Do Government Expenditure Inhibit or Promote Economic Growth: Empirical Evidence from Kenya

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ABSTRACT

Every government is a captive institution both from demand side special interests and supply side take over by insiders operating for their own benefit and at the expense of the electorate. State national decline often arises from special interests corrupting a country’s institutions. Such narrow captive interests include crony capitalists (bankers), consumer activists, economic elites and labour unions. Though media does pay less censored attention to government insider-rulers, elected officials, bureaucrats, and public employees, their sphere of economic influence is seismically destructive. In Kenya, these insiders have the ill motive, means and opportunity to co-opt political power for their own benefit and at the expense of national well-being. Political rulers with exorbitant influence in banking and media have enslaved the country for its entire “independent” life. Corruption is an intricate web of fabric upon which fiscal policy is written. Political dynasties continue to thrive fueled by constant media hero worship, economic sabotage and outright brute elimination of any threat to their dominance.

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1. Introduction

Economic welfare depends on economic growth and economic development. Yet a lot of emphasis is on economic growth at the expense of economic development. This could be attributable to data availability and political prominence, which uses economic growth, figures for blanket communication to the electorate. The role of fiscal policy in stimulating growth is poorly understood. In the standard neoclassical growth model, the pace of growth in output over the long-run is determined by growth in labor supply, accumulation of physical and human capital, and technological change. If fiscal policy increases the incentive to save or to invest, the equilibrium capital-output ratio will be altered; thus, the growth rate will rise as the economy transitions to a new higher level of output per capita, but in the long-run it will return to its previous level.

Turnovsky (2004) developed a neoclassical-type model in which changes in tax rates have long-lasting effects on growth. In contrast, in endogenous growth models, an increase in government spending may raise the steady-state rate of growth due to positive spillover effects on investment in physical and/or human capital. Within the endogenous growth framework, Dalgaard and Kreiner (2003), Howitt (2000), Eicher and Turnovsky (1999) and Ghazi (2010) have predicted that growth effect of fiscal policy can be temporary and the speed of convergence may be fast or slow. Thus, with a wide range of models suggesting that fiscal policy could have long-lasting effects on growth, it becomes important to establish empirically whether it does, and if so, what the strength and duration of the effects are.

The recent global economic and financial crisis, and the associated austerity reforms, have resulted in a renewed interest in the dilemma between fiscal sustainability and economic growth. The reason is that after the expansionary fiscal response following the global crisis of 2008, many countries have been suffering from fiscal imbalances due to large increases in government deficits and debt. As a result, many governments, most notably the peripheral countries of the Eurozone, have undertaken large spending cuts and tax hikes for fiscal sustainability. Even in countries with relatively positive fiscal outlook, such as the U.S. and U.K., fiscal adjustment has been at the forefront of academic and policy discussions alike.

Although there is widespread agreement that a reduction of deficit and debt has important benefits in the long term, there are fewer agreements regarding the short-term effects of fiscal adjustment. In the 1980s, Denmark and Ireland experienced improved growth performance after periods of strict fiscal austerity. This result is in contrast to the conventional Keynesian
theory, which predicts negative short-run economic effects of restrictive fiscal policy. Subsequently, Giavazzi and Pagano (1990), Alesina and Perotti (1997), Alesina and Ardagna (1998, 2010) and others investigated this issue and sought to find examples of similar expansionary fiscal adjustments and identify the conditions under which it prevails. As a result, some argue that fiscal adjustment can stimulate economic growth even in the short term, a phenomenon referred to as ‘Non-Keynesian effect’ or ‘expansionary fiscal contraction’.

Many studies developed theory that can explain the existence of expansionary fiscal contractions as well as explored their determinants empirically. Most rely on changes in the cyclically adjusted primary balance (CAPB) to identify fiscal adjustment episodes. The CAPB is an indicator of fiscal policy that reflects discretionary fiscal policy and other noncyclical factors by excluding the automatic effects of business cycle fluctuations on the budget (transfer, tax system, and interest payments). However, Guajardo et al. (2011) were the first to apply the narrative approach whereby they use historical documents to identify fiscal adjustment episodes in OECD countries. Their study fails to identify any expansionary fiscal adjustments and argue that the CAPB measure is methodologically flawed by comparing the CAPB-based approach with their narrative approach.

