Social Security: a pillar of inclusive growth for Kenya?

How can a progressive social security system transform Kenya's economy?

Executive summary

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Financial Sector Deepening Kenya (FSD Kenya) is an independent trust dedicated to the achievement of a financial system that delivers value for a green and inclusive digital economy while improving financial health and capability for women and micro and small enterprises (MSEs).

FSD Kenya works closely with the public sector, the financial services industry, and other partners to develop financial solutions that better address the real-world challenges that low-income households, micro and small enterprises, and underserved groups such as women and youth face.

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Executive summary

A comprehensive social security system is a core component of any sustainable economic growth strategy. However, the paradigm in which social security is designed matters. The aim of this paper is to provide the evidence and a theory of change that explain how investments in universal social security designed under a 'citizenship paradigm' can generate inclusive and sustainable economic growth. It identifies pathways through which universal social security could strengthen economic growth in Kenya in the short-, medium- and long-term. These multiple pathways would compound each other, having large spill over effects over time and space that would drive economic growth and greater prosperity for all. It also presents a series of recommendations of how Kenya can build on its current social security framework to harness economic growth through expanding universal social security through the introduction of a universal child benefit that leaves no child behind.

Well-designed social security programmes can stimulate stronger and more inclusive economic growth through a number of pathways

Short-term pathways to growth

Generating higher demand in the economy,

Markets can only function if there is, in fact, a market – comprising cash – to sell into. If markets are restricted in size, the opportunities for entrepreneurs are limited. Therefore, it is important for business that there are consumers with sufficient cash to buy their products and services. One means of achieving this is through the provision of social security, which can place cash into the hands of consumers, thereby generating greater demand across the economy.

At local level, the additional cash from social security transfers can create economic multipliers. Research in Kenya has found multipliers of between 1.3, 1.8 and 2.6 within communities, meaning that each Shilling spent by recipients generates an additional 0.3, 0.8 and 1.6 Shillings. When national social security programmes are introduced, the boost to local economies is consolidated into a national stimulus, facilitating higher economic growth country-wide. One study of eight low- and middle-income countries found that an investment in social security equivalent to one per cent of GDP would generate multipliers of between 0.7 and 1.9.

A fiscal stimulus to support economic recovery from the COVID-19 crisis

Injecting cash into economies is particularly important during a recession and Kenya's economy has suffered badly from COVID-19. If Kenya were to put in place a large-scale social security stimulus package, the economy would receive a significant boost and economic recovery would be facilitated. If the investment in social security continues in the long-term, Kenya's economic growth would be further strengthened, potentially enabling the economy to recover the losses that it experienced from the COVID-19 shock.

Medium-term pathways to growth

Increased investments by recipients of social security in income-generating activities

The guarantee of a regular and predictable income encourages recipients of social security to invest in more productive activities. It can change people's worldview: recipients may no longer worry about feeding their families since they know that, even if the business fails, they will be able to put food on the table. They can make longer-term plans and investments in their own income generating activities. Indeed, they may be more willing to take risks and engage in potentially higher return activities. Globally, and in Kenya, there are many examples of social security enabling families to increase their investments in micro-enterprises and agriculture. A recent study in two counties in Kenya found a 40% increase in revenue for MSEs and a 14% increase in enterprises in just two years, from a universal cash transfer in selected villages. Even old age pensions have helped recipients engage more actively in economic activities. The opportunities for investment in productive activities by recipients of social security transfers are enhanced by the fact that, by having a regular and predictable income, they are regarded as more creditworthy and, as a result, better able to access loans for investment.

Social security helps generate higher levels of employment

It is often believed that, if people receive cash from social security, they will become lazy and stop working. Yet, there is no evidence that well-designed, universal schemes cause people to become more dependent. In fact, global evidence across low- and middle-income countries indicates that, when people access social security schemes, their chances of accessing the labour market are enhanced. Within Kenya, the CT-OVC scheme has strengthened labour force participation by 13 percentage points for those living further from markets while, within HSNP, there has been an 11-percentage point increase in households reporting a positive change to their work patterns. In particular, the introduction of social security benefits can have significant gender impacts by facilitating women's access to employment.

