I. Country Context

1. Although Kenya has maintained a good track record in macroeconomic management, with economic growth rebounding after the 2009 crisis and remaining robust in the range of 5 percent, prevailing levels of growth (around 2 percent growth in income per person) have not been sufficient to make a significant dent on poverty currently estimated at about 43 percent.¹

2. There are major and persistent disparities in poverty levels, human development indicators and access to services across different regions². Poverty appears to have lessened in recent years, but levels of inequality remain higher in Kenya than in neighboring countries. Poverty levels vary widely (See Figure 1), and are highest in the arid and semi-arid regions in the north and north east -- areas with very little annual rainfall and low agricultural potential. Still, most poor people live in the more urbanized, agriculturally productive counties. Kenya’s gini coefficient is estimated at about 0.45, one of the highest in the East African Community region. High levels of income inequality and inequitable access to basic services impede poverty reduction, and can feed conflict.

3. Kenya has steadily improved economic management, and scores relatively well on

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¹ As outlined in the County Partnership Strategy and elsewhere, Kenya has experienced relatively steady growth that has been predominantly driven by domestic consumption and services, rather than extractive industries; it is likely that the benefits from growth have been spread broadly across income groups. Still, it is notable that Kenya’s growth is largely urban (Nairobi and Mombasa alone account for about 40 percent of the country’s wage earnings), while there has been a slow overall rate of increase in agricultural productivity.

² The populations, land areas, levels of urbanization, and economic potential of the new counties vary widely. County populations range from 102,000 in Lamu, to 3.5 million in Nairobi. County land areas range from Mombasa, with 219 km², to Marsabit, with 70,961 km².
measures of citizen voice and press freedom. However, the public sector faces persistent governance challenges, and the business environment is not enabling the growth rates needed to significantly reduce poverty – due to a combination of constraints in infrastructure, quality of business services, and corruption that impede investment and productivity improvements. These impediments hinder service delivery, private sector-led growth and job creation, which in turn exacerbate inequality and increase conflict vulnerabilities. These governance challenges disproportionately impact the poor.

4. Kenya’s 2010 Constitution seeks to address these challenges, and represents a fundamental shift in the country’s policy and institutional framework. The Constitution seeks to rebalance accountabilities and increase the responsiveness, inclusiveness, and efficiency of government service delivery. It provides for multiple reforms, including a strengthened legislature, judiciary, decentralization, new oversight bodies, and increased transparency and accountability to citizens. Implementation has largely proceeded according to Constitutional timetables, as the Government established new oversight bodies, and overhauled the legal architecture to make way for 47 new elected county governments and county assemblies.

II. Sectoral (or multi-sectoral) and Institutional Context

5. Among the many reforms ushered in by the Constitution, devolution is arguably the most ambitious. Devolution brings a tectonic shift in Kenya’s institutions, as multiple powers, responsibilities, and funds have shifted from the national government to 47 elected county governments. Devolution reforms seek to tackle long-term, deeply entrenched disparities between regions; shift from highly centralized, top-down government to a more responsive, “bottom-up” form of government; allow greater degrees of autonomy to different regions; reduce unequal access of the population to basic services, and address key drivers of conflict. Kenya’s devolution is one of the most ambitious underway in the world, given that it involves the simultaneous transfer of power and finances to an entirely new level of government.

6. Devolution formally began with the March 2013 elections, which proceeded peacefully without widespread violence. Forty-seven new county governors, county assemblies, and senators were elected, consolidating multiple former levels of government. Central Ministries were consolidated, from 40+ preceding the elections down to 18 new Ministries, including a new Ministry of Devolution and Planning. A new Senate, representing the counties in the national legislature, was established. And new inter-governmental bodies – including the Council of Governors (CoG), the Integrated Budget and Economic Council (IBEC) – were established soon afterwards.

7. The 47 new county governments quickly assumed responsibilities for delivering devolved services, including health, agriculture, urban services, and local infrastructure. Other devolved functions include county roads, county planning and development, management of village polytechnics, and county public works and services. Although the Constitution envisaged a three-year incremental transition and transfer of these functions, most functions were

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transferred to the new counties within the first six months following the elections. National
government maintains a policy and standard setting in these areas.