2. Related Literature

2.1. Theoretical Considerations

There is a general agreement that reducing government debt via active fiscal consolidation contributes to long-run economic growth. However, Keynesian economics advocates the use of automatic or discretionary countercyclical fiscal policies to lessen the impact of business cycles. On the other hand, other schools favour a laissez-faire fiscal policy. In practice, the pro-cyclical fiscal policy is often observed in developing countries due to various reasons such as imperfections in international credit markets that constrain developing countries from borrowing in recessions (Gavin and Perotti, 1997; Kaminsky et al., 2004) or political distortions that intensify the competition of common resources and rent-seeking in booms (Tornell and Lane, 1999; Alesina et al., 2008).

In Kenya, the years 2013 to 2017 is characterized by huge infrastructural fiscal expenditure as an implementation mechanism of projects drawn up by a previous regime. Such a move brought with it huge infrastructural loans especially from The Peoples Republic of China and other external entities. Political rulers and their cronies have used this opportunity to amass wealth through single sourced tenders thereby locking out ordinary hard working Kenyans from
reaping trickle-down economic benefits from such huge infrastructural projects. Gross domestic product statistics would actually improve from such flawed economic activity with economic growth and per capita income figures distorting real economic position of the country. No wonder no mention is ever made of economic development as a campaign tool for political contest. It is a real measure of economic empowerment unlike its nominal counterpart, economic growth which is elitist and a mirage to the working class, a birth right to economic slavery.

Even in advanced countries, pro-cyclical policies such as ‘austerity in recession’ and ‘budgetary expansions during boom’ became common. In this context, there is no consensus regarding the short-run effects of fiscal adjustment. A standard Keynesian model such as the IS-LM framework predicts that a cut in government spending or an increase in taxes reduces the aggregate demand and income directly, which leads to negative multiplier effects on the output indirectly in the short term. In this case, the government debt ratio also may not be reduced as much as expected because both output and tax revenues fall due to contractionary effects of the fiscal adjustment.

However, in the Neoclassical model, fiscal adjustments aimed at reducing the government budget deficit can stimulate the economy with an increase in private consumption and investment through several transmission mechanisms even in the short term, which helps reduce the government debt ratio. Both demand and supply side effects can explain these mechanisms. First, on the demand side, wealth effects or credibility effects are suggested to be at work. Blanchard (1990) proposes a model in which a consumer reacts to two kinds of effects. One is the inter-temporal tax redistribution effect by non-Ricardian agents in a Keynesian model where an increase in taxes decreases consumption.

In the presence of deadweight loss of distortionary taxes, an increase in taxes can eliminate the need for larger and disruptive adjustment above the critical level in the future. As a result, people can expect to increase their permanent income due to the future reduction in the deadweight loss and increase their consumption. He argues that if people exhibit little myopia and the fiscal adjustment is made from a high debt level, consumption can react positively. Bertola and Drazen (1993) present an optimizing model and demonstrate that if a change of fiscal policy induces sufficiently strong expectation of future policy change in the opposite direction, it can cause a nonlinear relationship between private consumption and government spending. If a cut in government spending induces expectation of significantly lower future taxes, it may induce an increase in current private consumption.
Similarly, Sunderland (1997) uses a model that links current fiscal policy and future expected taxes. However, his model emphasizes the dynamics of government debt and considers consumers with finite horizons. At low levels of debt, fiscal policy has the usual Keynesian effects because people expect the debt stabilization programme as something distant from their perspective. On the other hand, at high levels of debt, as a major fiscal consolidation is imminent, people react to government spending in a non-Keynesian way, expecting that they will have to pay more taxes shortly. When debt ratio is near the threshold level, an increase in taxes delays reaching the threshold such that it could induce people to expect higher permanent income and to increase their consumption. In these models, the positive wealth expectation effects can be at work especially when fiscal adjustment occurs with a high and rapidly growing debt-to-GDP ratio. Other mechanisms include credibility effects, which mean that fiscal adjustment could improve the credibility of government finances by reducing the default and inflation risk via the decline in interest rates (Feldstein, 1982).

