterproductively increasing costs for critical sectors like affordable housing. Focus on stimulating local production of steel and cement through improved access to finance, technology, and skills development rather than just import protection.

4.3.2. Fiscal Reforms for Competitiveness

Reforming CIT is sensible within a broader policy environment aimed at boosting competitiveness. As laid out in chapter 2, reforming CIT would involve lowering the rate while reducing exemptions. In isolation, this reform can be risky. For the Kenyan government, lowering the CIT rate may at least initially imply a loss of revenue, which it can ill afford when fiscal buffers are already depleted. Moreover, broader competitiveness constraints may mute the expected investment response, further aggravating revenue shortfalls. For businesses, the removal of CIT exemptions may harm profitability unless this move is offset by other measures that grow profitability. The following suggestions for a reform of CIT thus form part of the proposed policy package 2—which includes the structural reform package illustrated in the previous section— complemented by a further measure: raising the dividend tax.

[67] Leather News. (2024, March 27). Kenya aims to double leather production and create 100,000 new jobs by end of 2024. https://leathernews.org/kenya-aims-to-double-leather-production-and-create-100000-new-jobs-by-end-of-2024/
[68] Mount Kenya Times. (2024, April 10). Parliamentary Trade Committee orders probe into high cost of cement and steel. https://mountkenyatimes.co.ke/parliamentary-trade-committee-orders-probe-into-high-cost-of-cement-and-steel/

Lowering CIT and raising the dividend tax

Kenya's Medium-Term Revenue Strategy suggests reducing the CIT rate to 25 percent to incentivize investments in the private sector. This could be complemented with an increase in the dividend tax. Reducing the CIT rate widens the gap between the tax burden on retained earnings and the tax burden on distributed profits. To address this asymmetry, the dividend tax could be raised, which should keep the overall tax levied on corporate cash flows roughly constant by ensuring that businesses face the same marginal cost of capital, whether they reinvest or pay out profits. This revenue-neutral reform would help preserve public finances and encourage reinvestment in businesses, discouraging profit shifting, and steer investment choices toward productive projects.

Revisiting CIT exemptions

Reforming CIT exemptions will be critical to broaden the tax base and remove distortions. Streamlining and reducing CIT exemptions will broaden the tax base, letting the government collect steadier revenue without the need to raise other rates, and thereby funding public goods more efficiently. At the same time, reducing CIT exemptions will help 'level the playing field', letting businesses compete on innovation and cost control rather than on their ability to secure the benefits, lowering barriers to entry and directing investment toward the most productive businesses. Reducing the exemptions will be politically more feasible when businesses, particularly those that compete internationally, are under less pressure from other policy measures that harm competitiveness.

The Organisation for Economic Co-operation and Development (OECD) and Group of Twenty (G-20) are leading global efforts to regulate harmful special economic zone (SEZ) tax competition and profit shifting, which has led to many distortions across countries. Specifically, the reform aims to establish a uniform CIT rate of 15 percent, and 138 jurisdictions have signed an agreement to apply the global minimum CIT rate. Kenya currently offers SEZ investors a CIT rate of 10 percent for the first 10 years as a core component of the SEZ value proposition—this could be raised to 15 percent and then be aligned with the standard CIT rate. In addition, Kenya is keen to move to a smart SEZ incentives regime, shifting from blanket fiscal incentives to other, performance-based incentives (tied to jobs, exports, and so on) and production-linked incentives. Reforming fiscal incentives can promote competitiveness while broadening the tax base—an updated incentives regime would then also need to be consistently applied to reduce investor uncertainty and promote investment.

4.3.3. Overall Fiscal and Jobs Impacts

Significant fiscal and social impacts can be expected from raising the competitiveness of Kenya's economy. For example, AfCFTA is expected to raise tariff revenues by 3 percent (in real terms) by 2035, through increasing import volumes. Revenues would also rise more broadly via increased formal wages, business growth, and greater export activity. AfCFTA also offers major equity benefits, with real wages projected to rise by 23 percent by 2035—with slightly higher gains for women supported by increased formal employment, SME integration, and skills development. Reforming trade levies could further aid low-income groups across value chains. More broadly, both AfCFTA and levy reforms aim to reduce market distortions by removing tariff barriers, simplifying customs procedures, promoting economies of scale, and improving investment flows, while avoiding the inefficiencies and compliance issues linked to current levies. The economic and social impacts of AfCFTA have been discussed at length (World Bank 2022).

In a context of rising competitiveness, Kenya could afford to reform CIT. World Bank modeling suggests that a combination of lowering the CIT rate to 25 percent, increasing the dividend tax rate to 10 percent, and reducing CIT tax expenditures by about 1.2 percentage points of GDP would result in the following long-run impacts relative to the baseline: **debt to GDP**: -7.6 percentage points; **real wages**: +1.5 percent; **GDP**: +1.9 percent.

4.4. Policy Package 3: From Public to Private Firms

Transfers to state-owned enterprises (SOEs) have grown substantially in Kenya in recent years—yet the financial performance of many SOEs has deteriorated, with losses concentrated in SOEs operating in competitive sectors (see discussion in chapter 3). Among the 57 enterprises with financial data on profits and losses as at 2023, only five showed improved profitability over the preceding five years, indicating significant performance challenges among SOEs as a

whole. Moreover, at least seven enterprises that had been profitable in 2019 were by 2023 reporting cumulative losses exceeding US$94 million, with notable declines in profits among SOEs such as Kenya Power and Lighting Company, National Bank of Kenya, and Centum Investment Company. Further, enterprises already in financial distress in 2019—such as Kenya Airways and Kenya Railways Corporation—saw their financial losses more than double by 2023. Strikingly, financial losses in SOEs are particularly concentrated among businesses operating in competitive sectors, with profitability deteriorating from an aggregate net profit of about US$103 million in 2019 to an aggregate net loss of about US$45 million in 2023 (figure 4.1 and figure 4.2). An important share of this decline is explained by deteriorating market conditions across the economy, with total revenues from Kenyan SOEs having decreased from about US$1 billion in 2019 to approximately US$710 million in 2023.

While there is a role for SOEs in the economy, many of Kenya's SOEs operate in competitive sectors, which causes an 'uneven playing field' and can undermine growth. In natural monopoly sectors such as water collection and treatment, there are potential justifications for state ownership, as high entry barriers and economies of scale can justify state involvement, if adequately managed. Less clear is the rationale for SOEs that operate in competitive sectors, which are characterized by low entry barriers, a well-established private sector, and the potential for private provision. Moreover, their presence raises concerns about market distortion, especially where government policies provide strategic advantages to SOEs that lead to an uneven playing field. This crowds out new entrants, limiting opportunities for job creation and the expansion of the tax revenue base. Thus, a balanced approach to state intervention in the economy is critical. Notably, the number of Kenyan SOEs in the World Bank's Businesses of State database increased from 132 in 2019 to 209 in 2023.[69] Though mainly a reflection of better data coverage, this increase also signals the creation of several new SOEs since 2020 (for example, Kenya Shipyards and Kenya Development Corporation), further exacerbating the challenges faced by the private sector.

Figure 4.1. Distribution of State-Owned Enterprises in Kenya, by Industry Type and Level of Government, as at 2023

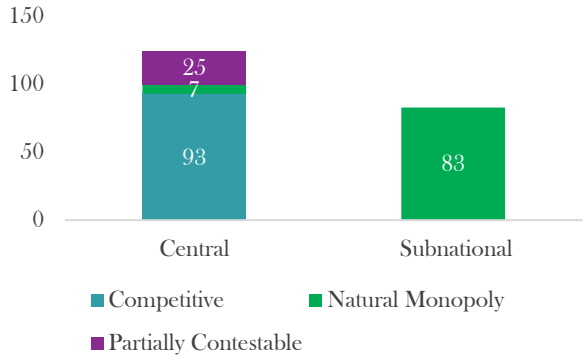
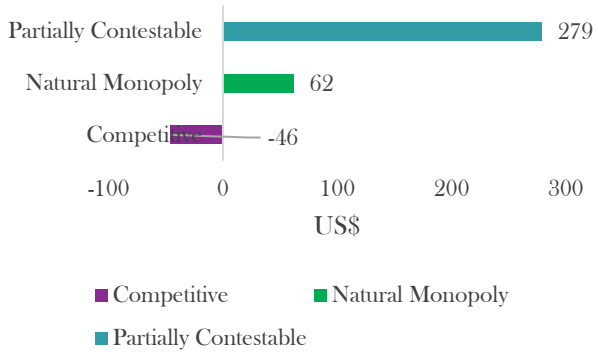


Figure 4.2. Net Profits by Category of State-Owned Enterprise, 2023



Source: World Bank staff calculations using the WB BOS database (World Bank, 2023h).

4.4.1. Leveling the Playing Field while Raising Revenue: Divestiture and Improved Corporate Governance

By privatizing SOEs in competitive sectors, the Kenyan government could boost fiscal revenues, reduce expenditures, and promote private sector jobs. Using a simple but conservative enterprise value to revenue methodology, the estimated total value of Kenyan SOEs in competitive sectors ranges from roughly US$350 million to US$700 million (45 billion to 90 billion Kenyan shillings). If the performance of these enterprises improves, the valuation could increase further,

[69] World Bank. (2023). The business of the state. World Bank. https://www.worldbank.org/en/publication/business-of-the-state

potentially reaching US$800 million to US$1.2 billion (100 billion to 155 billion Kenyan shillings).[70] Not only does privatization provide one-time revenues, but it also generates fiscal benefits by stopping fiscal transfers and associated bailouts for poorly performing SOEs. Finally, if done correctly and in conjunction with regulatory reforms, privatization can reduce market distortions caused by the presence of SOEs, opening up opportunities for private investment that creates more jobs. The Privatization Act, 2023 was enacted to streamline the privatization process and establish the Privatization Commission to oversee implementation of this process, but the act has since faced legal challenges in court. More can be done, starting with reestablishing clarity and transparency around the privatization process, and embedding best practices, like competition assessments, will be critical.

For SOEs in natural monopoly sectors, improving corporate governance and strengthening the regulatory framework are key to improving service delivery while reducing the drain on the national budget. To improve governance in SOEs will require the resolution of several key issues identified in reports published by the Office of the Auditor-General in 2022 and 2023.[71] Enhancing transparency, disclosure practices, and reporting will build stakeholder confidence in the use of public funds and reduce diversion of these funds. It will also be crucial to address governance, regulatory, and management challenges such as preferential treatment and state support to struggling SOEs. Setting performance targets linked to public service delivery obligations, with proper costing, can improve the efficient use of public funds. Mitigating risks of technical insolvency due to high levels of debt and ensuring accurate financial reporting can reduce fiscal and market risks, promoting a more competitive and fair business environment.

Complementary structural policies are necessary to ensure that SOEs—as well as privatized former SOEs—do not create additional market distortions that affect consumers. First, implementing robust competition and market regulations prior to privatization is crucial to prevent incumbents from gaining excessive market control and undermining competition. This includes evaluating market structures and the degree of competition to manage risks associated with acquisitions and vertical integration. Second, establishing caps or restrictions on which businesses can participate in privatization tenders can help mitigate the risk of reinforcing dominance. Additionally, merger control rules should be enforced to allow the Competition Authority of Kenya to review transactions for potential anticompetitive effects. Conducting a comprehensive competition assessment to identify and address regulations that restrict or distort competition will ensure a fair and competitive market environment. Finally, various regulations that potentially restrict entry, distort key markets, and favor SOEs, as indicated by the latest OECD Product Market Regulation indicators (Competition Authority of Kenya and World Bank, forthcoming), are another important avenue for reforms.

4.4.2. Illustrative Example: Complementary Policies for the Sugar Sector

SOEs in the sugar sector have been characterized by poor performance, financial losses, and inefficiencies, as the sector faces significant challenges. Over the three years to June 30, 2023, the five sugar mills owned and managed by the state (Chemelil, Miwani, Muhoroni, Nzoia, and South Nyanza) collectively generated over US$130 million in net losses, and none were profitable for even a single year. The losses incurred by SOEs in the sugar sector have generated public fiscal burdens in the form of repeated bailouts and unpaid taxes (figure 4.3 and figure 4.4). Further, SOE participation in the sector has coincided with regulatory barriers. For example, the establishment of sugar farmer catchment areas restricts competition and keeps more efficient businesses from entering the market and gaining market share. This crowds out private sector investment and innovation, limiting job creation, and results in higher prices to consumers.