8. The counties receive annual transfers from national government of over US$2.5 billion
(KSh.250 billion) to carry out these devolved functions. This financing is primarily provided
through an unconditional transfer – called the “Equitable Share” – of nationally collected
revenues. The Constitution provides that counties receive a minimum of 15 percent of national
revenues of the last audited financial year. Counties were allocated KSh.190 billion (US$2.2
billion), KSh.226 billion (US$2.5 billion), and KSh.259 billion (US$2.6 billion) for the fiscal
years 2013/14, 2014/15 and 2015/16, amounting to about 3.9 percent of Gross Domestic Product
(GDP) per year.

9. These resources are then shared among the counties via a progressive formula that gives
historically marginalized counties a larger per capita transfer than historically privileged
counties. The formula, known as the “Equitable Share formula,” is based on population (45
percent), poverty (20 percent), equal shares (25 percent), land area (8 percent), and a ‘fiscal
discipline’ component (2 percent) that is currently shared on an equal basis. County populations,
land areas, levels of urbanization, and economic potential vary widely – county populations
range from 102,000 in Lamu to 3.5 million in Nairobi. A consequence of this formula is that
historically marginalized counties, in arid and semi-arid regions of the country, have significant
discretionary budget resources, whereas historically privileged counties, including most urban
areas, face fiscal constraints. The Constitution also provides for an Equalization Fund
amounting to 0.5 percent of total nationally generated revenues (not yet implemented), as well as
for conditional transfers – currently covering provincial hospitals, and the operation and
maintenance of health facilities. The Constitution grants limited revenue-raising powers to
counties (the largest being property rates and single business permits), thus most counties remain
highly transfer-dependent.

10. The first three years of devolution have brought notable progress, as well as
significant challenges, as counties seek to simultaneously deliver devolved services and build
brand-new institutions and systems. New county governments and assemblies have been
established and are beginning to deliver investments and services, including services never seen
previously in some disadvantaged regions and communities. Not unexpectedly, there are also
major challenges: attracting, training, and retaining competent staff, and managing staff and
wage bills inherited from former local authorities and Ministries in devolved sectors; managing
public finances; translating county development priorities into budgets and actual projects; and
managing political and ethnic tensions within counties. There are regular allegations of
mismanagement of public funds, and signs that some forms of conflict have also “devolved”.
Progress is hindered by sustained competition – between county and national governments,
between county governments and assemblies, between governors and senators, as new
intergovernmental mechanisms are established. Nonetheless, public support for devolution has
remained quite constant, with around two-thirds of Kenyans expecting that devolution will bring
more opportunities than risks.

11. These achievements and challenges highlight the major implications that devolution has
for poverty reduction, service delivery and economic growth, and governance. There is widespread agreement that devolution has created a new reform space, and new momentum, for more responsive, equitable, efficient and accountable local service delivery. Converting this into actual improvements in on-the-ground service delivery will depend on the quality of county institutions – and their capacity to effectively plan, finance, implement and monitor investments and services – as well as on the incentives that drive them. In summary, the early years of devolution provide a window of opportunity to strengthen new county institutions and systems, and to reinforce positive incentives. But this will require significant, dedicated effort and financing.

III. Program Scope

Government program

12. In response to the major capacity challenges posed by devolution, the national and county governments developed the National Capacity Building Framework (NCBF) in 2013 to guide the establishment of necessary capacities for devolved government. The overall objective of the NCBF is “to ensure the devolution process is smooth and seamless to safeguard the delivery of quality services to the citizenry.” The NCBF has five pillars: Training and Induction; Technical Assistance to Counties; Inter-governmental Sectoral Forums; Civic Education and Public Awareness; and Institutional Support and Strengthening. During the first two years of devolution, under the NCBF, the national government put in place multiple new laws and policies, rolled out systems (e.g. the integrated financial management information system – IFMIS), designed and rolled out induction trainings for large numbers of new county staff from different levels of county government, and initiated medium-term capacity initiatives focused on the new counties.

