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KENYA
COUNTRY PARTNERSHIP STRATEGY
FY2014-2018

WORLD BANK GROUP

THE WORLD BANK IBRD • IDA | IFC International Finance Corporation | MIGA Multilateral Investment Guarantee Agency

Country Partnership Strategy for Kenya FY2014-2018

Partnership for Shared Growth and Prosperity

June 2014

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Abbreviations and Acronyms

CURRENCY EQUIVALENTS
(Exchange Rate Effective May 1, 2014)
Currency Unit = Kenyan Shilling
KES 86.9 = 1.0 US Dollar

FISCAL YEAR
July 1 – June 30

AAA	Analytical Advisory Activities
AIDS	Acquired Immunodeficiency Syndrome
AfDB	African Development Bank
CBK	Central Bank of Kenya
CDD	Community-driven Development
CPI	Consumer Price Index
CPIA	Country Policy and Institutional Assessment
CPS	Country Partnership Strategy
CPS CR	Country Partnership Strategy Completion Report
EAC	East African Community
EACC	Ethics and Anti-Corruption Commission
EMIS	Education Management Information System
ESMID	Efficient Securities Market Institutional Development
ESW	Economic Sector Work
GDP	Gross Domestic Product
GNI	Gross National Income
GoK	Government of Kenya
HISP	Health Insurance Subsidy Program
HR	Human Resources
IBRD	International Bank of Reconstruction and Development
ICT	Information and Communications Technology
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IHBS	Integrated Household Budget Survey
IMF	International Monetary Fund
INT	Integrity Vice Presidency
KDHS	Kenya Demographic and Health Survey
KIHBS	Kenya Integrated Household Budget Survey
KNBS	Kenya National Bureau of Statistics
KPLC	Kenya Power and Lighting Company
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MIGA	Multilateral Investment Guarantee Agency
MSME	Micro, Small, and Medium-size Enterprise
MTP	Medium-Term Plan
MW	Megawatt
NADA	National Data Archive
NCCAP	National Climate Change Action Plan
NGO	Non-governmental Organization
NHIF	National Health Insurance Fund
NSS	National Statistics System
OECD	Organization for Economic Cooperation and Development
PFM	Public Financial Management
PforR	Program for Results
PPP	Public-Private Partnership
PRSP	Poverty Reduction Strategy Paper
SBA	Sustainable Business Advisory
SCD	Systematic Country Diagnostic
SME	Small and Medium-size Enterprise
SSA	Sub-Saharan Africa
STATCAP	Statistical Capacity-Building Project
TA	Technical Assistance
UNFPA	United Nations Population Fund
VAT	Value-added Tax
WBG	World Bank Group
WBI	World Bank Institute
WSP	Water and Sanitation Program

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Kenya's path to shared prosperity

Kenya can be one of Africa's success stories. Its dynamic private sector, rapidly growing number of young people, new Constitution and recent peaceful elections are important ingredients in Kenya's journey to secure growing prosperity shared across all communities in the coming years. Yet poverty is high and income inequality persists; 4 out of 10 Kenyans are poor and the richest 10 percent of the population receive 40 percent of the nation's income.

What will it take to end extreme poverty and promote shared prosperity by 2030? And how can the World Bank Group—the IFC, MIGA, and the International Development Association—help in that journey over the next few years?

These questions shape the World Bank Group Country Partnership Strategy which has been prepared in close consultation with the Government of Kenya, county governments, the private sector, civil society organizations and international development partners. The report highlights the need for economic growth to take off at rapid, sustained rates and in sectors that are most likely to reach the poorest. The private sector can lead the expansion by creating jobs, with Government playing a constructive role in setting an environment that helps firms operate competitively.

Growth must be inclusive, however, so that prosperity can be shared by all. It cannot be right that so many Kenyans face a life full of hardships largely because of the place of their birth and family circumstances rather than their own talents and toils. Inclusive growth requires improving the health care system, ensuring young people are fit for work, boosting agricultural performance in low income rural communities, protecting the poor from the impact of disasters and climate-related changes, and making cities more livable.

Growth should also be accountable. The 2010 Constitution was a major step forward including provisions to promote gender equality and strengthen anti-corruption and oversight agencies. It also introduced a decentralization process at a scale never seen before elsewhere.

These are big challenges. We are striving to provide US$4 billion or more of new resources in the coming years to support the ambitious national agenda in promoting sustained, inclusive, and accountable growth. The World Bank Group is proud of its long-standing relationship with Kenya, and looks forward to collaborating with national and international partners—in the public and private sectors. Working together, Kenya can realize its potential to lift millions of families out of poverty and become a truly modern economy.

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Photo: KPLC

Executive summary

1 **Kenya can be one of Africa's success stories.** It holds great potential including from its growing and youthful population; dynamic private sector; a platform for change laid down by the new Constitution and recent peaceful elections; and its pivotal role within East Africa and further afield. Yet poverty remains high with 4 out of 10 Kenyans living in poverty and the richest 10 percent of the population receiving 40 percent of the nation's income. Governance concerns persist; and growth, while solid, has been constrained by low investment and low firm-level productivity and has yet to take off at the rapid, sustained rates needed to transform the lives of ordinary citizens.

Progress and prospects: Diagnostic review of the country context and development agenda

2 **This strategy is based on a systematic review of evidence to identify the key challenges and opportunities for Kenya to accelerate progress toward the twin goals.** The poverty rate fell from 47 percent in 2005 to 39 percent based on best estimates in 2012. Some social indicators have improved notably, yet inequality is high (Gini of 47.4); there are significant differences in opportunities and outcomes between women and men, for those living in the remote and most underdeveloped regions, and ethnicity remains an important factor in societal development. Looking ahead, ending extreme poverty by 2030 would imply a cut in the poverty rate of 2 percentage points each year, likely requiring the economic growth rate to double and inequality to halve. To unlock rapid and uninterrupted growth that is sustainable and inclusive, Kenya must address the key binding constraints of low investment and low firm-level productivity. Faster growth needs significant policy reform to redirect public spending to meet growing infrastructure needs. It also needs an improved business environment that encourages private sector expansion and carefully manages the tax burden on business.

Vision: Government priorities and medium-term strategy

3 Kenya wants to be a globally competitive and prosperous nation with a high quality of life. "Vision 2030", a broad-based agenda straddling the current and previous administration, rests on three pillars: economic, social, and political. The economic pillar envisages moving up the value chain in key areas, including agriculture and financial services, to consistently deliver 10 percent annual growth. The social pillar focuses on investing in people, including in education, health, and housing, and with a focus on women, youth, and vulnerable communities. The political pillar seeks to "move to the future as one nation," including improving the rule of law, transparency, and accountability. Vision 2030 is operationalized by the second Medium-Term Plan (MTP2, 2013-17), and this national agenda is entirely consistent with the Bank Group's global timeline targeting an end to extreme poverty. This, together with stakeholder input gathered in extensive consultations, provides a good anchor for this Country Partnership Strategy (CPS).

Development challenges and opportunities

4 Against this backdrop, achieving rapid and uninterrupted growth over a decade or more is the foundational challenge. The Government's second Medium-Term Plan calls for huge investments in infrastructure. A key opportunity here is to leverage private sector resources through innovative public-private partnerships (PPPs), which are currently underdeveloped. To underpin a sound macroeconomic framework, a renewed effort is merited to help stabilize the wage bill. A more forceful initiative is needed to improve the business environment, including tackling some of the deficiencies pinpointed in World Bank Group (WBG) analytical work. Much of this change agenda will only be possible when relevant, accurate, and timely statistics are produced to inform policies and help evaluate programs.

5 Placing a premium on human development is essential from several vantage points. Growth must be inclusive so that prosperity can be shared by all. From an equity perspective it cannot be right that maternal mortality is among Africa's highest at 488 deaths per 100,000 live births; and many lack access to food security, clean water, good healthcare, and proper housing. Youth unemployment at 21 percent is double the adult average. Equipping young people with a modern education and job opportunities is essential to make the most of their talents. Cities must not only generate economic activity but also provide basic services for those who dwell in them. And the cohesiveness of Kenyan society calls for renewed efforts to include the marginalized and disadvantaged. To curb poverty, growth must take place in sectors where the majority of the poor live. Investment must be redirected to projects closer to the poor, including improving agricultural productivity in rural areas, expanding and targeting unified social protection programs that keep people from slipping into poverty, attracting private sector investment and participation into education, and improving service delivery in health at the local level.

6 The changing institutional landscape is undergoing a tectonic shift with powers and 30 percent of government revenues moving from the national government to the 47 new county administrations. This transition is truly historic and few countries have attempted anything on this scale. The

forthcoming challenge is to deliver a "devolution dividend" through greater citizen engagement, direction, and oversight of public authorities to fundamentally deliver better services to ordinary people; building new local governmental structures that are responsive and responsible; and fresh inter-governmental relationships, including resource transfers that translate policy priorities into meaningful on-the-ground services.

7 **All of these opportunities would be amplified by improved governance and reduced corruption, or undermined by any deterioration in the prevailing environment.** In moving forward the WBG will be firm in its intolerance for corruption and desire for impunity to end, while setting expectations sensibly to make step-by-step progress. There are opportunities to continue improving public financial management, corporate governance standards, openness, transparency, and accountability in government; and to maintain robust safeguards. Such an "institution-building" approach will protect not only the integrity of WBG resources but also Kenya's internally generated resources that contribute to 90 percent of all public spending.

Strategic options to make the most of the WBG assets

8 **To help Kenya address these challenges, this CPS draws on a fruitful country relationship established over several decades and sets out how the combined resources of the Bank, IFC, and MIGA can best help Kenya fulfill its ambitions of becoming a modern economy in which growing prosperity is shared across all communities.** The Bank will use a "selectivity test" that deploys a four-pronged benchmark to guide the deployment of scarce resources to maximize the prospects of success: (a) confirming a credible line of sight to make a sustainable impact on poverty and prosperity; (b) critically reviewing WBG capability and comparative advantage, including assessing opportunities for WBG collaboration; (c) cementing client ownership; and (d) calibrating client capacity and accompanying project design. The selectivity test is used in a cascading fashion to establish the three domains of engagement, the sectors within each of the domains, and to make trade-offs between particular operations and analytical advisory activities (AAA).

9 **The first domain of engagement is competitiveness and sustainability.** Improving infrastructure and the business environment, while being responsive to environmental pressures, is the backbone of long-term growth. WBG policy advice will help the authorities create a well-functioning and properly regulated energy market; IDA financing will be used for some publicly merited investments; and IFC and MIGA instruments will help leverage more private resources. More broadly, the Bank Group will redouble its support to public-private partnerships, especially in the water and transport sectors where there is medium-term potential. On transport, the focus of new IDA lending will be on significant rural feeder roads within and between counties to connect communities to emerging economic opportunities. Competitiveness can also be enhanced through improving the business environment, unleashing the potential of specific sectors and geographic locations, and ramping up financing sector and capital market development. The Bank will support the Government's oversight of the rapidly emerging oil and gas sector. Both IFC and Bank resources will be deployed to help create private sector

jobs and try to make cities livable and sustainable, with a special focus on secondary cities where poverty is proving most stubborn.

10 **The second domain of engagement is to protect the vulnerable and help them develop their potential, which is critical to sharing in prosperity.** Social protection plays a pivotal role—the Bank's strong engagement will be maintained. Health is also a pressing priority; in this sector the combined resources of IDA and IFC, alongside global funds and other partners, will be scaled up. Another key to help target support for the poor is to focus on agriculture, a high priority since it has such a direct link with helping families in rural areas where a majority of Kenyans live. Potential IFC investments in infrastructure, agro processing, and financial institutions further support the goal. The burgeoning youth population brings opportunities and challenges for WBG support in education, jobs, and skills. Protecting the poor who are disproportionally impacted by climate variability will also be an area of support. And across the board the gender focus of WBG operations and analytical work will be upgraded, including support for female education, entrepreneurship, and rural women's groups.

11 **The third domain of engagement focuses on building consistency and equity.** This is a really long-term drive that has devolution at its core. The Bank's large-scale capacity-building and AAA program will inform a series of IDA operations to help counties and national agencies to make devolution work. Upon request, the Bank would assemble and manage a Trust Fund framework to maximize donor coherence in this fluid arena. IDA investments will support a more evidence-based approach to policy making, public spending, and public administration reform. The consistency of Kenya's development will be buttressed by deepening regional integration with its neighbors; and WBG investments will be made in multi-country projects, including in energy and transport.

12 **Individually and collectively the achievement of sustainable development results will only be possible if they are bound together through a connecting platform of garnering good governance, which in some ways has been an Achilles heel in the past.** The WBG support has at its heart supply-side capacity building to strengthen oversight institutions, including support for better public financial management and for more effective institutions of accountability, combined with demand-side accountability such as the use of open community meetings for beneficiary engagement. The Bank will continuously review the impact of project-level governance measures that have been put in place, scaling up those that have been effective, including drawing on input from the WBG's Integrity Vice Presidency (INT) on project safeguards and institutional support to agencies such as the Ethics and Anti-Corruption Commission (EACC). The WBG will deploy "corruption calibration" to its lending program—adjusting areas of focus and/or scaling back resources in the event of issues, which threaten the security of IDA and IFC resource use.

Implementing for results

13 **The strategy incorporates a results-focus in this CPS and in specific operations and is flexible in responding to new conditions and information such as updated poverty data in due course.** Targeted outcomes have been articulated in a multi-sector fashion, reflecting the interdependence of products across the strategy. The Bank Group's efforts to manage for

results across the country program are built on country systems and capabilities for measuring and monitoring progress. Collaboration across the Bank Group and with other partners will be purpose driven in specific areas such as business climate, financial sector, public-private partnerships, energy, and agriculture. The selectivity test is already pushing the Bank Group to expand in some fields—such as supporting secondary cities, promoting rural development and devolution—and tapering Bank involvement in others such as highways, natural resource management, and legal reform. This process is dynamic, and the assessment will be continuously updated.

14 **The WBG could be providing over US$1 billion per year to Kenya over the life of this CPS.** Careful portfolio management will continue to be an important ingredient of the drive for results—with tailored approaches to suit the particular circumstances of Bank, IFC, and MIGA investments. IFC is targeting portfolio expansion perhaps even beyond the US$785 million of commitments at mid-FY14 if market conditions permit. MIGA's current total exposure to Kenya is US$255 million, and international investors' interest in infrastructure, power, and agri-business sectors provides potential for this to expand further. The Bank's annual commitments will be governed by the IDA17 settlement, provisionally assumed at around US$600 million each year. This will build on the IDA portfolio in Kenya of US$4.3 billion at mid-FY14, covering 23 national projects (US$3.5 billion) and 7 regional projects in which Kenya is a partner (US$0.8 billion). It is important to continue to "move to scale" especially in IDA investments, but also in IFC commitments, by focusing on larger projects and the judicious use of additional finance.

