Public Debt and Economic Growth in Kenya: An Auto-Regressive Distributed Lag Specification Approach

Umulkher Ali Abdillahi and Dr.Muganda Munir Manini

Abstract

The principal objective of Kenya's public debt management is to meet the government financing requirements at the least cost with a prudent degree of risk while the secondary objective is to facilitate Government's access to financial markets and support development of a well-functioning vibrant domestic debt market. However Kenya's public debt has reached unsustainable levels, mainly due to heavy government borrowing to fund massive infrastructure projects. The main objective of this study was to examine the relationship between public debt and economic growth in Kenya. Specifically, the study sought to assess the influence of external and domestic debt on economic growth. The study theoretical framework was premised on the endogenous growth theory. This study employed annual data covering the period from 1995-2015 collected from the World Bank African Development Indicators. The variables of interest were; public debt and its various components and economic growth measured as the real gross domestic product. To empirically analyze the impact of public debt on economic growth, the ARDL model specification was used to examine the long-run and short run nexus and dynamic interactions between public debt and economic growth using Autoregressive Distributed Lag (ARDL) cointegration test. The bounds tests revealed that the study variables were bound together in the long-run. The results for the computed Wald test (F-statistics) revealed that calculated F-statistics of 7.782 was higher than the upper bound critical value 6.650 at 1% error level. Based on this result, a level long run cointegration relationship exists for the estimated ARDL models. Thus, the null hypotheses of no cointegration are rejected, implying long-run cointegration relationships amongst the variables when the regressions are normalized on GDP. The estimated coefficients of the long-run relationship show that external debt has a significant impact on economic growth. A 1% increase in external debt leads to approximately 3.17 percent increase in GDP. The domestic debt has negative relationship with economic growth implying it has crowded out private investment. On an aggregate level, public debt plays a key role in augmenting the growth level in Kenya. The findings of the study will form a basis for the formulation of policies relating to future government financing programs and schemes.

Keywords: *Public debt, Economic Growth, ARDL Cointegration, Sustainable Development Goals and Kenya*