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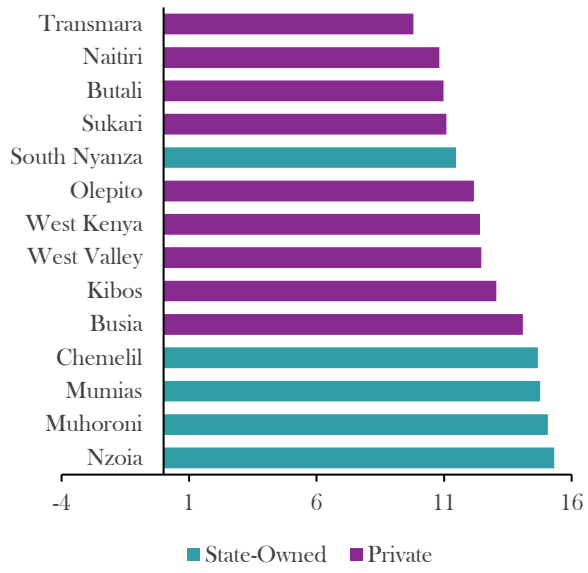
[70] These estimates are indicative, and the actual valuation could vary based on individual company circumstances. For estimation purposes, we used revenues and net profits from the World Bank Businesses of State database, where data are available, focusing on those SOEs that operate in competitive sectors. In total, there are 39 such enterprises, with aggregate revenues in 2023 of approximately US$712 million (down from US$1.03 billion in 2019), and an aggregate net loss of US$45 million (compared with an aggregate net profit of approximately US$102 million in 2019). Using the enterprise value to revenue methodology, and applying a conservative ratio of 0.5 to 1.0, put the estimated potential value of these companies at about US$350 million to US$700 million. Using the values from 2019, this estimate would, in fact, increase to about US$500 million to US$1 billion, potentially indicating value lost due to worsened performance of these SOEs. Separately, as these enterprises on aggregate recorded a net loss in 2023, the price to earnings valuation method would result in a negative valuation. It should be noted that these estimates are indicative only, since: (1) financial data are available for less than half of Kenyan SOEs operating in competitive sectors; (2) circumstances and ratios will be firm and industry-specific; (3) this does not account for SOEs in partially contestable and monopoly sectors, which are typically larger than those operating in competitive sectors; and (4) this does not account for the "opportunity cost" of holding onto these SOEs, which can accumulate and become significant over time.

[71] For example, see audit report on Kenya Railways Company, Kenya Port Authority, Kenya Power and Lightning Company, Kenya Pipeline Company.

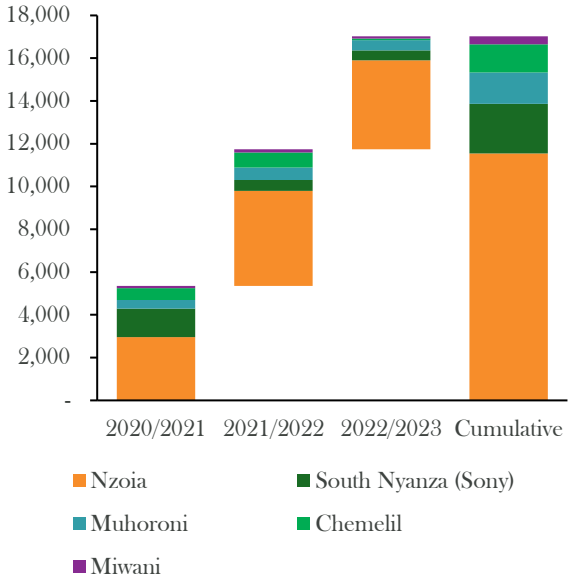
Privatizing sugar mills presents an opportunity for the Kenyan government to improve the competitiveness of the sector, as well as reduce expenditure from associated financial losses. Preliminary outside-in analyses suggest that privatization of sugar sector SOEs could generate at least US$50 million and up to US$200 million in sale or leasing proceeds, depending on whether or not parallel reforms and balance restructuring are completed beforehand.[72] More significantly, their privatization would avoid the government having to internalize the net losses of sugar sector SOEs, which have totaled at least US$40 million per year over the period 2020–23. The government has recently initiated processes to lease sugar sector SOEs to private players. This could generate significant benefits, although proper execution of leasing or privatization processes is essential to prevent additional market distortions, ensure transparency, and avoid allegations of misconduct.

Figure 4.3. Cane-to-Sugar Ratio by Factory, 2023



Source: AFA 2024.
Note: Cane-to-sugar ratio denotes the number of tons of sugarcane that a factory uses on average to produce one ton of refined sugar; lower numbers imply higher efficiency.

Figure 4.4. Net Losses of State-Owned Sugar Mills (KSh, millions), 2020/21 to 2022/23



Source: AFA 2024; KNBS 2024.
Note: Fiscal year denotes the 12 months to June 30 of the second year displayed.

To ensure the success of privatization in the sugar sector, complementary competition and trade policies are essential. Currently, Kenyan laws and policies create market power for Kenyan sugar mills relative to retailers, wholesalers, and consumers. The Sugar Act No. 11 of 2024 establishes catchment areas within which farmers must sell their sugarcane to specific sugar mills. In parallel, high tariffs on imported sugar prevent foreign suppliers from putting downward price pressure on Kenyan sugar mills. Taken together, these measures prevent more efficient mills from gaining market share by buying at higher prices from farmers or selling at lower prices to retailers, wholesalers, and consumers. The Kenyan government could thus consider removing legally mandated catchment areas and lowering tariffs to 'level the playing field' and encourage competition within the domestic market. Beyond increasing efficiency and improving pricing for farmers and consumers, these measures would also prevent privatization from inadvertently creating private mills with undue market power.

[72] Proceeds from leasing or privatization are calculated via the following methodologies: (1) Net book value (value of assets less non-Kenyan government liabilities); (2) multiple of maximum sugarcane crushed over the 2017–23 period applied to Mumias's leasing price (less non-Kenyan government liabilities); (3) multiple of maximum area under sugarcane cultivation (less non-Kenyan government liabilities); and (4) multiple of maximum sugar produced in 2017–23 period (less non-Kenyan government liabilities). The low range is the sum of minima per company, while the high range is the sum of maxima per company.

4.4.3. Overall Fiscal and Jobs Impacts

Reducing the footprint of the state in the economy will yield additional growth, jobs, and revenue effects. Reducing the footprint of the state in the economy by privatizing SOEs that create significant market distortions can have powerful indirect positive effects. Privatization can yield one-off revenue gains that can help pay down public debt: this public finance review (PFR) estimates potential privatization revenue of up to US$1.2 billion. If coupled with policies to level the playing field across private sector businesses, including the privatized enterprises, productivity gains can also be expected from reduced market distortions. World Bank modeling suggests that such a policy package would result in the following long-run impacts relative to the baseline: **debt to GDP**: -5.5 percentage points; **real wages**: +1.2 percent; **GDP**: +1.0 percent.

4.5. Policy Package 4: From Subsidizing Consumption to Supporting the Poor

The Kenyan government is focused on shifting from subsidizing consumption to supporting welfare. This can be achieved by reducing inefficient and inequitable subsidies, particularly those focused on the poorest households. While tax expenditures and subsidies (jointly referred to here as subsidies) on essential goods like fuel and food provide immediate relief to households, they often fail to address the underlying issues of underemployment and low productivity. As evidenced in chapter 2, Kenya's numerous exemptions for value added tax (VAT) are the main driver of declining VAT trends. Even with these exemptions, VAT is nearly neutral in its distributional impact, meaning that most income groups pay a share of these taxes approximately in line with their share of total income. Its direct effects have the highest poverty-increasing impact among the fiscal measures analyzed, while its indirect effects slightly increase income inequality. These findings suggest there is scope to adjust VAT exemptions to further increase equity and recycle revenues into targeted, poverty-reducing programs aligned with the country's fiscal consolidation priorities. In addition, chapter 2 argued that externalities are underpriced, essentially implying a subsidy for consumption of harmful goods that undermine health and accelerate climate change. Policy package 4 therefore focuses on reforming VAT, as well as health and climate-related taxes.

Policy package 4 suggests revisiting consumption and production subsidies to increase equity and efficiency, reducing fiscal pressures while protecting the poorest members of society. It also considers the government's objective to increase food security, which is particularly important when considering measures that affect consumption. This policy package makes proposals that can further these objectives. While it examines ways to reduce implicit consumption subsidies (VAT exemptions and underpriced health and environmental taxes), it also tackles inefficient production subsidies—after all, support to production should also be efficient. The policy package argues that Kenya can revisit inefficient and inequitable consumption and production subsidies to create fiscal savings, create jobs, protect the poor, and strengthen food security—a declared goal of the government under the Bottom-Up Economic Transformation Agenda. The savings can be used to remove major distortions such as pending bills that hurt the cash flow of businesses across the economy, enabling job creation and economic growth.

4.5.1. Tackling Inefficient and Regressive Consumption Subsidies

Discouraging harmful behaviors

Chapter 2 discussed how environmental and health taxes can discourage harmful behaviors while raising revenue. These taxes tend to benefit the poor, especially through indirect effects like lower pollution and better health outcomes. Taxes on carbon, as well as alcohol, tobacco, and sugar-sweetened beverages, are therefore included in this policy package, alongside other measures.

Reforming the VAT system for equity and growth

Broader adjustments to VAT rates should carefully consider trade-offs between revenue generation and impacts on poverty and inequality. Option to raise more revenues through VAT should be analyzed against the associated changes in revenues and gains in poverty reduction, equity, and efficiency. For instance, increasing the VAT rate by 2 percentage points to 18 percent is projected to raise VAT revenues by only 9 percent, but would also increase poverty by 0.2

percentage points and inequality by 0.02 Gini points. These trade-offs highlight the importance of a balanced reform approach, where fiscal gains are reinvested to protect poor and vulnerable populations and foster inclusive growth.

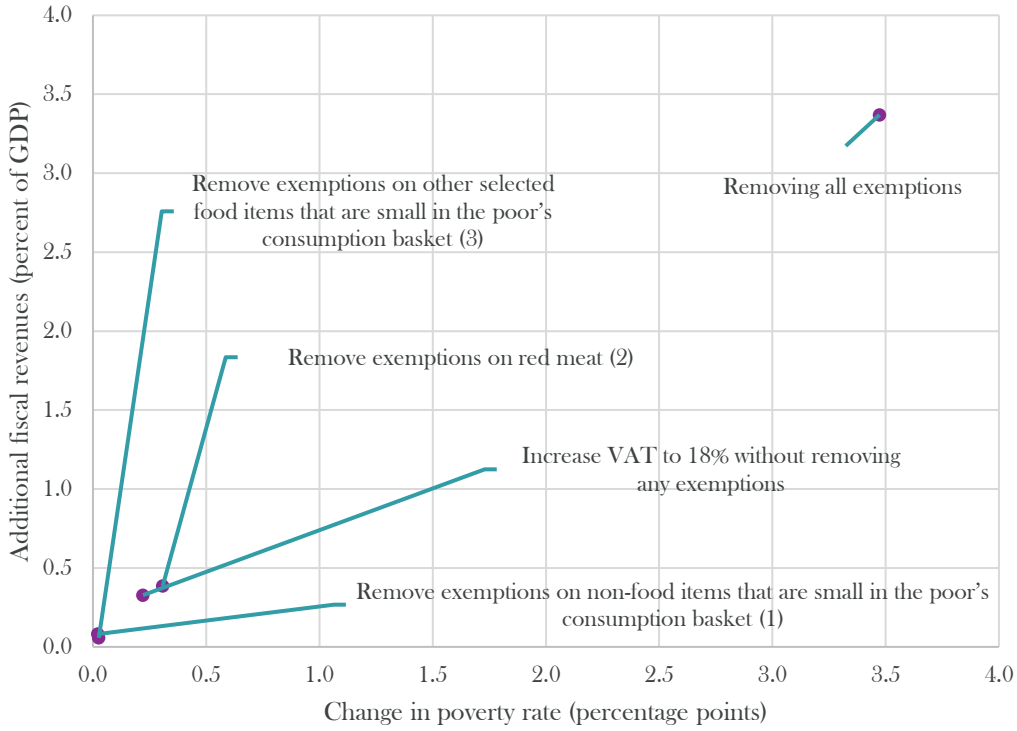
VAT reform offers a strategic opportunity to enhance revenues while promoting equity; revising VAT exemptions is particularly impactful. World Bank simulations show that significant fiscal gains are achievable through VAT reform—even with compensation for the poor—, depending on the scenario and the compensation approach (table 4.1). While eliminating all exemptions could raise VAT revenues by 92.1 percent and yield about 3.4 percent of GDP of revenues, it would also increase poverty by 3.5 percentage points and widen inequality by 0.13 Gini points. However, targeted reforms, such as removing exemptions on goods with low consumption among poor households (for example, nonfood items, red meat, selected food products), offer a more balanced and sustainable path—delivering positive fiscal savings and higher tax buoyancy with minimal poverty and inequality impacts; Table 4.1 and Figure 4.5 show illustrative options to showcase that modest VAT rate increases and targeted removal of exemptions can generate important revenue gains with limited adverse effects. When paired with well-targeted social protection, these reforms offer a fiscally and socially sustainable path toward achieving Kenya's revenue and equity objectives. *Across all simulated scenarios, the net fiscal gains remain significant even after accounting for targeted transfers to offset potential poverty impacts.*