A healthier and more productive labour force

A healthy workforce is a more productive workforce. Yet, low incomes are a huge barrier to accessing healthcare and can instigate a 'medical poverty trap' in which poverty and ill-health reinforce each other in a vicious cycle. When families receive social security transfers and enjoy higher incomes, this feeds through into improved health and nutrition. Recipients can eat more as well as enjoying better quality diets. There is evidence from across the world of social security improving health and access to healthcare. For example, a study across five countries has shown how social security transfers have reduced the likelihood of illness by 37 per cent. There is evidence from Kenya of social security enabling more nutritious diets and positive impacts on health.

Empowering persons with disabilities and strengthening their ability to engage in the labour force

Social security can play an important role in helping persons with disabilities engage in the labour force while also enhancing their productivity. It has been estimated that not offering adequate support to persons with disabilities can reduce national GDP in low- and middle-income countries by between 1 and 6 per cent. A lifecycle system of disability benefits can enable persons with disabilities to engage more actively in economic activities. Persons with disabilities are more likely to find employment – for example, by being able to cover the costs of travelling to work – as well as having the regular and predictable income that enables them to invest in income generating activities. At the same time, it is also critical to provide financial support to children with disabilities to help them build the skills that will facilitate more productive employment in the future.

Mitigating the impacts of shocks and enabling households to recover their productivity

As COVID-19 has shown, covariate shocks and crises – such as natural disasters and external economic crises – can cause significant damage to national economies, especially if the families affected have to sell their productive assets as a coping strategy, meaning that they will struggle to return to the same level of productivity as before the crisis. Household-level shocks – such as ill-health, disability or unemployment – can have similar impacts, inhibiting national economic growth. A high proportion of households in Kenya are affected by shocks each year. As a result, incomes can be very changeable and many families experience some time living under the poverty line: for example, across rural Kenya, through the ten-year period between 1997 and 2007, 84 per cent of rural households spent all, or some time, living in poverty.

Ensuring that producers can address risk and shocks is an essential component of a successful economic growth strategy. There is good global evidence that, if families and producers can access social security, they are less likely to sell their productive assets. As a result, they can bounce back to higher productivity more quickly once the crisis dissipates, offering a boost to the economy. In fact, if the owners of micro-enterprises access social security during a shock, they may be able to weather the loss of income and even maintain productivity. Research in Marsabit during 2020 finds that, despite COVID-19, the income from small businesses increased among HSNP recipients by 20 per cent whereas it fell across Kenya where most owners of small firms were unable to receive protection from social security.

If Kenya were to invest in a comprehensive lifecycle social security system, it could reach the vast majority of households in Kenya with regular income support, providing them with the resilience that would enable them to protect their productive assets and maintain their businesses. If a shock were to hit an area of the country, not only would households already be more resilient due to the regular transfer, the Government could trigger an additional payment for the period of the shock. If such a system had been in place prior to COVID-19, the Government would have found it easy to support families and deliver a fiscal stimulus.

Extending financial services to rural and more remote communities

The potential for economic growth in many low- and middle-income countries is constrained by the absence of adequate financial services in rural and more remote communities. The introduction of social security can be used by governments to extend financial services into these areas. Governments can use the private sector – for example, banks or mobile phone companies – to make the social security payments to recipients. Forward-thinking payment service providers can establish pay-points and use them, not only to pay the recipients, but also to offer financial services – such as loans, savings accounts and insurance products – to all members of the community. In effect, governments can effectively subsidise the expansion of financial services throughout the nation, by giving payment service providers a small fee to deliver transfers.

Long-term pathways to growth

Strengthening the nation's human capital

A successful national economy depends on the quality of its workforce. Therefore, Kenya must invest in the skills of its children and young people, to enhance their productivity and prepare them for their future entry into the labour market. A skilled labour force means that national economies are more competitive and more likely to attract private sector investment. Due to widespread low incomes, Kenya's children face many challenges which, if not addressed, will severely impact on their productivity in later life. These encompass poor nutrition as well as difficulties in gaining a good quality education. Addressing income-related constraints by investing in inclusive social security would help maximise the returns of existing investments in health and education.