When a high level of government debt affects interest rate risk premium, a reliable fiscal adjustment can reduce the premium and in turn, the reduction of interest rate contributes to raise people’s permanent income. In addition, lower interest rate can also lead to the appreciation of financial assets which triggers higher consumption and investment. In addition, expansionary fiscal adjustment may take place on the supply side via the labour market and investment (Alesina et al, 2002). If fiscal adjustment is performed through a cut in public spending, especially in the area of public employment, rather than an increase in taxes, it can lead to a reduction of overall wage pressure in the economy and stimulate private employment and investment. This is currently the position in Kenya (April, 2017), where there has been a freeze on public sector employment save for in security, education and health sectors and the salaries and remuneration commission is proposing a harmonization of public sector wages to a manageable status.

At the national level, Kenya’s fiscal policy is curtailing economic development even as its economic growth figures remain promising due to lopsided public guaranteed debt specifically from the Peoples Republic of China to put up several infrastructural projects. Such projects are marred in corrupt practices and kick backs that would put to shame Lulu da Silva’s corruption history.
At the same time, from 2010, Kenya is organized as a sovereign republic, a multi-party democratic state with two levels of government one at the national level and 47 county governments. The legislature exists at both levels with the national level hosting a two chamber parliament consisting of the national assembly and senate while each of the 47 counties has its own county assembly. Such a structure has seen a bloated number of legislators with special seats for political cronies. All the legislators in Kenya are full time employees with huge perks to their bank accounts. No wonder Kenya’s public wage bill is alarmingly skewed to the political rulers. To sustain such a huge recurrent expenditure, the government has to borrow mostly from international capital markets, domestically to a less extent and increase taxes both direct and indirect. Kenya’s structural budget deficit is expanding exponentially with increased interest rate payments for debt just as the cyclical deficit is also rising because the corporate sector in Kenya is struggling to remain a going concern.

**Figure 1**

Kenya’s outstanding public debt from August 2015 to August 2016
A county member of assembly in Kenya, who in most cases is a high school graduate, earns better perks than a university professor. Misplaced priorities stifle economic development as the Keynesian foundation of corrective government actions on market anomalies is shaken to the core. Pure capture of government by supply side insiders for their own preservation is a modern evolutionary idea that would provide sound empirical evidence on survival of political rulers as a species. Kenya lacks a middle class because you either belong to the political ruling class or to the working class.

The working class is deep in debt from student loans and mortgages (car loans, residential matrimonial homes and commercial buildings) and are heavily taxed to support a bloated government. This situation has created political parties in Kenya to be very successful investment vehicles. These parties are owned by the political rulers. Prospective clients who are mostly from the working class take huge bank loans to invest in such political parties to gain elective posts into legislatures. Returns from such investments would challenge Markowitz’ portfolio selection and Fama’s efficient market hypothesis in terms of empirical evidence. Prospects of even more taxes in future are rife in Kenya as the political rulers generate sophisticated ways of retaining their political influence. A case in point is a former devolution cabinet secretary under whose watch the government lost huge sums of money to single sourced tenders, coupled with flawed online payment system, but is seeking to be elected to govern a county government. Illicit money propelling corrupt individuals to political power.
the same way former Brazilian President Lulu da Silva was appointed chief of staff by his hand-picked successor, Dilma Vana Rousseff.

2.2. Empirical Considerations

There has been a considerable amount of empirical research on the relationship between fiscal policy and economic growth, covering different fiscal measures, different sets of countries and using cross-sectional, panel, and time-series regression methods. In a meta-analysis of 41 studies exploring the impact of fiscal policies on long-run growth, Nijkamp and Poot (2004) found that 17 percent of studies showed positive relationships between different measures of fiscal policy and economic growth; 29 percent showed negative relationships; and 54 percent were inconclusive. While they found indications of strong effects of education and infrastructure spending on growth, there was no similar impact of fiscal variables in general. This is not surprising considering mixed effects of different fiscal aggregates, as well as the composition of spending and financing methods used.