Managing risks

15 **Any instability in the macroeconomic environment would probably be the single most damaging factor to overall poverty prospects.** The mitigation strategy revolves around the long-term drive to improve competitiveness and exports, combined with a prudent strategy on reserves and international capital access to cope with potential volatility. Disasters and insecurity, natural or man-made, can be expected to occur even though their timing and severity typically cannot be predicted; and the Bank Group and its partners will seek ways to help cope with such risks in the future. Other strategic risks include unexpected changes in political leadership, policy direction and ministerial leads in key sectors, funding priorities of other donors, or a loss of appetite of strategic partners for IFC- and MIGA-supported deals. Each of these would require nimble re-engagement to prevent changes unduly affecting the WBG-supported program. Finally, operational risks include a worsening of the governance and corruption environment, including in new county administrations as their activities expand. The mitigating measures include (a) the thrust of this CPS to help garner good governance, including as part of the devolution process; (b) active cooperation between INT, the Bank, and the authorities in order that preventive measures are built into project design, and allegations when received are handled firmly and decisively; and (c) good communication with stakeholders, including the Board, so due proportionality can be applied in any strategic response needed by the Bank.

KENYA COUNTY MAP

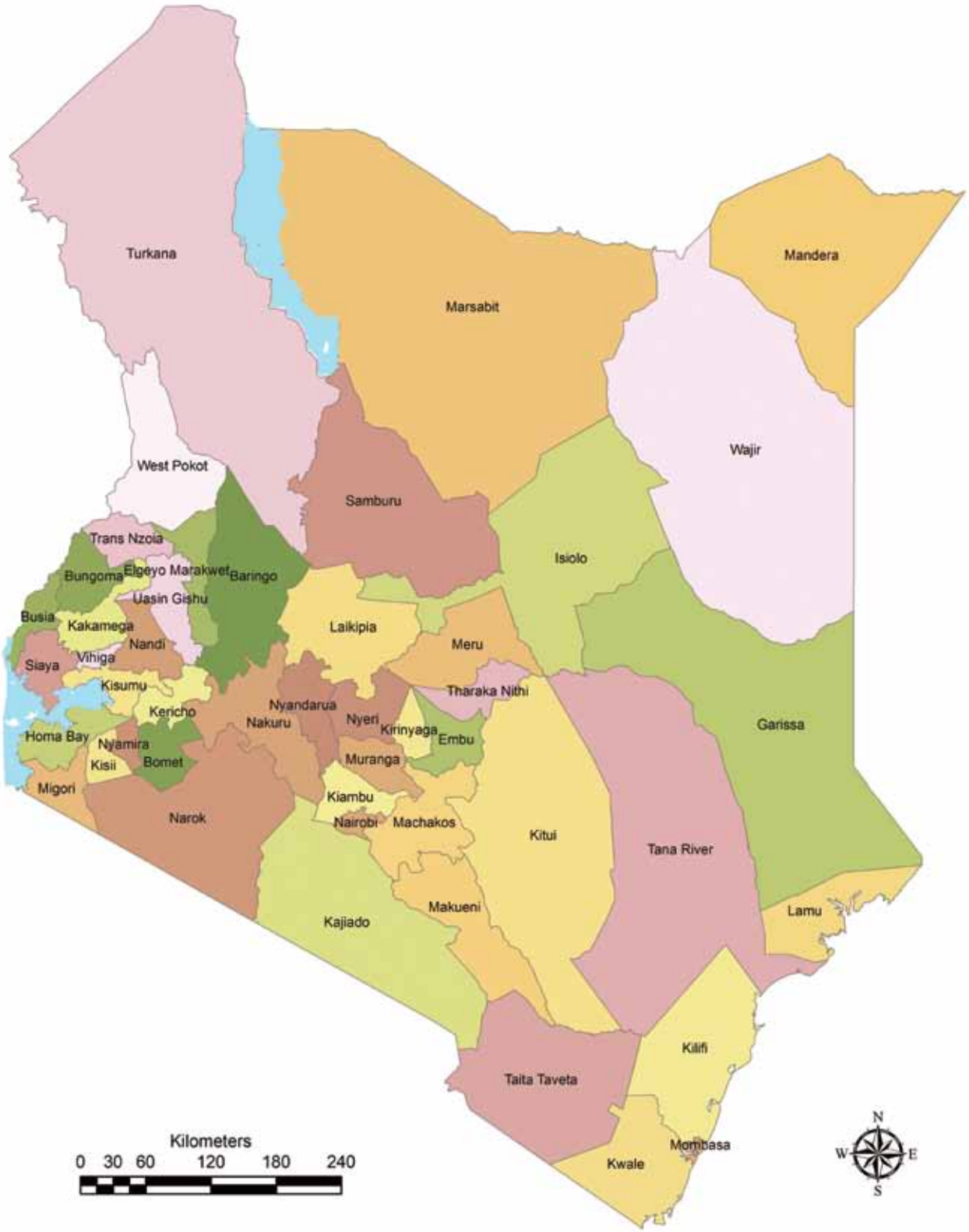



Photo: World Bank

Introduction

1 **Kenya can be one of Africa's success stories.** Its outlook is one of hope and positive prospects, with huge development opportunities combined with substantial challenges. It holds great potential including from its expanding and youthful population; dynamic private sector; a platform for change laid down by the new Constitution and recent peaceful elections; and its pivotal role within East Africa and further afield. Yet Kenya's poverty rate remains high and governance concerns persist. Growth, while solid, has been constrained by low investment and low firm-level productivity and has yet to takeoff at the rapid, sustained rates needed to transform the lives of ordinary citizens. This World Bank Group (WBG) Country Partnership Strategy (CPS) draws on a fruitful relationship established over several decades. It sets out how the combined resources of the World Bank, IFC, and MIGA can, in line with the WBG's twin goals—eliminating extreme poverty by 2030 and boosting shared prosperity—best help Kenya rapidly reduce poverty and fulfill its ambitions of becoming a modern economy in which growing prosperity is shared across all communities.


Photo: World Bank

I. Progress and prospects: A diagnostic review of country context and development agenda

A. Trends in poverty and shared prosperity

2 **This CPS is based on a systematic review of evidence from within and outside the WBG as well as an extensive consultation process.** The analytical approach has drawn upon the emerging principles that guide the new systematic country diagnostic (SCD) approach. A formal systematic country diagnostic document would be premature at this point and hence has not been developed. A wide range of perspectives and input from Kenyan counterparts complements the analysis. The consultations, which were conducted in various locations across the country, included representatives from national government, county governments, the private sector, including business leaders, non-governmental organizations (NGOs); development partners; and respected Kenyan development practitioners.

3 **Poverty reduction is clearly the single most pressing issue and while Kenya's poverty rate has been falling—from 47 percent in 2005/06 to about 39 percent based on best estimates in 2012/13—several formidable challenges lie ahead.** There is a pressing need to solidify estimates with more recent data since Kenya's last household budget survey was in 2005/6. The Government intends to conduct a new survey in 2014, and the Bank is supporting such plans. Poverty reduction has been driven by solid growth across most of the economy, together with some improvements in social safety nets targeting the poor and continuing migration to urban areas—especially metropolitan Nairobi—that offer better job prospects (albeit largely in the informal sector) as well as easier access to health and education services. The distribution of the nearly 4 in every 10 Kenyans living in extreme poverty—"Kenya's bottom 40"—is by no means even, most notably with a growing rural-urban split that needs action on both sides. In the remote, arid, sparsely populated north-eastern parts of the country (Turkana, Mandera, and Wajir), poverty rates are above 80 percent; agro-climatic shocks impact vulnerable livelihoods that depend on livestock and low-productivity agricultural activities; and people's assets, including educational opportunity and

achievement, are very limited. The populations in the western and coastal parts of the country benefit from better natural resource endowments; but the poor remain especially prone to contracting insect and water-borne diseases, and agricultural potential has been limited by the effects of flood-induced, land degradation in certain rural areas.

4 Tackling poverty must address both the difficulties of low-income, rural communities and the distinct problems of urban poverty that also encompasses secondary cities. The proportion of Kenya's poor that live in major cities other than Nairobi has increased from 17 to 22 percent over the past decade, suggesting that economic growth in these urban settlements was unable to absorb the population growth. And even though the poverty rate of 22 percent in Nairobi has been falling and is low compared to the rest of the country, the absolute numbers of poor and their concentration in informal settlements remains high. Across the country women tend to fare less well than men in many dimensions, including being much less likely to find a job in the formal labor market and earning lower wages when they do. Women in rural areas have less access to income-producing assets such as land and credit, and receive lower incomes for comparable farm work in rural areas. Poverty is also more prevalent among large households (the poorest families have 5.2 members compared to 3.5 members in more well-off households).

5 Income inequality levels are not likely to have decreased in recent years, and achieving inclusive growth remains a development objective. Kenya's Gini coefficient of 47.7 is above that of neighboring comparators, including Ethiopia, Tanzania, and Uganda. The richest 10 percent of the population garner 40 percent of the nation's income, whereas the poorest 10 percent receive only 2 percent of national income. There is domestic interest in addressing this challenge and the WBG support to promote shared prosperity meets with a warm reception. While fostering income growth of the bottom 40 is not currently a target set explicitly by the national authorities, in practice it is currently equivalent to fostering income growth of the extreme poor. The WBG team is working with the authorities on this challenge, in an effort to convey the importance of securing a reduction in inequality as one step toward ensuring that attainable growth can meet the overarching target to end poverty in a generation.

6 Significant investment and economic reform must be part of the effort to cut the poverty rate by 2 percentage points each year from now to 2030 if extreme poverty is to be ended in that timeframe. Simulations—which will be refined once more up-to-date poverty statistics become available with Bank support in 2015—show that both the pace and extent to which economic growth is inclusive will have a major influence on the poverty outlook (see Annex 7). Eliminating poverty by 2030 in Kenya is beset by two formidable challenges: the rate of economic growth would need to double; and inequality, measured by the Gini coefficient, would need to be halved. If growth remains at historic levels of around 4 percent per year and inequality remains unchanged, poverty rate will fall to 35 percent by 2018 and to 27 percent by 2030, as shown in Table 1. The progress in poverty reduction depends strongly on what happens to inequality in the country. If inequality falls each year by one percentage point, with a GDP growth rate of 4 percent, the poverty rate would fall to 28 percent by 2018 and to 11 percent by 2030. Under this inequality reduction scenario, the goal of eliminating extreme poverty is attainable if annual GDP growth rates increase to 6 percent. However, if inequality worsens this goal would not be tenable in the medium term.

TABLE 1: *Projected poverty rates for different growth and inequality scenarios*

	2018				2030		
	Inequality scenario (% growth in Gini coefficient per year)						
		-1	0	+1	-1	0	+1
GDP scenario (% growth per year)	+4	27.6	35.4	41.6	11.1	27.4	41.1
	+6	19.8	28.5	36.3	1.9	13.1	29.3
	+8	14.2	22.9	30.8	0.19	5.9	21.4
	+10	9.4	17.9	26.6	0.017	2.8	16.1

Note: These estimates are computed using the observed 2005/06 distribution of per capita consumption and observed GDP per worker growth rates up to 2012, and projected overall GDP scenarios thereafter (not factoring sectoral dynamics) based on baseline fertility rates.

7 **Beyond the poverty data, it is also important to account for non-income dimensions of well-being.** Kenya has met the targets of relatively few Millennium Development Goals (MDGs) as analyzed in Annex 7. The recent UN report on the post-2015 development agenda has drawn attention to how factors beyond the direct poverty metric need coordinated international support. In Kenya, some social indicators have improved: notably falling children's mortality (from 102 deaths per 1,000 live births in 2000 to 73 in 2012), near-universal primary school enrolment, and narrowing gender gaps in education. Some improvements have been secured through well-targeted interventions such as the extensive deployment of insecticide-treated bed nets to guard against malaria, and increased public spending (albeit not typically used efficiently) on lower-level education. While prevalence of HIV/AIDS has been ameliorated thus meeting the targeted MDG, it is still a pressing issue for certain segments of the population. But other indicators remain stubbornly vexing. Secondary school enrolments are at a low 32 percent, and learning achievement levels are well below their potential and what is needed to fuel a modern market economy. And maternal mortality is among the highest in Africa with 488 deaths per 100,000 live births. This prompted an immediate policy response by the new Government to provide maternal healthcare for free at all public health facilities.

8 **There is also an important "jobs lens" through which to view people's sense of engagement in and benefit from the country's development.** Kenyans rate "tackling unemployment" as a top priority for the Government, which in fact has set an ambitious target of creating 1 million new jobs annually. Within this target there is a special need for jobs for the growing youth cohort; each year more and more young people are graduating from school and college and facing a rather despondent task of finding work. Kenya needs an acceleration of structural change that creates more high-productivity (modern) jobs in the formal sector (currently accounting for 1 in 7 jobs). Yet, it must also help grow jobs and improve conditions in the informal sector, not least in the family farm and off-farm sectors in which nearly half of all Kenyans work.

9 **Enabling people to realize their potential and lifting them out of poverty involves, at the most basic level ensuring that they are healthy, educated, and have basic life skills to be able to participate in social and economic life.** This is part of a broader drive to solidify the nation's social capital, which has been enhanced by the widespread support for the

new Constitution adopted in 2010, and the free, fair, and peaceful elections in 2013. The tragic terrorist atrocities in Nairobi, however, serve as a reminder of the importance of domestic security in all its facets, including curbing crime across-the-board and upholding the rule of law.

B. Drivers and constraints of economic growth

10 **GDP growth has played the main role in reducing poverty, but the average rate of 4.6 percent annually over the last decade is not sufficient to end extreme poverty by 2030.** On the positive side, for the first time in a generation Kenya avoided an "election disruption" to growth in 2013, helped by the new Constitution adopted in 2010 that set the platform for peaceful elections. It has drawn on its strong track record in economic management (its 3.9 rating in the Country Policy and Institutional Assessment was Africa's highest in 2012 as well as a prudent debt position). It has a vibrant private sector and financial services industry; and IFC increased the number of transactions per year by a factor of 4 between FY09 and FY13. The country also has regionally important assets, including a financial sector hub, port, and airport. All of this has delivered decent growth; but, on a per capita basis, as Figures 1 and 2 show, itis trailing behind Kenya's peers.

11 **What has held back growth? Kenya has been hampered by low investment and low productivity that in turn clog the "export engine".** There has been a weak contribution of capital stock to GDP growth as shown in Figure 2. Private sector investment, at around 15 percent of GDP, is below that of competitors; and foreign direct investment at 1 percent of GDP in recent years is far below what could be achieved (e.g., Tanzania and Uganda attract foreign direct investment of about 5 percent of GDP). Public investment has also been constrained. That is not principally because of inherently inadequate funding considering Kenya collects revenue of around 24 percent of GDP annually—a leader in Africa. That strong performance has been driven by progress in economic policy and reform, including the review and update of the Value Added Tax (VAT) Law, supported by the US$750 million IMF External Credit Facility (ECF), which was completed successfully in December 2013.

