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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT

ON

A PROPOSED **IBRD** LOAN IN THE AMOUNT OF US\$500 MILLION

AND

A PROPOSED **IDA** CREDIT IN THE AMOUNT OF US\$185 MILLION

AND

A PROPOSED **IDA** CREDIT ON SHORTER MATURITY LOAN TERMS
IN THE AMOUNT OF US\$315 MILLION

TO THE REPUBLIC OF KENYA FOR

THE FISCAL SUSTAINABILITY AND INCLUSIVE GREEN GROWTH
DEVELOPMENT POLICY OPERATION

May 1, 2023

Macroeconomics, Trade and Investment Global Practice
Eastern And Southern Africa Region

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Republic of Kenya
GOVERNMENT FISCAL YEAR

July 1 – June 30

CURRENCY EQUIVALENTS

Exchange rate effective as of April 20, 2023

Kenya shilling (KES) 135.19=US\$1.00

ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank	KES/KSh	Kenyan Shilling
ALPP	Areas of Low Pest Prevalence	KNBS	Kenya National Bureau of Statistics
AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism	KPLC	Kenya Power and Lighting Company
ASAL	Arid and Semi-Arid Lands	kWh	Kilowatt hours
BETA	Bottom-up Economic Transformation Agenda	MDAs	Ministries, Departments and Agencies
CBK	Central Bank of Kenya	MoALD	Ministry of Agriculture, Livestock, Fisheries and Cooperatives
CBR	Central Bank Rate	MoEF	Ministry of Environment and Forestry
CCDR	Country Climate and Development Report	M-PESA	M for mobile, PESA is Swahili for money
CFS	consolidated fund services	MSMEs	Micro, Small and Medium Enterprises
CO	Conflict of Interest	MTEF	Medium-Term Expenditure Framework
COMESA	Common Market for Eastern and Southern Africa	MTPs	Medium-Term Plans
CPF	Country Partnership Framework	NASMP	National Agricultural Soil Management Policy
CPI	Consumer Price Index	NCPB	National Cereals and Produce Board
DLIs	Disbursement linked indicators	ND-GAIN	Notre Dame Global Adaptation Initiative
DPG	Development Partners Group	NDMA	National Drought Management Authority
DPO	Development Policy Operation	NEMA	National Environment Management Authority
DSA	Debt Sustainability Analysis	NET	National Environmental Tribunal
DSSI	Debt Service Suspension Initiative	NEXT	Nairobi Securities Exchange Derivatives Market
EAC	East African Community	NFR	National Food Reserve
EACC	Ethics and Anti-Corruption Commission	NIS	National intelligence services
ECF	Extended Credit Facility	NPL	Nonperforming loan
EFF	Extended Fund Facility	NSE	Nairobi Securities Exchange
EGSM	Excisable Goods Management System	NSNP	National Safety Net Program
EIA	Environmental Impact Assessment	OAG	Office of the Auditor General
EMCA	Environmental Management and Coordination Act	OVC	Orphans and Vulnerable Children
EPRA	Energy and Petroleum Regulatory Authority	PA	Prior action
EU	European Union	PC	Policy Commitments
FDI	Foreign Direct Investment	PER	Public Expenditure Review
FIGG	Fiscal Sustainability and Inclusive Green Growth	PFA	Pest-Free Areas
FY	Financial year	PFM	Public Finance Management
GCRF	Global Crisis Response Framework (GCRF)	PFMA	Public Financial Management Act

GDP	Gross Domestic Product	P4R	Programs for Results
GEAR UP	Kenya Government Efficiency, Accountability, and Results Upscaling Program	PFPP	Pest-Free Places of Production
GESDeK	Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya	PS	Principal Secretary
GHG	Greenhouse gas	PV	Present Value
GIMIS	Government Investment Management Information System	RI	Results indicator
GoK	Government of Kenya	SAFER	Supporting Access to Finance and Enterprise Recovery
GREEN	Green and Resilient Expansion of Energy	SCD	Systematic Country Diagnostic
GRS	Grievance Redress Service	SC	State Corporation
HLO	High-Level Outcome	SDFP	Sustainable Development Finance Policy
HOM	Head of Mission	SDR	Special Drawing Rights
HSNP	Hunger Safety Net Program	SEA	Strategic Environmental Assessment
IBRD	International Bank for Reconstruction and Development	SOE	State-Owned Enterprise
ICR	Implementation Completion Report	SML	Shorter Maturity Loan
IDA	International Development Association	SPS	Sanitary and Phytosanitary
IFC	International Finance Corporation	US	United States
IFMIS	Integrated Financial Management Information System	US\$	United States dollar
IMF	International Monetary Fund	VAT	Value Added Tax
IPCC	Intergovernmental Panel on Climate Change	VCI	Vegetation Condition Index
IT	Information technology	VTDP	Voluntary Tax Disclosure Program
KEMSA	Kenya Medical Supplies Agency	WBG	World Bank Group
		WRS	Warehouse Receipt System

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REPUBLIC OF KENYA
FISCAL SUSTAINABILITY AND INCLUSIVE GREEN GROWTH DEVELOPMENT POLICY OPERATION

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SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P180339	No

Proposed Development Objective(s)

The program development objective is: (i) creating fiscal space in a sustainable and equitable manner; (ii) improving competitiveness to boost agricultural exports; and (iii) improving governance and financial inclusion for private sector driven development.

Organizations

Borrower: THE REPUBLIC OF KENYA

Implementing Agency: National Treasury

PROJECT FINANCING DATA (US\$, Millions)

SUMMARY

Total Financing	1,000.00
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DETAILS

International Bank for Reconstruction and Development (IBRD)	500.00
International Development Association (IDA)	500.00
IDA Credit	185.00
IDA Shorter Maturity Loan (SML)	315.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks



Overall Risk Rating

Results

	Indicator Name	Baseline	Target
RI1	Government operating subsidies to KPLC other than for last mile, KSh	Value: KSh 7.05 billion Date: FY2021/22	Value: < KSh 0.5 billion Date: FY2023/24
RI2	Tax revenue measured as a share of GDP	Value: 13.7% Date: FY2021/22	Value: 14.6% Date: FY2023/24
RI3	Achievement of primary fiscal surplus	Value: No Date: FY2021/22	Value: Yes Date: FY2023/24
RI4i	Proportion of National Safety Net Program (NSNP) beneficiaries who have received cash transfers as per the payments calendar	Value: 0% Date: FY2021/22	Value: 65% Date: FY2023/24
RI4ii	Proportion of Hunger Safety Net Program (HSNP) emergency cash transfer beneficiaries who are paid on time Of which, female beneficiaries as a share of total beneficiaries	Value: 39% Date: FY2021/22 Value: 65% Date: FY2021/22	Value: ≥70% Date: FY2023/24 Value: >65% Date: FY2023/24
RI5i	Share of National Food Reserves procured through competitively sourced warehouse receipts	Value: 0 Date: 2022	Value: 90% Date: 2024
RI5ii	Share of new national public sector projects approved for FY2024/25 and determined as relevant to soil, land and fertilizer management by the MoALD Policy Unit which the Soil Management Unit has reviewed and provided inputs on	Value: 0% Date: 2022	Value: 80% Date: 2024
RI6i	Proportion of the Agricultural Export Production Counties that have designated Pest Free Areas	Value: 0% Date: 2022	Value: 20% Date: 2024
RI6ii	Proportion of food laws aligned to risk-based approach to food safety control	Value: 0% Date: 2022	Value: 30% Date: 2024
RI7	Share of declarations of personal interests of public officials verified by the Ethics and Anti-Corruption Commission (EACC)	Value: 0% Date: 2022	Value: 80% Date: 2024
RI8	Number of high fiscal risk SOEs for which a divestiture program has been published.	Value: 0% Date: 2022	Value: 3 Date: 2024
RI9	Share of Government Climate Actions (i.e any law, policy, or strategy on climate change) that is informed by public input provided as per the regulation.	Value: 0% Date: 2022	Value: 90% Date: 2024
RI10i	Percentage of volume of loans disbursed under the Financial Inclusion Fund accessed by individual beneficiaries for loans below Ksh 1,000.	Value: 0 Date: 2022	Value: 20% Date: 2022
RI10ii	Share of female-headed micro enterprises that have accessed credit through the micro loan window of the Financial Inclusion Fund	Value: 0 Date: 2022	Value: 50% Date: 20224

IBRD and IDA PROGRAM DOCUMENT FOR A PROPOSED LOAN and CREDIT TO REPUBLIC OF KENYA



1. INTRODUCTION AND COUNTRY CONTEXT

1. This stand-alone Fiscal Sustainability and Inclusive Green Growth (FIGG) Development Policy Operation (DPO) supports Kenya’s new administration’s near-term objectives of fiscal consolidation while planting the seeds for the medium-term goal of green and inclusive growth. The financing for the operation takes the form of an International Development Association (IDA) credit amounting to US\$185 million, an IDA credit of US\$315 million on Performance-Based Allocation (PBA) Shorter Maturity Loan (SML) terms, and an International Bank for Reconstruction and Development loan of US\$500 million to the Republic of Kenya. The reforms supported by this operation expand fiscal space and create preconditions for boosting competitiveness and resilience in agriculture in the face of increasingly frequent climate shocks. They also strive to improve governance to renew the trust of the citizens and firms to promote inclusive private sector-led growth. This operation builds on the earlier reform effort supported through two impactful series of DPOs and the government’s strong post-election reform momentum. It supports the new administration’s “bottom-up” growth agenda, geared toward raising the productivity and earnings of low-income Kenyans. The government envisions achieving these goals through reforms and investments in agriculture, micro, small, and medium-sized enterprises, and in environmental sustainability. The operation is also aligned with the World Bank Group’s Country Partnership Framework (CPF) FY23-28 for Kenya.

2. Kenya’s economy has demonstrated resilience to shocks, but the challenges are vast. These include the lasting economic effects of the COVID-19 pandemic, the global impacts of Russia’s invasion of Ukraine, and increasingly frequent climate shocks, such as the ongoing drought. In addition, Kenya’s growth has been largely driven by the public sector resulting in debt vulnerabilities which have exacerbated further amid tightening financing conditions globally. As a result, fiscal consolidation is a priority as is creating conditions for private sector driven growth. This requires both supporting the development in those sectors where Kenya has comparative advantage, such as agriculture, as well as de-emphasizing the government’s role in the economy to create a space for the private sector to expand and create jobs. To restore confidence of the private sector and unleash its potential, the government is committed to making significant steps to improve transparency, accountability, and combat corruption. Finally, inequality is persistently constraining development in Kenya, as the poor and vulnerable are most exposed to climate shocks, and the progress in female empowerment remains insufficient.

3. Though sustained economic growth has translated into improved living standards and a steady reduction in poverty, a series of successive shocks has reversed this trend. The share of the population living below Kenya’s national poverty line decreased from 47 percent in 2005 to 34 percent in 2019, an average decline of about one percentage point per year. The COVID-19 pandemic, however, dealt a heavy blow to Kenya’s services-dependent economy, leading to a sharp increase in poverty due to large jobs and earnings losses, concentrated in urban areas.¹ While the strong economic rebound in 2021 was on course to bring poverty rates down to their pre-COVID-19 levels, the recovery was interrupted by successive shocks including emergency food insecurity because of the drought, especially in the northern pastoral

¹ The number of unemployed more than doubled from 0.8 million in Q2 of 2019 to 1.8 million by Q2 2020. Employment decreased by almost two million (Kenya National Bureau of Statistics, 2020).



areas² and a sharp spike in food prices linked to Russia's invasion of Ukraine. Even before the pandemic and the impacts of more recent shocks, Kenya had not been able to reduce the absolute number of poor, like many of its regional peers.

4. The new administration, sworn in on September 12, 2022, has sustained an impressive post-election reform momentum. It has signaled that it intends to prioritize the fiscal and debt sustainability while pursuing policies focused on improving inclusive growth. The government has announced its staunch commitment to fiscal consolidation, initiating measures to reduce fiscal deficit and reverse accumulation of both domestic and external debt. This goes together with the government's commitment to reducing the role of the state in the economy. The authorities plan to realize this objective both through privatization of selected state-owned enterprises (SOEs), as well as reducing domestic borrowing that has been crowding out private sector credit.

5. At the same time, through its Bottom-up Economic Transformation Agenda (BETA), the new administration introduced policy measures focused on raising living standards and creating opportunities for the poor. This is to be achieved by focusing on policies to improve their access to financial services by addressing market distortions and raising productivity and competitiveness in the priority sectors where poor are concentrated, such as agriculture.

6. The government is implementing the reforms in a challenging political environment that is further complicated by unfavorable external developments. The government has initiated removal of fuel subsidies and a tariff review for the electricity to eliminate untargeted and fiscally unsustainable subsidies. While doing it the government focuses on measures to protect the livelihood of most vulnerable, including through the life-line tariffs, protecting social safety net, and enabling access to finances for most disadvantaged. However, persistently high energy and food prices, coupled with exchange rate depreciation, fuels public sentiments about cost-of-living crisis further complicating the political landscape for the reforms.

7. This DPO supports the new administration's efforts to make the government leaner, more transparent, and accountable, while setting the country on the path of a more inclusive, greener, and private-sector-led growth. The program is rooted in government's key policy priorities—fiscal consolidation, developing agriculture sector, and improving governance—while combatting climate change and improving inclusion. Therefore, the program clusters the reforms it supports into three pillars: (i) creating fiscal space in a sustainable and equitable manner; (ii) improving competitiveness to boost agricultural exports; and (iii) improving governance and financial inclusion for private sector driven development. Fiscal consolidation reforms include revenue and expenditure measures, strengthening debt management framework, and protecting the pro-poor expenditures. Boosting agricultural exports is key because agriculture is both a powerhouse sector where Kenya has a clear comparative advantage and a sector that employs most of Kenya's poor. Improving governance is important to restore the confidence of the private sector in the government's commitment to a level playing field, while financial inclusion will

² National Drought Management Authority (NDMA). National Drought Early Warning Bulletin. January 2023. Retrieved from: <https://www.ndma.go.ke/index.php/resource-center/national-drought-bulletin/send/39-drought-updates/6778-national-monthly-drought-updates-january-2023>



further expand the private sector. At the same time, two elements—combatting climate change and improving inclusion—are cross-cutting throughout the operation, as each of the three pillars contains relevant reforms that focus on these two transversal priorities.

8. This DPO builds on the previous series of World Bank policy lending in Kenya to support policy and institutional reforms. The series delivered in FY21 and FY22 served as a platform for important reform areas, including public investment management and public procurement reforms, the removal of the interest rate cap and markets distortions in the financial markets, introduction of e-vouchers for fertilizers in an overhaul of distribution of subsidized fertilizers to hundreds of thousands of farmers, and the reforms in the regulatory framework that helped to boost the supply of affordable housing. The series also facilitated close engagement and policy dialogue between the government and the World Bank, especially in the context of post-COVID-19 recovery and the design of fiscal consolidation. This highlights the role of DPOs in a challenging domestic and external environment.

9. This operation plays a central role in the World Bank’s programmatic portfolio approach and is closely coordinated with other lending support that address sustainability and governance. The design of the operation is informed by ongoing preparations of World Bank’s pipeline programs, especially Programs for Results (P4Rs) in energy, agriculture, and public financial management. By supporting higher-level policy and institutional actions, the proposed DPO sets the stage for subsequent operational engagement focused on successful implementation of key reforms to be supported by the upcoming programs.

10. This DPO is designed as a standalone operation. It provides immediate financial support to the new government at the time of pressing financing need in the context of unfavorable market conditions. At the same time, this operation will lay the foundations for a possible programmatic series in the future, as the new government develops its longer-term reform agenda. At the same time, the implementation of legislative reforms in this operation will be supported through P4Rs currently under preparation. Although fiscal consolidation is on track, the issuance of international bonds in FY22/23 was canceled due to the high cost of borrowing. The authorities are also cognizant of the crowding-out effects of excessive domestic borrowing that could undermine the recovery momentum led by the private sector. Thus, budget support from the World Bank, combined with the ongoing program by the International Monetary Fund, will allow the government to reduce commercial borrowing needs from both external and domestic sources and will also send a strong positive signal to the market paving the way for future market borrowing under more favorable terms.

11. The challenge of achieving inclusive and resilient growth is further amplified by Kenya’s elevated vulnerability to climate change.³ According to ND-GAIN ranking Kenya is the 39th most vulnerable country and has an overall high vulnerability score that considers the gaps in readiness.⁴ Annual mean temperatures have risen by 1.0 degree Celsius since the 1960s and are projected to continue rising by 1.7 degree Celsius by 2050. Though overall precipitation will increase, it is expected to remain highly variable and uncertain, leading to excessive rain, droughts and floods, and heatwaves. This already causes crop-

³ Kenya Climate Risk Country Profile (2020); Kenya Country Climate and Development Report (forthcoming 2023)

⁴ Worldwide ranking by ND-GAIN Index, <https://gain-new.crc.nd.edu/country/kenya>



and livestock-loss, forest fires, damage to fisheries, and reduced hydropower generation and industrial production in Kenya. Kenya's risk to flooding (coastal, urban, river) and wildfire is assessed high.⁵ The climatic changes put both urban and rural infrastructure at risk, particularly for poor and vulnerable groups. While the reforms in this proposed operation are not affected by climate change, climate events pose a risk to the achievement of the PDO, as intense climate shocks may disrupt the livelihoods of the poor and thus jeopardize inclusive growth. Kenya has a well-developed policy and institutional framework for climate action and adopted a National Adaptation Plan covering the 2015–30 period (for example, Kenya already obtains about 90 percent of its electricity from renewable energy sources) but there are gaps in readiness that the government is addressing through implementation of an ambitious climate agenda, including through reforms supported by this DPO.⁶ The design of the proposed operation has been closely coordinated with the preparation of Kenya's Country Climate and Development Report (CCDR), focusing on two key areas: policies for ensuring the role of agriculture in the evolving global context as a driver of green and inclusive growth, and strengthening the institutional framework for climate policy discussions and implementation.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

12. Kenya's growth performance of the past two decades has been relatively strong. Pre-COVID-19, real GDP grew at an annual average of 4.8 percent (2015–19). Alongside a steep reduction in the poverty headcount from 47 percent to 34 percent (based on the national poverty line), this trend was reflected in robust growth of private consumption at an annual average rate of 5 percent. The economy has also shown considerable resilience in the face of recent shocks (Table 1). The recovery has been driven by broad-based expansion of services, including tourism. The growth momentum in 2022 remained strong despite domestic political uncertainty in the run up to the August 2022 elections, downturn international financial cycle coupled with global commodity shocks, regional droughts that severely affected agricultural activities, and fiscal consolidation

13. Despite the overall resilience, elevated fiscal risks, further exacerbated by the pandemic and recent shocks, have emerged as a major obstacle to Kenya's development agenda. Economic growth of the past decade was supported by an ambitious public investment push, aimed at plugging the large infrastructure gap and the devolution process. Government spending expanded drastically amid sluggish revenue performance in the recent years, leading to an average fiscal deficit of 7.3 percent of GDP in 2015–19. External borrowing was secured through Eurobonds (first issued in 2014 and currently totaling US\$7.1 billion), and official bilateral credit (mostly from China), which amounted to US\$4.6 billion by end of 2022. Subsequently, interest payments increased from 2.7 percent of GDP in 2014 to 4.6 percent in 2022, squeezing priority spending and elevating public sectors' vulnerabilities to shocks. Fiscal risks were further exacerbated by the pandemic and the recent shocks, resulting in reclassification of Kenya's risk of debt

⁵ <https://thinkhazard.org/en/report/133-kenya>

⁶ Ministry of Environment and Natural Resources (2016). Kenya National Adaptation Plan, 2015–2030. URL: https://www4.unfccc.int/sites/NAPC/Documents%20NAP/Kenya_NAP_Final.pdf



distress from “moderate” to “high” in 2020 by the joint IMF-World Bank Debt Sustainability Analysis (DSA).

14. Inflation remains elevated amid high food and fuel prices, and exchange rate depreciation. Headline inflation has exceeded the upper bound target of the Central Bank of Kenya (CBK) since June 2022 and peaked at 9.6 percent in October 2022 but has subsided to 7.8 percent as of April 2023. Food price inflation, driven by external shocks and prolonged droughts, contributed most to the headline inflation. Energy price increases, which surged following the withdrawal of the subsidies on petrol and shilling’s depreciation, also contributed to the inflation. In May 2022, CBK started raising its policy rate from 7.0 percent (a level maintained over a two-year period to support COVID-19 response) to 9.5 percent by March 2023. This was in addition to the withdrawal of liquidity buffers that had been offered to the financial system and firms to avoid a credit crunch during the pandemic. While the exchange rate has depreciated playing a larger role in accommodation of external shocks, the foreign exchange reserves sustained losses, especially in the period when the policy rate was negative in real terms. This highlights difficult policy trade-offs that the authorities are facing due to the magnitude in the deterioration in external financing conditions and price shocks.

