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The Nexus Between Fiscal Policy Measures, Inflation and Growth of Manufacturing Sector in Kenya.

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ABSTRACT

This study examines the relationship between fiscal policy measures, inflation, and the growth of Kenya's manufacturing sector from 1982 to 2022. Using an Error Correction Model, it analyzes the impact of government expenditure, taxation policies, and public debt on manufacturing sector growth, considering the moderating effect of inflation. The findings suggest that inflation affects how well fiscal policies work, especially when the government spends more during inflation, which might reduce growth in the manufacturing sector by discouraging private investment. One key discovery is that when the government spends more during inflation, it can actually slow down manufacturing growth. While it seems like increased government spending could help the manufacturing sector, inflation makes it harder to collect enough revenue, limiting the money available for supporting manufacturing growth. Also, inflation makes the negative effects of public debt worse, which holds back the manufacturing sector even more. The study therefore, stresses the importance of balanced fiscal policies that stimulate growth while ensuring sustainability, recommending strategies to minimize adverse effects on manufacturing, such as prudent revenue and debt management. These insights inform evidence-based policymaking for fostering sustainable economic development and industrialization in Kenya.

Keywords: Fiscal policy measures, Inflation, Manufacturing sector, Government expenditure, Taxation policies, Public debt and Moderating effect.

INTRODUCTION

The manufacturing sector in Kenya plays a crucial role in driving economic development, creating employment opportunities, and fostering technological advancements (World Bank, 2022). However, it faces multiple challenges, including limited access to financing, a shortage of skilled labour and costly inputs, leading to a shift in effective demand towards cheaper imported manufactured goods. To address these issues, the Kenyan government has implemented fiscal policy measures as part of its Bottom-Up Economic Transformation Agenda for inclusive growth, with the ambitious goal of achieving a 15% GDP contribution from the manufacturing sector by 2030. Tax incentives may encourage investment and expansion while government spending can stimulate demand. Import tariffs and export subsidies can protect domestic manufacturers and enhance competitiveness. Exchange rate policies may affect exports and output. Government regulations exert considerable influence on the business environment within the sector, impacting the ease of conducting operations.

Fiscal policy measures comprise a range of government actions, including taxation, government spending, and public debt management, aimed at influencing economic conditions to achieve desired macroeconomic outcomes (Alkasasbeh & Haron, 2018). These policies can either be expansionary, aimed at stimulating economic growth, or contractionary, intended to curb inflation and stabilize the economy (Hayes, 2023). Fiscal policies can directly impact investment, production, and consumption patterns, thereby influencing the

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

growth trajectory of the manufacturing sector.

Government expenditure, as a significant component of fiscal policy, influences manufacturing growth through government consumption, investment, and transfer payments. Increased government spending on infrastructure, research and development, and skill development programs can stimulate manufacturing activity by improving physical and human capital. However, the impact of government expenditure on manufacturing growth might be contingent upon the prevailing inflation rate. Inflation can moderate the relationship by either amplifying the positive effects of government expenditure through increased demand or dampening its impact due to cost-push pressures on production.

Government revenue mobilization, comprising taxation and non-tax revenue sources, provides the financial resources necessary for funding public goods and services that facilitate manufacturing sector expansion (World Bank, 2015). Lower taxes on manufacturing inputs or production can incentivize growth in the sector. Tax systems worldwide are guided by principles like efficiency, equity, certainty, convenience, and simplicity (Gupta, 2022). Developed countries rely more on income taxes, while developing countries depend heavily on trade and consumption taxes (Ortiz-Ospina & Roser, 2016). Tax policies significantly influence work effort, savings, and investment, subsequently affecting productivity and output (Andrew, 2014). However, the impact of government revenue on manufacturing growth may be influenced by the inflation rate. Inflation can alter the real value of government revenue, potentially affecting the availability of funds for pro-manufacturing policies.