For children's potential to be realised, it is essential that they receive adequate nutrition during their first 1,000 days. Nutritional health has a significant impact on cognitive development during a child's formative years which can affect their ability to perform at school. Stunting and a lack of iron in the diet impact on a child's brain development, with long-term consequences: for example, if children experience stunting during their first few years of life, their lifetime earnings can fall by as much as 26 per cent. Stunting can have a significant detrimental impact on economic growth: across low- and middle-income countries, it has caused a total economic cost of US$177 billion per cohort.

Social security transfers can have significant positive impacts on the nutritional health of children. A study has shown that a ten per cent increase in income can improve household food security by five per cent, due to the increase in calories available for consumption. There is a range of examples from low- and middle-income countries of social security reducing stunting and, indeed, of higher incomes improving educational outcomes.

Governments that wish to invest in a high-quality workforce should also ensure that children can access school through to the end of secondary education and be given the opportunities to perform well. International research has indicated that 86 per cent of the variation on educational performance among children is the result of out of school factors, including the home learning environment. Higher incomes – including from social security – have been shown to not only increase the likelihood of children attending school, but to create a better environment at home, to facilitate learning by children.

Therefore, if Kenya were to increase its investment in social security – including through child benefits – the knock-on effects in terms of a more highly skilled and competitive labour force are likely to be significant. An assessment of the costs and benefits of investing in a child benefit for all children across Kenya has estimated that the cumulative increase in earnings among recipients resulting from the benefit up to 2040 would be KES2,900 billion (US$26.35 billion) in 2022 values. This would be the equivalent of 22.5 per cent of 2022's predicted GDP.

Strengthening national social cohesion and building a better investment climate for businesses

Historically, investments in universal social security have been an important mechanism used by governments to strengthen national social cohesion and build more peaceful societies. One of the reasons for Western Europe's economic success has been its investment in universal social security – and other universal public services – following the Second World War. There are also indications that universal, lifecycle social security has helped build more cohesive societies across a range of low- and middle-income countries, reducing the risk of social unrest. In contrast, poverty-targeted social security can undermine trust in government and threaten social cohesion.

If Kenya chooses to build on its investment in the universal Older Persons Cash Transfer (OPCT) to expand its universal social security system, this is likely to engender a more equal and cohesive society, reducing the threat of social unrest. It would enable Kenya to avoid the type of political turmoil and unrest that hit many countries in the North Africa and Middle East region following the 2008/09 global recession, which devastated their economies. Greater social cohesion would enhance the investment climate for entrepreneurs, potentially attracting into the country more foreign investors.

Strengthening the national social contract and expanding government revenues

A major constraint holding back Kenya's economy is limited government finances. The IMF estimates that government revenues in 2021 are likely to be only 16.3 per cent of GDP. This is very low and well behind the revenues found across high-income countries, where rates of between 35 and 50 per cent of GDP are the norm. Due to low revenues, the Government of Kenya is constrained in its ability to invest in good quality, universal public services as well as in other areas, such as infrastructure and agriculture. Consequently, economic growth is also constrained.

By investing in universal social security, the Government of Kenya could, as indicated above, engender greater trust between citizens and the state and create a stronger social contract. The cash that people receive in their hands each month would be visible proof that the Government is committed to improving public services and would encourage citizens to accept higher levels of taxation, thereby building a virtuous circle that generates higher levels of government revenue and more government investment, not only in social security but in public services more generally. As a result, a more propitious environment for stronger economic growth would be created.

The economic potential of social security is influenced by the overall design approach

There are different approaches to building national social security systems, which reflect distinct ideologies, as outlined by Figure 0 1. In its limited ambition and emphasis on low taxes and public spending, programmes designed under the **charity paradigm** – namely, poverty-targeted schemes – overlook the transformative economic potential of larger and more inclusive investments in social security. In doing so, the pathways to economic growth mapped out in this paper are not accessed when countries pursue the **charity paradigm.** In contrast, when programmes are designed from a **citizenship approach** using the principle of universality, this can have a transformative impact on societies and economies through the pathways identified in this paper, viewing social security as a core and necessary component of a healthy and inclusive economy. Therefore, the choice of paradigm direction that countries make when designing social security programmes and systems – as well as their effective implementation – are critical when determining their potential impact on economic growth.

