THE EFFECT OF PROPERTY TAXATION ON ECONOMIC GROWTH IN KENYA

BY

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DECLARATION

I hereby declare that no part of the work that appears in this study has been utilized in the application of a degree or any other qualification to the University or any other institution of learning

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This project report has been presented for examination with my approval as the University Supervisor.

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May the almighty God bless you all.

DEDICATION

I dedicate this project to my friends and classmates.

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LIST OF ABBREVIATIONS

EU	European Union
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
KNBS	Kenya National Bureau of statistics
KRA	Kenya revenue Authority
OLS	Operating Least Square
SPSS	Statistical Package for Social Sciences
US	United States

ABSTRACT

Public expenditure in all nations across the world is funded by money collected from taxes as the major source with other supplementary sources like government debt among others. All the land contained in a given geographical location such as the county could be developed by the County government itself through purchasing the land at the price quoted by the seller if no other buyer can purchase the property at the price offered by the owner. The planning powers of the county governments allow them to unlock their land based on small scale farms which fall under commercial farms and subjected to commercial property rates. The aim of this study was to determine the effect of property taxation on Economic growth in Kenya. The study was informed by the Classical Growth Theory and the Traditional Tax Handle Theory. A descriptive research design was used by the researcher. Secondary data was collected by the researcher from relevant publications by KNBS and KRA. The collected data was analyzed using descriptive statistics. The findings of correlation analysis indicated that property taxes had positive and significant relationship with economic growth ($r=0.691$, $p=0.000<0.05$). There was a further positive relationship between corporate taxes and economic growth ($r=0.011$, $p=0.946>0.05$). The study established an inverse relationship between individual taxes and economic growth ($r=-0.065$, $p=0.691>0.05$). Inflation was directly related with economic growth ($r=0.166$, $p=0.306>0.05$). The study established an inverse relationship between interest rate and economic growth ($r=-0.588$, $p=0.000<0.05$). From regression analysis, at 5% significance, property taxes ($p=0.000<0.05$), inflation ($p=0.003<0.05$) and interest rates ($p=0.000$) significantly contributed towards economic growth. The study concluded that an increase in property taxes could either decrease or increase economic growth of the country. An increase in inflation increase economic growth. A decrease in interest rates increases economic growth of the country. The study recommends that Kenya Revenue Authority should be careful when setting taxation rates for example on properties. The Central Bank of Kenya CBK ought to strengthen monetary policies that keep the interest rates and inflation at sustained levels for greater economic growth of the country. There is need for awareness programs and campaigns to remind citizens on the need to pay taxes for sustainable economic growth.

CHAPTER ONE
INTRODUCTION

1.1 Background of the Study

Public expenditure in all nations across the world is funded by money collected from taxes as the major source with other supplementary sources like government debt among others (Barnett and Grown, 2004). Taxation is the practice of collecting taxes (money) from citizens based on their earnings and property. The money raised from taxation supports the government. Various classes of taxes have been established to help diversify the revenue streams of Governments. One of the revenue streams of Government if taxes collected from property. Property taxes relate to real estate development taxes which vary from one city to another. Property taxes affect the level of a country's production and growth in equal measure.

This study will be anchored on two distinct theories: The Classical Growth Theory developed by Smith, Ricardo and Smith (1776) and identifies four general canons of taxation as including: equity, certainty, convenient and economic. In terms of equity, the theory holds that all citizens in a nation ought to contribute towards Government support in equal proportion to the protection they enjoy from it. On the principle of certainty, the scholars indicated that individuals are bound to pay a certain tax within a clearly defined timeframes, in a prescribed manner and the specified amounts. The principle of Convenient requires that the taxes levied to citizens at any one given time should be convenient to them. On the principle of economic, the scholars stated that the Government needs to ensure that after the citizens have paid their tax obligations, they need to be left with some money which should be adequate to meet their recurring needs. Traditional Tax Handle Theory formulated by Solow (1956) and Swan (1956) to explain the importance of fiscal policies on economic development. This theory argues that policies on taxation are important in the determination of economic development levels that a country records (Musgrave, 1969). A nation needs to collect adequate amount of national income from taxes if it aims to achieve a given level of economic growth rate of per capita income (Goode, 1984).

Property taxes (Rates) contribute to about 20% of the total recurrent local authorities' recurrent revenues and represent 0.25% of GDP and 1% of the total tax revenue of the

government. The value of Property Rates between 2000 and 2001 was Ksh 1.5 billion (US$19.2 million. Ksh 1.4 billion was allocated to Municipal Councils and Towns, whereas Ksh 83 million was allocated to the Urban and County Councils. According to the Ministry of Local government, property rates contribute to about 34% of the sum of municipalities' own source tax revenues and 4% of the revenues generated by counties and towns. Property tax is a vital source of revenue for the municipalities since it contains the valuation rolls which cover a wider tax base. Previously, 102 of the 147 local authorities found in Kenya applied property taxation. The 102 rating authorities applied rating as follows; 75 applied valuation rating, 55 applied area rating, whereas 29 combined both valuation and area rating. According to the Ministry of Local Authorities, valuation rating was mostly applied while dealing with urbanized properties while area rating was mostly used for rural or agricultural properties

1.1.1 Property Taxation

Property Tax is an advalorem tax on the value of a property, usually levied on real estate. The tax is levied by the governing authority of the jurisdiction in which the property is located. Property Sector consists of real estate; land and the buildings on it. The Valuation for Rating Act (cap 268) and Rating Act (cap 267), were introduced by the Kenyan government in 1972. The most desirable flexibility in defining tax base is achieved through the Rating Act, 1972. The formulation and implementation of property taxes need to be done with some caution so as to eliminate the negative effects on the environment especially in terms of substituting agricultural land for buildings meant for settlement.

Measurement of property taxes varies across various jurisdictions and range between five to ten percentage points of the market value of the properties involved (Cheng, 1974). In estimating the value of a property, an assessment official normally a government official applies the pre-determined tax rates on the market data to come up with the tax levy to be paid by an investor to the government (Clapp, 1990). In order to ensure the taxes are equitable, the fair market value of the property involved need to be determined (Haurin, 1988).

1.1.2 Economic Growth

Economic growth refers to the level of total outputs recorded in an economy over a given period of time which is normally one year (Haller, 2012). It summarizes the activities of country in creation of value over the period under review. Economic growth is basically measured as the annual rate of increase in the gross domestic product (GDP) of the country by economists or by related indicators, such as gross national income (GNI) and gross national product (GNP) which is acquired from the calculation of GDP (Schweitzer, 1964).

