Board Meeting of September 24, 1998
Statement by Jan Piercy

KENYA: COUNTRY ASSISTANCE STRATEGY

1. I commend the Kenya country team for an excellent CAS. The CAS correctly focuses on poor governance as the problem underlying poverty and low growth in Kenya. This CAS gives real meaning to the term “selectivity” by emphasizing the most important development issue facing Kenya. In that regard, I applaud staff for fully reflecting the lessons learned from the previous CAS and the OED Country Assistance Note.

2. The consultation process for developing this CAS has been extensive and effective. Government, private sector, civil society and donors have all been involved. I commend the country team for their efforts in making this CAS process an open and transparent one. With regard to donor consultation, I have been very impressed with the work of the multi-donor Economic Governance Group (EGG) in Kenya which strikes me as a model for the kind of collaboration envisioned in the Partnerships paper we also discuss today. I hope that the World Bank will continue to chair this important group. In addition, I strongly encourage a further strengthening of coordination and consultation with other stakeholders, including the private sector, which is key to any effort to accelerate reform and increase trade and investment.

3. Within the realm of governance, I note that the Bank has appropriately chosen to focus on select problem areas where it feels it has the appropriate expertise: public sector restructuring, public expenditure management reform, and strengthening accountability mechanisms. I agree with this focus as dysfunctional budget and public expenditure management as well as ineffective internal mechanisms for public debate are critical problems in Kenya. In this regard, I welcome the fact that the Public Expenditure Review was a precursor to the development of this CAS. Building on this work, I encourage staff, through the Medium-Term Expenditure Framework, to examine productive versus unproductive (including military) expenditures and the mechanism through which those expenditures are reported.

4. However, in the CAS presentation, I think that it would have been useful to recognize some of the other governance problems that are barriers to economic growth in Kenya, e.g. the ineffective court system, inadequate protection of property rights, and outdated laws. A weak rule of law is a major contributing factor to the governance
problem. I understand that the EGG has an analytical framework for assessing the governance problems in Kenya and would have appreciated seeing this framework in the CAS. The CAS program alone is insufficient to address the problem of poor governance. Unless the GOK adopts a comprehensive approach to tackle its problems, economic growth will remain low and the Bank’s program will not be successful.

5. I agree that Kenya is currently in a “low case” lending scenario and that it must meet a number of criteria before moving to the “base case”. The triggers the Bank has proposed for moving to the “base case”, however, are inadequate. The triggers must be action-oriented. While a “laundry list” of conditions would not be appropriate, I suggest strengthening the triggers for the “base case” along the following lines:

- **Action** to implement a comprehensive strategy to strengthen accountability institutions (rather than only the adoption of a comprehensive anti-corruption strategy).

- **Action** to implement a redefinition of the core functions of government (rather than only a redefinition itself).

- **Concrete milestones met** toward an effective medium-term expenditure framework.

6. Will resumption of an ESAF also be a trigger for the “base-case”? In this regard, I would appreciate IMF staff comment on the status of their consultations with the Kenyans.

7. I welcome the Government’s indications to make the next PFP participatory and strategic and encourage the Bank and Fund to support this process.

8. With regard to the lending scenarios, I am concerned that the $500 million figure proposed for the next three years (as noted in Annex B3) appears to be the expected program and that the “low-case” $150 million figure would be the exceptional program. We currently have an approximately $500 million undisbursed balance in Kenya. The Board has recently approved an El Nino Emergency credit and an Energy Sector Reform credit, (neither of which seem to be performing very well.) (I would appreciate staff comment on the status of these two credits.) I therefore find the $500 million proposed level overly optimistic. This heightens my concern regarding the current ambiguous triggers.

9. I am particularly concerned by the proposed use of adjustment lending to reduce domestic debt. The CAS states that necessary measures for the Bank to consider potential adjustment support in the “base case” would include implementation of the privatization program, proceeds from which could be used for domestic debt retirement. I understand that a recent Bank study showed that billions of shillings could be realized if the Government sold its parastatals. What incentive will Kenya have to privatize and use the proceeds to reduce domestic debt if they will receive Bank adjustment lending for that very purpose? I would appreciate staff comment on this point.
10. I would like to relate our discussion today to discussions we will have tomorrow in the Board on the *Assessing Aid* paper and in CODE on the ARPP.

- In *Assessing Aid*, the research shows that aid works in a good policy environment (where there is good economic management). The report notes that aid can nurture reform in even the most distorted environment - but it requires patience and a focus on ideas, not money.

- In this regard, the ARPP describes some new initiatives for portfolio management that I believe could be useful in the Kenya context. For example, in addition to the traditional tools like the PER and CPF, the Kenya country team could use new tools such as the Anti-Corruption Assessment and the Country Institutional Review (by the Public Sector Family of PREM). It seems to me that these non-lending instruments could prove to have a higher pay-off and development impact in Kenya than increased lending at this time. I would appreciate staff comment on this point.

11. Finally, since Kenya is in the "low case" lending program, now may be a good time for the Bank to provide Kenya some technical assistance.

- During Secretary Rubin’s visit to Kenya, the GOK indicated a need for technical assistance in reviewing current financial instruments in Kenya and developing harmonized banking legislation for the EAC region. Could the Bank consider some assistance in this area?

- I understand that the Bank has been working with Governor Cheserem on banking supervision and the banking system. I urge the Bank, as appropriate, to work with the GOK on financial sector reform. This is particularly important given the September 21, 1998 *Wall Street Journal* article reporting a regional banking crisis in East Africa with two Kenyan banks failing within the last 10 days. CBG Cheserem recently warned that at least one more Kenyan institution may be in trouble.