Figure 0.1: The main characteristics of the Citizenship Paradigm versus the Charity paradigm for social security

Kenya has already made significant strides in its national social security frameworks and investments

Over recent years, the Government of Kenya has taken impressive first steps to improve and expand its social security system. In particular, in 2018, Kenya took a major step towards a modern lifecycle system by expanding the OPCT to everyone aged over 70 years of age not in receipt of a public service pension. As such, it can be seen as a positive example to countries elsewhere in the region and, indeed, low- and middle-income countries globally, of what can be achieved with strong political will and a commitment to inclusive rights-based systems. Kenya has demonstrated how Governments can shift from a charity to a citizenship paradigm and progressively roll out universal lifecycle social security programmes over time in a way that is appropriate to their fiscal context.

However, despite positive steps taken recently to build a more inclusive system, the coverage of the population by Kenya's current social security system is low, since it reaches only 11 per cent of households nationally.[1] As a result, the impacts are also limited: for example, the current system reduces the national poverty rate by only 4 per cent.[2] While the system will have some impact on economic growth, the low level of investment and coverage means that the potential economic multiplier effects of Kenya's social security system is limited. Ultimately, these problems of low coverage and low levels of investment are facilitated by an over-emphasis on narrow poverty-targeted programmes designed under a charity paradigm, which hold back Kenya's true growth potential. If Kenya is to harness the true potential of its social security to promote inclusive and robust economic growth – as well protecting the wellbeing of its citizens by realising their right to social security – it must fast-track the journey it has already begun to transition from a charity paradigm to a citizenship paradigm.

Recommendations for investing in Kenya's economic growth through expanded social security

If Kenya were to expand its current social security programme, this would yield significant dividends to help realise the nation's economic potential. The paper demonstrates how Kenya can harness economic growth by expanding social security through the introduction of a child benefit that leaves no child benefit.

Strengthening the national social contract and expanding government revenues

Kenya could choose to invest in the nation's children and promote bottom-up resilient growth by gradually introducing a child benefit for all children as part of the recurrent national budget. Kenya has already begun to successfully pilot the introduction of a child benefit to roughly 8,000 children in the most populous sub-counties of Embu, Kajiado and Kisumu and discussions are on going in government for a mainstreamed long-term UCB to be implemented incrementally.

[1] This estimate only considers the tax-financed schemes OPCT, CT-OVC, HSNP and PwSD-CT, and is based on the total number of households from the 2019 Census—12.1 million households—and, in line with the 2015/16 KIHBS, assumes that on average there are 1.12 older persons aged 70 years and over in households with members 70 years and over in receipt of the OPCT.

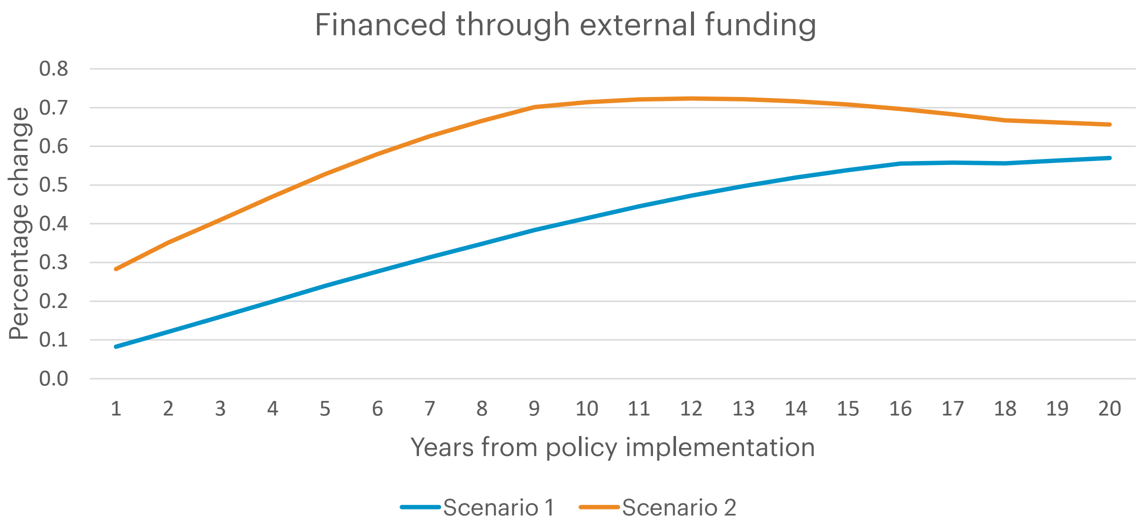
[2] Based on analysis by the authors of the 2015/16 KIHBS datasets but simulating coverage of the universal OPCT.