Table 4.1. Illustrative Scenarios for Removing VAT Exemptions from the Top Least Poverty-Inducing Items

	A	B	C	D=A-B	E=A-C	F=A/GDP
	Fiscal gain (K Sh, billions), annually	Welfare neutrality: Keeping consumption constant for everybody (K Sh, billions)	Welfare neutrality: Maintaining consumption levels for the poor and raising to the poverty line (not to their original level) the consumption of those pushed into poverty by the policy (K Sh, billions)	Net fiscal impact (K Sh, billions), annually (lower bound)	Net fiscal impact (K Sh, billions), annually (upper bound)	Savings as a share of GDP (%)
Scenario 1: Remove exemptions on nonfood items that represent a small share in poor household's consumption basket	12.2	4.0	0.6	8.2	11.6	0.1
Scenario 2: Remove exemptions on red meat	57.8	19.2	2.6	38.6	55.2	0.4
Scenario 3: Remove exemptions on other selected food items that represent a small share in poor household's consumption basket	8.6	3.0	0.7	5.6	7.9	0.1
Scenario 4: Remove all exemptions	505.5	167.7	42.3	337.8	463.2	3.4
Scenario 5: Increase VAT to 18% without removing any exemptions	49.1	16.3	3.0	32.8	46.1	0.3

Source: World Bank Staff estimates and World Bank 2025.
Note: Scenario 1: Nonfood items that represent a small share in poor household's consumption basket: television subscription fees, toothpaste/mouthwash, traditional beer, ferry/boat fares, taxi fares (non-matatu/boda boda), pet food, courier services, club membership fees, train fares, post office private rental box, amusement park fees. Scenario 2: Red meat: beef, goat/camel/rabbit meat, mutton, pork, offals, minced meat. Scenario 3: Other food items that that represent a small share in poor household's consumption basket: white wheat flour, avocado, coffee, popcorn. GDP = gross domestic product; VAT = value added tax.

Figure 4.5. Changes in Poverty Rate and Fiscal Savings by VAT Scenario

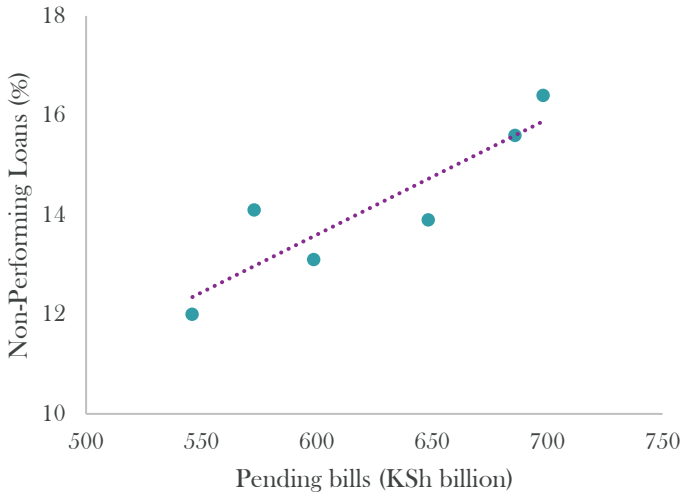


Source: World Bank staff calculations using KCHS data.
Note: Scenarios modeled following the note on Table 4.1.

4.5.2. Reducing Adverse Demand Impacts by Removing Distortions

Pending bills are a government liability that creates major distortions in the Kenyan economy. Chapter 3 highlighted that the stock of pending bills of the national government alone reached 3.2 percent of GDP in 2023/24. Pending bills attract penalties for the government while harming the financial health of the affected suppliers. In turn, this raises loan delinquencies (figure 4.6), which require banks to increase provisions and affect the availability and cost of credit across the economy. Using fiscal savings from higher consumption taxes to tackle pending bills would significantly improve the business climate for affected suppliers and beyond. Paying down pending bills, and using the remainder to reduce expensive domestic borrowing, will not only strengthen Kenya's fiscal and debt position but also generate economic activity that can help mitigate the reduction in aggregate demand caused by raising consumption taxes.

Figure 4.6. Pending Bills and Non-Performing Loans



Source: World Bank using Central Bank of Kenya data

4.5.3. Supporting the Poor while Strengthening Food Security

Food security is critical and can be achieved more efficiently. Addressing food security is not just a matter of agricultural production, especially in urban areas. Effective social protection programs, such as Kenya's Hunger Safety Net Program, are the most efficient way to reduce hunger, especially when coupled with interventions that ensure that food markets function. For example, implementing AfCFTA or other trade agreements, as discussed above, is one such intervention, as it ensures that countries can export surplus food while importing it when needs arise. Social transfers are the most efficient way to protect the poorest members of society—and they would also effectively address any adverse impacts from higher consumption taxes.

Input subsidies are a relatively inefficient way of promoting food security. While these subsidies lower the cost of production in Kenya, they do not necessarily benefit poor households or enhance Kenyan food security. Lower production costs increase agricultural competitiveness, leading to surplus food being exported and the subsidy benefiting consumers outside of Kenya. Therefore, input subsidies should be well targeted and focus on promoting productivity gains that are sustainable over time, rather than merely reduce production costs for a single year. Chapter 3 illustrates how fertilizer subsidies targeted at poor smallholder farmers can encourage them to experiment with new technologies, such as different types of fertilizer or other agricultural inputs. This targeted approach makes subsidies much more efficient. Yet, to effectively address food security, social protection measures are more efficient. For instance, the current budget allocated to Kenya's fertilizer subsidy program could fund the Hunger Safety Net Program twice over.

The current fertilizer subsidy program, if fully implemented, would be fiscally unaffordable, and there are potentially more efficient uses of the resources. The current fertilizer subsidy program does not yet reach all farmers, suggesting that rolling out the program to all eligible beneficiaries would significantly raise the cost. This adds a fiscal limit to the program, strengthening the case for improved targeting. Better pro-poor targeting of the fertilizer subsidy program could release up to 12 billion Kenyan shillings in funding for other activities, such as an expansion of social protection. In the longer term, given a stronger fiscal position and a more efficient agricultural support system, the fiscal allocation to agriculture should also be increased, in line with the Malabo Declaration's commitment to agricultural expenditure.

4.5.4. Overall Fiscal and Jobs Impacts

Reforming consumption taxes and production subsidies, while strengthening social protection expenditures and paying down pending bills, could significantly reduce debt without hurting the poorest members of society. World Bank modeling suggests that raising VAT immediately by 0.5 to 0.6 percent (table 4.1, scenarios 1–3) and phasing in higher environmental and health taxes, raising social protection spending, reducing fertilizer subsidies, and paying down pending bills would result in, among others, the following long-run (10-year) impacts relative to business as usual: **debt to GDP**: –5.9 percentage points; **real wages**: -0.4 percent; **GDP**: -0.1 percent.

These reforms would promote agricultural production and could strengthen food security. World Bank simulations of the reforms suggest that agricultural output would increase by 0.63 percent relative to the baseline, raising the domestic food supply. Targeting agricultural subsidies to poor farmers while releasing savings to strengthen social protection systems (such as the Hunger Safety Net Program) would raise food security, by increasing both food production and households' purchasing power to buy food items.

Although the poor would be protected, overall GDP, real wages, and consumption would fall because of the negative welfare effects of some of these tax measures—which highlights the urgency to combine policy packages. Real consumption would fall by 0.3 percent relative to the baseline. While reforming consumption taxes could be an attractive option in principle, because they can quickly raise revenues and stabilize the fiscal position, it can also have adverse welfare impacts that make this option unpopular and socially difficult to implement. Combining this policy package with other packages can offset negative social effects, as discussed further in chapter 5.

4.6. Policy Package 5: From Consumption Cities to Production Hubs

Kenya's cities hold strategic importance for development across the country. Cities play a critical role in reviving Kenya's faltering structural transformation, absorbing labor from agriculture and creating urban jobs beyond the formal sector (Fengler 2011). The high preponderance of informal labor in cities is symptomatic of low urban productivity generating only limited demand for labor. Nairobi, a city-county, accounts for about one-third of Kenyan GDP and is therefore a strategic location. For Nairobi to be an engine of growth, it needs to avoid becoming a consumption city based on national and international public spending—since consumption cities are based on largely nontradable sectors, their growth potential is constrained by the local market and limited room for raising productivity (Jedwab et al. 2022). Given the size and centrality of Nairobi, falling into such a trap could constrain growth across Kenya. Instead, fiscal policy can play a critical role in (1) promoting productivity by creating incentives to densify, while (2) generating fiscal resources for critical investments. Policy package 5 looks at how proposals around property taxes and the reduction of public sector allowances could promote productivity growth in Nairobi and Naivasha, two cities that are in close proximity and whose interdependence could be better leveraged to serve Kenya's development.

4.6.1. Leveraging Property-Based Revenues to Strengthen Nairobi as a Production Hub

As an international hub, Nairobi's costs of living are under pressure. Nairobi is both Kenya's capital and home to the majority of its civil servants, as well as an international hub for many international organizations, embassies, and nongovernmental organizations. In particular, it is the Eastern African hub for the diplomacy and aid sectors, attracting more than 7,000 international staff, who largely earn international salaries; even salaries for local staff working in international organizations are more than four times the average private sector salary in Kenya (KNBS n.d.). At least US$800 million per year enters Kenya as transfers to embassies and United Nations agencies, most of which are based in Nairobi—this sum is equivalent to about 0.8 percent of national GDP and 2.73 percent of Nairobi City County's GDP.[73] This sum does not take into account additional transfers for expenses such as rent and consumables, nor does it account for economic multipliers from demand for domestic goods and services. There is a risk, however, that these transfers, largely for administrative purposes, act as a resource rent, biasing sectoral allocations toward nontradable services. This influx of foreign exchange can put pressure on nontradable prices—such as for rent, schools, transport, and restaurants—and erode real wages for Kenyan residents who earn in local currency.

