IMPACT OF DEBT SERVICING ON SOCIAL SPENDING AND WELLBEING OF LOW-INCOME HOUSEHOLDS IN KENYA: A CASE STUDY OF NAIROBI CITY AND MOMBASA COUNTIES
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Kenya’s public debt service in national government spending has increased over the years from 21.6% to 29.2% in the period 2015 to 2019. Debt service in total ordinary revenue also increased from 34.9% to 49.8% in the same period. On the contrary, government spending in education and health recorded declining trends in the same period. The negative correlation between the trend of debt service and expenditures in health and education shows that debt service crowded out social spending in the analysis period.

Loan driven infrastructure investments from 2015 to 2020 in the social sectors cut across various programmes and are mainly aligned to Kenya’s long-term transformation objectives. Surveyed low income households in Mukuru area in Nairobi and Kalahani and Bangladesh slums in Mombasa have benefited from completed projects in health, education, water and sanitation, roads, electrification and security projects.

The reductions in spending in health and education have negatively impacted access to quality education and healthcare to low income households due to lack of medicines and specialised facilities in level three hospitals, inability to pay school fees and purchase learning resources. Rise in public debt has reduced the private sector’s access to credit resulting in low levels of private investments and reduced job opportunities and other economic trickle-down effects which hurt the low-income households the most.

New taxes, increase in existing tax rates, subsequent increase in costs of production, and increase in prices of basic commodities due to rising debt service burden have led to a general reduction in households’ final consumption expenditure.

The Level of Citizens Participation in the budget and debt cycle is low due to lack of awareness and capacity among citizens for effective participation, insufficient allocation of time and resources for the exercise with no clear established mechanisms at both County and National government levels for public participation.

Public borrowing on concessionary terms, Public - Private Partnerships on priority infrastructure and debt conversion could reduce spiralling growth of debt. Loans should go to projects with large positive externalities and potential income for repayment to reduce service burden on households. Progressive taxation and removal of taxes on basic commodities including VAT on cooking gas and vegetable oils can minimise the impacts on well-being of low-income households.

Timely disbursement of equitable share to Counties is critical for sustaining social and economic programmes as well as realisation of development budgetary allocations towards expanding capacity for services to growing populations.

The National and County Assemblies should legislate and enact clear procedures for effective implementation of citizen participation in the budget cycle. National and County governments to collaborate with civil society and other stakeholders to conduct civic education on the rights and role of citizens in fiscal management.
INTRODUCTION

Kenya envisions transforming into a rapidly industrializing middle-income country in which all citizens enjoy high quality of life in a clean and secure environment by the year 2030. However, due to economic bottlenecks in raising sufficient resources to finance the required infrastructure investment for the desired social and economic transformation, the Kenya government has accumulated debt from domestic and external sources. The increased accumulation of debt over the years saw Kenya debt stock rapidly increase by about 172% from 2.829 trillion in June 2015 shillings to 7.712 trillion in June 2021.

There has also been unprecedented increase in borrowing from commercial sources where loans have short grace periods but attract high interest rates. The rapid accumulation of debt consequently requires more resources for debt service and hence possible reductions on allocations to other government expenditures. Reduced allocations to social spending can have disproportionate negative impacts on the wellbeing of low-income households who rely heavily on government provision of social services in health, education, environmental protection among others. Further, the burden of public debt service due to introduction of new taxes, increased rates for existing taxes, increased costs of borrowing to the private sector, and rising costs of production leading to higher prices for goods and services have welfare reducing effects through decreased household consumption sets for low income households and fixed income earners.