13. Following a review of early NCBF implementation, the Government has developed the NCBF Medium-Term Interventions (NCBF-MTI), a results focussed implementation program and expenditure framework for the NCBF covering the period FY14/15 – FY17/18. The MTI provides a set of results and outputs against which capacity building activities at both levels of government, and across multiple government departments and partners can be measured. It provides the basis for a more coherent, well-resourced, and coordinated devolution capacity support across multiple government agencies at national and county levels, as well as by other actors. The MTI defines priority objectives, outputs, activities and budgets for building devolution capacity across 5 KRAs:

1. KRA 1: Public Finance Management
2. KRA 2: Planning, Monitoring and Evaluation
3. KRA 3: Human Resources and Performance Management
4. KRA 4: Devolution and Inter-Governmental Relations
5. KRA 5: Civic Education and Public Participation
14. For each of these KRAs, the NCBF-MTI defines both national and county level results, as well as key outputs and activities. In most cases, achieving priority results in each KRA depends on both national government and county government.

15. Many of the priority capacity results under the NCBF program will depend on counties to take specific implementation measures. Global and Kenyan experience, including experience under the NCBF, have highlighted that centrally-executed capacity building programs, although they provide critical inputs, by themselves may not be adequate to catalyse sub-national government capacity results. Supporting and incentivizing counties to achieve these results is equally or more important.

16. Based on this experience, the Government intends to introduce new fiscal transfers from the central government to counties. The 2015 Budget Policy Statement (BPS) states that the national government will design a performance grant framework “to support county governments as the centres for service delivery and economic expansion, especially in the areas of public financial management (PFM), good governance practices and supporting the counties to be fully operational,” as well as to enhance fiscal responsibility principles. Performance and capacity grants to counties are thus envisioned to be a key instrument of devolution capacity building—by helping to define key capacity results at the county level, regularly assess progress, and strengthen incentives for counties to achieve these results. In turn, counties that manage to strengthen these key PFM, human resource management (HRM), M&E, and citizen engagement capacities will be better equipped to manage county revenues and service delivery, achieve county development objectives, as well as to access other sources of development financing.

17. These government-executed activities are complemented by extensive support from multiple development partners who are supporting devolution capacity support under the NCBF. The three largest programs are supported by the United Nations Development Program (UNDP), the European Union (EU), and United States Agency for International Development (USAID) as well as by the WB’s Kenya Accountable Devolution Program (KADP), which is provided via a multi-donor trust fund (MDTF) financed by the Department for International Development-UK (DfID), DANIDA, the EU, Finland, Sweden, and USAID. Together, these programs will provide more than US$100 million in devolution capacity building support over the coming four to five years. Via the Devolution Sector Working Group (DSWG), discussions are underway with partners on how to align activities around the NCBF-MTI, as well as on how the new fiscal transfers and annual capacity and performance assessment (ACPA) – assessment methodology by the Program – can reinforce and be complemented by capacity building supported directly by external partners at the county level. A substantial part of development partner support focuses on the five NCBF-MTI key results areas, toward which the partners provide a wide range of capacity building inputs, often to specific targeted counties.

The PforR Program: Kenya Devolution Support Program

18. The Kenya Devolution Support Program (KDSP) will support implementation of
the NCBF-MTI. It will finance results around the strengthened capacity of national and county institutions in the key results areas (KRAs) under the NCBF-MTI. The PforR will provide incentives and support to critical parts of each KRA:

- **KRA 1 - Public Financial Management** including improved county budgeting, revenue management; use of IFMIS; financial accounting, recording and reporting, procurement, internal and external audit performance

- **KRA 2 - M&E and Planning** including improved county planning, annual progress reports, monitoring and evaluation, and linkages between county plans and budgets.

- **KRA 3 - Human Resource Management** including development of county staffing plans, HR competency frameworks, appraisal and performance contracting systems. *(to be refined once GoK Capacity Assessment and Rationalization of the Public Service (CARPS) is finalized.)*

- **KRA 4 – Devolution and Inter-Governmental Relations:** including introduction of a new performance-based conditional grant.

- **KRA 5 - Civic Education and Public Participation:** enhanced rollout of civic education and county civic education units; greater number of counties that meet County Government Act (CGA) requirements for public participation and transparency.

19. For each KRA, the PforR will support both national-level and county-level results that contribute to strengthened institutions for devolved service delivery. Essentially, the PforR will support and incentivize national government to provide improved capacity building support to counties in each KRA, while simultaneously supporting counties to make system and capacity improvements.