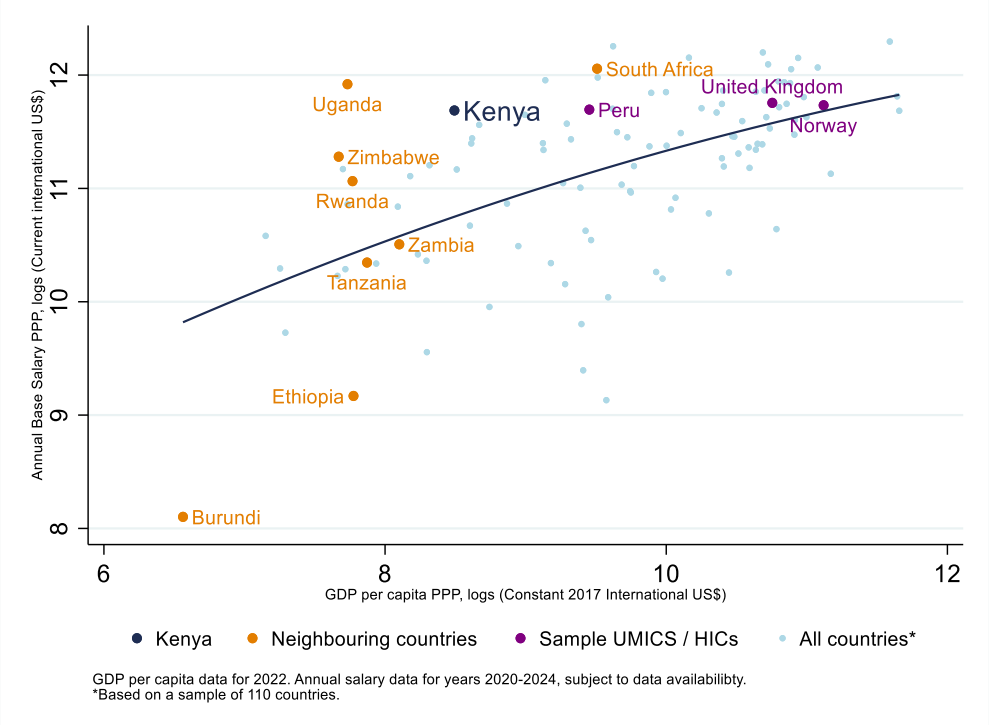
This puts Nairobi at risk of becoming a consumption city, dependent on the national and international public sector (Gollin 2016). A highly distorted property market in the so-called blue zone around the United Nations campus, where rent for housing easily costs 24 times Kenya's GDP per capita, is symptomatic of these emerging pressures, although they still remain somewhat restricted to that geographic area. The clustering of jobs in the city center, high rental prices in the formal housing market, and poor transport connectivity for locations on the outskirts or outside of Nairobi are likely to be key reasons why Nairobi has one of the biggest informal settlements on the African continent (Duranton and Puga 2015; Collier and Venables 2017).[74] As Kenya's hubs continue to expand, it is critical to prepare Nairobi to keep living costs in check and avoid falling into the trap of becoming a consumption city (Gollin 2016).

If Nairobi were to become a pure consumption city, it would also pose problems for wage bill consolidation. In this case, pressures would intensify to raise public sector nominal wages to compensate for the increase in nontradable prices such as rent. In most cases, this is not yet happening as real wages have been falling in the public sector (Chapter 1 of this report, from KNBS). There are, however, pockets where this symptom seems to be appearing. Nairobi's property price-to-income ratio ranks 43 out of 283 cities across the world[75] – higher than cities like Paris, Milan, or Tokyo – and the actual monthly mortgage cost as a percentage of take-home family income is about 265.6 percent for Nairobi city, also high for global standards (Numbeo 2025).[76] Property and rental affordability is, thus, a key issue to address. If not,

[73] Source: Balance of Payments estimates, Central Bank of Kenya.
[74] Informal settlements, like Kibera, emerged near central Nairobi because of their proximity to jobs, as commuting from Nairobi's outskirts is too costly and time-consuming.
[75] From Numbeo, the price to income ratio is a measure for apartment purchase affordability, where a lower ratio indicates better affordability. It is calculated as the ratio of median apartment prices to median familial disposable income, expressed as years of income. Please see: https://www.numbeo.com/property-investment/indicators_explained.jsp
[76] Numeo. (2025). Property Prices Index by City 2025. https://www.numbeo.com/property-investment/rankings.jsp

pressures to raise the nominal wage will continue to increase: parliamentarian salaries (figure 4.7) and senior civil servant wage premiums (Chapter 3 of this report) seem already high for a country at Kenya's level of income. Eventually, rising nontradable prices will find their way into wages across the board. Such wage gains would require similar productivity gains. Yet consumption cities are relatively unproductive, constraining productivity growth. The risk is that the wage bill can outpace revenue relatively quickly. Promoting Nairobi's competitiveness, so that the private sector grows at least at the same pace as the public and international sector, can help mitigate this.

Figure 4.7. Annual Basic Salary of Parliamentarians and Gross Domestic Product per Capita (USD PPP)*



Source: Global data on national parliaments, Inter-parliamentary Union (https://www.ipu.org/), and WDI. *Note:* * Data correspond to years 2020–24, subject to availability, for parliamentarians in the lower chamber or unicameral parliaments. USD PPP = US dollar purchasing power parity.

Reforms related to land-based revenues (rents and rates) could play an important role in addressing some of the Nairobi real estate market distortions that put pressure on living costs. High rents translate into high profits for landowners, which should be appropriately taxed via the income and corporation tax mechanisms. This means that Nairobi forgoes considerable potential revenues, estimated in 2020 at 5 billion Kenyan shillings annually (Commission on Revenue Allocation. 2022.). Adding to the system more properties that should be contributing to rates and rents and simultaneously updating the valuation methodology—such that it is better able to capture gains from Nairobi's rapid urbanization—could improve the allocative efficiency of land, potentially reduce land speculation, and spur market activity toward more productive ends. In addition to these possible effects, the much-needed revenues from property rates, a local revenue source, could gradually help pay down the county's pending bills to resolve liquidity pressures and stimulate investment. Nairobi's pending bills reached a total of 118.4 billion Kenyan shillings by end 2023/24, equivalent to nearly four times Nairobi City County's budget, and accounting for 65 percent of Kenya's county-level pending bills for that fiscal year.

Beyond this, the resources could be invested in urban infrastructure and transport that reduces congestion, promotes productivity through economic density, and, in turn, raises the city's competitiveness, addressing nontradable price pressures. An initial step could be to conduct a diagnostic analysis on the potential for reforming land-based revenues. Many such assessments have been done globally, and done right, diagnostic analysis offers the opportunity to create a

steady income stream for reinvestment into local services and infrastructure linked to gains from urbanization. This measure can be enhanced by updating the valuation systems for both rents and rates. With appropriate investments and other accompanying reforms, both of these key land-based revenues can become efficient, anti-cyclical, inflation-proofed long-term income streams—ideal for funding infrastructure and government service provision, either directly or when used to underpin bond issuance. Allowing the country to more broadly and evenly benefit from the concentrated gains of a narrow landowning and property development sector is expected to have broader equity and fairness benefits. This pathway has the potential to underpin public sector and PPP initiatives that facilitate urban regeneration and which can be viewed to an extent as self-financing, owing to the positive effects that such expenditures have on land values.

4.6.2. Repurposing Allowances to Shift from Public to Private Tourism in Naivasha

Reducing facilitative allowances like the Daily Subsistence Allowance, or the public sector travel budget more generally, presents a meaningful opportunity to reallocate public funds toward more productive and publicly supported uses. While remunerative allowances help maintain public sector wage competitiveness, facilitative allowances are often excessive, poorly targeted, and widely viewed as a symbol of government waste. Cutting these allowances would not harm public service delivery but would improve fiscal discipline and public trust.

Naivasha, a popular destination for government retreats, is well positioned to benefit from redirected public travel spending. As a key meetings, incentives, conferences, and exhibitions destination, Naivasha attracts significant public sector traffic, but the town has much greater private sector potential. Developing it into a tourism hub and gateway destination would leverage its natural beauty, unique wildlife experiences, proximity to Nairobi, and prominence in high-profile events like the East African Safari Rally. Pulling more international tourists out of Nairobi to stop overnight in Naivasha would also reduce traffic congestion in the capital and enhance Kenya's overall tourism competitiveness.

Redirected travel savings could leverage 25 billion Kenyan shillings to catalyze Naivasha's private sector-led transformation, while easing pressure on Nairobi. A strategic investment approach—including stakeholder engagement, eco-tourism promotion, and integrated infrastructure planning supported by geothermal energy—would lay the foundation for the sustainable growth of the town and its surrounds. Using just one-quarter of the proposed travel savings (as highlighted in chapter 3) could yield 2.5 billion Kenyan shillings, which could seed and derisk a private sector lending facility through local banks, specifically for tourism, SMEs, and green upgrades to conference facilities. Based on the development costs of ongoing real estate investments in the Naivasha area, as well as the per room development cost for 4-star resort hotels in Kenya, World Bank estimates suggest that these public investments would crowd in up to 25 billion Kenyan shillings in private capital and generate tens of thousands of jobs. Redirecting both government activity and international tourism toward Naivasha—by positioning it as a modern, tourism-friendly town, and a central pillar of Kenya's tourism economy—would also help decongest Nairobi. Equivalent arguments could be made for other Kenyan cities and towns like Naivasha.

4.6.3. Overall Fiscal and Jobs Impacts

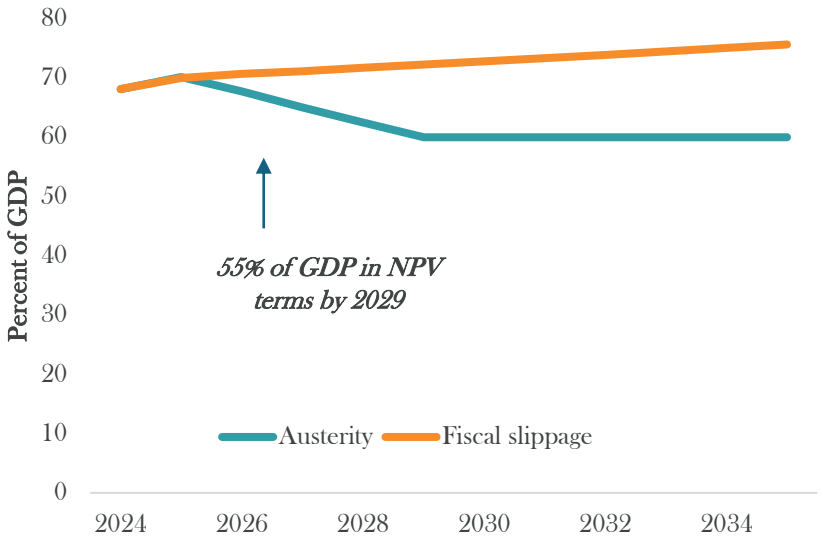
Fiscal policy can help generate the productivity gains required for Kenyan cities to become production hubs. World Bank modeling suggests that to maintain the competitiveness of Nairobi's living costs in light of large inflows from international organizations and embassies, total factor productivity would have to increase by 0.3 percent per year nationwide. A policy package that combines reformed property taxes with urban infrastructure planning and investment, and public sector savings with strategic private sector financing, as illustrated above, would contribute to higher total factor productivity. World Bank modeling suggests that such total factor productivity gains would result in the following long-term impacts relative to the baseline: **debt to GDP**: -1.3 percent; **real wages**: +1.2 percent; **GDP**: +1.2 percent.

Chapter 5.
Summarizing Overall Impacts and Sequencing of Reforms

5.1. Summarizing Policy Proposals and Impacts

Kenya is at a crossroads and faces three options. The first option is business-as-usual: the continuation of fiscal slippage, and in the absence of fiscal consolidation, the country is likely to face a slow grind toward unsustainable public debt, potentially with severe impacts. Following Farah-Yacoub et al (2024) studied evidence from 221 default episodes over the period 1815–2020, suggesting that sovereign defaults, on average, reduce gross domestic product (GDP) per capita by 8.5 percent within three years, raise poverty by 6 percent within five years, and worsen other outcomes from infant mortality to life expectancy (Farah-Yacoub, Graf von Luckner, and Reinhart 2024). Kenya's second option is severe austerity measures, which forces a strong fiscal adjustment in the shorter term (figure 5.1) but risks associated pains to the economy and Kenya's citizens – especially the poor-, and which are unlikely to be socially sustainable (for example, the discussion of policy package 4 highlighted some of the welfare impacts from strong VAT tax adjustments—see chapter 4). The third option is a mix of interventions that simultaneously address macroeconomic imbalances, economic competitiveness and jobs challenges, weak governance, and the regressive policies that jointly undermine the social contract. The reform options presented in chapters 2–4 (and summarized in tables 5.1 and 5.2) have the potential to restore the health of Kenya's public finances while advancing prosperity across the country.

