I. Project Context

Country Context

Kenya is a low-income country with a GNI per capita (Atlas method) of US$ 840 in 2012. Economic performance over the past decade has been solid, but less stellar than some of its neighbors or the best performing developing countries across the world. Growth over the past decade averaged just above 4 percent per year, compared to 7-8 percent annual growth in Uganda, Rwanda, and Tanzania. Growth began to accelerate in 2005 and reached 7 percent in 2007, but the trend was brought to a halt in 2008 by the political crisis that arose from the December 2007 elections. The economy has been hit by several shocks since then, and the pace of growth has yet to return to pre-2008 rates. Moving to upper middle-income country in 2030—as stated in the Vision 2030 strategy—implies a rapid and sustained economic growth. The Vision 2030 foresees GDP growth of 10 percent over the medium-term and the Second Medium Term Plan (MTP-2) projects GDP growth to accelerate to 10 percent by 2017. However, the IMF and the World Bank forecast GDP growth at around 6 percent over the medium-term. The newly discovered natural resources could help the economy accelerate growth to reach the objectives of the Vision 2030 strategy.
Sectoral and institutional Context

Until recently, Kenya had no known commercial reserves of petroleum, despite 50 years of exploration. In March, 2012 Tullow Oil (UK) and Africa Oil (Canada) announced an oil discovery in block 10BB (northwestern Kenya) and a subsequent discovery in block 13T. Similar exploration prospects in the Tertiary Rift basin, the Anza basin and the Mandera basin are promising. Current oil resources are estimated at 600 million barrels. There is a rapidly growing private sector interest to continue onshore and offshore oil exploration, also influenced by commercial oil discoveries in neighboring Uganda. Some of the international companies already operate in Kenya, such as BG group, UK, Total, France and Anadarko, US. Kenya currently has no natural gas reserves but the discovery of world class natural gas reserves in Tanzania and Mozambique has generated private sector interest for onshore and offshore exploration of natural gas in Kenya. The possibility that the favorable geological conditions of these two countries extend into Kenya has been confirmed by an offshore gas discovery by Apache (USA) (that subsequently left Kenya in October 2013) in block L8. The well encountered approximately 52 net meters of natural gas pay in three zones. Recent oil and gas discoveries may have a substantial transformational impact on the Kenyan economy. The institutional set up of the petroleum sector in Kenya reflects its limited exploration history. The Ministry of Energy and Petroleum (MEP) is responsible for policy making for the petroleum sector, for promoting exploration, and for negotiating and signing license agreements with the private sector. In practice there is neither a Regulatory nor a Safety Authority for the petroleum upstream sector. Institutional and regulatory framework reforms for the development of the petroleum sector will be required, in accordance with policy objectives to be established by the GoK, and taking into consideration lessons learned from other countries’ experience. The energy policy, particularly the petroleum sector development plan, should be defined in close coordination with the national economic program. For this purpose the creation of a National Energy Policy Board (NEPB) should be considered. This Board would consist of all the ministers responsible for the definition of the national economic plan. Brazil and Thailand provide a reference for this type of government institution. An independent upstream regulator is needed to ensure that oil and gas exploitation is carried out in the best interests of the country. Active participation of the National Oil Corporation of Kenya (NOCK) in both commercial and regulation activities is not a prudent industry practice. The NOCK, as any other operator, should be under the regulation of an upstream authority. NOCK needs to be transformed to a competitive oil company that is capable of participating strategically in upstream activities and LNG projects. To accomplish these objectives, the first step is to establish a clear separation of government roles. Additionally, in the short term a strategic business plan for NOCK should be developed, a key component of which should be the assessment of potential strategic partners. When designing the institutional arrangement for natural gas transportation, a clear separation should be introduced between the entities responsible for the upstream business, transportation in the midstream, and distribution. Failure to do so could foster anticompetitive practices, which could prevent the development of the national transportation infrastructure. The Energy Regulatory Commission's (ERC’s) legal framework requires some adjustments to include a mandate for oil and gas midstream regulation. With strongly increased petroleum exploration activity and the potential for petroleum production over the next three to four years, the volume of activity in the GoK’s petroleum sector is expected to multiply. Increasingly activities will take place in environmentally sensitive and technologically complex areas, which will dramatically increase the level of expertise required in the GoK. The importance for the GoK to be able to extract optimal revenues from this opportunity, to adequately forecast and manage revenues, as well as manage the potential macro-economic, social, and environmental consequences and the impact
on economic development justify a significant capacity building effort in the GoK along all aspects of the Extractive Industries Value Chain.

II. Proposed Development Objectives
The project development objective (PDO) is to strengthen the capacity of the GoK to manage its petroleum sector and wealth for sustainable development impacts.

