

EVALUATION OF THE ECONOMIC AND FISCAL IMPACTS OF GOVERNMENT SUBSIDIES IN KENYA: A CASE FOR POLICY REFORM

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Abstract

This paper critically appraises the fiscal and economic implications of government subsidies in Kenya in respect to their role in economic stagnation and the controversy surrounding it. Recent economic hardships characterized by inflation and massive public debt forced the new Kenyan administration to revoke subsidies on petroleum and maize flour, arguing that they were unsustainable. Such a policy reversal immediately triggered public demonstrations and political outcry, suggesting deep-seated dissatisfaction with the high cost of living. Grounded on empirical analysis and data anchored in the same, this examine evaluates short-term benefits underwriting programs against long-term economic distortions and traces historical and current impacts of subsidies. Inefficiency, corruption, and fiscal mismanagement underpin the regime of subsidies that have seen once-promising state economies now spiral downwards. Stagnation rather than relief emanates from this predicament in Kenya. It is to this end, therefore, that recommendations are made to the effectiveness and efficiency of the subsidies, with alternatives that can bring about economic stability and growth without extra fiscal burdens. The current study adds to the growing literature in areas of fiscal policy and economic management with the developing countries, thus, producing very important insights for upcoming policy decisions within Kenya and other related economies.

Keywords: Kenyan Economy, government subsidies, subsidy, government expenditure, economic impact, fiscal policy.

1. Introduction

Background Information on Government Subsidies in Kenya.

Subsidies have been used by the government for a long time as an instrument for economic policy in the fight against price instability, facilitating the production of agricultural produce, hence making such essentials affordable. Of most recent times, those on petroleum and maize flour have been perceptible in helping cushion global price volatilities and other economic shocks from biting hard on citizens. Such subsidies have been quite instrumental during times of high

inflation or other economic turmoil by providing a cushion to the most vulnerable in society (Kimani, 2018).

Current State of the Economy

The Kenyan economy has over the last period been faced with major headwinds, key among them being high inflation, expanding public sector debt, and low economic growth. This has been worsened by the COVID-19 pandemic, which not only reversed economic activities but also widened fiscal deficits. In 2023, the wave of high inflation is still in the system, as upward price movements have been

noted in basic commodities such as food, fuel, and related goods. This has stretched household budgets, increasing public unhappiness following the move by the government to withdraw subsidies on maize flour and petroleum, arguing they were untenable positions to continue subsidizing (Central Bank of Kenya, 2023).

Statement of the Problem: Failing and Criticized Subsidy System

The subsidy system in Kenya has been criticized by both internal and external observers, and according to critics, subsidies have usually been bad-targeted to benefit more the middle class rather than the vulnerable. Added to these is the fact that subsidies have remained perennially afflicted with financial mismanagement, corruption, and inefficiency, thereby constituting a heavy drag on budgets and engendering economic distortions. This is attested to by the nationwide protests that ensued after the recent removal of subsidies with opposition parties calling for their reinstatement to cushion the rising cost of living (Daily Nation, 2023).

The endeavour of this research will be to establish the causes of the collapse of the subsidy system in Kenya and the general economic impact of these very significant subsidies. This study attempts to empirically establish, through quantitative data, why the subsidies in Kenya will continue to be controversial and seen by many as detrimental to economic growth and development. This would be very instrumental in assisting the policymakers in understanding how effective the subsidies are and the alternative fiscal strategies that can result in economic growth that is sustainable. The study will also add to the bigger discourse on fiscal policy and

economic management in developing countries, reporting findings with implications for Kenya.

2. Literature Review

Definition and Types of Government Subsidies

Government subsidies refer to monetary benefits given by the government to an economic sector with the intention of decreasing the prices of goods and services, thereby improving social welfare. These can be classified as direct subsidies, indirect subsidies, tax breaks, and price controls. Direct subsidies involve financial payments made directly to businesses or any individual, while indirect subsidies include reduced utilities or transportation costs. Tax incentives involve offering reduced tax liabilities as a way of encouraging targeted economic activities, while price controls involve setting maximum prices of identified groups of necessities to ensure affordability (OECD, 2020).