The growing concern on the rising burden of debt service in Kenya motivated Oxfam to commission a study aimed at providing empirical evidence on how debt servicing is impacting social spending and the wellbeing of low-income households in Kenya. Specifically, the study sought to: establish the correlation between debt servicing and social spending; establish the impact of changes in social spending on low income households; assess the trends in investment of the loan-driven infrastructural development on socio-economic development from 2015 to 2020; determine the opportunity costs of debt financing to social and economic prosperity of low-income citizens and to analyse the levels of citizens participation in debt cycle. Using a mixed method approach the study analysed data from secondary sources as well as primary data collected through personal in-depth interviews with 387 households sampled from informal settlements in Mukuru area in Nairobi City county, Bangladesh and Kalahari slums in Mombasa County; key informant interviews and focus group discussions. Secondary data on debt service, national government expenditures on education, health and social protection; Nairobi City and Mombasa County budget allocations and actual spending on health, education, water and sanitation were extracted from statistical abstracts of the Kenya National Bureau of Statistics (KNBS) and the Controller of Budget (COB) reports.
The trends for debt service and expenditures in two key social sectors (Health and Education) are negatively correlated. The proportion of debt service in national government spending increased exponentially from 18.5 per cent in 2011/2012 to 29.2 percent in 2018/2019 with a fall recorded in the 2019/2020 year. Similarly, the proportion of debt service in total ordinary revenue grew from 23.97 per cent 2011/2012 to a high of 49.82 per cent in 2018/2019 but also recorded a drop in the 2019/2020 year. Against the rising trend on spending on public debt service, spending on education dropped from 20.3 per cent to 15.6 per cent and spending on health also reduced from 6.0 per cent to 3.6 per cent in the same period as shown in Figure 1. The negative correlation shows that debt service on the growing stock of Kenya’s public debt crowded out social spending in the analysis period. Insufficient spending in the social sectors is manifested through lack of essential services at health and education facilities. The sampled households, key informants and participants in the focus group discussions cited lack of medicines and specialized equipment in most of the level three hospitals, requirement for parents to purchase books and provide most of the resources needed for learning in public schools, delays in government disbursements of capitations to schools as well as payments for social protection transfers and public works programmes as some of the indicators of insufficient funding for social services.

The interest component of debt service grew at an increasing rate and remained higher above total spending on social protection programmes with a widening gap across the years as shown in Figure 2. The widening gap between interest payment on debt and spending in social protection shows that accumulation of public debt over in Kenya appears to be an indirect fiscal instrument for transferring wealth from poor taxpayers to government bondholders, thereby worsening inequality. Furthermore, most of Kenya government spending in social protection is financed through grants from development partners, without which the inequalities driven by debt would be enormous.

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1. https://www.centralbank.go.ke
2. The falls in debt service recorded in 2019/2020 are due to the temporary debt service suspension initiative that was rolled out by multilateral lenders during the COVID – 19 period.
3. Level three hospitals and below provide health services freely to citizens.
IMPACT OF CHANGES IN SOCIAL SPENDING ON LOW INCOME HOUSEHOLDS

Trends in the recurrent and development spending by the county governments of Nairobi and Mombasa on health and Education are not consistent with rising demand for services. Development spending on health and Education remained far below budgetary allocations across the years indicating uncertainty in realisation of expansion in the facilities needed to enhance access to and provision of quality services. Recurrent expenditure on health in Mombasa had a rising trend due to utilisation of funds raised within facilities. Recurrent spending on health for Nairobi City County largely fluctuated in the same period. In education, recurrent spending fluctuated across the years for the two counties as shown in Figure 3. Fluctuations in spending indicate instability and inconsistency in improvement of service delivery in public facilities.

According to a majority of the respondents, insufficient allocations and spending for public health and education facilities has negatively impacted the quality of services to citizens. Lack of medicine, inadequate medical laboratory services, insufficient number of qualified staff in level three hospitals and below, have denied the low-income household’s access to quality healthcare. Congestion in classrooms in the few schools and few teachers to handle very many students, lack of water and good sanitation facilities as well as requirement to pay for services were cited by households as causes of ineffective learning from public education institutions. Children from low income households are increasingly absent from school because they are often sent home for fees and other required resources which they are unable to get quickly. Implementation of the bursary programmes to support very needy students for secondary education is poorly targeted hence students who get bursaries to join form one drop out after failing to get support in subsequent years. Delays in disbursements of government cash transfer to beneficiaries [old persons, orphans and vulnerable children] were cited as inconveniencing since with the delays, spending plans are affected. Due to lack of clear criteria for awarding bursaries and lack of updates on cash transfer programmes beneficiaries’ registers, there are some of the most vulnerable groups that are left out of such government transfer programmes.

FLUCTUATIONS IN SPENDING INDICATE INSTABILITY AND INCONSISTENCY IN IMPROVEMENT OF SERVICE DELIVERY IN PUBLIC FACILITIES.
LOAN-DRIVEN INFRASTRUCTURE INVESTMENT FOR SOCIAL AND ECONOMIC DEVELOPMENT FROM 2015 TO 2020

L.oan driven infrastructure investment for social and economic development from 2015 to 2020 in the social sectors cut across various programmes and subsectors in the social sectors. 