Economic growth is defined in terms of an increase in national income per capita. It is measured in terms of the changes recorded in the GDP, GNP and National Income (Net Income) (Haller, 2012). It is perceived as the process which results to an increase in the sizes of national economies, macro-economic indicators (Agrawal & Khan, 2011). Economic development encompasses increases in a country's level of per capita income and real national income over a long period of time. It records changes in resource supplies, capital formation, technology, demographic composition and skills and efficiency (Shah & Attullah, 2011).

1.1.3 Property Taxes and Economic Growth

The strategies adopted by governments on tax policies' implementation have a major impact on the level of economic growth. According to Lea and Gordon (2005), there exists a negative link between taxes and economic growth rate. A reduction of 10 percent in tax rates was reported to have led to a rise in the level of economic growth rate to the tune of 1.1 percent. Arnold (2008) argues that Property taxes affect an economy's level of growth especially recurring taxes on immovable property which positively influences the economic growth.

Using data from the Romanian economy, Brasovenu and Brasovenu (2008) established that increases in property taxes was harmful to economic growth as it resulted in a decline in the growth rate. Countries therefore need to be cautious in setting their property taxes for optimal economic growth rate. An increase in the taxation rate results in a decline in research and development and returns to investment which are the main contributor of economic growth. Taxation has a positive effect since productivity can be enhanced by public expenditure such as such

as the public education, health care and provision of infrastructure. Taxation avails an entity of financing these expenditures and thus an significantly contribute to a rise in growth rate.

1.1.4 Property Taxes and Economic Growth in Kenya

The Rating Act (cap 267), and the Valuation for Rating Act (cap 268) were introduced by the Kenyan government in 1972. The most desirable flexibility in defining tax base is achieved through the Rating Act, 1972. The rating criterion used by the rating authorities include; an agricultural rental value rate, area rating, a site value rate or a combination of site value rate and improvement rate. Flexibility in the adoption of either of the five methods is only possible through the Rating Act (Section 5).This methods includes; The use of a graduated or flat rate upon the unit area of land, differentiated flat or graduated rates as per land use or any other method rating method upon buildings or land that may be resolved by the Rating authority (Kelly, 2000).

Previously, 102 of the 147 local authorities found in Kenya applied property taxation. The 102 rating authorities applied rating as follows; 75 applied valuation rating, 55 applied area rating, whereas 29 combined both valuation and area rating. According to the Ministry of Local Authorities, valuation rating was mostly applied while dealing with urbanized properties while area rating was mostly used for rural or agricultural properties. Property taxes (Rates) contribute to about 20% of the total recurrent local authorities' recurrent revenues and represent 0.25% of GDP and 1% of the total tax revenue of the government. The value of Property Rates between 2000 and 2001 was Ksh 1.5 billion (US$19.2 million. Ksh 1.4 billion was allocated to Municipal Councils and Towns, whereas Ksh 83 million was allocated to the Urban and County Councils (World Bank Report, 2001).

According to the Ministry of Local government, property rates contribute to about 34% of the sum of municipalities' own source tax revenues and 4% of the revenues generated by counties and towns. Property tax is a vital source of revenue for the municipalities since it contains the valuation rolls which cover a wider tax base.

1.2 Research Problem

According to Klutznick, Property Tax and Local Finance (1983), property taxation

has great impact on several other factors such as location of business premises, investment decisions, employment, among other factors. As a rule, the tax inducements that effectively increase the mortgage ability and amount of mortgage and consequently reduce the developer's capital (equity) outlay and risk will always receive high-priority consideration. All the land contained in a given geographical location such as the county could be developed by the County government itself through purchasing the land at the price quoted by the seller if no other buyer can purchase the property at the price offered by the owner. A default in payment of property tax rates leads to the loss of the actual property. The planning powers of the county governments allow them to unlock their land based on small scale farms which fall under commercial farms and subjected to commercial property rates. Through this initiative, settlements will be transformed.

Several studies have been conducted to examine the association between taxes and economic growth of nations across the world. On the global space, Tomalty and Skaburskis (2000) conducted a study on the influence of development cost charges and property taxes on urban development from the developers, finance officers and planners' perspective in Ottawa and Toronto. The study notes that property taxes had been on a continuous increase in North America. Veronika and Lenka (2012) studied the reaction of economic growth and the changes in the taxation of corporate among European countries. The result did not provide clear results as all estimates showed insignificant statistical influence between individual tax burden proxies.

Szarowska (2013) studied how tax burden impacted economic growth of nations in the European Union between 1995 to the year 2010. The findings indicated that a two-way causality between existed between change of implicit tax rate of GDP rate and implicit tax rate of consumption. The study however, concentrated more on the shift in tax burdens and how it affected economic growth of European Union Nations. Rudolf (2014) used the data from various OECD countries spanning a period of eleven years from 2000 – 2011 to the effect of individual taxes on the level of economic growth. The study results also supported the theory on the relationship between human capital and economic growth. In another study, Gale, Krupkin and Rueben (2015) examined how tax policies of nations affected the growth of their economies through creation of employment and entrepreneurship using secondary

data between 1977–2011. The findings indicate that neither top income tax rates nor tax revenues indicated valid associations to employment or economic growth across states and over time.

Locally, Gacanja (2012) studied the relationship between revenues raised from Taxes by the Government and their effect on the Kenyan economic growth. The findings of the study revealed the existence of a positive correlation between tax revenues and economic growth rate. However, this study did not pay attention to property taxes. Awiti (2013) examined the reaction of economic growth following changes in taxes using a theoretical approach. In conditions where higher levels of income elasticity of capital existed, an increase in wage tax and consumption tax lowers the level of capital at steady state.

Alegana (2014) examined the relationship between tax incentives given to investors and economic growth in Kenya. The findings indicated the existence of an inverse relationship between economic growth as proxied by GDP growth rate and tax incentives. Masika (2014) examined the link between direct taxes and economic in Kenya. The study found a positive association between corporate and individual taxes and economic growth. The local studies concentrated on other aspects of tax other than property taxes hence exposing a research gap that this study will seek to fill. The study will seek to answer one research question: How does property taxation affect Economic growth in Kenya?

1.3 Research Objective

To investigate the effect of property taxation on Economic growth in Kenya.