Thus, several studies have explored how different categories of public spending influence economic growth. These studies predict that each type of government expenditure can influence growth through different channels. For instance, public investment in infrastructure may affect growth by increasing the quantity of factors of production, while public spending on education and health services have an impact on growth by improving the marginal productivity of human capital. However, some types of public spending such as subsidies on food imports such as subsidized maize imports from Mexico in Kenya in Q2/Q3 2017 in Kenya and military expenditure may not be productivity enhancing in the long-run. They are myopic short-term low-hanging fruits to supply side take over insiders.

The traditional approach of categorizing public expenditure into consumption or current spending, versus investment or capital spending, assumes that the latter generally promotes growth more than the former. Thus, for example, Gupta et al. (2005) analyze data on 39 low-income countries during the 1990s, demonstrating that higher wages tend to lower growth, while higher capital and non-wage expenditure tend to increase it. However, the assumption that capital expenditures are more growth-promoting than current expenditures requires caution since some types of current expenditures are beneficial for growth (e.g. education and training, R&D), while some public investment projects may be “white-elephants” that do not increase the country’s productive capacity.
Consistent with this cautionary note, Devarajan et al. (1996) studied the relationship between expenditure composition and growth for 43 developing countries for the period 1970-1990 and found no significant effect of total public spending on economic growth. But contrary to the commonly-held view, they found that public consumption had a significant positive effect on economic growth, while public investment had a significant negative effect. This negative effect also held for each of the components of government investment, including transportation and communication. The authors interpreted these results as a matter of over-investment in public projects with negative marginal returns.

However, a number of studies contradict the results of Devarajan et al. (1996), at least with respect to some types of investment spending. Fedderke et al. (2006) and Albala-Bertrand and Mamatzakis (2001) examine effects of infrastructure investment on long-run growth in South Africa and Chile respectively, using a vector error correction model (VECM); both studies find a positive growth effect of ‘productive’ public expenditure in infrastructure. Using a similar methodology, M’Amanja and Morrissey (2005) examined the Kenyan case for 1964-2002, also finding a positive growth effect of public investment. Haque and Kim (2003) used fixed- and random effects models to analyze panel data for 15 developing countries for 1970-1987, finding that investment in transportation and communication has a positive impact on economic growth. Likewise, Easterly and Rebelo (1993) used cross-section and panel data of different samples for more than 100 countries and concluded that investment in transportation and communication has a positive and strong effect on growth.

Using panel data for 28 developing countries for 1981-1991, Dessus and Herrera (2000) found that public capital accumulation has a positive long run growth effect. Findings with respect to growth effects of other categories of government expenditure are varied. Using panel data on 120 developing countries, Baldacci et al. (2004) found that spending on human capital (i.e. education and health) is associated with higher economic growth. Baffes and Shah (1998) investigated the relationship between the sectoral allocation of public spending and economic growth, using a sample of 21 low- and medium-income countries from 1965 to 1984. They concluded that ‘human development’ capital investment has the highest output elasticity; investment in infrastructure capital had a positive but much smaller output elasticity, while military capital showed a negative output elasticity in half the countries in the study.

In research specifically on Saudi Arabia, Al-Jarrah (2005) examined the causal relationship between defense spending and economic growth for 1970-2003 using time-series methodologies. He found evidence of bi-directional causalities, wherein higher defense
spending lowered economic growth in the long run. This is consistent with many empirical studies for developing countries. Using annual data for 1970-2001, Al Obaid (2004) investigated the long-run relationship between total government expenditure and real gross domestic product in order to assess the validity of “Wagner’s law” – the hypothesis that public spending tends to rise with economic growth. The co-integration test showed a positive long-run relationship between the share of public spending in GDP and GDP per capita, consistent with Wagner's prediction.