15. The recent shocks have reversed Kenya’s hard-earned gains in poverty reduction. The pandemic’s impact on Kenya’s services-dependent economy led to an increase in poverty due to large jobs and earnings losses concentrated in urban areas. While the strong economic rebound in 2021 was on course to bring poverty rates down to their pre-COVID-19 levels, the recovery was interrupted by severe droughts, with emergency food insecurity levels in the northern pastoral areas. In addition, a sharp spike in food prices linked to Russia’s invasion of Ukraine pushed up poverty rates especially in rural areas. Though official poverty data for 2022 are not yet available, microsimulations based on the High-Frequency Surveys estimate poverty at approximately 40 percent in June 2022, higher than the poverty rate of 36 percent in 2015/16.⁷ The government put in place measures to shield the population from food and fuel price shocks. Several large-scale measures, such as subsidies for reducing fuel, electricity, and maize flour prices, were untargeted, and were subsequently scaled back. The new government removed the subsidy on petrol, the costliest of all measures, in September 2022. It further plans to gradually phase-out subsidies on diesel and kerosene. The subsidy on maize flour was cancelled within a month of its introduction due to implementation challenges.⁸

16. A fiscal consolidation program is the cornerstone of the new administration’s economic strategy. In 2021, GoK resumed its fiscal consolidation plan that was interrupted by the pandemic; it is also a key priority of the new government elected in 2022. The reduction in the fiscal deficit through rationalization of capital spending, phasing out costly consumption subsidies, and a wage freeze, coupled with a strengthened revenue effort cements the government’s fiscal consolidation path. Supported by strong performance of domestic revenues and some reduction in spending, the fiscal deficit for FY2021/22 was brought down to 6.2 percent of GDP; it is projected to reach 5.7 percent of GDP in FY2022/23, as additional revenue mobilization and expenditure rationalization measures are implemented. Revenues reached 17.3

⁷ As the surveys took place as food and fuel prices were at their peak it is expected that poverty has come down since mid-2022.

⁸ To block the passthrough of international oil prices to domestic fuel prices and electricity generation costs, Government maintained below-market retail price caps on fuels and paid compensation to distributors for the loss in FY2021/22. It also cut the electricity tariff by 15 percent in December 2021. Also, In July 2022, Government introduced a subsidy on maize meal (that lasted for a month) and suspended the railway development levy and import declaration fee on imported maize, to cushion the rise in food prices.



percent of GDP in FY2021/22, with Value Added Tax (VAT) and excise taxes driving the momentum. Broader revenue-enhancing measures have also played a role, such as a reduction in tax expenditures, improvements in tax administration, adoption of the voluntary tax disclosure program (VTDP) to collect undeclared tax against full or partial relief of penalties and enhance overall tax compliance, and adoption of technologies to plug loopholes for corruption and easing access to the Kenya Revenue Authority web system.

Table 1: Selected economic indicators

	2019	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.
Real economy	(Annual percentage change, unless otherwise indicated)							
Real GDP	5.2	-0.3	7.5	5.4	5.1	5.4	5.5	5.5
Private consumption	5.0	-2.5	6.2	5.4	5.1	5.3	5.3	5.4
Government consumption	5.6	3.0	5.7	4.9	4.8	4.1	3.9	3.4
Gross fixed capital investment	4.5	2.5	10.9	7.0	7.7	8.4	8.8	9.2
Exports	-3.2	-8.8	12.9	10.3	7.4	7.8	7.6	8.3
Imports	1.8	-9.2	18.9	9.0	8.3	8.3	8.1	8.4
GDP per capita (real)	3.1	-2.2	5.4	3.4	3.1	3.3	3.5	3.5
Prices and selected monetary accounts	(Annual percentage change, unless otherwise indicated)							
Consumer price index (average)	5.2	5.3	6.1	7.6	8.9	6.3	5.5	5.5
Broad money (M3)	5.6	13.2	6.1	7.2	..	..	..	..
Credit to non-government sector	7.1	8.5	8.5	12.5	..	..	..	..
Policy rate (Central Bank Rate, CBR)	8.5	7.0	7.0	8.75	9.5	..	..	..
Nonperforming Loans (percent in total)	10.0	12.2	11.1	11.4	..	..	..	..
Fiscal accounts	(Percent of GDP, unless otherwise indicated)							
Total revenue and grants	17.7	17.1	16.0	17.3	17.5	17.8	17.9	18.2
Expenditure	25.0	24.2	24.2	23.5	23.3	22.4	22.0	21.8
Overall balance including grants	-7.3	-7.0	-8.2	-6.2	-5.8	-4.6	-4.1	-3.6
Balance of payments	(Percent of GDP, unless otherwise indicated)							
Current account balance (inc. grants)	-5.2	-4.8	-5.2	-4.7	-4.8	-4.8	-4.8	-5.0
Exports	11.4	9.7	10.7	12.2	13.3	14.0	14.5	14.5
Imports	20.3	17.7	19.8	20.9	21.7	22.3	22.9	23.1
Foreign direct investment, net inflow	0.9	0.5	0.0	0.5	0.6	0.7	0.9	1.2
Gross int. reserves (official, US\$ bn)	9.1	8.3	9.5	8.0	7.2	7.4	7.8	8.8
In months of imports	5.5	5.1	4.7	3.8	..	..	..	..
Terms of trade	3.1	-3.0	1.1	11.4	..	..	..	..
Exchange rate (USD, average)	102.0	106.5	109.6	117.9	..	..	..	..
Public debt (gross)	62.1	68.0	67.8	66.9	68.0	66.7	65.1	63.7
External	31.5	35.4	34.5	33.8	36.1	36.4	35.4	34.7
Domestic	30.6	32.6	33.3	33.1	31.9	30.3	29.7	29.0
Present value of public debt	56.6	58.7	60.4	61.8	61.8	59.9	58.3	56.8
Memo:								
GDP at current market prices (US\$ bn)	100.4	100.6	110.6	115.9	115.5	120.2	127.9	135.1

Source: Kenya National Bureau of Statistics, Central Bank of Kenya, National Treasury and Economic Planning, and World Bank estimates.



17. The decline in public expenditures significantly contributed to the fiscal consolidation, but the momentum of overall expenditure rationalization remains strong. The capital budget was reduced to 4.2 percent of GDP in 2021/22, from an average of 6.7 percent in the five fiscal years prior to the pandemic. This offset the increase of one percentage point of GDP in recurrent spending for the higher interest payments (currently accounting for around 20 percent of expenditures and net lending) and government's response to recent shocks.⁹ The government has scaled back budget transfers for fuel subsidies and other direct subsidies since September 2022. Additional expenditure measures, such as a freeze in recruitment, remuneration, and benefits, postponement of new investment projects not authorized by the National Treasury and Economic Planning, and capping county transfers at a constant nominal level of KES 370 billion, are in effect. In parallel, the government has been clearing its pending bills to contractors and suppliers, which were estimated at around 4 percent of GDP in FY2021/22.¹⁰ Clearance of arrears will continue to be a priority for the government to return cash to the private sector and to reduce non-performing loans.

18. Deficit financing has become more challenging amid tightening financing conditions further highlighting the criticality of medium-term fiscal consolidation. Over the years, deficit financing through domestic borrowing, leading to significant crowding-out of the private sector. The share of deficit financing through domestic credit markets peaked at more than 80 percent in the first half of FY2022/23 as government of Kenya (GoK) had to postpone the issuance of international bonds amid prohibitive external financing conditions for the emerging markets. More recently, accessing domestic financial markets have also proven challenging resulting in significant under-subscription for domestic bond issuance and further tensions in funding which is putting additional pressures cash flow management by GoK. To address these challenges, GoK will access additional external financing through the Extended Credit Facility of the IMF and the World Bank-financed DPO. This will allow the government to sustainably finance its external financing requirement in FY2022/23 and reduce the pressure on domestic credit markets while improving the public debt profile.

19. Kenya's public debt is sustainable, but costs are piling up. Public debt increased from less than 40 percent of GDP in 2013 to around 68 percent estimated as of 2020, driven by a prolonged period of large fiscal deficits and negative public savings and exacerbated by the impacts of the pandemic. Despite ongoing fiscal consolidation, public debt-to-GDP ratio is estimated to remain at 68 percent of GDP by the end of the calendar year 2023 due to the compensating effects of a sharp depreciation. Public debt in present value terms has reached 61.8 percent of GDP as of 2022.

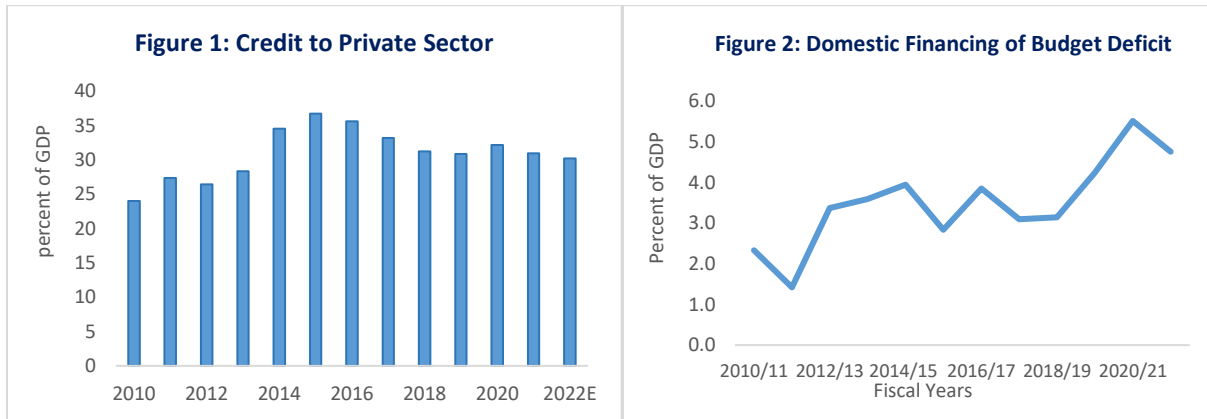
20. The authorities are committed to striking an optimal balance between alleviating the pressure on foreign exchange reserves, avoiding excessive volatility in the exchange rate, and the policy rate hikes. The overall macroeconomic policy response has benefited from a more depreciated exchange rate with a 12-month nominal depreciation against US dollar reaching 15 percent as of April 2023, coupled with the

⁹ The subsidies included a reduction in pump prices, 15 percent reduction in the electricity tariff, waiver of import duty for maize; fertilizer subsidies; halving the VAT rate on liquefied petroleum gas to 8 percent; and subsidizing maize flour. The cost of these subsidies is estimated at 0.6 percent of GDP during FY2021/22.

¹⁰ Pending bills by the central government rose to KSh 504.7 billion (4.0 percent of GDP) in FY2021/22 from KSh 359.5 billion (3.2 percent of GDP) in FY2020/21. At the county government level, pending bills reached KSh 153.0 billion (1.2 percent of GDP) in FY2021/22.



policy rate hike by CBK. To prevent excessive volatility in the exchange rate while reducing the burden on foreign exchange reserves, GoK has launched a 6-month fuel importation mechanism to defer forex payments. The arrangement, which includes a Letter of Support issued by the GoK, is partly using the borrowing headroom created by postponing of international bond issuance and several externally financed projects. In this context, the oil mechanism is not expected to substantially change the baseline debt accumulation scenario. It is expected that the mechanism will be temporary and will be scaled back as the external environment stabilizes.



Source: National Treasury and Economic Planning, World Development Indicators, World Bank staff calculations.

21. Kenya’s banking sector remains resilient, but banks’ ability to support investments remains hampered by persistent crowding-out. Private sector credit growth is estimated at 12.5 percent in 2022, up from 8.6 percent in driven by transport and communication, manufacturing, trade, business services, and consumer durables, with a sizable increase in the number of applications and approvals. Non-performing loans remained prevalent at around 13 percent of total loans. Credit is growing more slowly than GDP, highlighting that banks’ role in facilitating investments and economic activity remains challenged, as it has been the case since mid-2010s. Banking sector credit to the private sector peaked in 2015 (Figure 1). This shift in the dynamic took place against a background of elevated demand by the government for domestic financing of budget deficit, coupled with the cap on interest rates that was in place in 2016–18 (Figure 2).

22. In addition, the financial sector has not been able to provide sufficient credit access to micro-enterprises and underserved population due to prevailing market distortions. In response, the government launched the financial inclusion fund (“The Hustler Fund”) in November 2022 to enhance credit availability for under-served population and micro-enterprises. Strengthening consumer protection is also a key priority of the authorities. The amendment of the Central Bank of Kenya Act in December 2021 legislates digital credit providers and is expected to strengthen consumer protection while support the government’s anti-money laundering and combating the financing of terrorism (AML/CFT) efforts.

**Table 2: Key fiscal indicators (percent of GDP)**

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	Act.	Act.	Prel.	Est.	Proj.	Proj.	Proj.
Total revenue and grants	17.1	16.0	17.3	17.5	17.8	18.0	18.2
Revenue	16.9	15.7	17.0	17.3	17.4	17.7	18.0
Tax revenue	13.0	12.6	13.7	13.9	14.6	14.9	15.2
Other revenues	3.9	3.1	3.3	3.4	2.8	2.8	2.7
Grants	0.2	0.3	0.2	0.2	0.3	0.3	0.3
Expenditure and net lending	24.2	24.2	23.5	23.3	22.2	21.9	21.8
Recurrent	18.6	19.3	19.3	19.1	17.7	17.0	16.5
Transfer to counties	3.1	3.5	2.8	3.0	2.6	2.3	2.2
Interest payments	4.1	4.4	4.5	4.7	4.8	4.6	4.3
Domestic	3.0	3.4	3.6	3.7	3.9	3.7	3.6
Foreign interest due	1.1	0.9	1.0	1.0	0.9	0.8	0.8
Wages	4.2	4.3	4.1	3.7	3.6	3.4	3.4
Pensions and other CFS	0.8	1.0	1.0	1.0	0.9	1.1	1.1
Defense and NIS	1.3	1.4	1.4	1.2	1.0	0.9	0.8
Other	5.0	4.7	5.5	5.6	4.8	4.7	4.7
Development	5.6	4.9	4.2	4.2	4.5	4.9	5.3
Deficit including grants (cash basis)	-7.0	-8.2	-6.2	-5.8	-4.4	-3.9	-3.6
Primary balance	-2.8	-4.0	-1.3	-1.0	0.4	0.7	0.7
Statistical discrepancy	0.5	0.2	-0.3	0.0	0.0	0.0	0.0
Financing (net)	7.4	8.4	5.9	5.8	4.6	3.9	3.6
External financing	3.2	2.9	1.1	1.9	2.5	1.3	0.6
Domestic financing	4.2	5.5	4.8	3.9	2.1	2.6	3.0

Notes: Fiscal year is from July to June. Current fiscal year is FY2023, ending June 2023. NIS = National intelligence services; CFS = consolidated fund services.

Source: The National Treasury and Economic Planning (Quarterly Economic and Budgetary Review, Q2 2022/23 and 2023 Budget Policy Statement, February 2023) and World Bank staff projections.

23. Growth of remittances and the recovery of tourism helped to strengthen the current account balance with the deficit narrowing to 4.7 percent of GDP. Albeit still below pre-pandemic levels, international visitor arrivals to Kenya jumped to more than 800 thousand between January and September 2022, from around 450 thousand in the same period of 2021. Remittances grew by 8.3 percent y/y in US\$ terms, exceeding US\$4 billion in 2022. Surging commodity prices, however, pushed imports to an all-time high of US\$25 billion in the year to August 2022, with oil imports swelling by 85.7 percent y/y. Nonetheless, the current account deficit narrowed to US\$5.4 billion in 2022, from US\$5.8 billion in 2021.

24. Unfavorable global financing conditions affected net capital and financial account inflows reducing Kenya's foreign exchange reserves amid slow hikes in the policy rate by the Central Bank. Portfolio



investments turned negative by mid-2022 as international investors rushed towards safe-haven assets, while the recovery in Foreign Direct Investment (FDI) has been slow. Together with reduced external borrowing by the government because of unfavorable financing terms, and a negative policy rate, these factors have led to a decline in foreign exchange reserves in 2022 and in the first quarter of 2023, currently estimated at US\$6.6 billion or 3.5 months of import cover, compared to an average of 5.4 in 2019–21. By end-March 2023, the shilling's 12-month depreciation against the U.S. dollar reached 15 percent.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

25. Kenya's growth and recovery momentum is expected to remain relatively strong despite tighter external and domestic financing conditions and prolonged droughts. GDP is expected to grow by 5.1 percent in 2023, mainly driven by private sector as business confidence strengthens and the public sector continues to scale back. Private sector investments and remittances will continue to support Kenya's growth, while agriculture is expected to rebound over the medium term, coupled with expected improvement in external and financing environment. Tourism is projected to surpass pre-COVID-19 levels by 2024. Overall, the World Bank projects GDP growth around 5.2 percent in 2023–26.

26. Fiscal consolidation is expected to be growth friendly with reduction of domestic borrowing needs amid improved use of public resources. Eliminating inefficient recurrent spending will be the focus of government's medium-term fiscal consolidation, while capital spending will be maintained at relatively high levels of around 5 percent of GDP, increasingly funded by public savings. This will reduce domestic borrowing and alleviate the extent of crowding-out of the private sector; in this context, domestic financing is projected to decline from an average of 4.7 percent of GDP in FY20/21–FY22/23 to 2.6 percent in FY23/24–FY25/26. Business confidence will benefit from expected reversal in the trajectory of public debt. The government will contribute to the momentum by clearing pending bills to the private sector, currently estimated at more than 3 percent of GDP, to unlock cash flows and expand business activities.

27. Inflation will remain elevated in 2023 but is expected to gradually return within CBK's target of 5 percent over the medium term. While the decline of commodity price inflation will offset the effects from the depreciation of the shilling in short-term, elevated food prices are expected to reverse over the medium term. The CBK is expected to maintain a balanced stance through an adequate policy rate to navigate the economy to a lower inflation and keep inflation expectations anchored.

28. The current account deficit is projected to remain at around 5.0 percent of GDP. Exports are projected to increase in the medium term, supported by high prices for Kenya's commodity exports (coffee, tea, and horticulture), the recovery in Kenya's trading partners in Africa, and stronger transport and tourism receipts. Supply-side reforms initiated by the government are expected to strengthen Kenya's export potential, including in agriculture, through implementation of the National Phytosanitary Policy and the of the Food and Feed Safety Coordination Bill. The competitiveness of domestic companies will also benefit from a more favorable real exchange rate because of lower inflation and a greater exchange rate flexibility. This baseline scenario forecasts robust growth in investment and imports, to be offset by projected lower fuel prices over the medium term. International remittances are projected to remain strong, estimated at around 3 percent of GDP, supported by the recovery in the global economy.



29. **Gross external financing needs will be met with a mix of private and public borrowing.** Non-debt creating FDI inflows have been very low since the COVID-19 pandemic and are expected to normalize. Kenya's gross external financing needs are projected at US\$7.5 billion in 2023 (Table 3). Private direct investment, other financial investments, and government's external commercial borrowing have been revised downward due to the unfavorable global environment. While the depreciation of the exchange rate has helped reduce external imbalances and overall external financing requirements, there is still a need for additional public sector borrowing. Government plans to realize this largely through concessional and semi-concessional sources.

Table 3: External financing requirements and sources (US\$, millions)

	2020	2021	2022	2023	2024	2025	2026
	Act.	Act.	Est.	Proj.	Proj.	Proj.	Proj.
1. Gross external financing requirements:	6,283	7,563	7,291	7,515	9,605	8,634	9,261
Current account deficit	4,847	5,844	5,454	5,544	5,770	6,140	6,755
Medium- and long-term debt repayments	1,436	1,719	1,837	1,971	3,835	2,494	2,506
2. Gross external financing sources:	4,068	5,700	4,266	4,603	8,226	8,298	10,299
Public sector	3,233	3,130	1,988	2,684	5,054	4,263	5,101
Grants	49	100	135	135	135	135	135
Borrowing	3,184	3,030	1,853	2,549	4,919	4,128	4,966
Private sector	835	2,570	2,278	2,044	3,172	4,035	5,198
Foreign direct investment, net	504	53	562	673	889	1,157	1,629
Other investments	331	2,517	1,716	1,371	2,283	2,878	3,569
3. Change in reserves (+ = increase)	-925	1,194	-1,491	-802	150	397	1,038
4. Errors and omissions	522	566	0	0	0	0	0
5. Total financing requirement	768	2,491	1,534	1,985	1,529	733	0
6. Additional external financing sources:	768	2,491	1,534	1,985	1,529	733	0
Official support (World Bank and other IFIs)	768	2,491	1,534	1,985	1,529	733	0
of which: Exceptional financing: DSSI	0	505	0	0	0	0	0

Source: Kenya National Bureau of Statistics, Central Bank of Kenya, National Treasury and Economic Planning, and World Bank estimates.

