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Report No.18391 KE

MEMORANDUM OF THE PRESIDENT
OF THE
INTERNATIONAL DEVELOPMENT ASSOCIATION
TO THE
EXECUTIVE DIRECTORS
ON A
COUNTRY ASSISTANCE STRATEGY
OF THE
WORLD BANK GROUP
FOR
THE REPUBLIC OF KENYA

September 2, 1998

Country Department for Kenya
Africa Region

CURRENCY EQUIVALENTS

Currency Unit: Kenya Shillings

US $1.00 = Kshs 59.5

FISCAL YEAR: July 1-June 30

GLOSSARY OF ABBREVIATIONS AND ACRONYMS

CAS	Country Assistance Strategy
CBK	Central Bank of Kenya
CIDA	Canadian International Development Agency
CPPR	Country Portfolio Performance Review
CSR	Civil Service Reform
DANIDA	Danish International Development Agency
DDG	Democratic Development Group
DFID	Department for International Development
EGG	Economic Governance Group
ESAF	Enhanced Structural Adjustment Facility
ESW	Economic and Sector Work
EU	European Union
GDP	Gross Domestic Product
GNP	Gross National Product
GTZ	Gesellschaft für Technische Zusammenarbeit
ICOR	Incremental Capital Output Ratio
IDA	International Development Association
IDF	Institutional Development Fund
IFC	International Finance Corporation
JICA	Japan International Cooperation Agency
IMF	International Monetary Fund
KACA	Kenya Anti-Corruption Authority
KfW	Kreditanstalt für Wiederaufbau
KPTC	Kenya Posts & Telecommunications Corporation
KANU	Kenya African National Union
KRA	Kenya Revenue Authority
MIGA	Multilateral Investment Guarantee Agency
MPER	Ministerial Public Expenditure Review
MTEF	Medium Term Expenditure Framework
NGOs	Non-Governmental Organizations
NIC	Newly Industrialized Country
O&M	Operation and Maintenance
OED	Operations Evaluation Department
PER	Public Expenditure Review
PFP	Policy Framework Papers
PIP	Public Investment Program
SAC	Structural Adjustment Credit
SDS	Service Delivery Survey
SIDA	Swedish International Development Agency
UNDP	United Nations Development Programme
US$	United States Dollar
USAID	United States Agency for International Development
WDR	World Development Report
WMS	Welfare Monitoring Survey

Vice President	Callisto Madavo
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KENYA
COUNTRY ASSISTANCE STRATEGY
Improving Economic Governance for Sustainable Development

September 2, 1998

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EXECUTIVE SUMMARY

i. **Economic Potential and Performance**. Kenya has long been viewed as the African economy most likely to achieve its development objectives. At the time of its independence in 1963, Kenya's basic physical and institutional infrastructure, the educational level of its population, and the depth of the private sector were all considered among the best on the continent. The country has also enjoyed remarkable political stability. Yet, long-term economic trends are disappointing. GDP growth has steadily slowed since the mid 1970s, and fell below the population growth rate by the early 1990s. Income inequality and poverty have worsened. Social indicators show worrisome trends and social tensions have risen. Investor confidence is weak, and private sector initiatives are stifled. In short, Kenya has under-performed its economic potential.

ii. **Poor Economic Governance Explains Performance**. As confirmed by the consultative CAS process, there is broad consensus today both in Kenyan society and among donors, that the central development challenge in Kenya is weak economic governance. By "governance" we refer to (a) the process by which authority is exercised in the management of a country's economic and social resources for development, and (b) the Government institutions' capacity to formulate and implement policies and programs. In Kenya, poor governance has systematically undermined independence, capacity, and accountability of the public sector. This has resulted in poor management of public resources, corruption, the weakened rule of law, and uneven implementation of policy reforms, which are all inimical to economic growth, equity, and sustained development.

iii. **Government Response to Crisis**. A combination of pre-election tensions, post-election political uncertainty, and infrastructure damage inflicted by heavy El Niño rainfall has deepened the economic recession in 1998. High interest rates continue to crowd out the private sector. The increased cost of servicing the domestic debt in the budget together with large wage concessions to teachers has intensified fiscal pressure in the past year.

iv. In response, the Government of Kenya (GOK) has adopted a strategy of medium-term fiscal adjustment and public sector reforms. The GOK fiscal strategy involves a balanced budget and use of privatization proceeds as key to its own effort to reduce the large stock of domestic debt. By reducing the heavy burden of debt servicing, this fiscal adjustment would free up budgetary resources for operations and maintenance (O&M) and public investment. A sustainable fiscal adjustment would require a fundamental restructuring of the public sector through aggressive programs of privatization, divestiture, and public service downsizing. It also must be accompanied with establishment of better linkage between policy and budgetary frameworks. A medium-term expenditure framework (MTEF) is intended to provide this link by ensuring that expenditure decisions are based on clear government-wide policy commitments. Both MTEF and the design of the structural reforms offer opportunities to build Kenyan ownership, which would be critical for the sustained implementation of the reform programs. The Government has indicated its intention to ensure broad ownership of the reforms by consulting widely with all stakeholders.

v. **The Bank's Assistance Strategy**. Although poverty reduction remains the ultimate objective of the Bank's assistance to Kenya, poor economic governance is the central bottleneck for sustained development. The Bank has learned that it must focus more on facilitating Kenyan-led reform efforts, rather than prescribing reforms through conditionality, and that it should downplay lending (especially conventional lending) in the near-term. This CAS concentrates on supporting GOK's own efforts at

improving economic governance and achieving a fiscal adjustment. However, the Kenya program is in the low case now because of poor economic governance. The triggers for moving up to the base case would consist of: (a) sound macroeconomic management; (b) specific measures to implement public sector reform and improve economic governance; and (c) improvement in IDA portfolio performance.

vi. To support GOK's stated intention to improve economic governance, the CAS will emphasize the following three areas: **public sector restructuring** to build a more responsive and effective public sector; **public expenditure management reform** to ensure efficient use of public resources; and **strengthening of accountability mechanisms** to restore institutional checks and balances and to fight corruption. In the base case, the Bank would be prepared to provide fast-disbursing support for fiscal adjustment under appropriate conditions, including evidence that GOK has implemented key economic governance reform measures. Such support could enable GOK to swap expensive short-term domestic debt for concessional IDA debt. By reducing the domestic debt service burden, GOK could increase funding for priority operations and investments. The expected reduction of interest rates would also revive private investments, and reinforce recovery of economic growth. In light of poor implementation of past adjustment programs, however, the release of adjustment support would be linked to completed actions on public sector reforms, and to full implementation of the agreed annual budgets, including achievement of a balanced budget or a surplus.

vii. Successful implementation of the comprehensive public sector reform as announced by GOK will hinge on strong and sustained political commitment. While weak GOK commitment has resulted in poor reform implementation in the past, Kenyan ownership of the reform can be strengthened through consultative processes of designing reform. GOK has already indicated its intention to consult widely with various stakeholder groups during the design and implementation of the public sector reform. Specifically, the Government proposes to follow a consultative process to formulate the next Policy Framework Paper. The Bank and other major donors have indicated their willingness to support this reform process.

viii. While economic governance reforms are central to our strategy of *long-term poverty reduction*, Bank assistance will be used to target and improve the effectiveness of our poverty-focused interventions. Under the CAS, the Bank will closely monitor poverty levels and will explicitly incorporate the trend in the poverty levels as a performance indicator. Anticipated project assistance in the low and the base cases will focus on key social and rural sectors (basic education, primary health care, rural roads, and water supply). In order to establish alternative channels for delivering assistance to the poor, the Bank will collaborate with the Government to explore innovative partnership arrangements with local and international NGOs.

ix. **Risks and Remedies.** Improvement from low-case conditions to base-case conditions is likely to be gradual, at best, reflecting the fragility of the perceived political commitment and capacity for effective reform implementation. In the long run, a more inclusive approach to economic policy making would enhance transparency and accountability, and likely build stronger national ownership of reforms. The consultative process the Government has proposed is expected to bring about greater inclusiveness to the reform process. However, there is a substantial risk that Kenya will not be able to move out of the low case within the CAS period, or even face long-term economic stagnation, as improvement in economic governance prove elusive. In such a case, the Bank would be prepared to sustain a low level of lending support for a relatively long period of time, while continuing to encourage the Government to build ownership of reforms through policy dialogue and non-lending services.

MEMORANDUM OF THE PRESIDENT OF THE INTERNATIONAL DEVELOPMENT ASSOCIATION TO THE EXECUTIVE DIRECTORS ON A COUNTRY ASSISTANCE STRATEGY OF THE WORLD BANK GROUP FOR THE REPUBLIC OF KENYA

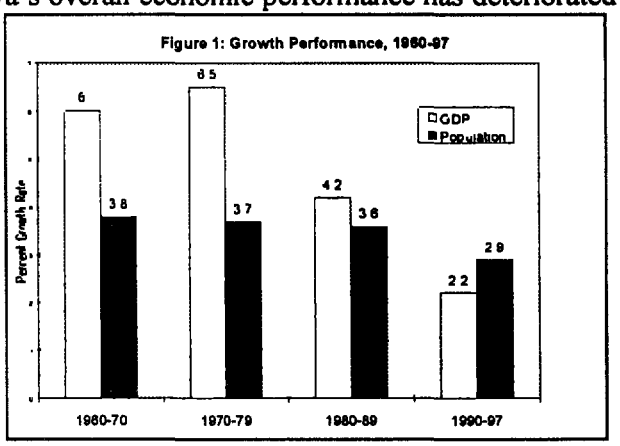
I. CONTEXT

Development Challenge for Kenya

1. There is a broad consensus today both in Kenyan society and the donor community that the central development challenge for Kenya is poor economic governance (see Attachment 1). In Kenya, the public sector's capacity to serve public purposes has been systematically undermined over many years. This has led to poor management of public resources, widespread corruption, the weakened rule of law, and uneven implementation of policy reforms, which have stifled the energies of the private sector, aggravated the plight of the poor, and hindered sustainable economic development. The economic and fiscal crises since late 1997 have focused GOK's attention on the problem of poor economic governance. However, the problem is deep-seated, and hence resolving it will require creative and sustained efforts by GOK, other stakeholder groups, and donors. The challenge for this CAS is to define an effective approach for the Bank to help GOK address the economic governance problem in an environment where political commitment to change is fragile.

A Stagnant Economy and Deteriorating Social Indicators

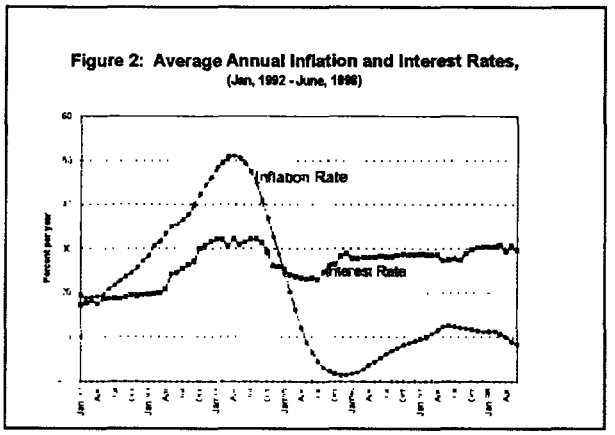
2. **The Collapse of Economic Growth.** Kenya's overall economic performance has deteriorated since the mid-70s, and worsened markedly in the 1990s. The average GDP growth rate declined from about 7% in the 1970s to 2.2% during 1990-97, falling below the average population growth rate of 2.9%. Though growth recovered to 3.8% in 1994-96, when implementation of key economic liberalization measures coincided with good harvests, it fell to 2.3% in 1997, as bad weather conditions compounded existing economic management problems and the effects of political uncertainty. Kenya's 2.2% average growth rate in the 1990s does not compare favorably with those of Tanzania (4%) and Uganda (5.6%).



3. Despite collecting close to 30% of GDP in revenues, GOK has been unable to provide and maintain the basic economic and social infrastructure to support private investments. Private sector investments have fallen by 7% in real terms between the second half of the 1980s and the first half of the 1990s. Investment inefficiency, measured by the size of the ICOR (incremental capital-output ratio), rose from 4.5 to 9.2 during the same period. In addition, Kenya's domestic savings rate has declined from 18% in the latter half of the 1980s to 16% in 1990-96. Both the trend and the levels compare unfavorably with average ratios of 33% for East Asia and 31% for Southeast Asia. The private sector accounts for virtually all the decline in domestic savings. While Government savings in

the form of revenue surpluses over recurrent expenditures have improved, this was due mainly to higher taxes and came at the expense of the private sector.

4. **Macroeconomic Management**. Kenya's macroeconomic management has been relatively strong in recent years. While the IMF's ESAF program lapsed in August 1997, it was not on account of failure to meet the macroeconomic benchmarks (see para. 45). Inflation has been effectively checked over the period 1994-98 (see Figure 2). Fiscal deficits have also been reduced sharply since the high levels of 1992-94, though the fiscal balance is again threatened by the structural distortions in public expenditures. Further, a large stock of short-term debt and continued government borrowing have resulted in high nominal interest rates. Short-term capital inflows have complicated macroeconomic management. As a result, the principal failure of macroeconomic policy has been in reducing real interest rates. Real returns on 3-month Treasury bills averaged over 15% during 1993-98 and reached 40% in late 1994, adding even more to domestic public debt. The high interest rates have lowered the returns to entrepreneurial activity and depressed private investment and growth.



5. **A Vulnerable Banking Sector.** Kenya experienced banking failures in the 1980s and most recently in the early 1990's when a number of banks, including the Exchange Bank associated with the Goldenberg financial scandal, were closed. Questionable loans to the well-connected and political pressure to influence the lending of state-owned banks have reportedly been the principal cause of past bank failures.[1] Since 1993, the Central Bank of Kenya (CBK) has tightly restricted banking licenses and instituted a relatively strict banking supervision regime, thereby averting the recurrence of major banking failures. Improved vigilance by the CBK in the period 1994-98 has been apparent in the swift reaction to evidence of improper banking practices. GOK has recently amended the Banking Act to strengthen the CBK's ability to enforce a stricter governance norm on directors and senior management of banks. In addition, the gradual and ongoing privatization of both the National Bank of Kenya and the Kenya Commercial Bank has reduced the degree of state control over these two major banks. These developments provide some reason to discount, but not dismiss, the risks to the banking system from poor governance.

6. Nonetheless, the banking sector is significantly affected by the general decline of economic activity. High nominal and real lending interest rates have been the norm in much of the past four years. Such high interest rates in a context of low real growth poses an increased risk to the loan portfolio of the financial sector. While the large number of banks (55 commercial banks) and other financial institutions suggests a highly competitive sector, 66% of deposits are held by only seven commercial banks. The wide spreads between lending and deposit rates reflect both the limited real

[1] A recent and widely reported case is the allegation that the Kenya Commercial Bank (KCB) gave large loans to its directors, which resulted in removal of the KCB's senior management from their posts.

competition, and the increasing risk of loan defaults.[2] Although these spreads have allowed banks to operate profitably in the past, an increasing share of non-performing loans poses a serious threat to the sector. The volume of non-performing loans increased by 61% in the two years to end-1997 reaching 20.5% of total loans. Smaller banks with limited access to deposits are particularly vulnerable to further increase in loan default rates. The Bank has been providing policy advisory assistance to CBK since late 1997 to enhance its autonomy and supervision capacity, to strengthen regulations relating to disclosure, and to improve bank failure management.

7. **Poverty and Social Indicators.** Growing poverty and widening inequality pose the greatest threat to political and social stability in Kenya. The 1994 Welfare Monitoring Survey (WMS) found 11.5 million individuals (43% of the population) below the poverty line. This figure is estimated to have increased by 1 million by 1997, according to the ongoing 1997 WMS. Based on the 1994 poverty gap index, GOK also estimates that US$150 million would have been needed to bring the expenditures of the poor up to the poverty line.[3] Income inequality is severe, with the richest 20 percent of households receiving 62% of total income.

8. Kenya's social indicators reflect the retrogression in a number of areas. Between 1980 and 1995, primary school gross enrollment declined from 115 to 85. GOK and community success in the control of diseases and increased infant immunization which contributed to an increase in life expectancy from 55 to 58 years and a decline in child mortality from 115 to 90 per thousand, is placed at risk by the HIV/AIDS epidemic. With 10% of population aged 15 - 49 infected with HIV and further large annual increases in the newly infected population, the economic cost of the epidemic is expected to grow to over US$2 billion in the next 5-7 years. Meanwhile per capita expenditure on health declined from US$9.50 in FY80/81 to US$4.50 in FY91/92, and is estimated to have further declined to US$3.50 by FY97/98.

9. **Social Cohesion**. A growing labor force in a context of economic stagnation has contributed to greater social tension. While increasing political competition may have heightened the more general ethnic tension and property rights conflict, the negative social trends are fundamentally rooted in the decline in living standards, widening income inequality, rising unemployment, and the lack of broad-based safety net programs for vulnerable groups. In contrast to the public sector's ineffectiveness in redressing the economic decline so far, there are encouraging signs of strength at the local level. The extended family system remains the basic safety net, and communal self-help (Harambee) programs remain strong, as exemplified by the remarkable resilience of the education system that survives through extraordinary parental support and involvement. A number of new local NGOs, community-based organizations, and church-led programs have emerged to fill the vacuum left by the Government and large donors, and to support community self-help efforts.

Political Developments

10. Although the lack of a pluralistic system characterized much of Kenya's first 29 years of history, important political changes have occurred in the 1990s. Societal pressure for greater democratization mounted and culminated in the introduction of a multi-party system in 1992. Although

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[2] While the average interest on savings is around 11% and the interest rate on 3-month deposits 21%, the lending rate was around 30% in August 1998.