FIGURE 1: *Kenya's GDP per capita – Underperforming its peers over the long term*

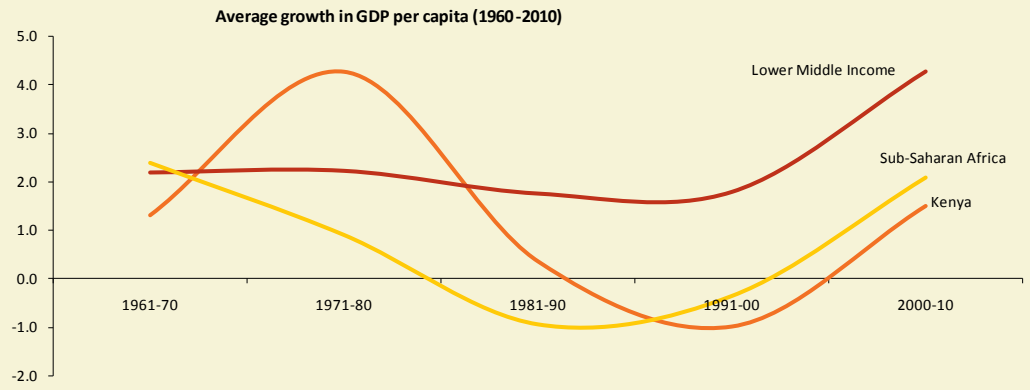
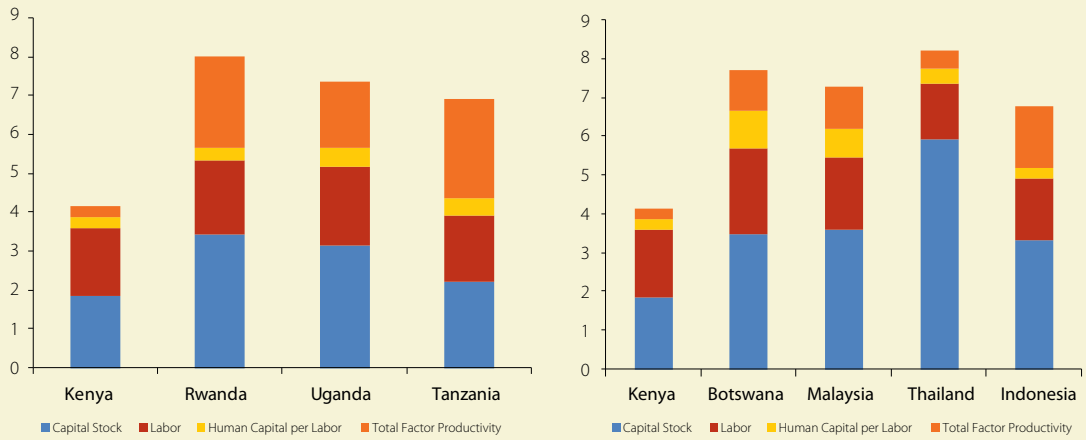


FIGURE 2: *Contributions to growth (in percent of GDP), 2000-2011 annual average*



Note: The left chart shows regional comparators; the right chart some global comparators. The period corresponds to high growth period for Botswana (1985-2000), Malaysia (1980-1997), Thailand (1985-1997), and Indonesia (1980-1997).
Source: World Bank.

Rather a significant share of the tax revenue has to be deployed on a substantial public sector wage bill that is high by international standards. This means that while public sector development expenditure has edged up over the past decade, it is constantly under pressure and needs more room to increase.

12 **Low productivity and low returns that constrain private investment persist for several reasons.** First, essential infrastructure services such as energy and transportation are too costly and inadequately supplied. Second, the environment for doing business, where Kenya notably lags its competitors, has weaknesses, including governance and corruption challenges, and regulatory frameworks, which in some cases are not well enforced and in other cases are too burdensome. Third, human capital has been improving and is relatively good compared to many other low-income countries in Africa, but still many firms—especially those competing on international markets—cannot secure the workforce to drive their growth. And fourth, limited access to finance often with overbearing requirements for collateral (e.g., for rural businesses), means companies in arid counties and small entrepreneurs are not grasping many growth opportunities. This is part of the broader challenge for the economy to mobilize domestic savings to direct toward investment needs. Many of these issues can be addressed at least in part by policy and market reforms, emulating some of the positive steps, such as trade reform and energy market liberalization that Kenya has taken in earlier years. Good clear laws backed by a strong and credible judiciary are an essential element in creating an environment that is conducive to business and financial activity to promote credit to a wider population.

13 **To unlock rapid and uninterrupted growth that is sustainable and inclusive, the WBG will continue to address significant binding constraints of low investment and low firm-level productivity.** The Government has been committed to fiscal discipline and the primary budget balance of the central government has remained at reasonable levels. The authorities seek to re-orient fiscal policy to

providing infrastructure investment that lowers the cost of doing business. In addition the Government targets improving the business climate—part of which involves pursuing a careful tax policy that removes distortions and avoids undue burdens on private enterprise that could stifle entrepreneurship. Spending at national- and county-level government falls under the Public Financial Management (PFM) Law and within the Integrated Financial Management Information System (IFMIS), which should limit the risk of overspending and emphasize lowering non-priority outlays.

14 **Kenya's public sector debt remained sustainable with low risk of distress.** Overall, fiscal policy and borrowing decisions remained in line over the medium-term plans and its debt management strategy. Kenya's external debt has remained sustainable, largely on account of prudent borrowing on non-concessional terms while Government guarantees were limited to energy-related projects. According to the 2013 Debt Sustainability Assessment, the Eurobond issuance planned for the first half of 2014 does not change the favorable conclusions of Kenya's external and public debt position. Going forward, Kenya has planned a fiscal consolidation path of achieving a net public debt ratio of about 40 percent in 2017/18 and a deficit of 3 percent meeting the fiscal convergence criteria of the East African Community (EAC) Monetary Union much earlier than 2024.

15 **Appropriate monetary policy has kept inflation within the Central Bank of Kenya (CBK) target range (5,±2½, percent) for more than one year while the banking sector has built adequate capital buffers.** Average inflation in 2013 was 5.4 percent compared to 9.4 percent in 2012 and 14.0 percent in 2011. After the policy mishap in 2011, the Central Bank adopted a prudent approach by keeping its policy rate constant at 8.5 percent since mid-2012. In the banking sector, banks are implementing enhanced CBK-prudential guidelines in advance of the end-2014 deadlines. Kenyan commercial banks are increasing their capital adequacy buffers in line with individual banks' risk profiles, adopting more stringent provisioning requirement for non-performing loans and introducing contingency liquidity provisions into their planning in response to revised CBK-prudential guidelines.

16 **Kenya's external position has substantially strengthened.** The high current account deficit that has afflicted Kenya since 2005 and exposed its external vulnerability abated in 2013 to 8.4 percent of GDP due to tight fiscal and monetary policies, good weather, and improving exports of financial services. This also happened in an environment of a substantial increase in capital-goods imports emanating from foreign direct investment in oil-exploration equipment. Capital inflows and the participation of foreign investors in domestic bond markets have increased, attracted by high domestic interest rates and a stable exchange rate reflecting strong foreign investors' interest in Kenya's stock market and increased appetite for medium-term government securities. In addition Kenya has succeeded in building up international reserve buffers to above US$6.6 billion around 4.5 months of projected imports despite a large deterioration of the terms of trade. The strong external position has increasingly supported the shilling; improved public debt sustainability has placed the government in a more comfortable position to access international capital markets.

17 **Several sectors have performed particularly well, including high-value horticulture, tea, tourism, financial services, and emerging ICT—key ingredients in the modernization of Kenya's economy.** Consistent with this performance, the IFC has been able to step up financial investments dramatically—

reaching about US$167 million of new business in FY13 and US$330 million in FY12. Kenya's faster growth has gained momentum by its rapidly growing working-age population, cities reaching significant scale to reap agglomeration gains, and the rising predominance of "modern" sectors. For example, Kenya's M-Pesa, the global leader in mobile money transfer systems, reaches more than 23 million subscribers or more than half of the population, and illustrates the power of innovation to make a dramatic change in people's lives. Still, foreign direct investment is limited, exports lag behind imports (a structural trade deficit that reflects weak competitiveness), and the private sector struggles to create one million new jobs needed each year for the country's growing labor force. Infrastructure needs are pressing, firm-level productivity is low, and weak governance and a poor business regulatory environment (the Doing Business rating dropped from 72nd place in 2007 to 129th place in 2014) stifles growth and entrepreneurship and holds back the effectiveness of some public spending.

18 **So what is Kenya's economic outlook? Can its growth accelerate and be maintained at a higher level? Yes, but it is a tall order.** The fact that historic growth of just under 5 percent per annum was below potential and below that of the country's peers is a good sign in so far as it shows there is room to improve. But it also shows that a significant agenda of policy reform and targeted investment is needed to accelerate economic performance across the board. The 2013 WBG report, "Achieving Shared Prosperity in Kenya," sets out systematically where there is considerable scope for change involving policy and institutional reforms and greater private sector

TABLE 2: *Kenya: selected economic and financial indicators, 2010-18*

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Nominal GDP (US$, billions)	32.2	34.3	40.0	44.9	44.9	51.1	56.8	62.5	70.1
Real GDP (%)	5.8	4.4	4.6	5.0	5.5	6.0	6.0	6.0	6.0
CPI (annual average) %	4.3	14.0	9.4	5.4	5.0	5.0	5.0	5.0	5.0
Import volume growth %	8.0	0.0	9.8	3.6	11.8	8.2	7.6	6.8	8.9
Export volume growth %	6.2	-5.4	12.3	4.6	9.8	8.2	9.2	18.5	8.6
Current external balance (% of GDP)	-6.0	-9.6	-9.3	-7.8	-7.3	-6.6	-6.1	-4.8	-4.6
Gross International Reserves									
In billions of US$	5.1	6.0	7.2	7.2	8.0				
Import cover	3.85	3.71	4.0	4.3	4.0				
Central Government Budget (% of GDP)									
Total revenue	24.6	23.8	23.5	24.5	25.6	25.7	25.5	25.4	25.3
Total expenditure and net lending	30.1	28.9	29.8	30.3	29.9	29.4	29.1	28.9	28.7
Primary balance	-3.2	-2.8	-2.8	-3.1	-2.1	-1.8	-1.6	-1.4	-1.4
Public debt, gross	49.8	48.2	48.7	49.4	48.9	48.6	47.9	47.6	47.0
External	25.9	27.5	25.9	25.6	24.9	26.1	26.1	26.1	26.1
Domestic debt	23.9	20.7	22.8	23.8	24.0	22.5	21.8	21.5	20.9

Source: IMF WEO database, The National Treasury - Estimates (shaded) from 2013 onwards.

participation in key challenges. The country's manufacturing base is small and as a share of GDP (around 10 percent) has hardly risen in decades—whereas if Kenya were to emulate the success of global growth leaders among developing economies, manufacturing would have to expand dramatically. Improvements are also needed in the operations of the Port of Mombasa; in reform of agriculture, especially agricultural purchasing (the National Cereals and Produce Board); and in greater efficiency in public services. How far and how fast those types of adjustments take place will influence growth prospects along with global economic conditions and domestic macroeconomic policy. The Bank's central estimates (see Table 2) for the CPS period anticipate inflation being controlled and growth averaging about 6 percent per annum. More rapid growth is of course possible, and the WBG will work with the Government, the private sector, and other partners with exactly that aim.

C. Sustainability

19 **Accelerated growth will have sustainability implications.** When the country won its independence in 1963, its population was under 9 million and the pressure on natural resources (and human/animal conflict) was relatively modest. Now 50 years later, there are more than 43 million residents, and the population is projected to grow by around 1 million per year over the coming 40 years, to be the world's 20th most populous nation by 2050 (compared to 31st today). Although high fertility rates were the main driver in previous decades, these are now falling as incomes rise and family planning has become more prevalent.

20 **Managing population growth, both its scale and impact, remains a significant challenge.** A majority of Kenyans do not have reliable access to clean water and good sanitation. In rural areas women typically bear the brunt of life-sustaining household chores such as fetching water and firewood; this becomes even more challenging without sustainable land management practices. In the fast-growing cities (where in fact fertility rates are typically lower than rural areas, which may lessen population growth somewhat over the longer term), the task of providing housing, proper waste and pollution management, and security is increasingly complex. Proper spatial planning and effective urban policies are essential if migration from the countryside to the city is really to improve people's lives over the long term.

21 **Overall the Millennium Development Goal on sustainability (MDG 7) is seriously off-track.** This is true for several other MDG targets (see Annex 7). Kenya is vulnerable to natural disasters and other climate-related impacts; droughts brought hardship and costs of US$12 billion over the last decade. Kenya is classified as "chronically water scarce" with one of the most degraded areas in the region; about 70 percent of the population lives in the small share (about 12 percent) of the country's total land area that has agricultural potential. The growing population and the resulting increase in demand for land, energy, and water is putting tremendous pressure on the natural resource base. These concerns are reinforced given that Kenya's natural assets—landscape and wildlife—are important for the population as a whole, for some specific indigenous groups whose livelihoods and culture are so tied up with the land, and for the pivotal position they play in the nation's tourism industry (which accounts for 2 percent of GDP and 15 percent of export earnings).

22 **Land issues are contentious and need to be approached carefully by all interested parties.** The Constitution puts emphasis on land and the environment, including aiming to achieve and maintain tree cover of at least

10 percent of Kenya's land area. The National Climate Change Action Plan (NCCAP) has identified restoration of forests on degraded lands and agroforestry as a 'big win' opportunity. Yet the challenge is to develop and sensitively implement win-win solutions that properly handle the rights and position of indigenous peoples, including those whose long-standing place of abode is in forest areas.

23 **Kenya's fiscal sustainability over the coming years has reasonably secure prospects based on Kenya's track record to date.** Policymakers would be loath to lose the hard-won gains from prudent macroeconomic policy. The potential Achilles heel is the public sector wage bill, which at over 50 percent of recurrent spending (compared to Sub-Saharan African average of 30-35 percent) and upwards of 7 percent of GDP is higher than many comparators. It is constantly under pressure especially now that account must be taken of former local authority staff salaries being absorbed by county governments and national civil servants whose functions have been devolved but are still on the government payroll. The move to devolution should not in and of itself raise public spending, but some policymakers especially at the county level may "turn on the spending taps." It will therefore be important that public financial management is strengthened, unnecessary or unplanned contingent fiscal liabilities are avoided, and fiscal responsibility is followed as required by the Public Financial Management Act 2012.

24 **Social cohesion requires renewed attention to equitable access to opportunities for all regions and communities, youth, and women as part of the Government's ambition for "unity" to ensure all groups have a proper share in Kenya's future.** The 2010 Constitution was a major step forward on women's rights and provides that at least 30 percent of all appointees to public bodies are female, including at the county level. However, there is a long way to go to ensure that women are economically empowered and can fully develop their potential (see Annex 12). In agriculture, women comprise more than 70 percent of the labor force, yet they own only 1-5 percent of agricultural land titles. In terms of non-agricultural employment, only 29 percent of those earning a formal wage are women and female youths are twice as likely to be unemployed as adult females. Girls are also less likely than boys to enroll in secondary schools (female-male secondary enrollment ratio of 92 percent) and are more likely to drop out due to unfriendly school environments, early marriages, and the high cost of secondary schooling. Maternal mortality is one of the highest in Africa at 488 deaths per 100,000 live births and the proportion of women who receive child delivery with skilled attendance is only 44 percent and has remained unchanged over the last 10 years.