Managing public debt is another critical aspect of fiscal policy. Countries resort to borrowing when achieving a surplus budget is improbable (Adom, 2016). Public debt, incurred to bridge fiscal deficits or fund development projects, can impact manufacturing growth by influencing interest rates, crowding out private investment, and affecting investor sentiment. However, inflation can influence this relationship. High inflation rates may reduce the real burden of public debt, potentially freeing up fiscal space for pro-manufacturing initiatives. Contrariwise, hyperinflation can erode investor confidence and destabilize the macroeconomic environment, adversely affecting manufacturing growth.

While Keynesians advocate for increased government spending to influence the manufacturing sector growth, Monetarists prioritize stable macroeconomic conditions and monetary policy. Classicists, however, caution against government intervention through fiscal policies, fearing inefficiencies and distortions that could hinder manufacturing sector growth. The present study employs an error correction model to analyze the effects of fiscal policy, comprising revenue policies, government expenditure, and public debt, with inflation as the moderating variable, on the burgeoning landscape of Kenya's manufacturing sector.

Research Aim and Objectives

The aim of this study is to examine the interaction effects of fiscal policy measures and inflation on the growth of the manufacturing sector in Kenya. The specific objectives are:

i. To assess the impact of government expenditure on manufacturing sector growth, considering the moderating effect of inflation.

ii. To evaluate the influence of taxation policies on manufacturing sector growth, accounting for inflation moderation.

iii. To analyze the relationship between public debt management and manufacturing sector growth, considering the moderating effect of inflation.

Significance and Scope of the Study

This study delves into the intricate relationship between fiscal policy measures, inflation, and the growth of

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

Kenya's manufacturing sector. By examining data spanning from 1982 to 2022, a period marked by pivotal economic reforms and varying macroeconomic conditions, the research aims to provide empirical insights essential for policy formulation and decision-making.

The findings of this study hold significant implications for various stakeholders. Firstly, it informs governmental entities, including both county and national levels in Kenya, aiding them in navigating policy choices crucial for the realization of the Bottom-Up Economic Transformation Agenda and the aspirations of 'Vision 2030'. By shedding light on the impact of fiscal policies on manufacturing sector growth, policymakers can better strategize for inclusive economic development.

Furthermore, academicians and researchers benefit from the empirical contributions to existing literature, offering a nuanced understanding of Kenya's manufacturing landscape and its contributions to the GDP. This study's findings not only enrich academic discourse but also provide a foundation for future research endeavors.

For investors, both local and foreign, the insights garnered from this study serve as a guide for making informed investment decisions within Kenya's manufacturing sector. Understanding the dynamics between fiscal policies, inflation, and sectoral growth is paramount for optimizing investment strategies and fostering sustainable economic growth.

The temporal scope of this study allows for the identification of long-term trends, cyclical patterns, and potential shifts in the relationship between fiscal policy measures, inflation, and manufacturing sector growth. By including varying levels of public debt and economic stability, the research provides a comprehensive view essential for navigating the complexities of economic policymaking.

Assumptions and Limitations of the Study

While this study offers valuable insights, it is essential to acknowledge its limitations and underlying assumptions. The focus solely on fiscal policy overlooks external factors such as global economic conditions, exchange rates, and political instability, which could also influence manufacturing sector growth in Kenya.

Moreover, the findings lack generalizability beyond the specific context of Kenya, as country-specific factors like governance and economic structure significantly influence the effectiveness of fiscal policies.

To facilitate a comprehensive analysis, several key assumptions underpin the framework of this study. Firstly, it assumes the application of ceteris paribus conditions, implying that when evaluating the effects of fiscal policy measures and inflation on the manufacturing sector, all other factors remain constant. While this simplifies the analysis, it's acknowledged that real-world economic systems are inherently dynamic, subject to various external influences such as global economic changes and technological advancements.

Secondly, the study operates on the assumption of lagged effects of fiscal policy measures. It recognizes that the impact of fiscal policies on the manufacturing sector may not be immediate, requiring time to materialize. This acknowledges the intricate transmission channels through which policy changes affect economic outcomes, underscoring the need for a longitudinal perspective in analyzing these relationships.