IV. Program Development Objective(s)

20. The Program Development Objective (PDO) will be to strengthen capacity of core national and county institutions to improve delivery of devolved services at the county level.

National Government Results

21. The National Government Results supported by the PforR will include improved county audits, assessments of county capacity, and enhanced provision of policies, systems, guidelines, training modules, and technical assistance that counties require to strengthen their PFM, HRM, M&E, and citizen engagement systems mechanisms. These will include the following results at the national government level:

- Result 1: Improved timeliness and quality of county audits.
- Result 2: County capacity in the NCBF-MTI Key Results Areas is assessed annually.
- Result 3: Improved nationally-executed capacity support to counties in PFM, HR, M&E, and citizen engagement.
- Result 4: New performance-based grant system is established that measures and
incentivizes counties for improving core systems in PFM, HRM, M&E, and citizen engagement.

County Government Results

22. At the county level, the capacity and performance grants supported by KDSP will finance and support county capacity building activities, investments, and create incentives for improved performance. The magnitude of these grants will average about US$1.8 million per qualifying county per year. The grants will flow through normal government systems as a conditional transfer from national to county governments. All counties that qualify to access the capacity and performance grants will receive grants for capacity building. Starting in year two, all counties that meet more rigorous conditions will be eligible to receive larger grants to fund part of their investment program.

- Result 5: Increased number of counties have basic fiduciary, procurement, environmental and social management, grievance redress systems and staff in place.

- Result 6: Improved performance of participating counties in PFM, HRM, Planning and M&E, and public participation. Implementation of the results

23. National Government capacity building results will be achieved through annual workplans and implementation reports, which will be defined and assessed annually. MoDP, DPSM, NT and KSG will each develop annual workplans that plan interventions to address weaknesses identified by counties and through the ACPA. These workplans will be supported by resources in the government budget. Departments will monitor and report on implementation of these workplans, which will be reviewed by the Technical Committee including county representatives. The government’s Performance Contracting Unit will verify whether departments have met target implementation rates.

24. Each year the ACPA will assess counties on three sets of indicators: (i) Minimum Access Conditions, (ii) Minimum Performance Conditions, and (iii) Performance Measures. The ACPA will be conducted by an independent firm procured by a KDSP Secretariat housed in MoDP, under the oversight of the KDSP Technical and Joint Steering Committees. The allocations, based on this assessment, will be included in the draft Budget Policy Statement and relevant draft budget legislation that is submitted to the National Assembly in February. The Minimum Access Conditions, Minimum Performance Conditions, and Performance Measures are drawn from the NCBF-MTI, and were further refined through an extensive design process involving multiple agencies and departments and field testing in several counties. The minimum conditions and performance measures were developed in parallel with the Fiduciary Systems Assessment and the Environmental and Social Systems Assessment, and the minimum performance conditions and performance measures are designed to address key gaps and capacity needs that emerged from those assessments.

25. To qualify to receive any capacity and performance grants allocation, counties must
meet Minimum access conditions, including: signing a letter of commitment agreeing to grant conditions; developing an annual capacity building plan; implementing the previous year’s capacity building plan satisfactorily (from the 2nd assessment onwards); and adhering to the capacity building investment menu.

26. Each year, counties that meet the Minimum access conditions will receive a ‘level 1’ allocation averaging KSh.30 million (approx. US$300 thousand). With the exception of the assessment for grants in FY 2016/17, the assessment of achievement of these minimum access conditions will be conducted as part of the ACPA conducted by an external firm, to be hired by MoDP. The assessment teams will conduct fieldwork in September – October each year, starting in 2016. For the 2016/17 allocation, counties will conduct a self-assessment as the basis for developing capacity building plans. MoDP will then review whether these plans meet the Program requirements.

27. To receive larger “level 2” grants for county investments, counties will need to meet the minimum performance conditions. These are measures of a county’s basic capacity in PFM, environmental and social safeguards, and complaints handling. The minimum performance conditions are designed to assess whether a county has the basic systems and capacities to manage additional funds. As mentioned above, these minimum performance conditions also draw on findings of the Fiduciary; and Environmental & Social Systems Assessments conducted by the Bank. The size of the level 2 allocation to each county will depend on their score on a set of performance measures, assessed through the ACPA, and will average around KSh.150 million (approx. US$1.5 million).