25 **To strengthen advancement of Kenya's women, this CPS has been informed by key gender analyses.** These analyses include a recently conducted gender portfolio review and a poverty and inequality assessment (see Annex 12). In addition, given that the last gender assessment predates gender-relevant provisions in the 2010 Constitution, the Bank will undertake a Joint Poverty and Gender Assessment targeted for FY15 that will directly inform the Kenya country program and ensure that activities are guided by the most accurate and up-to-date gender analysis (Box 1). Finally, support for setting, collecting, and monitoring sex-disaggregated data is planned in response to a lack of gender-disaggregated data.

26 **How well Kenya's youth fare in the coming years will also have a significant bearing on social cohesion.** On the positive side there is a huge demographic dividend whereby some 26 million Kenyans (more than

one-half the population) are below age 25, and this ratio will rise to almost two-thirds by 2030. More broadly it is economically productive adults (15-64 years) that are the fastest growing cohort, yielding a massive improvement in the dependency ratio over the coming decades (Figure 3). If these citizens—especially the young—are equipped with the skills and competencies for the changing marketplace and secure gainful work, they will provide a huge boost to productivity and output. But if too many of them fall from this path, there is a risk of social capital being undermined by crime and delinquency. That is why it is so important for the private sector to create jobs and for young people to continue their education and acquire skills to fit those jobs.

D. Institutions and governance

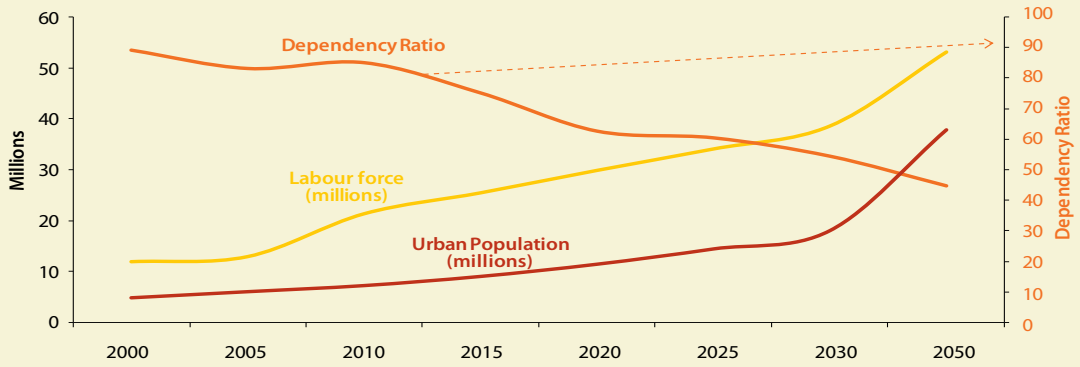
27 **The institutional and governance environment plays a part in the nation's performance and how the WBG program unfolds.** Kenya has a mixed record on governance performance, falling below the average for SSA countries in the World Governance Indicators, except in government effectiveness and regulatory quality (see Annex 9 for an overview of governance issues). Ratings in surveys such as those from Transparency International (where Kenya was rated 139 out of 174 countries in 2012) and extensive media coverage of governance and corruption justifiably draw attention to the issue. Likewise for the WBG, there is emphasis on tackling these issues, including taking measures to safeguard the use of WBG funds in projects, where deepened collaboration between the Bank's Department of Institutional Integrity (INT) and the Kenya National Audit Office has proven fruitful. The WBG has addressed the after-effects of somewhat contentious experiences with past (and closed) projects (that dealt with education and arid lands) where referrals have been made to the Ethics and Anti-Corruption Commission (EACC).

BOX 1: *Gender focus: Enabling women to help themselves, their families, and their country*

Inclusion of women fully in Kenya's development is sensible from its intrinsic value of equal rights and its support for faster economic growth by helping all citizens, male and female, to achieve their greatest potential. The current development context in Kenya—devolution, the Constitution, and other policy reforms—offers compelling opportunities to advance these values. With the adoption of the new Constitution, women and men now formally have the right to equal treatment and opportunities in political, economic, cultural and social spheres without discrimination. The Constitution provides that not more than two-thirds of members of elective public bodies be of the same sex and also provides for numerous other rights for women, including those related to citizenship, marriage/divorce, land, and public service opportunities. However, there is still progress to be made in ensuring that women are able to realize these rights in practice.

The WBG, through the IDA portfolio, IFC investments, and analytical work is supporting key gender issues. A recent gender portfolio review estimated that 76 percent of active and pipeline IDA operations are gender informed. The current strategy builds on the previous CAS period that saw a focus on gender issues in agriculture, health, education, and social protection, with proposed indicators for each of these areas. WBG support has helped generate tangible results: a 10 percent increase in incomes for both female and male small-holder farmers; the provision of basic health, nutrition, and population services to over 21 million women; employment for 40 percent of interns benefiting from the Youth Empowerment Project (both female and male); and the provision of cash transfers to 56,000 orphan and vulnerable children households. The IFC SME Banking Advisory Program improves the availability of financial services to women by training commercial bank staff and supporting specific products aimed at women. The current CPS results framework includes gender-related outcome indicators in health services and water *(see Outcome 5 in Annex 1, CPS Results Framework).*

FIGURE 3: *Kenya's demographic and geographic transitions*



28 **It would be wrong to paint too gloomy a picture of governance problems.** But realistically, the governance analysis in this CPS shows that these problems have deep-rooted causes in accountability (or lack thereof), including vested interests, elite capture, and weaknesses in institutions of accountability that encompass the legal and judicial system and enforcement agencies. But in some respects it is the vibrancy, openness, and international connectivity of the media and civil society in Kenya that bring these issues to the attention of a much wider audience than perhaps is experienced by other countries with similar patterns of corruption. Many businesses do operate effectively; for example, IFC has been able to expand its business without governance issues grinding things to a halt. The country has an almost unparalleled openness among its peers in making public appointments, including Cabinet ministers, senior civil servants, and vetting of judges when replacement is necessary. A strengthened Ethics and Anti-Corruption Commission (EACC) and more creative and extensive use of technology can increasingly provide "sunshine" transparency (of public oversight) on public spending and other aspects of official public life. The 2010 Constitution has strengthened existing institutions and created new ones for oversight, including the Controller of Budget (who authorizes release of funds and is appointed on an eight-year, non-renewable tenure) and a reforming and independent Judiciary.

29 **Devolution in Kenya is a huge change in the institutional landscape.** The 2010 Constitution provided for the creation in 2013 of 47 new county governments with considerable oversight of affairs in their jurisdictions (see Annex 10 for the challenges and opportunities of devolution). If implemented successfully, it can, over the long term have a positive impact on governance and the promotion of shared prosperity. By bringing government closer to the people and enhancing local-level accountability mechanisms, governance can be improved; this will not happen automatically but rather requires specific actions, including establishing strong public financial management and budget transparency within county administrations. By improving and better targeting service delivery (such as education, core public services, local infrastructure) at the county level, local citizens and companies will benefit. There is considerable variation in capacity and resources among the counties, which will take a concerted effort to address.

The new structures provide an avenue for a clearer and more equitable allocation of national resources across counties, which should help less-developed regions.

E. Regional dimensions

30 **The country diagnostic would not be complete without recognition of the distinctive position Kenya holds in East Africa.** The country is a leader and connector within the East African Community (EAC), not least through its facilitation of regional trade, investment, and flow of skills across borders. But for it to become an economic powerhouse, Kenya must tackle key obstacles, among which is remedying major transport corridors, including border crossings that remain tortuous and hold back growth in neighboring countries (which in turn would benefit Kenya). Solidifying peace and security right across the Horn of Africa will also be of mutual benefit for Kenya and its neighbors. The new Government has affirmed its regional credentials, according considerable importance to cross-country collaboration as a way to promote economic development and security. President Kenyatta has formed active alliances with his counterparts to push forward specific initiatives, including transport connectivity, and to harmonize financial sector frameworks and infrastructure in the EAC. These last two initiatives are supported by the Bank's regional (multi-country) portfolio that has expanded considerably, albeit with growing pains (slow start up and disbursement). IFC clients and sponsors are increasingly being sourced from within Africa as well as among its global network. Some Kenyan enterprises such as those in financial services have made significant cross-border investments facilitated by IFC engagements. There is therefore potential to do more on regional issues; and while the transformative effect can be substantial over the long term, the costs and difficulties in delivering this must not be underestimated.

II. Vision and framework: Government priorities and medium-term strategy

31 **By 2030 Kenya wants to be a globally competitive and prosperous nation with a high quality of life for its citizens.** This clear ambition is encapsulated in "Vision 2030", a broad-based agenda straddling the current and previous administrations. The Vision provides a framework for this CPS. It rests on three pillars: economic, social, and political. The economic pillar envisages creating a modern economy by moving up the value chain in key areas, including agriculture and financial services, to consistently deliver 10 percent annual growth. The social pillar focuses on investing in people, including in education, health, and housing, with a focus on women, youth, and vulnerable communities. The political pillar seeks to "move to the future as one nation, "including improving the rule of law, transparency, and accountability.

32 **Vision 2030 is operationalized by the Medium-Term Plan (MTP), which drives policy actions, public investment priorities, and expenditure planning.** Its second edition, MTP2 (2013-17)—"Transforming Kenya"—was launched by the new administration in October 2013. It is clear that MTP2 is a sensible anchor for a good deal of the WBG work, including how IDA, IFC, and MIGA investments help leverage job creation. But WBG will need to have its own approach to selectivity in the deployment of its resources since it cannot match the appropriate comprehensiveness of the MTP2. The MTP2 and the Vision 2030 results framework provide a good anchor for the CPS to ensure solid monitoring of results of Bank-supported interventions with a clear line of sight to longer-term development results.

33 **Overall this national agenda is entirely consistent with the WBG aspirations.** The global timeline targeting an end to extreme poverty is aligned with Kenya's overall approach. Although the country has not explicitly proposed monitoring the growth in incomes of the bottom 40 percent (who are in fact those currently living below the poverty line), this focus resonates with the thrust of the domestic strategy. Policymakers are

concerned—including for reasons of societal cohesion—and want to ensure that all groups share in advancing prosperity. And within the population, they have highlighted several segments, including the prospects for women and the rapidly growing youth cohort.

34 **It is important to enrich the understanding of this national vision with other sources of views from key stakeholders in Kenya's development.** For this reason the CPS has been informed by client and stakeholder views summarized in Annex 13. Dialogues and meetings with national and county governments have been held in various locations across the country. In many respects their views were consonant with the country's broad vision while providing additional insights into particular points of emphasis such as how to deliver "One Kenya" for women and men alike; dealing with the special challenges of youth; recognizing the intricate features of governance; and liberating the dynamism of the private sector, including by sensible tax policy at national and county level that avoids excessive or distortionary burdens on firms. Other feedback emphasized the issue of making devolution work, ensuring that WBG support helped as many counties as possible, especially those communities in the greatest need, and finding new methods of working with the counties.

"No man climbs the mountain alone"
~ Kipchoge Keino

Photo: World Bank

III. Development challenges and opportunities

35 **Some of Kenya's challenges are not new, and many exist similarly in other WBG client countries.** Yet there are certain distinctive features that have been identified in the systematic diagnosis of key constraints and opportunities relevant to the CPS timeframe. Those distinctive features provide one thrust (but not the only criteria) that accounts for how this CPS implements a selective approach to how the WBG deploys its resources going forward.

36 **Kenya's newly elected Government has a change mandate from an impatient citizenry, yet arguably with no diminution of the clientilism and interest group pressures that have influenced politics and business for decades.** There is potential within a burgeoning private sector, including the most effective of operations in fields as diverse as horticulture, tourism, power generation and transmission, and signs of significant new resources in the extractive industries sector. Financial services innovations are particularly impressive, such as M-Pesa that leads the world in "mobile money for ordinary citizens," and in deepening stock exchange and capital markets. There are openings for Kenya to punch at a higher weight in regional East African Community activity—both in the public and private sectors.

37 **The new Constitution provides opportunities to implement major shifts in Kenya's institutions to improve how they serve the public.** With broad public support, the Constitution intends to accelerate development outcomes, reduce spatial inequality, and strengthen governance. Several key changes that it heralds are significant (Box 2) and set the scene for shaping how WBG input can help embed these changes over the coming year.

38 **Against this backdrop, achieving rapid and uninterrupted growth over a decade or more is the foundational challenge.** Based on this diagnostic review in Kenya, there are prospects for maintaining a sound macroeconomic framework that needs, in part, prudent control of the public sector wage bill; but, this is linked with wider issues of equity

BOX 2: *A 50th birthday present: How the constitution opens new doors for Kenya*

Kenya's original Constitution adopted upon independence in 1963 provided a degree of stability in the subsequent decades, but its weaknesses in serving a modernizing and ambitious Kenya were becoming more apparent as time passed. The 2010 Constitution establishes significant new provisions in several areas including gender equality (where women are achieving fairer representation in elected chambers and executive positions, although there is still a fair way to go) and governance and the rule of law (where anti-corruption agencies are empowered more solidly). To improve public administration broadly, changes include a strengthened legislature and new senate; initial reforms in the judiciary; increased emphasis on transparency, participation, and accountability; and an ambitious devolution that transfers significant resources and responsibilities to 47 newly elected county governors and county assemblies. The March 2013 elections allowed the implementation phase to begin in earnest—an immense task of converting Constitutional provisions and laws into functioning institutions. The first steps in this daunting journey have been positive: election process issues are being resolved in court; public vetting of key leadership positions, especially in the judiciary, has increased; and devolution has largely proceeded according to Constitutional timetables, albeit with fits and starts.

and public service efficiency. The Salary and Remuneration Commission is in the forefront of trying to resolve wage demands in the public sector. How this Commission resolves labor disputes and helps stabilize the wage bill will be a test of fiscal resoluteness. At the same time, Bank-supported analysis of the delivery of public services has pinpointed glaring deficiencies in the way resources are deployed such as a troubling number of teachers failing to be present in the classroom for the equivalent of two days per week. All this points to public sector modernization as a continuing area of emphasis.

39 **The long-term economic engine is the private sector—including the large segment of informal activity—whose energy and dynamism should be the principal source of growth and where there are significant opportunities.** As part of its day-to-day business, the IFC has seen that several important sectors are attractive in their ability to create jobs, make an impact on poverty, and be commercially viable. These sectors include financial services, infrastructure, ICT, education, agriculture and food processing, and manufacturing. All these sectors are part of a modernization in the economy's structure. Overall firm-level productivity nevertheless remains low, constraining firms' abilities to grow and generate employment.[1]

40 **Hence, progress on investment climate reforms, combined with improving firm-level productivity and innovation, is essential to raising private sector investment and job creation.** Moving vibrant sectors to the next level and critically ensuring that they are able to compete internationally, thus boosting Kenya's lagging exports, needs a mixture of capital and expertise from domestic and international partners. But beyond individual opportunities for the marketplace to grow across-the-board, the Government needs to deepen and build on the strengths of the financial sector and be much more forceful in improving the business environment. The WBG analytical work identified some of the deficiencies that need boosting: weak contract enforcement, overly regulated sub-markets (e.g., maize), and a stagnating manufacturing base. Innovation and competitiveness programs in key sectors could be helped by public support for science, technology, and higher education.