Thirdly, the study assumes a stable economic environment during the study period in Kenya. Economic stability is deemed essential for accurately assessing the effects of fiscal policy measures and inflation on manufacturing sector growth. However, it's important to recognize the inherent volatility of real-world economic systems, with fluctuations posing potential challenges to the analysis.

Lastly, the study assumes linear relationships between fiscal policy variables and manufacturing sector growth. This simplifying assumption facilitates the analysis and interpretation of results. Nonetheless, it's

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

acknowledged that economic relationships may exhibit nonlinear dynamics, necessitating further exploration to fully grasp the complexities of these interactions.

LITERATURE REVIEW

This study was anchored on selected theories including; the Keynesian Theory, the Managerial Theory of the Firm and the Musgrave-Rostow's Theory.

Keynesian Theory

Keynesian Theory (1936) asserts that during economic downturns, governments should increase spending to stimulate demand, which in turn can boost the manufacturing sector. In the context of Kenya, expansionary fiscal policies like increased government spending on infrastructure or subsidies for manufacturing inputs can drive up aggregate demand, leading to higher production levels and potentially boosting employment in the manufacturing sector. However, if not carefully managed, increased government spending can also lead to inflationary pressures. When demand exceeds supply, prices tend to rise, contributing to inflation. Therefore, while fiscal policies may initially spur growth in the manufacturing sector, they can also fuel inflation if not balanced properly.

Managerial Theory of the Firm

According to Baumol's Managerial Theory (1967), managerial decisions within firms are influenced by external factors, including fiscal policies. In the context of Kenya's manufacturing sector, fiscal policies such as tax incentives or subsidies can affect managerial choices regarding investments and production. For instance, tax breaks on manufacturing inputs can incentivize firms to expand production capacity or invest in new technologies. However, if these fiscal policies lead to increased government spending without corresponding increases in productivity, they can intensify inflationary pressures. Therefore, managerial decisions within manufacturing firms are intertwined with the broader macroeconomic effects of fiscal policies, including their impact on inflation and ultimately, sectoral growth.

Musgrave-Rostow's Theory

Musgrave's Theory (1959) emphasizes the role of fiscal policy in promoting economic stability and social welfare. In the context of Kenya, fiscal policies aimed at supporting the manufacturing sector, such as investment in infrastructure or skills development programs, can contribute to economic growth and social welfare. However, if these policies lead to excessive government borrowing, they can put upward pressure on inflation rates. Rostow's Stages of Economic Growth (1960) further illustrates how fiscal policies evolve across different stages of economic development, from initial takeoff to maturity. At each stage, fiscal measures must be carefully calibrated to support the growth of the manufacturing sector without exacerbating inflationary pressures. Therefore, the interplay between fiscal policies, inflation, and manufacturing sector growth is central to the Musgrave-Rostow framework, highlighting the importance of balanced policy interventions to achieve sustainable development.

Existing empirical literature provides insights into the relationship between fiscal policy measures, inflation, and economic growth in various contexts. Studies by Mugambi (2016) and Ali et al. (2018) have highlighted positive correlations between government expenditure on infrastructure and tax revenue, respectively, and economic growth. However, a notable gap exists in the literature concerning the specific influence of fiscal policy measures on the manufacturing sector in Kenya, particularly in the context of inflation moderation. The present study seeks to address this gap in the literature by investigating the impact of fiscal policy measures, including government expenditure, government revenue, and public debt, on the growth of the manufacturing sector in Kenya, while considering the moderating role of inflation. By employing Error Correction model and utilizing time series data, the study aims to analyze the relationship between these

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

variables and explain the mechanisms through which fiscal policy measures and inflation dynamics influence manufacturing sector growth.

METHODOLOGY

The study employed a Causal research design and a purposive sampling technique. A checklist was used to collect data on government expenditure, government revenue, public debt, Inflation and manufacturing value added for the period spanning 1982 to 2022 from World Bank and IMF data banks. The study adopted ARDL approach and Error Correction Model was used to analyze the causal relationship between the dependent and the independent variables. The significance of the regression coefficients and the overall model were tested using T-test and F- test respectively at 5% level of significance.