Figure 5.1. Two Fiscal Pathways: Fiscal Slippage and Austerity, Public Debt to Gross Domestic Product, 2024–35



Source: World Bank staff calculations.
Note: GDP = gross domestic product; NPV = net present value. The slippage scenario assumes that the average annual fiscal slippage of the last three fiscal years (0.7 percent of GDP) is maintained. The austerity scenario assumes tax measures that ensure that the debt-to-GDP ratio converges to 55 percent of GDP in NPV terms by 2029.

Table 5.1. A summary of Recommendations for Revenue and Expenditure Measures and Impacts on Productivity, Equity, and the Budget

Revenue Measures				
Objective	Policy recommendation	Impacts		
		Productivity	Equity	Budget Revenues*
Promote formalization and progressivity by reforming personal income tax (PIT)	Adjust tax rates for top and bottom decile earners to reduce the average PIT rates and levies on low-wage workers	+	+++	Up to +0.2 per year
	Phase out mortgage interest rate deductions	++	+++	Up to +0.05 per year
	Align capital income tax (CIT) rates more closely with PIT rates	+	+++	Positive
	Implement a single tax rate of 15 percent on dividends	+	+++	Positive
Promote formalization and progressivity by reforming the tax regime for micro, small, and medium enterprises	Reform the turnover tax (TOT) by increasing the value added tax (VAT) registration threshold and aligning it with a reduced TOT maximum threshold, and align the TOT filing and payment period with the assessment of the exemption threshold	++	++	Neutral to positive
Strengthen the efficiency of tax incentives	Phase out CIT exemptions, including: (1) for collective investment schemes; and (2) from capital gains tax	++	++	Up to +1.2 per year (combined)
	Remove capital gains exemptions on: (1) transfers to immediate family members; (2) companies with a 100 percent family shareholding; (3) private residences occupied for three years; and (4) any capital gains realized as a result of internal group restructurings Repeal the tax exemption on dividend payments made by special economic zone (SEZ) enterprises	++	+++	Up to +1.0 per year
	Place a moratorium on new incentives for SEZs and export processing zones (EPZs), pending a review on the rationale for and practice of incentives, and revisit and grandfather existing incentives pending the review outcome	+++	+	Positive
	Reform VAT to eliminate certain regressive exemptions as part of a set of policy packages (see table ES.3)	+	-	Up to +3.4 per year (extreme scenario)
Capture value of real estate	*National level.* Improve coverage of properties; make improvements to the area-based valuation methodology of the ground rent calculation; strengthen enforcement and communications; and raise rates	+++	++	At least +0.05 per year
	County level. Update and simplify the property rate's legal system; streamline and standardize valuation methodologies; invest in property tax administration systems; and raise rates	+++	++	At least +0.09 per year
Correct for externalities (harmful effects on society)	Introduce a carbon tax on fuel at point of entry, and recycle revenues	+	+	+0.18 by 2030
	Raise excise taxes on alcohol, tobacco, and sugar	+	+	+0.3 to 0.6 per year
Strengthen tax compliance	Register all VAT taxpayers on e-TIMS, automate tax exemptions, and expand scope of e-Citizen platform	+	+	Up to +0.6 per year

Expenditure Measures				
Objective	Policy recommendation	Impacts		
		Productivity	Equity	Budget Savings*
Strengthen efficiency and compliance of the public wage bill	Adopt a temporary hiring freeze for nontechnical positions to allow for a review of the efficient allocation of existing public servants; and strengthen establishment controls, including through implementation of HRIS-Ke	+	+	Up to +0.4 per year
	Reduce the budget for domestic and international travel budget by half and improve compliance, including through the use of an operationalized travel management module in IFMIS that interfaces with HRIS-Ke	+	+	+0.07 per year
Limit liabilities from state-owned enterprises (SOEs)	Divestment of SOEs in commercial and competitive sectors	+++	+	Up to US$1.2 billion
	Discontinuation of transfers to commercial SOEs and prioritization of transfers to SOEs that deliver on public policy obligations	++	+	+0.26 per year
Improve public financial management	- *Public investment management.* Strengthen project preparation and selection; accelerate PIMIS rollout and integration; enhance cross-government coordination - *Public–private partnerships (PPPs).* Ensure competitive biddings, and ensure investments follow the least-cost planning approach; ensure suitable technical design, clear terms, risk allocation, and performance standards; establish clear performance benchmarks and monitoring - *Procurement.* Fully implement electronic government procurement - *Cash management.* Fully transition to the Treasury Single Account	+++	+	Up to +1.0 per year
Improve service delivery	*Education.* Prioritize allocation of funds to underserved regions; implement results-based financing; adjust capitation grants for equity; strategically invest in infrastructure and leverage PPPs; expand digital and distance learning; and hire teachers	+++	+++	At least –1.0 per year
	Health. Strengthen capacity and equity (staffing, resources, and service delivery gaps); improve governance and efficiency (national–county coordination, pooling of procurement of medicines, and linking of funding to improved budget execution) and ensure sustainable financing; consider removing Social Health Insurance Fund contributions for low-wage earners	+++	+++	Up to –3.0 per year
	Water supply and sanitation. Raise tariffs to cost-recovery levels and recycle the fiscal savings into expansion of water supply and sanitation; resolve legacy debt in county water utilities	++	++	Neutral
	Social protection. Increase benefit levels from 2,000 to 3,000 Kenyan shillings per month for all current beneficiaries; strategic expansion of poverty-targeted cash transfer programs to cover a larger share of the population in the 10 poorest counties; strengthen shock-responsiveness of the National Hunger Safety Net Program *Social insurance.* Reform National Social Security Fund to reduce costs and improve data accuracy through automation, while extending social insurance	+	+++	–0.3 per year

	for informal workers via enhanced processes, awareness programs, and collaborative savings efforts	+	++	Neutral
	Agriculture. Reform the fertilizer subsidy program to target poor smallholder farmers, eliminate public procurement of fertilizer, and include agro-dealers in distribution	+++	+++	Up to +0.1 per year

Source: Original tables for this report, based on chapters 2 and 3 of the report.
Note: A + symbol indicates a fiscal saving, reduced distortion, or improved progressivity; a - symbol indicates higher funding needs, increased distortion, or reduced progressivity. Additional symbols denote relatively stronger effects (as determined by a World Bank staff assessment).
*Percentage points of gross domestic product [GDP].

Table 5.2: Summary of Policy Packages and Impacts on Growth, Jobs, and Public Debt

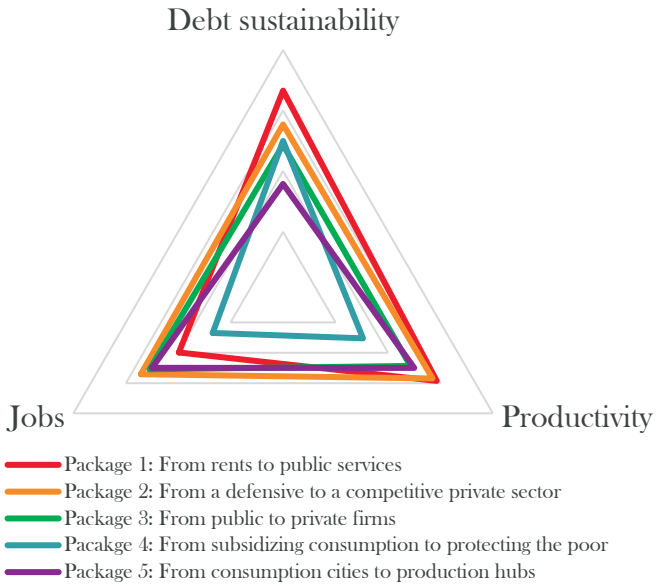
Objective	Policy recommendation	Impacts		
		GDP (%deviation from baseline in 2035)	Real wages (% deviation from baseline in 2035)	Debt to GDP ratio (pp. deviation from baseline in 2035)
Policy package 1: From rents to public services	Conflict-of-Interest and Anti-Money Laundering/Combating the Financing of Terrorism policies; public financial management measures; instant fines/business regulations; reduced public domestic borrowing	+2.98	+0.46	-11.19
Policy package 2: From a defensive to a competitive private sector	Competitiveness and competition measures; reduction in the corporate interest tax rate (to 25%) and increase in the dividend tax rate	+1.86	+1.46	-7.6
Policy package 3: From public to private firms	Promote a level playing field while divesting of SOEs in competitive sectors	+0.96	+1.23	-5.47
Policy package 4: From subsidizing consumption to supporting the poor	Reform VAT (remove value added tax exemptions for goods with low consumption by the poorest members of society) and excise taxes on environmental and health externalities, while raising social protection transfers and paying down pending bills	-0.11	-0.43	-5.88
Policy package 5: From consumption cities to production hubs	In Nairobi, leverage property taxes to reduce the distortive effects on prices in Nairobi, increasing housing supply and supporting densification. In Naivasha, recycle one-quarter of savings from the public travel budget to leverage private finance to promote tourism	+1.23	+1.16	-1.33

Source: Chapter 4.

Note: Individual effects are per annum and combined effects are by 2035. Economic growth and real wages are deviations relative to business-as-usual while public debt is the percentage point change in the debt-to-GDP ratio.

All five policy packages individually strengthen fiscal and debt sustainability, equity and jobs, and productivity. Combining them will also raise real consumption across society. All policy recommendations in this public finance review (PFR) are designed in such a way that they would enhance progressivity. The discussion of the policy packages in chapter 4 estimated the impacts of each package on fiscal and debt sustainability (a reduction in the debt-to-GDP ratio), jobs (an increase in real wages), and productivity (an increase in labor productivity and GDP). Figure 5.2 summarizes the expected impacts in those three dimensions. The fastest and largest estimated impact on debt reduction can be achieved by policy package 4, which involves reforming consumption taxes, including value added tax (VAT). This is, however, a sensitive reform—even if the poorest members of Kenyan society can be protected—as its implementation may reduce private consumption. Implementing all five policy packages together raises wages and consumption overall, while reducing public debt. Strategically sequencing the reforms can have the biggest and most sustainable impact for short- and long-term effects.

Figure 5.2. Summary of Fiscal, Social, and Economic Impacts of the Five Policy Packages



Source: Original figure for this publication, based on estimates made using the World Bank Macro Fiscal Model for Kenya (KENMOD).
Note: The estimates across packages are normalized (debt-to-GDP ratios, real wages, and labor productivity) with a mean of zero and standard deviation of 1 for comparison reasons.

5.2. Sequencing Reforms

Strategically sequencing reforms can build social support while addressing immediate and longer-term fiscal and growth challenges. Currently, fiscal policy lacks credibility because fiscal targets continuously slip, both on the revenue and expenditure side. Fiscal slippage is then offset by attempts to raise additional revenue, generating frequent changes to tax policy that deepen policy uncertainty and undermine confidence and investment. At the same time, social support for fiscal tightening is weak because fiscal policy is not considered sufficiently progressive and is undermined by rent-seeking behaviors, while service delivery is inadequate, hampering job creation. This PFR proposes to sequence policies in such a way that they address the urgent challenges while strengthening the foundation for longer-term economic growth, job creation, and service delivery.