41 **The bottlenecks to private sector dynamism go well beyond the policy environment and are equally if not more rooted in on-the-ground realities of poor infrastructure;** hence, leveraging private investment in infrastructure is essential and compels WBG engagement in the public-private partnership (PPP) agenda. Firms are currently faced with high transport costs given dilapidated roads and railways, and a clogged-up Mombasa port: the average cost to export a container is US$2,255, compared to US$1,620 in South Africa, US$660 in Mauritius, and US$456 in Singapore. In addition, firms pay high energy costs at $0.21 per Kwh (versus per Kwh of $0.18 in Nigeria, $0.10 in South Africa, and $0.08 in China and India). To this end, the MTP2 identifies huge investments in infrastructure (roads, national railways, urban transport); energy; and agriculture among other areas. A fraction of these can legitimately be met from public resources, including those from IDA. But the real opportunity here is to leverage private sector resources through innovative public-private partnerships, which are currently rather underdeveloped. Parts of the legal framework for designing and executing PPPs are in reasonable shape. Hence specific transactions (including those with joint Bank, IFC, and MIGA support—see Annex 8 on WBG collaboration) in the power sector, for example, have been successfully arranged. More can be done on financing power generation and distribution yet the trick is now to expand and widen this approach. In terms of other infrastructural priorities, institutional and policy reforms with complex political economy considerations are long-needed such as liberalizing the grain and maize market.

42 **The effect of many of these actions on growth, and ultimately on poverty, can only be properly traced when relevant and accurate statistics are made available in a timely manner to policymakers and the general public alike.** Such an approach is an essential component of evidence-based policymaking and for monitoring and evaluating development impacts of programs being implemented. While Kenya has some strong statistical data, there are gaps (see Annex 11—Statistics for Results). The last MSME census was in 1999, and a nationwide household survey—central to reliable poverty data—was last conducted eight years ago. Action is needed to rectify this situation in the near-term, and to improve statistical coverage (including gender disaggregation where relevant), accuracy, dissemination and usage over the longer term.

43 **Placing a premium on human development is essential from several vantage points.** Critically, as the analysis in section 2 demonstrated, growth on its own almost certainly will not be enough to the deliver the "poverty yield" that Kenya seeks. Inroads must be made in inequality, and that is more productively achieved by empowering those at the lower ends of the distribution to move up than by squeezing the top. Furthermore, from an equity perspective, it cannot be right that so many Kenyans face a life of full of hardships largely because of the place of their birth and family circumstances rather than their own talents and toils. Enhancing people's skills and capacity also allows them to become part of a better-qualified workforce needed to elevate firm-level productivity.

44 There is an opportunity to make progress in improving public services that have a direct impact on people's well-being. Healthcare may be foremost in this regard, given that the Government—and new county administrations—are behind a program of health reform. Although total national spending on healthcare, at around 5 percent of GDP is not low by comparable international standards, the effectiveness of such spending requires attention. Improved healthcare tends to be accompanied not only by better health status but also by lower fertility rates over the medium term. There is a great opportunity to help build better systems, including a stronger reliance on results-based healthcare financing at the local level, to leverage change. The central challenge in education is similar: apply resources more effectively and lift quality of outcomes rather than quantity of inputs. There is scope to attract more private sector investment and participation into health and education. Pointers can be taken from IFC's financing of a private sector service provider in Kenya and structured, social-service PPPs in other parts of the world. A brighter picture can be seen on social protection policy, where solid foundations have been laid to harmonize the somewhat disparate cash transfer programs and target those even more closely on poor households. This Bank-supported initiative is beginning to bear fruit now and should continue to do so over the next several years.

45 In promoting human development, the Government has heightened its emphasis on youth and youth jobs. Several schemes have been floated, including establishing "Institutes of Technology" in every ward of the country, and allocating 2.5 percent of national revenue to a "Youth Enterprise Capital Fund". From a private sector perspective, there may be interest and potentially growing involvement from companies who want to work alongside the public sector in creating jobs, such as those in the Bank-supported Youth Empowerment Project, to educate and train young people so they fit those openings. WBG is engaging the Ministry of Education's new PPP unit as well as other development partners, and exploring mechanisms with which to strengthen industry-academic linkages. Because the initiatives are so new, it is important to evaluate progress critically and adapt quickly as needed.

46 For Kenya to make a huge dent on poverty, support for the growth and realization of people's potential must focus on sectors and locations where the majority of the poor can benefit. In rural areas, the single biggest and most sustainable impact would be to improve agricultural performance. This is the area where the private sector has an important role to play in raising incomes by financing small farms, ensuring equitable access to markets, lowering risk and optimizing value chains. The agricultural agenda, of course, is very much tied up with Kenya's competitiveness, and policy/institutional reforms are needed to lift certain constraints to growth. There is considerable room to improve agricultural productivity, including through more effective extension services, sustainable soil management practices, better livestock management (a critical sub-sector for many of the poorest arid and semi-arid counties) and better management of market, production, and enabling environment risks. Basic rural infrastructure, notably access roads and irrigation, needs a huge upgrade. Finally long term enhancements to the use of land resources are called for, such as those facilitated by efficient land registries and

secure tenure. The rural poor would also gains from community driven development which empowers local people, including women and marginalized groups, to take charge of their own fortunes. In other cases mechanisms such as formal social safety nets, including cash transfers, food security for the most vulnerable, and sustainable land management support can make the best impact.

47 **In cities it is essential to engage the private sector to help put in place better infrastructure, housing, health and education to serve the growing population.** The prospects and approaches for doing this must be tailored to specific conditions. In the largest and relatively more prosperous cities, PPPs will become increasingly tenable (subject to a solid regulatory framework); and putting these in place will deliver better services and have a demonstration/knowledge-sharing dimension for elsewhere in the country. In the emerging secondary cities, there is a chance for public agencies to invest right at the outset to lay the platform for manageable growth over the long term. And whether in the countryside or on urban streets, the poor are most exposed to the impacts of disasters, thus making it important to strengthen disaster planning and management.

48 **The changing institutional landscape is undergoing a tectonic shift with powers and responsibilities moving from the national government to the 47 new county administrations.** The Bank provided a "Devolution without Disruption" report and supports implementation through the Accountable Devolution Trust Fund. This transition is truly historic and by no means easy—few if any countries have attempted anything on this scale or speed in the recent past. The Constitution envisaged transferring functions gradually over three years, but most county functions have already been transferred along with approximately 30 percent of government revenues rather than the Constitutional minimum of 15 percent, leaving some national government functions potentially under-funded. At this pace, the changes could bring about risk of service-delivery disruption, including in devolved functions like urban management, water, health, agriculture, and local roads.

49 **Devolution challenges will likely persist throughout the CPS period, as reviewed in Annex 10.** These include:

- Major capacity challenges to get core county planning, PFM, and HR systems in place.
- Risks in the largest cities that have inherited significant payroll and debt obligations, at the same time as reduced central transfers.
- Unique challenges of historically marginalized areas. Larger transfers to counties in arid and semi-arid regions provide an opportunity to address long-standing infrastructure and service delivery gaps. But these counties typically face major capacity gaps.
- Sectors that are being devolved to counties the fastest, including health, agriculture, and local infrastructure service delivery.
- Implementation of constitutional and legal provisions on incorporating transparency and citizen participation into county (and urban) planning, budgeting, and performance management systems.

50 **While it is essential to minimize what will be inevitable hiccups over the next several years, the real challenge is to deliver a "devolution dividend".** That dividend will be manifested through greater citizen

engagement, direction, and oversight of public authorities to fundamentally deliver better services to ordinary people and build better local-level business environments. Maintaining expectations is important as devolution is a long-term process that goes well beyond this CPS period. At the local level it involves building new governmental structures, institutions, and systems that are responsive and responsible; and fresh inter-governmental relationships, including resource transfers that translate policy priorities into meaningful on-the-ground services.

51 **In practice, the needs and opportunities for institutional improvement vary across the levels of agencies involved in the devolution landscape.** At the central level, ministries—especially the Treasury and the Ministry of Devolution—have to build capacity to oversee a new way of doing business in which a large share of national tax revenue is passed to county administrations. The approach has to be "lean and mean" (there is no point building local public administration if central government also expands) yet effective in rigorous public financial management and sensible fiscal discipline. At the county level, the 47 units need to develop their own ability to be responsive and accountable, not least through transparency in resource use and active citizen engagement. They must also find ways of working together, perhaps through the Council of County Governors, so they can exploit synergies on cross-boundary issues, such as sub-regional (multi-county) business competitiveness, and promote learning from each other.

52 **The 2010 Constitution ushered in other major changes to help reinforce the institutional "pillars of integrity".** Alongside the Public Financial Management Act (2012), it has clarified roles and responsibilities of the Office of the Auditor General, created the Office of the Controller of Budget, and increased the checks and balances with stronger oversight by the legislature over the executive. Furthermore, the judiciary has been strengthened with greater independence, with the roles of Chief Justice and Supreme Court undergoing transformation to improve their judicial performance.

IV. Strategic options to make the most of WBG assets

A. Aligning with WBG win goals and being selective

53 **The WBG-supported program in Kenya aligns with the WBG twin goals and must be—and will be—selective against a wide-ranging national agenda.** The MTP2, for example, identifies 38 areas of intervention, and its results framework sets as many as 292 targeted outputs. What is the best way of doing this? The Bank will use a selectivity test that deploys a four-pronged benchmark to guide deployment of its scarce resources to maximize the prospects of success. Specifically:

- **Confirming a credible line of sight to make a sustainable impact on poverty and prosperity.** Selectivity will be driven by the degree in which interventions directly target the poor, whether there is evidence to show that the expected economic benefit is substantial, taking into consideration, where appropriate, creating jobs and helping poor beneficiaries, including women.
- **Critically reviewing WBG capability and comparative advantage (including assessing opportunities for collaboration).** The role of other development players will be important in assessing how the WBG can add value. This benchmark also examines whether the WBG has an established track record in the suggested areas of intervention and, if not, whether an experienced team can be deployed.
- **Cementing client ownership.** The existence of a forceful, meaningful, and formal request from the relevant line ministry and Treasury, the intervention's inclusion in the MTP2, and a review of any resistance to the proposed intervention are some considerations that will gauge the level of client engagement.
- **Calibrating client capacity and accompanying project design.** The track record will be reviewed regarding adequate client capacity in relevant line ministries, credible procurement and financial management resources and expertise, integrity and corruption concerns, and how gaps in the above can be addressed and built into project design where needed.

54 **This selectivity test is used in a cascading fashion.** First, broad domains of engagement have been established that are drawn from the systematic diagnosis of constraints and opportunities highlighted above(see Figure 4 and Annex 15). A limited set of specific and measurable outcomes within each domain of engagement have been identified, in line with the Government of Kenya's key strategic vision. These targeted results help identify sectors within these domains that will be given priority. Conversely, as sectors gain higher priority, selectivity inevitably means that WBG will scale down or not engage in some areas. And in implementing the CPS, the selectivity test will be applied to make detailed choices on particular operations and analytical advisory activities (AAA).

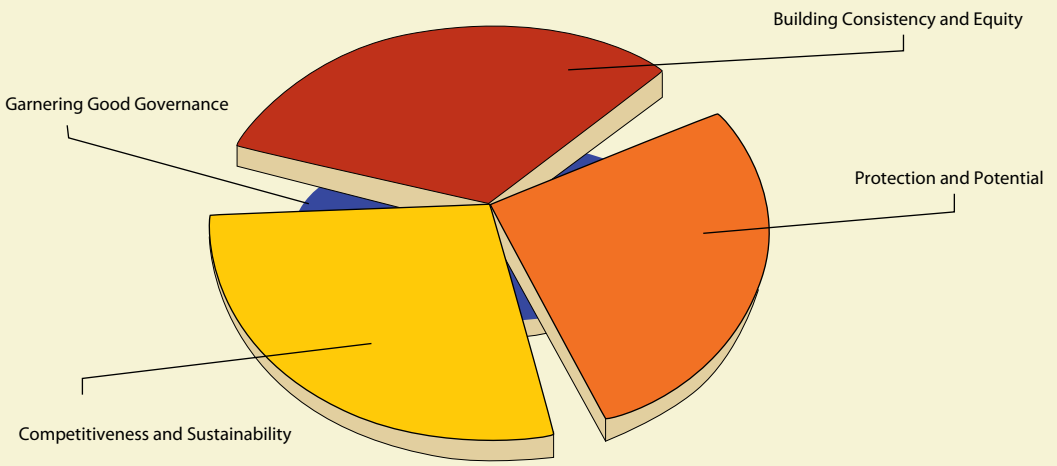
B. Focus of engagement

55 **The overall strategy will move forward with three domains of engagement:**

- Competitiveness and sustainability –growth to eradicate poverty;
- Protection and potential –human resource development for shared prosperity;
- Building consistency and equity –delivering a devolution dividend.

56 **Individually and collectively, the achievement of sustainable development results will only be possible if they are bound together through a connecting platform of garnering good governance, which in some ways has been an Achilles heel in the past.** More needs to be done on both the demand and supply side of governance.