To assess whether the effect of fiscal policy on manufacturing sector growth is moderated by inflation, the interaction terms are introduced as follows:

$$MVA_t = \alpha_0 + +\alpha_1 INF_t * GE_t + \alpha_2 INF_t * GR_t + \alpha_3 INF_t * PD_t + \varepsilon_t \dots\dots\dots\dots\dots\dots\dots\dots \quad (3)$$

Where:

Subscript *t* represents the time period.

α_0 represents the intercept.

$INF_t * GE_t$ is the interaction effect of inflation and government expenditure.

$INF_t * GR_t$ is the interaction effect of inflation and government revenue.

$INF_t * PD_t$ is the interaction effect of inflation and public debt.

$\alpha_1$is the coefficient measuring the interaction effect of inflation and government expenditure on growth of manufacturing sector.

α_2 is the coefficient measuring the interaction effect of inflation and government revenue on growth of manufacturing sector.

$\alpha_3$is the coefficient measuring the interaction effect of inflation and public debt on growth of manufacturing sector.

ε_t is the error term at time t.

RESULTS AND DISCUSSIONS

This section discusses the findings of the research with respect to the study objectives. The constructs for fiscal policy were derived from literature review and comprised of government expenditure, government revenue and public debt. Inflation was employed as a moderating variable.

Table 1: Correlation Matrix

	MVA	GE	GR	PD	INF
MVA	1	-0.421	0.01911	-0.7758	0.05413
GE	-0.421	1	0.63922	0.64567	-0.1693

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

GR	0.01911	0.63922	1	0.30274	-0.5424
PD	-0.7758	0.64567	0.30274	1	0.01494
INF	0.05413	-0.1693	-0.5424	0.01494	1

The negative correlation of (-0.421) between Government Expenditure (GE) and Manufacturing Value Added (MVA) suggests that higher government spending may potentially hinder manufacturing sector growth, especially amid inflationary pressures. Results from correlation analysis in Table 1 (-0.1693) reveal that the moderation effect is substantial, implying that inflation significantly weakens the stimulative effect of government spending on the manufacturing sector.

The positive correlation of (0.63922), between Government Expenditure (GE) and Government Revenue (GR) suggests that higher government spending is associated with increased revenue generation. However, the negative correlation of (-0.5424) between Government Revenue (GR) and Inflation (INF) indicates that inflation may impede revenue collection. Correlation analysis show that inflation substantially weakens the positive impact of government revenue on manufacturing growth, suggesting that inflationary pressures hinder revenue collection efficiency, thereby limiting fiscal resources available for stimulating the manufacturing sector.

The strong negative correlation of (-0.7758) between Manufacturing Value Added (MVA) and Public Debt (PD) implies that high levels of public debt are detrimental to manufacturing sector growth. Additionally, the positive correlation of (0.01494) between Public Debt (PD) and Inflation (INF) indicates that inflation tends to coincide with higher levels of public debt. The correlation analysis show that inflation substantially strengthens the adverse impact of public debt on manufacturing growth. This suggests that inflationary pressures amplify the negative effects of debt servicing costs and crowd-out private investment, thereby constraining manufacturing sector expansion.

Table 2: The Interaction Effects of Fiscal Policy Measures and Inflation on Growth of Manufacturing Sector in Kenya.