30. **The fiscal deficit is projected to decline to 4.4 percent of GDP in FY2023/24, and further to 3.9 percent by FY2024/25 (resulting in a primary surplus), supported by newly established debt anchor.** Revenue measures include rationalizing tax exemptions and operationalizing several tax law amendments to broaden the tax base by capturing new activities like digital activities, financial derivatives, among others, and improving tax administration and compliance. These measures are projected to increase tax



revenues to 17.7 percent of GDP by FY2025/26 (Table 2). Expenditure controls have been followed by freezing of government recruitment, remuneration and benefits which will arrest the discretionary spending at a lower level. Capital spending will benefit from further strengthening of public investment management and ongoing procurement reforms.¹¹

31. The government is mitigating the high risk of debt distress through strengthening fiscal and debt management.

The latest DSA (November 2022) attributes Kenya's high debt risk rating to high deficits in the past, combined with export and output losses in 2020 caused by the pandemic. The DSA also suggests that Kenya is susceptible to export and exchange rate shocks. Overall, Kenya's debt sustainability is underpinned by GoK's commitments supported by fiscal consolidation embedded in the medium-term budget frame. The debt stock and the cost of debt servicing are projected to peak in 2023. The present value of public debt is projected to decline to below 60 percent of GDP by 2025 after peaking at around 62 percent in 2023.¹² To strengthen the framework for debt sustainability, the government is planning to introduce a medium-term debt anchor of 55

Box 1: SOE reforms: SOE's guaranteed debt was estimated at 2.5 percent of GDP as at end June 2021. Kenya has around 300 state corporations and other public entities (such as autonomous public agencies, public funds, and universities) many of which face financial challenges and pose contingent liability risks for the government. The government is pursuing institutional reforms to mitigate these risks, including mergers of SOEs in different sectors (agriculture, industry, and finance); developing a Management Information System for the National Treasury and Economic Planning to help strengthen its capacity to monitor and analyze SOEs' financial and operational performance; a review of the terms and conditions of SOE Boards; and a more granular classification of SOEs for more effective and differentiated oversight. The proposed DPO supports Kenya's SOE reform agenda.

percent of GDP in present value terms to be supported by an accountability requirement, mandating transparent communication to the Parliament on the measures towards achieving the debt anchor within a specific timeframe. GoK's 2023 medium term debt management strategy underscores the medium-term debt objectives aimed at reducing the cost and risk linked to public debt and is anchored in the 2023 Budget Policy Statement. GoK aims at maximizing the use of concessional and semi-concessional borrowing to meet financing needs in a sustainable manner, while proposing liability management operations in the domestic and in the international capital markets. These liability management operations would aim to lengthen maturities and or reduce costs of borrowings.¹³ The domestic bond market will continue to remain an important source of financing, and measures to deepen the domestic capital will continue. Managing fiscal vulnerabilities arising from Kenya's large public sector is another factor mitigating high risks of debt distress (Box 1). Kenya's fiscal and debt framework and ongoing reforms continue to remain in line with the Sustainable Development Finance Policy (SDFP).¹⁴

¹¹ World Bank, Kenya Public Expenditure Review 2020: Options for Fiscal Consolidation after the COVID-19 Crisis" estimates that if fully implemented these measures could yield fiscal savings of 2.6 percentage points of GDP.

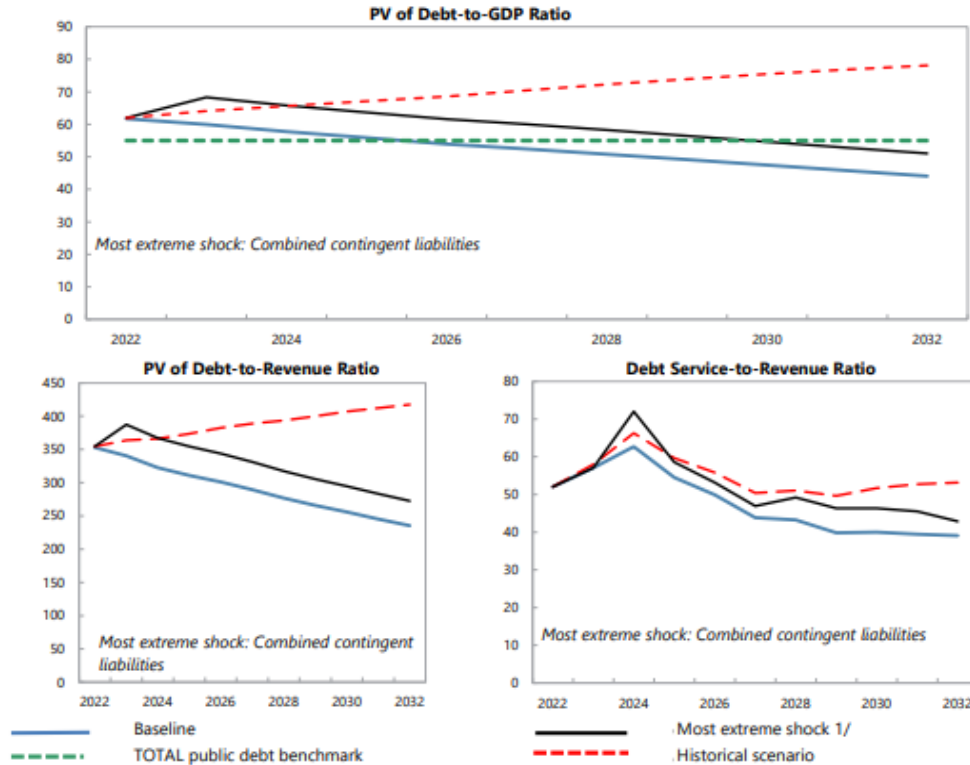
¹² Based on preliminary analysis for the DSA to be completed in June 2023 which show no material changes in assessment compared to the November 2022 DSA (public debt is assessed as sustainable with a high risk of debt distress)

¹³ As part of the optimal strategy GoK would plan to maintain presence in the international financial markets through refinancing the existing commercial maturities and may consider liability management operations ahead of scheduled maturities if the international debt capital market condition improves.

¹⁴ The actions under the SDFP include: cumulative present value of new external debt contracted or guaranteed in FY22 and FY23



Figure 3: Kenya Public Debt Indicators under alternative scenarios, 2022-32¹⁵



32. **The outlook is subject to elevated uncertainty largely because of external factors.** Lower than anticipated growth in Europe could undercut ongoing recovery, as Europe remains an important destination for Kenya’s exports and source of diaspora remittances and tourist arrivals. Elevated commodity prices can increase Kenya’s imports bill and increase the cost of reducing inflation. There are also major risks from further tightening of financial conditions if high inflation persists in advanced economies. The main risk on the domestic front is linked to spending pressures to reduce the high cost of living and safeguarding public finances from such pressures should remain a key priority. A slowdown in tax efforts is another risk. Upside risks are mostly linked to faster than expected normalization in financing conditions, as well as lower international fuel and food prices that will strengthen Kenya’s external balances.

33. **Kenya’s macroeconomic policy framework is adequate for development policy financing.** Kenya’s economy has shown considerable resilience. The policy framework has helped to weather the impacts of pandemic, and the authorities have remained responsive to the fluid situation by calibrating their policy

to be below of US\$11.6 billion; on debt transparency, an enhanced annual debt report which expands debt coverage to the outstanding debt of state-owned enterprises; on fiscal sustainability, an enhanced wage bill control to roll out the Unified Payroll System to the Teachers Service Commission and at least 200 MDAs.

¹⁵ Based on Joint Bank/Fund DSA for Kenya, November 2022.



responses. Macroeconomic stability has been maintained, including through exchange rate flexibility, which has helped to absorb the shock and reduce pressure on foreign reserves, which remain adequate. A credible commitment to medium-term fiscal consolidation is critical to support the recovery through creating space for the private sector, reducing debt vulnerabilities, and improving external imbalances. This commitment, along with government determination to reduce the risks arising from broader public sector, will underpin Kenya’s medium term economic strategy. The ongoing fiscal measures are supported by a range of reforms for better functioning of markets and improved governance, including those supported by the proposed operation, to help the private sector to unleash its potential and generate jobs.

Figure 4: Public and Publicly Guaranteed External Debt ind. under alternative scenarios, 2022–32¹⁶



2.3. IMF RELATIONS

34. The IMF Board approved a 38-month, SDR 1.66 billion (approximately US\$2.34 billion) program under the Extended Credit Facility (ECF) and the Extended Fund Facility (EFF) on April 2, 2021. The program supports fiscal consolidation and the economic recovery from the COVID-19 crisis. The IMF has conducted four reviews to date and made two disbursements during Kenya’s 2022/23 fiscal year: SDR 179.13 million in July 2022 (third review) and SDR 336.54 million in December 2022 (fourth review). The

¹⁶ Based on Joint Bank/Fund DSA for Kenya, November 2022.



IMF program and the proposed DPO will provide the government with comparable amounts this fiscal year and together cover about one third of the government's financing needs and supporting complementary reform areas in fiscal and debt sustainability, Public Finance Management (PFM), and procurement. This operation has been prepared in close collaboration with the IMF, ensuring complementarities of reforms supported by ECF/EFF and DPO.

3. GOVERNMENT PROGRAM

35. The government's long-term development blueprint, "Kenya Vision 2030," aims to transform Kenya into a middle-income industrialized country offering a high quality of life to all its citizens. Its priorities include: (i) sustaining 10 percent average annual economic growth until 2030; (ii) creating a just, cohesive, and equitable path for social development in a clean and secure environment; and (iii) building a democratic political system that respects the rule of law and protects the rights and freedoms of every individual in Kenyan society. The Vision is aligned with the United Nations Sustainable Development Goals and is being implemented through successive five-year Medium-Term Plans (MTPs).

36. While building on the Vision 2030, the new administration that came to power in September 2022 has laid out an economic transformation agenda in its Bottom-up Economic Transformation Agenda (BETA) 2022–27. Focused on empowering the population at the bottom of the economic pyramid, the BETA plan envisages carrying these goals out through appropriate market mechanisms to increase productivity and spur growth that is generated by and benefits the lower-income segments of society. The model emphasizes *"investing the limited capital available where it will create the most jobs at the bottom of the pyramid,"* with a strong focus on smallholder agriculture and the informal sector. Key promises in the plan include bringing down the cost of living, eradicating hunger, creating jobs, expanding the tax base, and promoting inclusive growth. Its five core pillars are agriculture, housing and settlement, Micro, Small and Medium Enterprises (MSMEs), healthcare, the digital superhighway, and creative economy. These are supported by secondary pillars, which include *inter alia* social protection, education, devolution and governance, environment and climate change, and women empowerment.

37. The new administration has committed to achieving these goals in a fiscally sustainable manner while actively promoting private investment in the economy. It has embraced a more aggressive fiscal consolidation path by further reducing the FY22/23 fiscal deficit target from 6.2 percent to 5.7 percent in FY23/24. This will be achieved by gradual phasing out of subsidies (among others, fuel subsidies and maize subsidies) and through domestic revenue management reforms. In the medium term, the government targets to reduce the overall fiscal deficit to 3.6 percent.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

38. The program development objective is: (i) creating fiscal space in a sustainable and equitable manner; (ii) improving competitiveness to boost agricultural exports; and (iii) improving governance



and financial inclusion for private sector driven development. Reforms supported by this operation reflect GoK’s priorities, including its fiscal consolidation goals, while pursuing priority investments focused on inclusive and green growth. At the same time, the proposed reforms reflect GoK’s focus on inclusion, including through protecting critical safety net spending in a strained fiscal context, safeguarding the incomes of extremely poor and vulnerable beneficiaries, and through the lifeline tariff. In addition, GoK’s priority focus on agriculture is reflected in the reforms will eliminate output markets distortions in agriculture, encourage private sector participation, and increase competitiveness of Kenyan agriculture on the world markets, while strengthening resilience to climate change and increasing productivity. GoK’s priority of improving governance is reflected in integrity reforms to curb corruption and conflict of interest. These will not only reduce public revenue leakage and expenditure wastage, but also result in more transparent government decisions, which will in turn help promote private sector development and investments. Finally, reforms to enable access to finance for the bottom of the pyramid will not only support more private sector growth but make growth inclusive. The proposed operation directly supports the government’s development goals. The reforms in this operation are tightly linked to the economic program of the current administration in BETA.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: Creating fiscal space in a sustainable and equitable manner

39. **This pillar aims to support government in strengthening public finances through expenditure rationalization, improved revenue mobilization, and strengthened debt management, while protecting the poor and vulnerable populations through more timely and predictable cash transfers.** The proposed reforms under this pillar will reduce fiscal subsidies to the power sector through a tariff review while providing for lifeline tariff; expand the tax base; enhance the debt framework to support medium-term fiscal consolidation; and protect social protection spending in the face of rising shocks.

Prior Action 1. To minimize fiscal burden caused by the power sector the Energy and Petroleum Regulatory Authority (EPRA) issued a tariff order for the next three-year period to ensure that the Kenya Power and Lighting Company (KPLC) revenues are sufficient to cover the cost of purchasing power and expanding investments.

40. **Rationale.** Kenya has a robust tariff setting methodology under which the regulator (EPRA) reviews base retail tariffs every three years. However, this methodology has been inconsistently applied in recent years, with base tariffs last reviewed in 2018, resulting in several years of tariffs below cost recovery. Tariff shortfalls have led to large arrears and years of underinvestment in maintenance and capital expenditure, which is now manifesting itself in deteriorating supply quality and reliability as well as persistently high levels of system losses. In 2022, the first time in recent history KPLC received operational subsidies other than for last mile connections. The revenue gap and its burden on the sector and public finances will persist and grow if tariffs remain below cost-reflective levels and electricity demand in Kenya continues to increase.

41. **Substance of the reform.** KPLC submitted a tariff application to EPRA in September 2022 and finalized



its first detailed tariff review since 2018. Public consultations on the tariff review have recently been concluded and a tariff order was gazetted on March 24, 2023. In its tariff order, EPRA has set new tariffs that would satisfy KPLC revenue requirements based on two criteria: covering the cost of purchasing power (as well as transmission and distribution) and being able to expand investments. This implies that KPLC should operate at cost recovery. Consequently, new tariff structure limits budgetary transfers to the KPLC to financing capital and operating and management expenses for last-mile connections. It also includes a social lifeline tariff of KSh30/kWh to safeguard the poor and vulnerable.

42. Expected results. KPLC will pass on reasonably incurred costs to consumers, which will help it return to a financially sustainable path and minimize the fiscal burden caused by the power sector. This reform will help GoK to substantially reduce operating subsidies to KPLC other than for last-mile connections which are currently estimated at more than KSh7 billion. In parallel to the tariff adjustment, KPLC has developed a robust and credible turnaround strategy with support from the World Bank, and the implementation of it will be supported through the Kenya Green and Resilient Expansion of Energy (GREEN) Program (P176698) currently under preparation as a Program for Results (P4R) operation. Among other reform actions, the GREEN Program includes disbursement linked indicators (DLIs) on timely and adequate quarterly adjustments in tariff complementing the prior action in this operation.

Prior Action 2: To broaden the tax base and improve tax administration the Recipient, through the National Treasury and Economic Planning issued: (i) Income Tax (Financial Derivatives) Regulations (2023); (ii) Value Added Tax (Electronic, Internet and Digital Marketplace Supply) Regulations (2023); and (iii) Excise Duty (Amendment) Regulations (2023).

43. Rationale. To maintain the momentum and remain on-track for achieving the target of a tax revenue to GDP ratio of 25 percent by 2030, GoK plans to operationalize its Medium-Term Revenue Strategy, which among other measures aims to tax activities such as trading in financial derivatives, an area that is steadily growing as an integral part of the financial market. The Nairobi Derivatives Market (NEXT) was launched in July 2019, and trades in equity index futures based on the NSE 25 share index and single stock futures based on the most liquid companies at the NSE. Attention is also required in the implementation of the Excisable Goods Management System (EGMS) to close the loopholes and inefficiencies such as undercharging excise stamp fees leading to non-recovery of the full cost of stamps from taxpayers and the absence of fair administrative actions. Higher revenue generation will also require addressing compliance issues within the VAT regime and streamlining implementation of the VAT Act (2013).

44. Substance of the reform. The proposed operation supports GoK to widen the tax base by implementing the provisions of the Finance Act 2022 related to financial derivatives and adopt strengthened EGMS and VAT regulations. To implement the provisions of the Act, which introduced a 15 percent withholding tax on gains earned by non-resident persons from financial derivatives, GoK has issued regulations to clarify the interpretation of terms, the scope of gains, realization of gain or loss, recording and characterization of income, and payment of taxes, on financial derivatives transactions. GoK has also issued EGMS regulations to amend the provisions concerning excise stamps on excisable goods, exemption from excise stamps, and disposal of forfeited and seized goods. To streamline implementation, excisable goods required to have excise stamps are now listed in the first schedule of the



EGMS regulations.¹⁷ The amendments will also promote fair administrative justice by introducing a new provision for a notification to the owners of seized or forfeited goods before disposal, as well as widen the provision on the application for license or registration and the minimum specifications for metering, measurement, and monitoring devices. GoK has also issued new VAT regulations on supplies through the digital marketplace (Electronic, Internet Digital Marketplace Supply) by providing the interpretation, scope, simplified registration framework, appointment of tax representatives, place and time of supply, accounting for and payment of tax, claim for input tax and penalties.¹⁸ These will complement the package of reforms that GoK is undertaking to expand the revenue base and raise compliance by preventing evasion, corruption, and money laundering.¹⁹

45. Expected results. The proposed reforms are expected to contribute to the GoK's plans to increase tax revenues by 0.7 percentage points of GDP by 2024 and remain on track to achieve the government's ambitious target of 2030. In addition to revenue mobilization, the reform will improve fairness of Kenya's tax system and promote a conducive environment for doing business by providing clarity for economic agents.

Prior Action 3: The Recipient: (i) through its Cabinet, approved and submitted to the Parliament amendments to the Public Finance Management Act (2012) which proposes: to align the definition of public debt with the provisions of the Constitution of Kenya; to introduce the concept of a public debt anchor (threshold); and, should such debt anchor be exceeded, to mandate the National Treasury and Economic Planning to submit a written report to Parliament explaining the cause of the breach and provide a time-bound remedial plan towards achieving the debt anchor; and, (ii) through the National Treasury and Economic Planning, issued the Public Finance Management (National Government) (Amendment) Regulations (2023) to establish a public debt anchor (threshold) at 55 percent of Gross Domestic Product in present value terms.

46. Rationale. The Public Financial Management Act (PFMA, 2012) established a ceiling of 50 percent of GDP in present value terms in line with Kenya's commitments under EAC. In 2019, the ceiling was replaced by a nominal fixed value at Ksh 8 trillion, which was subsequently increased to Ksh 10 trillion to enable full financing of the FY22/23 budget. In addition, the 2012 PFMA was amended in 2022 to allow the government to exceed the limit under certain circumstances (depreciation of the shilling, material balance of payments imbalances, or fiscal disruptions caused by emergencies such as wars, health pandemics, or national disasters). These revisions enabled government to run large fiscal deficits that led to an elevated level of debt at 62 percent of GDP in present value terms in 2022 and a high risk of debt distress.

47. Substance of the reform. The amendments to the PFMA (2012), submitted to Parliament on March 6, 2023, replaces the nominal debt ceiling with a medium-term debt anchor (55 percent of GDP in present

¹⁷ The current regulations require that all importers of excisable goods must be licensed and affixed with a stamp, except motor vehicle, which is not practical.

¹⁸ Revoking the VAT (Electronic, Internet Digital Marketplace Supply) Regulations (2020).

¹⁹ These include ratifying and facilitating adoption of the Multilateral Convention to Implement Tax Treaty Related Measures to prevent base erosion and profit shifting by multinational enterprise and enacting the Common Reporting Standards Regulation into law to improve public confidence in tax reporting, addressing corruption and money laundering.



value terms) and requires the government to present a time-specific plan of returning to a level in line with the anchor to the Parliament. The legislation will be underpinned by specific mechanisms to be established by the government that will govern the medium-term fiscal framework geared toward maintaining public debt aligned with the debt anchor. The law also harmonizes the definition of public debt to make it consistent with the Constitution which defines public debt as all financial obligations' attendant to loans raised or guaranteed and securities issued or guaranteed by the national government.

48. Expected results. This new framework will support government's fiscal consolidation objective and reverse Kenya's public debt trajectory to align with the debt anchor over the medium-term. This will be mainly achieved through achieving primary fiscal surplus in FY2023/24 (RI for this policy area) and beyond. A new governance P4R, the Kenya Government Efficiency, Accountability, and Results Upscaling Program (GEAR UP Kenya, P180287), through its DLIs, will continue supporting transparent and accountable debt management.

Prior Action 4: The Recipient, through its Cabinet: (i) designated the National Safety Net Program (NSNP) as a priority budgetary expenditure; and (ii) directed the National Treasury and Economic Planning to prioritize full disbursements to implementing agencies of NSNP in accordance with each cash transfer payment schedule.

49. Rationale. Kenya's social protection system has made major strides over the last decade. By 2020, the government's flagship Inua Jamii program supported 1.2 million households (roughly 4.6 million indirect beneficiaries) with safety net cash transfers fully financed by the general budget.²⁰ However, sizeable gaps remained in coverage, particularly among the vulnerable households affected most in case of shocks, including recurrent droughts in the North and Northeastern regions. The resource envelope for the program is roughly at 0.3 percent of GDP compared to the average of about 2 percent in upper-middle-income countries. Cash transfers account for less than one-eighth of the consumption needs of households in the poorest quintile. This low coverage is aggravated by persistent delays, often forcing beneficiaries to resort to adverse coping mechanisms. Ensuring predictability and timelines of payments to the beneficiaries of the NSNP would enhance the ability of Kenya's safety net system to reduce poverty and support accumulation of human capital among the poorest.