28. Grants will be sequenced over time, starting with capacity building in the first year followed by a broader range of investments in subsequent years. The menu of capacity building investments covers organizational development and system development, technical assistance and peer learning, relevant equipment investments, and training activities. Counties that meet the minimum performance conditions will be able to fund a broader set of investments, which includes any development project included in their CIDPs, except for projects that have a substantial risk of significant adverse environmental or social impact. Throughout the life of the Program, counties that meet only Minimum access conditions and not minimum performance conditions will be limited to capacity building investments.

V. Environmental and Social Effects

29. The Bank has conducted an environmental and social systems assessment (ESSA) of the proposed Program for potential environmental and social impacts and determined that there is a moderate risk that the Program will support activities or investments that will lead to major environmental or social impacts. Based on the Program design, there are no activities likely to have significant adverse impacts that are sensitive, diverse or unprecedented and that may affect an area broader than the sites subject to physical works.
30. The ESSA concluded that the existing environmental and social management procedures of the counties and NEMA are adequate for use under the KDSP. Nevertheless, the ESSA identified potential issues related to the capacity of County government, and NEMA at the county level; and construction and operational phases of proposed projects including potential resettlement.

31. For county government-executed capacity activities, the ESSA found that while existing systems and the Program design are adequate to manage environmental and social impacts associated with the planned capacity and performance grants, there are some issues relating to staffing and capacity at the county level. Based on consultations with county representatives from 12 of the 47 counties, the ESSA found that the county capacity to manage social and environmental risks is nascent and quite variable. In addition, the ESSA found that while both county government staff and NEMA staff at the county level tend to possess adequate or basic qualifications, both NEMA and county governments are currently under-staffed and under-funded to handle the current volume of projects.

32. With regard to county government investment projects supported by grants, the Program intends to support the construction and or rehabilitation, maintenance, and upgrading of key facilities in various sectors, which are likely to lead to construction and operation impacts on the environment. Potential adverse impacts during construction and operations include among others, air pollution from dust and exhaust emissions; nuisances such as noise, blocking access paths; water and soil pollution from the accidental spillage of fuels or other materials associated with construction works, as well as solid and liquid wastes from construction sites and worker campsites; traffic interruptions and accidents among others.

33. These types of impacts, however, are generally site-specific, and limited in scope and magnitude. These impacts are and can be for the most part prevented or mitigated with standard operational procedures and good construction management practices.

34. KDSP will not support investments that lead to significant displacement of people causing impacts on property and livelihoods. Nevertheless, proposed investments may lead to limited displacement (economic and physical), which could be temporary or permanent as well. A resettlement action plan will be required for any investment with a likelihood of displacement, and investments displacing over 200 people will be excluded from KDSP support. Other mitigation measures to minimise displacements include a requirement that whenever possible, investments be located in public land and within Right of Way for investments that are linear in nature. Guidelines for screening and mitigating social impacts will be included in the POM, and guidelines for resettlement will include considerations for vulnerable groups.

35. Several features built into the PforR design further limit the risk of grant-funded county projects having significant environmental and social impacts. First, the size of the expected grants will be relatively small, and so the grants will be unlikely to fund major infrastructure or other projects with significant impacts. Second, counties will need to satisfy basic minimum conditions of environmental capacity before they can qualify for a Level 2 grant (for
investments). Third, the investment menu of eligible uses for the grants excludes county projects that require environmental impact assessments (EIAs) or that will result in the relocation of more than 200 people. There exists no gap between the Environmental Act-EMCA-regulations enforced by NEMA and Bank operating procedures. Fourth, compliance with this investment menu is a “minimum condition” for counties to access grants for investments. The ACPA will review whether each county has followed the investment menu; and if a county has not, it will be excluded from competing for grants in the following year. Fifth, despite limited county capacity, the government’s overall capacity to screen proposed projects and require EIAs of projects with significant risks is quite robust. The ESSA found that excluding projects that require EIAs will effectively limit most of the possible environment and social risks. Finally, the PforR operation is designed to annually assess and gradually strengthen county capacity to manage social and environmental risks. The annual assessment of counties will measure key aspects of county environmental and social capacity. Additional measures based on the ESSA of the capacity of implementing institutions for environmental and social management will be incorporated into the PAP.