Table 0.1: Details of scenarios for introducing a child benefit for Kenya included in the CGE analysis

	Age eligibility in first year of programme (2023)	Expansion in age eligibility over time	Year that all 0–17-year-olds are reached	Monthly trans-fer value per child	Cost in first year of programme (KES billion)
Scenario 1	0-2 years (0-36 months or up until child's 3rd birthday)	Children stay on the scheme as they age	2038	KES 800	40.84
Scenario 2	0-9 years (up until child's 10th birthday)	Children stay on the scheme as they age	2031	KES 800	131.60

Computable General Equilibrium (CGE) analysis shows that the two scenarios for introducing a child benefit would boost Kenya's GDP, as presented in Figure 0 2 which shows the percentage change in GDP as a result of each policy scenario if it was financed through two different options for financing methods: externally financed via development partners or internally financed via a combination of corporate and income tax. The positive effects of the child benefit on GDP, tax revenue and employment are highest if transfers are funded through external funding via development partners but still significant if financed via domestic taxation.

The quicker roll-out option in Scenario 2 unsurprisingly results in a faster and larger annual increase in GDP (between 0.48 - 0.71 per cent in year 10 depending on financing methods) than in Scenario 1 (between 0.27 – 0.41 per cent in year 10). The cumulative effect on real GDP would be substantial, **boosting GDP by between 1.7 - 2.5 percentage points** by 2033 depending on the financing method under Scenario 1 and **boosting GDP by between 3.6 – 5.3 percentage points** under Scenario 2.



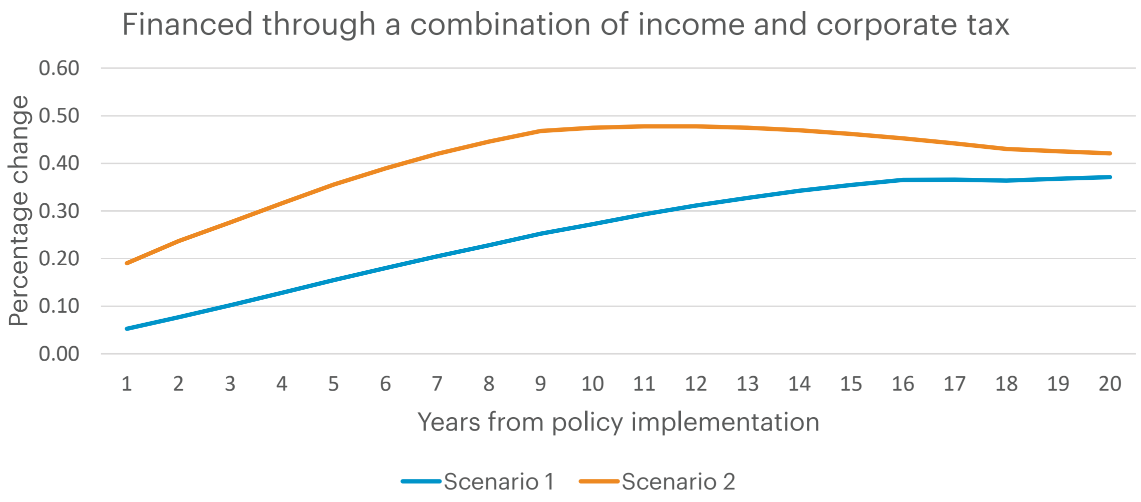


Figure 0.2: Annual percentage change in Kenya's GDP as a result of the two child benefit proposals under different financing methods