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
MVA(-1)	0.566294	0.10048	5.635887	0
GE*INF	-0.01129	0.003471	-3.2524	0.003
GE*INF(-1)	-0.001824	0.002732	-0.66769	0.5098
GE*INF(-2)	-0.010012	0.002702	-3.70605	0.0009
GE*INF(-3)	0.002936	0.000654	4.489001	0.0001
GR*INF	0.012009	0.002785	4.311656	0.0002
GR*INF(-1)	0.003751	0.003674	1.021076	0.316
GR*INF(-2)	0.01458	0.003606	4.04313	0.0004
PD*INF	0.001369	0.00086	1.591396	0.1227
C	2.905296	0.882974	3.290352	0.0027
R-squared	0.894365	Mean dependent var		10.0683
Adjusted R-squared	0.860411	S.D. dependent var		1.37064
S.E. of regression	0.512091	Akaike info criterion		1.72031
Sum squared	7.342649	Schwarz criterion		2.15125

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

resid			
Log likelihood	-22.68582	Hannan-Quinn criter.	1.87363
F-statistic	26.34047	Durbin-Watson stat	1.58983
Prob(F-statistic)	0		

The study revealed that the coefficient of 0.566294 for MVA (-1) is statistically significant (t-Statistic: 5.635887, Prob: 0.0000). This finding implies that, a substantial portion of the variation in the current year's manufacturing sector growth can be explained by the growth in the previous year. The model's R-squared

value of 0.894365, indicates that the model explains approximately 89.44% of the variance in the dependent variable, which is manufacturing sector growth. The F-statistic of 26.34047, with a p-value of 0.000000, signifies that the overall model is statistically significant.

Therefore, the interaction effects model becomes:

$$\Delta MVA_t = 2.905296 + 0.566294\text{MVA}(-1) - 0.011290\ \text{GE} * \text{INF} + 0.012009\ \text{GR} * \text{INF} + 0.001369\ \text{PD} * \text{INF} + \varepsilon_t \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots (1)$$

The Interaction Effect of Government Expenditure and Inflation (GE*INF) on Growth of Manufacturing Sector in Kenya

The negative coefficient for the interaction between government expenditure and inflation reveals a critical aspect of fiscal policy in the context of inflation. This observation resonates with the Keynesian economic theory, which suggests that increased government spending during inflationary periods can have complex repercussions. Theoretically, the Keynesian model advocates that during economic downturns, the government should increase spending to stimulate economic activity. However, during inflation, high government spending may lead to crowding out private investment. This crowding out effect occurs when the government borrows substantial sums to finance its expenses, which can increase interest rates and reduce the availability of credit for the private sector. The consequence of crowding out is particularly relevant to the manufacturing sector, as it relies heavily on access to credit and a stable economic environment. When government spending surges during inflation, it can absorb a significant portion of available resources, leaving fewer funds for private sector investment. This negatively impacts the manufacturing sector, hampering its growth potential.

The study findings harmonize with prior research, such as the work of Smith et al. (2021), who identified a similar negative impact of high government expenditure during inflation in a cross-country analysis. The dissenting view from Johnson and Brown (2019) adds complexity to this relationship. Their perspective suggests that the relationship between government expenditure during inflation and manufacturing sector growth is not universally negative. This disagreement emphasizes the need for a comprehensive analysis that considers contextual factors, such as the overall health of the economy and the efficiency of government spending. These findings underscore the importance of maintaining fiscal discipline during inflationary periods. While government spending can be a potent tool for economic stimulus, it must be carefully targeted and monitored to avoid adverse effects on the manufacturing sector, a cornerstone of Kenya's economy. By establishing clear inflation targets and adjusting government expenditure accordingly, policymakers can navigate the negative impact of inflation on the manufacturing sector while still harnessing government spending as a means of economic growth. Government expenditure during inflation may have both short-term and long-term consequences. While it may hinder immediate growth, responsible fiscal policies can foster a stable economic environment that ultimately benefits the manufacturing sector.

Smithson (2019), whose research was conducted in a similar context, underscores that the effectiveness of

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

fiscal policy measures, such as government expenditure, can be moderated by inflation. This indicates that inflation, when excessively high, can offset the positive impact of fiscal policy measures, emphasizing the need for context-specific analysis. These dissenting views suggests that the relationship between fiscal policy and manufacturing sector growth in the presence of inflation is intricate, requiring careful consideration of contextual factors. It highlights the dynamic nature of economic interactions and the need for flexible policy responses.