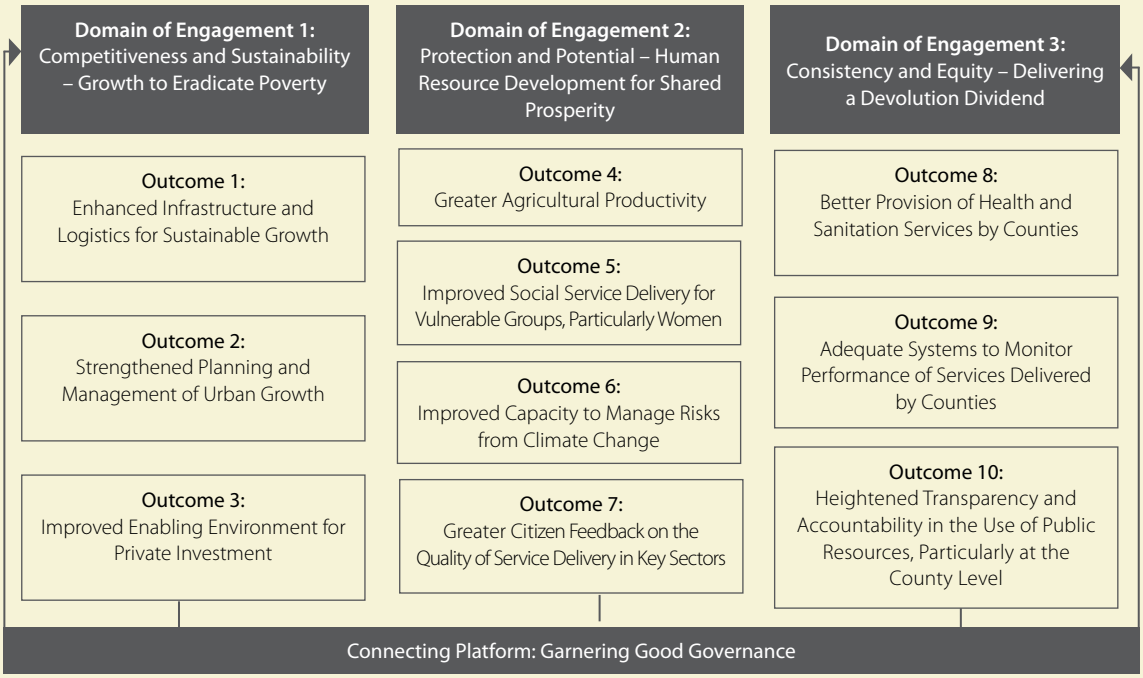
FIGURE 4: *Kenya CPS (FY14-18) - Three domains of engagement bound together by a connecting platform*

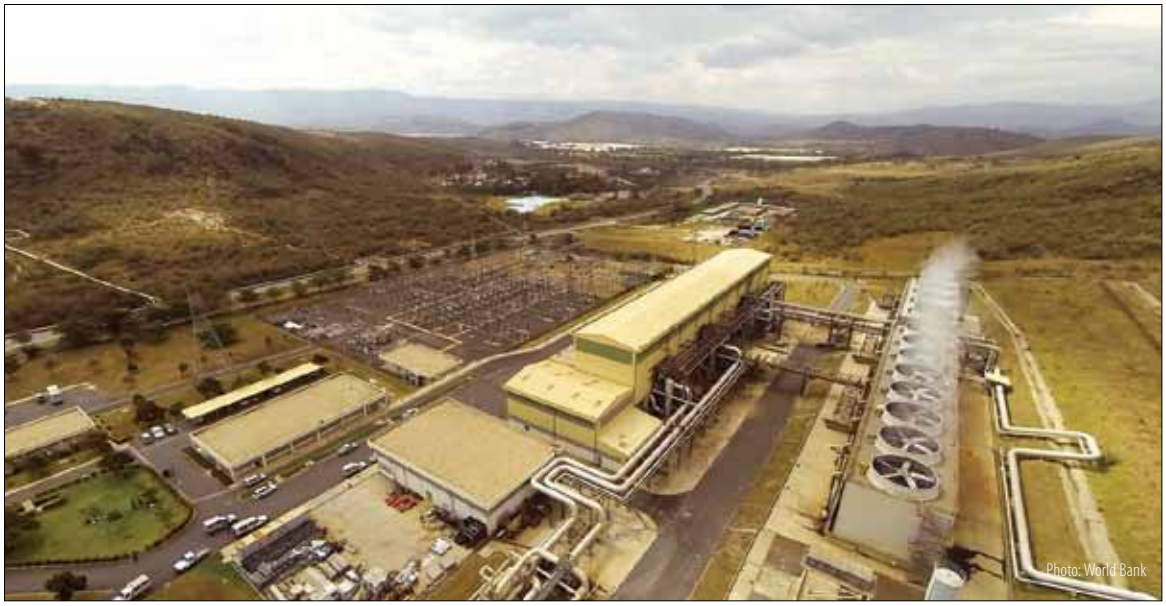


On the demand side of good governance, WBG interventions in the main domains will also build on governance-related dimensions such as transparency, accountability and openness, third-party monitoring, and increasingly robust public financial management. On the supply side of good governance, accountability will be built through strengthening critical institutions and processes such as the Parliamentary Budget Office, Auditor General, Controller of the Budget, new county assemblies, and citizen participation in key issues. This is an area where the input and expertise of the World Bank Institute (WBI or its successor) will be particularly valuable.

57 **The results-based focus helps define the country program and its selectivity within each domain.** The overview is shown in Figure 5, with details in Annex 1. Each domain is discussed in specific sections that follow, which conclude with a summary of specific results being targeted (as shown in the overviews by domain in Figures 6, 7, and 8).

FIGURE 5: *Targeted outcomes of Kenya CPS FY14-18*





C. Domain one: Competitiveness and sustainability—growth to eradicate poverty

58 **On competitiveness and sustainability, enhanced infrastructure and logistics are the backbone of long-term growth.** This is, however, a wide-ranging agenda; the MTP2 envisages investments upwards of US$43 billion over the next five years. Hence, the WBG is establishing some early priorities that are ambitious but not over-reaching. In the energy sector, WBG collaboration and long-established relationships with public and private sector partners will be expanded (Box 3). WBG policy advice will help the authorities create a well-functioning and properly regulated market and continue to provide technical assistance to selected government agencies. Support will extend to Kenya's cooperation with neighboring countries to facilitate energy cooperation, including through common technical standards and power-pool trading. IDA financing will be used for some publicly merited investments, in the first instance targeted at electricity modernization through upgrading of selected transmission and distribution networks that will hugely improve technical and billing efficiency. IFC and MIGA instruments will help leverage more private resources, most notably in independent power production and renewables, perhaps also including geothermal sources. IFC, if market conditions allow, is open

Box 3 : *Three is better than one: WBG collaboration powers ahead*

Over the last couple of years, the three WBG institutions along with MIGA, IFC, and IDA have pulled together path-breaking combinations of financial support in specific private-sector deals that are creating new power supply for the citizens of Kenya. In Thika Power and Triumph Power, MIGA has provided political risk insurance to make the projects bankable and attract foreign investment into Kenya. IDA has complemented that with a partial-risk guarantee supporting short-term liquidity. And IFC has underpinned it with direct investments into the private companies building and operating the new power plants. Thika Power itself will bring 87 megawatts of power on line with a 20-year power purchasing agreement. Just as importantly, a clear precedent has been set to demonstrate to the private sector, Government, and the WBG, that working together facilitates long-term investment and produces more results for all the players involved. Altogether, WBG engagement in the energy sector targets adding 2,300 MW installed generation capacity from diversified sources.

to substantially increasing its investments in infrastructure by drawing on an impressive network of investors that it has already built up. MIGA guarantees, which have recently been made more flexible to better cover breach of contract and state-owned enterprises, will also be marketed actively. A summary of the results for Domain One is in Figure 6 at end of this subsection.

59 **More broadly the WBG will ramp up its already considerable support to public-private partnerships, especially in the energy, water, and transport sectors where there is medium-term potential.** This assistance is grounded in the recently commenced Infrastructure Financing and Private Public Partnership Project that builds capacity of the enabling regulatory and institutional framework, including the Treasury's PPP unit. It also pushes the agenda through extensive analytic work, including detailed legal and operational lessons from comparable experience in other regions, especially South-South exchanges. As the Government's PPP pipeline solidifies, WBG will have a greater "transactions focus," exploiting the synergies between IFC instruments, complemented by MIGA products, and potential IDA leveraging. One example arises with the Government-proposed viability gap financing, where private sector project capital can be mobilized to get projects done. Another example is in the water sector that has a rather nascent institutional environment where private participation has yet to emerge. Here WBG specialists (including from the Water and Sanitation Program) are providing capacity building to help move things forward in progressive counties, including potential support for public-private partnerships in water treatment plants and water delivery.

60 **On transport, the different instruments available across the WBG will be used judiciously to support trade-offs in selective engagement.** For IDA resources, the focus of new lending will be on significant feeder (rural) roads within and between counties, connecting communities to emerging economic opportunities (and so tying closely to the poverty agenda). The current IDA portfolio will follow through on commitments made to larger-scale infrastructure, including public resources, as an emergency response to re-build core infrastructure following the tragic fire at Jomo Kenyatta International Airport in the summer of 2013. But, beyond that, the shift in approach means doing less in terms of allocating IDA to highways and similar programs.

61 **For IFC and MIGA resources, combined with Bank AAA expertise, there should be growing possibilities over the longer term from private sector engagement.** Public-private partnerships in airports, highways, and modern urban transport may be on the horizon and will be pursued by WBG. MIGA, whose products include both traditional political risk insurance coverage and new cover for non-honoring of financial obligations, can help leverage cross-border investments. MIGA will actively seek to deepen its engagement in Kenya through proactive business development efforts in the infrastructure, manufacturing, and agribusiness sectors, in addition to its already strong engagement in the energy sector. There is no doubt about the importance of making improvements at the Port of Mombasa if Kenya is to serve its own and neighboring economies properly. Other development partners are providing financial support; WGB has delivered analytical and investment support in this area over recent years, so given selectivity pressures further IDA resource allocation in the near term is a lower priority.

62 **Competitiveness can also be enhanced through improving the enabling environment, unleashing the potential of specific sectors and geographic locations, increasing firm-level productivity, and ramping up financial sector and capital market development**. The joint IFC-IDA/donor-financed Investment Climate Program will actively support renewed and increased commitment to improving the "Doing Business" position, particularly in the areas of business regulation, trade logistics, and advising on tax policy that supports entrepreneurship (see Figure 6). On growth sectors, WBG has a carefully crafted involvement in the rapidly emerging oil and gas sector. More broadly, IFC and MIGA see potential market opportunities—with a poverty-reducing angle—in agribusiness, health, education, and niche manufacturing, many of which WBG can open up through analytical work such as the ongoing Kenya Industrialization Road Map and the National Tourism Strategy. The IFC is already a major player in Kenya's financial services industry and will continue to look for new opportunities. IFC expects to increase commitments to financial institutions over the coming years as market conditions allow. IFC and World Bank advisory services will focus on strengthening the banking system and capital markets through support to the Central Bank and Capital Markets Authority as well as in developing corporate bond markets and county-level pension schemes, mortgage markets, financial sector regionalization in the East African Community, and financial inclusion.

63 **Kenya's large cities are engines of growth and the urbanization trend is unstoppable, so improving access to water and transport services in urban areas will be key.** Nearly one-third of Kenyans live in cities with expected growth to one-half by 2030 (Figure 3). Nairobi could become a metropolis of nearly 8 million inhabitants, and Mombasa could be a second piston in the growth engine. Secondary cities provide an important rural-urban linkage in the system of cities and can serve as an important driver for off-farm employment opportunities for the rural population. So WBG involvement will blend IFC and Bank resources that create private sector jobs, improve infrastructure, and provide better services to make cities more livable and sustainable. To shape future support, WBG will draw upon the lessons from its current project-level engagement and a comprehensive analytical piece (an Urbanization Review) to be completed in the first months of this CPS period. There are several binding constraints that WBG might help tackle, including providing access to clean water, coping with waste management through sanitary landfills, improving informal settlements (a third or more of the capital's population reportedly reside in peri-urban slums), stimulating mortgage financing more broadly, reducing transport congestion, and enhancing urban governance and management. There is considerable donor interest in this sector. And there is potential for the WBG to expand its already fruitful partnerships, perhaps even to include reimbursable service agreements to further this agenda. Moving from an input- to outcomes-based approach will be a fundamental tenant of the future support to urban development.

64 **As Kenya's rapid rise in population continues and if GDP growth accelerates, there will be commensurate pressure on environmental and social sustainability.** This is connected with the climate change agenda,

which affects Kenya in its propensity to suffer from natural calamities, including both drought and flooding (given the country's weather and territorial conditions, each of these impacts sometimes take place even within the same year in neighboring locations). Based on experience, especially in the most recent CPS period, the WBG can expect selective engagement on climate change issues to be focused on providing more resources for water security and climate resilience. Other development partners are expected to lend assistance for protecting coastal areas, the rift valley, and highland plains—containing areas of outstanding natural beauty and precious wildlife—against threats that include encroachment and pollution.

65 **The Government is meeting many of these challenges such as protecting natural heritage and managing some aspects of climate change with strong support from the AfDB and other development partners.** Given this level of support, WBG involvement will be highly selective on its comparative advantage, and focused in the first instance on water security and water sanitation. While land reform could also be an important contributor to long-term growth, it is a highly contested area and unless conditions look propitious, the WBG does not anticipate a heavy involvement during this CPS period.

FIGURE 6: *Domain one: Competitiveness and sustainability – Expected outcomes*

Outcome 1: Enhanced Infrastructure and Logistics for Sustainable Growth • Additional 2300 MW installed generation capacity from diversified sources (geothermal, thermal, wind) • Reduction of 2.8 percentage points in electricity system losses. • Reduction of waiting times in ports by 5 days and at border crossings by 1 day.	**Outcome 2:** Strengthened Planning and Management of Urban Growth • 14 urban centers with integrated strategic plans.
Outcome 3: Improved Enabling Environment for Private Investment (connecting platform) • 15 investment reforms in business regulation, trade logistics and industry.	


Photo: David Waldorf/World Bank

D. Domain two: Protection and potential—delivering shared prosperity

66 **To protect the vulnerable and help them develop their potential, multiple measures are needed that focus on key groups.** The WBG will continue its strong engagement in social protection. The Social Safety Nets Program for Results, which commenced operations in the fall of 2013, targets covering an additional 450,000 people (see Figure 7 at end of subsection). It is also being monitored closely along with the accompanying capacity-building work; WBG stands ready to supplement resources should that be merited in the latter part of the CPS period. With regard to health priority, the combined resources of IDA and IFC, alongside global funds and other partners, will be scaled up. IFC is pursuing an innovative combination of support for hospital care together with techniques to attract private sector expertise and resources into lower-level primary care as well. This is being complemented by near-term, IDA additional financing to scale-up results-based financing and support introduction of health insurance subsidies for the poor. The financing also targets increasing access to a basic package of health, nutrition, or reproductive health services to an additional 1,000,000 women (see Figure 7). Another planned operation during the CPS with a strong focus on results will include a relevant gender-focus as informed by the WBG's forthcoming Poverty and Gender Assessment. The Bank will join the ongoing multi-partner-supported effort to help the government to develop innovative financing options to sustain priority national programs such as HIV/AIDS, tuberculosis, and malaria and prepare for the emerging burden of non-communicable diseases. A summary of expected results for Domain Two are found in Figure 7.

67 **Another high priority to target support for the poor is a focus on agriculture—a direct link with helping families in rural areas.** There is considerable scope for public investments (including with IDA) to raise productivity and economic returns. Potential IFC investments in infrastructure, agro processing, and financial institutions further support this goal. Indeed supporting agribusiness and

food security in Africa as a whole and Kenya in particular are goals of an aggressive multiyear IFC initiative. The performance of agriculture in Kenya however is mixed. On the one hand, parts of its private sector-driven segments such as flowers and horticulture are global leaders—a lion's share of the huge European flower market is sourced from Kenya. Here the challenge is to continue that expansion in an environmentally sustainable way, which may provide opportunities for companies to benefit from IFC involvement, including through its internationally accepted performance standards on safeguards.

68 **On the other hand, much of publically influenced and small-scale agriculture performs very poorly.** Maize yields, for example, have hardly risen in years, and the domestic consumer price is actually higher than in major OECD economies. While women provide over 70 percent of the rural labor force, they own only less than 5 percent of land titles and face other obstacles to maximizing agricultural output. Part of existing operations are addressing women's productivity, technology adoption, and lifting other constraints to females generating sustainable livelihoods; but it is too early to declare success. Given this state of affairs, for the agricultural sector as a whole, the WBG will be deliberative in laying the groundwork to step up engagement in this sector where involvement has been modest to date. First, the WBG will reinvigorate that knowledge base to carefully delineate the precise constraints to and levers of change, including political economy considerations. Second, the WBG will use that knowledge to confirm energetic ownership by the authorities for specific transformative investments. Third, the WBG will continue to look for profitable, job-creating agribusiness, "access to rural finance", and value-added opportunity investments for IFC support, especially since increasing agribusiness investments is a strategic goal for IFC in Sub-Saharan Africa. Fourth, IDA operations will be designed to perhaps include community development support and irrigation of an additional 45,000 hectares of land (see Figure 7), to respond to these lessons.