[3] *The First Report on Poverty in Kenya*, June 1998.

the primary impetus for this political opening came from organized groups in civil society, particularly religious and professional communities, bilateral donors are seen to have played a supportive role in this process. With this transition came greater freedom of speech and a generally more open and pluralistic social and political environment. These civil society groups have continued to be vibrant, and to an extent become voices to represent broader, unorganized segments of Kenyans. In 1997, they joined force came together to demand constitutional reform, and more recently, they have become more focused on long-term economic issues. Nevertheless, the opposition political parties continue to be divided mainly along ethnic lines. Their inability to front a single candidate has allowed President Moi to win two successive elections in 1992 and 1997 with plurality of votes (about 40%).

11. KANU has a narrow majority in the post-election Parliament. President Moi's decision to defer selecting a Vice President in his last constitutional term in office has intensified factional maneuvering to influence the Presidential succession. The continuing debate over constitutional reform has also become increasingly divisive. These factors threaten to divert national attention away from long-term economic issues. On the other hand, political events since the late 1980's show that the Government does respond to demands that have a broad base in the Kenyan society. Thus, growing societal attention on the economic crisis, combined with healthy activism of civil society groups, has the potential to produce changes desired by the Kenyans themselves.

External Environment

12. Kenya's external environment is currently quite favorable. Its major trading partners in Europe and East Africa (i.e., Uganda and Tanzania), which together absorb about two-thirds of its exports, are growing strongly. Its external terms of trade should also pose no serious problem with tea prices strong, and any weakness in coffee prices more than offset by weak oil prices. Potential positive effects are expected from the revival of the East African Cooperation and from the new US Trade Initiative towards Africa. Kenya could also take better advantage of its tourism potential, possibilities of foreign direct investment, and favorable world financial markets, but in all cases it would first have to solve the economic governance problems that undermine its access to these opportunities and strengthen the financial system to reduce its vulnerability to shocks. It is therefore the internal rather than the external environment that is more likely to be problematic for Kenya.

II. GOVERNMENT AND BANK PERFORMANCE TO DATE

Government's Development Strategy, 1986-98

13. **Private Sector-led Growth with Public Sector Support**. Since the *Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth,* GOK has recognized its role in the development process as that of facilitating rapid private sector-led growth. GOK defined its new role as: (1) developing a stable political and economic climate; (2) providing administrative and social services such as education, health, and water; (3) providing critical infrastructure; and (4) establishing market-based incentives and regulatory structures that will attract private investment. This re-definition of the role of government was to be achieved through *reforms* that liberalized markets and strengthened public sector support to the private sector. The Government has reaffirmed these strategic and reform objectives in subsequent policy documents including sessional papers and the most recent Policy Framework Paper (PFP) of 1996-98.

14. **Implementation Record**. Despite various structural adjustment programs to support the reforms, actual implementation of the strategy has been sporadic, and limited to selected issues. Economic liberalization was undertaken in fits and starts with the removal of interest rate and price controls and the more contentious and hesitant process of eliminating import and foreign exchange licensing. Crisis has been a spur to sporadic reforms. In the first half of 1993, faced with an inflationary spiral and very low foreign exchange reserves, GOK completed a number of bold liberalization measures in trade, foreign exchange, and financial sector management. Although significant progress was made on the market liberalization aspect of the GOK strategy, implementation of. the public sector reforms has been disappointing. As a result, the performance of the public sector has been a handicap that has limited the gains from market liberalization reforms. With this important aspect of the strategy undone, the economy has continued to stagnate. The poor implementation of the public sector reforms raises questions about GOK's commitment to its own strategy.

Impact of Bank Assistance

15. The continuous and substantial lending by the Bank has so far failed to produce the desired impact on development in Kenya. Since last year, the Kenya Country Team has taken a critical look at the Bank's own work in Kenya. In parallel, the Operations Evaluation Department (OED) prepared a Country Assistance Note (CAN). This review of the Bank's performance in Kenya reinforced the assessment by the Country Team. Important lessons in four areas have emerged.

16. **Strategy.** The 1996 CAS was guided by the 1995 Poverty Assessment (see Attachment 2), which highlighted the increase in poverty levels in Kenya. Based on that report, and consistent with the stated GOK strategy, the 1996 CAS aimed to support rapid growth, investment in human resources, and targeted poverty programs.[4] It envisioned more vigorous private sector-led growth through macro-economic stability, further economic liberalization, strengthening supportive institutions for the private sector, and investment in basic infrastructure (roads, energy, and water). It emphasized investment in human resources through various interventions to improve the quality of and access to education and health care. Finally, it included special programs to help the disadvantaged (e.g., those living on remote arid lands and the population in early childhood for whom little public education was provided).

17. The Kenya Country Team concluded that this strategy remains valid at some fundamental level. However, it has not worked because of the lack of political commitment in Kenya to this strategy and the inability of the public sector institutions to carry out stated policy objectives effectively. Although the 1996 CAS recognized economic governance as <u>one</u> of the issues, we now view it as <u>the</u> central issue, which must be addressed <u>before</u> the rest of the poverty reduction strategy can work.

18. **Encouraging Reform.** The Bank has relied primarily on adjustment lending to encourage GOK to reform its economic and sector policies. Although some important market liberalization measures were taken in the 1992-93 period, for much of the rest of the period, there have been many policy reversals. Weak commitment to reform was also evidenced in the implementation of the measures supported by the recently closed Structural Adjustment Credit (Box 1). The Country Team concluded that our conditionality cannot substitute for GOK commitment. It also noted that there had

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[4] The 1990 WDR articulated a "three-pronged" poverty reduction strategy that focused on promoting labor-using, private-sector-led growth and investment in human resources as the two main prongs, complemented by a third element, which was targeted interventions to help those who may not be able to readily take advantage of the opportunities created by the two main elements of the strategy.

been tendencies for the Bank to be over-optimistic in assessing GOK's commitment to and ability to implement reform. The Bank must find a way to ensure deeper commitment to reform and provide financial support only for reform measures that have been actually implemented.

Box 1: Government Performance on Structural Adjustment Credit (1996-98)

The Bank's experience with the recent Structural Adjustment Credit (SAC) is instructive about Government performance. The SAC was approved in June 1996 and supported actions in three areas: (i) public expenditure management, (ii) parastatal reform and privatization, and (iii) civil service reform.

The objective of preserving expenditure allocations to priority areas in health, education and road maintenance was undermined by unbudgeted expenditures and cost over-runs on the financing of the 1997 election. While some progress was made in divesting non-strategic public enterprises, reforms needed to raise the efficiency of strategic parastatals (ports, railways, telecommunication, energy, financial services, and agricultural produce) made very slow progress. In civil service reform, the budgetary impact of the reduction of approximately 50,000 civil servants was offset by the recruitment of 30,000 more teachers and by the decision, in late 1997, to sharply increase teacher salaries and allowances. Measures to restructure 12 pilot ministries, which was part of the SAC-supported program, were not implemented by end June 1998. Because of poor implementation of agreed structural reforms, IDA closed the SAC on June 30, 1998 without releasing the second tranche (US$87 million).

In closing the SAC, the Bank was explicitly indicating to the Government its intention to make its future support contingent on full performance of any agreed action. The CAS pays particular attention to ensuring stronger commitment for any future adjustment operations.

19. **Portfolio Performance.**[5] The Kenya portfolio has long suffered from weak implementation. According to OED, only 57% of Bank-financed projects have been rated satisfactory in Kenya, against the Africa Region average of 63% and the Bank-wide average of 75% in the 1980-97 period. Disbursement performance has been unsatisfactory and is declining, physical implementation continues to be delayed, and as of late FY98, a large portion of the portfolio was rated "unsatisfactory" (12 operations) or "potentially at risk" (2 operations). Efforts to address poor portfolio performance have been unsuccessful. The 1994 CPPR found inadequate GOK budgetary allocation to be the main constraint to timely project implementation. Extensive efforts were made to ensure sufficient budgetary allocations for all core projects (including the IDA portfolio). The Bank has also sought to address other implementation constraints (weak management, accounts and audits, planning, and procurement) through substantial allocation of resources to project supervision, project restructuring, regular portfolio meetings with Treasury and Project Coordinators, procurement and disbursement training, and a participatory CPPR in 1997. Despite these efforts, disbursements remain slow. After a large increase in FY96 (19.2%), the disbursement ratio declined in FY97 (16.4%) and FY98 (12%). The Country Team concluded, in part informed by the 1997 PER discussed below, that the problem of poor project performance stems from the dysfunctional public expenditure management and the weakness of public sector institutions which implement IDA-supported projects. Until these problems are addressed, conventional project lending is unlikely to be effective.

20. **Nature of Assistance and Partnerships.** The Country Team recognized that improving economic governance will not require much funding, but demand a strong, concerted, and sustained

[5] By the beginning of FY98, the portfolio of Bank-financed projects in Kenya consisted of 22 operations, including a SAC, for a total commitment of $ 1.1 billion.

effort by GOK, other stakeholder groups in Kenya (such as Parliamentarians, NGOs, and other civil society groups), and the donor community. As part of such an effort, the Bank's work in Kenya will have to become much more open, consultative, and collaborative. Thus, the mix between lending and non-lending activities will have to shift significantly toward the latter, and the nature of non-lending activities will also shift from analytical and prescriptive work to activities that facilitate broad-based and Kenyan-led efforts to tackle economic governance problems.

21. **OED Evaluation.** The 1998 CAN found that the Bank's assistance to Kenya had been ineffective. In particular, our effort to encourage economic and sectoral reforms through adjustment lending (3 structural and 6 sector adjustment credits over 1980-97) has had limited success, indicating ineffectiveness of our conditionality in the absence of GOK commitment. While agreeing with the 1996 CAS objectives, OED found that the 1996 CAS lacked a credible strategy to deal with governance issues (though OED notes that the Bank's approach to governance issues was still weak then). OED also noted that the 1996 CAS should have paid more attention to poverty alleviation, human resource development, gender, and partnerships. OED recommended that until GOK addresses governance issues and shows serious commitment to reform, the Bank should provide only limited lending, for participatory and poverty-targeted projects.

III. NATURE OF THE ECONOMIC GOVERNANCE PROBLEM IN KENYA

22. To gain a better understanding of the disappointing development performance of Kenya and the ineffectiveness of Bank assistance, we have relied on the most recent Public Expenditure Review (PER), and extensive stakeholder consultations. The 1997 PER, which was conducted by GOK, with assistance from the Bank and selected donors, shows that systemic weaknesses in the policy formulation process and the management of budgetary resources are central to understanding the nature of the development problem in Kenya. The stakeholder consultations confirmed the Kenyan public's deep discontent with the weak public sector performance and the inability of GOK and the donors to deliver benefits to the poor. Taken together, both analyses led us to the conclusion that poor economic governance constituted the central development challenge in Kenya.

Public Expenditure Management

23. The 1997 PER found a number of weaknesses in the Kenyan budgetary system. While the system has proved capable of controlling deficits in a short run, it has not been able to maintain fiscal discipline over time as evidenced in the recurrence of large budget deficits in the past 30 years. The ability of public expenditures to foster economic growth and reduce poverty reduction has been hindered by the large debt service and wage components. Together, they have comprised more than half of the budget in recent years and squeezed out productive public expenditures for O&M and capital investment. At the same time, the process for setting priorities on investment projects is weak and has allowed the Public Investment Program (PIP) to become bloated with an excessive number of projects (e.g., 1,226 in FY97/98) *vis-à-vis* GOK's financial capacity. As a result, the 1997 PER estimated that, on average, only 3% of the ongoing PIP portfolio was completed in a given year, relative to the target of 25%. The failure of budget management is exacerbated by weak budget implementation, reflected in persistent existence of pending bills, frequent recurrence of large unbudgeted expenditures, and significant disparities between approved and actual expenditure allocations (see Attachment 3).

24. These symptoms of dysfunctional public expenditure management can be attributed to poor economic governance. The large debt service component is due to GOK's inability to control, and secure long-term financing for, budget deficits in a sustained manner. A more fundamental problem is the inadequacy in GOK's strategic priority setting mechanisms to focus scarce public resources on key areas of state intervention. For example, GOK has chosen to increase the size of the public service without sufficient regard to the long-term budgetary impact. The large wage bill in the context of limited budgetary resource availability has meant long-term erosion of real public service pay, and the resultant weakening of public sector morale and integrity, with a serious consequence on the public sector's institutional capacity to execute its functions. Weak expenditure control is a symptom of eroded institutional checks and balances. Recurrence of large unbudgeted expenditures are also an example of arbitrary policy decisions that do not take into account their budgetary implications. This reflects the lack of an effective linkage between policy-making and budgeting, which is one of the critical weaknesses in Kenya's economic governance.

Stakeholder Perceptions

25. In formulating this CAS, we consulted, with GOK endorsement, a wide range of stakeholder groups in Kenya on their perspectives on development issues and the appropriate role for the Bank in Kenya (see Attachment 4). In the first round of consultations (July-August 1997), four salient messages emerged:

- Failure of the public sector;
- Lack of effective participation at all levels;
- Failure of GOK and donors to deliver benefits to the poor; and
- Inseparability of political and economic reforms.

26. Kenyans across the board identified the failure of the public sector and GOK's lack of responsiveness to the public interest as the principal underlying causes of the economic stagnation in Kenya. The views and interests of the Kenyan public are not adequately taken into account in the policy-making and planning processes, and the discontent with poor service delivery is not heard by the authorities. Over the years, the capacity and integrity of public sector institutions have been weakened. Checks and balances have eroded and increasingly narrow political priorities have dominated the public interest. The different groups also underlined their view that in today's Kenya, improvement in economic management is inseparable from efforts at political reforms.

27. Many stakeholder groups think that donor assistance perpetuates a corrupt system. While our role as agencies of restraint on GOK was appreciated, the two Bretton Woods institutions were seen to have contributed to the problem by tolerating and encouraging secretive policy agreements with a small elite in the Government. This does not allow all the relevant Kenyan expertise to be brought to bear on the design and sequencing of reforms and it was felt that this reduces the commitment to the reforms. Neither does it allow broader public understanding and pressure for reforms and good governance to be exercised. In late 1997, the first Client Feedback Survey was conducted for Kenya. Although the focus of this survey was on the relationship between the Bank and the client, some of the key messages were consistent with what we heard in the stakeholder consultations for this CAS (see Attachment 5).

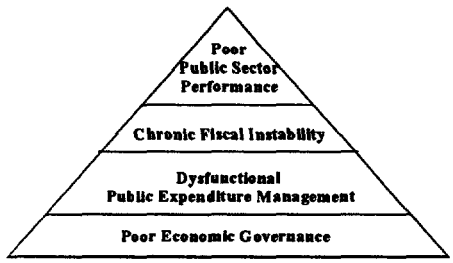
28. During the second round consultations (December 1997), the CAS team presented to the same stakeholder groups our strategic thinking based on the PER, the CPPR, and the views of the stakeholders themselves. The groups agreed with the problem definition and resoundingly endorsed

the proposed approach. These consultations have created high expectations that the Bank will, in fact, address the economic governance problem in its strategy. Despite some misgivings about our role in the past, many Kenyans see the Bank as an agency with the ability to positively influence GOK to accept the need for greater transparency in policy making and for the appropriate involvement of Kenyans in addressing the economic governance problems. They noted that greater information disclosure by both GOK and the Bank is essential for fostering meaningful participation.

Analytical Conclusion: Poor Economic Governance Is the Central Challenge

29. The "iceberg" depicted in Figure 3 illustrates the nature of the economic governance problem in Kenya, which serves as a conceptual guide to our proposed strategy. Poor public service delivery is the most visible aspect of the problem. Line managers who are provided with unpredictable budgets cannot be held entirely accountable for performance. In this sense, the repeated fiscal crises in Kenya have contributed to poor public sector management. The fiscal crises themselves reflect GOK's failure to identify and cost-effectively budget for an affordable set of priority activities. The persistence of dysfunctional public expenditure management is itself a reflection of poor economic governance. In Kenya, recovery of growth and development will hinge on improvements in all levels of the problem, which in turn requires targeting poor economic governance as their root cause .

Figure 3: Deeper Causes of Poor Public Sector Performance



IV. THE STRATEGIC CHALLENGE: IMPROVING ECONOMIC GOVERNANCE

Targeting Economic Governance

30. Until now the Bank's approach to dealing with the economic governance problem in Kenya has been to treat it on a case-by-case basis. This CAS adopts a more systemic approach to tackling poor economic governance, and targets three closely related areas of reform: **public sector restructuring** to build a more responsive and effective public sector; **public expenditure management reform** to ensure efficient use of public resources; and **strengthening of accountability mechanisms** to restore institutional checks and balances and to fight corruption. Although full implementation will require sustained efforts beyond the CAS period, effectively implemented, these reforms would be self-reinforcing and would begin improving economic governance and public sector performance.

31. **Public Sector Restructuring.** GOK has indicated its intention to implement a major public sector reform to establish the basis for performance-oriented public sector management. The first step in this process is the decision to rationalize the structure of government around a limited number of core public goods and externality functions, consistent with resource realities. The Bank is ready, in principle, to support this reform program, the design and sequencing of which is expected to emerge in the coming months from a consultative process involving GOK and other stakeholders. We expect that such reforms will involve reducing the number and functions of ministries, commercialization, divestiture or closure of non-core functions, rationalizing staffing levels in the public sector, public sector pay reforms, aggressive and transparent privatization of major parastatal firms, and establishing appropriate regulatory structures.

32. **Public Expenditure Management Reform.** A major public expenditure management reform will be an essential complement to the public sector restructuring. A significant improvement in the composition and quality of public expenditure depends on progress in the structural reforms, which in turn must be guided by the need to achieve specific fiscal, budgetary and service delivery outcomes. Both policies and projects must be rationalized to what is affordable over the medium term. To ensure that such improvements are sustained, the processes for formulating policies and budgets will have to be revamped so that the system ensures adequate budgetary considerations in making policy decisions. Another important objective of reforming the budget system would be to provide government ministries and agencies with greater resource predictability and to hold them accountable for performance. The planned adoption of an MTEF is expected to guide the institutional reform of the budget system to achieve these objectives.

33. **Strengthening Accountability Mechanisms.** In Kenya, the formal regulations and processes have become increasingly irrelevant and have been replaced by non-transparent, informal procedures that undermine accountability, financial discipline, and public morale. There are no quick fixes to this problem. However, restoring the system of checks and balances to ensure accountability will be indispensable to good economic governance. As a first and immediate step, the Bank will offer GOK support for a participatory institutional assessment of the public sector to establish more clearly the nature of the institutional failures and to design a Kenyan-led strategy for implementing appropriate reforms. The strategy also includes possible support for institutional building, including strengthening public procurement, financial management and tax administration, as well as legal sector reforms, on which there has been an ongoing dialogue with GOK. Finally, as part of our efforts to combat corruption, we will continue to highlight its adverse effect on economic development, and aggressively tackle corruption or any other public sector impropriety as a serious development challenge.

34. The Bank will ensure that its efforts to support GOK in improving economic governance will be mutually reinforcing with the strategies of other development partners. For example, the UK's Department for International Development intends to support reforms that "secure greater autonomy for key public institutions such as the judiciary and the Audit Office, whilst strengthening accountability to Parliament." At the grass roots level, organizations such as Action Aid Kenya have indicated their intention to support institution building and public policy research and advocacy.

Ownership and Commitment

35. More than ever, a reform program that seeks to improve economic governance will require strong and sustained political commitment. In light of the poor track record of reform implementation in Kenya, and the failure of multilateral conditionality to overcome this weakness, other mechanisms to build credible commitment will need to be devised to ensure sustained implementation of the reforms.

36. **Crisis as Catalyst**. The current development crisis in Kenya is an important motivating factor for GOK to forge a domestic consensus and to initiate extraordinary reform measures. The experiences of countries that have undergone significant reforms reveal the central importance of crisis as a catalyst for change.

37. A number of events since the second half of 1997 have allowed broader public understanding of the nature of the economic crisis. The consultative approach to preparing the CAS has itself been a valuable mechanism to increase understanding among key stakeholder groups, including the Bank, of the links between poor economic governance and the stagnation of development in Kenya. As the

fiscal crisis deepened in early 1998, this message began to resonate with GOK officials as well as those outside GOK. An internal GOK discussion of the 1997 PER in April 1998 involving all Permanent Secretaries and heads of parastatals provided the first forum to articulate to senior officials the nature and seriousness of the budgetary crisis. Later that month, some cabinet ministers, including the Minister for Finance, together with representatives of the Bank, IMF, and a number of donors, participated in a workshop on economic governance for about 160 Members of Parliament (MPs). That event provoked a significant increase in interest, understanding and concern about economic issues among the MPs. Specific proposals to reestablish Parliamentary committees to improve accountability emerged from this event. In early May, the President chaired a major economic forum that involved an even broader cross-section of Kenyans and relied on Kenyan experts to propose specific policy actions to address the economic stagnation. These events are widely viewed to have been responsible for a newly stated GOK commitment to implement a far-reaching public sector reform. In concluding the May forum, the President promised to convene a similar forum to review progress in reform implementation. Important aspects of the proposals such as the recommendation not to start any new projects, have been reflected as GOK policy in the budget for FY98/99.

38. **Participation as Key to Ownership and Commitment.** The experience of the past few months has vividly demonstrated that an effort led by Government (and assisted by Kenya's development partners) to explain the problems, to invite alternative perspectives, and to foster participation in defining solutions, is critical to achieving consensus. It suggests also that ownership of a reform program achieved through broader participation will be indispensable for strong commitment to implementation. Especially because of the complex nature of the institutional problems that will need to be addressed to improve economic governance, the solutions must be primarily inspired, designed, and implemented by those within Kenya. Participation by various segments of civil society will thus be critical for Kenya's success in improving development performance. Thus the CAS considers a credible and sustained effort by GOK to encourage participation as the most effective safeguard against poor reform implementation. Such an approach implies that the Bank, the IMF, and other development partners will need to rely increasingly on national initiatives and ownership, and support and facilitate the domestic design of reforms.

39. The distinction made in a recent IMF paper between ensuring ownership by the government and fostering national consensus for reform is useful and relevant for Kenya.[6] While both aspects will need to be greatly strengthened, the challenge of achieving internal government consensus is probably more formidable. In the past few years, preparation of the PFP has become more inclusive in Kenya, with sectoral ministries given greater scope to define their policy frameworks. The publication of the 1996-98 PFP was a major step forward in increasing the transparency of the reform process. Despite this progress, the internal mechanisms for debating and defining a consensus government position are not satisfactory. It is expected that GOK will foster more constructive internal discussion to ensure that the next PFP has stronger ownership within GOK.

40. But it is critical that participation also be widened to include those outside government in order to draw on expertise and perspectives in civil society, to incorporate the necessary service delivery orientation to the reforms, and to address the need to strengthen national understanding and consensus around reform. The prospects for such a participatory strategy are good. GOK has indicated its own

[6] See *Distilling Lessons from the ESAF Reviews*, IMF, July 1998.

commitment to participation both in the events of the first half of 1998 and in the statement by the Minister for Finance during his budget speech. To quote from the Budget Speech:

> "*our new ambition is to achieve high quality and sustainable growth with stability based on an unshakable commitment to pursue consistently prudent fiscal and monetary policies and good economic governance. We have to avoid the stop-go tendencies that create uncertainties for investors. We have also to ensure people's money is managed efficiently and in a transparent manner, the rule of law is effectively and fairly enforced and* ***that our people, both the general public and the business community, participate in decision making on economic issues that affect their lives. . . . We should, in designing our economic programmes, consult widely with all stakeholders in order to ensure Kenyans own such programmes***."

The preparation of the next PFP is expected to reflect this statement of intent.

41. Stakeholders whose prospective participation is viewed positively by GOK include Parliamentary committees whose role in public policy reviews and in timely oversight of public expenditures could be greatly strengthened. Progress in this area would clearly provide a strong indication of the real commitment to good economic governance. GOK has also indicated its intention to establish a formal process to allow necessary communication between the public and private sectors, since it was seen to be a weakness. Other forms in which participation might be strengthened consistent with the objective of achieving better economic governance will have to await the passage of time. Encouragement to civil society organizations to systematically monitor delivery of various core public services would provide strong feedback to guide the necessary public sector reforms and would encourage performance orientation in their operations.

Collaboration with Development Partners

42. **Donor Consensus on the Economic Governance Problem**. A strong consensus exists among major donors operating in Kenya that the key obstacle to development in Kenya is poor economic governance. Most donors perceive GOK as lacking commitment to tackle the economic governance problems such as rampant corruption and seriously weakened rule of law. Many of them have already diverted much of their financial assistance away from the Government to alternative channels. Without clear evidence that GOK is taking concrete actions to improve economic governance, these donors are likely to reduce significantly the amount of aid to Kenya.

43. Based on the common concerns with the economic governance problems, major donors formed the Economic Governance Group (EGG) in October 1997 to coordinate their strategies to improve economic governance in Kenya.[7] As Chair of the EGG, the Bank has actively led the discussions, and consulted extensively and transparently in formulating this CAS. Although some of the bilateral donors have broader governance concerns, such as constitutional reform and human rights, they have agreed to focus on the following four broad areas of governance as crucial to *economic* development: *broaden citizen participation in public affairs; improve public sector management; enhance accountability and integrity to reduce corruption; and promote the rule of law.*

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[7] The donors represented in EGG are US, UK, Japan, Germany, the Netherlands, Italy, France, Denmark, Sweden, Canada, European Commission, UNDP, IMF and the World Bank. Non-economic issues are discussed by a group of bilateral donors in the Democratic Development Group (DDG).

44. It will be critical for all donors to work together and consistently emphasize, in their dialogue with GOK, the importance of improving economic governance and reforming the public sector. The major donors are now in broad agreement with the Bank on the strategic direction to be taken in our coordinated approach. In particular, donor coordination is crucial in the following areas: *reduce investment projects that require GOK counterpart financing in the near term; provide technical assistance and policy advice for the economic governance reform; provide budget support, or support for sector-wide expenditure programs under appropriate conditions;* and *support GOK's participation/ consultations programs to build broad consensus on reform.*

45. **Collaboration with IMF.** The IMF and the Bank have worked closely over the last several years in highlighting governance issues. On several occasions of suspected corruption, misuse of public funds, and other irregularities, the two institutions have joined forces to press GOK for remedies. In addressing economic governance issues, the IMF and the Bank have stressed effective compliance with existing rules and enforcement of sanctions as the most appropriate corrective measure. The IMF also suspended the ESAF for Kenya in 1997 on account of governance related concerns. However, our efforts to seek enforcement of prescribed remedies for serious violation of proper procedures have had little success in restraining later violations. The IMF continues to place a great weight on sound regulations in public administration, and intends to introduce governance conditionality that will aim at enforcing existing rules, regulations, and financial procedures to fight corruption as part of a possible future ESAF-supported program. The Bank's strategy, by addressing reasons for non-enforcement of rules and regulations, would complement the IMF's approach.

46. **Collaboration with NGOs.** The NGOs in Kenya have primarily focused on empowering the vulnerable and marginalized groups, capacity building of communities, and assurance of their basic rights through their active participation and increased self-reliance. Increasingly aware of the systemic and institutional constraints, NGOs have expanded the scope of their activities to include more advocacy work. In light of the limited impact of their operations, a significant segment of them believe that the fundamental cause of poverty is poor governance. As a major governance-related issue that affects the poor disproportionately, NGOs have focused increasingly on corruption. They have stepped up the fight on corruption by research, information dissemination, advocating policy change, and monitoring corruption at all levels in Kenyan society. The NGO Council and some of its members have launched several initiatives such as "an alert on land grabbing" (Operation Firimbi) and an anti-corruption action network (Operation Futa Magendo).

47. A number of NGOs have also begun to pursue the political origins of Kenya's development problems by emphasizing efforts at improving political governance, including advocating constitutional reform. They see the Bank's new approach of focusing on *economic* governance as complementary to their own. NGO participation in formulating the broad public sector reform process and especially in monitoring service delivery and policy implementation would be critical. The Bank has been working closely with NGOs to explore ways to strengthen collaboration.

Government Response to the Current Crisis

48. The Economic Forum chaired by the President in May and the Budget Speech in June sum up GOK's own assessment of the nature and magnitude of the current economic crisis and its medium-term strategy for economic recovery. GOK has acknowledged that a sustainable fiscal adjustment and

improved public sector performance are critical for economic development and that this will require far-reaching structural and institutional reforms to improve economic governance.

49. The Budget speech set the following framework to the GOK strategy for public sector reform:

> *"It is now necessary to down-size the public sector in accordance with the changed roles and focus more on the core functions. ...To redress this situation the Government is undertaking four parallel but related programmes, namely: (i) a new Medium-Term Public Expenditure Framework; (ii) Phase II of the Civil Service Reform Programme along with a parallel rationalization of the Teachers Service; (iii) Privatization of commercial public enterprises and restructuring the utility sector; and (iv) the Kenya Local Government Reform Programme."*

50. From a purely fiscal perspective, the government recognizes the burden of high interest rates as the most immediate obstacle to reviving growth, since both the public and private sectors are severely constrained by it. The risks to the financial sector and to the economy as a whole from a continued high interest rate environment also underline the importance of this problem. GOK has proposed a fiscal adjustment strategy consistent with reducing the pressure for further government borrowing and reducing Government debt (see Box 2).

Box 2: The Government's Fiscal Targets

With the FY98/99 Budget, GOK announced its intention to undertake a medium-term fiscal adjustment program to reverse the unsustainable fiscal trends. The most pressing are the large and rapidly increasing domestic debt, which translates into large interest expenditures, and the even larger public sector wage bill. The Budget also tries to restore a healthier level of allocation of O&M. Specific targets are as follows.

- Reduce government expenditure from 30% of GDP to below 25%, while also curbing the revenue intake from 27% to about 24% of GDP.
- Achieve budget surpluses (including development grants). Together with receipts from privatization, this is intended to reduce the stock of domestic debt from 24% to 15% of GDP over the medium term.
- Increase the O&M budget by 50%.

Note: If the Government succeeds in balancing the budget, then an infusion of, for instance, $100 million from privatization proceeds and an IDA budget support operation could have a significant impact on the domestic debt situation. Although the total stock of $2.5 billion is large, retiring or refinancing $100 million of expensive bills (at about 25% interest) could directly save nearly $25 million in expenditures. More importantly, such a turnaround is likely to reduce domestic interest rates. A 5 percentage point reduction of the cost of domestic debt would mean an interest cost saving of about $120 million on the remaining stock, which could start a virtuous cycle of domestic debt reduction.

51. The Government has noted that improving the quality of public expenditure is central to its overall development strategy and that the ultimate objective of such a strategy is to improve public sector performance in general and service delivery in particular. The public sector restructuring will be initiated after a major **review of the core functions of government** and will be accomplished through **ministerial rationalization** and the second phase of the **Civil Service Reform Program** (extended to include the Teachers Service) which was recently approved by the Cabinet. The **Medium-Term Expenditure Framework** will guide these reforms while also undertaking major improvements in public expenditure management. Preparations for developing the first MTEF are already underway as all ministries and departments have received instructions to conduct Ministerial PERs. The concern for

improving service delivery is partly reflected in the decision to include **Local Government Reform** on the agenda since local authorities' role in service delivery is expected to grow in the future.

52. While it is still in an early stage of formulation, the GOK preference with regard to development assistance to support its strategy is fairly well defined. GOK would be most interested in the following forms of development assistance: *(a) financial assistance that would reinforce GOK's own efforts to reduce the stock of domestic debt; (b) financial and technical assistance that would enable GOK to implement the public sector restructuring, including the compensation arrangements for any necessary public sector retrenchment, (c) technical assistance to the design and implementation of the MTEF,* and *(d) assistance, as required, for institutional reforms and capacity building to improve accountability and transparency.*

53. At the Economic Forum in May, a halt to new projects was proposed in light of the excessive size of the existing project portfolio and the poor completion of projects. The Ministry of Finance has since indicated its reluctance to launch new projects until their priority has been well established through internal discussion. Since conventional development assistance is heavily oriented towards investment projects, donors, including the Bank, should assist GOK by restraining new project proposals until the mechanisms for restraint and prioritization within GOK have been strengthened, and the budgetary conditions allow new public investment to be undertaken with some assurance of effective completion and operation.

54. **MTEF as an Instrument to Guide Public Sector Reform.** GOK's decision to launch an MTEF is particularly appropriate since it represents perhaps the only effective instrument to guide the various aspects of reforms of the scope that are being proposed as well as achieve the required improvements in public expenditure management. The MTEF offers a way to begin to improve the link between policies, reforms, and the budget, and to provide a "bottom-line" orientation to reforms (see Box 3). The lack of such integration undermined the impact of the first phase of the Civil Service Reform and contributed to a policy framework that is unaffordable. An effective MTEF also offers a very useful analytical framework to understand and strengthen the institutional arrangements for making policy decisions, ensuring accountability, and improving public sector performance. If GOK is committed to improving the quality of its economic governance, an MTEF will be a powerful instrument to guide the reform effort.

Box 3: The Medium-Term Expenditure Framework

Despite the existence of an apparatus to introduce the necessary consistency checks (e.g., policy papers, development plans, public investment programs, and forward and annual budgets), policy making and planning in Kenya pays inadequate attention to resource constraints. Policies and projects are adopted despite unsustainable resource requirements. Budgetary authorities at the technocratic level are then forced to make sub-optimal and arbitrary decisions on priorities that should have been confronted transparently at a political level. The unstable and unpredictable budget allocations that result are disabling to public sector performance.

MTEF is not merely a multi-year expenditure plan, which Kenya already has in the form of the forward budget and PIP. MTEF aims at restoring the budget system's capacity to effectively link policy-making, planning and budgeting and to serve as a principal instrument of performance-oriented public sector management. Public expenditures flow from a set of public policies and requires particular institutional structures to implement them. Therefore, to make sustainable progress on public expenditure management, the change in budgetary allocations must be backed by reform of both public policies and public sector institutions. As such, an MTEF provides a hard budget constraint to motivate and guide reform.

Prospects for Success

55. GOK response to the crisis has initiated reforms in precisely the areas identified as the focus of the CAS. Donor consensus provides a strong basis for supporting these reform efforts. However, much will depend on Kenyan ownership in the design and implementation of the reform program. In turn, our own success will depend on an assistance program that builds Kenyan ownership.

V. THE BANK GROUP COUNTRY PROGRAM

56. Effecting the strategy described in Section V will require the Bank to rethink both the style and content of many aspects of its approach to development assistance to Kenya. Non-lending services, particularly those that facilitate greater participation and understanding of problems by civil society, are likely to be critical in the early stages of strategy implementation and will remain important through the whole CAS period. Given GOK's budgetary constraints, investment lending is likely to be very limited for the CAS period, while adjustment lending could be very supportive of GOK's reform strategy.

57. **Rationale of Potential Adjustment Support.** The fiscal and financial risks that confront Kenya are serious and pose a major obstacle to reviving growth and development. The large stock of high cost domestic debt has to be addressed urgently and is a priority in the GOK strategy. GOK has initiated a painful but necessary fiscal adjustment to reduce the stock of debt. Given the size of the domestic debt (US$2.5 billion equivalent), relying entirely on domestic effort will imply slower progress in debt reduction, and delay in the recovery of investment and growth.. While external financial assistance would clearly help speed up the adjustment process, it could not be justified unless GOK demonstrates strong commitment to fiscal adjustment as well as public sector reform. Necessary measures for the Bank to consider potential adjustment support in the base case include achievement of at least a balanced budget and aggressive implementation of the privatization program, proceeds from which could be used for domestic debt retirement. Such support from the Bank could reinforce the GOK effort to reduce domestic debt (by swapping high cost, short-term domestic debt for long-term concessional IDA debt) and contribute to setting in motion a virtuous cycle of reduced debt service payment, increased investment, and higher growth.

Scenarios for New Lending

58. **Low Case**. The Kenya program is now in the low case, due to slow disbursement of the current portfolio, cancellation of the second tranche of the SAC, and the diagnosis of poor economic governance (there was no new lending to Kenya in FY98).[8] Without a strong improvement in these conditions (see below), the Bank program will remain in the low case and will: (a) provide targeted support to vulnerable groups in Kenya, including the increased use of partnerships with NGOs to cost-effectively deliver assistance, (b) pilot specific projects with GOK to improve financial management and accountability in areas where GOK commitment is strong, and (c) build GOK support and commitment for improved economic governance through an intensive program of appropriate non-lending activities. The ESW program would focus on the monitoring of poverty and critical social indicators and expand the ongoing analysis of the social impact of public expenditure. In view of the financial sector's vulnerability, the Bank would assign the necessary priority to the already initiated policy advisory support to CBK. A three-year lending program of US$150 million is envisaged in this

[8] The El Niño Emergency Rehabilitation Project of US$40million was approved in July 1998.

low case, an amount lower than in the 1996 CAS on account of the increased recognition of economic governance constraints. No adjustment lending would be proposed in the low case.

59. **Base Case**. The CAS has noted important GOK reform initiatives which, if followed through, would pave the way for a base case lending program. The base case triggers will be based on an assessment of progress in three broad areas that correspond to the strategic focus of the CAS: (a) macroeconomic management, (b) economic governance reforms, and (c) portfolio performance. Specifically, the following conditions will trigger the base case (see Table 1).

Table 1: Triggers for Base Case

Key areas	*Triggers*
Macroeconomic management	• Satisfactory macroeconomic management as evidenced, for example, by compliance with an IMF arrangement
Economic governance reforms	• Progress on public sector restructuring: minimum requirements are ◊ Redefinition of core functions of government ◊ Privatization of KPTC • Improved public expenditure management through MTEF: minimum requirements are ◊ Balanced budget starting in FY98/99 (central government budget) ◊ Non-recurrence of unbudgeted expenditures (as noted in the 1997 PER) • Strengthening accountability institutions: minimum requirement is adoption of a comprehensive anti-corruption strategy (including coordination of various efforts by KACA, CBK, and KRA, and development of a prevention-focused strategy)
IDA Portfolio Performance	• Improved disbursement ratios of at least 20% per year for investment projects • Reduction in the proportion of problem projects (no more than 30% in FY99, 20% in FY00 and FY01)

60. Improvement from low to base case conditions is likely to be gradual at best, reflecting the fragility of the perceived political commitment to the reforms which exacerbates problems of weak capacity for implementation. Given this expectation, the lending program in the base case will be US$300-500 million for the three year period. If the base case were triggered, the volume of assistance in the first year would be around $100 million, but strong progress in implementation would justify increasing annual lending towards the higher end of range. Key indicators for such "strong performance" will include (i) timely implementation of the second phase of the Civil Service Reform Programme, including ministerial rationalization according to the redefined government functions, (ii) budgetary surpluses, and (iii) elimination of "pending bills."[9] This strategy therefore builds in a strong

[9] A "pending bill," or an unpaid bill of GOK, is in effect a form of deficit financing. Accumulation of large amounts of pending bills in recent years indicates the lack of effective expenditure control.

incentive for sustained effort that is critical to program success. The bulk of the lending support in the base case (over the low case) will be adjustment lending in support of major public sector and public expenditure reforms. This would be complemented by technical assistance for various institutional reforms that would improve accountability and financial management across government, including possible support for legal and judicial reforms (see Box 4). Investment lending would be relatively small and primarily poverty focused. Main interventions are planned for social and rural sectors (agricultural services, basic education, rural roads, basic health care, and water supply).

Box 4: Tackling Corruption in Kenya

Widespread corruption is a symptom of systemic decay of the public sector's institutional capacity and integrity. As such, tackling corruption would require a systemic approach to restore institutional integrity of the public sector. The Bank's fundamental strategy for addressing corruption is to support GOK's own efforts to improve public sector performance and integrity through a comprehensive reform of the role of government and strengthened institutional and individual accountability. To complement such a systemic approach, the Bank's support will also include the following specific elements.

Privatization: The opportunities to misuse public funds will be reduced by speeding up privatization, supported under the ongoing Parastatal Reform and Privatization Project.

Public service pay reform: Adequately remunerated civil servants are less likely to engage in corrupt practices. The aims of our support to the Civil Service Reform Program include raising public servants' real wages, while containing the overall public sector wage bill.

Transparency and accountability: Mechanisms for public accountability and transparency would include service delivery surveys, information disclosure on the use of public funds, and training of journalists and other watch-dog actors. Bank support for improving public accounting and auditing is also under discussion.

Public procurement: A recent IDF grant will help GOK in reforming public procurement laws and procedures.

Financial sector regulation: Recent analytical and advisory support to the Central Bank will be expanded, to help strengthen banking legislation and bank supervision.

The rule of law: The Government has established a Legal Sector Reform Coordinating Committee, composed of representatives of GOK, the Law Society of Kenya, the business community, CBK, NGOs, and the schools of law, to oversee legal and judicial reform activities. The Bank is discussing with GOK the possibility of financing the Committee's activities in implementing legal and judicial reforms.

Fraud in Bank-funded projects: In two recent cases where fraudulent practice in Bank-funded projects was uncovered, the Bank has asked for special audits. In one case, GOK has taken disciplinary action and begun criminal investigation. In the other case, conclusive findings have not been reached, and disbursements have been suspended. We will continue with our stance of zero tolerance for corruption in IDA-funded projects.

Managing the IDA Portfolio

61. **Dealing with the weakness of public resource management.** Given the tight budget, GOK has accepted the need to close weak projects as part of its own project rationalization. Seven of the twenty one investment projects, and one adjustment operation were closed by the end of FY98, canceling an undisbursed balance of about $160 million. Although three more projects will be closed by end-December 1998, GOK's FY98/99 budget still may not provide adequate funding for all IDA-supported projects. The past tendency for GOK allocations to fall short of the agreed amounts to implement IDA-funded projects necessitates caution. The Bank will urgently address this problem

with GOK and, if necessary, further restructure the existing portfolio according to GOK's priorities and budgetary capacity.

62. **Quality of projects.** To strengthen the ownership of projects and improve their implementation, we will encourage greater stakeholder participation. We will work with GOK to strengthen the mechanisms for effective stakeholder consultations in defining sector strategies, and for greater beneficiary participation in designing projects and monitoring their implementation.

Non-Lending Services

63. Non-lending services will concentrate on supporting GOK's efforts to improve economic governance. Specific areas of assistance include an institutional assessment to diagnose weaknesses within the public sector and explore reform options, facilitating the development of an MTEF, formulating a new PFP, and implementing the public sector reform programs; increasing efforts at information disclosure and partnerships; building capacity for better economic governance outside the executive branch of GOK, and participatory ESW to support sectoral reforms.

64. **Support for Public Sector Reform Program.** Development of an MTEF and parallel implementation of a broad reform program would require significant technical support. The Bank is already offering analytical and policy advice to support the on-going MPERs in key sectors as well as the execution of the medium-term strategy for Phase II of the Civil Service Reform Program. Further analytical work, such as an institutional assessment of the public sector, and a series of workshops on MTEF and public sector reforms for training and dissemination purposes would facilitate appropriate local adaptations of the reform processes. To monitor the quality of public sector performance, the Bank will assist in conducting service delivery surveys (SDSs) in key sectors, which, together with PERs, will be repeated annually so that domestic capacities to conduct these exercises can be built over time. The Government will likely expand the scope of the public sector reform program to include other elements, such as further privatization, and legal/judicial reforms. The Bank is prepared to provide advice on how to manage the combined reform process and offer analytical support to integrate various reform components. The Bank will also support the Government's effort to develop the next PFP through a consultative process, facilitating, if appropriate, effective consultations.

65. **External Communication and Capacity Building.** The central element of the CAS is to support GOK in its stated commitment to greater participation by Kenyans in the economic decision-making of their country. For this to happen, Kenyans must have more information and analytical tools. Although much of the information has to come from GOK, the Bank and other donors can play an important role in sharing information relevant for better problem understanding. Consistent with its information disclosure policy, the Bank will work closely with GOK to disclose more information as a matter of routine and disseminate more actively its analysis of economic issues in Kenya. This will give various stakeholder groups information that will help them engage GOK in deeper dialogue, and contribute to stronger national ownership of reform agenda.

66. There may also be need for targeted technical support for capacity building outside the GOK bureaucracy. For example, parliamentarians have reiterated their desire to build up the Parliament's information and analytical capacities so that they can participate more effectively in economic management and play more active roles in fighting corruption. There is scope for strengthening such capacity in the short run by establishing partnerships with private research institutes and think tanks. The Bank could play a useful role in facilitating such partnership arrangements.

67. **Economic and Sector Work.** The Bank anticipates several ESW activities to support GOK. The financial sector ESW will update our understanding and policy advisory capacity to manage the sector. An informal ESW with the Central Bureau of Statistics is intended to provide quarterly GNP estimates. Support for the analysis of the welfare surveys will be continued to improve the timely monitoring of poverty levels, and as input to the planned Poverty Assessment update. The ongoing PERs will include an expanded focus on the social impact of public expenditures. As far as possible, ESW will be carried out in a participatory fashion to learn more from the views and knowledge of the Kenyans as well as strengthen their own capacity. We also plan to develop in a participatory manner a water sector strategy. The Banks is ready to support GOK with participatory analytical work relevant for developing an anti-corruption program and a judicial reform program. The Bank will also explore alternative methods of delivering development assistance at the local level in collaboration with other development partners.

IFC and MIGA Strategy

68. IFC and MIGA support the CAS focus on improved economic governance as essential for long-term private sector development in Kenya. Both have an important role in supporting GOK in the program of privatization and investment promotion. The private sector's role in infrastructure development (power, telecom, etc.) and management is particularly critical and will benefit from strong IFC and MIGA involvement. As set out in Attachment 6, IFC's programs will focus on expanding the private sector through investment and advisory activities in three important areas: privatization of parastatals in public utilities, agro-business, and public financial institutions; development of capital markets, and growth of small and medium-sized enterprises. The Bank and IFC, through regular dialogue and coordination in Nairobi, have complemented each other in furthering regulatory reforms and/or privatization, particularly in infrastructure and energy sectors.

69. Kenya has been an active beneficiary of MIGA's technical assistance activities. These services include support for regional mining investment promotion activities and capacity-building activities for public and private sector organizations involved in investment promotion. MIGA has recently issued one guarantee contract for a project in the services industry, and is considering further support in the electricity, oil and gas, and manufacturing sectors.

VI. COUNTRY PROGRAM ISSUES

Creditworthiness

70. Kenya's external debt levels are high by African standards, with an estimated debt service ratio of 21.5%, debt to exports of goods and services of 217%, and debt to GDP of 67.7%. However, more than 60% of Kenya's debt is concessional, IDA credits alone accounting for about 32% of Kenya's debt.[10] Of the US$96.1 million in Kenya's debt service payments to the Bank in FY98, 77% went to IBRD and 23% to IDA. Debt service payments due to IBRD are projected to diminish rapidly over the next few years. By 2001, of the estimated US$79.8 million in debt service payments to the Bank, only 38% will accrue to IBRD and the remaining 62% to IDA. Kenya was unable to access about US$42 million IDA reflows when the second tranche of the SAC, to which they were attached, was canceled.

[10] Furthermore, earlier this year Kenya reached an agreement with commercial banks to reschedule US$ 70 million over ten years with a three year grace period.

71. An important element of risk is added by Kenya's domestic government debt. Although two-thirds of Kenya's overall debt is foreign, two thirds of all interest payments are on domestic debt which claimed about 20% of recurrent Government expenditures in FY97/98. Reduction of concessional aid to Kenya has forced GOK to rely heavily on expensive domestic borrowing, which has exacerbated the public expenditure crisis. Most of the domestic debt is in the form of high-cost 3-month treasury bills, which has contributed to volatility in short-term capital inflows.

Risks and Remedies

72. **Financial Sector Risk.** The current economic stagnation poses the risk of further drastic decline in economic well-being. Given the vulnerable state of the banking sector, continued economic stagnation could result in a financial sector crisis which would substantially set back Kenya's development prospects. This further underlines the importance and urgency of reviving economic growth. The Bank is providing advisory assistance to CBK to strengthen regulatory and provisioning arrangements to minimize the impact of a financial sector crisis.

73. **Risks to the Strategy.** While we believe that this strategy is the most appropriate response to the central development challenge in Kenya today, we recognize that the process of improving economic governance will be a long-term process under the best of circumstances. The risk that this strategy does not yield quick results is very high. In such a case, Kenya may well face prolonged economic stagnation, or even deterioration. There are four major risks to the strategy.

- *Political Commitment.* A strategy that targets poor economic governance is likely to be resisted by vested interests in the political system. Further, the uncertainty over the presidential succession may make it difficult for GOK to forge an internal consensus for meaningful reform to improve economic governance. Thus the probability of the reform effort stalling must be considered very high.

- *Implementation Capacity.* The technical and managerial requirements of the proposed reforms are very high. The demonstrated capacity of GOK to manage such reforms is weak and constitutes a significant risk to implementation. Both the failure to identify and assign competent personnel to manage the reforms as well as the wavering political support have led to the ineffective utilization of available skills and capacity. This risk would be manifested in weak implementation. There is no easy way to overcome this risk. However, getting underway serious efforts to reform the public sector in a participatory manner may be the best way to strengthen the capacity to implement reform.

- *Donor Cohesion.* For the proposed strategy to be effective, it is critical that donors work together. Instruments of reform such as the MTEF and the PFP can be undermined by lack of cooperative donor behavior. It is unavoidable that donor relations with GOK will be influenced by bilateral political considerations, which at times may not be consistent with Kenya's long-term development needs. The best insurance against this risk is continuous donor dialogue.

- *Managing a Participatory Process.* The Government has indicated its willingness to "consult widely with all stakeholders" in designing its economic program. Nevertheless, it will be a challenge to define and manage a consultative process and the expectations of various stakeholders. While most donors are supportive of the Government's openness to dialogue, expectations are not uniform. Thus there is also a risk that different standards of participation and different operational needs could lead to difficulties in donor coordination.

74. Perhaps the most serious are the political and implementation risks. These factors could delay the necessary reforms. However, the strategy tries to ensure that broad participation and national ownership of the required reforms will provide the basis for strong implementation and lay the foundation for better economic governance in the long run. Regardless of the prospects of quick progress, which will depend on many factors that the Bank cannot control, this strategy will be strengthening the essential building blocks of good economic governance. Indeed, openness, participation, and transparency may be the best response to mitigate all the difficulties and risks indicated above.

James D. Wolfensohn
President

by Sven Sandström
Managing Director

Washington, D.C.
September 2, 1998

POOR GOVERNANCE AND CORRUPTION IN KENYA

Dimensions of Poor Governance

1. The World Bank defines "governance" as "the manner in which power is exercised in the management of a country's economic and social resources for development." This definition covers the followin three specific aspects of governance: (a) the form of political regime; (b) the process by which authority is exercised in the management of a country's economic and social resources, and (c) the capacity of governments to design, formulate and implement policies and discharge functions. As the first aspect related to the form of political regime is clearly outside the Bank's mandate, the Bank's work on governance has focused on the latter two aspects.[1]

2. Following this conceptualization, the quality of governance in Kenya is poor both in terms of the prevailing governing styles and the institutional capacity of the government bureaucracy. Many Kenyans see the Government as non-responsive to their needs, and lacking in accountability for its own actions. Economic governance in Kenya also suffers from the inefficiency and ineffectiveness of the public sector institutions in carrying out their functions. Here we highlight three dimensions of poor governance that are particularly pertinent to the effectiveness of efforts by both the Government and donors to promote development.

3. **Decline in Institutional Integrity and Capacity**. A fundamental cause of the weakened institutional capacity is the politicization of public sector management. Political interference and patronage appointments have systematically reduced the public sector's institutional autonomy and integrity over the years. Informal, non-transparent systems for public sector management have increasingly come to dominate established procedures. This has greatly undermined both accountability and existing technocratic capacities in the public service. Faced with a politicized environment, coordination and technical consultation across bureaucratic boundaries have become difficult. The steady decline in civil servants' real wages has also encouraged the proliferation of "adaptive behaviors" manifested in the abuse of discretionary authority over budgets, ranging from diversion of O&M budgets to outright embezzlement.

4. **Arbitrary Actions**. The lack of effective mechanisms for formulating policies that are linked to budgetary constraints and weak enforcement of the rule of law contribute to a high degree of arbitrariness in government actions. The decision to increase teacher salaries late in 1997 and the recurrent phenomenon of large unbudgeted expenditures exemplify the ad hoc aspect of decision making on policies without adequate appreciation of the impact on the Government budget. As an indicator of the financial impact of arbitrary government decisions, the Controller and Auditor General's Reports have revealed unauthorized expenditures during both FY94/95 and FY95/96 of about Ksh. 15 billion.[2] Cases of inconsistent and murky applications of regulatory rules to private businesses are another example of arbitrary actions by the public sector. The lack of effective checks and balances against such actions leads to unpredictability in the governance environment, which constrains long-term planning not only by private economic actors but also by the public sector.

5. **Conflicts of Interest**. In 1970, the Ndegwa Commission recommended formally recognizing and allowing the informal practice by a large number of civil servants to hold private business interests. To

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[1] *Governance: The World Bank's Experience* 1994.

[2] The term used in the Report to refer to "unbudgeted expenditures" is "excess expenditure incurred without the authority of Parliament."

avoid obvious conflicts of interest, the Commission also recommended that all civil servants be required to declare their private interests. The recommendations were only partially adopted and while the legitimization of private interest of public servants was accepted, the transparency of declaring income sources was not. This decision has had unfortunate consequences of perpetuating the lack of transparency in important Government decision making, such as awarding contracts for government procurement.

Corruption in Kenya

6. Although "poor governance" encompasses more than just corruption, abuse of public office for private gains is a serious problem in Kenya. Corruption in Kenya, as in many other countries, occurs at varying levels ranging from "grand" corruption, to deliberate misuse of public resources by bureaucrats, to the petty daily occurrence that affects ordinary people in routine transactions. As a striking indication of the magnitude of financial irregularities within the public sector, the 1998 Controller and Auditor General's Report revealed "excess expenditure incurred without the authority of Parliament" during FY95/96 reaching Ksh. 3.5 billion, or 12.6% of the initial development budget.

7. **Grand Corruption:** In 1991-93, with the active connivance of Central Bank and Customs Department staff, a private businessman is alleged to have fraudulently obtained US$ 400 million (about 6.5% of GDP) through a special export compensation scheme against exports of gold and diamonds and through the sale of foreign exchange to the Central Bank. In addition to resulting in a large loss of public funds, this fraud created a surge in money supply that led to high inflation. The sterilization measures to contain it are still reflected in the high domestic debt and the current fiscal crisis. After considerable external pressure, GOK eventually took those involved in the "Goldenberg" case to court, where the case still lies. Unsatisfactory handling of this case by GOK was one of the reasons that led to the lapse of the ESAF arrangement in 1997.

8. **Petty Corruption:** Many Kenyans experience corruption in their daily lives. Citizens complain of police officers who stop the traffic to demand TKK (toa kitu kidogo - "give something small" in Swahili), or of "lost files" in the court system or in trying to obtain passports, motor vehicle registration, driver's licenses, etc. Numerous incidences of financial mismanagement documented annually in the Controller and Auditor General's Reports (e.g., irregularities related to public procurement, questionable sales of public land and assets, and misuse of public funds) imply corrupt behavior within the public bureaucracy, which is not vigorously corrected by GOK. Corruption of this type not only affects the quality of life in Kenya and erodes the institutional capacity of the government bureaucracy but also creates uncertain business environment and discourages private investment.

9. **GOK's Anti-Corruption Efforts:** Recently the President and other senior GOK officials have begun to talk openly about the need to fight corruption. Although GOK established the Kenya Anti-Corruption Authority (KACA) in December 1997, its director has recently been suspended on account of alleged incompetence. There are also anti-fraud units within the Central Bank and the Kenya Revenue Authority. To tighten financial control within ministries, the Ministry of Finance recently proposed assigning a financial controller to each ministry. Despite these individual efforts, the GOK has yet to develop a comprehensive anti-corruption program.

POVERTY IN KENYA

1995 Poverty Assessment Report

1. The Bank conducted its last comprehensive review of poverty issues in 1995 (Kenya Poverty Assessment Report). This report showed that from the early 1980s to 1992, the rural population living in poverty remained high, at about 47%. The ratio of the urban population in poverty was around 30% in 1992. In the early 1980s, Kenya had distinctly more favorable social indicators (life expectancy, infant mortality, primary education, etc.) than most countries in Africa. On some indicators, progress has continued in recent years. However, there have been some disturbing reversals, especially in the 1990s (e.g., worsening child malnutrition trend).

2. The 1995 Poverty Report identified the lack of sustained economic growth as the primary cause of continued income poverty in Kenya. The Report noted that Government policies failed to create an environment conducive to vigorous private sector activity. When the labor force is growing at well above 3% per annum, it is imperative that robust labor-absorbing growth take place. Compounding the plight of the impoverished is the poor performance of the public sector in delivering well-targeted services to the disadvantaged. Public services, from education, health, and food security to basic infrastructure (especially rural infrastructure), are distributed in such a way that the poor benefit disproportionately little. Nomadic pastoralists, who live largely on arid lands, are among those who receive least public sector services and remain very poor. However, a large segment of the rural poor also does not enjoy the critical level of basic public services that enables them to take advantage of economic opportunities that may exist.

3. The Report confirmed the appropriateness of the "three-pronged" strategy that consists of labor-absorbing, private-sector led growth; investment in human capital; and targeted intervention for the disadvantaged. In view of the continuing population pressure, strong emphasis was placed on increasing and sustaining higher growth rates (6% or higher). These recommendations formed the basis of the 1996 CAS.

More Recent Analysis

4. Two recent reports based on the Monitoring Survey of 1994 provide a review of Kenya's poverty situation since the last Poverty Assessment Report.[1] The head-count rural poverty index was estimated at 47%, and urban poverty 29%. Though the 1994 indices are about the same as those of 1982 and 1992, they are not comparable because the poverty line has not been adjusted for inflation. Underlying poverty has been increasing. Over 75% of respondents in a participatory poverty assessment conducted in seven districts in 1996 said that poverty had been worsening in the preceding 5 years. The absolute poor reached a record 11.5 million, and the hard-core poor - those unable to meet minimum daily calorie needs - were estimated at 6.8 million in 1994 (see Table A1). Based on the 1994 index, the number of the absolute poor is projected to have exceeded 13 million by 1997,

Table A1: Kenya Poverty: 1994

	Rural	Urban
Headcount (%)	47	29
Absolute (Mil)	10.3	1.2
Hardcore (Mil)	6.8	0.43

[1] Germano Mwabu (World Bank Consultant) & John Kirimi (Kenya Central Bureau of Statistics) *Social Sector Expenditures in Kenya : Effects on Poverty.* June 1998. Government of Kenya. Central Bureau of Statistics. *Poverty in Kenya.* (June 1997).

out of a total population of approximately 29 million. Income inequality has also increased, with the Gini coefficient rising from 0.40 in the early 1980s to 0.54.

5. Despite a declining population growth trend, the impact of economic stagnation on living conditions has been exacerbated by declining access to basic services. The limited safety net programs, which focus on disaster relief, the arid areas, labor-based construction and selected rural-based social services, account for only 7.5% of the budget in 1996/97, and are not likely to expand given the tight fiscal situation. While expenditures on education have risen, primary school enrollments have been falling - for example, from 95% in the 1980s to 77 % currently - test scores are stagnating, and imbalances persist in terms of (i) an excessive teachers' wage bill and (ii) lower enrollment of girls in secondary schools and the university system.

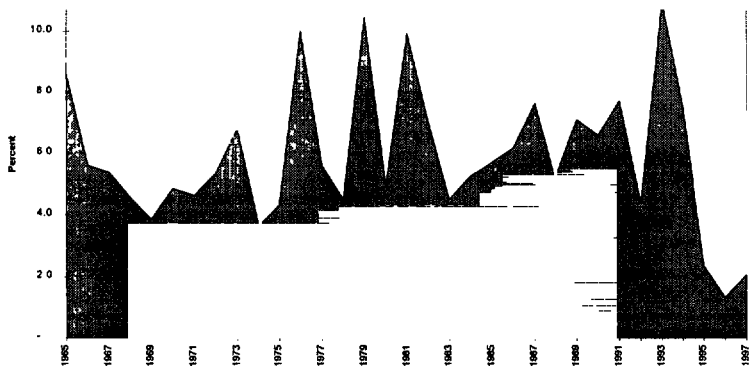
6. As in other African countries, literacy interacts positively with health services in reducing poverty. Prevalence of malaria and measles, and lack of access to sanitation and safe water correlate positively with poverty. Yet, Government expenditure support for health has declined by a half in real per capita terms in recent years, while progress is slow in targeting resources on preventive and primary health care that would improve public health. In addition, access to safe water has been limited by controls and low water rates resulting in an inability to maintain reliable quality and delivery. The main thrust of proposals for reform is to stress maintenance, decentralize the management of services, and enlist local level and user support to improve services.

PUBLIC EXPENDITURE MANAGEMENT

Symptoms of Dysfunctional Public Expenditure Management

1. The Kenyan budgetary system displays a number of weaknesses that compromise budgetary outcomes. Recurrent fiscal instability over the long term (Figure 3-1) is one indicator of the inadequate performance. IMF-monitored programs have not succeeded in containing deficits on a sustainable basis. Neither has annual deficit containment paid enough attention to protecting funding for priority activities. Even the commendable deficit reduction over 1994-96, which was largely achieved through revenue enhancement, did not protect high priority expenditures.

Figure 3-1: Chronic Fiscal Instability, 1965-1997
(Deficit as percentage of GDP)



2. The distorted allocation of the Kenyan budget among wages, interest, capital and operations and maintenance (O&M) also indicates the public expenditure crisis. The strikingly high share of interest payments in the Kenyan budget reflects the impact of a large stock of domestic debt (24% of GDP) as well as the prevailing high nominal interest rates (currently about 25%). The sharp increase in domestic debt occurred in 1993 when GOK issued short-term debt to absorb the excessive liquidity injected into the system following the financial scandal involving CBK and the now defunct Exchange Bank (see Attachment 1). The subsequent growth of that stock resulted from continued domestic borrowing to finance the deficit and to cover negative net foreign financing. Nominal interest rates, which had declined to about 18% in July 1997, escalated to 28% following the lapse of the ESAF in July 1997. This "domestic debt crisis" and the growing share of wages in the budget following pre-election salary concessions by the Government are important elements of the current fiscal crisis in Kenya.

3. In the absence of a well defined expenditure program linked to policy priorities, expenditure adjustments provoked by pressures such as growing interest payments or unbudgeted expenditures have typically been borne by repeated cuts to the O&M and development expenditures. As a result, Kenya in 1996 spent a mere 25% of its budget on O&M, down from 46% in 1980. Both figures appear grossly inadequate when contrasted with the 60-65% spent by high-performing countries such as South Korea and Chile on O&M (Tables 3-1).

Table 3-1: Cross-Country Comparison of Budget Allocations (% of total expenditure)

	Kenya		Chile		S. Korea		Ghana	
	1980	*1996*	1980	*1996*	1980	*1996*	1980	*1996*
Wages	25	***30***	21	***19***	13	***13***	25	***24***
Interest	7	***24***	3	***3***	5	***3***	2	***2***
O&M	46	***25***	67	***61***	71	***61***	46	***59***
Capital	22	***21***	9	***17***	11	***23***	27	***15***
Total	100	***100***	100	***100***	100	***100***	100	***100***
	1980-90	**1991-95**	1980-90	**1991-95**	1980-90	**1991-95**	1980-90	**1991-95**
Growth*	4.2	**1.4**	4.1	**7.3**	9.4	**7.2**	3.0	**4.3**

* The annual average rate of GDP growth.
Source: Government Finance Statistics, IMF, and World Development Reports.

4. Another illustration of budgetary inefficiency is the slow completion of development projects. The PER estimated that, on average, only 3% of the ongoing portfolio is completed in a given year, relative to a target of 25%. This is due to the absence of a priority setting mechanism to restrain line ministries and individual donor agencies from starting new projects. In FY97/98, the public investment program (PIP) included 1,226 projects of which 25% were donor financed projects accounting for 75% of the development budget. Donors have, in effect, compounded the weaknesses of the public expenditure management system by collectively encouraging the overexpansion of the project portfolio beyond sustainable levels, and by financing recurrent costs in the development budget. The over-commitment of projects contributes to inadequate local financing, budgetary under-allocations, slow implementation and cost over-runs, and ultimately, the rapid deterioration in public services now being witnessed in Kenya. Corruption is another cause of weak project implementation. Despite the large wage component in the GOK budget, real wages of public sector employees have steadily declined over many years, by about two-thirds between 1970 and 1994. As a result, the financial discipline has weakened in the public sector, which is partly manifested in abuse of discretionary authority over budgetary resources including project funds (see Attachment 1 for a discussion on corruption in Kenya).

5. Other problems of budget implementation as identified in the 1997 PER include: *recurrence of unbudgeted expenditures; informal fiscal management reflected in the increase of pending bills, excess issues and cheque floats*; and *discrepancies between Treasury Expenditure Ceilings and Exchequer Issues*. These are all symptoms of the system's inability to impose aggregate fiscal discipline while allocating budgetary resources to strategic priorities, and to ensure tight expenditure control.

Institutional Reform of the Public Expenditure Management System

6. Without correcting these failures, it is difficult to conceive of development assistance that achieves sustainable development in Kenya. In this sense, the proposed medium-term expenditure framework (MTEF) must be accompanied by a corresponding improvement in the public expenditure management system. First, better linkage between policy-making, planning and budgeting must be established in order to assure allocation of scarce budgetary resources to priority areas without compromising the aggregate fiscal discipline. This would mean that budgetary implications of all policy commitments must be considered before a decision is made and that reconciliation among competing priorities must be made in a transparent and systematic manner by an appropriate government organ, such as the cabinet. Second, greater predictability in resource availability must be ensured in order to allow line agencies to plan and execute their expenditure programs efficiently and effectively. This would require a better macroeconomic and revenue forecasting capacity as well as a discipline to restrain unbudgeted expenditures and other mid-year shifts in expenditure allocations, which would have to be financed either by increasing the deficit or by reducing allocations to other ministries. Finally, tighter financial management procedures and capacity must be built in order to achieve clear accountability for use of public financial resources, and ultimately to improve public services to citizens.

CAS CONSULTATION PROCESS

1. As an integral part of the CAS preparation process, the Bank has consulted extensively with the following stakeholder groups, with full endorsement of GOK.

- Kenya Association of Manufacturers
- Federation of Kenyan Employers
- Central Organization of Trade Unions
- NGOs
- Journalists and academics
- Donors
- Community groups in the Kiambu District, Central Province
- Community groups, NGO representatives, and church leaders in Kisumu
- Mid-level civil servants of GOK
- The Bank's local staff

2. **Preparatory Meetings (April 1997).** The CAS team met with donor and NGO representatives to discuss the process of consultations.

3. **First Round (July-August 1997).** The CAS team started with a series of separate meetings with Kenyan stakeholder groups. In these sessions, the Bank team made a brief presentation outlining the Bank's approach to poverty reduction, which guided the previous CAS. The stakeholders offered their views on the effectiveness of the Bank assistance, and primary challenges to development in Kenya. After the first round of consultations, we shared with each group a summary note of the stakeholder views.

4. **Second Round (December 1997).** The CAS team met with the same stakeholder groups to present the broad outline of our evolving thinking on the new strategy. The objectives of the second-round consultations were to assure the stakeholders that their views had been taken into account in our strategy formulation, and to seek their further input in refining the strategy. After separate meetings, we held a one-day plenary session to bring stakeholder groups together. At this meeting, representatives of stakeholder groups firmly endorsed the broad direction of our strategy, and expressed strong interests in continued consultations through the rest of the CAS process.

5. **Third Round (August 1998 -).** A third round of stakeholder consultations is planned, to explain the content of the new CAS.

6. Besides these consultations, we have kept the donors and the NGO community well informed of the CAS process. Since the formation of the donors' Economic Governance Group in October 1997, the Bank team has presented to the Group its evolving strategic thinking on several occasions. We have also made efforts to maintain close contacts with the NGO community on CAS-related matters.

1997 CLIENT FEEDBACK SURVEY

1. The first Client Feedback Survey for Kenya was conducted during November - December 1997. It consisted of quantitative assessments from 131 respondents (of which 63% were "clients" and the rest Bank staff) and qualitative feedback from 26 individuals interviewed (14 were officials of the Government or related entities, 5 represented the business community, 3 donors, and 4 other groups, such as NGOs, the press, and churches). Although the focus of the survey was on the Bank-client relationship, and the interviewees heavily skewed toward the Government, some of the key messages are consistent with what we heard in the CAS consultations, which covered a broader cross section of Kenyans. The clients acknowledged technical competence of Bank staff. But, they were generally quite critical of the results on the ground.

A. The areas in which the Bank is perceived as being ineffective include:

	Percentage Responding as		
	Favorable	**Unfavorable**	**Neutral**
1. The overall impact of the Bank' assistance on development was seen to be weak	**47**	**21**	**32**
2. The Bank's assistance had little impact on improving the status of the poor	**13**	**45**	**42**
3. The Bank spends too much time between project identification and loan approval	**24**	**51**	**25**
4. Bank policies and practices are not easy to understand and implement	**25**	**52**	**23**
5. Bank projects take too long to complete	**25**	**52**	**22**

B. The areas in which the Bank is perceived as being effective include:

	Percentage Responding as		
	Favorable	**Unfavorable**	**Neutral**
1. Doing quality work	**74**	**2**	**24**
2. Bringing useful intellectual and technical knowledge	**88**	**5**	**7**
3. The Bank is accessible to clients	**81**	**8**	**11**
4. The Bank has become much more participatory in its approach to development	**59**	**18**	**25**
5. The Bank undertakes good economic and sector work	**84**	**1**	**15**

2. Thus the survey paints a picture of the Bank as being poor in activity relating to poverty reduction, and timely project implementation. The survey commends the Bank staff as being intellectuals with good technical knowledge. It also shows that the Bank's approach to participation could be improved further. The challenge is, therefore, to get the Bank to design a sound strategy that will see projects implemented on time and assist the country to formulate and implement policies that will create rapid employment

THE ROLE OF IFC AND ITS STRATEGY

1. IFC will reinforce the Bank's efforts to improve economic governance by helping in the privatization process, as well as support the development of a strong private sector. Specifically, IFC's activities will focus on the following three main areas: privatization of selected parastatal enterprises, development of capital markets, and support for small and medium-sized enterprises.

2. **Advancing privatization efforts.** Further to assisting with the privatization of Kenya Airways, IFC will help to advance privatization of other Kenyan public enterprises. However, IFC's efforts to continue this strategy could be severely hampered by the government's delays in its institutional reforms and lack of transparency in the privatization program. The privatization of Kenya Airways was hoped to be a beacon to accelerate the process of privatization in the country, but this has not happened. IFC sees transparency in the privatization process as the key to its continued financing and technical support in this area.

3. Opportunities exist for the private-sector infrastructure projects and agro-businesses, and IFC is involved in the following areas: (i) IFC is working with Wartsila of Finland on the 75MW diesel engine power plant known as Kipevu II in Mombasa; (ii) the Kenya Power and Lighting Company is due to be privatized and may lead to further activity for IFC in the medium term; (iii)IFC is lending support to the establishment of a bulk terminal by investing US$10 million in Grain Bulk Handlers Ltd, to help the company build the first modern bulk handling and storage facility for unloading grain and fertilizer at the port of Mombasa; (iv) with the recent passage of the Communications Bill, allowing for the privatization of Kenya Post & Telecommunications Corporation (KPTC), IFC has been approached to provide financing of up to US$20 million and technical support; (v) opportunities in agro-processing include sugar and tea factories, and cotton ginneries, most of which are suitable for financing by the Africa Enterprise Fund (AEF).

4. **Developing capital markets.** IFC's strategy in developing Kenyan's capital market and financial sector is built on three main themes: (i) supporting development of specialized non-bank financial institutions through selective investments; (ii) strengthening the financial sector's capacity to support small and medium-sized enterprises (SMEs) through credit lines; and (iii) providing highly specialized technical assistance to financial institutions. In aiding institutional building in Kenya, IFC successfully concluded the first joint venture with American International Group last year to set up the first full-fledged asset management company in Africa. IFC is also working to establish: (i) a credit rating agency with a leading international rating agency; (ii) a central depository system company for the Nairobi Stock Exchange, in partnership with leading local and international financial institutions; and (iii) a leasing company.

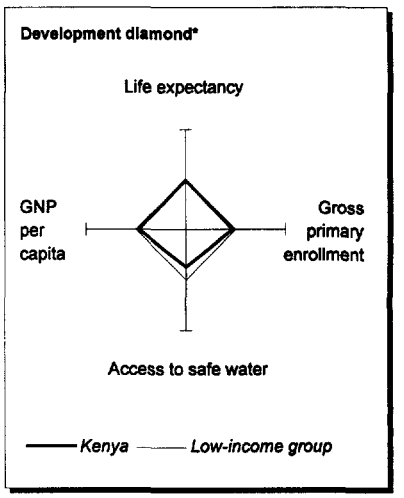
5. **Assisting small and medium-sized businesses.** Support for SMEs is an important component of IFC's strategy in Kenya. This sector will continue to be a driving force as well as the source of significant employment growth in Kenya. IFC has set up three key facilities to help provide financing, advisory services and technical assistance to Kenyan entrepreneurs and small businesses. First, the Africa Enterprise Fund (AEF), which provides financing from US$100,000 up to US$1.5 million to small and medium-sized projects, has been mostly active in supporting horticulture and vegetable processing, tourism, wildlife and school projects. Second, the Africa Project Development Facility (APDF) assists small entrepreneurs to develop business plans, design and implement management information systems, and to locate local or foreign financial and technical partners. Finally, the African Management Services Company (AMSCO) helps to manage and train local managers and staff to become more internationally

competitive. As part of its efforts to increase credit lines available to SMEs, IFC has recently signed a loan agreement of US$10 million with the Development Bank of Kenya (DBK) to finance export-oriented SMEs. The loan will help DBK pursue opportunities to finance new and expansion projects in tourism, agriculture, and manufacturing, which will help develop the private sector's export capacity. In particular, manufacturing for domestic and regional markets present the most likely opportunities for IFC's mainstream business.

Kenya at a glance

8/25/98

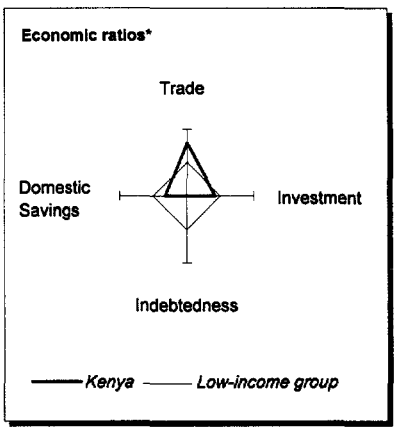
POVERTY and SOCIAL	Kenya	Sub-Saharan Africa	Low-income
1997			
Population, mid-year *(millions)*	28.0	614	2,048
GNP per capita *(Atlas method, US$)*	330	500	350
GNP *(Atlas method, US$ billions)*	9.3	309	722
Average annual growth, 1991-97			
Population *(%)*	2.6	2.7	2.1
Labor force *(%)*	2.7	2.6	2.3
Most recent estimate (latest year available, 1991-97)			
Poverty *(% of population below national poverty line)*	42	..	..
Urban population *(% of total population)*	30	32	28
Life expectancy at birth *(years)*	58	52	59
Infant mortality *(per 1,000 live births)*	56	90	78
Child malnutrition *(% of children under 5)*	23	..	61
Access to safe water *(% of population)*	53	44	71
Illiteracy *(% of population age 15+)*	22	43	47
Gross primary enrollment *(% of school-age population)*	85	75	91
Male	85	82	100
Female	85	67	81



KEY ECONOMIC RATIOS and LONG-TERM TRENDS

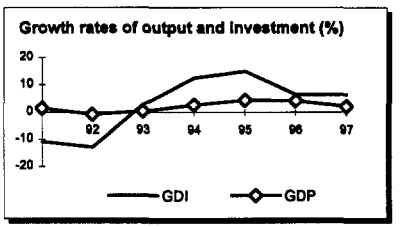
	1976	1986	1996	1997
GDP *(US$ billions)*	3.5	7.2	9.2	10.2
Gross domestic investment/GDP	20.2	21.8	20.4	19.1
Exports of goods and services/GDP	32.5	25.8	32.9	29.2
Gross domestic savings/GDP	20.9	21.9	16.3	11.4
Gross national savings/GDP	15.7	19.2	18.2	14.5
Current account balance/GDP	-3.6	-6.6	-2.4	-3.3
Interest payments/GDP	1.5	2.6	2.6	1.8
Total debt/GDP	43.0	63.4	74.6	67.7
Total debt service/exports	14.8	36.1	28.0	23.5
Present value of debt/GDP	0.0	0.0	..	..
Present value of debt/exports	0.0	0.0	..	..

	1976-86	1987-97	1996	1997	1998-02
(average annual growth)					
GDP	4.3	2.5	4.1	2.1	4.2
GNP per capita	0.6	-0.2	2.8	0.4	1.7
Exports of goods and services	1.0	5.0	-0.4	-12.0	6.0

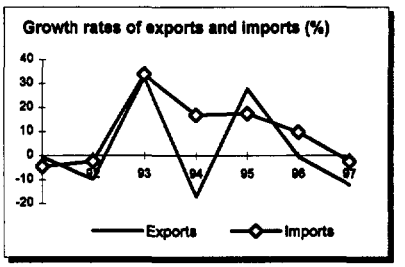


STRUCTURE of the ECONOMY

	1976	1986	1996	1997
(% of GDP)				
Agriculture	37.9	33.0	29.5	28.8
Industry	18.6	18.6	16.1	15.5
Manufacturing	11.3	11.9	10.2	10.1
Services	43.5	48.4	54.5	55.6
Private consumption	61.6	59.7	68.2	71.7
General government consumption	17.5	18.3	15.5	16.9
Imports of goods and services	31.8	25.6	37.0	37.0



	1976-86	1987-97	1996	1997
(average annual growth)				
Agriculture	3.4	1.2	4.5	1.3
Industry	4.2	2.6	3.4	1.9
Manufacturing	5.6	3.3	3.7	1.9
Services	5.7	3.9	5.2	3.0
Private consumption	2.7	3.2	10.2	-3.9
General government consumption	3.1	9.5	2.7	22.8
Gross domestic investment	-0.3	1.2	6.4	6.4
Imports of goods and services	-4.5	9.4	9.8	-2.4
Gross national product	4.5	2.5	5.4	2.9



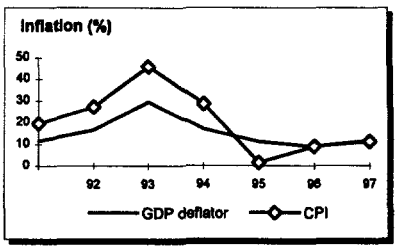
Note: 1997 data are preliminary estimates.

* The diamonds show four key indicators in the country (in bold) compared with its income-group average. If data are missing, the diamond will be incomplete.

Kenya

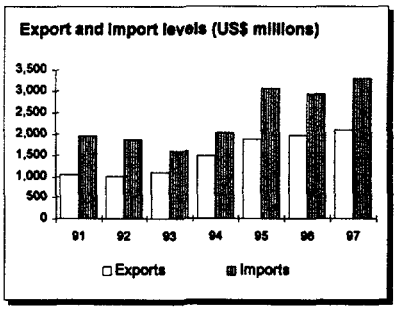
PRICES and GOVERNMENT FINANCE

	1976	1986	1996	1997
Domestic prices				
(% change)				
Consumer prices	..	6.8	9.0	11.2
Implicit GDP deflator	18.9	8.8	8.9	11.6
Government finance				
(% of GDP, includes current grants)				
Current revenue	..	23.2	28.8	27.8
Current budget balance	..	-0.7	3.9	3.2
Overall surplus/deficit	..	-6.3	-1.5	-2.0



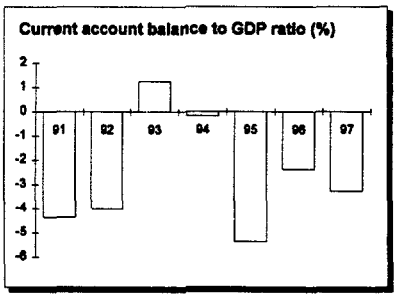
TRADE

	1976	1986	1996	1997
(US$ millions)				
Total exports (fob)	..	1,168	1,969	2,100
Fuel	..	92	124	131
Coffee	..	479	287	300
Manufactures	..	120	211	210
Total imports (cif)	..	1,704	2,928	3,294
Food	..	118	227	252
Fuel and energy	..	300	448	515
Capital goods	..	433	961	1,069
Export price index *(1995=100)*	..	80	97	110
Import price index *(1995=100)*	..	107	98	97
Terms of trade *(1995=100)*	..	75	99	114



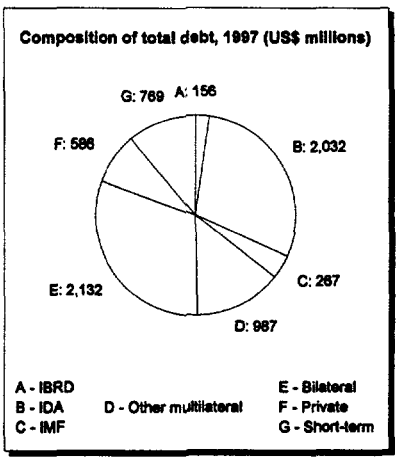
BALANCE of PAYMENTS

	1976	1986	1996	1997
(US$ millions)				
Exports of goods and services	1,108	1,871	2,973	3,154
Imports of goods and services	1,104	2,164	3,401	3,790
Resource balance	3	-293	-428	-636
Net income	-142	-240	-226	-203
Net current transfers	12	58	433	503
Current account balance	-127	-475	-221	-336
Financing items (net)	212	614	634	354
Changes in net reserves	-86	-139	-413	-18
Memo:				
Reserves including gold *(US$ millions)*	276	444	853	805
Conversion rate *(DEC, local/US$)*	8.4	16.2	57.1	58.7



EXTERNAL DEBT and RESOURCE FLOWS

	1976	1986	1996	1997
(US$ millions)				
Total debt outstanding and disbursed	1,493	4,589	6,893	6,929
IBRD	170	931	312	156
IDA	95	451	2,062	2,032
Total debt service	169	686	840	749
IBRD	15	116	122	75
IDA	1	6	25	26
Composition of net resource flows				
Official grants	40	193	295	..
Official creditors	135	194	95	89
Private creditors	67	19	-160	-60
Foreign direct investment	46	33	38	..
Portfolio equity	0	0	46	..
World Bank program				
Commitments	45	87	327	94
Disbursements	80	81	156	84
Principal repayments	3	45	99	64
Net flows	77	36	57	20
Interest payments	12	77	48	38
Net transfers	65	-40	9	-18



Kenya - Selected Indicators of Bank Portfolio Performance and Management

Indicator	1996	1997	1998	1999
Portfolio Assessment				
Number of Projects under implementation[a]	23	23	22	15
Average implementation period (years)[b]	4.17	3.75	4.73	3.34
Percent of problem projects[a, c]				
by number	21.74	39.13	54.55	40.00
by amount	13.51	42.84	57.75	39.15
Percent of projects at risk[a, d]				
by number	52.63	45.45	78.57	73.33
by amount	43.29	47.74	81.48	76.84
Disbursement ratio (%)[e]	19.20	16.23	11.77	0.00
Portfolio Management				
CPPR during the year (yes/no)	No	Yes	No	No
Supervision resources (total US$)	1,591.10	1,988.28	2,095.89	0.00
Average Supervision (US$/project)	69.18	86.45	95.27	0.00

Memorandum item	Since FY80	Last five FYs
Projects evaluated by OED		
by number	78	25
by amount (US$ millions)	2838.83	981.33
Percent rated U or HU		
by number	51.28	40.00
by amount	49.52	24.32

a. As shown in the Annual Report on Portfolio Performance (except for current FY)
b. Average age of projects in the Bank's country portfolio.
c. Percent of projects rated U or HU on development objectives (DO) and/or implementation progress (IP).
d. As defined under the Portfolio Improvement Program.
e. Ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the beginning of the year: investment projects only.

Kenya - Bank Group Program Summary, FY 1999-2001

Proposed IBRD/IDA Base-Case Lending Program, FY 1999-2001[a]

FY	*Project*	*US$(M)*	*Strategic rewards[b] (H/M/L)*	*Implementation[b] risks (H/M/L)*
1999	EL NINO EMERGENCY PROJECT *	40.0	High	High
	BUDGET REFORM/PUBLIC SECTOR REFORM	80.0	High	Moderate [c]
	Subtotal	**120.0**		
2000	ROADS 2000-DISTRICT RURAL ROAD NETWORK REHABILITATION PROJECT*	30.0	Moderate	Moderate
	STRENGTHENING PRIMARY/SECONDARY EDUC.*	30.0	High	High
	AGRICULTURE SECTOR INVESTMENT PROJECT*	27.0	High	Moderate
	PUBLIC SECTOR MANAGEMENT AND ACCOUNTABILITY PROJECT (T/A)	10.0	Moderate	Low
	BUDGET REFORM/PUBLIC SECTOR REFORM	83.0	High	Moderate [c]
	Subtotal	**180.0**		
2001	HEALTH SECTOR REFORM *	30.0	High	High
	MOMBASA WATER & SANITATION *	40.0	Moderate	Moderate
	BUDGET REFORM/PUBLIC SECTOR REFORM	130.0	High	Moderate [c]
	Subtotal	**200.0**		
	Total FY 1999-2001	**500.0**		

a. This table presents the proposed program for the next three fiscal years.
b. For each project, indicate whether the strategic rewards and implementation risks are expected to be high (H), moderate (M), or low (L).
c The implementation risks for the budget support operations are considered moderate because a large part of the support is intended to be given in the form of one-tranche operations against satisfactory budget outcomes, rather than plans. Some amounts may be provided in the form of floating tranches that are tied to specific public sector reform actions that are difficult to reverse. This element would involve higher risks. Overall, we consider the risks to be moderate.

NOTE: The broad lending volumes and the breakdown between investment lending and budget support have been agreed with the Government. However, the Government has recently started an extensive review of its priorities in each sector and across sectors, which will not be completed until fall. This could lead to some changes in the lending program. However, any change is likely to be more in terms of the phasing and the design of the projects, rather than the sector focus and primary objectives.

Low Case Lending Program will consist of the projects that are marked by an asterisk (*) in the above table. However, the scope and the size of the projects will be scaled back to reflect the slower progress in public sector reform or other unfavorable conditions, and the total lending volume for the 3 years will be no more than US$ 150 million.

Kenya - IFC and MIGA Program, FY96-99

Category	Past			
	1996	1997	1998	1999
IFC approvals (US$m) [a]	15.00	10.00	20.00	0.00
Sector (%)				
	0.00	0.00	0.00	0.00
Financial Services	0.00	100.00	50.00	0.00
Infrastructure	0.00	0.00	50.00	0.00
Timber, Pulp & Paper	100.00	0.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
Investment instrument (%)				
Loans	0.00	0.00	0.00	0.00
Equity	0.00	0.00	0.00	0.00
Quasi-Equity [b]	0.00	0.00	0.00	0.00
Other	0.00	0.00	0.00	0.00
TOTAL	100.00	100.00	100.00	100.00
MIGA guarantees (US$m)	0.00	0.00	0.00	0.00
MIGA commitments (US$m)	0.00	0.00	0.00	0.00

[a]Excludes AEF projects.
[b]Includes quasi-equity types of both loan and equity instruments.

Kenya—Summary of Nonlending Services

Product	*Completion FY*	*Cost (US$000)*	*Audience*[a]	*Objective*[b]
Recent completions				
CESP	FY95	125.6	Bank/Govt	Knowledge generation
Agricultural Sector Memo	FY95	1156.5	Bank/Govt	Public Debate, Problem-solving, Knowledge generation
PFP	FY96	112.8	Govt/Public Dissemination	Knowledge generation, Public Debate
PER	FY97	171.3	Bank/Govt/ Donors	Problem-solving
Financial Sector Panel	FY97	62.3	Bank/Govt	Problem-solving
Rationalizing Reg. Structures	FY98	114.1	Bank/Govt	Problem-solving, Public Debate, Knowledge generation
Underway				
Tariff Harmonization Study (CBI)	FY98	70.0	Govt	Knowledge generation, Problem-solving
PER	FY98	70.0	Bank/Govt/ Donors/Public Dissemination	Problem- solving
Growth Performance	FY98	69.2	Bank/Govt	Knowledge generation
Planned				
PFP	FY99	70.0	Bank/Govt/ Public Dissemination	Knowledge generation, Public Debate
Water Sector Review	FY99	40.0	Bank/Govt	Knowledge generation
Education Sector PER	FY99	40.0	Bank/Govt	Knowledge generation
Env/Nat. Res. PER	FY99	40.0	Bank/Govt	Knowledge generation
Health PER	FY99	40.0	Bank/Govt	Knowledge generation
Energy PER	FY99	40.0	Bank/Govt	Knowledge generation
Transport PER	FY99	40.0	Bank/Govt	Knowledge generation
PER/Medium Term Expenditure Framework (MTEF)	FY99	150.0	Bank/Govt/ Public Dissemination	Problem-solving
Financial Sector Study	FY99	50.0	Bank/Govt	Knowledge generation

a. Government, donor, Bank, public dissemination.
b. Knowledge generation, public debate, problem-solving.

Kenya Social Indicators

	Latest single year			Same region/income group	
	1970-75	1980-85	1990-96	Sub-Saharan Africa	Low-income
POPULATION					
Total population, mid-year (millions)	13.7	20.0	27.4	596.4	3,236.2
Growth rate (% annual average)	3.6	3.8	2.6	2.7	1.8
Urban population (% of population)	12.9	19.8	29.5	31.7	29.1
Total fertility rate (births per woman)	8.1	6.9	4.6	5.6	3.2
POVERTY					
(% of population)					
National headcount index	..	..	42.0	..	..
Urban headcount index	..	..	29.3	..	..
Rural headcount index	..	..	46.4	..	..
INCOME					
GNP per capita (US$)	250	300	320	490	490
Consumer price index (1987=100)	26	89	465	266	275
Food price index (1987=100)	..	..	..	..	..
INCOME/CONSUMPTION DISTRIBUTION					
(% of income or consumption)					
Lowest quintile	2.6	..	3.4	..	..
Highest quintile	60.4	..	62.1	..	..
SOCIAL INDICATORS					
Public expenditure					
Health (% of GDP)	..	..	1.9	..	1.5
Education (% of GNP)	..	6.4	6.8	5.3	3.6
Social security and welfare (% of GDP)	..	..	..	..	..
Net primary school enrollment rate					
(% of age group)					
Total	88	91	..	..	..
Male	..	92	..	..	..
Female	..	89	..	..	..
Access to safe water					
(% of population)					
Total	17	27	53	45	76
Urban	100	61	67	63	80
Rural	4	21	49	34	72
Immunization rate					
(% under 12 months)					
Measles	..	63	35	56	80
DPT	..	70	40	55	81
Child malnutrition (% under 5 years)	..	22	23	..	..
Life expectancy at birth					
(years)					
Total	51	52	58	52	63
Male	49	50	57	51	62
Female	53	54	60	54	64
Mortality					
Infant (per thousand live births)	98	64	57	91	68
Under 5 (per thousand live births)	156	115	90	147	94
Adult (15-59)					
Male (per 1,000 population)	467	417	362	448	231
Female (per 1,000 population)	379	339	295	376	206
Maternal (per 100,000 live births)	..	510	650	..	..

Note: HIV/AIDS Prevalence Rates (end 1997): Adults: 11.64%
Children: 0.52%

World Development Indicators 1998 CD-ROM, World Bank

Kenya - Key Economic Indicators (under base case)

Indicator	Actual			Estimate			Projected			
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
National accounts (as % GDP at current market prices)										
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture[a]	23.0	26.8	28.1	26.3	25.1	24.7	24.3	24.2	24.3	24.5
Industry[a]	16.4	14.4	14.6	13.5	13.7	13.3	13.2	13.2	13.4	13.5
Services[a]	46.4	43.9	41.7	44.8	46.3	47.7	47.2	47.0	46.9	46.9
Total Consumption	82.4	77.6	77.6	84.1	83.7	88.6	86.5	85.2	84.3	83.3
Gross domestic fixed investment	17.1	16.9	18.9	21.4	19.8	18.2	20.2	20.1	20.9	21.4
Government investment	5.9	5.9	6.4	6.0	5.3	4.6	5.2	5.4	5.4	5.4
Private investment (includes increase in stocks)	11.6	11.7	12.9	15.8	15.0	14.6	15.2	15.0	15.7	16.2
Exports (GNFS)[b]	27.1	40.4	37.0	32.8	32.9	29.2	30.8	30.7	31.1	31.0
Imports (GNFS)	27.0	35.7	33.9	38.7	37.0	37.0	37.8	36.3	36.5	35.8
Gross domestic savings	17.6	22.4	22.4	15.9	16.3	11.4	13.5	14.8	15.7	16.7
Gross national savings[c]	13.6	17.7	19.0	16.4	18.2	14.5	16.8	17.7	18.3	19.3
Memorandum items										
Gross domestic product (US$ million at current prices)	7951	5752	7149	9054	9244	10240	10252	10813	11544	12328
Gross national product per capita (US$, Atlas method)	340.0	270.0	270.0	280.0	320.0	330.0	350.0	370.0	370.0	390.0
Real annual growth rates (%, calculated from 1982 prices)										
Gross domestic product at market prices	-0.8%	0.4%	2.6%	4.4%	4.1%	2.1%	2.7%	4.1%	4.1%	4.1%
Gross Domestic Income	2.6%	6.2%	12.4%	-5.9%	9.6%	0.0%	4.8%	5.4%	4.5%	4.7%
Real annual per capita growth rates (%, calculated from 1982 prices)										
Gross domestic product at market prices	-3.5%	-2.3%	0.0%	1.8%	1.7%	-0.8%	-0.2%	1.3%	1.3%	1.3%
Total consumption	1.3%	-1.4%	11.2%	-0.7%	5.4%	0.5%	0.3%	0.4%	0.6%	0.1%
Private consumption	-0.1%	-3.1%	6.6%	-3.5%	7.5%	-6.6%	2.0%	1.1%	1.9%	0.7%

(Continued)

Kenya - Key Economic Indicators (Continued)

Indicator	Actual 1992	1993	1994	Estimate 1995	1996	1997	Projected 1998	1999	2000	2001
Balance of Payments (US$m)										
Exports (GNFS)[b]	2158.8	2237.9	2647.6	2966.9	2973.1	3153.6	3157.5	3322.4	3587.3	3822.0
Merchandise FOB	1012.6	1103.1	1483.9	1875.2	1968.9	2099.8	2121.6	2195.1	2335.2	2487.5
Imports (GNFS)[b]	2192.5	1953.3	2446.6	3538.9	3401.2	3789.9	3874.3	3925.0	4216.5	4417.7
Merchandise FOB	1608.4	1384.6	1760.3	2643.8	2523.9	2839.5	2909.1	2935.4	3176.2	3337.1
Resource balance	-33.7	284.6	201.0	-572.0	-428.1	-636.3	-716.8	-602.6	-629.2	-595.8
Net current transfers (including official current transfers)	68.2	146.9	147.5	404.8	432.8	503.4	529.3	471.6	445.0	453.6
Current account balance (after official capital grants)	-106.3	165.4	73.1	-397.2	-116.4	-242.9	-243.9	-184.5	-213.7	-161.2
Net private foreign direct investment	6.0	1.5	4.0	12.9	36.0	6.0	6.3	6.6	6.9	7.3
Long-term loans (net)	-130.7	44.7	-207.4	-61.2	-92.4	-181.8	82.4	-48.7	-74.2	-38.1
Official	154.1	139.9	-22.9	289.3	94.6	88.8	153.0	59.3	-27.1	-43.8
Private	-284.8	-95.2	-184.5	-350.5	-187.0	-270.6	-70.6	-108.0	-47.0	5.6
Other capital (net, including errors and omissions)	306.8	118.9	234.6	312.4	586.0	436.8	347.4	472.6	446.8	200.0
Change in reserves[d]	-75.8	-330.5	-104.3	133.1	-413.2	-18.1	-192.2	-246.0	-165.9	-8.0
Memorandum items										
Resource balance (% of GDP at current market prices)	-0.4%	4.9%	2.8%	-6.3%	-4.6%	-6.2%	-7.0%	-5.6%	-5.5%	-4.8%
Real annual growth rates (1982 prices)										
Merchandise exports (FOB)	-6.1%	11.6%	7.0%	18.8%	12.5%	-6.2%	1.8%	6.1%	6.1%	6.2%
Primary	-11.6%	12.5%	-6.8%	27.1%	12.0%	-14.9%	0.1%	7.3%	7.9%	5.1%
Manufactures	-8.3%	7.0%	10.2%	9.4%	18.8%	5.2%	7.1%	6.6%	6.4%	6.4%
Merchandise imports (CIF)	-0.4%	-12.2%	30.6%	30.5%	-6.0%	13.9%	5.3%	5.0%	6.5%	5.6%
Public finance (as % of GDP at current market prices)[e]										
Current revenues	26.7	27.0	29.6	30.2	28.8	27.8	27.3	27.6	26.7	26.1
Current expenditures	27.6	28.6	26.3	24.4	25.0	24.6	24.1	22.8	20.9	20.3

(Continued)

Kenya - Key Economic Indicators (Continued)

Indicator	Actual			Estimate		Projected				
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Current account surplus (+) or deficit (-)	-0.8	-1.5	3.3	5.8	3.9	3.2	3.2	4.8	5.8	5.8
Capital expenditure	6.2	6.4	6.9	6.5	5.4	5.2	5.2	5.4	5.4	5.4
Foreign financing	1.3	1.0	-0.4	-0.4	-0.4	-0.9	2.4	1.3	0.5	0.3
Monetary indicators										
M2/GDP (at current market prices)	38.8	37.4	40.6	41.4	45.2	45.5	45.5	45.5	45.5	45.2
Growth of M2 (%)	33.6	25.7	30.4	18.6	23.8	14.4	12.6	11.9	11.9	11.4
Private sector credit growth / total credit growth (%)	102.3	551.5	42.9	78.1	88.7	112.1	98.5	98.1	97.8	97.8
Price indices(1982 =100)										
Merchandise export price index	99.4	97.1	122.0	129.8	121.2	137.7	136.8	133.4	133.7	134.0
Merchandise import price index	81.1	79.5	77.2	89.0	90.4	89.3	86.9	83.5	84.8	84.4
Merchandise terms of trade index	122.6	122.1	158.2	145.9	134.1	154.3	157.4	159.7	157.6	158.8
Real exchange rate (US$/LCU)[f]	102.5	89.3	112.0	111.0	108.7	94.7	94.7	94.7	94.7	94.7
Real interest rates										
Consumer price index (% growth rate)	27.3%	46.0%	28.8%	1.5%	9.0%	11.2%	8.4%	7.0%	7.5%	7.7%
GDP deflator (% growth rate)	16.7%	29.8%	17.0%	11.3%	8.9%	11.6%	9.6%	7.5%	7.5%	7.5%

a. If GDP components are estimated at factor cost, a footnoote indicating this fact should be added.
b. "GNFS" denotes "goods and nonfactor services."
c. Includes net unrequited transfers excluding official capital grants.
d. Includes use of IMF resources.
e. Should indicate the level of the government to which the data refer.
f. "LCU" denotes "local currency units." An increase in US$/LCU denotes appreciation.

Kenya - Key Exposure Indicators

Indicator	Actual			Estimate		Projected				
	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Total debt outstanding and disbursed (TDO) (US$m)[a]	6907	7118	7152	7347	6893	6928	7435	7792	7996	8029
Net disbursements (US$m)[a]	117	146	-348	94	-174	343	510	361	205	33
Total debt service (TDS) (US$m)[a]	665	627	877	899	840	686	711	798	816	835
Debt and debt service indicators (%)										
TDO/XGS[b]	318.8	316.5	268.1	245.5	230.2	217.0	232.3	230.8	218.9	206.3
TDO/GDP	86.9	123.7	100.0	81.1	74.6	67.7	72.5	72.1	69.3	65.1
TDS/XGS	30.7	27.9	32.9	30.0	28.0	21.5	22.2	23.6	22.3	21.5
Concessional/TDO	..	..	..	..	..	61.2	61.6	62.2	62.6	64.0
IBRD exposure indicators (%)										
IBRD DS/public DS	31.7	33.1	21.5	19.5	17.2	16.0	14.7	11.9	8.2	5.0
Preferred creditor DS/public DS (%)[c]	62.2	61.7	34.1	36.4	38.2	40.5	40.2	37.7	33.5	31.0
IBRD DS/XGS	7.3	6.9	5.8	4.8	4.1	3.3	2.8	2.3	1.4	0.7
IBRD TDO (US$m)[d]	656	566	501	435	312	233	160	95	52	27
Of which present value of guarantees (US$m)										
Share of IBRD portfolio (%)	..	..	..	..	..	..	..	..	..	..
IDA TDO (US$m)[d]	1411	1631	1789	1977	2062	2230	2435	2583	2687	2791
IFC (US$m)										
Loans										
Equity and quasi-equity /c										
MIGA										
MIGA guarantees (US$m)										

a. Includes public and publicly guaranteed debt, private nonguaranteed, use of IMF credits and net short-term capital.

b. "XGS" denotes exports of goods and services, including workers' remittances.

c. Preferred creditors are defined as IBRD, IDA, the regional multilateral development banks, the IMF, and the Bank for International Settlements.

d. Includes present value of guarantees.

e. Includes equity and quasi-equity types of both loan and equity instruments.

Status of Bank Group Operations in Kenya
IBRD Loans and IDA Credits in the Operations Portfolio

Project ID	Loan or Credit No.	Fiscal Year	Borrower	Purpose	Original Amount in US$ Millions				Difference Between expected and actual disbursements a/		Last ARPP Supervision Rating b/	
					IBRD	IDA	Cancellations	Undisbursed	Orig	Frm Rev'd	Dev Obj	Imp Prog
Number of Closed Loans/credits: 142												
Active Loans												
KE-PE-1345	IDA 23340	1992	REPUBLIC OF KENYA	WILDLIFE SERVICES PR	0.00	60.50	0.00	10.34	6.99	0.00	S	S
KE-PE-1361	IDA 23330	1992	GOVERNMENT	MOMBASA WATER II ENG	0.00	43.20	0.00	4.28	2.32	.58	U	S
KE-PE-1362	IDA 23090	1992	GOVERNMENT	UNIVERSITIES	0.00	55.00	0.00	27.56	25.73	16.73	U	U
KE-PE-1348	IDA 24400	1993	GOVERNMENT	PARASTATAL REFORM TA	0.00	23.32	0.00	6.63	7.70	0.00	S	U
KE-PE-1353	IDA 25960	1994	GOVERNMENT	MICRO & SMALL ENTERP	0.00	21.83	0.00	18.00	8.58	1.27	S	S
KE-PE-1333	IDA 26860	1995	GOVT OF KENYA	SEXUALLY TRANSMITTED	0.00	40.00	0.00	25.69	9.92	0.00	S	S
KE-PE-1367	IDA 26710	1995	GOK	INST. DEVELOPMENT	0.00	25.35	0.00	13.45	15.31	0.00	U	U
KE-PE-35691	IDA 28120	1996	GOVERNMENT OF KENYA	NAIROBI MOMBASA ROAD	0.00	50.00	0.00	41.20	21.65	0.00	S	S
KE-PE-1319	IDA 28110	1996	GOVERNMENT	URBAN TRANSPORT	0.00	115.00	0.00	95.51	19.44	0.00	S	U
KE-PE-1331	IDA 27970	1996	GOVT	ARID LANDS	0.00	22.00	0.00	16.54	6.72	0.00	S	S
KE-PE-1344	IDA 29660	1997	GOVERNMENT	ENERGY SECTOR REFORM	0.00	125.00	0.00	115.31	28.66	0.00	S	S
KE-PE-1354	IDA 29350	1997	GOVERNMENT	NARP II	0.00	39.70	0.00	32.07	-1.62	0.00	S	S
KE-PE-46838	IDA 29070	1997	GOVT OF KENYA	LAKE VICTORIA ENV.	0.00	12.80	0.00	11.61	2.15	0.00	U	U
KE-PE-34180	IDA N0150	1997	GOK	EARLY CHILDHOOD DEV	0.00	27.80	0.00	24.59	1.92	0.00	S	S
KE-PE-56595	IDA 31200	1999	GOV OF KENYA	EMERGENCY INFRAS.REH	0.00	40.00	0.00	40.00	0.00	0.00		
Total					0.00	701.50	0.00	482.78	155.47	18.58		

	Active Loans	Closed Loans	Total
Total Disbursed (IBRD and IDA):	184.74	2,939.56	3,124.30
of which has been repaid:	0.00	939.76	939.76
Total now held by IBRD and IDA:	701.50	2,078.08	2,779.58
Amount sold :	0.00	11.74	11.74
Of which repaid :	0.00	11.74	11.74
Total Undisbursed :	482.78	138.25	621.03

a. Intended disbursements to date minus actual disbursements to date as projected at appraisal.
b. Following the FY94 Annual Review of Portfolio performance (ARPP), a letter based system was introduced (HS = highly Satisfactory, S = satisfactory, U = unsatisfactory, HU = highly unsatisfactory): see proposed Improvements in Project and Portfolio Performance Rating Methodology (SecM94-901), August 23, 1994.

Note:
Disbursement data is updated at the end of the first week of the month.

Kenya
STATEMENT OF IFC's
Committed and Disbursed Portfolio
As of 30-Jun-98
(In US Dollar Millions)

		Committed				Disbursed			
		IFC				IFC			
FY Approval	Company	Loan	Equity	Quasi	Partic	Loan	Equity	Quasi	Partic
1970/74/77/79/81/88/89/94/96	Panafrican	26.78	4.51	0.00	0.00	24.78	4.51	0.00	0.00
1972	TPS (Kenya)	0.00	.04	0.00	0.00	0.00	.04	0.00	0.00
1976	RIVATEX	0.00	0.00	2.06	.39	0.00	0.00	2.06	.39
1980/83/98	DBK	10.00	1.31	0.00	0.00	0.00	1.31	0.00	0.00
1982	Diamond Trust	0.00	.80	0.00	0.00	0.00	.80	0.00	0.00
1982	IPS(K)	0.00	.55	0.00	0.00	0.00	.55	0.00	0.00
1983/91	LIK	0.00	.63	0.00	0.00	0.00	.63	0.00	0.00
1985	EBP	4.25	0.00	0.00	0.00	4.25	0.00	0.00	0.00
1986	IPS(K)-Allpack	0.00	.36	0.00	0.00	0.00	.36	0.00	0.00
1986	IPS(K)-AL	0.00	.62	0.00	0.00	0.00	0.00	0.00	0.00
1986	IPS(K)-Frigoken	0.00	.06	0.00	0.00	0.00	.06	0.00	0.00
1986	IPS(K)-Novaskins	0.00	.14	0.00	0.00	0.00	.14	0.00	0.00
1986	IPS(K)-Prem Food	0.00	.11	0.00	0.00	0.00	.11	0.00	0.00
1992	AEF Future Hotel	.29	0.00	0.00	0.00	.29	0.00	0.00	0.00
1994	AEF Capital Fish	.45	0.00	0.00	0.00	.45	0.00	0.00	0.00
1994	AEF Mosi	.11	0.00	0.00	0.00	.11	0.00	0.00	0.00
1994	EARC	0.00	1.10	0.00	0.00	0.00	.80	0.00	0.00
1994	Intl Hotels-Ken	6.00	0.00	0.00	0.00	6.00	0.00	0.00	0.00
1995	AEF Bawan Roses	.45	0.00	0.00	0.00	.45	0.00	0.00	0.00
1995	AEF Kihingo Rose	.40	0.00	0.00	0.00	.40	0.00	0.00	0.00
1995	AEF Vegpro	.48	0.00	0.00	0.00	.48	0.00	0.00	0.00
1995	Magadi Soda Co.	8.20	0.00	0.00	0.00	8.20	0.00	0.00	0.00
1996	AEF Equitea	.27	.12	0.00	0.00	0.00	.12	0.00	0.00
1996	AEF K-Rep Bank	0.00	1.00	0.00	0.00	0.00	0.00	0.00	0.00
1996	AEF Landmark	.44	0.00	0.00	0.00	.44	0.00	0.00	0.00
1997	AEF Ceres	.93	0.00	0.00	0.00	.93	0.00	0.00	0.00
1997	AEF Makini	.55	0.00	0.00	0.00	.55	0.00	0.00	0.00
1997	AEF Redhill Flrs	.32	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1997	CFC	9.00	0.00	0.00	0.00	4.00	0.00	0.00	0.00
1998	AEF AAR Clinic	0.00	.50	0.00	0.00	0.00	.50	0.00	0.00
1998	AEF Locland	.59	0.00	0.00	0.00	0.00	0.00	0.00	0.00
1998	GBHL	7.00	0.00	3.00	0.00	0.00	0.00	0.00	0.00
Total Portfolio:		76.51	11.85	5.06	.39	51.33	9.93	2.06	.39

Approvals Pending Commitment

		Loan	Equity	Quasi	Partic
1997	AEF DERAS LTD.	1.00	0.00	0.00	0.00
Total Pending Commitment:		1.00	0.00	0.00	0.00

Generated by the Operations Information System (OIS) on 08/31/98

Kenya—CAS Program Matrix

Development Objective: Maintain Macroeconomic Stability					
Strategic Objective	***Government Actions***	***Bank Group Actions***	***Bank Group Instruments***	***Donor Activities*****	***Performance Indicators***
Prudent macro and financial sector management	Implement fiscal strategy of balanced budget (FY98/99) and small surpluses (FY99/00, FY00/01) Maintain monetary policy consistent with low inflation Retire domestic debt through accelerated privatization Strengthen financial sector regulation and capacity for management of bank failure	Provide close monitoring and policy advice as needed Provide policy advice and TA to CBK	*Non-Lending* Participation in joint IMF-Bank missions Quarterly GNP Estimation and Forecasting (ESW) *Lending* Parastatal Reform and Privatization (ongoing TA credit) *Non-Lending* Financial Sector Study (ESW)	IMF: - ESAF (currently suspended) - Article IV consultations	Fiscal balances in 1998/2001 Publication of quarterly GNP series on a timely basis Inflation rate in line with IMF framework Revenue realized from privatization allocated to reduction of stock of debt Strengthened capacity of the Deposit Protection Fund
Development Objective: Improve Economic Governance for Sustainable Development					
Strategic Objective	***Government Actions***	***Bank Group Actions***	***Bank Group Instruments***	***Donor Activities*****	***Performance Indicators***
Achieve more responsive and effective public sector	Redefine core functions of government and indicate plan for implementation	Provide intensive on-the-ground technical support for public sector reforms	*Non-Lending* Annual macro & sectoral PERs	DFID: - Civil Service Reform Programme	GOK leadership in an open and broadly participatory process of reform design

	Implement: - Comprehensive ministerial rationalization and restructuring - Civil Service Reform - Teacher Service Reform - Privatization - Local Government Reform Build broad ownership of comprehensive public sector reform - Consult with stakeholders both within GOK and outside (Parliament, civil society & private sector) for better design and stronger ownership of reform	Support institutional and expenditure reforms at sectoral level Facilitate broad participation in design of reform Enhance information disclosure (Communication Strategy) Assist civil society and other groups (e.g., MPs) in strengthening their capacity to address economic issues	Annual service delivery surveys EDI seminar/workshops on public sector reform, role of media, etc. Water Sector Review (ESW) *Lending* Institutional Development & Civil Service Reform (ongoing TA credit - to be restructured) Parastatal Reform and Privatization (ongoing TA credit) IFC support for privatization in agro-business, infrastructure and financial institutions **Budget Reform/Public Sector Reform (adjustment credit)** **Public Sector Management & Accountability (TA credit)** **Possible sector expenditure reform programs in agriculture/education/ health**	GTZ /KfW: - Support for commercialization/ privatization of the water and sewerage departments of local authorities JICA: - TA to Kenya Institute of Administration (under consideration) UNDP: - Enhanced Public Administration and Participatory Development Programme	Core functions of government redefined and ministerial rationalization/restructuring completed Complete implementation of the Civil Service Reform Program Phase II by 2001 Minimum 30% staff reduction and minimum 10% increase in average pay in civil service by 2001 Minimum 30% staff reduction and minimum 20% increase in average pay in teaching service by 2001 Sustained improvement in public service delivery monitored through annual service delivery surveys Container terminal concessioned by end of 2000 and container handling productivity - Gross TEU (twenty foot equivalent container) moves per ship/day) improved from 200 in 1998 to 350 by 2001 Improved private investment trends and recovery of investor confidence reflected in private sector surveys

Achieve better public expenditure management	Maintain budgetary discipline Introduce MTEF as a mechanism for integrating policy-making, planning and budgeting Reform the planning & budgeting system Strengthen procurement and public financial management systems and processes (accounting & auditing) Rationalize PIP	Assist GOK's own effort to reduce domestic debt Provide technical support for introducing MTEF Support strengthening of GOK's financial management and procurement	*Non-Lending* Annual macro & sector PERs Social Impact of Public Expenditures (ESW) Institutional assessment Annual service delivery surveys EDI workshops on public expenditure management *Lending* **Budget Reform/Public Sector Reform (adjustment credit)** **Public Sector Management & Accountability (TA credit)**	DFID, EU, GTZ: - Participation in Ministerial PERs EU: - Support for the Project Management Dept. and for the Kenya Institute of Policy Research and Analysis, Ministry of Planning and National Development DFID, SIDA: - Financial Management Project	Balanced budget in FY98/99, surplus in later years Public expenditures reduced to less than 25% of GDP by 2001 Elimination and non-recurrence of large unbudgeted expenditures by end FY98/99 Elimination and non-recurrence of pending bills by end FY98/99 Reduction in domestic debt from 24% to 15% of GDP by 2001 Project completion rate improves from 3% to 18% per year by 2001
Achieve enhanced accountability and integrity within the public sector	Develop a comprehensive accountability & anti-corruption strategy with a clear implementation plan Eliminate opportunities for rent-seeking (e.g., privatization, public service pay reform, tax reform)	Policy and technical advice on strategy formulation Support GOK's public sector management and institutional reforms Help promote greater understanding of corruption issues	*Non-Lending* Annual corruption surveys, media support to improve transparency* EDI workshops on corruption, governance and cabinet functions*	CIDA, Netherlands,: - Good Governance Fund/Grant IMF: - ESAF conditions on governance	Increased credibility in GOK's anti-corruption efforts as reflected in annual corruption surveys Reduce corruption as perceived by private sector and civil society measured through annual corruption survey

	Strengthen the judicial and legal sector institutions Empower Auditor General's Office and other auditing functions within government Strengthen accounting and procurement systems Strengthen tax administration	Assist in strengthening of key mechanisms for checks and balances	IDF grant to support strengthening of procurement and financial management Legal sector reform* Strengthening tax administration* *Lending* Institutional Development & Civil Service Reform (ongoing TA credit - to be restructured) Privatization & Parastatal Reform (ongoing TA credit) **Public Sector Management & Accountability (TA credit)**	US/USAID: - Support for public dialogue on economic governance (e.g., Mombasa forum) - Democracy & Governance Program	Improved public expenditure control as documented in annual Controller & Auditor General's Reports Timely parliamentary review of Controller & Auditor General's Reports and prompt and appropriate actions taken to correct the irregularities
Development Objectives: Reduce Poverty by Promoting Rural and Human Development					
Strategic Objective	***Government Actions***	***Bank Group Actions***	***Bank Group Instruments***	***Donor Activities*****	***Performance Indicators***
Improve public service deliveries for poverty focused interventions	Improve service delivery in - Agricultural services - Rural roads rehabilitation & maintenance - Basic education	Promote sector-specific reforms in poverty-focused sectors (e.g. rural and social sectors) Ensure effective beneficiary participation in project design and implementation	*Non-Lending* Social Impact of Public Expenditures (ESW) Water Sector Review (ESW) Poverty Assessment Update (ESW)	GTZ: - Support to improve social service delivery mechanisms; - Integrated Rural District Development Programmes.	No further increase in the headcount poverty ratio over the 1997 levels Primary gross enrollment rate maintained through 2001 Teacher-pupil ratio increased to 1/35 at primary and 1/22 at secondary by 2001

	- Health services - Water & sanitation		*Lending* ASIP Roads 2000 STEPS Health Sector Reform Mombasa Water/Sanitation	DANIDA, DFID, EU, GTZ, JICA Netherlands, USAID: - ASIP CIDA, DANIDA, EU, KfW, Netherlands, SIDA: - Roads 2000 DFID, Netherlands: - Support for basic education projects DANIDA, EU, SIDA USAID: - Health Sector Reform JICA: - Support to water supply and sewerage system in Kisumu	Roads 2000 Strategy for unpaved roads introduced in all districts by end FY04 Proportion of paved roads in "good" conditions increased from 25% in 1998 to 50% in 2004 Infant mortality rate reduced from 59/1,000 live births (1998) to 50/1,000 by end 2000 HIV/AIDS prevalence rates reduced from 11.6% to 10% for adults and 0.5% to 0.2% for children by end 2000 Timely implementation of the El Niño Emergency Project (in 2 years) with no financial irregularities
Development Objectives: Improve the Effectiveness of Bank Group Assistance					
Strategic Objective	***Government Actions***	***Bank Group Actions***	***Bank Group Instruments***	***Donor Activities*****	***Performance Indicators***
Improve the impact of Bank investment assistance	*Ongoing & New Projects* Rationalize the overall Public Investment Program	*Ongoing Projects* Review the existing project portfolio and close/restructure poorly performing projects	A joint GOK/Bank review of the existing portfolio and performance indicators (by October 1998)		Number of problem projects reduced to 20% by end FY00 Disbursement ratio improved to minimum 25% by end FY99 and raised further in subsequent years

	Ensure adequate budgetary provision for IDA as well as all the other investment projects Strengthen project management capacity *New Projects* Improve project selection process, consistent with MTEF	Ensure timely and orderly closure of poorly performing projects and restructure other projects to improve impact *New Projects* Ensure new projects are consistent with GOK's policy priorities and resource availability Ensure new projects are participatory to maximize impact	A review of progress (by May 1999) Annual macro & sectoral PERs		Appropriate participatory arrangements in place for all IDA projects
Strategy, Policy, and Donor Coordination	Actively guide and coordinate support from development partners to achieve priority objectives	Provide support to GOK policy analysis and design Facilitate GOK efforts to improve coordination with donors Expand inputs from NGOs and other stakeholders	Policy Framework Paper (PFP) Country Assistance Strategy (CAS) CG and informal donor meetings Dialogue with GOK/other stakeholders	Economic Governance Group	Sustained consensus among the development partners on the collective approach to economic governance issues Constructive working relationships between GOK and its development partners maintained

Note: 1. * Possible areas of support - specific details to be defined
2. ** The list is not exhaustive of all donor activities in Kenya, and is meant to give an indication of activities by some of the major donors.
3. **Bold** in the "Bank Group Instruments" column indicates planned support in the base case only.

Kenya—CAS Summary of Development Priorities

Network area	*Country performance a*	*Major issue[b]*	*Country priority[c]*	*Bank priority[c]*	*Reconciliation of country and Bank priorities[d]*
Poverty Reduction & Economic Management					
• Poverty reduction	Poor	Slow growth, Governance	High	High	
• Economic policy	Poor	Governance	High	High	
• Public sector	Poor	Governance	High	High	
• Gender	Fair	Education, Legal rights	Low	Low	
Human Development Department					
• Education	Fair	Inefficiency	Moderate	Moderate	
• Health, nutrition & population	Poor	Poor focus	Moderate	Moderate	
• Social protection	Fair	Low service	Moderate	Moderate	
Environmentally & Socially Sustainable Development					
• Rural development	Poor	Poor service delivery, Poor inftrastructure	Low	Moderate	Policy dialogue will address the difference
• Environment	Fair	Lack of enforcement mechanisms	Low	Low	
• Social development	Fair	Participation	Moderate	High	Policy dialogue will address the difference
Finance, Private Sector & Infrastructure					
• Financial sector	Poor	Weak competition	Moderate	Moderate	
• Private sector	Fair	Enabling Environment	Moderate	Moderate	
• Energy & mining	Fair	Privatization	Moderate	Low	Private sector can take a greater financing role
• Infrastructure	Poor	Poor quality	High	Moderate	Private sector can take a greater financing role

NOTE:

1. Where possible, country performance is based on the 1998 country policy performance rating.
2. For the rating of country and Bank priorities, we have tried to indicate the relative importance by allowing no more than 1/3 of the issues to be rated "high," while requiring at least 1/3 to be rated "low."

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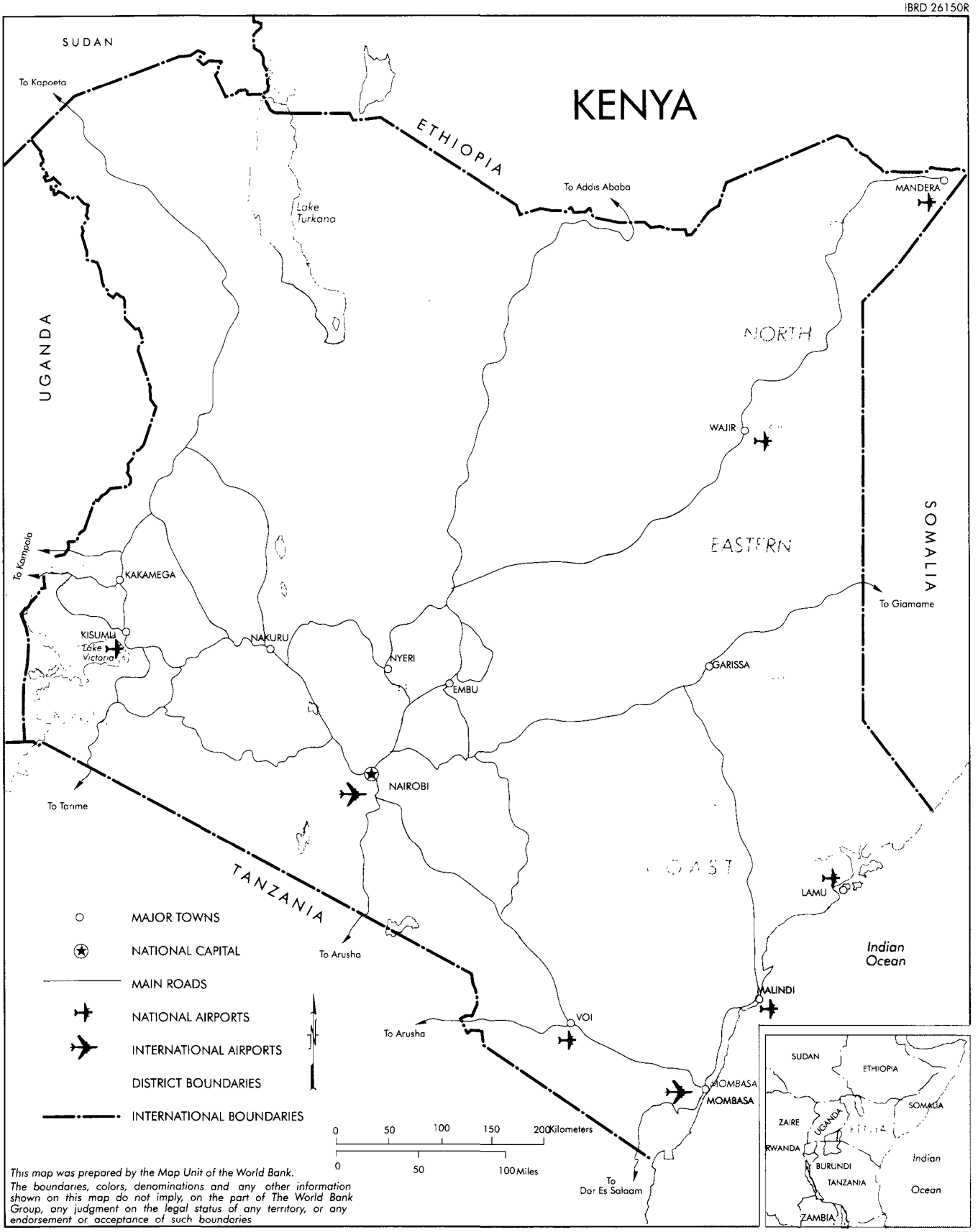
a. Use "excellent," "good," "fair," or "poor."
b. Indicate principal country-specific problems (e.g., for poverty reduction, "rural poverty;" for education, "female secondary completion;" for environment, "urban air pollution").
c. To indicate priority, use "low," "moderate," or "high."
d. Give explanation, if priorities do not agree; for example, another MDB may have the lead on the issue, or there may be ongoing dialogue.

MAP SECTION

IBRD 26150R



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