1.4 Value of the Study

This study will enable the market players to adjust their trading activities based on the prevailing tax regimes. It enables them to understand the tax implication that comes with the ownership of properties. This enables them to engage appropriate timing on when to enter or exit a particular market based on the tax costs.

People also organize themselves across jurisdictions based on the existing tax environments. This enables them to run their activities in compliance with the requirements of the local authorities and governments

The tax environment avails some form of differentiation which allows market participants to produce the best combination of goods and services that are produced locally depending on their ability to pay for the goods and services.

CHAPTER TWO
LITERATURE REVIEW

2.1 Introduction

The chapter outlines the documented knowledge from previous studies carried out by other researchers, academicians, and various scholars on the effects of taxation of property in Kenya. Specifically, it discusses the theoretical framework, determinants of economic growth, empirical literature, summary of the literature reviewed and the conceptual framework.

2.2 Theoretical Review

This section examines various theories on which the study will be anchored. Specifically, two theories have been explained in detail: The Classical Growth Theory and the traditional tax handle theory.

2.2.1 The Classical Growth Theory

This theory was developed by Smith, Ricardo and Smith (1776) and identifies four general canons of taxation as including: equity, certainty, convenient and economic. The policies developed by Governments relating to payment of taxes by its citizens needs to be responsive to these four canons. In terms of equity, the theory holds that all citizens in a nation ought to contribute towards Government support in equal proportion to the protection they enjoy from it. It therefore means that individuals enjoying higher level of security from the state needs to pay higher taxes compared to those enjoying less. On the principle of certainty, the scholars indicated that individuals are bound to pay a certain tax within a clearly defined timeframes, in a prescribed manner and the specified amounts. This explains why the Government has formulates policies regarding the various levels of percentages levied on regulate incomes for employed individuals and the case of value added taxes which attract a certain percentage of the sales involved.

The principle of Convenient requires that the taxes levied to citizens at any one given time should be convenient to them. They should not be too high, demanded too early but at the appropriate timing to avoid inconveniencing the tax payer. By ensuring this, the tax payers will even be more will to comply with the legal provisions and pay

their tax obligations in a timely manner to enable the Government meet its expenditure needs. On the principle of economic, the scholars stated that the Government needs to ensure that after the citizens have paid their tax obligations, they need to be left with some money which should be adequate to meet their recurring needs.

Some of the theories falling under classical theories that adhere to the four canons of taxation include: Ability to pay theory and the benefits received theory. According to the ability to pay theory, taxes need to be levied on individuals based on their ability to meet the tax obligations. This needs to ensure that there prevails equal sacrifice among all tax payers in a nation so that some of the citizens are not over-taxed at the expense of another lot. This means that individuals making more income need to be taxed more as compared to those with less income. This scenario has been termed as a progressive tax regime which ensures complete egalitarian distribution of income after the Government taxes are paid. In measuring ability to pay, the scholars recommended use of assets, expenditure and incomes that individuals control within a given time period. The benefits received theory on the other hand argues that the Government needs to levy taxes on tax payers by putting into consideration the benefits they receive. This therefore means that individuals receiving more benefits that an individual receives from the Government the higher the taxes such individuals are supposed to pay. This theory is relevant for this study because it helps explain the role of taxes in economic growth. It explains what the Governments need to do to ensure equity in collection of taxes, convenience, and economic so that all individuals contribute to economic development of their country.

2.2.2 Traditional Tax Handle Theory

This theory was formulated by Solow (1956) and Swan (1956) to explain the importance of fiscal policies on economic development. This theory argues that policies on taxation are important in the determination of economic development levels that a country records (Musgrave, 1969). A nation needs to collect adequate amount of national income from taxes if it aims to achieve a given level of economic growth rate of per capita income (Goode, 1984). Taxes are compulsory contributions by citizens to the Government which guarantees no immediate or direct benefit in return. The taxes collected enable the Government in providing common goods and

services that would otherwise be difficult for individual investors to procure (Mansfield, 1988).

Taxation influences the manner in which resources are allocated within a nation as the investments undertaken by Governments in infrastructure and other social investments may not be necessarily factored into the market prices of goods and services but contribute towards easing business and general trade (Bird, 1987). This theory is relevant for this study because it advocates for country development following increases in the per capita income as the government pursues modernization and development of infrastructures.

2.3 Determinants of Economic Growth

A number of variables have been found to affect the level of economic growth of nations across the world. Some of these variables include: Foreign Direct Investment (FDI),

2.3.1 Foreign Direct Investment

FDI is associated with the general status of the world economy at large because FDI is concerned with the flow of investments into an economy. According to Laplane and Sarti (2002), in situations where the world economy is undergoing expansion, the level of international liquidity is high which allows capital flows to extend to peripheral countries. FDI spurs the level of domestic investment and makes available opportunities for growth in terms of technology and knowledge spillovers besides the growth of employment opportunities (Kaur, Yadav and Gautam, 2012). These findings are consistent with Fry (1996) who established the existence of unidirectional causality from FDI to Current Account.

FDI has significantly contributed to the internalization of economic activity which has led to technological transfer and improved economic growth. Previous studies on on the effects of FDI on have concluded that a significant positive association exists between the two (Lensink and Morrissey, 2006).

2.3.2 Infrastructure and Labour Productivity

The infrastructure of a nation plays a major role in the facilitation of trade. It enables the movement of goods from areas of production to markets with ease and at a

cheaper cost. Therefore, the level of infrastructure development plays a key role in the determination of economic growth rates. Development in infrastructure has been measured in several ways across nations. The common measure however is the length of roads although this may not be a representative as it eliminates areas dominantly served by other means of transport like the railway line.

Other scholars have also applied the level of telephone connectivity in the measurement of infrastructure development. Labour productivity refers to how much of a given output an individual labour unit is able to produce with a given level of resources. In areas where labour productivity is high, higher levels of economic growth rate will be recorded. This is supported by the findings of Lin (1992) which established a positive association between economic growth rate and the level of labour productivity.

2.3.3 Taxes

Taxation has a major contribution of the economic growth levels recorded by economies. This is because they form a key source of revenue to the Government which is then used in the provision of key infrastructure to facilitate trade and development (Padovano & Galli, 2001). Changes in the tax rates and types have a great effect on the level of activity among the population especially through income and substitution effects. Reduction in taxes leads to a raise in the after-tax reward in terms of, saving and investing (Yagan, 2015).