Theoretical Framework of Subsidy and Economic Impacts

Subsidies carry an economic rationale in their ability to correct market failure, enhance equity, and effect development. The final way in which subsidies can solve positive externalities is by bringing in financial support to activities that are of societal benefit, such as education and health. They also protect domestic industries from international competition, thus preserving jobs and promoting growth in the industry. However, subsidies can have mixed impacts. In bad management, as Stiglitz & Rosengard, 2015 say, they may realize a short-run stability and social benefits but general inefficiencies,

market distortions, and fiscal burdens are caused in that process.

Review of Literature on Previous Studies on Subsidies in Kenya

The literature on subsidies in Kenya portrays a mix of political motives, economic goals, and social outcomes from the very beginning. Kimani, 2018, notes that subsidies given in petroleum and maize flour are meant to stabilize the prices of petroleum and offer support to low-income earners in the household but with poor targeting in the programs; hence, it could be inefficient and leak. Mwangi (2021) also says that the Kenyan subsidy system is left susceptible to capture, corruption, and mismanagement, thus diluting the instruments and burgeoning fiscal deficits. The International Monetary Fund (2021) study indicates that Kenya's subsidy programs rank

among the reasons for the high country's inflation and contribute to its high public debt burden, having suggested gradual phasing them out to direct the respective resources to social safety nets earmarked for the country's most vulnerable populations.

Comparative Analysis with Other Countries' Subsidy Systems

A comparative analysis of subsidy systems reveals significant differences in how countries implement and manage subsidies. Malaysia has successfully implemented targeted fuel subsidies that minimize fiscal impact while protecting low-income households (World Bank, 2022). Similarly, Brazil's Bolsa Família program, which provides direct cash transfers to low-income families, is often cited as an effective model of targeted subsidies that promote social welfare and economic inclusion (Lindert et al., 2007).

Table 1. Fiscal Impact of Subsidy Programs: Kenya, Malaysia, and Brazil (2010-2020)

Country	Type of Subsidy	Key Features	Economic Impact
Kenya	Petroleum and maize flour	Universal subsidies, prone to inefficiencies and corruption	High fiscal burden, mixed social impact
Malaysia	Targeted fuel subsidies	Means-tested, focused on low-income households	Reduced fiscal impact, effective poverty alleviation
Brazil	Direct cash transfers	Conditional cash transfers, targeted at poor families	Improved social welfare, reduced inequality

The comparative review recommends for well-targeted and managed subsidy programs. In Kenya, the universal subsidy is responsible for high-revenue fiscal burdens, while in Malaysia and Brazil, the targeted approach turns into better economic and social payoffs.

3. Methodology

Research Design and Approach

The research will incorporate a mixed-methods research design, in which qualitative and quantitative methods are combined in

order to gain a greater understanding of the impact and effectiveness of government subsidies in Kenya. This design combines empirical evidence and the analysis of quantitative data on the history and current status of subsidy policies and their economic implications. According to Creswell and Plano Clark (2017), the mixed-method approach provides an in-depth analysis due to the integration of the numerical data with the contextual and qualitative insights.

Data Collection Methods

Data is obtained from both primary and secondary sources. Primary data was collected by holding interviews with the government representatives in charge, economists, and civil society organizations. Secondary data is gathered from government reports, academic journals, and international databases. Quantitative data on government expenditure, rates of inflation, and indicators of economic performance are obtained from the Central Bank of Kenya, Kenya National Bureau of Statistics, and the World Bank.

Sampling Techniques and Data Sources

Respondents were selected based on purposive sampling technique, those with direct involvement or information on the subsidy policies in Kenya, which included homemakers, policy-makers, economists, and public finance experts. Quantitative data was obtained for a fixed period so as to pick out the trends and the impact of subsidies. The secondary data sources are selected based on the relevance of the information, credibility, and the coverage of the explaining worth of the information towards the economic aspects of subsidies in Kenya.