This PFR proposes that the reforms are sequenced as follows:

- The first priority is to restore the credibility of the national budget and ensure that the fiscal accounts remain sustainable. This requires fiscal and governance measures. Given the high risk of debt distress, these measures should be included in the 2025/26 budget or in the first supplementary budget of 2025/26. Largely rigid expenditures and underfunding across many sectors necessitate the mobilization of revenue. For this to be effective and social acceptable, revenue mobilization should be accompanied by the simultaneous implementation of impactful complementary governance interventions to reduce revenue leakage, and measures to protect the poorest members of society.
- The second priority is to strengthen fiscal policy—complemented by structural and governance measures—to deliver equity, productivity, and jobs, and further build fiscal space. This requires the reform of fiscal policy to make it less distortionary and more equitable, while increasing the effectiveness of fiscal policy with complementary structural measures. This activity should be on Kenya's short- to medium-term agenda.
- The third priority is to raise additional revenue to adequately fund efficient public services. Higher growth coupled with improved buoyancy from tax reforms, including a growing tax base, will yield additional revenue that can help fund priority sectors such as health, education, water supply and sanitation, social protection, and

agriculture. Raising efficiency in service delivery is critical to ensure that every taxpayer shilling spent on public services has the intended impact.

5.2.1. Restore the Credibility of the Budget and Ensure that the Fiscal Accounts Remain Sustainable

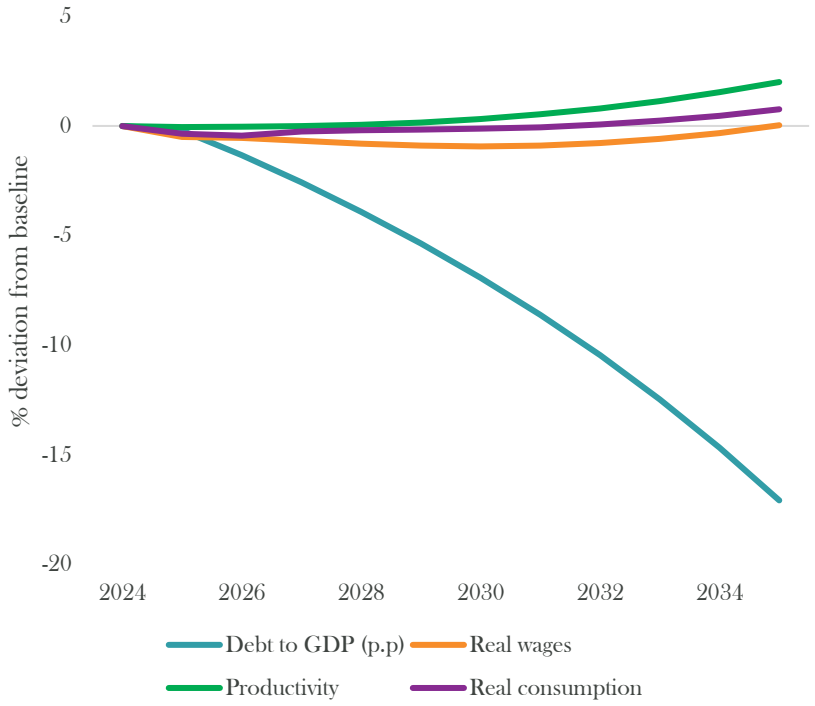
To ensure that the fiscal accounts remain sustainable, the government is introducing reforms that aim to expand the tax base through the Finance Bill 2025. On April 30, 2025, the Kenyan Cabinet Secretary presented the Finance Bill 2025 to Parliament, proposing amendments to tax laws including the Income Tax Act, VAT Act, and Excise Duty Act. The bill seeks, among other objectives, to repeal a number of tax exemptions and strengthen tax administration, including taxing digital services provided by nonresident suppliers, removing preferential tax rates for some sectors, and reducing export promotion levies.

Further measures are needed. Raising consumption taxes is the most impactful short-term fiscal measure available to pursue fiscal consolidation. Complementary governance interventions will be required alongside this reform. Low trust in government and a weak social contract limit the feasibility of ambitious fiscal measures. Thus, improving governance is a critical priority. This could be achieved by swiftly implementing the proposed policy package 1, starting with measures that are already quite advanced in terms of their development. For example, the Conflict of Interest Bill and its implementing regulations, county licensing reform, and rollout of electronic government procurement (e-GP) and the Treasury Single Account could be put in place almost immediately; the implementation of instant fines could be achieved over the next 12 months and be ready by the end of FY 2025/26. This could make it more feasible to then introduce more ambitious fiscal measures, such as raising excise taxes on health and climate externalities, which are harmful to society, and reforming VAT by implementing policy package 4.

Fiscal measures that tend to be relatively regressive or inefficient should also be tackled in the short term, alongside improving protection for the poorest households. On the revenue side, this includes removing exemptions on capital gains and dividend payments, aligning capital income tax rates more closely with personal income tax (PIT) rates, and removing mortgage interest rate deductions, while placing a moratorium on new tax incentives for special economic zones (SEZs) and export processing zones (EPZs). On the expenditure side, it includes cuts to the public sector travel budget and the strengthening of hiring controls and wage adjustments in the public sector. Policy package 4 also suggests reducing the subsidy distributed by the fertilizer subsidy program until the program is improved and using the savings to strengthen social protection spending for the poorest Kenyan households.

Figure 5.3 illustrates the effects of some of the most impactful short-term reforms. Combining policy packages 1 and 4 would mitigate adverse effects on consumption while building social support. Yet additional interventions are needed. World Bank modeling for figure 5.3 uses the business-as-usual situation, the first option described above, as the baseline. It is modeled as the government's fiscal outlook with an additional fiscal slippage assumption, include half of the average fiscal slippage from the past three years. The projected fiscal slippage results in rising public debt. The scenario in figure 5.3 includes the implementation of policy packages 1 and 4 (for details about the modeling, see appendix of this report). The figure shows that the governance interventions of policy package 1 can help offset the adverse welfare impacts of the tighter revenue measures. This would support the social sustainability of this combination of packages, but real wages would still fall relative to business as usual. To raise both consumption and wages, while also reducing debt, it is critical to leverage the rest of policy packages.

Figure 5.3. Simulation of Policy Packages 1 and 4: Joint Effects over Short, Medium, and Long Term



Source: Original figure for this publication based on Chapter 4.
Note: GDP = gross domestic product; p.p. = percentage point. **Package 1:** Anti-corruption measures (over 10 years): Reduce risk premia by 5.4 percentage points through control of corruption and generate 0.5 percent of GDP from instant fines; generate cost savings in public investment of 10%, plus 0.6 percent of GDP for the broader procurement budget. **Package 4:** Raise value added tax (VAT) revenue by removing exemptions equivalent to about 0.5 percent of GDP (items with low consumption by the poor); raise health taxes equivalent to 0.6 percent of GDP gradually in long term and introduce carbon tax equivalent to 0.25 percent of GDP by 2030; reduce agricultural subsidies by 0.1 percent of GDP from 2025 onwards, pay down pending bills, and increase social protection spending by 0.3% of GDP in 2025.

5.2.2. Strengthen Fiscal Policy, Complemented by Structural and Governance Measures, to Deliver Equity, Productivity, and Jobs, and Further Build Fiscal Space

Over the short to medium term, it will be critical to address Kenya's fiscal, structural, and governance challenges. Areas of focus must include public financial management, wage bill management, and revenue administration. The fiscal and governance agenda outlined in policy packages 1 and 4 will deliver some quick wins in the short term but implementing some of these measures in full will take longer. Additional medium-term reforms include strengthening the efficiency of the wage bill, on the expenditure side, and revenue administration, on the revenue side. Better governance in public financial management is also critical to enhance growth, for example, by strengthening the public investment management (PIM) and public–private partnerships (PPP) frameworks that affect the delivery of infrastructure. Resolving bottlenecks to the flow of funds across government will improve service delivery. Beyond governance, it will also be important to deploy fiscal and structural policies to remove distortions in the economy, promote equity, generate jobs, and further strengthen fiscal buffers.

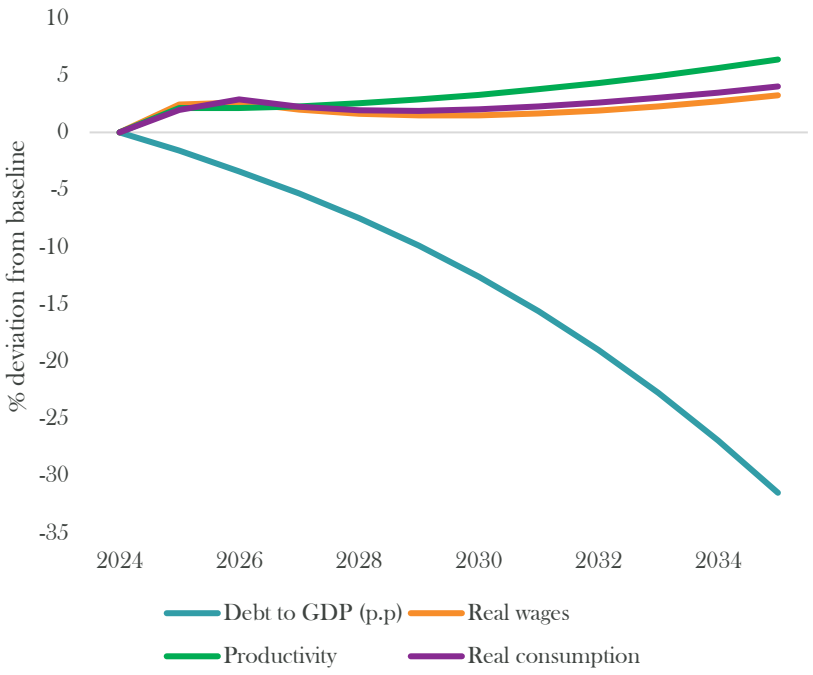
Removing distortions that undermine job creation will help address Kenya's jobs challenge. These distortions are mainly fiscal in nature and include the current structure of PIT, as well as levies and contributions that make labor relatively expensive: this encourages informality and a substitution away from labor to capital. Adjusting PIT brackets and rates and potentially exempting low wage earners from the housing levy and Social Health Insurance Fund (SHIF) contribution could be achieved in a revenue-neutral way while promoting equity, progressivity, and a broadening tax base. Given the large share of employment in micro, small, and medium enterprises, reforming the turnover tax would also help promote job creation without significant negative expected impacts on revenue collections.

Both job creation and long-term revenue mobilization require a more competitive economy. Policy package 2 (from a defensive to a competitive private sector), package 3 (from public to private firms), and package 5 (from consumption cities to production hubs) feature a mix of fiscal and structural policies that could further economic growth, job creation, and revenue mobilization.

To lift a potential moratorium on new tax incentives to businesses, the current system should be reviewed to ensure that it delivers the intended benefits, such as additional investment and jobs. The new system should have clearer objectives and be applied more rigorously, including through the consistent application of incentives, once they have been transparently awarded.

Figure 5.4 illustrates the potential impacts of some of these reforms: jointly, the packages reduce debt, raise consumption, and generate better jobs. Building on figure 5.3, figure 5.4 presents modeling of additional policy scenarios, based on adding policy packages 2, 3, and 5 to the mix. It shows how combining all five packages would have large fiscal impacts, reducing the public debt-to-GDP ratio by about one-third within 10 years and returning Kenya to a position closer to its debt level of the early 2010s, when the big debt buildup began. Importantly, combining these measures would significantly raise consumption as well as real wages relative to business as usual and make the Kenyan population noticeably better off—further generating support for reforms.

Figure 5.4. Simulation of Combination of Policy Packages 1 to 5



Source: Original figure for this publication based on Chapter 4.
Note: GDP = gross domestic product; p.p. = percentage point. Packages 1 and 4 plus (see note to figure 5.3). **Package 2:** Reduce corporate income tax (CIT) rate to 25 percent while raising the dividend tax by 15 percent; generate savings from reformed CIT exemptions by 1.2 percent of GDP over 10 years. **Package 3:** Divest state-owned enterprises (SOEs) in competitive sectors for US$1.2 billion over five years, reduce transfers to SOEs by 0.26% of GDP over five years, increase total factor productivity based on reduction in SOE presence in the economy. **Package 5:** Additional revenue from property taxation and expenditure savings invested to raise the productivity-to-investment ratio by 1 percent of GDP, reducing the cost of living and therefore the public wage bill by 0.47 percent of GDP over three years.