50. Substance of the reform. On March 8, 2023, the Cabinet approved a Cabinet Memorandum to designate the National Safety Net Program (NSNP) expenditures as non-discretionary spending (as is the case for wages and salaries for public servants). This designation supports adequate allocation of budget for NSNP, minimizes the risk of uncertainty arising from use of supplementary grants to fill financing gaps, and institutes a system of automated release of funds to the NSNP implementers (State Department of

²⁰ The Inua Jamii National Safety Net Program is an umbrella term for four social assistance cash transfer programs, which include: 1) the Cash Transfer for Orphans and Vulnerable Children; 2) the Older Persons Cash Transfer; 3) the Persons with Severe Disability Cash Transfer; and 4) the HSNP comprising of both basic and shock responsive scalable cash transfers targeted to the poor and vulnerable families living in the Counties, most vulnerable to recurrent droughts in the North and Northeastern region of Kenya. These cash transfers are complemented by Nutrition Improvements through Cash and Health Education and Economic Inclusion interventions to incentivize investments in human capital and enhance sustainable livelihoods to support bottom-up economic transformation and inclusive growth agenda of the Government.



Social Protection and the National Drought Management Authority) to effectively manage their operations and hence pay beneficiaries in a timely manner. This reform will strengthen the Hunger Safety Net Program (HSNP), one of Kenya's key safety net instruments to respond to recurrent droughts and other climate induced shocks in the Arid and Semi-Arid Lands (ASAL) counties. The reform will also allow the government to scale up the ongoing pilots in selected Counties that link cash transfer with essential nutrition and health services, and economic inclusion programs.

51. Expected results. This reform is expected to ensure timely, secure, and predictable spending on social protection by ensuring timely, secure, and predictable delivery of NSNP cash transfers to all beneficiaries enrolled in the program. Once fully implemented, the policy will fully align timeliness of delivery of cash transfers as per the payments calendar of each program under the NSNP; raise the proportion of NSNP beneficiaries who are eligible for scalable emergency cash transfers (including to cope with the effects of droughts) receiving their entitlements in accordance with program's payment schedule from current 39 percent to 70 percent; and maintain the performance of covering the female beneficiaries in the HSNP scalable emergency cash transfers to at least 65 percent of the total caseload as the coverage of HSNP expands from existing 4 to 8 Counties in the North and Northeastern region of Kenya. Over the medium to long term, this change will enhance predictable financing and institutional arrangements for social protection and delivery systems and strengthen the foundation for effective implementation of cash plus interventions to accelerate poverty alleviation and human capital development outcomes.

52. Gender equity. This policy action indirectly contributes to closing the gender gap in monetary welfare. Poverty rates in rural Kenya are higher for female-headed than male-headed households. The gender difference is greater in the ASAL of Kenya, where historical underdevelopment and climate change conspire with cultural factors to increase the vulnerability of women. In the counties covered by the HSNP, the poverty rate among female-headed households is 75 percent, 15 percentage points higher than poverty among male-headed households. HSNP mainly covers female-headed households, and safety net transfers represent a higher share of total income for female-headed households. By protecting safety net budget expenditures and improving timeliness, this PA will disproportionately benefit female-headed households, contributing to closing the gender welfare gap (RI4ii to monitor this policy area).

53. Climate change adaptation. This reform contributes to climate change adaptation by safeguarding budgets for the horizontal expansion of safety nets in case of droughts and other climatic shocks that are becoming increasingly frequent and severe with climate change. The HSNP consists both of a core component and a flexible component, with the latter component being triggered in case the Vegetation Condition Index (VCI)—an objective indicator of drought conditions—falls below a pre-determined threshold. When this happens, vulnerable households affected by droughts that are not included in the core component become eligible for a HSNP transfer. During the severe 2022 drought, the rollout of the flexible component was hindered by delayed release of funds from the exchequer. By protecting NSNP expenditures, the reform measure will ensure that expansion of safety net payments triggered by drought is adequately funded and disbursed in a timely fashion, boosting climate adaptation of households in drought-prone places (RI4ii).



Pillar 2: Improving competitiveness to boost agricultural exports

Prior Action 5: The Recipient: (i) through its Ministry of Agriculture and Livestock Development, eliminated the outright purchase of publicly-procured cereals from farmers and instead has instituted a policy of holding a physical base stock through warehouse receipts by issuing the National Cereals and Produce Board (National Food Reserve) Regulations (2023), and (ii) through its Cabinet, approved the National Agricultural Soil Management Policy (2023), which creates an institutional framework for effective management and enforcement of issues pertaining to agricultural soils and water.

54. **Rationale.** Kenya's government retains an outsized role in marketing agriculture outputs, especially maize, through the National Cereals and Produce Board (NCPB). This creates opportunities for rent-seeking and leaves little room for private sector participation in the marketing of maize, Kenya's main staple crop. Prior to this reform, the National Treasury and Economic Planning allocated public resources to the Strategic Food Reserve Trust Fund, which in turn financed maize purchases by NCPB. NCPB used to buy maize at a premium above the price offered by the market and sell to milling companies at discounted prices. These direct market interventions created disincentives for the private sector to participate in maize storage, marketing, and value chain activities; they also disadvantaged the smallholders, who form the majority of Kenya's farmers. In addition, the growth of smallholder farms is constrained by declining soil fertility, compounded by the effects of increasingly frequent climate shocks. The country lacks a comprehensive policy on sustainable soil management to address the challenges of soil degradation and climate change. This has resulted in a low adoption of agricultural soil management technologies, threatening sustainable agricultural production and food security.

55. **Substance of the reform.** The NCPB regulations, prepared by the Ministry of Agriculture and Livestock Development and gazetted on March 13, 2023, eliminate the outright purchase of maize from farmers at administratively determined prices. Instead, the newly created National Food Reserve (NFR) division in NCPB will maintain a physical stock of strategic and volatile commodities through a hold-and-release process of competitively procured warehouse receipts, creating the conditions for a transparent and predictable agricultural market based on market prices.²¹ The reform also opens storage space through competitive commercial leases to encourage private sector participation in the agriculture value chain.

56. While the NCPB reform makes progress towards a more competitive agricultural market, the extent to which smallholders will benefit from this will depend on whether they can increase their productivity. Productivity of smallholders is constrained by soil depletion, erosion, and climate change. The National Agricultural Soil Management Policy (NASMP), approved by the Cabinet on March 21, 2023, provides an institutional framework for effective management and enforcement of issues pertaining to soil and water

²¹ Under the Warehouse Receipt System (WRS), owners of commodities, who may be producers or dealers, deposit produce in certified warehouses. They are issued a title document called a Warehouse Receipt as proof of ownership. The receipt can be used as collateral, reducing pressure on farmers to sell their produce immediately after harvests when prices are usually low. As collateral, the receipts can be used to access credit from participating financial institutions or traded in commodity markets. The WRS also results in lower post-harvest losses as produce is stored in certified warehouses with specific expertise in drying and storing commodities.



management. The adoption and implementation of the NSMP aims to increase the productivity of small farmers through soil preservation, water management, and climate adaptation measures, which will enable farmers to take advantage of a more competitive agricultural market. The policy also commits the government to facilitate the establishment of an accurate climate early warning system, raise awareness about adaptation and mitigation measures, and to support climate-smart agriculture. During the implementation stage, this Policy will be complemented by institutional and legal frameworks, sectoral strategies, and county development strategies to provide an orderly and rapid development of the agricultural soil management mechanism.

57. Expected results. The reforms aim at creating a predictable and transparent agricultural market by eliminating administrative, non-market-based price-setting for Kenya's main crop and increasing agricultural productivity and resilience. This will boost competition in agricultural output markets, encourage private sector participation in agricultural value chains, and strengthen productivity and resilience of smallholder farmers. Specific results include: (i) making public procurement of strategic food stocks transparent and market-based, increasing the efficiency of public spending on food reserves, and freeing up resources; (ii) enhancing private sector participation and competition in storage and commercialization of agricultural produce; and (iii) including agricultural soil and water management practices in the planning agenda of both national and county governments.

58. Climate change adaptation. The NASMP is expected to deliver significant climate change adaptation benefits. Soil is the largest store of terrestrial carbon,²² and its preservation may contribute to climate change adaptation and mitigation. The policy will increase the rate of soil organic carbon sequestration. The policy will also facilitate the establishment of an accurate climate early warning system at the national and county levels to enhance preparedness in managing sudden climate variability and weather extremes, hereby strengthening adaptive capacity. In addition, the policy will establish mechanisms to fund water conservation and harvesting works, increasing resilience of agriculture to extended dry spells.

Prior Action 6: To secure and expand access to international markets for Kenyan farmers by facilitating their compliance with importers' food safety and phytosanitary requirements, the Recipient, through its Cabinet: (i) approved and submitted to Parliament the Food and Feed Safety Control Coordination Bill (2023), and (ii) approved the National Phytosanitary Policy (2023), that together help coordinate all government activities in the field of food safety, food quality, and safety systems, as well as regulate compliance with importing countries' phytosanitary and food safety requirements.

59. Rationale. Agricultural exports are critical for Kenya. In 2020, agricultural products fetched over US\$3.5 billion in export earnings, accounting for 36 percent of all exports. Securing existing export markets and/or obtaining new ones is however jeopardized by non-compliance with importing countries' phytosanitary and food safety norms. For instance, Kenya's fresh avocados, one of the country's main horticultural exports, are not allowed in the United States or South Africa due to non-compliance with sanitary and phytosanitary (SPS) requirements. Avocado exports to China were only allowed in 2022 and

²² See European Commission (2011). Soil: The Hidden Part of the Climate Cycle. Brussels. Available at https://ec.europa.eu/environment/archives/soil/pdf/soil_and_climate.pdf (retrieved on April 7, 2023).



resulted in exports of over US\$56 million in the first three months of access to the Chinese market, highlighting the importance of meeting importing countries' SPS requirements. In a similar fashion, Kenyan bean exports to the EU have faced increased inspection rates since 2020 due to repeated violations of maximum residue levels in exports. Securing existing and opening new markets for agricultural products will depend on Kenyan authorities' capacity to comply with international food safety regulations in importing countries. There are currently twenty-five statutes for food safety control in Kenya; monitoring of their enforcement is not well coordinated. Various regulatory agencies adopt different measures governing food safety and quality, undermining Kenya's competitiveness in international food trade.

60. Substance of the reform. The Food and Feed Safety Coordination Bill was submitted to the Parliament on April 20, 2023; in addition, the Cabinet approved the National Phytosanitary Policy on March 21, 2023. The Food and Feed Safety Coordination Bill will create the Office of Food and Feed Safety Control that will streamline and coordinate all government activities in the field of food safety, food quality, and safety systems, as well as regulate compliance with importing countries' phytosanitary and food safety requirements. A crucial step is the establishment of pest-free areas (PFA), pest-free places of production (PFPP), and areas of low pest prevalence (ALPP), especially in counties producing at least one of Kenya's ten most important export commodities.²³ PFAs, PFPPs and ALPPs refer to geographical locations that are declared fully "pest free." Given that importing countries do a "pest risk analysis" before allowing imports of agriculture commodities, the creation of the PFAs, PFPPs and ALPPs will ensure that Kenya is able to increase international market access across multiple agriculture commodities. In addition, the policy strengthens phytosanitary institutional capacity and coordination between national and county levels, as agriculture is a devolved sector in Kenya. Finally, the policy will kickstart a review of the legislation on phytosanitary matters to strengthen the regulatory framework for phytosanitary systems.

61. Expected results. Together, the approval of the Food and Feed Safety Coordination Bill and the implementation of the National Phytosanitary Policy are expected to help Kenyan producers comply with importing countries' technical requirements, resulting in higher agricultural exports and increased incomes for farmers. The ultimate result of this Prior Action will only materialize once the strengthened phytosanitary and food safety systems will have been firmly institutionalized. The phytosanitary policy is expected to enhance domestic agricultural productivity through better pest management. Similarly, the food safety bill is expected to contribute to better public health, as unsafe food is a significant contributor to the burden of disease in Kenya.

Pillar 3: Improving governance and financial inclusion for private sector driven development

Prior Action 7: To mitigate risks associated with conflicts of interest, the Recipient, through its Cabinet, approved and submitted to the Parliament the Conflict-of-Interest Bill (2023), expanding the scope of public officers and decision-making processes under the purview of the law, and providing a coherent institutional framework for the management of conflict of interest in the discharge of official duties.

²³ According to Kenya National Statistics Agency, Kenya's ten most important commodity exports by 2022, included flowers, fresh vegetables, fruits, tea, coffee, tobacco, sugar, maize, wheat, and beans.



62. Rationale. Government officials with large private sector interests continue to influence and benefit from public procurement in Kenya. Throughout Kenya's post-independence history, numerous Commissions of Inquiry, task forces, and special technical committees have consistently pointed to the close relationship between politics, corruption, and the state. As most recently revealed through the Kenya Medical Supplies Agency (KEMSA) scandal, little-known companies closely connected with prominent politicians are often improperly awarded large tenders.²⁴ The costs of goods and services are inflated, of substandard quality once delivered, or payments are made for non-existent goods and services. All this leads to significant exchequer losses. While various approaches have been used over the years to confront this issue, they have had limited impact. Over the years, a plethora of laws, regulations, and codes of conduct have been enacted.²⁵ However, they are too limited in scope to be applied uniformly across the public service, too general to respond to the evolving and sophisticated nature of the challenge, and difficult to enforce.

63. Substance of the reform. The Conflict-of-Interest (COI) bill, submitted to the Parliament on March 13, 2023, provides an overarching legal framework to comprehensively address all aspects of conflict of interest. The COI bill enhances mechanisms for collaboration, transparency, and disclosure. This builds on initiatives supported under previous DPO series, including revamping the State Procurement Portal, full operationalization of the beneficial ownership e-register, and the roll out of e-GP. The COI bill changes key aspects of the current legal framework by: (i) expanding the scope of public officers and decision making processes under the purview of the law, including politically exposed persons; (ii) expanding the definition of private interests to include interests that benefit other persons, family, relatives, or associates of a public officer; (iii) providing more comprehensive definitions of COI (e.g., preferential treatment, offers of employment, complimentary treatment, acquisition of interests in partnerships and private companies, conflict in recruitment and political neutrality); and (iv) providing a coherent institutional framework for the management of COI, i.e., roles, responsibilities and reporting obligations between the Ethics and Anti-Corruption Commission (EACC) and other agencies.

64. Expected results. The COI law is expected to enhance collaboration, synergies, and efficiencies among oversight agencies, as it defines reporting and accountability mechanisms with greater access to, and sharing of, information among agencies. It will further increase the level of transparency and disclosures of private interests and wealth of public officials (income, assets, and wealth declaration process). The robust mechanisms for managing conflicts of interest, as established by the COI law, will be reflected in the increased proportion of declarations of personal interests of public officials reviewed and verified by the EACC; increased number of inquiries conducted on conflict of interest and recommendations made to relevant bodies; and increased number of advisory opinions provided on COI. In the long run, integrity

²⁴ According to the Auditor General's forensic reports 2020-2022, approximately Kshs 2.3 billion (US\$21 million) was misappropriated through the KEMSA COVID-19 related procurements.

²⁵ Some laws seek to establish standards of conduct for public officers (e.g., the Public Officers Ethics Act 2003, Leadership and Integrity Act Cap 182, Public Service Values and Principles Act Cap 185). Others seek to establish and operationalize processes and systems intended to disaggregate roles and responsibilities (PFM Act, Public Procurement and Regulatory Act etc.). Other laws (e.g., State Corporations Act and other laws establishing semi-autonomous government institutions) have generic provisions on declaring conflict of interest as well as prohibiting management and staff carrying out business with their respective institutions.



reforms to curb corruption and conflict of interest will not only reduce public revenue leakage and expenditure wastage, but also result in more transparent government decisions, which will in turn promote private sector development and investments. GEAR UP Kenya, through its DLIs, will provide incentives for implementation of the provisions of this law.

Prior Action 8: To streamline the process for the government to exit commercial investments, the Recipient, through its Cabinet, approved and submitted to the Parliament the Privatization Bill (2023), whose objective is to streamline the regulatory and institutional framework for the privatization of public entities.

65. Rationale. Currently, Kenya has close to 300 State Corporation (SCs) operating in different sectors of the economy such as agriculture, transport, communications, manufacturing, and trade. SCs face governance and fiscal transparency challenges, overlapping laws, mandates, and regulations that hinder accountability, autonomy, and service delivery leading to inefficiency and duplication. Key drivers to fiscal risks posed by SCs are liquidity risks and arrears accumulation, direct and contingent liabilities with explicit legal obligations, expenditure and revenue shocks due to unforeseen developments, weak institutional, oversight and governance arrangements.²⁶ To reduce the footprint of the state in the economy and reduce fiscal risk, the government is committed to exit a significant share of its current commercial investments. However, the current legal framework for privatization is obsolete and does not provide adequate or streamlined governance framework for privatization.

66. Substance of the reform. The new SC Privatization Bill, submitted to Parliament on March 21, 2023, strengthens the legal and institutional framework to support privatization; institutionalizes structured approach and analytics to classify and identify key SCs for privatization; and fast-tracks privatization program to mitigate fiscal risk and unlock private sector potential. Government continues to accelerate the implementation of SC governance reforms outlined in the SC Reform Blueprint, IMF program, and a new administration policy directive. All of these promote efficient service delivery by SCs, prudent fiscal consolidation and risk management, transparent ownership policy, and operational efficiency. The Bill will provide legal basis for the establishment of a Privatization Authority, which will advise the government on SCs privatization, facilitate the implementation of government privatization policies, and implement privatization programs. The new administration has also embarked on the review of the SCs reform Blueprint to align it with the new policy priorities and sequencing reform measures.

67. Expected results. The measures enshrined in the Bill are designed to accelerate privatization program efforts to mitigate fiscal and governance risks and prioritize development of the Government Investment

²⁶ The evaluation included 18 of the 248 SCs: Kenya Ports Authority, Kenya Pipeline Corporation, Kenya Airports Authority (KAA), Kenya Electricity Generation Company (KenGen), Kenya Power and Lighting Company, Kenya Railways Corporation (KRC), Kenya Broadcasting Corporation (KBC), East African Portland Cement Company (EAPCC), Postal Corporation of Kenya (PCK), Kenya Post Office Savings Bank (KPOSB), Kenyatta National Hospital, Kenya National Examinations Council (KNEC), Athi Water Works Development Agency (AWWDA), Kenya Wildlife Service (KWS), Jomo Kenyatta University of Agriculture and Technology (JKUAT), Moi University (MU), Kenyatta University (KU), and the University of Nairobi (UON). The maximum gross fiscal exposure of the 18 SCs is estimated at KShs 436.2 billion (4.5 percent of GDP), estimated financial liquidity gap stood at Kshs 382b over the next 5 years assuming no reform option, 14 SCs had accumulated arrears totaling KShs 211b (2.2 percent of GDP).



Management Information System (GIMIS) that facilitate fiscal risk reporting, oversight, and transparency. Increasing SCs' revenues and reducing expenditures related to SCs will not only contribute to government's fiscal consolidation goals, but also enable GoK to pursue priority investments focused on inclusive growth. At the same time, the new SC law will enable the government to exit less productive commercial investments and instead increase private sector's role in the economy. In the short term, GoK will accelerate to readiness for divestiture three non-strategic commercial SC that contribute a significant share of the fiscal risks (RI8 under this operation). Additional reforms are expected to fast-track establishment of robust performance management, oversight, and privatization institutional framework. GEAR UP Kenya, through its DLIs, will provide incentives for implementation of the provisions of this law, the SC Blueprint, and associated reforms.

Prior Action 9: The Recipient, through its National Climate Change Council, issued the Climate Change (Public Participation and Access to Climate Change Information) Regulations (2023), to improve access to climate change information by providing detailed guidance on the conduct of mandatory public consultations for any proposed law, policy, and strategy related to government's climate actions.

68. Rationale. The Intergovernmental Panel on Climate Change (IPCC) Special Report on the Impacts of Global Warming (2018) specifically identified public participation in adaptation planning as a means to enhance capacity to cope with climate change risks. However, current public participation and input into government climate action are not well-regulated, either in process or in substance. The GoK estimated has estimated that Kenya needs approximately US\$5.39 billion of additional financing *per annum* to deliver its updated Nationally Determined Contribution. However, there are competing priorities and scarce resources; priorities are in some cases identified in an *ad hoc* and subjective manner. The appropriately channeled inputs from the public and from private sector will help determine priorities for climate action and improve both its planning and implementation.

69. Substance of the reform. The regulation of Public Participation and Access to Climate Change Information, gazetted on March 30, 2023, provides the substantive and procedural mechanisms of public participation in the context of government climate action. It creates space for citizens and enterprises to influence the determination of sectors for climate change priority actions. This will be done as part of the climate change action plans reviewed every five years at the national level. The public participation also enables the public and private sector to inform the formulation of regulations governing the national climate change fund and counties' climate change funds, thereby improving the transparency and accountability of the funds' allocation for priority actions. The regulation also ensures the public access to information on the utilization of resources, proposed actions, and on progress on reducing greenhouse gases emissions. Where relevant, the regulation allows to complement the government-financed measures with private measures for addressing climate change. The regulation also addresses three issues that previously have undermined the effectiveness of public consultations: inadequate time for comment or review of material; lack of clarity of who must be consulted and ensuring accommodations are provided for those who need them; and clear sense of how feedback provided during public consultation was considered.