Using OLS regressions, Al-Yousif (2000) showed that measurement of government could influence estimates of its relationship with economic growth: if size reflects percentage change in government expenditure, then it is positively related to growth, but if it is measured as a ratio of government expenditure to GDP, the relationship is negative. Kireyev (1998) tested the relationship between growth in non-oil GDP and public spending using annual data for 1969-1997. His results suggested a significant and positive relationship between public spending and growth in non-oil GDP, wherein a one percent increase in public expenditure causes about half a percent increase in non-oil GDP. In contrast, Ghali (1997) used vector auto regression (VAR) and Granger causality analysis to analyze data for 1960-1996. He found no evidence that public expenditure increased output growth, whether the analysis included total expenditure or expenditures on consumption and investment.

There has been a large empirical literature studying expansionary fiscal adjustment (Non-Keynesian effects) since Giavazzi and Pagano (1990) demonstrated, based on examples of Denmark and Ireland in the 1980s, that large and decisive fiscal adjustment could stimulate private consumption. In the bulk of empirical studies, fiscal adjustment is defined in terms of improvement of CAPB. The individual adjustment episodes are, correspondingly, identified according to how large the fiscal adjustment is over a given period or according to how long is the period over which fiscal adjustment is performed. Two strands of empirical studies have evolved in verifying the above-discussed theoretical views on the possibility of an expansionary fiscal adjustment. One focuses on the factors that are associated with expansionary or successful fiscal adjustment. The other sets out to analyze the effects of fiscal adjustment in terms of macroeconomic outcomes rather than fiscal outcomes such as government debt.

The former seeks to classify the episodes according to the definition of expansionary or successful fiscal adjustment and then to perform a descriptive analysis of the characteristics of fiscal components and other related macroeconomic variables such as GDP and interest rate
before, during, and after the fiscal adjustment period (Alesina and Perotti, 1995, 1997; Alesina and Ardagna 1998, 2010, 2012; McDermott and Westcott, 1996; and Giudice et al., 2007). These studies tend to find that fiscal consolidations based on spending cuts rather than on tax increases are more likely to be expansionary or successful. Some other papers use mainly binary dependent variable model such as logit and probit to analyze which factors determine the success of fiscal consolidation (McDermott and Westcott, 1996; Afonso et al., 2006) and its expansionary effects (Alesina and Ardagna, 1998; Giudice et al., 2007).

McDermott and Westcott (1996) argue that success in reducing debt ratio could be attributed to the size and composition of fiscal adjustments. They show that fiscal adjustment based on spending cuts is more likely to be successful than tax-based ones and that the greater the magnitude of fiscal adjustment, the more likely it is to succeed. Moreover, they show that fiscal adjustment is more likely to fail in a global recession. On their part, Afonso et al. (2006) use logit model to assess fiscal consolidation in Central and Eastern European countries and suggest that spending-based consolidation tends to be more successful. With probit regression analysis, Giudice et al. (2007) conclude that fiscal consolidation is more likely to promote economic growth during periods of below potential output and in case the fiscal adjustment is based on spending cuts.

The latter strand is relatively rare compared with the former. Using panel data of industrial and developing countries, Giavazzi et al. (2000) analyze the general relationship between fiscal policy and national savings and conclude that their relationship can be nonlinear when fiscal impulse is sufficiently large and persistent, similar to previous studies for fiscal policy and private consumption (Giavazzi and Pagano 1990, 1995). Ardagna (2004) also studies the determinants and channels through which fiscal adjustment affect GDP growth. She shows that whether a fiscal adjustment is expansionary depends largely on the composition of fiscal policy, and that spending cuts can lead to higher GDP growth rates via the labour market rather than through agent’s expectation.

