Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 06-May-2021 | Report No: PIDA31925

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kenya	P175251	Accelerating Reforms for an Inclusive & Resilient Recovery DPO (P175251)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
AFRICA EAST	31-May-2021	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
The National Treasury	The National Treasury		

Proposed Development Objective(s)

Accelerating reforms for a resilient and sustainable recovery from the COVID-19 shock, and the continued advancement of Kenya's inclusive growth agenda.

Financing (in US$, Millions)

SUMMARY

Total Financing	750.00

DETAILS

Total World Bank Group Financing	750.00
World Bank Lending	750.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

Prior to the COVID-19 shock, Kenya was making significant progress towards meeting its ambitious development goals, building on successes such as achieving a 90% clean energy mix and the highest Human Capital Index score in continental sub-Saharan Africa. The economy was sustaining growth of above 5% a year, poverty was declining, and important reforms (such as removing agricultural market distortions) were underway, guided by the government's "Big Four" agenda and with the support of the previous DPO series. However, the pandemic caused growth to stall in 2020, and has pushed an estimated 2 million Kenyans into poverty, despite swift actions by the authorities to contain the virus and protect vulnerable households and firms. Furthermore, Kenya entered into the crisis with its public finances already stretched and the government has been forced to delay fiscal consolidation plans. This has increased the risk of debt distress, and makes it urgent to make spending more transparent and efficient, address fiscal risks emanating from poorly-performing public entities, and return to a debt-stabilizing fiscal path as soon as economic conditions allow. The economy has shown resilience and staged a significant recovery in recent months, but the outlook remains highly uncertain and contingent on the future course of the pandemic. The government has signaled its determination to achieve a resilient recovery from the shock, and to chart a course towards green, resilient and inclusive development (GRID), including by maintaining the reform momentum that has been achieved in recent years to address long-standing policy and institutional weaknesses.

The economy is expected to stage a partial recovery in the near-term. Real GDP growth is projected to be 4.5% in 2021 and 4.7% in 2022. The base case projection factors in that COVID-19 vaccination is underway, contributing progressively to a normalization in economic activity. Kenya received its first COVID-19 vaccines on March 3 (1.02 million doses of the AstraZeneca-Oxford vaccine via COVID-19 Vaccines Global Access [COVAX]). By the end of April, 876,708 people had received their first free dose. The base case also assumes that normal weather supports agricultural production. On the domestic front, a final key assumption underpinning the base case is that the government resumes fiscal consolidation in the upcoming 2021/22 fiscal year, opening more space for private credit extension and supporting investor confidence and growth. On the external front, global economic recovery is expected to lift the demand for Kenya's merchandise exports in 2021, but a fuller recovery in services exports (mainly tourism) is expected only in 2022 and beyond.

The proposed DPO supports the government's strategy to resume fiscal consolidation and support a resilient recovery. Kenya's growth drivers are well-diversified and the cornerstone economic sector – agriculture – has been resilient, making it reasonable to expect good economic performance to resume post-crisis. The policy framework has weathered the COVID-19 shock so far. A coherent mix of supportive fiscal and monetary policy, and other response measures, were implemented quickly, and subsequently policy settings have been responsive to the very fluid situation. Macroeconomic stability has been maintained, including through currency flexibility which has helped to absorb the shock and reduce pressure on foreign exchange reserves, which have remained adequate. As will be critical to reduce debt distress risks, rebuild space for development spending, and support the recovery, the government is expected to resume fiscal consolidation and has already begun to take actions towards this. Social expenditures have been increased to counter the crisis impacts. Kenya has also established a strong track record of carrying through economic reforms, as evidenced by its ambitious government devolution program, progress in combatting corruption, and achieving critical sectoral reforms, including those supported by previous DPOs. The ongoing reform efforts, including those supported by the proposed operation, should further strengthen the macroeconomic and fiscal policy framework.

Relationship to CPF

The proposed operation will contribute to realizing the twin goals of eliminating extreme poverty and boosting shared prosperity in Kenya, by supporting policy and institutional reforms which are critical to the government's efforts to restructure in the wake of the crisis and achieve a resilient recovery. The package prioritizes reforms which have been made urgent by the impact of the crisis, whilst also maintaining a line of sight to the Government's medium-term development agenda for inclusive growth. This is expected to be fully aligned with the Country Partnership Framework (CPF) currently under preparation, contributing to the World Bank Group's overall program of support to Kenya, including through complementarities with projects in public financial management (Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya, GESDeK, P161387), energy (Kenya Electricity Modernization Project, P120014), environment (Marine Fisheries and Socio-Economic Development Project, P163980); water (Water and Sanitation Development Project, P156634, and Kenya Water Security and Climate Resilience Project, P117635); health (Transforming Health Systems for Universal care Project, P152394); and education (Eastern and Southern Africa Higher Education Centers of Excellence Project, P151847).

C. Proposed Development Objective(s)

Accelerating reforms for a resilient and sustainable recovery from the COVID-19 shock, and the continued advancement of Kenya's inclusive growth agenda.

Key Results

The key results of the operation include: (i) fiscal and debt management results such as more transparency and accountability in state procurement spending, more effective public investment spending, and a more transparent and liquid domestic debt market; (ii) a stronger energy sector through improved financial and operational performance of the state-owned electricity distribution company, and a streamlined energy project investment pipeline placing Kenya on a least-cost, clean energy path; (iii) more sustainable and inclusive governance of natural resources, including improved governance and service provision in the water sector; and (iv) human capital gains through increased access to healthcare and more efficient public spending on health.

D. Project Description

The proposed operation is the first in a programmatic series of two operations. The program is organized into four pillars. The supported reforms complement and reinforce each other to address the drivers behind fiscal vulnerabilities and help chart a market-oriented path towards, green, resilient and inclusive development (GRID). The pillars are: (1) fiscal and debt, (2) energy, (3) natural capital, and (4) human capital. Critical reforms in each pillar are summarized below.

Fiscal and debt reforms: Transparency and accountability of public sector spending: the government will implement e-procurement of all goods and services across the public sector (including state-owned entities). The new digital platform and attendant regulations will improve transparency and the accountability of public spending. Fiscal savings from such public procurement reforms are estimated at about 1% of GDP. Effectiveness of public investment spending: the government will implement rigorous public investment project selection criteria and monitoring and evaluation (M&E) of ongoing projects, and undertake a stocktaking exercise to consolidate the large, underperforming public investment portfolio, rationalize stalled projects and re-prioritize spending on the highest impact, priority projects. Savings from the rationalization and prioritization of public investments can yield at least 1.5% of GDP. Domestic debt market transparency & performance: this operation complements recent efforts to improve external debt transparency by improving transparency in the domestic debt market (which accounts for half of the government debt stock). Specifically, new, transparent auction rules will be published in the primary market for government securities and a benchmark building program will be undertaken in the secondary market. This will support wider institutional participation and confidence in the debt market, result in larger benchmark bond sizes , support liquidity, lower the cost of borrowing by the government and interest service payment), and contribute to capital market development.

Electricity sector reforms: Strengthening the state-owned monopoly distribution company (KPLC): cost-recovery in retail tariffs will be restored (while retaining lifeline tariff protection for small users), and future power purchases will come from clean, competitively-sourced projects under a new auction policy, replacing the old Feed-in-Tariffs policy which locked KPLC into an increasing number of relatively expensive “take or pay” power purchases. Cost savings from the new policy are estimated at $1.1bn over the next ten years. Together, the measures aim to prevent fiscal risks from this large SOE from crystallizing and to maintain the progress made over the last decade in the electricity sector (where off- and on-grid electricity access has approximately doubled, to 75% of households). Keeping the sector on a least-cost, green energy path: future investments will be guided by a technically-sound least-cost power development plan linked to a push towards 100% clean energy. The updated plan is critical to align new power generation with needs, maintain orientation towards the least-cost options, and build on Kenya’s current 90% clean energy mix towards 100% clean energy and phasing-out existing emergency thermal capacity.

Natural capital reforms: Enhancing environment and climate change governance: increased and accelerated climate change mitigation and adaptation commitments by Kenya are being supported by the proposed DPO, including through improvements to the keystone environmental management legislation that will mainstream climate change considerations (the Environmental Management & Coordination Act), and supporting inter-governmental coordination and the implementation capacity of county governments. Water and irrigation: this is an area critical for human and economic development, but water resources are under strain from climate change and rising demand. The DPO supports reforms towards prudent management of Kenya’s scarce water resources and to close water and sanitation access gaps.