70. **Expected results.** The regulation will result in improved transparency and accountability of government's climate actions, including allocation of climate funds to priority actions, monitoring of progress on reducing GHG emissions, and prioritization of actions in national climate change action plan. Progress will be measured through the share of government climate actions that have been informed by public/enterprise provision of inputs because of this regulation (R9).

Prior Action 10: The Recipient, through the National Treasury and Economic Planning, issued the Public Finance Management (Financial Inclusion Fund) Regulations (2022), to create the Financial Inclusion Fund, which enhances financial inclusion of the under-served segment of the population and small and micro-enterprises in a sustainable manner leveraging market-based mechanisms.

71. **Rationale.** Although Kenya has a relatively high level of financial inclusion, with about 83 percent of Kenyans having at least one form of a transaction account (mostly on mobile money), access to finance remains a key constraint to many poor households and other vulnerable groups as well as to MSME. According to the 2021 FinAccess Household Survey, the lowest quintile of households had the highest level of exclusion (22.1 percent) and use informal channels (15.1 percent), compared to 3.6 percent and 1.3 percent for the highest quintile. Additionally, only 12.7 percent of the poorest households had access to banks. Commercial banks are risk-averse to these vulnerable groups and the alternative sources of finance to smoothen their consumption and business needs (e.g., through their mobile money loan products) are exorbitantly priced. This has created a vicious cycle of non-repayments, further reducing the ability of these segments of the population to access finance. The government of Kenya sees a role in addressing the existing acute market distortions by leveraging the digital finance network in Kenya and putting in place innovative but prudently managed mechanisms. This is in line with the government's BETA, prioritizing the poor and low-income households in informal urban settlements, small and micro-level businesses, rural areas, and women. The new administration established the Financial Inclusion Fund with the objective of developing and deploying affordable, accessible, and appropriate financial services and products for the bottom of economic pyramid.

72. **Gender aspects.** While one in four start-ups in Kenya are female co-founded, their businesses are smaller compared to those of men as they access less funding or debt due to irregular cashflows. According to KNBS's 2016 MSME Survey, 57 percent of businesses that had to close were owned solely or jointly by women, compared to 35 percent for men. The main reasons for closures included shortage of operating funds and personal reasons, particularly related prenatal and postnatal care of children. While the gender gap has declined, exclusion rates remain higher for females (12.4 percent), compared to males (10.8 percent), with the percentage of women using informal groups (6 percent), almost twice that for men (3.2 percent). Informal channels can include unregulated money lenders that can charge higher than market rates due to the credit risk perception of this underserved group.

73. **Substance of the reform.** The National Treasury and Economic Planning issued the Financial Inclusion Fund regulations on November 23, 2022. The regulations support the operation of the Fund in an efficient and transparent manner, including its source of funding, governance framework, eligibility conditions, and key operational aspects. The Fund is expected to deliver saving, credit, insurance, and investment products, through digital channels and small financial institutions with the appetite to serve the



underserved segment, including the microfinance banks, Saccos, and group-based financial services providers such as “Chamas” and “table banking groups”. The Fund will leverage the existing digital capacity in the economy and well-structured commercial infrastructure. As the Fund grows, it will need to monitor and measure impact. The World Bank-financed recently approved project, Supporting Access to Finance and Enterprise Recovery (SAFER, P175017), will allow to effectively engage with the GoK on further enhancing targeting, governance structures, and effective monitoring and evaluation.

74. **Expected results.** Once fully implemented and rolled out, the fund will remain as a source of small loans by individual beneficiaries (to ensure access for the poor) (RI10i) and micro firm owned by women will access finance through the fund (RI10ii). Over the medium to long term, this policy will enable the formal financial sector to lend to the poor and low-income households and MSMEs by improving the quality of borrower credit information and limiting unethical lending behavior. It will also strengthen institutional capacities to provide financial services through cooperative societies, chamas, table banking groups and micro-finance institutions that best serve the informal sector. The focus on market-based mechanism and re-payment discipline requires that the Fund maintain its self-sufficiency and reduce the dependence on governments injections overtime, necessitating a close monitor the budget transfers to the fund, expected to reduce as it grows into self-sufficiency.

Table 4. DPO Prior Actions and Analytical Underpinnings

Prior Action Substance	Analytical Underpinnings
Operation Pillar 1: Creating fiscal space in a sustainable and equitable manner	
Prior action #1. Expenditure rationalization reforms – electricity tariff review	<i>Kenya Public Expenditure Review 2020: Options for Fiscal Consolidation after the COVID-19 Crisis</i> identified the need for expenditure rationalization, including through abolishing subsidies. A cost-of-service study was supported by <i>Kenya Electricity Modernization Project (P120014)</i> informed the process of the detailed tariff review by KPLC. A financial model developed for KPLC with Bank support is the analytical tool used for analyzing financial constraints of KPLC and identifying the tariff adjustment needed.
Prior action #2. Revenue enhancing reforms	<i>Kenya Economic Update</i> , June 2022 found that revenue measures, including further reducing tax expenditures, introducing a digital tax, and strengthening tax administration to expand the tax base and improve compliance, are expected to raise revenue by 1.8 percent of GDP by FY24.
Prior action #3. Debt management – debt ceiling	<i>Kenya Public Expenditure Review 2020: Options for Fiscal Consolidation after the COVID-19 Crisis</i> found that aiming for a primary balance surplus remains a key priority once the COVID-19 crisis abates to curb debt trajectory over the medium-term. The debt anchor of 55 percent of GDP in PV is aligned with the threshold used by <i>Joint World Bank-IMF Debt Sustainability Analysis</i> .
Prior action #4. Timeliness of cash transfers to protect the poor	<i>Social Protection and Jobs Public Expenditure Review (2023)</i> found that an ongoing challenge to timely payments has been the delayed release of National Treasury and Economic Planning allocations to the Inua Jamii programs. Prompter payment of civil service pensions and public salaries indicates that cash transfers can occur on time if such issues are overcome and the cash transfer budget lines are elevated to the priority of government payroll, ensuring that the Treasury releases payments when they fall due.
Operation Pillar 2: Improving competitiveness to boost agricultural exports	
Prior action #5. Competitive procurement of National Food Reserve and NASMP	<i>Kenya Agricultural Sector Risk Assessment (2015)</i> found that NCPB intervention pushes up maize prices in short term and that release of stocks by NCPB is a risk for private traders with large inventories. <i>Kenya Economic Update 19: Transforming Agriculture Sector Productivity</i>



	<i>and Linkages to Poverty Reduction (2019)</i> reports that NCPB buys maize at a premium above the market price, resulting in undue fiscal pressures and misallocation of resources.
Prior action #6. Food Safety and NSPSP	<i>Kenya Agricultural Sector Risk Assessment (2015)</i> reports that small-scale farmers have increasingly been hit by the EU’s stringent food safety regulations concerning agro-chemical residues, affecting their competitiveness. <i>Kenya Trade Integration (P172285) ASA</i> finds that that current state of sanitary and phytosanitary systems (SPS) results in missed opportunities for growth and export diversification due to repeated violation of food safety standards in importing countries. Establishing SPS management systems that build confidence in Kenya’s exports while minimizing compliance costs is key to increasing agricultural market access.
Operation Pillar 3: Improving governance and financial inclusion for private sector driven development	
Prior action #7. Conflict-of-Interest Bill	A recent study, <i>“Rethinking the Conflict-of-Interest Policy in Kenya” (2017)</i> , identified gaps in conflict-of-interest policy and existing legal framework, and makes recommendations for a wider definition of conflict of interest and stronger enforcement (more powers to oversight institutions). <i>“Conflict of Interest and Public Office in Kenya” (2021)</i> provides comparative analysis of COI regimes and teases out best practices as applicable to Kenya, underpinning the current bill. Kenya’s Ethics and Anti-Corruption Commission (<i>EACC Annual Report (2021/22)</i>) details the complaints under investigation by the EACC that relate to conflict of interest.
Prior action #8. SOE Privatization Act	“Kenya State Corporations Review: Corporate Governance and Fiscal Risks of State Corporations,” a chapter in <i>Kenya Public Expenditure Review</i> , World Bank (August 2021), identifies fiscal risks of state corporations and points to gaps in the current governance framework for their privatization.
Prior action #9. Climate Change Act Regulations on transparency and accountability	<i>Intergovernmental Panel on Climate Change (IPCC) Special Report on the Impacts of Global Warming (2018)</i> specifically identified public participation in adaptation planning as a means to enhance capacity to cope with climate change risks. <i>Kenya Climate Change and Development Report (CCDR, forthcoming 2023)</i> states that incorporation of local knowledge and stakeholders in the formulation and implementation of climate change policies, strategies, and plans would significantly enhance their effectiveness.
Prior action #10. Financial Inclusion Fund (Hustler Fund) Regulations	<i>Informal Sectors Skills and Occupations Survey (2020)</i> finds that lack of access to credit is the main constraint for 57 percent of informal enterprises in Kenya. Over 60 percent of individuals in the <i>FinAccess Survey (2021)</i> cited they were unable to meet their daily spending needs at some point in the last 12 months.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

75. The DPO supports several objectives and High-Level Outcomes (HLOs) of the WBG Country Partnership Framework FY23-FY28 for Kenya (CPF).²⁷ Both the DPO and the CPF are underpinned by Kenya’s Vision 2030 agenda, as operationalized through the respective MTPs. The DPO helps to advance the HLOs and objectives set out in the CPF. The proposed DPO supports HLO1 (“faster and more equitable labor productivity and income growth”) and HLO3 (“greater resilience and sustainability of Kenya’s natural capital”). Within HLO1, the CPF objective 1 “boost fiscal and debt sustainability” is supported by the proposed reforms under Pillar 1 of the DPO (the reduction of subsidies for electricity tariffs, the measures to expand the revenue base, the amendments to the Public Financial Management Act) and the reform of NCPB under Pillar 2 (the elimination of administratively determined maize prices above the market price). CPF objective 2 (“strengthen the efficiency and transparency of public spending”) is also supported

²⁷ Report #72255, discussed by the Board on November 17, 2022



by several of the reforms proposed under Pillar 1, Pillar 2 (the NCPB reform) and Pillar 3 (access to information, the Conflict-of-Interest Bill). The phytosanitary and food safety systems reforms also contribute directly HLO1 by securing and expanding access to international markets for Kenya's farmers. Within HLO3, several proposed reforms support the sixth CPF objective of "increasing household resilience to, and national preparedness for, shocks." The NSNP reform under Pillar 1 protects safety net transfers and hence strengthens household resilience to climate shocks, while the adoption of the NASMP under Pillar 2 strengthens the resilience of landscapes and soils and improves national preparedness for shocks by facilitating the establishment of an accurate climate early warning system.

76. This operation complements other ongoing projects supporting the government's development agenda. These include Kenya National Agricultural Value Chain Development Project (P176758); Kenya Climate Smart Agriculture Project (P154784); Kenya Social and Economic Inclusion Project (P164654); Transforming Health Systems for Universal Care Project (P152394); Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya (GESDeK, P161387); Kenya Financing Locally-Led Climate Action Program-for-Results (P173065); and Supporting Access to Finance and Enterprise Recovery (SAFER, P175017). The operation complements contributions by other development partners to support Kenya's recovery from the pandemic and achieve its development goals, including the current IMF program.

77. The design of this operation builds on the lessons learned from the previous DPOs in Kenya. The Implementation Completion Report (ICR) for the Kenya Inclusive Growth and Management DPO (P172321) identifies the following key lessons: (i) importance of identifying the confluence between government priorities and those of the World Bank; (ii) strong government co-ordination role, spearheaded by the National Treasury and Economic Planning; and (iii) close focus on implementation, including the support through other World Bank-financed operations, as well as the work with the government and other development partners in areas of reform where World Bank funds are not available. Although ICR for the latest DPO series (FY21-22) is not yet available, similar lessons emerge, whereby sustained engagement and trust-building with the National Treasury and Economic Planning underpins ownership, which leads to successful implementation. Building on these lessons, this operation is centered around the new administration's priorities that the World Bank considers most critical, such as fiscal consolidation, governance reforms, and growth-enhancing reforms focused on competitiveness and resilience in agriculture. Linked to this is the built-in driving and coordinating role of the National Treasury and Economic Planning, ensuring government buy-in and ownership, as well as follow-through. Finally, the focus on implementation and achieving results is paramount in this operation. Most prior actions are supported by the ongoing operations and prior analytical work and non-lending TA.

78. The proposed operation is aligned with the World Bank Africa Strategy (2019-2023) and contributes to IDA20 Policy commitments. The DPO program contributes to the following World Bank priorities for supporting Africa: creating jobs and transforming economies (DPO Pillar 2), making institutions more efficient and accountable (DPO Pillar 3), and supporting climate change mitigation and adaptation (cross-cutting throughout the DPO: PAs 1,4,5, and 9). Table 5 shows the contribution of the DPO to IDA20 policy commitments in areas of Human Capital, Jobs and Transformation, and Governance and Institutions.



Table 5. IDA Policy Commitments

Reforms supported by the operation	IDA20 Policy Commitments (PC)
Reducing transfers for electricity tariff subsidies (PA#1); introducing a medium-term debt anchor (PA#3)	Increasing debt transparency and fiscal sustainability (Governance and Institutions PC#1)
Broadened the tax base and improving tax compliance (PA#2)	Improving domestic resource mobilization (Governance and Institutions PC#2)
Protecting critical social spending for the most vulnerable (PA#4)	Leveraging adequate, efficient financing for human capital (Human Capital PC#8)
Enhancing access to finance at the bottom of the economic pyramid in a sustainable manner by leveraging market-based mechanism, through adopting a sound operational and governance framework for the Financial Inclusion Fund (aka Hustler Fund) (PA#10)	Supporting resilient financial systems for recovery (Jobs and Economic Transformation, PC#1)

79. **The proposed operation is aligned with the Global Crisis Response Framework (GCRF).** Several reforms under the operation also support the “Macro-Fiscal, Financial, and Debt Sustainability” theme of GCRF Pillar 3 by phasing out consumption subsidies, broadening the tax base, and providing a revised legal framework for privatization of SOEs. Moreover, this operation supports the adoption and implementation of an agricultural soil management policy and strengthening of the policy and legislative framework for phytosanitary and food safety systems. These reforms aim to increase agricultural productivity and resilience by restoring soil fertility and rolling out appropriate technologies for soil conservation and water harvesting. They further aim to upgrade the institutional and policy framework for more effective management of pests, which are made more frequent by climate change. The operation also supports the effective implementation of adaptive safety nets by safeguarding budget allocation for the scalable (and therefore unpredictable) components of Kenya’s Hunger Safety Net Program (HSNP). Specifically, PA#1,2,3 can be mapped to the “Macro-fiscal, financial, and debt sustainability” theme of GCRF Pillar 3; PA#4 to GCRF Pillar 1 (scale up social protection support to the vulnerable); PA#5 to the “Macro-fiscal, financial, and debt sustainability” and “Climate resilience” themes of GCRF Pillar 3; PA#6 to GCRF Pillar 3 (nutrition sensitive and sustainable food systems); PA#7 to GCRF Pillar 4 (institutional strengthening theme); PA#8 to the “macro-fiscal, financial, and debt sustainability” theme of GCRF Pillar 3; PA#9 to Pillar 4 (climate smart policies theme); and PA#10 to Pillar 2 (protecting people and preserving jobs theme).

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

80. **The reform program benefits from strong government ownership and the World Bank Group’s deep, extensive engagement in Kenya.** The policy matrix (Annex 1) has been developed through extensive dialogue and collaboration and draws on analytical work and experience from the implementation of the WBG’s project portfolio in Kenya. To prepare this DPO, the government has regularly convened a Technical Committee chaired by the Principal Secretary (PS) of the National Treasury and Economic Planning, comprising government focal points from implementing Ministries, Departments and Agencies (MDAs) at the PS level, and the World Bank. The government’s strong ownership of the reform program flows on from the experience with the previous DPOs for Kenya, which have demonstrated to policymakers the



usefulness of this instrument in supporting the government to formulate and implement an ambitious multi-sectoral reform program. The implementation of government reforms is underpinned by an extensive technical assistance program involving the World Bank, International Finance Corporation, IMF, and other development partners.

81. Stakeholder consultations have informed the underlying national and sector plans and the associated policy changes supported by the proposed DPO. Public participation is a constitutional requirement for the government when making or implementing public policy decisions under Article 10(1) of the Constitution of Kenya. The legislative changes supported by this operation have undergone stakeholder consultations. The comments received from the public and a record of the extent to which they have been incorporated in the final draft will be uploaded onto a public website for further public access.

82. Collaboration with development partners has been facilitated by the Development Partners Group (DPG), the main donor co-ordination platform in Kenya. The development partners are committed to supporting efforts by the government to mitigate the adverse socioeconomic effects of the pandemic and facilitate opening of the economy, accelerate economic recovery and attain higher and sustained economic growth. The World Bank has regularly engaged with the Heads of Co-operation of the DPG on the design and implementation of the DPO. Further, Heads of Missions (HOMs) have also been engaged on the DPO, both through DPG-HOMs meetings as well as bilaterally. This has been complemented by the government's own communications with development partners, including concerning the budget support operation.

83. This operation complements contributions from development partners, including other budget support. The World Bank, the African Development Bank (AfDB) and the IMF have consulted closely in developing and implementing their respective programs. JICA has shown strong interest in supporting Kenyan government in the future, possibly through direct budget support. The European Union (EU) has supported the Public Finance Management Reform Strategy, which is integral to these programs. Further, in general, development partners including Canada, Denmark, the European Commission, Finland, France, Germany, Japan, the Netherlands, Norway, Sweden, the United Kingdom, the United States, and the AfDB, in coordination with the WBG, are providing financial and non-lending support in several areas covered by the operation.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

84. The overall medium- to long-run poverty and social impacts of the reform package supported by the proposed operation are expected to be positive. Prior Action 4 under Pillar 1, which classifies NSNP payments as essential budget expenditures and regularizes disbursement to beneficiaries according to a pre-determined timeline, will have direct benefits for extremely poor and vulnerable households by ensuring that safety net transfers are protected and disbursed in a timely manner even during a fiscal



crunch (so that a repeat of the 2022 situation, during which safety net transfers to poor households were delayed by many months in the midst of a severe drought, can no longer happen). The other proposed reforms under Pillar 1 have the potential to benefit the poor and vulnerable indirectly by creating the fiscal space to support the government's inclusive growth agenda. The prior actions under Pillar 2 are expected to raise productivity and resilience of agriculture in the medium-term and secure markets for Kenya's agricultural products, benefiting the income growth and income stability of households that derive their livelihoods from agriculture. Under Pillar 3, the establishment of the Financial Inclusion Fund is expected to improve access to finance for informal micro-enterprises and low-income households, with positive effects on incomes and household welfare (e.g., nutrition) in the medium term. The other proposed reforms under Pillar 3 are not expected to have significant distributional impacts in the short run. The World Bank recommends however that potential government divestments from commercial activities resulting from the Privatization Act (Prior Action 8) be subject to social impact assessments to inform appropriate mitigation measures.

85. While the proposed energy tariff reform (Prior Action 1) is the reform with the highest risk of adversely affecting low-income households, the overall poverty effect is neutral. At a national level, just over one-third of households reported expenditure on mains electricity.²⁸ This ranges from 4 percent among the poorest rural quintile to just under 90 percent among the richest urban quintile (Figure 5). Taken together, the poorest quintile in Kenya (both urban and rural) account for seven percent of total household spending on electricity, while the richest quintile account for 43 percent (Figure 6). Given that poorer households are less likely to consume mains electricity, the direct poverty impact of an increase in household budget share allocated to mains electricity is expected to be small. In fact, the analysis shows that thanks to the counteracting effects of the lifeline reform, the aggregate poverty impact of the reform is close to zero (an increase in poverty of 0.02 percentage points at the national level – Figure 7). On one hand, the increase in tariffs for households consuming between 30–100 kWh per month negatively affects the purchasing power of poor households that fall within this bracket. This effect however applies to only four percent of poor households (focusing only on poor households that consume mains electricity, the tariff applies to 27 percent of poor households – Figure 8). On the other hand, the decrease in tariffs for households consuming less than 30 kWh per month (the new lifeline) increases real incomes, cancelling out, at the aggregate level, the poverty impact of the overall reform. The figures also show that the former lifeline (0-100 kWh) was too high, with over 90 percent of non-poor households consuming less electricity than the lifeline threshold (Figure 8).

²⁸ Based on the latest publicly available household survey data (2015/16).



Figure 5: Share of Households Consuming Electricity from Main Grid, 2015/16

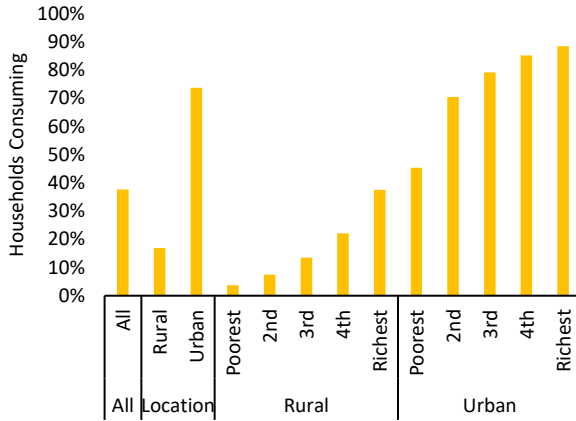


Figure 6: Share of Total Expenditure by Quintile, 2015/16



Figure 71: Poverty Impact of Direct Price Increases

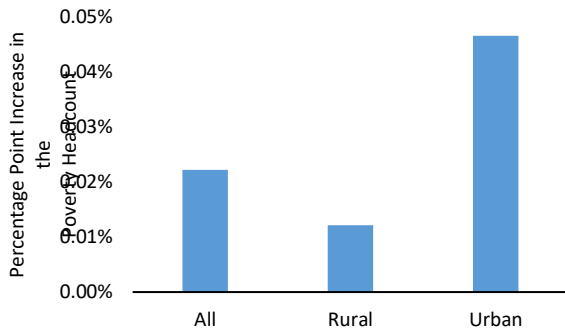
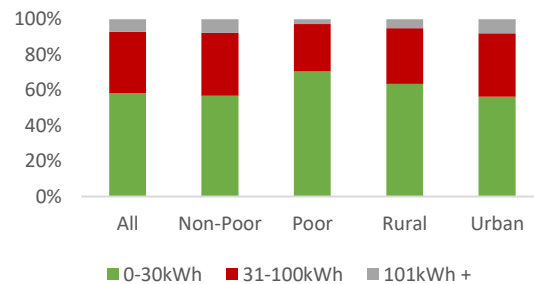


Figure 82: Share of Electricity Users by Old and New Lifeline Threshold



Source: World Bank staff calculations on 2015/16 KIHBS

Notes: The poverty impact of prices changes to electricity is simulated by adjusting the value of expenditure by a range of percentages (1,2,5,10,15,20, and 25 percent). The increase in expenditure is then subtracted from a household’s consumption and poverty is recalculated. The baseline for the simulation is 2021, which is produced from the COVID-19 microsimulations.



86. The prior action on NSNP (Prior Action 4) will have immediate positive distributional impacts, especially for female-headed households. While the share of households in Kenya that receive cash transfers is low overall, it is substantially higher for the poorest welfare quintile (Figure 9), for whom the transfers represent a sizable share of household income. Depending on the program and the location of the household, cash transfers represent between two and 26 percent of total household income in the bottom quintile (Figure 10). Female-headed households are more likely to receive cash transfers, and these represent a higher share of income for female-headed households (Figures 10 and 11). The temporary loss of these transfers due to disbursement delays is simulated to have modest poverty impacts, increasing the poverty headcount rate by 0.4 percentage points and the poverty gap by 0.3 percentage point in Kenya’s arid regions which are most dependent on the transfers (Figure 11). Protecting the budget expenditures allocated to these programs will avoid this poverty impact and mainly benefit female-headed households, who are relatively more dependent on safety net cash transfers.

Figure 9: Share of Households Receiving a cash transfer, 2015/16

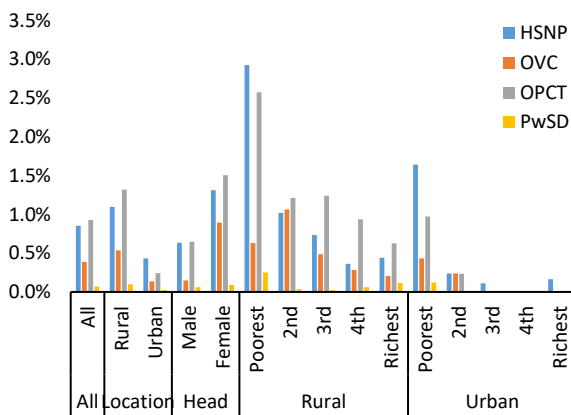


Figure 10: Median Household Budget Share, 2015/16

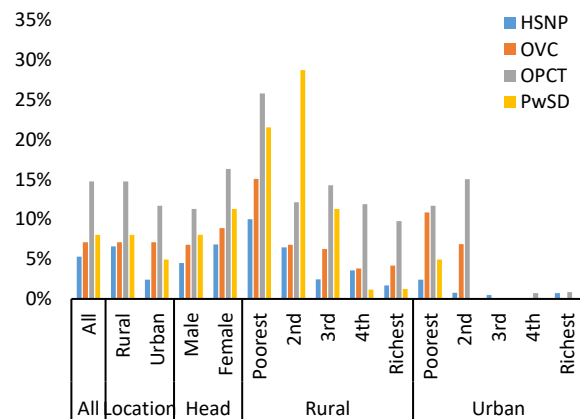
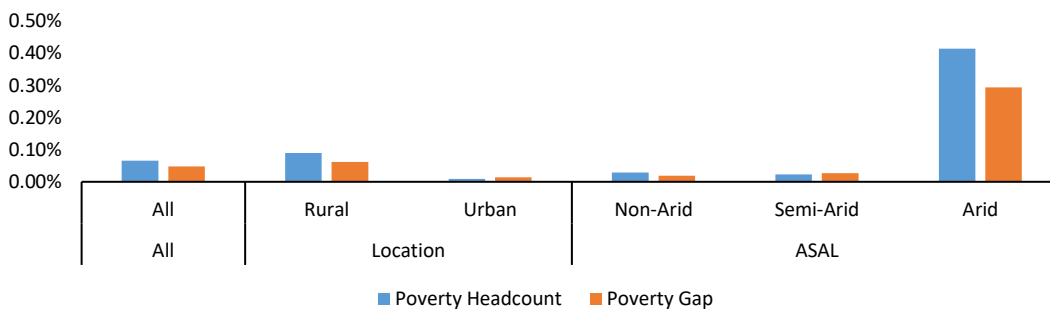


Figure 11: Poverty Impact of the delay in Cash Transfer Payments



Source: World Bank staff calculations on 2015/16 KIHBS



87. Finally, the prior action establishing the Financial Inclusion Fund (PA#10) is expected to have positive welfare impacts through further boosting financial inclusion. Kenya has been a pioneer in developing and boosting digital financial inclusion through M-PESA, a mobile phone-based money transfer, payments, and microfinancing service. Launched in 2007, M-PESA is currently used by 80 percent of the adult population in Kenya²⁹ and has lifted, according to research, two percent of Kenyan households out of poverty and facilitated earnings-boosting occupational change among women.³⁰ Despite this success, gaps remain, with people in the poorest counties (the arid and semi-arid counties in the north-east of the country) and women more likely to be financially excluded or relying on informal financial mechanisms (such as savings groups, shopkeepers, moneylenders). Early data from the rollout of the Financial Inclusion Fund suggest that the fund is being successful in reaching underserved population groups: 47 percent of beneficiaries of the Fund (up until March 6, 2023) were women, 53 percent made the loan application from a feature phone (a proxy for lower incomes, as opposed to smartphones), the average loan size amounted to KES645 (US\$4.90), indicating that loans are going towards low-income populations, and over 900,000 of the so far 15 million borrowers live in the nine arid counties, which are by far the poorest in the country.³¹ The Fund thus appears to be reaching the intended beneficiaries, though it is too early to estimate the actual welfare effects.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

88. Kenya has put in place a legal and institutional framework to manage environmental risks and negative impacts of projects, but it is undermined by adequate capacity and lack of enforcement, especially at the country level due to devolution of some activities. Alongside an overseer Ministry of Environment and Forestry that guides policies on environmental, forest, and protection and conservation of natural resources, the 2013 National Environment Policy and the 1999 EMCA (amended in 2015) established the National Environment Management Authority (NEMA) to coordinate environmental management activities and integration of environmental consideration into policies, plans, programs, and projects. Since 1999, NEMA has used the Environmental Impact Assessment (EIA) as a management tool to screen projects that risk adversely impacting the environment. Projects are required to submit an EIA report to NEMA to receive a license, be subject to public participation, and to provide project affected persons with information about the project, its anticipated impacts, and benefits. Policies, plans, and programs assessed by NEMA to likely have significant effects on the environment, are subjected to a Strategic Environmental Assessment (SEA). Routine environmental self-audits are supported by control audits conducted at the initiative of NEMA as and when necessary to ensure compliance. NEMA enforces the EIA recommendations and the license conditions while the National Environmental Tribunal adjudicates NEMA actions. Petitions can also be logged with the Environment and Land Court. These efforts are complimented by the World Bank's Environmental and Social Risks Framework. Nonetheless, the environmental management systems are still nascent and there is low compliance with the environmental provisions at the county level due to the devolution of certain environmental responsibilities to the counties.

²⁹ According to the 2021 FinAccess Household Survey (<https://www.knbs.or.ke/wp-content/uploads/2021/12/2021-Finaccess-Household-Survey-Report.pdf>).

³⁰ Suri, T. and Jack, W. (2016). "The long-run poverty and gender impacts of mobile money". Science 354(6317).

³¹ These counties are Garissa, Madera, Marsabit, Wajir, Turkana, Samburu, Isiolo, Tana River, and Baringo.



89. The proposed operation supports the environment and management of climate change. Prior action #1 supports a review of retail electricity tariffs resulting into increased electricity cost to both households and businesses will likely results into both negative and positive environmental effects. Commercial firms and businesses that use large amounts of electricity may consider transitioning to renewable energy sources such as solar, by installing solar generation plants, this will result in cutting electricity costs and reducing carbon emissions, thus, resulting in positive outcome. While, poor households, the increase of electricity tariffs may result to households transitioning to alternative affordable energy options for both cooking and lighting, these may include adoption of paraffin for lighting and charcoal for cooking. This will likely contribute negative environmental impacts that include increased indoor household pollution, increased carbon emissions and deforestation.

90. Some reforms are expected to have direct environmental and climate effects. Prior action #6 supports reforms aiming to strengthen the national phytosanitary policy and food and safety bill, expected to strengthen the phytosanitary system for effective pest risk mitigation and management by enhancing safety and integrity of the agri-food produce throughout the export value chain. The implementation of this policy and legislation is expected to contribute to the promotion, adoption and use of sustainable integrated pest management strategies and good agricultural practices and hence improve pest management practices and reduce inappropriate and excessive application of pesticides. In addition to containing the spread of pests, it will minimize the contamination of the agricultural produce, and the wider environment (air, soil, and water sources) and hence control the loss of the biodiversity, including beneficial organisms. The development of this Policy should be subjected to the strategic environmental and assessment.

91. Similarly, the adoption of the National Agricultural Soil and Management Policy (NASMP) under PA#5, expected to promote sustainable soil management practices, will be crucial for raising agricultural productivity while preserving the environment. It will promote efficient use of inorganic fertilizers by farmers, training the farmers to use the right types and application of fertilizers, with emphasis on soil analysis to establish the soil nutrient status and corrective nutrient replenishment. In addition to providing a regulatory framework for the production and use of bio-fertilizers (environment friendly), the policy promotes the adoption of organic agriculture and farming. The resultant sustainable agricultural soils and environmental management, and specifically soil and water conservation, soil fertility management, agroforestry and soil restoration and rehabilitation aspects, all contribute positively to the environment.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

92. Kenya maintains good standards of budget transparency. Budget formulation involves public participation through public forums organized by the National Treasury and Economic Planning, which publishes the budget on its website. It also publishes the budget policy statement, a document that states the government's budgets plans and the main priorities on which it will spend its resources.³² In addition,

³² <https://www.treasury.go.ke/budgets/>



the National Treasury and Economic Planning and the Office of the Controller of Budget produce regular budget implementation reviews, namely the Quarterly Budget and Economic Review and the National Government Budget Implementation Report.

93. The PFM system and public procurement framework, together with the government's commitment to improve their performance through various initiatives, provide reasonable assurance that the government can manage the country's budget resources appropriately. The strengths of the PFM system include a relatively strong budget system that is transparent and accurate; reengineering, roll-out and use of Integrated Financial Management Information System (IFMIS) in all line ministries and counties; well trained and qualified accountants and budget officers in the National Treasury and Economic Planning and MDAs; and a functioning Internal Audit Department and independent Supreme Audit Institution, the Office of the Auditor General (OAG). Areas for improvement include delays in the rollout of some of the IFMIS modules; integration of IFMIS with some GoK information technology (IT) systems remains pending; review and enhancing of IT controls in IFMIS; automation of consolidation of MDAs' financial statements; and delays in submission of audit reports to Parliament. The government is working on PFM improvements with support from development partners. The World Bank is providing support to the National Treasury and Economic Planning on PFM improvements through the Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya (P161387) and the Kenya Accountable Devolution Project (P149129) by use of targeted DLIs addressing the areas of weakness. As a result, there has been further strengthening in the areas of (i) improved prioritization and management of public investments; (ii) improved borrowing and cash management practices to enable reliable funding for service delivery and investment projects; (iii) consolidation of staff data for better human resource management; (iv) timeliness and quality of financial statements; and (v) quality of external and internal audit practices.

94. The CBK continues to maintain effective operational controls and foreign exchange management. The FY2020/21 and FY2021/22 audits were completed within the required timelines and audit certificates issued dated September 27, 2021, and September 19, 2022, respectively. The reports were unmodified for two years. Other matters raised in the reports relate to the failure to maintain the required number of non-executive directors and the lack of a second deputy governor. The OAG audit reports did not flag any other weaknesses in the CBK's internal audit function and internal controls. An updated safeguard assessment of Central Bank of Kenya was completed by IMF in September 2019. CBK continues to maintain sound external and financial reporting practices, and its Board has active oversight operations. In addition, the CBK continues to maintain effective operational controls. The CBK has implemented most of the recommendations from the 2019 assessment. Draft amendments to the CBK Act, prepared in consultation with IMF, largely address safeguards recommendations and await submission to Parliament.

95. Loan and credit disbursement will follow the World Bank's procedures for development policy financing. The World Bank will disburse the funds to an account opened by the National Treasury and Economic Planning in the CBK which will form part of the foreign exchange reserves. After the deposit of the funds, the CBK would immediately credit the disbursed amounts to the Treasury Single Account as part of the overall exchequer funds. The funds would then be available to finance budgeted expenditures. The accounting of the credit proceeds will be in line with existing PFM arrangements. Government



procedures will be followed to administer, record, and audit transactions relating to the credit proceeds and related payments. When the funds enter the government's foreign exchange reserves and the budget, they will be combined with the government's other funds. Therefore, the World Bank will not require tracking of the end use of the DPO funds. This means that disbursements of the loan and credit will not be linked to any specific purchases and no procurement requirements must be satisfied, except that the Borrower is required to comply with the standard negative list of excluded items that may not be financed with World Bank loan and credit proceeds, as defined in the Loan Agreement and the Financing Agreements.

96. The government will provide written confirmation within 30 days after loan and credit disbursement of the following: (i) the loan and credit proceeds were received into an account of the government that is part of the country's foreign exchange reserves (including the date and the name/number of the government's bank account in which the amount has been deposited); and (ii) an equivalent amount has been accounted for in the government's budget management system (including the chart of accounts name, account number, the date, and the exchange rate used).

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

97. The National Treasury and Economic Planning will be the coordinating institution for monitoring and evaluation among all the participating MDAs for this DPO. The institutional and policy reforms supported by this DPO fall under the purview of the following MDAs: EPRA, Kenya Power and Lighting Company (KPLC), Ministry of Agriculture, Ministry of Energy, Ministry of Petroleum, Ministry of Environment, State Department of Social Protection, National Drought Management Authority, and National Treasury and Economic Planning. The National Treasury and Economic Planning chairs the multi-sector coordinating committee established to oversee the preparation of the operation. This committee will remain in place during the implementation of the program. The committee will also be responsible for monitoring of results indicators and evaluation activities.

98. The results framework presented in Annex 1 will be used as a monitoring tool by both the GoK and the World Bank. Data availability and quality are appropriate to monitor progress towards the achievement of the results indicators. The National Treasury and Economic Planning will be responsible for the overall coordination and monitoring of the reform program supported by the DPO and will furnish information to the World Bank, as required, to monitor outcomes in the results framework. Most of the results indicators are based on information which is routinely published by the government. For those that are not, the National Treasury and Economic Planning will liaise with focal points in the other ministries involved, as needed, to provide such information at a frequency and in a format satisfactory to the World Bank. The World Bank may provide implementation support and periodic monitoring and dialogue with the relevant ministries and other stakeholders to ensure timely implementation and adequate monitoring of indicators and outcomes of the program.

99. Grievance Redress. Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate



local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, because of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit <http://www.worldbank.org/GRS>. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit <https://accountability.worldbank.org>.

6. SUMMARY OF RISKS AND MITIGATION

100. There is a substantial overall risk to the achievement of the intended development results, driven by high macroeconomic risks, and substantial political and governance and stakeholder-related risks. The program is being undertaken in the context of high uncertainty in the global economic and political environment due to the ongoing Russia's invasion of Ukraine, uncertainties regarding global financing conditions, and deteriorating near-term regional and global growth outlook.

101. Political and governance risk is substantial. Kenya's political environment has improved following the peaceful transition of power after the August 2022 elections, yet vulnerabilities remain. There is renewed high-level commitment to tackle corruption, presenting an opportunity to learn from past efforts and make continued progress on effectively implementing devolution following the radical 2013 reforms. However, political and governance risks could complicate the reform path, particularly if fiscal consolidation efforts, as well as politically sensitive reforms, run into resistance or are reoriented to favor connected groups. To help mitigate these risks to the DPO results, the government is taking measures to improve governance by addressing the bottlenecks to improved economic management and service delivery, including through World Bank and other externally financed projects. The DPO is complemented by operations such as the GESDeK P4R and its two successor P4Rs, GEAR UP and CPPP that supports the implementation of the PFM Reform strategy at the national level. The Kenya Accountable Devolution Program (P167841), a multi-donor trust fund, supports counties in PFM and service delivery. The DPO and complementary operations will help maintain the positive trajectory in Kenya's fiduciary and other governance systems. Despite these mitigating factors, the residual political and governance risk will remain substantial.

102. Macroeconomic risk is rated as high. A weakening global and regional outlook, inflationary pressures, and the impacts of Russia's invasion of Ukraine might lead to reduced budget revenues and further challenges in funding, putting at risk reforms in the program that require fiscal financing, as well as in weakening in revenue mobilization and broader fiscal consolidation reforms underpinning the program. Adverse developments can also lead to a reversal in fiscal consolidation further elevating debt sustainability risks that this program aims to address. While the government's strong commitments to the implementation of the structural reforms agenda and fiscal consolidation supported, coupled with



additional support to the reforms by the IMF program are potential risk mitigating factors, the residual risks remain high.

103. **Stakeholder risk is substantial.** The implementation of some of the reforms supported by the proposed operation could encounter opposition from some stakeholders who benefit from the status quo. To mitigate these risks, the government is taking steps to continue engaging and informing key supporters of the reforms, thus creating strong pro-reform coalitions. Increased transparency also contributes to credible commitment to reforms by the government and makes it difficult to roll back these efforts. World Bank will support their sound implementation with existing, and potentially additional, technical assistance and projects. Fully mitigating these risks may be complicated by the political cycle, thus the residual risk in this area is assessed as substantial.

Table 6: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	● Substantial
2. Macroeconomic	● High
3. Sector Strategies and Policies	● Moderate
4. Technical Design of Project or Program	● Moderate
5. Institutional Capacity for Implementation and Sustainability	● Moderate
6. Fiduciary	● Moderate
7. Environment and Social	● Moderate
8. Stakeholders	● Substantial
9. Other	
Overall	● Substantial



ANNEX 1: POLICY AND RESULTS MATRIX

Prior actions	Results		
	Indicator Target	Baseline	
Pillar 1: Creating fiscal space in a sustainable and equitable manner			
<p>Prior Action #1. To minimize fiscal burden caused by the power sector the Energy and Petroleum Regulatory Authority (EPRA) issued a tariff order for the next three-year period to ensure that the Kenya Power and Lighting Company (KPLC) revenues are sufficient to cover the cost of purchasing power and expanding investments.</p>	<p>Result #1. Public expenditure savings through reducing government subsidies to power sector</p> <p>RI1: Government operating subsidies to KPLC other than for last mile, KSh</p>	<p>Value: KSh 7.05 billion</p> <p>Date: FY 2021/22</p>	<p>Value: less than KSh 0.5 billion</p> <p>Date: end of FY2023/24</p>
<p>Prior Action #2. To broaden the tax base and improve tax administration the Recipient, through the National Treasury and Economic Planning issued:</p> <ul style="list-style-type: none"> (i) Income Tax (Financial Derivatives) Regulations (2023); (ii) Value Added Tax (Electronic, Internet and Digital Marketplace Supply) Regulations (2023); (iii) Excise Duty (Amendment) Regulations (2023). 	<p>Result #2. Improved collection of revenue</p> <p>RI2: Tax revenue, percent of GDP</p>	<p>Value: 13.7%</p> <p>Date: FY2021/22</p>	<p>Value: 14.6%</p> <p>Date: end of FY2023/24</p>



Prior actions	Results		
	Indicator Target	Baseline	
<p>Prior Action #3. The Recipient:</p> <p>(i) through its Cabinet, approved and submitted to the Parliament amendments to the Public Finance Management Act (2012) which proposes: to align the definition of public debt with the provisions of the Constitution of Kenya, to introduce the concept of a public debt anchor (threshold) and, should such debt anchor be exceeded, to mandate the National Treasury and Economic Planning to submit a written report to Parliament explaining the cause of the breach and provide a time-bound remedial plan towards achieving the debt anchor;</p> <p>(ii) through the National Treasury and Economic Planning, issued the Public Finance Management (National Government) (Amendment) Regulations (2023) to establish a public debt anchor (threshold) at 55 percent of Gross Domestic Product in present value terms.</p>	<p>Result #3: Reduction in fiscal deficit consistent with the fiscal anchor</p> <p>RI3: Achievement of primary fiscal surplus</p>	<p>Value: No Date: FY2021/22</p>	<p>Value: Yes Date: end of FY2023/24</p>



Prior actions	Results		
	Indicator Target	Baseline	
<p>Prior Action #4. The Recipient, through its Cabinet:</p> <p>(i) designated the National Safety Net Program (NSNP) as a priority budgetary expenditure;</p> <p>(ii) directed the National Treasury and Economic Planning to prioritize full disbursements to implementing agencies of NSNP in accordance with each cash transfer payment schedule.</p>	<p>Result #4. Timely and protected critical social spending, including for female beneficiaries</p> <p>RI4i: Proportion of National Safety Net Program (NSNP) beneficiaries who have received cash transfers as per the payments calendar</p> <p>RI4ii: Proportion of Hunger Safety Net Program (HSNP) emergency cash transfer beneficiaries who are paid on time</p> <p><i>Of which: female beneficiaries as a share of total beneficiaries</i></p>	<p>Value: 0% Date: FY2021/22</p> <p>Value: 39% Date: FY2021/22</p> <p>Value: 65% Date: FY2021/22</p>	<p>Value: 65% Date: end of FY 2023/24</p> <p>Value: ≥70% Date: end of FY 2023/24</p> <p>Value: >65% Date: end of FY 2023/24</p>



Prior actions	Results		
	Indicator Target	Baseline	
Pillar 2: Improving competitiveness to boost agricultural exports			
<p>Prior Action #5. The Recipient:</p> <p>(i) through its Ministry of Agriculture and Livestock Development, eliminated the outright purchase of publicly-procured cereals from farmers and instead has instituted a policy of holding a physical base stock through warehouse receipts by issuing the National Cereals and Produce Board (National Food Reserve) Regulations (2023);</p> <p>(ii) through its Cabinet, approved the National Agricultural Soil Management Policy (2023), which creates an institutional framework for effective management and enforcement of issues pertaining to agricultural soils and water.</p>	<p>Result #5. Competitive procurement of National Food Reserves and increased oversight on soil management approaches in public projects</p> <p>R15i: Share of National Food Reserves procured through competitively sourced warehouse receipts.</p> <p>R15ii: Share of new national public sector projects approved for FY2024/25 and determined as relevant to soil, land, and fertilizer management by the MoALD Policy Unit which the Soil Management Unit has reviewed and provided inputs on.</p>	<p>Value: 0% Date: 2022</p> <p>Value: 0% Date: 2022</p>	<p>Value: 90% Date: end of 2024</p> <p>Value: 80% Date: end of 2024</p>



Prior actions	Results		
	Indicator Target	Baseline	
<p>Prior Action #6. To secure and expand access to international markets for Kenyan farmers by facilitating their compliance with importers' food safety and phytosanitary requirements, the Recipient, through its Cabinet:</p> <ul style="list-style-type: none"> (i) approved and submitted to Parliament the Food and Feed Safety Control Coordination Bill (2023); (ii) approved the National Phytosanitary Policy (2023), that together help coordinate all government activities in the field of food safety, food quality, and safety systems, as well as regulate compliance with importing countries' phytosanitary and food safety requirements. 	<p>Result #6. Improved production practices to enhance safety and quality to ease access to agro-food export markets.</p> <p>R16i: Proportion of the Agricultural Export Production Counties that have designated Pest Free Areas or Low Pest Prevalence Areas</p> <p>R16ii: Proportion of food laws reviewed and aligned to risk-based approach to food safety control.</p>	<p>Value: 0% Date: 2022</p> <p>Value: 0% Date: 2022</p>	<p>Value: 20% Date: end of 2024</p> <p>Value: 30% Date: end of 2024</p>
<p>Pillar 3: Improving governance and financial inclusion for inclusive private sector driven development</p>			
<p>Prior Action #7. To mitigate risks associated with conflicts of interest, the Recipient, through its Cabinet, approved and submitted to the Parliament the Conflict-of-Interest Bill (2023), expanding the scope of public officers and decision-making processes under the purview of the law, and providing a coherent institutional framework for the management of conflict of interest in the discharge of official duties.</p>	<p>Result #7: Increased transparency of income and assets of public officials</p> <p>R17. Proportion of declarations of personal interests of public officials reviewed and verified by the EACC.</p>	<p>Value: 0% Date: 2022</p>	<p>Value: 80% Date: end of 2024</p>



Prior actions	Results		
	Indicator Target	Baseline	
<p>Prior Action #8. To streamline the process for the government to exit commercial investments, the Recipient, through its Cabinet, approved and submitted to the Parliament the Privatization Bill (2023), whose objective is to streamline the regulatory and institutional framework for the privatization of public entities.</p>	<p>Results #8: Increased ability of the state to exit commercial investments</p> <p>R18. Number of high fiscal risk SOEs for which a divestiture program has been published.</p>	<p>Value: 0 Date: 2022</p>	<p>Value: 3 Date: end of 2024</p>
<p>Prior Action #9. The Recipient, through its National Climate Change Council, issued the Climate Change (Public Participation and Access to Climate Change Information) Regulations (2023), to improve access to climate change information by providing detailed guidance on the conduct of mandatory public consultations for any proposed law, policy, and strategy related to government’s climate actions.</p>	<p>Result #9: Increased integration of private sector and citizen concerns in climate-change related measures.</p> <p>R19. Share of Government Climate Actions (i.e any law, policy, or strategy on climate change) that is informed by public input provided as per the regulation.</p>	<p>Value: 0 Date: 2022</p>	<p>Value: 90% Date: end of 2024</p>



Prior actions	Results		
	Indicator Target	Baseline	
<p>Prior Action #10. The Recipient, through the National Treasury and Economic Planning, issued the Public Finance Management (Financial Inclusion Fund) Regulations (2022), to create the Financial Inclusion Fund, which enhances financial inclusion of the under-served segment of the population and small and micro-enterprises in a sustainable manner leveraging market-based mechanisms.</p>	<p>Result #10: Increased financial inclusion of the underserved segment of the population with limited fiscal burden</p>		
	<p>RI10i. Percentage of volume of loans disbursed under the Financial Inclusion Fund accessed by individual beneficiaries for loans below Ksh 1,000.</p>	<p>Value: 0% Date: 2022</p>	<p>Value: 20% Date: end of 2024</p>
	<p>RI10ii. Share of female-headed micro enterprises that have accessed credit through the micro loan window of the Financial Inclusion Fund.</p>	<p>Value: 0% Date: 2022</p>	<p>Value: 50% Date: end of 2024</p>



ANNEX 2: FUND RELATIONS ANNEX

IMF Executive Board Completes Fourth Review of EFF and ECF Arrangements for Kenya Providing a US\$447.39 million Disbursement (December 19, 2022)

- The IMF Executive Board completed the Fourth reviews of the EFF/ECF arrangements with Kenya, providing the country with access to SDR336.54 million (about US\$447.39 million). This includes an SDR162.34 million (US\$215.81 million) augmentation of access.
- Global developments have contributed to rising inflation and slowing growth, but the economy remains resilient amid a continuing severe drought in some regions.
- With strong commitment to the Fund-supported program, Kenya is making progress in addressing debt vulnerabilities and promoting more inclusive growth.

Washington, DC: The Executive Board of the International Monetary Fund (IMF) [today] completed the Fourth reviews of the 38-month arrangements under the *Extended Credit Facility* (ECF) and the *Extended Fund Facility* (EFF) arrangements. The Board's decision enables immediate disbursement of SDR336.54 million (about US\$447.39 million) usable for budget support, including an augmentation under the ECF arrangement of SDR162.34 million (30 percent of quota, about US\$215.81 million). This brings Kenya's cumulative disbursements under the EFF/ECF arrangements to about US\$1.655.59 million. With the augmentation, the total amount under the EFF/ECF arrangements rises to SDR 1.818 billion (335 percent of quota or about US\$2.416 billion).

The EFF/ECF arrangements (approved on April 2, 2021, see Press Release [21/98](#)), aim to support Kenya's program to address debt vulnerabilities, the authorities' response to the COVID-19 pandemic and global shocks, and to enhance governance and broader economic reforms.

Kenya's economy remains resilient against a challenging global backdrop and is projected to grow 5.3 percent in 2022. Inflation moved above the Central Bank of Kenya's (CBK) target band in June and is expected to peak in early 2023. Despite double-digit export growth, the current account is expected to widen on higher global oil prices in 2022. Downside risks predominate in the near term, while Kenya's medium-term outlook remains favorable although climate-related risks are elevated.

With progress on fiscal consolidation, public debt has begun leveling off. Taxes performed strongly in FY2021/22, while spending was compressed on shortfalls in external commercial financing, leading to an overperformance of 1.7 percent of GDP in the primary deficit. However, obligations carried over from last fiscal year and an increase in unbudgeted spending in early FY2022/23 increased pressures on the budget. The new administration of President Ruto has reasserted Kenya's commitment to fiscal consolidation, targeting a lower overall fiscal deficit than the original budget.

The CBK has raised policy rates by a cumulative 175 basis points in 2022. The Kenyan Shilling continued to depreciate against the U.S. dollar while the dollar strengthened globally, and liquidity has declined in the interbank forex market. A lower projected path of FX reserves reflects financing shortfalls last fiscal year and planned cuts in foreign-financed projects during FY2022/23. Reserves remain adequate at 3 months of imports, gradually increasing over the medium term.

Kenya's structural reform agenda is advancing, albeit with some delays. In the areas of governance and transparency, the authorities have now completed and published audits of COVID-19 vaccine spending and begun



publishing beneficial ownership information of successful bidders in new procurements. However, progress on addressing financial weaknesses in state-owned enterprises and a planned review of the fuel pricing mechanism were delayed during the political transition.

At the conclusion of the Executive Board’s discussion, Ms. Antoinette Sayeh, Deputy Managing Director and Acting Chair, made the following statement:

“Kenya’s commitment to its economic program supported by the Fund’s Extended Fund Facility and the Extended Credit Facility arrangements is anchoring debt sustainability. The economy has performed well amid slowing global growth, tighter financing conditions and volatile commodity prices, while the continuing drought has increased food insecurity, and climate-related risks pose ongoing challenges. Mutually reinforcing prudent macroeconomic policies and resolute implementation of structural reforms remain essential to safeguard positive medium-term prospects.

“Strong performance of tax revenues supported resilience and cushioned the initial impact of global shocks on households and businesses, and the new administration’s elimination of petrol subsidies and plans for significant reprioritization of expenditure to keep the fiscal deficit below the budgeted level are commendable. Looking ahead, continued strong commitment to fiscal consolidation over the medium term remains key to reduce debt vulnerabilities. Additional tax policy measures, anchored in a Medium-Term Revenue Strategy to secure space for needed social and development spending, and improved spending efficiency, revenue administration, and public financial and debt management will be key.

“The Central Bank of Kenya’s (CBK) monetary policy stance is welcome. Further tightening would limit second-round effects and keep inflationary expectations well-anchored while supporting external adjustment. The exchange rate should function as a shock absorber, supported by a well-functioning interbank FX market, with forex interventions (sales) limited to addressing excessive volatility. Continued monitoring of the banking system is also important.

“Alongside new initiatives to promote inclusive growth, progress on the structural reform agenda should continue. By beginning to publish beneficial ownership information for successful bidders of new procurements, Kenya delivers on a key commitment to enhance transparency and accountability. However, the AML/CFT legal framework needs strengthening and stepped-up efforts on compliance. Addressing vulnerabilities at Kenya Airways and Kenya Power and Lighting Company is urgent, along with strengthening the governance framework for state-owned corporations. Planned reviews of the fuel pricing mechanism and the audit of extrabudgetary spending are also important. High vulnerability to climate change calls for multi-faceted policy action.”

Kenya: Selected Economic Indicators, 2021—2024

	2021	2022	2023	2024
	Act.	Proj.	Proj.	Proj.
Output				
Real GDP growth (%)	7.5	5.3	5.1	5.5



Prices	6.1	7.7	7.8	5.7
Inflation - average (%)				
Central government finances (fiscal year)¹				
Revenue (% GDP)	16.0	17.3	17.5	17.8
Expenditure (% GDP)	24.2	23.5	23.3	22.1
Fiscal balance (% GDP)	-8.2	-6.2	-5.8	-4.4
Public debt (% GDP)	67.7	66.6	67.6	66.2
External debt (% GDP)	35.2	33.3	34.1	33.9
Money and Credit	6.1	9.0	7.4	9.4
Broad money (% change)				
Credit to private sector (% change)	8.6	12.0	12.3	13.3
Policy rate, end of period (%)	7.0	...	...	...
Balance of payments	-5.2	-5.7	-5.4	-5.3
Current account (% GDP)				
Reserves (in months of imports)	4.5	3.7	3.0	3.2
Exchange rate	-2.6	...	...	...
REER (% change)				

Source: Kenyan authorities and IMF staff estimates and projections. 1 Based on fiscal year (i.e., 2023 represents 2022/23, ending in June 2023).



ANNEX 3: LETTER OF DEVELOPMENT POLICY



REPUBLIC OF KENYA
THE NATIONAL TREASURY AND ECONOMIC PLANNING

Telegraphic Address: 22921
Finance – Nairobi
FAX NO. 310833
Telephone: 2252299

THE NATIONAL TREASURY
P O BOX 30007-00100
NAIROBI
KENYA

When Replying Please Quote

NT/PDMO/RMD/07/02/01 'H' (40)

6th April 2023

President
World Bank Group
1818 H Street, N.W.
Washington D.C. 20433
UNITED STATES OF AMERICA

Dear Mr. Malpass,

RE: KENYA: LETTER OF DEVELOPMENT POLICY

1. On behalf of the Government of the Republic of Kenya, I write to request for a stand-alone Development Policy Operation (DPO) from the International Development Association (IDA) and the International Bank for Reconstruction and Development (IBRD) aimed at supporting policy and institutional reforms which are critical to the Government's Bottom-Up Economic Transformation Agenda (BETA). BETA is geared towards economic turnaround and inclusive growth with special focus on interventions to reduce the cost of living, increase employment, incentivize investment and production, achieve more equitable distribution of income, enhance social security, expand tax base for more revenue, and increase foreign exchange earnings.
2. The economic turnaround program seeks to increase investments in at least five sectors envisaged to have the biggest impact on the economy as well as on household welfare. These include Agricultural Transformation; Micro, Small and Medium Enterprise (MSME); Housing and Settlement; Healthcare; and Digital Superhighway and Creative Industry.
3. This DPO helps to advance the Government of Kenya's (GoK) inclusive growth agenda and resilient recovery by supporting policy and institutional reforms that aim to: (i)



create fiscal space for growth-oriented policies by implementing significant expenditure and revenue measures and by better debt management, while at the same time safeguarding equity by protecting key social spending; (ii) enhance competitiveness to boost exports, especially in the sectors such as agriculture where the country has competitive advantage and untapped potential; and (iii) accelerate the transition toward greener and more inclusive growth and to enable the bottom-up economic transformation through improving governance, climate policies, transparency, and financial inclusion to level the playing field.

Macroeconomic Performance and Developments

A. Recent Economic Developments

4. **The Kenyan economy demonstrated remarkable resilience and recovery as the effects of COVID-19 pandemic started to fade away.** The economy expanded by 7.5 percent in 2021, a much stronger level from a contraction of 0.3 percent in 2020 propelled by heavy public investments in infrastructure and the diversified nature of the economy. While Kenya has been able to maintain the recovery momentum with the GDP growth estimated at 2022, the economy is currently affected by multiple shocks that include lingering effects of COVID-19 pandemic; the Russian invasion of Ukraine leading to increased prices of fuel, fertiliser and food prices; climate change that has affected agricultural productivity and the well-being of Kenyans; and the rising US interest rates and capital flight resulting unto tightened financing conditions and forex liquidity shortage in the frontier and emerging markets.
5. **The economy is expected to remain resilient and grow by 6.1 percent in 2023 and maintain that momentum over the medium-term.** The growth will be supported by a broad-based private sector growth, including recoveries in agriculture, while the public sector consolidates. From an expenditure perspective, private consumption is expected to support aggregate demand, supported by the ongoing labor market recovery, improved consumer confidence, and resilient remittances. The outlook will be reinforced by the implementation of interventions under BETA.
6. **The coordination between monetary and fiscal policies continued to support macroeconomic stability.** Our monetary policy stance remains tight to anchor inflation expectations due to the sustained inflationary pressures, the elevated global risks, and their potential impact on the domestic economy. To this regard, the Central Bank rate was raised to 9.5 on March 29 to strengthen the macroeconomic policy framework for achieving price and external stability goals. The inflation is expected to decline in the near term, supported by the macroeconomic policy mix and targeted and temporary Government measures in key products.



7. **The external sector has remained stable despite the tight global financial conditions attributed to strengthening of US Dollar and uncertainties regarding the ongoing war in Ukraine.** The current account deficit for 2022 declined to 4.9 percent of GDP, reflecting decline in non-energy import, strong export growth particularly of tea and manufactures, strong remittances, and continued recovery of services receipts. However, tight global financial conditions and the strengthening of the US dollar amid higher interest rates in the US and uncertainties regarding the ongoing war in Ukraine have impacted Kenya's capital and financial accounts putting substantial pressures on Kenya's foreign exchange reserves. Despite these challenges, the official foreign exchange reserves remained at around USD 6.5 billion (3.6 months of import cover) as of March 2023 and continues to provide adequate buffer against short-term shocks.
8. **On fiscal performance, budget execution for the FY 2022/23 with a focus on fiscal consolidation is progressing well.** Revenues continued to record positive growth, albeit below target performance. Revenues collected in February 2023 grew by 10.8 percent. Total cumulative revenue collection including appropriation in aid (A-I-A) by end of February 2023 amounted to Ksh 1,464.0 billion against a target of Ksh 1,516.2 billion. This performance below the set target by 52.2 billion. The total expenditure and net lending amounted to Ksh 1,817.2 billion which was below the projected amount of Ksh 1,997.1 billion by Ksh 179.9 billion. As a result, fiscal balance including grants amounted to a deficit of Ksh 353.1 billion against a targeted deficit of Ksh 480.9 billion.
9. **Risks to the economic outlook remain.** On the domestic side, risks emanate from climate change resulting in unfavorable weather conditions that affects agricultural production and food security, affecting economic growth and increasing the fiscal burden. On the external front, the risks emanate from: possible worsening of the war in Ukraine which could heighten the risk of elevated inflationary pressures through oil and commodity price volatility; the lingering adverse effects of COVID-19 that could disrupt the global supply chains; further monetary policy tightening, especially in the United States, could increase volatility in the financial markets and worsen forex liquidity for African economies.

B. Fiscal Policy and Framework

10. **Our fiscal policy stance over the medium term aims at supporting BETA through a growth-friendly fiscal consolidation plan.** This plan is designed to slow down the annual growth in public debt and implement an effective liability management strategy, without compromising service delivery to citizens. This is expected to boost the country's debt sustainability position and ensure that Kenya's development agenda



honors the principle of inter-generational equity. The fiscal policy also indicates a deliberate convergence path towards the fiscal targets under the East African Community Monetary Union Protocol that sets a ceiling of fiscal deficit including grants of 3.0 percent of GDP and deficit excluding grants of 6.0 percent of GDP. Importantly, Government's top priority for the medium-term is to bring public and publicly guaranteed debt to below 55 percent of GDP in present value terms.

11. **In line with our fiscal consolidation plan, we will reduce fiscal deficit in the FY 2022/23 to 5.7 percent of GDP from the projected 6.2 percent of GDP in the approved budget.** The fiscal deficit is projected to decline to 4.4 percent of GDP in the FY 2023/24 budget and decline further to 3.6 percent of GDP over the medium term. Total revenues are projected to increase to 17.8 percent of GDP in FY 2023/24 and above 18.0 percent of GDP over the medium term. Towards this end, we will scale up revenue collection efforts by the Kenya Revenue Authority (KRA) to Ksh 3.0 trillion in the FY 2023/24 and Ksh 4.0 trillion over the medium term. To achieve this, we will undertake a combination of both tax administration and tax policy reforms, including reforms supported by the DPO.
12. **On the tax policy, the Government will implement various tax policy measures to further boost revenue collection and will finalize the development of the National Tax Policy and the Medium-Term Revenue Strategy (MTRS) for the period FY 2023/24 - 2026/27.** The objective is to reverse the declining trend of domestic revenues by improving efficiency in revenue administration, close loopholes for tax evasion and enhance taxpayer compliance and engagement.
13. **On the spending side, total expenditures are projected to decline from 23.7 percent as a share of GDP in the FY 2021/22 to 22.3 percent as a share of GDP in the FY 2026/27.** We will sustain efforts to improve efficiency in public spending and ensure value for money by eliminating non-priority expenditures; retiring expensive and unsustainable consumption subsidies; reducing tax exemptions; scaling up the use of Public Private Partnerships financing for commercially viable projects; rolling out an end-to-end e-procurement system; and implementing the Public Investment Management (PIM) Regulations (2022). The PIM Regulations will enhance efficiency in identification and implementation of priority social and economic investment projects.
14. **The primary balance is projected to decline from a deficit of 1.6 percent of GDP in FY 2021/22 to a deficit of 1.0 percent in FY 2022/23 and further to a surplus of 0.3 percent in FY 2023/24 and 0.7 percent of GDP over the medium term.** This highlights the Government's strong commitment to reduce growth of public debt and boost debt sustainability position.