5.2.3. Adequately Fund Efficient Public Services

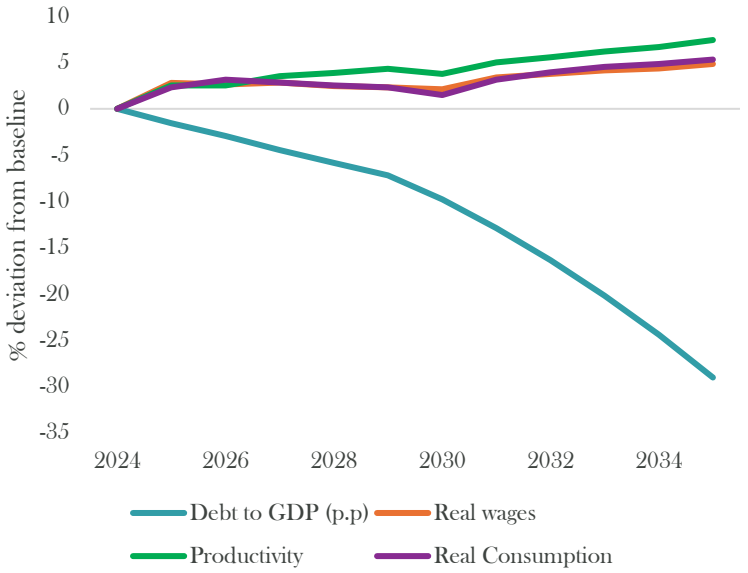
Improving governance, expenditure, revenue, and growth performance is critical for service delivery. Chapter 3 demonstrated that many public services are both inefficient and underfunded. The chapter laid out key reforms to raise efficiency and equity in sectors such as health, education, water supply and sanitation, social protection, and agriculture, and more broadly across the civil service. There are other important sectors that this PFR does not cover, but implementing reforms to raise the efficiency of spending will create social support for funding them better. Kenya's current domestic resource mobilization of less than 15 percent of GDP is far from sufficient for adequate service delivery—health and education alone are estimated to collectively require at least another 4 percent of GDP. In addition, other social and infrastructure needs require funding. Kenya's economy has the potential to raise this revenue, and as revenues rise with improving growth and buoyancy as efficiency improves, more and better public services can be funded. More efficient wage bill management and rising revenues will also make it easier for Kenya to comply with its legal obligations under the Public Financial Management Act to keep wage bill growth in line with revenue benchmarks.

Figure 5.5 illustrates how implementing reforms can generate space for additional social spending. The figure uses the scenario based on the implementation of all five policy packages and, instead of reducing debt, gradually invests another 4 percent of GDP in health and education. While debt now declines less steeply, a considerable reduction remains, while consumption, wages, and productivity continue to grow.

5.2.4. Final Assessment

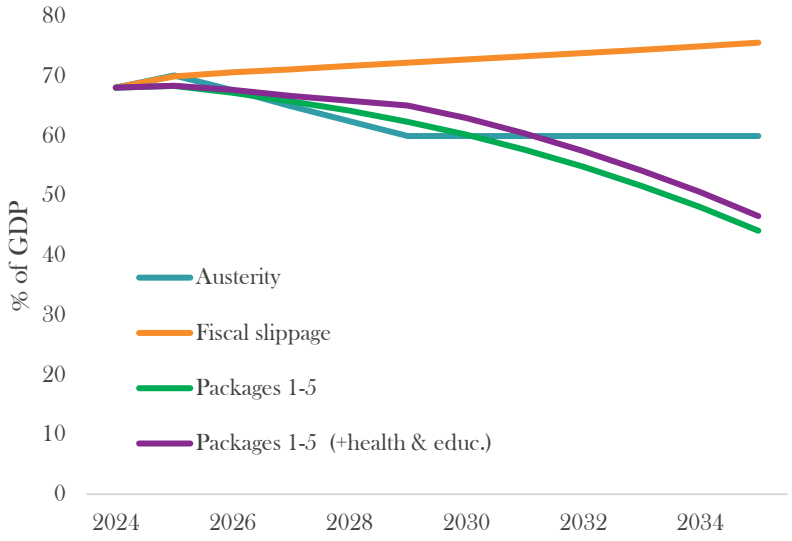
It is possible to simultaneously promote economic growth, jobs, equity, and fiscal and debt sustainability in Kenya. Figure 5.6 combines all scenarios and compares them with fiscal slippage and with austerity scenarios. Continuous fiscal slippage would eventually result in risking a liquidity problem becoming a solvency issue. Austerity measures would reduce the public debt burden to the 2029 target of 55 percent of GDP in net present value terms, but with limited growth and jobs results and uncertain social costs. Figure 5.6 shows that the five policy packages presented in this PFR could also help Kenya meet its debt target—but inclusive of growth, jobs, and social dividends. Improving service delivery is a paramount objective for development in Kenya, and thus the whole range of options—and, potentially, additional options—would need to be implemented to generate additional fiscal space for increasing spending, for example, on health and education, within the 2029 debt target. Yet a budget that delivers economic and social gains to the Kenyan population will more likely be able to mobilize such resources, as improving development outcomes, growing trust, and progressive fiscal measures become elements of a virtuous cycle.

Figure 5.5. Policy Reform Unlocks Additional Funding for Health and Education



Source: Original figure for this publication based on Chapter 4.
Note: GDP = gross domestic product; p.p. = percentage point. The modeling builds on the implementation of the combined policy packages 1 to 5, as shown in figure 5.4, and gradually invests another 4% of GDP in health and education over five years.

Figure 5.6. Public Debt to Gross Domestic Product ratio under Different Scenarios (% of GDP)



Source: Original figure for this publication, based on figures 5.2, 5.3, 5.4, and 5.5.

All in all, looking beyond the budget, by implementing fiscal, governance, and structural reforms, Kenya can achieve fiscal sustainability while creating jobs and delivering quality public services. This PFR provides a range of policy options to achieve these objectives in the short to longer term. High risks of unsustainable debt or fiscal austerity are not the only options Kenya has for fiscal policy going forward: there is another way.

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Technical Appendix: Kenya World Bank Macro-Fiscal Model (KENMOD)

Adapted from Burns et al. (2019)

This appendix summarizes the key principles and mechanisms of the Kenya World Bank Macro-Fiscal Model (KENMOD), a country-specific adaptation of the World Bank's Macro-Fiscal Model (MFMOD). KENMOD is used to assess the impact of fiscal policies on Kenya's macroeconomic aggregates and is based on the framework outlined in Burns et al. (2019). [77] KENMOD is a structural econometric (macro-structural) model that traces the flow of funds across the economy by representing the core identities of the national accounts, balance of payments, labor markets, and financial sectors. Its structure is consistent with both economic theory and observed historical dynamics in Kenya. The model's adjustment speed and long-term equilibrium paths are driven by empirically calibrated parameters that reflect Kenya's historical economic behavior.

1. The Supply Side Equilibrium and the Output Gap

The core of KENMOD centers on potential output, defined as the level of output that corresponds to full capacity utilization—where demand equals supply, and the economy operates at full employment. Mechanically, the model ensures convergence between supply and demand in the long run.

Potential output is produced using capital and labor as production inputs:

$$Y_t^* = A_t N_t^{*\alpha} K_{t-1}^{1-\alpha}$$

$$N_t^* = Pop_t \cdot P_t^* \cdot (1 - U_t^*)$$

Where Y_t^* is potential output, A_t is the Total Factor Productivity, N_t^* is Structural Employment, K_{t-1} is the level of capital stock at the end of the period, and α is the labor share of income, which we assume is 0.4. Structural employment is also calculated using the working age population (15-65) Pop_t, the equilibrium labor force participation rate P_t^*, and the natural rate of unemployment U_t^*. The asterisk * refers to the trends of each of the series, which are calculated using an HP filter. The nominal wage bill is defined as:

$$WB = W.N = \alpha.P.Y$$

Thus, real wages are a function of labor productivity in the long run:

$$\frac{W}{P} = \alpha.\frac{Y}{N}$$

Participation and structural unemployment rates are held constant beyond the forecast period, reflecting their slow-moving nature. [78] Thus, potential output growth is driven solely by changes in capital stock, structural employment, or TFP. In the long run, as the capital-to-output ratio stabilizes, diminishing returns to capital imply that TFP becomes the primary source of growth.

The model defines the *output gap* as the percentage deviation of actual output from potential output:

[77] For further references and details of the models, including estimates for exports, imports, the current and financial accounts from the balance of payments, deflators, and the production-side accounts, please see *Burns, Andrew et al. 2019. The World Bank Macro-Fiscal Model. Technical Description. World Bank Policy Research Paper 8965.*

[78] It is also possible to use a Phillips Curve to estimate the non-accelerating natural rate of unemployment (NAIRU).

$$Output\ Gap_t = \tilde{y}_t = \left(\frac{Y_t}{Y_t^*} - 1\right) * 100$$

A positive output gap reflects demand exceeding supply, exerting upward pressure on prices; a negative gap reflects the opposite. Price adjustments influence real incomes, consumption, investment, and ultimately help steer the economy back to potential output (Burns et al., 2019).

The model ensures that gaps in output and unemployment close over time, with the pace determined by empirically estimated relationships. Short-term dynamics are anchored to long-term potential GDP, ensuring convergence of unemployment and inflation to their long-term values.[79]

2. The Demand Side of KENMOD – Key Equations

Actual output is defined as the sum of expenditure components:

$$Y_t = C_t + I_t + G_t + (X_t - M_t)$$

Where C_t is private consumption, I_t is investment, G_t is government consumption, and $X_t - M_t$ is the trade balance, exports minus imports. In practice, there is an additional statistical discrepancy component that reflects discrepancies between supply and demand side data.

In the short run, actual GDP converges to potential output. Private consumption, investment, exports, and imports follow error-correction mechanisms (ECMs) to ensure alignment with their long-run trends.

Private Consumption

Real private consumption depends on real disposable income and the real interest rate, consistent with the Permanent Income Hypothesis. It is modeled as:

$$\Delta \ln(C_t) = \alpha + \theta\left[\ln(C_{t-1}) - \ln\left(\frac{YD_{t-1}^N}{P_{t-1}^C}\right)\right] + \beta_2 \Delta \ln\left(\frac{YD_t^N}{P_t^C}\right) + (1-\beta_2)\Delta \ln(C_{t-1})$$
$$+\beta_1(r_t - \pi_t) + \varepsilon_t^C$$

Where C_t is private consumption, P_{t-1}^C the private consumption deflator, $r_t - \pi_t$ the real interest rate, and YD_{t-1}^N the real household disposable income. For Kenya, this is a function of labor income (net of taxes), government transfers, remittances, and the US/ KSh exchange rate.

$$YD_{t-1}^N = WB_{t-1}(1 - \tau^{DRCT}) + GovExp_{t-1}^{SS} + (XREMT_{t-1}^{CD} - MREMT_{t-1}^{CD}) * E_{t-1}^{US}$$

Note that long-run wage bill is the product of average real wage and employment. In the long run, employment growth follows working-age population growth ($\Delta n_{LR} = \Delta pop_{LR}$) and real wage growth equals the growth in the marginal product of labor ($\Delta w_{LR} = \Delta y_{LR} - \Delta pop_{LR}$). Noting that that long run growth is approximately equal to TFP growth, real wages in the long run is pinned down by TFP. This forces consumption to be a fixed share of GDP in the steady state – something we observe with most countries that converge.

The equilibrium is determined by:

$$C_t = \beta \cdot \frac{YD_t^N}{P_t^C}$$

[79] Marginal costs are determined by the firm's cost minimizing behavior, which is derived from the production function. See Burns et al (2019) for their derivation.