Investing in universal benefits – such as the proposed child benefit – is also likely to play a key role in beginning to address weak demand and high public debt in Kenya and promote healthier levels of government revenue over time by stimulating the economy. In fact, CGE analysis conducted for this study suggests that there will likely be a significant increase in tax revenues because of the proposed child benefit options. As Figure 0 3 shows, by 2033, as a result of the increased economic activity stimulated by the child benefit, the two child benefit options are projected to increase tax revenue in Kenya by 4.5 percentage points under Scenario 1 and 6.7 percentage points under Scenario 2. In doing so, the simulated child benefit scenarios can trigger a virtuous cycle in which poverty reduction can also be positively associated with fiscal sustainability.

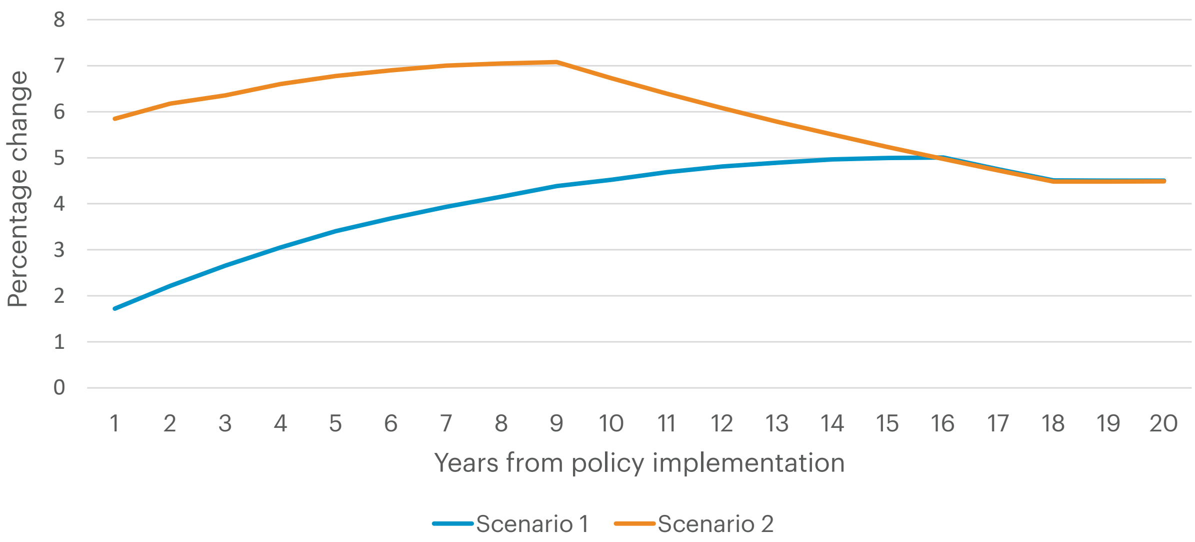


Figure 0.3: Annual percentage change in tax revenue in Kenya as a result of the two child benefit proposals if financed through an equal combination of income and corporate tax[3]

Conclusion

Although social security does not guarantee higher economic growth, since it depends on other factors being in place, it is an essential component of an effective and sustainable economic growth strategy. While Kenya has made good first strides, its current level of investment in social security is too limited to bring about the scale of impact on economic growth found in high-income countries and, increasingly, other low- and middle-income countries. Greater investment in social security – as well as in other public services – will result in a stronger economy and a workforce and businesses that are able to compete in global markets. The Government should not shy away from the fiscal consequences of further investment, since, over time, social security will begin to pay for itself while government revenues will expand, as the national social contract is strengthened. The real concern should come from not investing in social security.

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[3] Assumed to be financed through a combination of corporate and income tax (50/50) with progressive income taxation and unchanged consumption in real terms for the highest income quintile.

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