On the other hand, Burger and Zagler (2008) analyze the relation between U.S. growth and fiscal adjustments in the 1990’s and argue that non-Keynesian effects prevail through an increase in consumption because of improved consumer confidence and an increase in investment via the labour market and financial market. Afonso (2010) assesses expansionary fiscal adjustment in European countries and finds that fiscal consolidations tend to have long-term expansionary effects, but no significant effects in the short-run. Although there are some differences among these empirical studies in the factors affecting expansionary fiscal
adjustment such as the size, composition, and also initial conditions, overall, the empirical literature provides more evidence in favour of the non-Keynesian effects with the fiscal adjustment episodes identified by the changes in the CAPB based on multiple countries and years or with several case studies.

On the other hand, several papers take issue with the results of empirical studies on the expansionary fiscal adjustment. First, there could be a selection bias or measurement error with respect to identifying fiscal consolidation episodes using the CAPB in addition to spurious correlations and simultaneity issues in the links between fiscal policy and economic activity. Using the same panel data as Giavazzi et al. (2000), Kamps (2006) refutes their finding that non-Keynesian effects are a general and easily exploitable phenomenon by showing that the nonlinear effect cannot be robust if cross-country heterogeneity is taken into account. A different perspective is provided by Song and Park (2010) and Hernández de Cos and Moral-Benito (2011) who suggest that endogeneity of the fiscal consolidation decision to GDP and suggest that fiscal adjustments have negative effects on GDP when taking endogeneity problem via exogenous instruments into account.

Specifically, IMF (2010), Guajardo et al. (2011) and its companion paper, Devries et al. (2011) suggest an alternative way of identifying fiscal consolidations instead of the CAPB. They choose the episodes of discretionary fiscal changes motivated by the desire to reduce the budget deficit following the narrative approach based on historical documents similar to Romer and Romer (2010). They then compare their episodes with those of Alesina and Ardagna (2010) and show that their episodes have contractionary effects on GDP, while the CAPB-based episodes are associated with a rise in GDP. Hence, using the CAPB is likely to lead to a bias toward supporting for non-Keynesian effects. They identify a number of problems related to using the CAPB. First, using a statistical concept such as the CAPB can result in including non-policy related changes caused by other development affecting economic activity such as a boom in the stock market. Second, the CAPB method is likely to ignore the motivation behind fiscal changes.

For example, the rise of CAPB could reflect deliberate fiscal policy for restraining economic overheating, not for reducing the budget deficit. In addition, it could omit some episodes of fiscal adjustment followed by an adverse shock and discretionary fiscal stimulus. Third, the CAPB data could not exclude some cases of offsetting positive changes in the CAPB caused by large one-off accounting operation in the previous year such as the capital transfer of Japan in 1998 and of Netherlands in 1995 which is unrelated to fiscal adjustment measures. Based on
a new dataset, they conclude that fiscal adjustments have contractionary effects on economic activity, and argue that large spending-based fiscal consolidation could not be expansionary.

On the other hand, Alesina and Ardagna (2012) re-estimate the effect again with new episodes identified based on the persistence criterion of CAPB rather than on their size criterion of CAPB in Alesina and Ardagna (2010). Then, they make a somewhat intermediate conclusion that results of two different approaches are not different in that spending-based adjustment cause smaller recession than tax-based one. They also argue that even an expansionary fiscal adjustment is possible when it is combined with monetary policy. In fact, literature such as Alesina and Ardagna (2010, 2012) usually identify the expansionary fiscal adjustment episodes on the basis of ex-post criteria at first and then analyze the characteristics of fiscal and macro variables. Hence, the results of these studies do not necessarily mean that fiscal consolidation generates economic growth. Fiscal adjustment may affect the economic activity and vice versa. In addition, a country that considers fiscal adjustment as a tool for managing debt-to-GDP ratio may be in a situation of comparatively better economic growth.

Therefore, expansionary fiscal adjustment can be a result of self-selection so that the decision to implement fiscal adjustment is endogenous. Despite being cyclically adjusted, the CAPB can be biased toward overstating expansionary effects as Guajardo et al. (2011) speculate. Moreover, as many theoretical studies argue, if wealth effects and expectations are the main channels by which the fiscal adjustment may affect economic activity, the episodes identified by the narrative approach based upon announced plans for deficit cuts can capture the fiscal adjustment and its effects better and more correctly than those identified by the CAPB based on actual fiscal outcomes. The main advantages of CAPB for identifying fiscal adjustments are its simple and easy application. Therefore, if the criteria of CAPB are improved to reflect the problems pointed out by the narrative approach, the CAPB can nevertheless be a useful indicator of fiscal policy.