2.4 Empirical Literature

This section presents empirical literature as conducted by other scholars from a global perspective to the local context. The studies are arranged in a chronological order to clearly identify the development of a research gap.

2.4.1 International Studies

Tomalty and Skaburskis (2000) examined how urban development is influenced by development and property rates charges from the perspectives of developers, planners, and finance officers in Toronto and Ottawa. The study was based on the peripheral expansion of cities as opposed to fostering economic growth. The tax laws in North America had been tailored in such a way that developers paid in proportion to the benefits received as opposed to standard taxation ranges. The taxes on land

component in real estate development was capitalized into land prices and taken as not to be affecting the development patterns adopted by developers. The study notes that property taxes had been on a continuous increase in North America leading to disapproval by developers argue that they derail their capability of paying their housing rates comfortably. This led to a drop in raw land prices. The study collected qualitative data using key interviews with development stakeholders and municipal finance officers on two case study regions. The findings indicated that developers were conversant on the effect of property tax in the demand-driven markets. Conclusions indicate that fiscalisation effects of property taxes encouraged cities' spread.

Veronika and Lenka (2012) studied the reaction of economic growth and the changes in the taxation of corporate among European countries. The study chose on corporate taxes because of their unique qualities of their tax bases being mobile factors of production. It also set to verify the existence of a negative relationship between corporate taxation and long-term economic growth in the sample countries. The independent variables thought to influence economic growth and considered in this study included: workforce, capital accumulation and technological progress. The study used qualitative secondary data for thirteen years spanning 1998 to 2010. The sample comprised 27 countries that were EU members. The dependent variable was economic growth measured by GDP. The study used regression analysis on panel data which allows two-dimensions of data view. The result did not provide clear results as all estimates showed insignificant statistical influence between individual tax burden proxies.

Szarowska (2013) studied how tax burden impacted economic growth of nations in the European Union between 1995 to the year 2010. The study identifies the main purpose of government tax measures which is to optimize public finance and boost economic growth. The study however, concentrated more on the shift in tax burdens and how it affected economic growth of European Union Nations. The study applied a Pairwise Granger Causality Test to examine the relationship between tax burden and economic growth rate of the short-term economic functions. The findings indicated that a two way causality between existed between change of implicit tax rate of GDP growth and implicit tax rate.

Rudolf (2014) used the data from various OECD countries spanning a period of eleven years from 2000 – 2011 to examine the impact of individual taxes on the level of economic growth. The study based its analysis on the neoclassical growth model of Romer, Weil and Mankew (1992). To estimate the relationship between taxation and economic growth, the study used panel regression method. The proxies for taxation involved traditional tax quota and the World Tax Index which combines hard and soft data. From the findings, the study shows that capital accumulation increased with the growth in economy as measured by the product growth rate until it reached the steady state. It was concluded that OECD nations had not reached the steady state because the result was statistically significant. The study results also supported the theory on the link between human capital and economic growth. Manpower played a key role in the long term economic growth of nations. Further findings indicated that Government spending was inversely related to economic growth mainly attributed to crowding out effects and in proportionate spending in unproductive ventures. For corporate taxes and personal taxes, a negative relationship was established.

In another study, Gale, Krupkin and Rueben (2015) examined how tax policies of nations affected the growth of their economies through creation of employment and entrepreneurship using secondary data between 1977–2011. The study was informed by inconclusive findings in previous studies where it was not clear as to whether tax policy changes through cuts, raise, or reduce, had any clear effect on growth. The same findings also did not appear coherent when it came to corporate taxes, property taxes and individual taxes. The differences in conclusions and findings were attributed to application of different variables, use of control experiments and variations in identification methods.

2.4.2 Local Studies

Gacanja (2012) studied the relationship between revenues raised from Taxes by the Government and their effect on economic growth in Kenya. This study was informed by the inconclusive debates by earlier scholars on the relationship between the two study variables. Majority of the literature that existed had explored the relationship

between taxation revenue and economic growth across countries and not at a country specific level. The study applied the classical linear regression model through use pf Operating Least Square (OLS) estimation technique. The study further tested the variables using the granger causality test and co integration test. It was noted from the study's findings that a positive link exists between economic growth and tax revenues. The co integration indicated that at least one co integrating equation exists while the Granger Causality test indicated a bi-directional association between a unidirectional link between income tax and economic growth and economic growth and excise duties.

Gachanja (2012) examined the impact of various tax reforms initiated in Kenya and economic factors on tax revenues in Kenya. The study concentrated on the entire period and efforts put in to modernize the taxation programme in Kenya. The study applied a correlation study design using a ten span of time panel data from the year 2000 to 2009. The dependent variable was tax revenues collected by the Government over annual periodicity measured against tax reforms which was measured as a dummy variable. Regression analysis was used to determine extent of the relationship. The findings indicated that tax reforms were negatively related to tax revenues and economic growth impacted positively on tax revenues.

Awiti (2013) examined the reaction of economic growth following changes in taxes using a theoretical approach. The study was informed by the move by the Kenyan Government to raise taxes with the aim of increasing government revenue and reduce reliance of government debt. Specifically, the study considered the effects of various taxes on economic growth. Some of these taxes included: consumption tax, wage tax and capital tax. The study used secondary data where the findings indicated that income elasticity of capital is an important element of economic growth as opposed to tax increases. In conditions where higher levels of income elasticity of capital existed, an increase in wage tax and consumption tax lowers the level of capital at steady state.

Alegana (2014) examined the relationship between tax incentives given to investors and economic growth in Kenya. This was informed by the need to raise adequate taxes for the Government and at the same time encouraging investors to prefer Kenya as their investment destination especially for the case of Foreign Direct investment

(FDI). The study used secondary data which was analyzed using descriptive analysis and inferential statistics which comprised correlation analysis and regression analysis. The findings indicated the existence of an inverse relationship between economic growth as proxied by GDP growth rate and tax incentives.

Masika (2014) explored the association between direct taxes and economic growth using data from the Kenyan economy. Specifically, the concentration of the study was on personal income taxes, corporate income and how they impacted economic growth of Kenya. The study applied secondary data collected between 1970 and 2012. Granger causality test was used to test for causal relationship between direct taxes and economic growth. The findings indicate an inverse insignificant relationship between investments and economic growth in Kenya. The study found a positive link between corporate and individual taxes and economic growth.

2.5 Conceptual Framework

A conceptual framework is a pictorial expression of the variables of a study clearly showing the way they interact with one another. The exact independent variables in this study include: property taxes, individual taxes, corporate taxes, inflation, and lending rates while the dependent variable is the economic growth as estimated by the GDP Growth rate. Theoretically, property taxes are a form of government revenue which is then invested in the provision of infrastructure and other amenities which are significant in economic growth. It is therefore theoretically expected that an increase in property tax collections would lead to higher economic growth rate as postulated by Skaburskis and Tomalty (2000). This is well illustrated in the figure 2.1 below:

Figure 2.1: Conceptual Model

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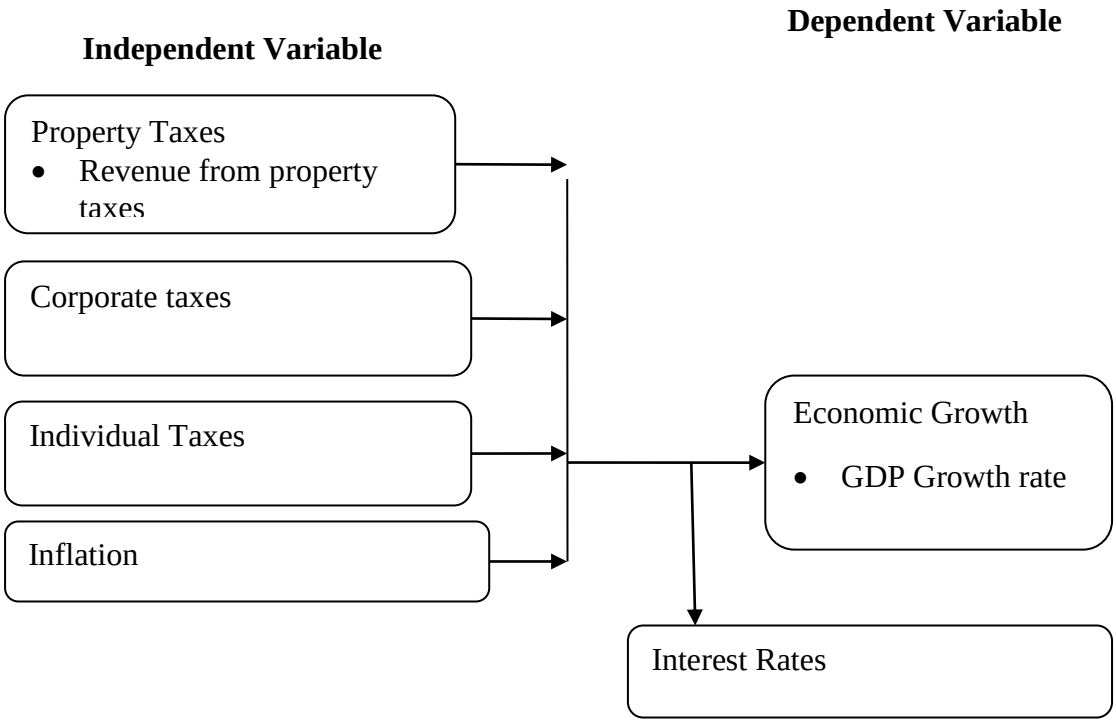

Source: (Author, 2017)

2.6 Summary of the Literature Review

Several studies have been examined in the empirical literature to help bring out what other scholars have studied. Globally, Tomalty and Skaburskis (2000) conducted a study on the influence of property taxes and development cost charges on urban development from the perspectives of planners, developers and finance officers in Toronto and Ottawa. This study was conducted in a different country with a different operating environment thereby limiting its application on the Kenyan market. Veronika and Lenka (2012) studied the reaction of economic growth and the changes in the taxation of corporate among European countries. This study considered general taxes and not property taxes hence limiting its application. The current study focuses on property taxes and economic growth of Kenya. Szarowska (2013) studied how tax burden impacted economic growth of nations in the European Union between 1995 to the year 2010. This study considered general taxes and not property taxes hence limiting its application. The current study focuses on property taxes and economic growth of Kenya. Rudolf (2014) used the data from various OECD countries spanning

a period of eleven years from 2000 – 2011 to examine the impact that individual taxes had the level of economic growth. This study considered general taxes and not property taxes hence limiting its application. The current study focuses on property taxes and economic growth of Kenya. Gale, Krupkin and Rueben (2015) examined how tax policies of nations affected the growth of their economies through creation of employment and entrepreneurship using secondary data between 1977–2011. This study considered general taxes and not property taxes hence limiting its application. The current study focuses on property taxes and economic growth of Kenya.

Locally, Gacanja (2012) studied the relationship between revenues raised from Taxes by the Government and their effect on economic growth in Kenya. This study though done in the Kenyan context, did not pay much attention to property taxes as a variable. Gachanja (2012) studied the effect of various tax reforms initiated in Kenya and economic factors on tax revenues in Kenya. The study concentrated on the entire period and efforts put in to modernize the taxation programme in Kenya. This study ignored property taxes in its computations. Awiti (2013) examined the reaction of economic growth following changes in taxes using a theoretical approach. The study was informed by the move by the Kenyan Government to raise taxes with the aim of increasing government revenue and reduce reliance of government debt. This study considered general taxes and not property taxes in particular. Alegana (2014) examined the relationship between tax incentives given to investors and economic growth in Kenya. This was informed by the need to raise adequate taxes for the Government and at the same time encouraging investors to prefer Kenya as their investment destination especially for the case of Foreign Direct investment (FDI). This study ignore property taxes. Masika (2014) examined the asssociation between direct taxes and economic growth using data from the Kenyan economy.

CHAPTER THREE
RESEARCH METHODOLOGY

3.1 Introduction

Research methodology deals with identification of steps that a researcher wishes to adopt to ensure accurate and reliable data is collected to enable completion of the study (Kothari, 2004). It specifically covers the research design, population of the study, data collection and analysis.

3.2 Research Design

The study will adopt a descriptive research design. This design is concerned with the establishment of issues relating to what, where and how of a phenomenon (Kothari, 2004). It helps in building a profile of a phenomenon under study. The choice of the descriptive survey research design is informed by the fact that this study is interested on the state of affairs as they already exist and no variable will be manipulated. This will promote generalization of study findings to a larger population. The study will seek to establish the effects of property taxes on economic growth in Kenya.

3.3 Data Collection

This study will be done using secondary data which will be extracted from published revenue statements of the Kenya revenue Authority (KRA). The statements will be accessed from Authority websites and management reports. Data on inflation and interest rates will be collected from the KNBS. The study will collect data from for a period of ten years quarterly spanning from 2006 to 2016.

