# THE IMPACT OF PUBLIC DEBT ON ECONOMIC GROWTH IN KENYA

**BY**

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# ABSTRACT

Over the years, public borrowing has been employed by governments to meet their financial deficits. Kenya's public debt has been on a continuous rise, with sharp increases being experienced in the last 7 years. Domestic and external debts currently share a similar portfolio, each contributing to half of the total public debt.

This paper sought to study how each type of debt, that is, domestic and external debt impacts individually on the country's economic growth. The study incorporated quarterly data for the period 1995-2015. The study employed a modified Solow's growth model. Growth was explained by both domestic and external debt separately and other macroeconomic control variables including physical capital, human capital, population, inflation, broad money and trade. The two models were thereof compared for analysis.

Cointegration analysis was employed to empirically establish the existence of a long-run relationship between Gross Domestic Product, and the above-named variables. The study revealed that in the case of domestic debt, it has an insignificant but positive impact on economic growth, while physical capital, human capital, inflation and trade significantly explained variations in economic growth. Population and broad money supply were also found insignificant at 5% level of significance.

In the case of external debt, it was found to have a significant but negative relationship with growth. Physical capital, human capital, population, inflation and trade together with external debt significantly explained variations in economic growth, while money supply was insignificant. The short-run Error Correction models affirmed the existence of cointegrating relationships for the growth models. In the case of domestic debt model, when an exogenous shock disturbs the equilibrium condition, 91.8% of its effect is adjusted in one quarter, compared to 91.1% in the case of external debt as depicted by the respective error correction terms.

This study recommends that government borrowings from international markets must be put into efficient use, and concessionary loans as opposed to commercial loans should be pursued to avoid debt overhang problems. The government should also pursue a balanced budget, and intensify local revenue collection.