**Education** - School infrastructure projects in early and basic education, vocational and technical training as well as University education and Research have been financed using loans from external sources. The projects are mainly focussed on establishment of education, training and research centers, construction of new and rehabilitation of existing facilities as well as equipping them to enhance quality in training. The aim is to expand the facilities to increase access to quality training and support effective transition across all levels of education. At the time of the study, there were ongoing construction of a girls’ boarding secondary school in Mukuru kwa Reuben and facilities at Shanzu area in Mombasa to facilitate relocation of Mama Ngina Girls to Shanzu area for expansion of the national school.

**Health** - Loan financed infrastructure projects are in health promotion, communicable disease control, national referral systems and Forensic and diagnostics. Health promotion projects are aimed at enhancing food and nutrition for vulnerable, Environmental health services and public laboratory networking projects. While projects in communicable disease programmes are aimed at prevention and treatment for HIV/AIDS, Tuberculosis and Malaria. In the National referral systems, projects components include modernization, expansion and equipping of hospitals including Kenyatta National Hospital, Moi Teaching and Referral Hospital, and Wajir District hospital. Other projects in Forensic and Diagnostics focus on construction, rehabilitation and equipping of hospitals and dispensaries, clinical waste management, technical support, basic health insurance for the poor and informally employed and Universal Health Coverage (UHC). In Nairobi and Mombasa Counties there were completed health projects on facilities for improved access to health services.

**Water and sanitation** - Infrastructure investments in water and sanitation are mainly for increased water supply and access to modern sanitation facilities in rural and urban areas. They include the rehabilitation of rural water schemes, drilling boreholes and construction of small dams/pan in ASALs and implementation of rural and urban water and sanitation projects in low-income areas. In Mombasa County, the ongoing WASH projects at the time of study were the replacement of the old water pipe network in Mombasa town to serve the rising demand due to increased population; the Mwache Dam in Kwale intended to supply water to Mombasa county. Boreholes to increase water supply, sewerage network reliability projects and construction of public toilets. In the Mukuru area of Nairobi County, a number of boreholes had been drilled to supply water to residents who previously entirely bought water from vendors and an ongoing sewer line project.

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4 Two level 3 hospitals (Mukuru Kwa Reuben Hospital and Our lady of Nazareth in Mukuru kwa Njenga) in in Nairobi while in Mombasa, an Oncology center established at the Coast General Hospital and four community Outreach health centers for the Coast General Hospital at Shika Adabu, Mtongwe, Vikwatami and Chaani.

5 In Mombasa, Kibarai road and Dongo Kundu bypass; Mama Ngina waterfront, rehabilitation of in Old Town area around Fort Jesus and other recreation facilities had been completed, in Nairobi’sMukuru area, other major infrastructure projects by the government include paved roads, police post, railway station and security lighting.
Other major infrastructure projects undertaken at the study sites are on roads, electrification, recreational facilities and security projects. The infrastructure projects in the informal settlements have generated a range of benefits to the low-income households. For example, in Mukuru area in Nairobi, residents no longer walk for long distances to access health care facilities, they can easily access schools, hospitals and public transport due to the paved roads and the improved water access has reduced living costs. Security has also improved due to the street lights and the police post established within the community.

**OPPORTUNITY COSTS OF DEBT FINANCING TO SOCIAL ECONOMIC PROSPERITY OF LOW-INCOME CITIZENS**

Increase in total public debt as a percentage of GDP was followed by a reduction in access to credit and private investments as a percentage of GDP. In the period 2013 to 2020 the total public debt as a percentage of GDP increased from 41.1 percent to nearly 66 percent. At the same time, there was a remarkable decrease in both growth in the access to credit by the private sector and private investment by 12.4 percent and 7.3 percent respectively as shown in Figure 4. Reduced private sector’s access to credit and investments hurt low income households the most following low employment creation and the shrinking trickle-down effect in the economy hence worsening their welfare. Further, growth in public debt was followed by reduced growth in final household consumption expenditure showing that economic welfare of households worsened. This points to a growing need for the government to institute wide ranging safety nets to cushion households in the low-income brackets from adverse economic shocks.