15. **The fiscal and debt framework is in line with the Sustainable Development Finance Policy (SDPF) recommendations for Kenya.** We expect that cumulative present value of new external debt contracted or guaranteed in FY22 and FY23 will not exceed US\$ 11.6 billion. Beyond this fiscal year, the Government will continue prioritizing debt sustainability in financing the budget deficit. External non-concessional financing will be confined to (i) funding essential projects integral to our development program for which concessional financing is not available and (ii) debt management purposes via operations that would result in both a reduction in the net present value of public debt and an improved debt service profile. Such external financing will complement our domestic financing and help prevent an unnecessary crowding-out of private sector credit.

C. Fiscal and Structural Reform Agenda

Fiscal reforms

16. **The Government is undertaking comprehensive tax reforms to boost domestic tax revenues and improving the tax system over the medium term through MTRS.** This Strategy, covering the period FY 2023/24 to FY 2026/27, targets to raise ordinary revenue to GDP collection by an additional 5 percent gradually through the strategy period. This will be achieved through putting in place tax policies and administrative measures that support economic growth in the short-term; simplifying the tax system to reduce the cost of tax administration and minimize the cost of compliance; enhancing efficiency by increasing the tax base so that tax rates can be reduced; reducing the average tax burden; and promoting equity and fairness by ensuring tax policies are fair and combat inequality. MTRS will provide a comprehensive approach of undertaking effective tax system reforms for boosting tax revenues and improving the tax system over the medium term.

17. In the near-term, the Government is undertaking reforms to broaden the tax base by expanding the tax base to apply VAT in the digital marketplace and improve taxation of financial derivatives, as well as improve administration of the Excise Tax.

18. **The Government expects significant savings from controlling the government wage bill.** We continue pursuing our objective of reducing the government wage bill by 0.6 percentage points of GDP between FY2020/21 and FY2023/24 with a view to free much-needed resources for priority social and development spending. To this end, we implemented a wage freeze for FY2021/22 and FY2022/23, and we have maintained our policy of limiting new employment to priority areas. Further actions planned in relation to controlling the wage bill include:

- Harmonize and rationalize the categories, rates, and rules for allowances;



- Implement a common payroll system linked to IFMIS across all National Government ministries and departments as well as all counties (MDCs);
 - Ensuring that Collective Bargaining Agreements consider available resources.
19. **The Government is also working diligently to strengthen the public procurement system.** We are in the process of acquiring an e-procurement system that will be incorporated in our Integrated Financial Management Information System (IFMIS) to automate application of the Procurement Act and regulations. Due to delays in mobilizing the needed resources, we intend to pilot the new system by July 2023 and to fully roll it out across Government Ministries, Departments, and Agencies (MDAs) by end-December 2023, providing the necessary training with support from the World Bank.
20. **The Government will continue improving Public Investment Management (PIM) to deliver value for money in public capital expenditure.** To this end, the Government is: rationalizing the pipeline of existing projects; developing a Public Investment Management Information System (PIMIS) to automate Public Investments (projects) as per the PIM Regulations; and implementing new PIM regulations. PIM regulations have been developed and are expected to be rolled out to national government entities and the Counties as a prerequisite to the roll-out of PIM manuals, which is planned by end-July 2023.
21. **The Government's development agenda is anchored on prudent management of available public resources through improved Public Financial Management (PFM).** As such, the Government will continue to strengthen expenditure control and improve the efficiency and effectiveness of public spending through necessary public financial management reforms. Focus areas include strengthening budget processes, IFMIS functionality, commitment controls, and cash management. Having strengthened the IFMIS infrastructure, the Government is adding functionality to the system and enhancing controls. The Government has also introduced a new Cash Management Framework that involves regularly updated cash and debt plans approved by the Cash Management Committee. By end-December 2023, the Government will ensure that all MDA budget proposals for FY2024/25 have been prepared using a common costing approach based on the Hyperion system, which is being improved to develop costing tools for vendors.
22. **As part of strengthening debt management, the Government will submit to Parliament legislative amendments to harmonize the definition of public debt and replace the existing nominal debt limit with a debt anchor.** The reform will be centered on two pillars: (i) a medium-term debt anchor set at 55 percent of GDP with



debt measured in present value terms; and (ii) an accountability requirement that mandates transparent communication to Parliament and the public on plans and progress towards achieving the debt anchor within a specific timeframe.

23. The Government is also enhancing debt reporting, lengthening maturities, and avoiding bunching of repayments to mitigate refinancing risks. More generally, the Government is enhancing the structures and functions of the Public Debt Management Office (PDMO) to oversee debt management as envisioned in the PFM Law. To deepen the domestic debt securities market, the National Treasury is working with CBK to implement several reforms. The Government has strengthened the auction management process by implementing the Treasury Mobile Direct platform for retail sale of government securities, and enabled auction of bids by banks through internet banking. Additionally, the Government is: (a) further strengthening market infrastructures and auction management processes for government securities by developing the Central Securities Depository System; (b) maintaining a smooth yield curve for domestic debt securities; (c) supporting the enhancement of market structure and conduct through treasurers and dealers of commercial banks; (d) lengthening the maturity profile of government debt securities; (e) enhancing transparency through publication of auction rules and guidelines; and (f) strengthening the bond benchmark building program.

- As a result of these efforts, the average time to maturity of outstanding treasury securities has increased from 7.7 years in June 2020 to 9.1 years in June 2022, with the ratio of T-bills to T-bonds moving from 30:70 to 85:15. Regarding external debt, the Government is proactively working to ensure increasing utilization of committed concessional financing while maintaining a presence in the international financial market. The Government has also established an Investor Relations Unit (IRU) to strengthen communication with external stakeholders. The IRU now has a page on the National Treasury website.
- The Government has broadened the reporting of State-owned entities' non-guaranteed debts (excluding debt to government which is already captured in existing metrics) from the 18 entities out of a total of around 260—considered to pose the highest fiscal risk—included in the FY2020/21 Public Debt Management Report (PDMR) to 26 in the FY2021/22 PDMR. Going forward, the Government plans to automate data collection from all State-owned entities by linking to existing electronic reporting systems.

24. The Government will also continue to support vulnerable members of the society through the Social Safety Nets Program (Inua Jamii), the Hunger Safety Net Program, and the National Council for Persons Living with Disabilities Fund. To protect the elderly, the Government will push for attainment of 100 percent NHIF



coverage for senior citizens within three years; revamp the cash transfer program for elderly and vulnerable households to improve operational efficiency, prompt payment accountability and coverage; invest in education and training for caregivers and medical staff to fill the gap of skills in the provision of specialized care for older people.

25. **The Government prioritizes timely, secure, and predictable spending on social protection under the National Safety Net Program (NSNP).** To achieve this, the Government has approved designation of the NSNP as a priority budgetary expenditure and regularized disbursements according to the NSNP payment schedule for maintaining predictability and timeliness of cash transfers to the NSNP. These measures will ensure predictability and timelines of payments to the beneficiaries of the NSNP will and enhance the ability of Kenya's safety net system to reduce poverty.
26. **Safeguarding the budget from fiscal risks in the energy sector is a key priority for the Government.** The tariff review by EPRA in March that followed public consultations paves the way for strengthening KPLC's financial situation and reducing the fiscal burden while maintaining an adequate life-line tariff to support most vulnerable consumers.
27. **In addition, considering the fiscal risks posed by KPLC, an action plan will be developed and submitted to the relevant Cabinet Sub-Committee with an aim to restore KPLC's medium-term profitability and cover fully any financing gaps (pre-existing and new) through end-2023.** This plan will be jointly prepared by National Treasury and the Ministry of Energy and informed by the findings of the Presidential Taskforce report and the updated KPLC's 2022 financial evaluations. It will identify steps that KPLC will take to improve operational efficiency and realize targeted cost saving by implementing a turnaround strategy that is premised on meeting customer needs, increasing power sales and revenue collection, improvement of cash flow management, reduction of operational costs, reduction of system losses, and restructuring of expensive commercial debt. KPLC will re-engineer its business process, focusing on delivery of services to its customers through automated billing, metering, and payments. It is also expected that KPLC will reduce system losses, resulting from both technical and commercial factors, to be within the medium-term loss benchmark of 15 percent approved by the regulator. Further, KPLC organization structure and staffing levels should be fit for purpose with suitable skills and performance-based management culture to increase staff productivity and reduction of operational costs. Reforms will be undertaken in procurement and stock management to optimize the use of available resource and reduce wastage. Reforms to improve KPLC's corporate governance are also underway, with a view to increase private sector representation on KPLC's Board of Directors.



28. **The Government remains fully committed to carefully evaluate cost and risks associated to Public Private Partnerships (PPPs).** To this end, the PPP Directorate (PPPD) is expanding its staff with a view to strengthen its analytical capacities by attracting critical talent in project origination and structuring, safeguards, and legal support. To ensure that only projects with the highest socioeconomic returns are undertaken, the National Treasury is in the process of creating and institutionalizing a joint PIM planning framework. This will streamline the decision-making process of determining whether projects should be procured through the traditional on-budget public procurement method or through the PPP framework. The PPPD will continue strengthen its reporting on risks. To this end, a quantification and likelihood of fiscal risks associated to PPPs, informed by the Fiscal Commitments and Contingency Liability (FCCL) framework, will be included in the Fiscal Risk Register, and discussed within the Fiscal Risk Committee.

D. Other Structural Reforms

29. **The government is implementing an ambitious climate change agenda, including through reforms supported by this DPO.** Recognizing the additional challenges posed by climate change, the government has set out ambitious climate change mitigation and adaptation goals, reflected in the legislative and regulatory frameworks for the country to progress towards these goals (including through efforts at both national and county government level). Kenya already obtains about 90 percent of its electricity from renewable energy sources, and the government's strategic sector priorities have a focus on supporting green, climate-smart investments. To further strengthen Kenya's institutional strength to respond to the climate challenge, the Government prioritizes public engagement in decision making, and in that context the regulation on Public Participation and Access to Climate Change Information approved by the Government provides the substantive and procedural mechanisms of public participation in the context of climate change by creating space for citizens and enterprises to influence the determination of sectors for climate change priority actions. The regulation enables the public and private sector to inform the formulation of regulations governing the National climate change fund and counties' climate change funds, thereby improving the transparency and accountability aspects of the funds' allocation for priority actions. The regulation will significantly strengthen transparency and accountability of government's climate actions.
30. **As part of its inclusive growth strategy, the Government launched the Hustlers' Fund on November 30th, 2022, as an intervention to correct market failure problems at the bottom of the pyramid.** This program aims to lift those at the bottom of the pyramid through structured products in personnel finance that includes savings,



credit, insurance, and investment. The Hustlers' Fund is part of the Administration's answer to predatory lending that historically has denied many households an opportunity to make their rightful contribution to nation building. The Fund is expected to offer much needed relief and a new lease of life to over 8 million Kenyans who had been blacklisted by various credit rating agencies. Besides being accorded a second chance to access the credit needed to grow their enterprises, the Hustlers' Fund also offers affordable credit by charging an interest of 0.002% per day, which is 500 times cheaper than the cheapest current products which range between 1% and 10% per day. While prioritizing inclusivity, the activities of the Fund will be based on market-based mechanism with a strong focus on re-payment discipline. This will ensure that the Fund maintains its self-sufficiency and does not depend on Government's support, while making sure that the beneficiaries of the Fund build credit history through timely repayments. The operational and governance framework of the Fund established by the National Treasury will ensure meeting the objective of enhancing financial inclusion of the under-served segment of the population and small and micro-enterprises in a sustainable manner and based on market-based mechanisms.

31. **The Government has made a strong commitment to strengthen social insurance across the population.** Included in the plan is a pension arrangement that covers the workforce in both formal and informal payrolls. To ensure the sustainability of the pension system, the Government introduced a funded pension scheme for public sector workers, the Public Service Superannuation Scheme (PSSS). In line with the Government policy to avail services online and through mobile platforms, the Government will scale up the modernization of pension services by amongst others re-engineering the Pension Management Information System (PMIS) to make it a modern ERP system with an end-to-end integration with all actors in the public pension ecosystem including the pensioners themselves. This will enable pensioners to interact with the Pensions Department through mobile and computer APPS for ease of administration.
32. **The government is in the process of enacting the Conflict of Interest (COI) law that provides an overarching legal framework to comprehensively address all aspects of conflict of interest.** This builds on initiatives supported under previous DPO series, including revamping the State Procurement Portal, full operationalization of the beneficial ownership e-register, and the roll out of e-GP. Integrity reforms to curb corruption and conflict of interest will not only reduce public revenue leakage and expenditure wastage, but also result in more transparent government decisions, which will in turn help promote private sector development and investments.
33. **The Government prioritizes the privatization program to de-emphasize the role of the public sector in the economy and to reduce fiscal risks.** The new State



Corporations (SCs) Privatization Bill supported by the DPO, expected to be approved by the legislature by end of the fiscal year, will provide a framework for the privatization of SCs. This includes strengthened legal and institutional framework to support privatization; institutionalization of structured approach and analytics to classify and identify key SCs for privatization; and fast track-privatization program to mitigate fiscal risk and unlock private sector potential. Government continues to accelerate the implementation of SC governance reforms outlined in the SC Reform Blueprint, IMF program, and new administration policy directives that promote SCs efficient service delivery. In addition, the Government envisions reforms for prudent fiscal consolidation and risk management, transparent ownership policy, and operational efficiency. Increasing SCs' revenues and reducing expenditures related to SCs will not only contribute to government's fiscal consolidation goals, but also enable the government to pursue priority investments focused on inclusive growth.

- 34. Government will prioritize reforming the institutions governing inputs and outputs markets in agriculture to boost productivity and encourage private sector participation in agricultural value chains and strengthen productivity and resilience of smallholder farmers.** For this the Government has eliminated administrative price-setting for publicly procured cereals and has created an institutional framework for effective management and enforcement of issues pertaining to agricultural soils and water. These reforms aim at creating a predictable and transparent agricultural market by eliminating administrative, non-market-based price-setting for Kenya's main crop and increasing agricultural productivity and resilience. In addition, recent legislative initiatives are aimed at boosting competitiveness of Kenya's agricultural exports through upgrading phytosanitary and food safety standards. This reform will help Kenyan producers comply with importing countries' technical requirements, resulting in higher agricultural exports and increased incomes for farmers. It is expected that the Bill will be approval by the Parliament by end of the fiscal year.
- 35. The Government is committed to transparent and timely public dissemination and accessibility of official statistics.** Considering the 2022 electoral cycle, several important official statistics have not been released in due time. For example, three annual poverty reports (2019, 2020 and 2021) have been prepared but not yet publicly disseminated or made accessible. The Government of Kenya reaffirms its commitment to the Fundamental Principles of Official Statistics as embedded in the revised Statistics Act, 2006 (page 20) which notes that "official statistics that meet the test of practical utility should [sic] compiled and made available on an impartial basis by the Kenya National Bureau of Statistics to honor citizens' entitlement to public information". The Government commits to make available official statistics whose public dissemination



is overdue at the earliest convenience. Further, the Government recognizes the professional independence of the Kenya National Bureau of Statistics (KNBS) regarding the production and dissemination of statistics as per the Statistics Act, 2006. Official statistics will therefore be disseminated according to the annual KNBS Advance Release Calendar.

E. Achievements of previous DPOs

36. **This operation builds on previous series of DPOs that the Government of Kenya has designed and implemented together with the World Bank to advance country's policy and institutional reform agenda.** The series provided a strong impetus for the reforms and served as a useful platform for engaging with the World Bank on various aspects of policy discussions, paving the way for long-term cooperation between the Bank and the Government of Kenya. The series were also closely coordinated with Kenya's other development partners, including the IMF. The reforms supported by previous DPOs covered a wide range of policy areas. The results so far include: a significant increase in availability of affordable housing through the change in the legal and regulatory framework; establishment the E-voucher system for farmers to enhance access to subsidized fertilizer and boost farm income; and launch of the Treasury Mobile Direct System to allow institutional and retail investors to participate in the issuance of government securities through an electronic online platform, thus enhancing the transparency and efficiency of this market. Beyond supporting the reforms, results monitoring under the DPO series greatly contributed to the strengthening of Government's own monitoring and evaluation capacities.

F. Conclusion

37. The Government believes that the policies and actions in this letter will go a long way towards achieving strengthen economic management for resilient and inclusive growth to support the **Bottom-up Economic Transformation Agenda (BETA)** of the current Administration. Against this background we request the World Bank's assistance of USD 1 Billion to support the realization of this program.

Yours

NJUGUNA NDUNG'U
CABINET SECRETARY



ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Creating fiscal space in a sustainable and equitable manner		
<p>Prior Action #1. To minimize fiscal burden caused by the power sector the Energy and Petroleum Regulatory Authority (EPRA) issued a tariff order for the next three-year period to ensure that the Kenya Power and Lighting Company (KPLC) revenues are sufficient to cover the cost of purchasing power and expanding investments.</p>	Both positive and negative	Marginal negative impact, poorest largely shielded thanks to reduction in lifeline tariff.
<p>Prior Action #2. To broaden the tax base and improve tax administration the Recipient, through the National Treasury and Economic Planning issued: (i) Income Tax (Financial Derivatives) Regulations (2023); (ii) Value Added Tax (Electronic, Internet and Digital Marketplace Supply) Regulations (2023); and (iii) Excise Duty (Amendment) Regulations (2023).</p>	No significant impacts	No significant impacts
<p>Prior Action #3. The Recipient: (i) through its Cabinet, approved and submitted to the Parliament amendments to the Public Finance Management Act (2012) which proposes: to align the definition of public debt with the provisions of the Constitution of Kenya; to introduce the concept of a public debt anchor (threshold); and, should such debt anchor be exceeded, to mandate the National Treasury and Economic Planning to submit a written report to Parliament explaining the cause of the breach and provide a time-bound remedial plan towards achieving the debt anchor; and, (ii) through the National Treasury and Economic Planning, issued the Public Finance Management (National Government) (Amendment) Regulations (2023) to establish a public debt anchor (threshold) at 55 percent of Gross Domestic Product in present value terms.</p>	No significant impacts	No significant impacts
<p>Prior Action #4. The Recipient, through its Cabinet: (i) designated the National Safety Net Program (NSNP) as a priority budgetary expenditure; and (ii) directed the National Treasury and Economic Planning to prioritize full disbursements to implementing agencies of NSNP in accordance with each cash transfer payment schedule.</p>	Positive	Direct positive impacts
Pillar 2: Improving competitiveness to boost agricultural exports		
<p>Prior Action #5. The Recipient: (i) through its Ministry of Agriculture and Livestock Development, eliminated the outright purchase of publicly-procured cereals from farmers and instead has instituted a policy of holding a physical base stock through warehouse receipts by issuing the National Cereals and Produce Board (National Food</p>	Positive	Positive in medium term through increased productivity and



Reserve) Regulations (2023), and (ii) through its Cabinet, approved the National Agricultural Soil Management Policy (2023), which creates an institutional framework for effective management and enforcement of issues pertaining to agricultural soils and water.		resilience of smallholder farmers and the establishment of a predictable agricultural market
Prior Action #6. To secure and expand access to international markets for Kenyan farmers by facilitating their compliance with importers’ food safety and phytosanitary requirements, the Recipient, through its Cabinet: (i) approved and submitted to Parliament the Food and Feed Safety Control Coordination Bill (2023) and (ii) approved the National Phytosanitary Policy (2023) that together help coordinate all government activities in the field of food safety, food quality, and safety systems, as well as regulate compliance with importing countries’ phytosanitary and food safety requirements.	Positive	Potentially positive in longer run by expanding market access for Kenya’s smallholder farmers
Pillar 3: Improving governance and financial inclusion for private sector driven development		
Prior Action #7. To mitigate risks associated with conflicts of interest, the Recipient, through its Cabinet, approved and submitted to the Parliament the Conflict-of-Interest Bill (2023), expanding the scope of public officers and decision-making processes under the purview of the law, and providing a coherent institutional framework for the management of conflict of interest in the discharge of official duties.	No significant impacts	No significant impacts
Prior Action #8. To streamline the process for the government to exit commercial investments, the Recipient, through its Cabinet, approved and submitted to the Parliament the Privatization Bill (2023), whose objective is to streamline the regulatory and institutional framework for the privatization of public entities.	No significant impacts	No significant impacts
Prior Action #9. The Recipient, through its National Climate Change Council, issued the Climate Change (Public Participation and Access to Climate Change Information) Regulations (2023), to improve access to climate change information by providing detailed guidance on the conduct of mandatory public consultations for any proposed law, policy, and strategy related to government’s climate actions.	Positive	No significant impacts
Prior Action #10. The Recipient, through the National Treasury and Economic Planning, issued the Public Finance Management (Financial Inclusion Fund) Regulations (2022), to create the Financial Inclusion Fund, which enhances financial inclusion of the under-served segment of the population and small and micro-enterprises in a sustainable manner leveraging market-based mechanisms.	No significant impacts	Positive impacts through increased access to finance for micro-enterprises and low-income households