And the short and long-run follow the equations:

$$\text{Long run (LR)}: \ln(C_{t-1}) - \ln\left(\frac{YD^N_{t-1}}{P^C_{t-1}}\right) = 0$$

$$Short\ run\ ECM: \Delta\ln(C_t) = \alpha - \lambda[LR] + \beta_2\,\Delta\ln\left(\frac{YD^N_t}{P^C_t}\right) + (1-\beta_2)\Delta\ln(C_{t-1}) + \beta_1(r_t - \pi_t) + \varepsilon^C_t$$

Investment

Capital accumulation follows the standard perpetual inventory method and equals to previous capital accounting for depreciation and any new investment:

$$K_t = (1-\delta)K_{t-1} + I_t$$

Note that capital stock data is not readily available. Consequently, we approximate initial capital as:

$$K_0 = \frac{I_0}{\Delta y_{LR} + \delta}$$

Where K_t is the stock of capital, δ is the rate of depreciation, and I_t is total investment. From the production function, the demand for capital can be derived from the first-order conditions for profit maximization as:

$$K_{t-1} = \frac{(1-\alpha)P_tY^*_t}{R_t}$$

And thus, the long-run equilibrium investment will be:

$$\frac{(1-\alpha)P_tY^*_t}{R_t} = \frac{I_t}{\Delta y_{LR} + \delta}$$

$$I^*_t = \frac{(\Delta y_{LR} + \delta)(1-\alpha)P_tY^*_t}{R_t}$$

With Δy_{LR} being real long-term growth, $(1-\alpha)P_tY^*_t$ corporate profits (gross operating surplus), and R_t the cost of capital. In the short run, the model has the following ECM form, where investment fluctuates around its long-term anchors, which is real profits and the relative cost of capital:

$$\Delta\ln(I_t) = \alpha + \theta\left[\ln(I_{t-1}) - \ln\left(\frac{(g+\delta)(1-\alpha)P_tY^*_t}{R_t}\right)\right] + \beta_1\Delta\,ln(Y_t) - \beta_2\Delta\,ln\left(\frac{R_t}{P_t}\right) + \varepsilon^C_t$$

Exports and imports

Exports in KENMOD is a function of relative prices and foreign demand for Kenyan goods and services. Kenya is a price taker – this means that if export prices increase relative to domestic prices then Kenya becomes more competitive. Exports solve a supply problem – whatever is produced can either be sold domestically or externally. Using a constant elasticity of transformation, the export equation can be written as:

$$X_t = \omega_X\left(\frac{P^X_t}{P^C_t}\right)^{\sigma_X} XMKT_t$$

Where P^X_t is the export price (in local currency terms), P^C_t is the consumer price and $XMKT_t$ is a variable that captures Kenya's main trading partners (i.e., a weighted average of trading partner imports of Kenyans goods). The elasticity of substitution ($\sigma_X > 1$) measures the sensitivity of exports to relative prices.

The export price is a function of input costs (P^{CST}) and international prices (P^{XKEY}) multiplied by the bilateral exchange rate to the US dollar:

$$\Delta \ln(P_t^X) = \gamma_1 + \theta[\ln(P_{t-1}^X) - \lambda \ln(P_{t-1}^{CST}) - (1-\lambda)\ln(P_{t-1}^{XKEY}.FX_{t-1})] + \beta_1 \Delta \ln(P_t^{CST}) + \beta_2 \Delta \ln(P_t^{XKEY}.FX_t) + \varepsilon_t^{PX}$$

Note that the international price index is a weighted average of roughly 30 or so commodity prices in USD. The weights equal COMTRADE export weights.

Imports solve a problem of demand. Kenya can either consume local goods and services produced or import those goods and services. A constant elasticity of substitution maps import volumes to relative price of imports to domestic prices:

$$M_t = \omega_M \left(\frac{P_t^M}{P_t^C}\right)^{-\sigma_M} (C_t + G_t + I_t)$$

If import prices rise, then import volumes will fall. If domestic demand $(C_t + G_t + I_t)$ rises then imports will fall.

Import prices are functions of foreign prices corrected for the exchange rate and import duties (customs):

$$\Delta \ln(P_t^M) = \gamma_1 + \theta[\ln(P_{t-1}^M) - \ln(P_{t-1}^{MKEY}.FX_{t-1}) - \ln(1+\tau_{t-1}^M)] + \beta_2 \Delta \ln(P_t^{MKEY}.FX_t) + \Delta \ln(1+\tau_t^M) + \varepsilon_t^{PM}$$

Wages and Prices

Wages are estimated using the ECM functional form:

$$\Delta \ln W_t = \gamma \Delta \ln W_{t-1} + (1-\gamma)[\Delta \ln(MPL_t^*) + \Delta \ln(P_t^C)] - \beta_1(U_t - U_t^*) + \varepsilon_t^W$$

Where γ is a measure of nominal wage rigidities, MPL_t^* is the marginal product of labor, and P_t^C is equal to inflation expectations.

Consumer prices are a weighted average of producer prices and import prices accounting for value-added taxes:

$$P_t^C = {P_t^P}^{\alpha} {P_t^M}^{1-\alpha} (1+\tau_t^{VAT})$$

Producer prices are simply a markup over marginal costs in the long-run, while the output gap effects the short run:

$$\pi_t^P = \gamma \ln(MC_t) + \beta \pi_{t-1}^P + \kappa\, \tilde{y}_t + \varepsilon_t^{\pi}$$

Note that $\pi_t^P = \Delta \ln\left(\frac{P_t^P}{P_{t-1}^P}\right)$ and $MC_t = \left(\frac{1}{A_t}\right)\left(\frac{W_t}{\alpha}\right)^{\alpha}\left(\frac{R_t}{1-\alpha}\right)^{1-\alpha}$.

Fiscal Accounts

The government balance (BB_t) is determined by the difference between total revenues and expenditures $R_t - G_t$, while the stock of debt by the stock of debt in the last period plus the budget balance.

$$BB_t = R_t - G_t$$

$$D_t = D_{t-1} - BB_t$$

For government revenues, direct, indirect, and trade tax revenues are modeled based on a proportion of private and government consumption, wages and salaries, and exports and imports, respectively. The functional forms map revenues as a function of the effective tax rate multiplied by the tax base:

$$R_{i,t} = \tau_i^E . TB_{i,t}$$

As an example, VAT revenues depend on the effective rate and nominal consumption ($R_{VAT,t} = \tau_{VAT,t} . P_t^C . C_t$).

In the case of government expenditures, we estimate a constant ratio to GDP for each government expenditure category, mainly compensation to employees, expenditure on goods and services, and capital expenditures. The cost of financing is modeled both for domestic and external interest payments. They are endogenous to the model. The risk premium is an increasing function of debt beyond a threshold. We write interest expenses as:

$$G_{INT,t} = i_t^D . D_{t-1}$$

Interest expenses thus increase with the size of the average interest on government debt as well as an increase in the previous stock of debt. We model interest expenditures as a function of the short-term monetary policy rate and a risk premium:

$$i_t^B = \gamma i_t^{MP} + \rho_t$$

Thus, an increase in the short-term monetary policy rate will increase average bond yields. The risk premium is an exponentially increasing function of debt:

$$\rho_t = \beta + e^{\theta\left(\frac{D_t}{P_t Y_t} - \frac{D^*}{PY^*}\right)}$$

Where θ is an empirical estimate regarding the sensitivity of yields to debt deviations from target debt (assumed to be 60% of GDP).

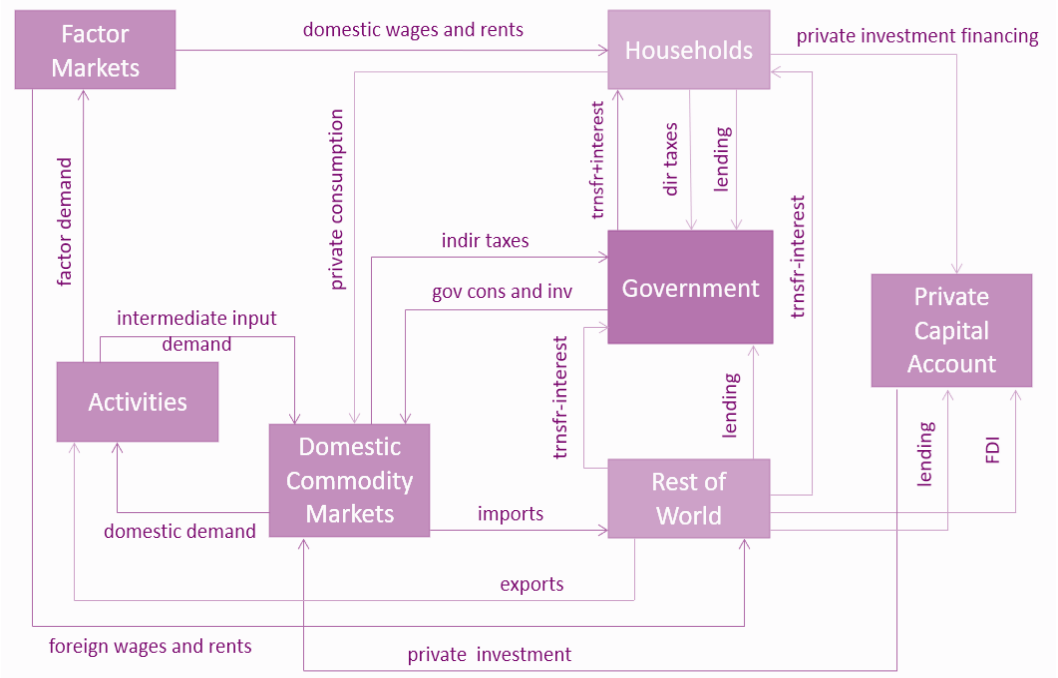
Balance of payments

The balance of payments captures Kenya's transactions with the rest of the world, including the current account (net trade in goods, services, and transfers) and the capital and financial accounts (net capital flows). The modeling of exports, imports, and price deflators follows the methodology described in Burns et al. (2019). [80]

The model's flow of funds as modeled in KENMOD is shown in figure A.1.

In general, exports of goods and services in MFMOD depend on Kenya's trading partners', the demand for imports, and the competitiveness of that country's exports. In turn, imports reflect both final and intermediate demand for goods and services (both consumption and capital goods) as well as the relative price of domestic goods compared to imported goods.

Figure A.1. KENMOD General Flow of Funds



Sources: The World Bank, from Burns et. al (2019).

3. Packages and modelling assumptions

This PFR has 3 overall scenarios: (i) a slippage scenario, (ii) austerity, and (iii) implementation of packages. The baseline is constructed using the latest World Bank Macro-Poverty Outlook estimates (April, 2025) and October 2024 World Bank – IMF debt sustainability analysis. It assumes that GDP converges to potential over the long-term (to 4.7 percent growth), while fiscal and external figures are kept constant as a share of GDP after 2027. The assumptions are the following:

- Fiscal slippage scenario: a 0.35 percent deficit deviation is added to World Bank estimates. This is based on half of the average fiscal slippage during the last 3 fiscal years (budgeted versus actual fiscal deficit).
- Austerity scenario: This scenario assumes that assumes a fiscal path consistent with the GDP ratio reaching 55 percent in 2029 (in NPV terms).
- Policy Packages (1 to 5):
    - Package 1.
        - Governance and anti-corruption measures (0.5 percent of GDP in police reforms, decreasing risk premium for increasing control of corruption)
        - Public investment efficiency reforms (cost savings decreases by 10 percent relative to the baseline, 0.6 percent of GDP from public investment management reforms (w/o infrastructure))
    - Package 2:
        - Corporate and dividend tax reforms (government savings increase by 1.2 percent of GDP from revising CIT exemptions over 10 years, 15 percent dividend tax rate).
    - Package 3:
        - SOE reforms (USD 1.2bn privatization proceeds over 5 years, transfers to SOEs reduce by 0.26 percentage points over 5 years).

        - Elasticity of economy-wide firms' mark ups to productivity (a 1 percent decrease in mu dispersion increases TFP by 2percent*\sigma (elasticity of substitution among goods) over 5 years.
- Package 4:
    - Increase in consumption taxes (removing VAT exemptions by 0.52 percent of GDP, +0.6 percent of GDP gradually from health taxes, 0.25 percent of GDP in carbon taxes by 2030).
    - Removal of agricultural subsidies (0.1 percent of GDP)
    - Increase social protection spending (0.3 percent of GDP)
    - Payment of pending bills (reduction of average interest rates through lower NPLs)
- Package 5:
    - Distortion of 1 percent of GDP, which translates into 1 percent increase in TFP if removed (permanent)
    - Real estate taxation and wage bill savings (0.61 percent of GDP)
- Additional healthcare and education expenditure: 4 percent GDP