Households feel the burden of debt servicing in a number of ways including increased cost of commodities, high tax rates, increased number of taxes, and increased cost of services at the government facilities. Responses from 231 sampled households linked the rising cost of commodities in the country to the burden of debt servicing. For 110 households, the increased taxes on citizens are meant to help the government with public debt repayment. Other respondents including the key informants and the participants in the focus group discussions held the view that increased cost of services at the government facilities was a result of increased burden of debt servicing faced by the government. The responses confirm that increased budgetary needs to service public has adverse economic effects on the welfare of low-income households.
LEVELS OF CITIZEN’S PARTICIPATION IN THE DEBT CYCLE

The constitution of Kenya clearly stipulates space for citizens participation in fiscal policy decision making throughout the budget and debt cycle. There is provision for two levels of public participation in the budget cycle which include direct public participation by members of the public at the budget formulation stage and indirect participation by elected representatives at the National and County Assemblies. The implementation of the constitutional provision for public participation has not been satisfactory as manifested in failure to prioritize public participation by the authorities, the time allocated for the exercise has been largely insufficient and there are no well-established mechanisms for public participation at the two levels of government. There is also inadequate staffing of personnel and budgetary allocation to facilitate the exercise effectively.

Due to the shortcomings, the level of citizen participation in the debt cycle remains low as shown in Figures 5 and 6. From the responses from the majority (96%) of the surveyed households, public borrowing decisions are perceived to be a preserve of the political class led by the president, governors, and members of parliament and county assemblies as shown in Figure 7. They expressed dissatisfaction with the prevailing public borrowing decision making because they are not adequately involved, they feel a good proportion of the debt proceeds is embezzled, and not invested in projects that directly benefit them. As such it is a widespread view of most of the respondents that increased citizens participation in the debt cycle can enhance accountability and contribute to sustainable debt accumulation.
RECOMMENDATIONS

1) The National Treasury should adhere to the Debt Policy that encourages increasing amounts of public debt on concessionary terms and reduced commercial external loans.

2) The Government and the Semi-Autonomous Agencies should exploit the alternative options for infrastructure investments in Public Private Partnerships (PPPs) to reduce growth in debt to free up revenues for provision of services while also allowing the debt service burden to fizzle out.

3) Loans for infrastructure investments should only be approved if the outputs are associated with large positive externalities and potential income can sustain repayment of the debt to reduce debt service burden on households.

4) The government should explore opportunities for debt conversion in cases where the current interest rate is lower than the rate in which the government is repaying to reduce the current increasing burden of public debt servicing.

5) The National Treasury should disburse the equitable share to the counties in time to sustain critical programmes that rely on private suppliers such as school feeding programmes.

6) County governments should strive to fully finance development budgetary allocation to the social sectors to enable expansion of capacity for quality services in response to rising demand.

7) New taxes increased rates on existing taxes should enhance progressivity with less impact on the low-income households. As such, Value Added Tax (VAT) on basic commodities such as cooking gas and vegetable oils should be removed.

8) National and County Assemblies should develop and fully legislate on the procedures and mechanisms for effective and full implementation of the constitutional provisions for citizen participation in the budget cycle.

9) National and county governments in collaboration with civil society organisations and other stakeholders should conduct civic education for citizens on their rights and role in public participation on fiscal management matters.

10) The government should enforce stringent measures to fight graft and promote accountability and transparency in fiscal management to enhance productive investments of public debt.
Figure 1 showing proportion of public debt service in total ordinary revenue and national government spending as well as proportion of national government spending on education and health

Data Source: Statistical abstracts from National Bureau of statistics (Various issues)

Figure 2 showing the widening gap between trends of interest payments on Public debt and Government spending on Social protection

Data Source: Statistical abstracts from National Bureau of statistics (Various issues)
Figure 3 showing that actual spending in education and health by the county governments of Nairobi and Mombasa in the period 2015 to 2020 was lower than budgetary allocations for the sectors.

(a) Education – Mombasa County

(b) Health – Mombasa County

(c) Education – Nairobi City

(d) Health – Nairobi City
Figure 4: Showing the comparison in total Public Debt, Private Investment & Credit access to Private Sector as a percentage of GDP (2013 – 2020)

![Figure 4: Showing the comparison in total Public Debt, Private Investment & Credit access to Private Sector as a percentage of GDP (2013 – 2020)](image)


Figure 5: Showing Households’ Awareness of the need for Public Participation in Government Budgeting and Borrowing Decisions

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Figure 6: Showing Households’ Attendance of Public Participation Meetings

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