3.4 Data Analysis

Data analysis is the processing of raw data collected from the field so as to make sense of the data collected. The data collected could be in a form that may not be easily consumed or processed unless data cleaning is done. Various software applications exist to assist with the data analysis processes. For this study, the researcher will make use of Statistical Package for Social Sciences

(SPSS) version 23.0 for the analysis. In order to ensure that the findings portray the right picture, the study will check data for completeness and consistencies. In cases where data will be incomplete, the researcher will re-visit financial statements to ensure that the right data is collected (Katebire, 2007).

3.4.1 Diagnostic Tests

The study will utilize a T-test at 95 percent confidence level in order to determine the level of significance in which the independent variable attempts to account for variations in the dependent variable.

3.4.2. Analytical Model

The study will apply multivariate regression analysis in estimating the extent to which economic growth rate changes as a result of changes in the study independent variables. The model will assume the following format:

$$\mathbf{Y= \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \beta_5 X_5 + Ee}$$

Where

Y = Economic Growth measured by (GDP Growth rate)
X_1 = Property Taxes (Income from property taxes expressed as a percentage of property Income)
X_2 = Corporate Taxes (Corporate Taxes Expressed as a percentage of corporate income)
X_3 = Individual taxes: taxes paid by a natural person on his or her self assessment; proprietor (Individual taxes expressed as a percentage of Individual taxable income)
X_4 = Inflation (Measured using Consumer Price Index)
X_5 = Interest Rates (Using Lending Rates)
β_0 = Constant

3.4.3.Test of Significance

This study will make use of the F test and Analysis of variance to test the significance of the model in predicting the relationship between property taxes and economic growth in Kenya.

CHAPTER FOUR DATA ANALYSIS, RESULTS AND DISCUSSIONS

4.1 Introduction

The researcher presents the findings of data analysis in this chapter. The purpose of the study was to determine the effect of property taxation on Economic growth in Kenya. The study collected data from secondary sources and the analysis was done using SPSS software.

4.2 Response Rate

The researcher sought to collect information on GDP growth rates, inflation, interest rates, property taxes, corporate tax and individual taxes from 2007 to 2016 i.e. 10 Years. The researcher collected quarterly data. All this data was readily available and was collected by the researcher and thus the response rate was 100%.

4.3 Descriptive Statistics

The researcher used means and standard deviation, skewness and Kurtosis to describe how of property taxation affected economic growth in Kenya. The findings are clearly illustrated in subsequent sections.

4.4.1 Means and Standard Deviations

Means and standard deviation are indicated in Table 4.1.

Table 4.1: Means and Standard Deviations

	N	Minimum	Maximum	Mean	Std. Deviation
GDP Growth Rate	40	.30	8.30	4.872	1.870
Property Taxes	40	.01	2.50	.438	.680
Corporate Taxes	40	.00	.01	.0002	.001
Individual Taxes	40	.00	.07	.0070	.014
Inflation	40	2.70	19.20	8.317	4.532
Interest Rate	40	2.04	18.30	9.541	4.673

From the findings, GDP growth rate had a minimum value of 0.30, maximum of 8.30, mean of 4.8725 and standard deviation of 1.870. Property taxes had a minimum value of 0.01, maximum of 2.50, mean of 0.438 and standard deviation of 0.680. Corporate taxes had a minimum value of 0.00, maximum of 0.01, mean of 0.0002 and standard deviation of 0.001. Individual taxes indicated a minimum value of 0.00, maximum of 0.07, mean of 0.007 and standard deviation of 0.014. Inflation had a minimum of 2.70, maximum of 19.20, mean of 8.317 and standard deviation of 4.532. Interest rates had a minimum value of 2.04, maximum of 18.30 mean of 9.541 and standard deviation of 4.673.

This shows that of the study variables, inflation significantly varied across the study period which affected economic growth. This was followed by interest rates.

4.4.2 Skewness and Kurtosis

Table 4.2 shows Skewness and Kurtosis.

Table 4.2: Skewness and Kurtosis

	N	Skewness		Kurtosis	
	Statistic	Statistic	Std. Error	Statistic	Std. Error
GDP Growth Rate	40	-.790	.374	.220	.733
Property Tax	40	1.819	.374	2.570	.733
Corporate Tax	40	6.325	.374	40.000	.733
Individual Tax	40	2.932	.374	10.314	.733
Inflation	40	1.035	.374	-.039	.733
Interest Rate	40	.580	.374	-.537	.733

The study established that GDP growth rate had Skewness of -0.790 and Kurtosis of 0.220. Property taxes had 1.819 as Skewness and 2.57 as Kurtosis. Corporate taxes had 6.325 as Skewness and 40 as Kurtosis. Individual taxes had 2.932 as Skewness and 10.314 as Kurtosis. Inflation indicated a Skewness of 1.035 and Kurtosis of -0.039 while for interest rates, skewness was 0.580 and Kurtosis was -0.537.

4.4 Correlation Analysis

The researcher conducted correlation analysis to establish the relationship between the study variables. Correlation analysis was to help the researcher in identifying whether there was a positive or negative relationship between the variables of the study. It would also help the researcher determine whether the relationship between the variables is weak, moderate or strong. The findings are indicated in Table 4.3.

Table 4. 3: Correlation Analysis

		GDP Growth Rate	Property Tax	Corporate Tax	Individual Tax	Inflation	Interest Rate
GDP Growth Rate	Pearson Correlation	1					
	Sig. (2-tailed)						
	N	40					
Property Tax	Pearson Correlation	.691	1				
	Sig. (2-tailed)	.000					
	N	40	40				
Corporate Tax	Pearson Correlation	.011	-.100	1			
	Sig. (2-tailed)	.946	.540				
	N	40	40	40			
Individual Tax	Pearson Correlation	-.065	-.317	.266	1		
	Sig. (2-tailed)	.691	.046	.096			
	N	40	40	40	40		
Inflation	Pearson Correlation	.166	-.012	.125	-.091	1	
	Sig. (2-tailed)	.306	.944	.444	.577		
	N	40	40	40	40	40	
Interest Rate	Pearson Correlation	-.588	-.365	.019	.044	.265	1
	Sig. (2-tailed)	.000	.020	.907	.787	.098	
	N	40	40	40	40	40	40

Correlation results are shown in Table 4.3. Pearson Correlation Coefficient r and the p values play a significant role during the interpretation and drawing of inferences while carrying out correlation analysis. From the findings, property taxes had positive and significant relationship with economic growth ($r=0.691$, $p=0.000<0.05$). There was a further positive relationship between corporate taxes and economic growth ($r=0.011$, $p=0.946>0.05$). The study established an inverse relationship between individual taxes and economic growth ($r=-0.065$, $p=0.691>0.05$). Inflation was directly related with economic growth ($r=0.166$, $p=0.306>0.05$). The study established an inverse relationship between interest rate and economic growth ($r=-0.588$, $p=0.000<0.05$).

From correlation analysis, property taxes and interest rates were variables with significant influence on economic growth. The nature of the relationship between these variables however differed in that for property taxes, the relationship was positive while for interest rates, it was an inverse relationship. This shows that an increase in property taxes coupled with reduction in interest rates significantly contributes towards economic growth of the country as a whole.

4.5 Regression Analysis

In addition to correlation analysis, regression analysis was conducted to establish the effect of property taxation on Economic growth in Kenya. Regression analysis indicated the Coefficient of correlation R, coefficient of determination R square, the F calculated and the p values which helped the researcher to make meaningful inferences. The findings are indicated in subsequent Tables.

Table 4.4: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.845	.715	.673	1.07013

The coefficient of correlation R is 0.855 showing that property taxes have far reaching effect on economic growth of Kenya as a country. The coefficient of determination R square is 0.715, showing that 71.5% change in economic growth in

Kenya is explained by property taxes. Therefore, property taxes explain a significant proportion of change in economic growth. This further opens a debate on the other factors that explain the remaining 29.5% change in economic growth.

Table 4.5: ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	97.463	5	19.493	17.021	.000
Residual	38.936	34	1.145		
Total	**136.400**	**39**			

An Analysis of Variance ANOVA was processed at 5% level of significance. From the findings, F calculated is 17.012 while F critical at (d.f 5 & 34) is 2.494. The value of F calculated is greater than F critical and therefore the overall regression model had significant effect in predicting the effect of property taxation on Economic growth in Kenya. The p value 0.000<0.05 further supports these argument of significance.

Table 4.6: Regression Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	4.735	.540		8.763	.000
Property Tax	1.583	.286	.576	5.525	.000
Corporate Tax	-7.660	113.932	-.006	-.067	.947
Individual Tax	22.518	13.465	.169	1.672	.104
Inflation	.129	.040	.313	3.227	.003
Interest Rate	-.187	.041	-.468	-4.555	.000

The resultant equation therefore becomes:

$$\mathbf{Y= 4.735 + 1.583\ X_1 + 0.129X_4 -0.187\ X_5}$$

Where

Y = Economic Growth (GDP Growth rate)

X_1 = Property Taxes (Income from property taxes expressed as a percentage of property income)

X_4 = Inflation (Measured using Consumer Price Index)

X_5 = Interest Rates (Using Lending Rates)

$$\mathbf{Y= 4.735 + 1.583\ X_1 + 0.129X_4 -0.187\ X_5}$$

Therefore, when all the study variables were held constant, economic growth in Kenya would be at 4.735. A unit increase in property taxes with other factors constant would result into 1.583 changes in economic growth. A unit increase in inflation would result into 0.129 changes in economic growth. A unit decrease in interest rates would lead to 0.187 increases in economic growth. At 5% significance, property taxes ($p=0.000<0.05$), inflation ($p=0.003<0.05$) and interest rates ($p=0.000$) significantly contributed towards economic growth.

4.6 Discussions

The findings of correlation analysis indicated that property taxes had positive and significant relationship with economic growth ($r=0.691$, $p=0.000<0.05$). There was a further positive relationship between corporate taxes and economic growth ($r=0.011$, $p=0.946>0.05$). The study established an inverse relationship between individual taxes and economic growth ($r=-0.065$, $p=0.691>0.05$). Inflation was directly related with economic growth ($r=0.166$, $p=0.306>0.05$). The study established an inverse relationship between interest rate and economic growth ($r=-0.588$, $p=0.000<0.05$). In view of correlation results therefore, property taxes ($p=0.000<0.05$) and interest rates ($p=0.000<0.05$) had significant but varied effect on economic growth of the country. These findings imply that a decrease in inflation followed by an increase in property taxes would have a significant effect on growth of the economy. These findings contradict with Gale, Krupkin and Rueben (2015) who applied the Reed (2008) and indicated that neither tax revenues nor top income tax rates posted stable relationships to economic growth or employment across states and over time. Similar findings were

sought by Alegana (2014) whose findings indicated the existence of an inverse relationship between economic growth as proxied by GDP growth rate and tax incentives.

From regression analysis, at 5% significance, property taxes ($p=0.000<0.05$), inflation ($p=0.003<0.05$) and interest rates ($p=0.000$) significantly contributed towards economic growth. The findings are in line with Gacanja (2012) who studied the relationship between revenues raised from Taxes by the Government and their effect on economic growth in Kenya and established existence of a positive relationship between economic growth and tax revenues. Masika (2014) also established a positive link between corporate and individual taxes and economic growth.

Whereas a negative and significant established was established between property taxes and economic growth in correlation analysis, for regression analysis this relationship was positive and significant. According to Skaburskis and Tomalty (2000), it is theoretically expected that an increase in property tax collections would lead to higher economic growth rate. Both regression and correlation analysis agreed on an inverse relationship between interest rates and economic growth showing that as interest rates in the economy goes up, economic growth slows down.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Introduction

The researcher makes a summary of the key findings in this chapter in line with research objectives. The chapter also concludes the study of the study in relation to key findings. The recommendations are presented for policy makers, relevant authorities and regulators in the economy. The limitations encountered in carrying out the study are also presented besides suggestions for further research to scholars and future researchers.

5.2 Summary of the Findings

The main objective of the study was to examine how property taxation affects on economic growth in Kenya. The study specifically examined how property taxes, corporate taxes, individual taxes, inflation and interest rates affect economic growth in Kenya. The researcher exclusively relied on secondary data where 75% of it was collected from the Kenya National Bureau of Statistics KNBS. The collected data was coded into SPSS and analyzed using both descriptive and inferential statistics.

From correlation analysis, property taxes had positive and significant relationship with economic growth ($r=0.691$, $p=0.000<0.05$). There was a further positive relationship between corporate taxes and economic growth ($r=0.011$, $p=0.946>0.05$). The study established an inverse relationship between individual taxes and economic growth ($r=-0.065$, $p=0.691>0.05$). Inflation was directly related with economic growth ($r=0.166$, $p=0.306>0.05$). The study established an inverse relationship between interest rate and economic growth ($r=-0.588$, $p=0.000<0.05$).

From regression analysis, the coefficient of correlation R was 0.855 while the coefficient of determination R square was 0.715, showing that 71.5% change in economic growth in Kenya is explained by property taxes. F calculated was 17.012 against F critical 2.494 at (d.f 5 & 34). At 5% significance, property taxes ($p=0.000<0.05$), inflation ($p=0.003<0.05$) and interest rates ($p=0.000$) significantly contributed towards economic growth.

Both correlation and regression analysis agreed on an inverse relationship between interest rates and economic growth showing that as interest rates in the economy goes up, economic growth slows down. However, regression and correlation offered different result on how property taxes affect economic growth, where regression indicated a positive relation while correlation established an inverse relationship.

5.3 Conclusion

An increase in property taxes could either decrease or increase economic growth of the country. The implication of this finding is that caution should be exercised while setting rates for property taxes in an economy by the taxman, Kenya Revenue Authority. This is because as per the findings, it is not automatic that an increase in this category of tax would result into economic growth. This argument is founded on the convenience canon in the Classical Growth Theory developed by Smith, Ricardo and Smith (1776).

An increase in inflation increase economic growth. This however holds depending on whether at the time inflation is increasing, prices of goods in an economy has been too low (deflation) or too high (stagflation). During times when levels of inflation in an economy are relatively low, suppliers loose more than consumers which may hinder production and therefore economic growth. This will trigger a rise in inflation to enhance economic growth. One way which the government can rise the price of goods (inflation) is taxation and therefore there exists a link between these two. The Traditional Tax Handle Theory formulated by Solow (1956) and Swan (1956) supports this argument.

A decrease in interest rates increases economic growth of the country. This is also subject to whether the interest rate in question refers to the one charged by commercial banks on deposits or the one on lending. A rise on interest rates charged by commercial banks on deposits of customers is more beneficial to customers as compared to lending institutions themselves.

5.4 Recommendations of the Study

The Kenya Revenue Authority should be careful when setting taxation rates for example on properties. The taxman ought to carry out wider consultations with all

stakeholders and determine the actual impact of the changes in tax rates on amount collected before implementation.

The Central Bank of Kenya CBK ought to strengthen monetary policies that keep the interest rates and inflation at sustained levels for greater economic growth of the country. These monetary policies ought to be harmonized with the fiscal policies especially taxation for enhanced economic growth.

There is need for awareness programs and campaigns to remind citizens on the need to pay taxes for sustainable economic growth. The government should also increase or rather strengthen its provision of tax incentives to encourage voluntary rather than compulsory payment of taxes.

5.5 Limitations of the Study

It was the wish of the researcher collect monthly data so as to increase the number of data points and therefore the response rate. However, this was not practical as data on taxation is usually released on quarterly and annual basis. This made the researcher to simply use quarterly data.

5.6 Suggestions for Further Research

In the current study, economic growth was measured by GDP growth rate; future studies should measured economic growth in other indicators for example GDP per Capita or nominal GDP. Property tax was studied in relation to economic growth, future studies should carry out similar studies but with use of economic development in state. Future studies should be examined in other countries across say East Africa for example Uganda and Tanzania for comparison of results.

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APPENDIX 1: DATA COLLECTION SHEET

Period	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
GDP Growth rate									
Corporate taxes									
Individual taxes									
Property Taxes									
Inflation									
Interest Rate (Lending)									

APPENDIX II: RAW DATA

GDP Growth Rate	Inflation	Interest Rates	Property Taxes	Corporate Taxes	Individual Taxes
8.3	3.4	6.32	2.5	4.7E-05	0.000193
7.5	2.7	6.53	2.41	5.61E-05	0.000333
7.3	5.3	7.35	1.93	4.5E-06	0.00073
7.1	5.6	6.87	1.45	3.06E-05	0.000164
6.4	10.5	6.9	1.45	4.04E-05	0.000166
6.4	17.4	7.73	1.33	4.78E-05	0.000283
6.4	15.9	7.69	1.1	3.82E-06	0.000619
6.3	16.6	8.59	0.82	2.65E-05	0.000142
6.1	14.1	7.31	0.78	3.31E-05	0.000136
6.1	10.6	7.33	0.71	4.07E-05	0.000241
6	9.8	7.29	0.59	3.26E-06	0.000529
6	8	6.82	0.44	2.29E-05	0.000123
6	5.5	5.98	0.39	2.49E-05	0.000102
6	3.7	2.98	0.35	3.07E-05	0.000182
6	3.3	2.04	0.29	2.43E-06	0.000394
5.8	3.8	2.28	0.21	1.69E-05	9.03E-05
5.6	7	2.77	0.16	1.82E-05	7.48E-05
5.6	13.2	8.95	0.14	2.28E-05	0.000135
5.5	16.5	11.93	0.13	1.8E-06	0.000292
5.2	19.2	18.3	0.08	1.24E-05	6.63E-05
5.1	16.9	17.8	0.02	0.004393	0.01802
5	11.8	10.09	0.02	0.005123	0.030357
5	6.4	9.36	0.02	0.000455	0.073764
4.8	3.5	9.25	0.02	0.003099	0.016608
4.8	4.1	10.31	0.02	0.0025	0.010256
4.8	4.4	5.11	0.02	0.002889	0.017121
4.7	7	9.1	0.02	0.000252	0.040774
4.6	7.4	9.4	0.02	0.001791	0.009596

4.3	6.8	8.85	0.02	0.001341	0.0055
4.2	7	11.4	0.01	0.001549	0.009176
4	7.5	8.65	0.01	0.000134	0.021724
3.5	6.2	8.57	0.01	0.000964	0.005166
3.5	5.8	15.62	0.01	0.000665	0.002726
2.6	7	15.57	0.01	0.00075	0.004443
2.2	6.1	16.08	0.01	6.54E-05	0.0106
2.1	7.4	17.35	0.01	0.000482	0.002585
1.9	7.1	17.93	0.01	0.000347	0.001191
1.1	5.4	18.15	0.01	2.58E-05	0.001746
0.8	6.3	16.54	0.01	0.000178	0.004242
0.3	6.5	4.55	0.01	0.000181	0.001083