Human capital reforms: Health: a new National Health Insurance Fund (NHIF) Act will accelerate progress to sustainably increase access to healthcare services and drive down out-of-pocket costs by strengthening the National Health Insurance Fund and reorienting it to effectively deliver universal health care. The number of poor and vulnerable households covered through government-financed health insurance subsidies is expected to rise from ~200k at present to 1m by 2022. Education: Through ongoing IPFs the bank is addressing inequities in primary and lower secondary education. This operation focuses on higher education by supporting a shift towards a performance-related financing model in higher education (through a revised Universities Act), to support better-quality education service provision and financial sustainability in the sector, such that at least 30% of recurrent funding for universities will be performance-based by 2022. Higher education consumes about ¼ of total education expenditure (1.3% of GDP), the sector is expanding rapidly, and its performance is critical to the continued growth of Kenya’s human capital and meeting development aspirations (building on Kenya’s achievement of the highest Human Capital Index score in continental sub-Saharan Africa).

E. Implementation

Institutional and Implementation Arrangements

The National Treasury and Planning will be the coordinating institution for monitoring and evaluation among all the participating ministries for this DPO. The institutional and policy reforms supported by the programmatic DPF series fall under the purview of 14 ministries and agencies. These are: CBK, NHIF, MoALFI; Ministry of Lands and Physical Planning; Ministry of Education, Ministry of Environment, Ministry of Energy, KPLC, EPRA, Ministry of Health, Ministry of Water and irrigation, The National Treasury and Planning; National Lands Commission, and the Public Procurement and Regulatory Agency. The National Treasury and Planning has chaired 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.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

The overall poverty and social impacts of the policy and institutional reforms under this proposed programmatic DPO series are expected to be positive. The poor are expected to benefit in the short-term from the interventions to improve the accessibility and affordability of healthcare, increased access to improved water and sanitation services, and better availability of irrigation. In the medium to longer term, the poor are also likely to benefit from interventions in the electricity sector, and human capital reforms focusing on higher education.

Environmental, Forests, and Other Natural Resource Aspects

Kenya's national environmental institutional framework is broadly aligned with good international practices. The framework is defined by the 2013 National Environment Policy and the 1999 Environmental Management and Coordination Act (EMCA, amended in 2015) that established the National Environment Management Authority (NEMA). The Ministry of Environment and Forestry (MoEF) is responsible for establishing policy guidelines on environmental, forest, and protection and conservation of natural resources. The proposed operation is expected to have broadly positive environmental effects, notably by supporting an efficient, clean energy mix and supporting enhanced management of Kenya's scarce water resources.

G. Risks and Mitigation

The overall program risk rating is substantial, recognizing the uncertainty generated by the ongoing pandemic and additional complexity this adds to the economic, political and institutional capacity backdrop for implementing the reforms. The Government has established a track record of undertaking difficult reforms and is moving ahead quickly to address priorities arising from the COVID-19 crisis and maintain the momentum to achieve its ambitious development goals. However, as the pandemic and its economic effects continue to play out, the public health and economic situation remains fluid, and uncertainty remains elevated. There is therefore a substantial risk to the achievement of the intended development results, driven primarily by substantial macroeconomic and political risks.

In mitigation of implementation risks arising from a more adverse economic and fiscal scenario, many of the reforms supported through this operation contribute directly to reducing macroeconomic risk, by supporting fiscal performance and consolidation efforts, and by reducing fiscal risks emanating from SOEs. These include the measures to strengthen public procurement, public investment management, and the domestic debt market, as well as sector reforms to strengthen the financial and operational performance of key state entities. Risks to the DPO results from governance challenges are being addressed through support by the World Bank and other development partners to measures to improve governance by addressing the bottlenecks to improved economic management and service delivery. The DPO is complemented by operations such as the GESDeK Program for Results (P161387) that supports the implementation of the PFM Reform strategy at the national level. The Kenya Devolution Support Project (P149129) supports the institutional strengthening of county governments including on PFM, and the Kenya Accountable Devolution Program (P167841), a multi-donor trust fund, support counties in PFM and service delivery. The DPO and these complementary operations will help maintain the positive trajectory in Kenya's fiduciary and other governance systems.

CONTACT POINT

World Bank

Alexis Sienaert, Allen Curtis K. Dennis
Senior Economist

Borrower/Client/Recipient

The National Treasury
Dr. Julius Muia
Principal Secretary
ps@treasury.go.ke

Implementing Agencies

The National Treasury
Dr. Julius Muia
Principal Secretary
ps@treasury.go.ke

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Alexis Sienaert, Allen Curtis K. Dennis

Approved By

Country Director:	Keith E. Hansen	03-May-2021