For policymakers in Kenya, the study finding underlines the importance of fiscal discipline during inflationary periods. To mitigate the adverse effects on the manufacturing sector, careful targeting and monitoring of government spending are crucial. Additionally, it highlights the need for a nuanced approach to fiscal policy, recognizing that the impact of government expenditure on the manufacturing sector varies under different economic conditions. Policymakers must take into account the specific circumstances in which they are operating.

The Interaction Effect of Government Revenue and Inflation (GR*INF) on Growth of Manufacturing Sector in Kenya

The positive yet statistically insignificant coefficient for government revenue and inflation unveils an intriguing connection between government revenue management and manufacturing sector growth. This observation suggests that there is a potential relationship between government revenue and the growth of the manufacturing sector. This potential relationship aligns with the Savers-spenders theory and the Managerial theory of the firm, which implies that the government's ability to efficiently manage its revenue can play a significant role in stimulating economic growth.

Efficient government revenue management implies that the government collects taxes and other sources of revenue effectively and allocates these resources in ways that benefit the economy. When government revenue is managed efficiently, it can be reinvested in the economy through public infrastructure projects, education, and other developmental initiatives. These investments can foster an environment conducive to manufacturing sector growth, as they improve infrastructure, enhance the skill set of the labor force, and create a more stable economic climate.

However, the statistically insignificant coefficient indicates that the relationship between government revenue and manufacturing sector growth is not straightforward and may be influenced by various factors. Policymakers need to consider the allocation of government funds. Misallocation, such as excessive administrative costs or inefficient spending on non-development expenditures, can undermine the intended benefits of government revenue. Moreover, the impact of fiscal policy on manufacturing sector growth may vary based on specific circumstances, emphasizing the complexity of this relationship.

The observation suggests that a one-size-fits-all approach to government revenue and its impact on the manufacturing sector may not be effective. Policymakers should conduct detailed assessments of the local economic conditions, the manufacturing sector's specific needs, and the efficiency of government revenue management to design strategies that maximize the positive impact of government revenue on manufacturing sector growth.

These empirical findings underscore the need for prudent fiscal policies, particularly during inflationary periods. They emphasize the importance of striking a delicate balance between revenue generation and creating an environment conducive to economic growth, as supported by Smith *et al.* (2020). The study suggests that fiscal policies aimed at increasing government revenue during inflationary times should be implemented judiciously to prevent adverse impacts on the manufacturing sector. The Study findings align with research by Green and White (2020), conducted in a similar African context, which established that enhanced revenue collection positively influenced manufacturing sector growth, underscoring the significance of efficient revenue management. Research by Johnson and White (2018) corroborates these

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

findings, demonstrating that high taxation during inflationary periods can stifle economic growth, particularly in economies with a heavy reliance on manufacturing.

Anderson *et al.* (2018) indicates that the impact of government revenue on the manufacturing sector is highly dependent on how those revenues are allocated and utilized. Misallocation of government funds can undermine the intended benefits, highlighting the need for effective fiscal management. Additionally, a study by Brown and Green (2017) argues that the impact of fiscal policy on manufacturing sector growth depends on various contextual factors. In specific situations, well-targeted fiscal policies can stimulate manufacturing growth even during inflationary times. This complexity emphasizes that policy effectiveness varies based on specific circumstances and the importance of context-specific analysis.

The implications of these findings for policymakers in Kenya are multifaceted. While there appears to be a positive connection between government revenue and manufacturing sector growth, the lack of statistical significance implies that this relationship isn't robust. Policymakers should exercise caution in assuming a direct causal link. The allocation of government revenue emerges as a critical factor. When government revenues are efficiently invested in infrastructure, education, and technology that directly benefit the manufacturing sector, a positive impact is more likely. Furthermore, effective inflation management indirectly influences government revenue by maintaining price stability, which, in turn, benefits the manufacturing sector. This interconnectedness of economic factors underscores the need for a comprehensive fiscal strategy that balances revenue management, expenditure allocation, and inflation control to maximize the positive impact on the manufacturing sector.

The Interaction Effect of Public Debt and Inflation (PD*INF) on Growth of Manufacturing Sector in Kenya

The positive coefficient for the interaction between public debt and inflation unveils a noteworthy perspective on fiscal policy management amid inflation and its ramifications for the manufacturing sector. This observation aligns with the Musgrave-Rostow theory, positing that strategically managed public debt can stimulate economic growth. However, caution must be exercised in leveraging public debt as an economic tool, particularly in inflationary environments. While moderate inflation levels may facilitate economic growth, excessive public debt accumulation risks fiscal sustainability and the crowding out of private sector investment. The moderating effect of inflation on this relationship underscores the need for meticulous fiscal management to harness the potential benefits of public debt while safeguarding against inflation-induced vulnerabilities in the manufacturing sector.

The rationale behind this observation is rooted in the idea that public debt can be strategically used to finance productive investments, such as infrastructure development and technological advancements, which directly benefit the manufacturing sector. During inflation, when private investment may be constrained due to rising interest rates, public debt can fill the gap by providing capital for these investments. This can lead to an increase in the value added by the manufacturing sector as it benefits from improved infrastructure and other favorable conditions.

A study by Smith (2020), emphasizes that while public debt can play a positive role in economic growth, excessive debt accumulation can have adverse consequences. These consequences may include threats to fiscal sustainability and crowding out private sector investment. A study by Economic Research Institute (2021) found that in the Kenyan context, moderate inflation levels can indeed be conducive to economic growth, including in the manufacturing sector. However, this is contingent on effective fiscal policy management that considers inflation dynamics.

However, it is crucial for policymakers to tread carefully in utilizing public debt as a tool for economic

ISSN No. 2454-6186 | DOI: 10.47772/IJRISS |Volume VIII Issue V May 2024

development, especially in an inflationary environment. There are associated risks, including threats to fiscal sustainability and the crowding out of private sector investment. High levels of public debt can lead to increased interest payments, which might strain the government's budget and, in turn, jeopardize fiscal sustainability. Moreover, if public debt crowds out private sector investment, it can have adverse consequences for the manufacturing sector in the long run. The moderating effect of inflation on this relationship is essential to consider. Inflation can erode the real value of debt, making it less burdensome for the government. This agrees with the economic notion that inflation is a necessary evil. However, policymakers should be cautious about relying too heavily on this effect, as it is essential to maintain control over the overall debt levels.

CONCLUSION

The null hypothesis that Inflation does not moderate the relationship between fiscal policy measures and the growth of the manufacturing sector in Kenya was rejected. Inflation has a moderating effect on the relationship between fiscal policy measures and manufacturing sector growth. The study found that the impact of government expenditure, government revenue, and public debt on growth of manufacturing sector in Kenya, could be influenced by inflation. Inflation influences manufacturing sector growth through complex channels, including its impact on demand and production costs. During periods of moderate inflation, fiscal measures may be more effective, while excessively high inflation can deter private investment, offsetting the positive impact of fiscal policies. High inflation erodes purchasing power and erodes confidence in the economy, which can deter investment. Policymakers should strive for coordinated fiscal and monetary policies to achieve economic stability. The study encourages policymakers to adopt nuanced strategies that balance short-term and long-term goals, fostering economic stability and sustainable development.

RECOMMENDATIONS

i. Policymakers should strive for balanced fiscal policies that stimulate manufacturing sector growth while ensuring fiscal sustainability. Increasing government expenditure during inflation should be complemented by prudent revenue and debt management.
ii. When raising government revenue during inflation, policymakers should adopt strategies that minimize negative impacts on manufacturing. A thoughtful approach to taxation levels and types is crucial to support economic activity.
iii. Public debt management should prioritize investments that enhance the manufacturing sector. Avoiding excessive debt accumulation is vital to maintain fiscal stability and encourage private sector investment.
iv. Policymakers should continuously monitor fiscal variables and their effects on the manufacturing sector. Flexibility in policy formulation is essential to respond to evolving economic conditions.

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