69 **The burgeoning youth population brings with it a distinctive set of opportunities and problems.** WBG will help the Government address joblessness. A Global Partnership for Education operation (US$88 million) is under preparation. In addition, IFC has invested US$10 million to support the expansion of Bridge International Academies to provide high-quality primary education for children of poor families. More planned analytical work could be complemented by IFC investments as market opportunities develop. Current financial management and other fiduciary work will refine assessments and improve the governance environment in the education sector. Robust evidence of improved governance would then make possible deployment of IDA resources more feasible in the coming years. The Bank expects to continue its work as needed on youth employment, including exploring other interventions to help ensure young people are properly prepared for work. The AfDB has given particular emphasis to youth in its new strategy and plans significant investment. And across the board, the forthcoming Poverty and Gender Assessment will influence WBG operations and analytical work, including support for female education, entrepreneurship, and rural women's groups.

70 **The poor must be protected from the impact of disasters and climate-related changes to their environments.** Climate variability and hydro-climatic shocks (droughts and floods) impact disproportionately on the poor. It is estimated that as many as half of

the population lacks access to adequate and nutritious food. Climate change is projected to exacerbate existing climate risks and water resource constraints. The WBG will work on this through several channels. The Water Security and Climate Resilience Project helps set a sound institutional and investment framework to reduce vulnerability of the country and the poor segments of its population to these events. A new phase of this program will support the Coastal region through financing of infrastructure that will enhance the resilience of the poor in this region. The additional financing to the health sector project under the IDA Crisis Response Window provides the urgent response required to the drought-affected districts to manage acute malnutrition cases at health facilities and distribute supplementary foods at the community level for the moderately malnourished children using existing channels.

71 **In the four most marginalized counties of northern Kenya,** the Bank is supporting the improved social safety nets that will be financed through the National Drought Contingency Fund. Subject to Trust Fund resources being available, the WBG can work with the nascent National Disaster Risk Management Authority to build its capacity. There may also be scope for insurance instruments (involving the private sector) to help finance disaster-related spending. Across its portfolio, the WBG will support public and private sector counterparts in ensuring that building and design standards take into account disaster risks; the WBG will leave flexibility in IDA operations to respond to disaster needs should that occur. The WBG can also consider stand-alone investments on disaster risk management, but it is possible that other partners may have more of an opportunity in this field. The WBG will keep this under review as part of regular donor coordination.

FIGURE 7: *Domain two: Protection and potential—Expected outcomes*

Outcome 4: Greater Agricultural Productivity	**Outcome 5:** Improved Social Service Delivery for Vulnerable Groups, Particularly Women	**Outcome 6:** Improved Capacity to Manage Risks from Climate Change
• 5 percentage points increase in annual yields of smallholder farmers of maize, beans and Irish potatoes • Additional 45,000 ha of agricultural irrigated land and 10,000 ha of drainage.	• Additional 1,000,000 women with access to a basic package of health, nutrition or reproductive health services • Additional 500,000 women with access to improved water sources in areas supported by Bank operations • 9 percentage points increase in number of interns employed or self-employed within 6 months after internship completion • Additional 450,000 people covered by social safety nets • 75 percentage points increase in beneficiaries for whom payments are made electronically using two factor authentication.	• Reduction of 5% in crop losses due to droughts • 32 community action plans with concrete climate risk management activities reflected in the budget.
Outcome 7: Greater Citizen Feedback on the Quality of Service Delivery in Key Sectors(connecting platform) • 2 sectors use citizen report cards on service delivery.		


Photo: David Waldorf/World Bank

E. Domain three. Consistency and equity: delivering a devolution dividend

72 **The focus on building consistency and equity—a really long-term drive—has devolution at its core.** The WBG will use a large-scale, capacity-building and AAA program to inform a series of IDA operations, which help both counties and national agencies to make devolution work. The first of these will be completed in FY15, and others will follow—perhaps using a results-based instrument and quite possibly with substantial co-financing from other development partners. Upon request, the WBG is prepared to take a lead role in assembling and managing a trust fund framework to maximize donor coherence in this fluid arena. IFC will be engaged, but likely in a more limited way initially—such as engaging with subnational authorities on infrastructure provision or subnational reviews of the business climate—since devolution-related market opportunities are few and far between at this early stage. Analytical work will assess the fiscal impacts of devolution, including the approach to revenue collection, sharing, and debt management, with particular attention to potential imbalances between counties and among communities within counties. The WBG will also support the authorities in helping address the different risks faced by urban and marginalized rural areas so that their growth potential can be maximized. This will include on-the-ground investments targeting at least 25 percent of counties to deliver improved sanitation against benchmark standards, and an additional 200,000 children immunized in local health facilities. A summary of expected results for Domain Three is found in Figure 8 at end of this subsection.

73 **On governance,the Bank will expand support for programs to create and strengthen fiscal management capabilities at the county level and provide support to strengthen oversight institutions.** These institutions include the Office of the Controller of Budget, Office of the Auditor General, anti-corruption agency, finance committees in Parliament and country assemblies, and public procurement institutions. Also, the Bank will support roll-out of basic transparency and citizen

participation mechanisms in county planning, budgeting, and performance management (consistent with the Constitution and the legal framework) and will draw on growing global experience linking social accountability with enhanced development outcomes, targeting at least 20 percent of the counties (see Figure 8).

74 **Consistent and equitable treatment of vulnerable groups,** including indigenous peoples, will be a focus of tailored Bank engagement. In addition to careful application of good practice safeguards in Bank-supported operations, a program of dialogue and capacity building of key national authorities working in this field is anticipated. This long-term initiative will be calibrated to respond to Government ownership and also the engagement of other international partners, especially bilateral donors.

75 **A more evidence-based approach to policymaking and public investment decisions will certainly aid the consistency and impact of public administration reform.** A prerequisite for this is the availability and open dissemination of quality and timely statistics. Kenya has made some progress in this area (with support from the Bank and others) but remains vulnerable to some woeful gaps (see Annex 11). Given this, the WBG anticipates renewing its engagement with the Kenya National Bureau of Statistics (KNBS), the Treasury, the Ministry of Information Communications Technology, and other relevant institutions. The WBG will help in meeting an urgent need for a rigorous national Household Budget Survey (targeted for 2014/15), pivotal to producing up-to-date estimates of poverty and income growth. The Bank will also encourage and support strengthened collection and monitoring of gender disaggregated data. In addition, WBG joined the partners supporting the Kenya Demographic and Health Survey (KDHS2014). Data from these new surveys will confirm aspects of this CPS's approach; permit mid-course corrections as needed, including through a progress report to the Board; and inform the CPS results framework.

76 **The consistency of Kenya's development will be buttressed by deepening regional integration with its neighbors.** The WBG will provide a mixture of analytical activities and investment for near and longer-term initiatives. Some—such as advisory services to the capital markets authority to help facilitate regional financial deepening, or partnering for results with TradeMark East Africa on a Mombasa Port Charter to enhance operations—can be delivered primarily with Kenya counterparts. Others such as continuing transformative road and energy investments linking Kenya with Tanzania, Ethiopia, and other locations require multi-country agreements.

77 **To garner good governance, which is a connecting platform for equity and influences the success of broad efforts in all areas, a multi-pronged approach is used.** At its heart is capacity building to strengthen oversight institutions, including support for better public fiscal management and heightened transparency and accountability in the use of public resources through demand-side institutions such as the use of barazas (open community meetings) for beneficiary engagement. WBG support will help ensure greater citizen feedback on the quality of service delivery, including the use of citizen report cards in key sectors such as health. Other work includes (a) integrated Bank and IFC advice on investment climate (national and subnational), public-private partnerships, and corporate governance; (b) partnering

FIGURE 8: *Domain three: Building consistency and equity—expected outcomes*

Outcome 8: Better Provision of Health and Sanitation Services by Counties • 25% of counties with improved sanitation performance as measured by annual benchmarking • Additional 200,000 children immunized in local health facilities.	**Outcome 9:** Adequate Systems to Monitor Performance of Services Delivered by Counties • 20% of counties establish a performance monitoring system.
Outcome 10: Heightened Transparency and Accountability in the Use of Public Resources, Particularly at the County Level • 4 month reduction in the time it takes for the Kenya National Audit Office to submit the consolidated annual financial statements to Parliament • Additional 27 counties use IFMIS for budget preparation and execution, accounting, and financial reporting.	

with WBI (or its successor) on transparency, social accountability, and citizen engagement, including the voices of women, in coalitions of change; (c) reviewing the impact of project-level governance measures; and (d) scaling up those that have been effective, including drawing on input from the Department for Institutional Integrity on project safeguards and institutional support to agencies such as the Ethics and Anti-Corruption Commission (EACC). WBG stands ready to deploy "corruption calibration" to its lending program by which it adjusts areas of focus and/or scales back resources in the event of issues that unduly threaten the security of IDA and IFC resource use.


Photo: World Bank

V. Implementing for results

A. Lessons learned from the CPS completion report

78 **Lessons from experience including analysis from the Independent Evaluation Group (IEG) have contributed to this strategy.** Among past achievements have been (a) a gradual move to larger projects (i.e., those over US$100 million), some of which have simpler design; (b) notable WBG collaboration and performance in selected areas, including the power sector where IFC, MIGA, and Bank resources have been combined in specific investments; (c) expansion of IFC investments and improving profitability, helped by a strong on-the-ground presence in IFC's Nairobi-based hub office; and (d) effective collaboration between the Bank and Government to strengthen fiduciary management at project level. Energy, water and sanitation, ICT, agriculture, social protection, and the environment represent the sectors with outcomes that "achieved" or "mostly achieved" success with CPS outcomes. For more details of past achievements, Annex 2 provides the Completion Report for the CPS FY10-13.

79 **Lessons learned also include some weaknesses.** Several projects had not fully met their objectives because of poor monitoring and evaluation, and insufficient attention to political economy. One weakness observed was a heavy share of AAA that although technically competent was not driven by unambiguous client demand and thus had difficulty gaining traction. In another case, CPS results framework did not always fully capture Bank activities or in some instances was too ambitious. Private sector development, transport, education, urban development, and governance represent sectors with outcomes that were only "partially achieved" or "not achieved".

80 **Past components of success included dynamic government sponsorship** (ICT), systemic and strategic objective setting (energy), solid AAA (social protection), and maximizing opportunities for WBG collaboration and private sector involvement (energy). Conversely, weaknesses were more apparent when these components were absent or when as in the

case of the governance theme WBG work was not well captured in the results framework. The overall assessment of the outcome of the last CPS was "moderately satisfactory". This compares favorably with an outcome rating of "unsatisfactory" in the previous FY04-09 CPS Completion Report while suggesting room for improvement.

B. Operational responses and the focus on results

81 **In targeting such improvement, there are several practical areas to pursue over the coming years.** It is important to continue to "move to scale" especially in IDA investments, but also in IFC commitments, by focusing on larger projects and the judicious use of additional finance. IEG evidence suggests that historically larger IDA projects (above US$100 million) are twice as likely to be successful as smaller ones. Fiduciary management can be strengthened at project level by focusing more on governance systems at national and subnational levels. Renewed efforts to "stay on schedule" are also important since IDA projects, which complete within five years or so, are notably more successful than those that spin out over longer periods. This may necessitate some tough decisions in closing lagging projects as part of regular portfolio cleanup.

82 **To ensure that client service is prompt and responsive, the WBG will make maximum use of Nairobi-based expertise.** The new hub co-locates IFC and the Bank, and will help facilitate rapid deployment of expertise from the Global Practices. Working closely as well with the private sector will signal at an early stage to all parties what the due diligence requirements are, how long they are likely to take, and what the cost implications are likely to be. Verifying that there is sufficient capacity to commission and supervise these due diligence requirements within the relevant government ministries, utilities, and other corporate bodies is also important.

83 **A results focus will drive the implementation of the CPS, including with careful monitoring and evaluation.** The results matrix is detailed inAnnex 1. Targeted outcomes have been articulated in a multi-sector fashion, reflecting the interdependence of the activities across the strategy. Multidisciplinary WBG teams that produced the key elements of this results framework will continue to operate through strategy implementation. They will be responsible for conducting multi-sector dialogue for each outcome, ensuring adequate coordination and real-time monitoring of progress. Every six months, a country team workshop will assess progress toward CPS targets and make programmatic decisions toward results. Annually, a joint client-WBG workshop will review progress toward results, moving beyond the standard metrics of portfolio implementation and keeping an eye on the poverty and shared prosperity ambitions. Adjustments will be considered as needed to implementation modalities or the strategy itself.

84 **WBG's efforts to manage for results across the country program build on country systems and capabilities for measuring and monitoring progress.** Most of the indicators included in the results matrix have been drawn from the Government's MTP2, allowing for synergies in monitoring and capacity building (these are marked with an asterisk in Annex 1). The strategy also seeks to provide diverse support for relevant government partners in planning and budgeting, institutional strengthening, and statistical capacity building.

Raising awareness and strengthening capacity among implementing agencies to manage for results is fundamental; and new operations will, where possible, support sector monitoring and evaluation systems and reform of incentives to achieve results. Ultimately, strengthening domestic accountability mechanisms will create sustained incentives to achieve better results. Third-party monitoring in signature projects across strategic objectives of the CPS will be used where appropriate to provide an independent perspective on progress toward results, enhancing accountability for resources and outcomes.

C. Selectivity in practice

85 **Selectivity is key and at an operational level involves difficult trade-offs and, indeed competing pressures.** Coping with demands from line ministries and in-country donors for Bank involvement needs strong partnerships and mature dialogue. The potential pressure from such demands will also be managed by a disciplined strategic and operational approach. The latter is not a mechanistic filtering exercise and will call for professional judgment, but the process can be disciplined with a simple checklist that teams utilize during project concept and preparation. This process is dynamic and the assessments will be continuously updated. The current findings in Figure 9 show areas where more is likely to be

FIGURE 9: *Dynamic selectivity in the Kenya CPS: Directing WBG resources*

Domains of engagement		Doing Less / Doing Differently	Maintaining a robust engagement (About the same)	Doing More / Doing Differently
Competitiveness and Sustainability	Garnering Good Governance	Railways Ports/airports National highways Tourism Natural resource management Telecoms MSE finance/credit guarantees	Access to water and transport services	Infrastructure for sustainable growth Enabling environment for private investment
Protection and Potential		Secondary healthcare Orphans and street children	Climate change and natural disasters	Social service delivery for vulnerable groups, including youth Rural development & agricultural productivity
Equity and Consistency		Law enforcement Legal/judicial reform	Fiscal management, transparency and accountability (national & county level)	County-level service delivery, including citizen feedback on quality

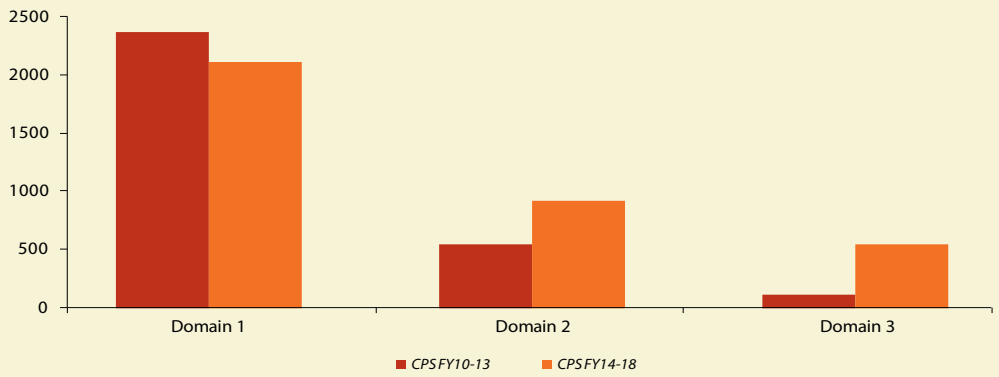
Note: This represents the current assessment of selectivity, especially in the relative allocation of new IDA resources in the CPS period. IFC investments are determined by market conditions and are also part of doing things differently (e.g., in PPPs in major transport schemes, other infrastructure). AAA planning will complement this approach and be available to meet other demands where the WBG has a comparative advantage and the resources to respond.

done especially in terms of IDA investment and, correspondingly, sectors where less will be done (or a new approach such as relying on private finance or other development partners).