36. The existing government system, complemented by the Program design features described above, are adequate to support the Program.

VI. Financing

Table 1: Program Financing Summary (US$ Million)

<table>
<thead>
<tr>
<th>Source</th>
<th>Amount</th>
<th>% of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government</td>
<td>93.3</td>
<td>32</td>
</tr>
<tr>
<td>IBRD/IDA</td>
<td>200</td>
<td>68</td>
</tr>
<tr>
<td>Total Program Financing</td>
<td>293.3</td>
<td>100</td>
</tr>
</tbody>
</table>

VII. Program Institutional and Implementation Arrangements

37. The Program will be implemented using the existing intergovernmental architecture as enshrined in the Kenya Constitution 2010.

County Governments

38. The majority of Program funds will be ultimately executed at the county level. Program Grant funds will be disbursed to the County Revenue Fund (CRF). County Treasuries (CT) will apply to the Controller of Budget (CoB) for release of funds from the CRF to county operating accounts. Counties will spend funds according to national laws and regulations, including those relating to environmental and social safeguards and complaints handling. All expenditures will be recorded in IFMIS. CTs will also submit quarterly budget implementation reports to the CoB which will identify use of Program grants.

39. The counties will be responsible for planning, budgeting, implementing and reporting on Program-funded activities, consistent with their mandate under the County Act. The county
secretary will be the focal person, responsible for implementing and reporting on Program activities and the contact point for e.g. the ACPA and other interventions. Counties will be represented on the JSC and TC. Counties will also be invited to be represented on the opening and evaluation Committees for procurement of the ACPA assessment teams.

40. County governments will also be responsible for implementing activities to improve capacity in NCBF KRAs, as measured by the ACPA. Counties will complete Annual Capacity Building Plans (ACBP), based on needs assessments informed by ACPA. Counties will execute these plans and report on progress towards plan objectives. Counties will also complete and submit an annual capacity self-assessment, and will facilitate the independent assessment teams in verification of the capacity assessments.

National Government

41. Several national government entities will support program implementation. MoDP will be responsible for overall Program Management, while NT will be responsible for Program financial management. Both NT and MoDP, as well as DPSM and KSG, will provide capacity building support to counties in the Program KRAs. The Office of the Auditor General will be responsible for all Program audits. The CoB and the National Environmental Management Authority (NEMA) will also support Program implementation. The DSWG, which has overall responsibility for the NCBF, will share information on the government program that will influence KDSP.

42. In order to support the functions under the KDSP a small dedicated Secretariat/Unit will be established within MoDP to support the operations of the new grant scheme, related capacity building support and the coordination of the ACPA. The KDSP Secretariat will be placed within the Directorate of the MoDP responsible for capacity building and will report, through the relevant Director, to the Principal Secretary (PS) Devolution in the MoDP, and will provide reports and secretariat functions to the KDSP Joint Steering Committee and Technical Committee.

Governance arrangements

43. Implementation of the NCBF is coordinated by the DSWG, which has a broad government and DP representation. To ensure full ownership and adequate coordination of government-executed activities under the NCBF, the government is establishing a KDSP JSC and TC, with a dedicated KDSP Secretariat. This will complement the broader DSWG framework by providing a forum and governance focussed on coordination and improvement of government-executed capacity building support.

VIII. Contact point
World Bank

Contact: Mr. Christopher Finch
Title: Task Team Leader
Tel: 5327+6018
Email: Cfinch@worldbank.org

Contact: Ms. Jane Kiringai
Title: Co-Task Team Leader
Tel: 5327+6446
Email: Jkiringai@worldbank.org

Borrower/Client/Recipient

Contact: Dr. Kamau Thugge
Title: Principal Secretary
Tel: +254(20) 2252299
Email: ps@treasury.go.ke

Implementing Agencies

Contact: Ms. Mwanamaka Mabruki
Title: Principal Secretary
Tel: +254(20)2250645
Email: psdevolution2013@gmail.com

IX. For more information contact:
The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop