POLICY BRIEF

Harnessing Non-Tax Revenue Potential for Improved Revenue Mobilization in Kenya

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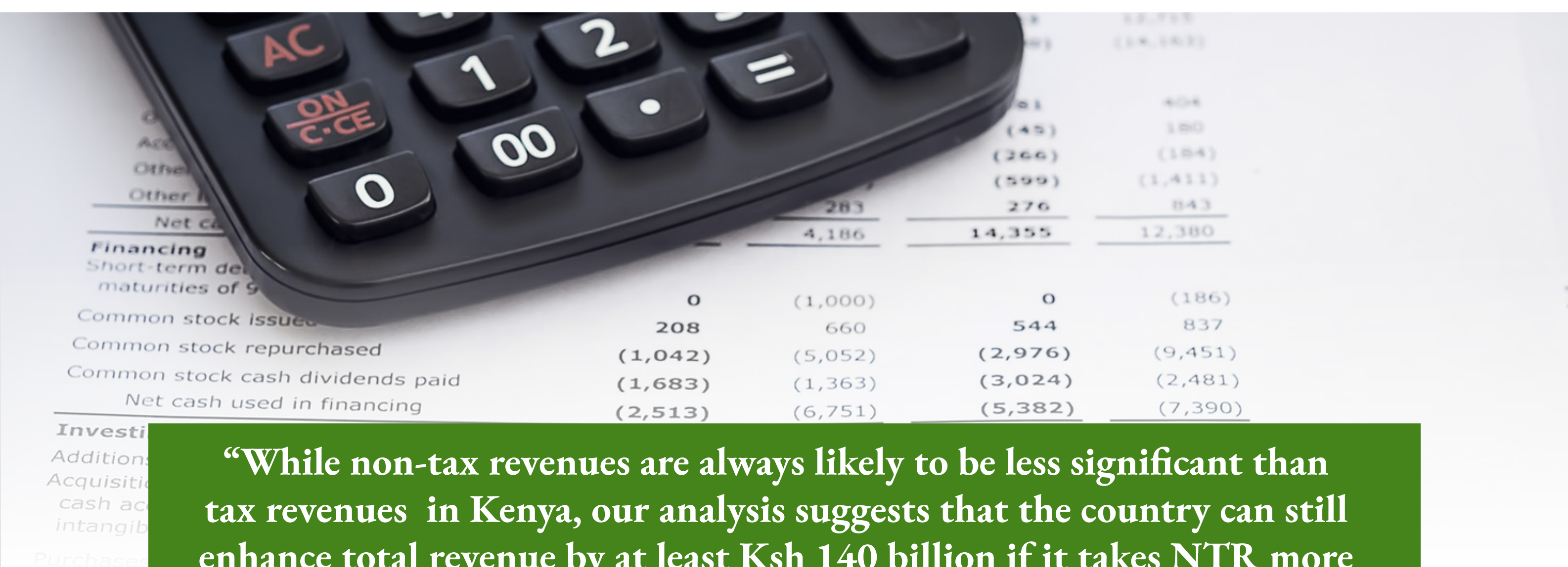


"While non-tax revenues are always likely to be less significant than tax revenues in Kenya, our analysis suggests that the country can still enhance total revenue by at least Ksh 140 billion if it takes NTR more seriously."

Introduction

Like many other developing countries, Kenya is facing significant challenges in funding expenditures, key among them the inability to generate sufficient revenues. This has resulted in ever-present annual fiscal deficits that have to be filled through borrowing. With the scope for borrowing reducing as debt mounts, the government can only step up its revenue mobilization efforts. But unfortunately, the reverse has been happening: the draft Medium Revenue Strategy (MTRS) notes that revenues as a share of the economy have dropped in the last decades from 18 percent in the FY 2013/14 to a low of 14 percent of gross domestic product (GDP) in the FY 2023/24. The draft also recognizes that growth in the hard-to-tax informal and digital economies pose challenges for increased taxation. While tax reform is central to revenue targets, less attention has been paid to the possibility of relying more heavily on non-tax revenue sources.[1] This brief explores the potential for non-tax revenues and concludes that the government could collect as much as Ksh 140 billion more from non-tax sources by exploring additional non-tax revenue streams, automating collection, enhancing profitability of state-owned enterprises, and standardizing the process of imposing fees, charges and rates.

NTRs have attractive features, but Kenya is not exploiting them

Non-tax revenues can be a consistent source of revenue and can ensure that core services are always funded. Some sources of non-tax revenues such as those linked to essential services or those required by law (such as license fees for professional services) or those services that lack viable alternatives (such as toll fees on certain roads) may also be less responsive to change in economic conditions. Government can also target specific programs or services, allowing governments to raise funds for specific purposes. For instance, the government may charge fees for the use of state-owned facilities, with the revenue generated used to maintain and improve those facilities. Some non-tax revenues (especially those linked to services such as licences and permits) can be a source of fiscal risk due their volatility, but as long as the overall balance of NTRs is biased toward less volatile sources, this should not inhibit their use.

To be sure, Kenya already has varied sources of non-tax revenue. These include grants; rents and royalties; property income including interest, dividends, and other returns on government investment; sale of goods and services which include some administrative fees such as passport fees and work permits; and fines and penalties (including fines and penalties due to tax violations), among others.

[i] OECD non-tax revenue estimates include grants and sub-national governments revenue.

Nevertheless, while Kenya has a wide range of NTRs on its books, it collects relatively little revenue by regional standards: only 2.3 percent of GDP in 2021, compared to nearly 6 percent of GDP for the region.[i] The below average performance is also evident in specific sources of non-tax revenues. Just 0.8 percent of GDP is generated from government property income and about 0.2 percent of GDP from administrative fees for government services.[2] Comparatively, the continent's average collection is 2.4 percent and 1 percent of GDP for property income and administrative fees respectively.[3] Kenya received grants amounting to just 0.3 percent of GDP in 2021, compared to the regional average of 1.4 percent.[4] Cabo Verde, Egypt, Ghana, Morocco and Seychelles generated more than 1 percent of GDP in non-tax revenues from sales of goods and services and administrative fees. Kenya on the other hand generated less than 0.5 percent of GDP from the same sources.[5]

Furthermore, NTR revenue in Kenya is actually falling over time. Overall, non-tax revenue (excluding grants and counties' own source revenues) exhibited a downward trend from about Ksh 74 billion (0.6 percent of GDP) in FY 2021/22 to just Ksh 70 billion (0.5 percent of GDP) in FY 2022/23. This is consistent with regional trends: Africa's average non-tax revenue collection also declined from 6.1 percent of GDP in 2020 to 5.8 percent in 2021 owing to a decline in grants and revenues from the Southern African Customs Union Common Revenue Pool (SACU).[6] Nevertheless, African NTR collections remain well above Kenya's rates.

Why is Kenya's non-tax revenue collection so low?

The relatively low revenue generated from NTRs in Kenya might be explained by several factors, including underreporting, lower reliance on grants than others in Africa, relatively few NTR sources, and inefficiencies in NTR administration. However, the research is inconclusive, suggesting a need to examine the issue further beyond the scope of this brief.

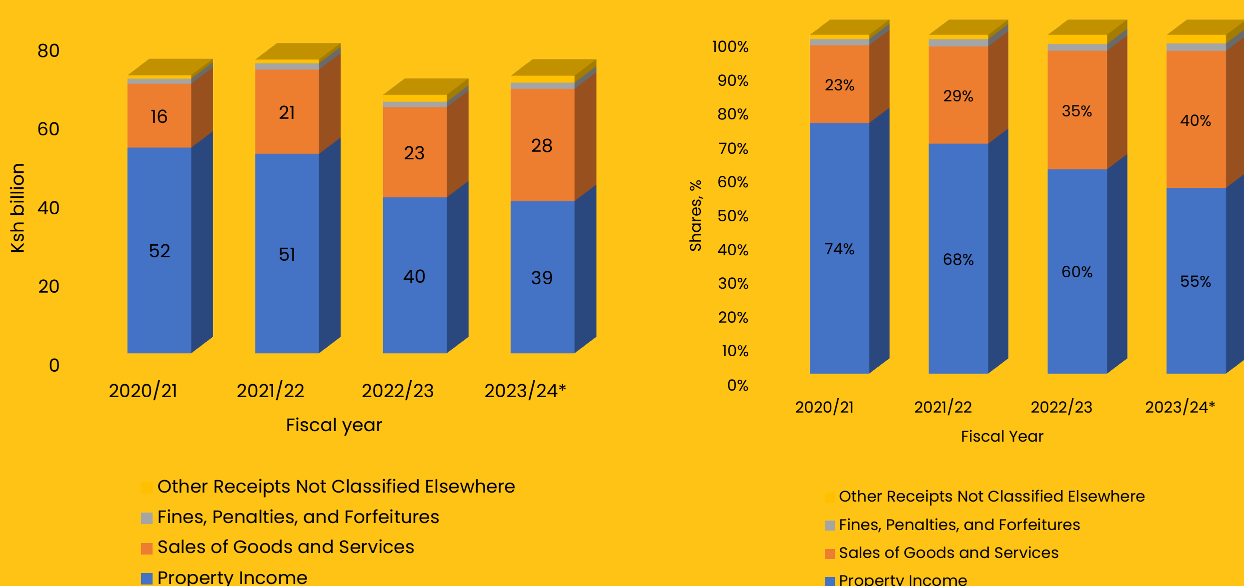
It must be noted that poor reporting could mean that Kenya collects somewhat more than the official figures suggest. Oxfam-Kenya and Tax Justice Network-Africa (TJNA) in the 2022 Kenya Fair Tax Monitor flagged fragmented reporting on non-tax revenue and recommended harmonised reporting as well as publication of disaggregated data on non-tax revenues. In Kenya, non-tax revenue is categorized in a non-uniform way by different government agencies. The lack of clarity in definition and reporting has made it difficult to compare and analyse revenue streams accurately. Whereas there are attempts to produce

data on non-tax revenues in the annual [Estimates of Revenue, Grants and Loans](), the data is not easy to interpret. Therefore, the publication would benefit from explanatory notes on what is included under each source of non-tax revenues.

Beyond underreporting, some international analysts have argued that Kenya could diversify its NTR sources, but it is not clear if this is true. A 2019 research report by the United Nation Economic Commission for Africa notes that Kenya uses only a few sources of non-tax revenue, and this may be limiting the amount of non-tax revenue it collects. The same study suggests that African countries can increase their non-tax revenues by 2 percent of GDP through improved efficiency and diversification.[7] However, the report does not identify the additional non-revenues streams that Kenya could tap into. In fact, it appears from the report that Kenya already has similar non-tax revenue streams to other countries such as Tunisia, Ghana, Egypt, Morocco, and South Africa.[8]

With respect to efficiency, a 2017 United Nations Children's Fund (UNICEF) study indicates that Kenya can generate more non-tax revenue by improving performance of state-owned enterprises both in terms of service delivery and profitability, from which the government can increase its dividend income. It is true that state corporation performance has declined in recent years leading to a decline in "property income" for the government, which is the income derived from interest, dividends and withdrawals from state corporations. Property income is the main source of non-tax revenue, but it declined from 74 percent to 55 percent of total NTR between FY 2020/21 and 2022/23 and is projected to decline further in the medium term. Given that dividends make up the largest share of property income, the drop is attributable to decreased profitability. In FY 2022/23, the government collected Ksh 42 billion in the form of dividends, surplus funds, directors' fees and loan interest receipts, a drop of 4 billion from FY 2021/22. This decline may explain National Treasury's resolve to develop regulations to tighten financial oversight over state owned enterprises in its draft MTRS.

Figure 1: Non-tax Revenue (exclusive of grants) declined in the FY 2022/23: while the share of property income declined, it remains the main source of non-tax revenues.



*Data source: National Treasury, Estimates of Revenue Grants and Loans, *forecast.*

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Beyond state corporations, the key to low NTR collections is poor administration

Policy, administrative, and regulatory challenges inhibit collection of non-tax revenue. Unlike tax mobilization, the structure of non-tax revenue sources is often convoluted, resulting in administrative challenges. The National Treasury in the draft 2024/25- 2026/27 Medium Term Revenue Strategy (MTRS) indicates that the government lacks a coherent policy on non-tax revenues, their collection system is semi-automated, and there are long delays to review fees, user charges and other non-tax revenues.

New guidelines on NTRs would be welcome, but implementation is critical. The government has proposed to develop guidelines to standardize imposition, management, and reporting of non-tax revenues. We applaud this initiative, but it is equally important that government entities comply with any new guidelines. These guidelines should provide clarity on non-tax revenue sources to be utilized, provide a comprehensive framework on the authority, procedures and regulations on imposition of fees, charges and rates, and provide for standardized reporting.

6.0 Recommendations: Diversify and target non-tax revenues, improve their reporting and explore the possibility of devolving collection of some of these revenues to counties.

One way to enhance collections is to ensure full automation: the government should speed up the introduction of digital systems for payment of government services. The president issued a directive on 4th August 2023 that all payments for government services, most of which are currently accessible online in single government portal- e-Citizen- be made through a single point managed by the National Treasury. According to National Treasury estimates this would generate an additional Ksh 10 billion. In the FY 2022/23, the government surpassed its non-tax revenue target by Ksh 16.4 billion. This performance is attributable to increased digitization of services, mop up of fund from parastatals, and increased dividends from firms.

The government can further diversify non-tax revenue sources. The government can generate new revenue by enhancing the protection and commercialization of intellectual property rights (patents, copyrights, trademarks, and licensing agreements), which can generate additional non-tax revenue from royalties and licensing fees. This can particularly benefit the creative industry's intellectual property, from which the government can generate non-tax revenue from copyright royalties, licensing fees and sales of assets such as art, films, music and software. Data from the 2023 Economic Survey shows that Ksh 121 billion (0.9 percent) of Kenya's 2022 GDP came from the creative industry.[ii] Other estimates show that the sector could be larger than what is reported in the Economic Survey. A 2016 Business Environment Reform Facility report estimated the size of Kenya's creative industry was 5.3 percent of GDP between 2007 and 2009 and indicates that the government believed that the sector could contribute up to 10 percent of GDP by 2020. With this contribution to GDP, the creative economy can become a significant source of non-tax revenues.

The government can also introduce new revenue streams earmarked for a particular purpose. The draft MTRS has already proposed introduction of an Environmental Levy on imported raw materials which will then be earmarked for factory waste management, and there should be further opportunities to develop similar NTRs in the environmental sector and beyond.

A look at some of the revenue streams can give an indication of additional revenue that Kenya can generate from non-tax sources. Exclusive of grants and mineral royalties, Africa's average non-tax revenue is 3.2 percent of GDP. Kenya's non-tax revenues exclusive of grants and mineral royalties is 2.0 percent of GDP, which falls into the third quartile when compared to 33 African economies.[iii] To move to the top quartile of performers, Kenya would need to generate an additional 1 percentage point of GDP (putting it at 3 percent of GDP, which would match Rwanda). With

[ii] Comprising of arts, entertainment and recreation and publishing, broadcasting, other IT and information activities sub-sectors

[iii] Author's calculations based on OECD's Revenue Statistics in Africa 1990-2021. Link. Quartiles divide data into four groups, from the lowest to the highest performers. In this data, Kenya (at 2% of GDP) performs just above the 50% level of performance of 1.8% of GDP. Our analysis asks what it Kenya needs to do to enter into the top 25% of performers.

a GDP of Ksh 13 trillion, this translates to Ksh 130 billion in addition to the projected additional Ksh 10 billion from digitalization of government services.

Kenya should also adopt transparent reporting mechanisms for non-tax revenue and strengthened policy and legal frameworks. Strengthening revenue administration capabilities through proper legal and policy frameworks for non-tax revenue collection and reporting will reduce non-disclosure of non-tax revenues and enhance revenue generation. Regular review of applicable fees and charges and automation (as is the case of taxes) could also increase non-tax revenues and help streamline their administration.

Even as we call on the government to increase revenues from non-tax sources, it is important to keep an eye on equity. If certain fees or charges disproportionately affect specific segments of the population, it can lead to an unequal distribution of the burden. This can be particularly relevant when fees or charges for public services hinder access for vulnerable or low-income individuals. For example, fees charged for out-of-pocket payments for accessing medical care in Kenya are fixed, disregarding ability to pay. This can deepen existing inequalities and hinder inclusive growth objectives. However, it is possible to have user fees and embed equity in their design as seen in some country examples. Japan for example, has set a maximum limit for monthly and annual household out-of-pocket spending for health care and long-term services based on age and income. Therefore, the government should spare charges on essential services and explore wealth-based user fees and charges such as charges on luxury recreational activities, environmental charges, surcharges on luxury goods.

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