86 **The approach also means that this is not business as usual.** To the contrary, this new CPS differs from the previous one. There is a strategic shift in IDA resource allocation that emerges from aligning with the WBG twin goals and the selectivity test, as shown in Figure 10. Relatively more is likely to be directed toward human resource development (Domain II) including in agriculture/rural development, and in delivering a devolution dividend (Domain III, which is new). Relatively less IDA financing will be deployed on competitiveness (Domain I), where new opportunities for private financing, including with growing IFC support, are expected to emerge.

87 **Careful portfolio management will continue to be important with tailored approaches to suit the particular circumstances of Bank, IFC, and MIGA investments.** At mid-FY14, the total IDA portfolio in Kenya was US$4.3 billion, covering 23 national projects (US$3.5 billion) and 7 regional projects in which Kenya is a partner (US$0.8 billion)—see Annex 4. Portfolio value more than doubled over the last four years and in many respects performance has been robust. The disbursement ratio, for example, was 18 percent in FY13, around Africa norms. But there are significant challenges—more than 20 percent of projects have less-than-satisfactory implementation progress, and vigilance is needed on governance and safeguard issues in some sectors. The slow flow of funds through government systems has been an obstacle to smooth project implementation. Further, some projects suffer from weak fiduciary performance and project management leading to slow project implementation. Delays in receiving audit reports and Interim Financial Reports (IFRs) are a continuing problem. The Bank also receives audit reports with qualifications relating to issues that the accountants should address, such as missing documentation. This occasionally leads to ineligible expenditures that take time to resolve (by the government submitting eligible

FIGURE 10: *Strategic shifts as IDA is selectively deployed: Likely focus of IDA in this CPS compared to the previous CPS*



Note: Lending made in the CPS FY10-13 period came under different themes but has been reclassified into the three domains of engagement in the new CPS to illustrate the strategic shift of the allocation of resources. Pipeline planning is advanced for FY15 (see Table 3). Outer years are still being developed and so are not shown in detail; but indicative broad allocations have been used to show likely evolution.

receipts or returning the ineligible funds). To help, many accountants, auditors, and project staff have participated in Bank-supported FM capacity-building training that will continue during this CPS.

88 **Acknowledging this problem, the Government of Kenya has initiated far-reaching portfolio-level FM reforms with the Bank's support to address identified fiduciary weaknesses in management of donor projects and devolved funds.** Over the CPS period, practical measures to address these will include (a) regular client-led reviews, at senior level, on cross-cutting portfolio issues; (b) semi-annual workshops for project implementation client teams on fiduciary, contract management, and disbursement performance; (c) locating a senior environmental expert in Nairobi to strengthen Bank safeguard resources; (d) collaborating with INT in outreach to Government counterparts in developing stronger vigilance measures; and (e) establishing a country-coordination mechanism across the WBG's new Global Practices to share experience and bring the best expertise to bear on implementation issues.

89 **The IFC portfolio has grown even more rapidly than that of IDA and stood at US$785 million at mid-FY14.** Decent market conditions have helped, and IFC has been able to drive forward development impact while retaining an appropriate focus on profitability. The IFC region-wide hub, co-located with the Bank in Nairobi, provides a critical mass of on-the-ground expertise, which helps foster ever-closer client connections, including just-in-time responses to portfolio challenges. MIGA's current total exposure to Kenya is US$255 million, and international investors' interest in the infrastructure, power, and agri-business sectors provides potential for this regional interaction to expand further.

90 **The WBG could be providing over US$1 billion per year to Kenya over the timeframe of this CPS.** With regard to the portfolio, IFC hopes to continue its expansion—perhaps even beyond the US$200 million rise each year in commitments over the last two full fiscal years—if market conditions permit, as well as a steady increase in Advisory Services engagements. MIGA is following a similar path and already extended over US$100 million of guarantees in each of the last couple of years. The Bank's annual commitments will be governed by the IDA17 settlement, provisionally around US$600 million each year. It should be noted that actual IDA allocations will depend on (a) total IDA resources available; (b) the country's performance rating, GNI per capita, and population; (c) the terms of IDA assistance (grants/credits) and the allocation deductions associated with Multilateral Debt Relief Initiative (MDRI) annual debt service forgone; (d) the performance, other allocation parameters, and IDA assistance terms for other IDA borrowers; and (e) the number of IDA-eligible countries.

91 **The lending program will be concentrated in key areas.** The near-term plan is shown in Table 3. Outer years will be firmed up as the CPS progresses, consistent with achieving the results framework targets. Kenya is also expected to continue to engage in regional projects that will leverage additional IDA resources from the set-aside pool. The new IDA portfolio will give significant emphasis to more systematically impactful projects—each informed by prior AAA.

TABLE 3: *Proposed lending program*

	IDA in US$ million	
	FY14	FY15
Competitiveness and Sustainability -- Growth to Eradicate Poverty		
Transport	204	100
Energy		250
Water Security		200
Protection and Potential -- Human Resource Development for Shared Prosperity		
Social Safety Nets	260	
Health Sector Support	41	
Pastoral Livelihoods / Community Development	77	44
Equity and Consistency -- Delivering a Devolution Dividend		
Transparency and Communication (ICT)	30	
Devolution Support		120
Better Statistics		50
Total	**612**	**764**

Note: The outer year pipeline will be firmed up using the selectivity test and other updates will be made in the CPS Progress Report. The amount in FY15 includes front-loading from outer years.

92 **Knowledge work will play an important role in the CPS program.** In the near term, the CPS will develop a strong knowledge platform around poverty, gender, infrastructure, agriculture, jobs/skills, and devolution as Table 4 shows. In outer years, AAA will be tailored to inform future lending, respond to Government needs, and deepen advice in key areas, including governance and public financial management.

93 **A broad range of WBG instruments will be used, including the Program-for-Results (PforR) tool, and financing innovations will be sought.** IDA investment lending has been the bread-and-butter of financial engagement in Kenya. This is expected to continue in this CPS period and be complemented by IDA's other lending instruments that provide the best fit for delivering strong development impact. The first PforRoperation for Kenya was approved in July 2013 and more use of PforR is expected, including for the devolution programs. The Government has indicated interest in also tapping into IBRD resources, perhaps as "enclave financing" for high-profile infrastructure projects. This is worth exploring as it can lay the foundations for Kenya to smoothly transition to fuller use of IBRD over the longer term.

94 **The WBG resources and activities are being aligned around collaboration with donors and other financiers.** Kenya has a multiplicity of donors. There are good mechanisms to cooperate, not least of which is the semi-annual Government-led Development Partnership Forum and the complementary monthly Development Partners Group meeting (see Annex 14 for details). In several areas—investment climate, social

TABLE 4: *Proposed AAA program*

FY2014	FY2015
Domain 1: Competitiveness and Sustainability	
• Joint Staff Assessment Note • Kenya PER • Powering Kenya's Future • TA on Regional Transport • TA on Infrastructure Finance/PPP • Financial Innovation NLTA	• Growth and Competitiveness CEM • Investment Climate
Domain 2: Protection and Potential	
• Agriculture ESW • Education AAA	• Youth skills and training • Heath financing and service delivery (South-South)
Domain 3: Equity and Consistency	
• Accountable Devolution	• Devolution Fiscal Risk Analysis • Political Economy of Governance and Sector Reform
Cross-Cutting Knowledge Work	
• Economic and Poverty Monitoring • Governance Dialogue • Gender Policy Notes • Demand-side Governance • Open Data Incubator Innovation	• Kenya Urbanization Review • Governance AAA • Poverty and Gender Assessment • Public Financial Management

Note: The outer year pipeline will be firmed up using the selectivity test and other updates will be made in the CPS Progress Report. The amount in FY15 includes front-loading from outer years.

protection, water security, and health, to name a few—there is explicit and large-scale co-financing of WBG-supported programs. That said, it is a fairly crowded landscape, and there is scope for clarification of comparative advantage and simplification of some processing burdens on the Kenyan administration. With this in mind, WBG will lead more explicitly taking a back seat or even withdrawing from some sectors where the AfDB and others may fit better. The WBG will continue to assist Kenya by raising and managing trust funds but only on a very selective basis since it is important to note that traditionally these have not been of a large-scale overall. That picture may not change in the near term.

95 **The benefits from the WBG program would be amplified by improved governance and reduced corruption, or undermined by any deterioration in the prevailing environment.** In moving forward the Bank will be firm in its intolerance for corruption and desire for impunity to end. Inevitably, scandals will occur; but as not to be thrown off course, the WBG will set sensible expectations to make step-by-step progress. Prudent features, informed by governance specialists from across the Bank, will continue to be built into project design. These include, for example, in-depth fiduciary reviews, third-party monitoring and reporting on physical project outputs, and robust procurement packages.

96 **The Bank's analytical work will continue to help improve public financial management**—most notably solidifying and extending the IFMIS, making greater use of properly controlled electronic funds transfer, and supporting capacity in the country's supreme audit institution (KENAO) to deepen its work, including in performance audits. The WBG together with other development partners will extend further support for better procurement practices, including through potential revisions to the Public Procurement Law, more efficient e-procurement, reforming of the supplies branch, and capacity building, especially at county level. This is part of a broader drive for institution building and the enhancing of corporate governance standards, openness, transparency, and accountability in government. This applies at a national and county level—and should help protect the integrity of WBG resources as well as Kenya's internally generated resources, which contribute to 90 percent of all public spending.

97 **Implementation of the CPS will receive guidance through a mid-way progress report to the Board, which will propose course corrections as needed.** In the coming year, for example, it is expected that the authorities will produce more up-to-date poverty estimates, which the Bank will complement with a new and detailed Poverty and Gender Assessment. The WBG should be open to the possibility that such findings may call for adjustments in the program. Similarly, the devolution field is fast moving so the WBG will adapt as new information and demands emerge. Finally, governance conditions and their implications for the WBG program will be monitored vigilantly.

"No masika (rain season) without mosquitoes"
~ Kenya proverb

Photo: World Bank

Vi. Managing risks

98 **The WBG faces significant risks in Kenya,** yet broadly it has a sanguine outlook that the downsides, which may emerge, are likely to be manageable and/or have a modest probability of occurring.

99 **The greatest risk to prospects of poverty reduction is any potential macroeconomic instability, including from possible fiscal pressures associated with devolution.** Kenya has a fairly open economy and even now its net exports remain a drag on GDP growth. If it were to be hit by an external shock such as reduced international demand, tightening global liquidity that curtailed short-term inflows, oil shock, or other deterioration in the terms of trade, the impact would be noticeable. The mitigation strategy has to revolve around the long-term drive to improve competitiveness and exports, combined with a prudent strategy on reserves and international capital access to cope with potential volatility. The threats to undermining sensible macroeconomic policy come largely from wage pressures on fiscal policy and populist politics that can create actual or contingent liabilities. For example, there are pressures to hold down power tariffs at unrealistic levels. More broadly the devolution process carries significant fiscal risks such as passing unaffordable central transfers to devolved administrative units, counties not controlling spending to fit available resources,or allowing counties to borrow without careful regulation and oversight.

100 **Disasters and insecurity, natural or man-made, can be expected to occur even though their timing and severity typically cannot be predicted.** Weather-related impacts such as droughts need a combination of long-term preventative measures combined with emergency responses (and on-hand resources) when they occur. Being a major exporter to the region, Kenya could experience interruptions with trade due to the conflicts in South Sudan and continued instability in Somalia. Trade with these economies also raises security concerns that spill across the border, including in terms of small arms proliferations. The recent terrorist atrocities at the Westgate Mall created great suffering but also served as an unwelcome reminder of the position Kenya holds in being a

target of such threats. Instability in the region can also displace local populations and disrupt their livelihoods. It has a negative impact on tourism, which is Kenya's main foreign exchange earner. In many ways instability and insecurity create a shock to the economy akin to that from natural sources that the Bank, IMF, and international community have in the past been able to react to with specific instruments.

101 **Other strategic risks include unexpected changes in political leadership, policy direction, and ministerial leads in key sectors.** Unexpected changes in the funding priorities of other donors or a loss of appetite of strategic partners for IFC- and MIGA-supported deals could also constitute a strategic risk. Each of these would require nimble re-engagement with partners to prevent changes unduly affecting the WBG-supported program.

102 **Operational risks include a worsening of the governance and corruption environment—or stakeholders' views and responses to such circumstances.** Corruption is corrosive and eats away at development prospects. The potential turbulence during the devolution process, for example, may see cases of irregularities reported in some of the new county administrations as their activities expand. Closer to home, if a major Bank engagement was to be hit by a proven fraud, theft, or other irregularity, it will undoubtedly require downscaling or termination of WBG work in that area and throw things off course (as has happened in the past). The mitigating measures include (a) the thrust of this CPS to help garner good governance, including as part of the devolution process; (b) active cooperation between INT, the Bank, and the authorities so that preventive measures are built into project design and allegations can be handled firmly and decisively when received; and (c) good communication with stakeholders, including the WBG Executive Board, in order that due proportionality can be applied in any strategic response needed by the Bank.

103 **Ineffective application of good practice social and environmental safeguards could also pose a risk to successful project implementation.** This is being mitigated by a combination of thorough preparatory work in project preparation, intensive supervision, and longer-term support for national capacity building in this area.

VII. Conclusion

104 **There is an optimistic yet credible scenario for Kenya to drive forward as a success story in Africa.** Certainly there are risks which may throw Kenya off course. By mitigating such risks, consistent with a renewed impetus to manage for results, the WBG will support Kenya's efforts to communicate its successes and its development story more effectively. This CPS sets the groundwork for the WBG to help Kenya and its citizens achieve their ambitions.

Annexes

Available at http://www.worldbank.org/africa/kenya/cps/annexes

Annex 1: CPS results framework
Annex 2: CPS completion report
Annex 3: Selected indicators of bank portfolio performance and management
Annex 4: Operations portfolio
Annex 5: IFC and MIGA activities
Annex 6: Trust funds
Annex 7: Poverty, shared prosperity and progress toward MDGs
Annex 8: Bank group collaboration
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