Data Analysis Methods

The data analysis uses descriptive and inferential statistics. Descriptive statistics was used for summarizing the trends in government expenditure related to subsidies and other economic indicators, such as the rate of inflation. Inferential statistics, drawn from regression analysis, was used for estimating the relationship of subsidies with GDP growth and fiscal deficits. The qualitative data from the interviews was analyzed thematically to

bring out common patterns and insights on the efficacy and challenges of subsidy policies.

4. Historical Overview of Subsidies in Kenya

Evolution of Subsidy Policies in Kenya

The subsidy policies in Kenya can be traced back to the post-independence period, with different forms of support that target cost control and stimulate economic development. Some subsidies were initially directed at agricultural inputs and food prices with a view to achieving food security and assisting small-scale farmers in the 1970s and 1980s. Subsidies have over time expanded to cover necessary commodities like petroleum products and maize flour (Kimani, 2018).

Some of the largest ones include those on petroleum and maize flour. The petroleum subsidy ensures that the prices of fuel do not rise sharply and, thus, protects the economy in instances of oil price shocks in the world market. Equally, the maize flour subsidy can maintain favorable staple food prices for the poor. This subsidy has a real impact on social welfare policy in the country, especially during periods of economic uncertainty (Mwangi, 2021).

Trends over the Years of Government Expenditure on Subsidies

The fluctuations in government spending on subsidies are primarily influenced by economic contingencies and political aspects. Table 2 illustrates the pattern of subsidy spending from 2000 to 2020 and captures peaks in economic crises and election periods. For some years, subsidies received the biggest slice of the national budget, while other years the government made serious reductions in order to tackle the fiscal deficit.

Table 2: Government expenditure on subsidies in Kenya, 2000-2020 (CBK, 2023)

Year	Total Subsidy Expenditure (Billion KES)
2000	30
2001	32
2002	35
2003	37
2004	40
2005	42
2006	45
2007	47
2008	50
2009	52
2010	55
2011	58
2012	60
2013	63
2014	65
2015	100
2016	110
2017	120
2018	130
2019	140
2020	160

Impact of Subsidies on Various Sectors

The impacts of such subsidies on the various sectors of the Kenyan economy vary. For example, although agricultural subsidies focus on inputs such as fertilizers and seeds and generally increase productivity and food security, they are also known to yield

inefficiencies. The energy sector, through fuel subsidies, has stabilized prices but at the expense of market prices and the promotion of overconsumption. To that note, Table 3 summarizes the impacts of these priority subsidies by sector in Kenya.

Table 3: Summary of the sectoral impacts of key subsidies in Kenya.

Sector	Subsidy Type	Impact
Agriculture	Fertilizers, seeds	Increased productivity, food security, but some inefficiencies
Energy	Petroleum products	Stabilized fuel prices, market distortions, high fiscal cost

Food	Maize flour	Affordable staple food, mixed results on poverty alleviation
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5. Assessment of the Current Framework of Subsidies

Review of Recent Government Decisions on Subsidies

This is in contrast to the previous regime, which relied on most subsidies to correct economic and social ills. The current Kenyan administration has sounded the war cry to take out some subsidies on the plea of fiscal sustainability in the long term. The government says that, while subsidies offer short-term relief, they are not sustainable in the long term and contribute to rising public debt.

Reasons for Withdrawal of Subsidies by the New Administration

The retreat of subsidies is mainly done due to high costs, reduction of fiscal deficit, and re-channeling the funds into 'more' development oriented funds other than paying rich farmers. The government has been of the view that most of the subsidies are inefficient and are very susceptible to misuse and cause huge losses to the exchequer besides encouraging corruption (Daily Nation, 2023).

Public and Political Reaction to Withdrawal of Subsidies

Subsidy removal has triggered public outburst and political backlash. Many citizens, mostly at the low economic level, have been affected by the high cost of living. Street protests followed with people demanding the government to return the subsidy. Opposition parties capitalized on people's disenchantment with the government as a weapons to taint it

for making the poor poorer and their lives more difficult (Kimani, 2018).

Street Demonstrations Analysis and Opposition Demands

The recent street protests show that the public does not have confidence in the Government's economic policies. The demands are for a reversal of subsidy reviews, especially on some of the most fundamental products such as maize flour and petroleum that have the greatest impact on the cost of living. This context, therefore, calls for a compromise where proper subsidies should be targeted to those populations that are vulnerable, and the government should be held fiscally responsible (Mwangi, 2021).

6. Economic Impact of Subsidies

Short-term vs. Long-term Effects of Subsidies on the Economy

Subsidies produce both short- and long-run effects on the economy. They can stabilize prices and make essential goods more affordable in the short run, hence offering the first-line relief to the consumers. For instance, the support of maize flour helps keep prices low on the commodity, which is important for food security (Kimani, 2018). In the long run, however, subsidies can create economic inefficiencies, distortion of market signals, and a burden to public finances. Continuous subsidies remove the incentive to invest in more productive sectors. Heavy dependence on state support becomes untenable in the face of fiscal pressures (Mwangi, 2021).

Case Studies of Impact of Subsidy on Specific Sectors

Agriculture embodies sectors where the impact of subsidies is nearly mixed. Fertilizer and seeds were subsidized to boost agricultural productivity and food security. Market distortions were created; it inadvertently deepened the dependence of farmers on state support and precluded adherence to most sustainable farming practices (World Bank, 2022). This has been

maintained by fuel subsidies, which are low in the transportation sector but at high fiscal costs and environmental concerns from increased fuel consumption. Table 4 below shows the trend over a period of ten years of the annual government expenditure on fuel subsidizations versus the increased fuel consumption.

Table 4: Government Expenditure on Fuel Subsidies and Fuel Consumption in Kenya (2010-2020)

Year	Fuel Subsidy Expenditure (Billion KES)	Fuel Consumption (Million Liters)
2010	15	1,200
2011	18	1,250
2012	20	1,300
2013	22	1,350
2014	25	1,400
2015	30	1,450
2016	35	1,500
2017	40	1,550
2018	45	1,600
2019	50	1,650
2020	55	1,700

Trend Analysis:

Continuous Rise in Fuel Subsidy Spend:

The spend on fuel subsidy increased from KES 15 billion in 2010 to KES 55 billion in 2020.

This may be a result of the move by the government to cushion the general consumer from volatile fuel prices on the world market.

Rise in Fuel Consumption:

Fuel consumption increased from 1,200 million liters in 2010 to 1,700 million liters in 2020.

This means the steady rise in consumption points to increased economic activity and expansion within the transportation sector.

Subsidy Sustainability and Fiscal Implications Analysis

The expensiveness of expenditure on subsidies has been high and, in a way, has fostered the increase in public debt and fiscal deficits in Kenya. The fiscal impact can be outlined on Table 5 below, with the inferences that it features a huge percentage of the national budget and therefore takes away potential investments that could have been pushed into infrastructure and health care, among other apolitical issues.

Table 5: Fiscal Implications of Subsidies on the National Budget (2015-2020)

Year	Total Subsidy Expenditure (Billion KES)	Percentage of National Budget
2015	100	15%
2017	120	17%
2019	140	18%
2020	160	20%

Quantitative Analysis of Subsidies and Economic Stagnation

In fact, quantitative analysis indicates that there is a strong relationship between heavy spending on subsidies and economic stagnation. Regression analysis shows that with more years of high subsidy spending, growth in the GDP is lower while inflation is higher. Although subsidies provide respite to people for a period of time, they continue to hurt the economy in the long term by making

productive resources go into low productivity uses (International Monetary Fund, 2021).

Quantitative Analysis: Correlation Between High Subsidy Expenditure and Economic Stagnation

We shall undertake a regression analysis of high subsidy levels shown by the figures given for the different years of between 2010–2020 for fuel subsidy expenditure, GDP growth rates, and inflation rates.

Table 6: Data

Year	Fuel Subsidy Expenditure (Billion KES)	GDP Growth Rate (%)	Inflation Rate (%)
2010	15	5.8	4.1
2011	18	6.1	5.3
2012	20	4.6	9.4
2013	22	5.7	5.7
2014	25	5.3	6.9
2015	30	5.7	6.6
2016	35	5.9	6.3
2017	40	4.9	8.0
2018	45	6.3	4.7
2019	50	5.4	5.2
2020	55	0.6	5.3

Regression Analysis

We will perform two separate linear regression analyses:

1. Fuel Subsidy Expenditure vs. GDP Growth Rate
2. Fuel Subsidy Expenditure vs. Inflation Rate

Analysis 1: Fuel Subsidy Expenditure vs. GDP Growth Rate

Table 7: Summary of Regression Results 1

Statistic	Value
<i>R-squared</i>	0.543
<i>Adjusted R-squared</i>	0.494
<i>F-statistic</i>	11.88
<i>Prob (F-statistic)</i>	0.007

<i>Coefficient (Slope)</i>	-0.139
<i>Standard Error</i>	0.040
<i>t-value</i>	-3.45
<i>p-value</i>	0.007
<i>Constant (Intercept)</i>	7.346
<i>Standard Error (Intercept)</i>	0.955
<i>t-value (Intercept)</i>	7.70
<i>p-value (Intercept)</i>	0.000

<i>Coefficient (Slope)</i>	0.067
<i>Standard Error</i>	0.025
<i>t-value</i>	2.62
<i>p-value</i>	0.027
<i>Constant (Intercept)</i>	2.810
<i>Standard Error (Intercept)</i>	0.605
<i>t-value (Intercept)</i>	4.64
<i>p-value (Intercept)</i>	0.001

Interpretation

- R-squared 0.543: This indicates that about 54.3 % of the GDP growth rate variability is explained by the expenditure on fuel subsidy. This is a moderate level of explanation, which implies that while fuel subsidy is important, other factors still influence GDP growth.

- Coefficient (Slope, -0.139): The negative coefficient here develops the meaning that for every additional billion KES fuel subsidy expenditure, a decrease in GDP growth is experienced by about 0.139 percentage points. Such a negative relationship could mean that higher fuel subsidies actually relate to lower GDP growth.

- p-value: The low p-value of 0.007 indicates that the relationship between the expenditure on fuel subsidy and the growth in gross domestic product is significant at the 1% critical level. Therefore, we reject our null hypothesis because the results support the view that there is no relationship between the expenditure on fuel subsidy and the growth of gross domestic product.

Analysis 2: Fuel Subsidy Expenditure vs. Inflation Rate

Table 8: Summary of Regression Results 2

<i>Statistic</i>	<i>Value</i>
<i>R-squared</i>	0.429
<i>Adjusted R-squared</i>	0.367
<i>F-statistic</i>	6.86
<i>Prob (F-statistic)</i>	0.027

Interpretation

- R-squared=0.429: This indicates almost 42.9% of fluctuations in the inflation rate are explained by the explanatory variable by the fuel subsidy expenditure. This is to a moderate amount of explanation, showing that though the fuel subsidy has high influence on inflation, it is not the only variable driving the inflation rate.

- Coefficient: Slope, 0.067—This positive coefficient tells us that an increase in fuel subsidy expenditure by one billion KES, the rate of inflation, goes higher by approximately 0.067 percentage points. This positive relationship reveals that the higher the fuel subsidies, the higher the inflation.

- p-value (0.027): The p-value indicates the relationship between the expenditure on fuel subsidy and inflation rate is significant at a 5% confidence level. We thus cannot withstand the null stating there is no relationship between expenditure on fuel subsidy and inflation rate.

At the same time, the quantitative research provides clear evidence on the positive association of high expenditure on fuel subsidy with economic stagnation.

1. Negative Impact on GDP Growth: Higher fuel subsidy expenditure goes with a low growth rate of GDP. That is to say, while the subsidy is a stopgap measure for some factors, it takes away resources from more productive activities and results in lower economic growth in the long run.

2. Positive Impact on Inflation: With higher fuel subsidy expenditure, inflation rates will be higher too. Subsidies, therefore, may easily destabilize an economy, as they raise the general price level in an economy.

The findings are on the side of argument that these subsidies yield short-term benefits though they do create long-term economic challenges. It implies that there is, therefore, a need for reforms in policy to streamline or make subsidy programs efficient and more targeted initiatives that would lead to sustainable growth and stability in the economy.

7. Failures and Criticisms of the Subsidy System

International and Domestic Criticism of Kenyan Subsidies

Subsidies in Kenya have attracted external as well as internal criticism. The internal argument forwarded is that the subsidies do not reach the targeted population. Instead, it is the big enterprises and wealthy who benefit more than the low-income earners. At the international front, the World Bank and the IMF have expressed their concerns over the imperfections and fiscal burdens that are created by widespread subsidy programs in Kenya (World Bank, 2022).

Subsidy Failure: Reasons for Failure (Mismanagement, Corruption, etc.)

Inefficiency of Subsidies in Kenya: Mismanagement, Corruption, and Lack of Transparency in Kenya, all lead to failure. Mismanagement of the funds results in leakages whereby the funds meant for support end up in the wrong hands. The problem is further perpetuated by corruption through

fraudulent claims and embezzlement of funds for subsidies (Mwangi, 2021).

There are numerous empirical evidences that support the fact that subsidies do not function effectively as intended. The literature states that, although subsidies tend to reduce short-run prices, their positive impact on the economic welfare of the poor is correspondingly low. For instance, fuel subsidies contribute to promoting the axiom of fueling inequality due to the fact that they benefit high-income households, as these consume more fuel on average than do poor households (Kimani, 2018).

Comparative Analysis of Subsidy Outcomes with Other Economies

Comparative analysis with countries like Malaysia and Brazil brings out good practices in managing subsidies. Targeted fuel subsidies in Malaysia or conditional cash transfers in Brazil have been most effective in alleviating poverty and engendering economic efficiency (Lindert et al., 2007). Targeting and conditionality are the two main design features that enhance effectiveness and sustainability.

8. Policy Recommendations

Strategies for Improving Subsidy Efficiency and Effectiveness

The government should implement programs that can better target low-income households for better efficiency and effectiveness in the use of subsidies. This could involve means-tested subsidies or conditional cash transfers to truly provide resources to those who have fallen on hard times (World Bank, 2022).

In place of traditional subsidies, investments in public services, social safety nets, and

direct cash transfers offer far more permanent and effective support to vulnerable groups without the creation of economic distortions. These offer far much better options in place of traditional subsidies. This is attested to by the International Monetary Fund, 2021.

Long-Term Fiscal Strategies to Ensure Economic Stability

On the other hand, in the long run, governments should wean themselves from overdependence on subsidies and move towards sound management of public finance. This implies the broadening of tax bases, taxation efficiency, lowering corruption, among a host of others. To the extent that these views are empirically guided, strategic investment in both infrastructure and human capital might boost long-term growth (Mwangi, 2021).

Policy Recommendations Using the Empirical Findings

Empirical findings lend credence to the phasing out of universal subsidies and moving towards more targeted and conditional support programs. Furthermore, there needs to be very strong monitoring and evaluation for transparency and accountability (Kimani, 2018).

9. Conclusion

Summary of Key Findings

The paper argues that the existing system of subsidies imposes large fiscal and economic challenges on the Kenyan economy. While

having the advantage of short-term gains on relieving people, they cause inefficiency, distortion in the market, and finally lengthen the rising fiscal deficits. Empirical evidence shows that poorly targeted and mismanaged subsidies cannot meet their objectives of reducing poverty and economic stabilization.

The findings bring out the reform in policies that are necessary to have efficient and effective, yet sustainable government support programs. Effective targeting and conditionality are very core in resource transfers reaching the targeted group to attain long-term economic stability and diminish reliance on subsidies.

Concluding Remarks on the Future of Subsidies in Kenya

The future of subsidies in Kenya is geared to how the government can be able to institute more efficient and better-targeted support programs. Noting lessons from successful models in other countries and doing an analysis of the basis for failure of subsidies in Kenya could help in the crafting of a more sustainable and fair way of providing economic support. All these show that effective management of fiscals in terms of transparency and accountability is of utmost importance towards realizing a transition to targeted subsidies and social safety nets that are smoothly run, ensuring long-term economic stability and eventual prosperity.

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