**Does Composition of Fiscal Adjustment Matter?**

Many studies analyze the effects of fiscal adjustment according to its composition. They generally agree that fiscal adjustment based on the spending side rather than on the tax side is more likely to have expansionary effects on GDP. Fiscal adjustment instances are categorized into two: ‘spending-based’ ones in which the change in the CAPB is mainly (by at least 50 per cent) due to spending cuts. *Tax-based* ones in which the change in the CAPB is mainly (by at least 50 per cent) due to revenue increase (Guajardo et al., 2011, and McDermott and Westcott,
1996, apply the same criterion). In addition, fiscal adjustments could further be split into three types: the ‘pure spending-based’ ones where the improvement in the CAPB is entirely due to spending cuts, ‘pure tax-based’ ones which are totally due to revenue increases, and ‘mix’ cases that combine the two types of adjustments.

First, although spending-based adjustments do not have significant expansionary effects, they also do not have significantly negative effect on GDP and private consumption except in the year of fiscal adjustment. When compared with tax-based adjustments, spending-based adjustments are less contractionary and can even offset the large negative effects of tax-based adjustment because the response of the baseline is in between the responses associated with the two types of fiscal adjustment. On this point, this result is consistent with Alesina and Ardagna (2012). On the other hand, a tax-based fiscal adjustment has a contractionary and statistically significant effect on GDP. While the results for mixed adjustments are almost the same as the baseline, pure tax-based fiscal adjustments decrease GDP significantly and pure spending-based fiscal adjustments appear contractionary, but not statistically significant even at the year of fiscal adjustment.

**Figure 3**

Kenya’s GDP growth rates from 2012 to 2015
An alternative way of investigating the role of compositions is to identify fiscal adjustments based on large changes of fiscal variables rather than by looking at changes of fiscal balance: as an increase in cyclically-adjusted revenues or a decrease in cyclically-adjusted spending. Although this method is different from the conventional method based on fiscal balance, it has a few advantages. First, we can capture some episodes of fiscal adjustment, which might otherwise be excluded. This is the case when fiscal adjustment on spending (revenue) side is offset by counter-balancing change of revenue (spending).

While fiscal adjustment based on an increase in revenues has a largely contractionary and statistically significant effect on GDP and private consumption, fiscal adjustment based on a decrease in spending has a small expansionary but not statistically significant effect on GDP and negligible effects on private consumption.

**Figure 4**
Kenya’s sectoral contribution to GDP from 2011 to 2013
Guajardo et al. (2011) argue that a possible reason for the different effects depending on the compositions of fiscal adjustment is that monetary policy is more favorable with spending cuts. They suggest that central banks conduct monetary stimulus more actively following spending cuts than tax hikes so that the policy rate increases in response to tax hikes and decreases in response to spending cuts. The response of short-term interest rate is significantly different according to the two types of fiscal adjustment only in the year of fiscal adjustment. After the second year, the short-term interest rate falls significantly in both cases. Therefore, this result could partially support the argument of Guajardo et al. (2011) and Weonho et al. (2013) that fiscal policy stances adopted are most effective when aligned with correct monetary policy directives from the central bank.

Figure 5
Kenya’s public debt as a percentage of GDP
3. Conclusion

Keynesian economics rests on the inefficiencies of invisible forces of demand and supply. The existence of market anomalies allows the government to come in and influence aggregate demand in an economy by taking on investments with no immediate financial rewards, which are shunned by for profit organizations. Nevertheless, the government is a veil through which interested economic agents drive their own for profit agendas at the opportunity cost of public good. Huge security tenders, banking and media are tools of influence by the political rulers to perpetually subject the working class to servitude, patronage and beggar status. Kenya is no exception to this unfortunate situation.

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