III. Project Description
Component Name
Petroleum Sector - Reforms and Capacity Building
Comments (optional)

Component Name
Revenue and Investment Management - Reforms and Capacity Building
Comments (optional)

Component Name
Sustainable Impact of Oil and Gas Industry –Reforms and Capacity Building
Comments (optional)

Component Name
Project Management
Comments (optional)

IV. Financing (in USD Million)

<table>
<thead>
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<th></th>
<th>Amount</th>
</tr>
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<tbody>
<tr>
<td>Total Project Cost</td>
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<tr>
<td>Total Bank Financing</td>
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<td>BORROWER/RECIPIENT</td>
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<td>International Development Association (IDA)</td>
<td>50.00</td>
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<tr>
<td>Total</td>
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V. Implementation
The Project will be developed in the form of an IDA-funded Investment Project Financing Credit in the amount of US$50.0 million equivalent for the Republic of Kenya. The Credit is planned to be deployed over a six year period from September 2014 (expected Effective Date) to June 2020. The activities under the proposed project, as described below, will be performed at the central government level and any procurement of goods and services will be related only to the onshore areas of Kenya as well as to those areas offshore the coast of Kenya that are not disputed. The proposed Project Area will therefore be defined to exclude any disputed areas, whether onshore or offshore. As a consequence, none of the envisaged activities are expected to have any impact on any
areas that may be the subject of a dispute between Kenya and any of the neighboring countries. The proposed Project has three main components plus a separate component for project implementation:

COMPONENT A: Petroleum Sector- Reforms and Capacity Building (total costs US$ 39.68 million, of which IDA US$ 36.68 million). The objective of Component A is to support strengthening the capacity of the Recipient’s major institutions engaged in the development and governance of the petroleum sector to allow them to execute their mandates in a way that is conducive to investments while ensuring that safeguards and safety standards are met in accordance with international standards.

Through Component A, at the policy level, the Project would support the drafting of a comprehensive Petroleum Policy outlining a vision and policy for the petroleum sector. Also, through this Component the Project would provide technical assistance to develop a Petroleum Master Plan that considers strategic options and decision hierarchies for policies and investments in the Project Area on a sound economic basis. A National Communication Strategy (NCS) would also be developed to empower a greater proportion of the Kenyan public to effectively access, understand and participate in the ongoing dialogue on using the petroleum and mining deposits as a source of national wealth.

At the regulatory level, the Project would support the implementation of a comprehensive, clear and workable regulatory framework for the development of Kenya’s petroleum resources. At the same time, the Project would support the implementation of institutional reforms including the identification and division of roles, establishment of new institutions if needed and capacity building for relevant institutions.

At the transaction level, the Project would also support capacity building for negotiation of petroleum deals. Also, through this Project, GoK would hire and contract consultants for provision of transaction advisory services. The Project would also support the acquisition, interpretation and promotion of geodata in the Project Area and capacity building related to petroleum cadastre database of the Project Area.

The Project would also provide technical assistance to manage the impacts from the petroleum sector including the implementation of health & safety reforms, implementation of environmental and social reforms and development of a framework for oil spill preparedness and response capacity.

COMPONENT B: Revenue and Investment Management- Reforms and Capacity Building (total costs US$ 9.40 million, of which IDA US$ 6.65 million). The objective of Component B is to support strengthening the government’s capacity to manage revenue streams from the petroleum sector for sustainable development impacts.

Through the activities grouped under Component B, the Project would support the design and implementation of fiscal framework reforms in order to improve extractive industries taxation in Kenya. The Project would also address transparency and accountability across the extractive industries value chain through a variety of mechanisms including technical assistance to subscribe to and become compliant with EITI. The Project would also provide technical assistance for drafting and implementing the appropriate legal and institutional mechanisms to allocate revenues from the extractive industries in a balanced way. In addition, through this Component, the Project will provide technical assistance to the Ministry of Finance and Central Bank for the design and
implementation of the appropriate fiscal mechanisms to address 1) the finite nature of most natural resource endowments (e.g. savings funds) and 2) the volatility of resource revenues (e.g. dedicated buffer or price stabilization funds).

Also, the Project would finance capacity building for setting-up a robust system of public financial and investment management in anticipation of extractives revenues and potential increase in public investments.

COMPONENT C: Sustainable Impact of Oil and Gas Industry –Reforms and Capacity Building (total costs US$ 11.82 million, of which IDA US$ 3.20 million). The objective of Component C is to support strengthening the government’s capacity to integrate the petroleum sector in its broader economy.

Through this component the Project would support the upward and downward linkages of the petroleum sector. The Project will provide: (1) support to stimulating local goods and services procurement, including identification of local content opportunities in terms of goods and services and assigning the responsibility for implementation and monitoring; and (2) support to stimulation of the development of downstream oil and gas industry through technical assistance for follow up activities to the Petroleum Master Plan related to the downstream oil and gas industry.

Also, through this component the Project would support education and skills Development. The Project will provide: (1) support to stimulation of local skills development, including conducting a demand-side analysis, assessment of manpower requirements, skills gap and educational gap analysis as well as development of educational program and staffing policy; (2) support to development of sector-specific vocational training, implementation of an educational development plan and preparation of curriculum; and (3) support to development of sector-specific academic and technical college programs in petroleum engineering.

COMPONENT D: Project Management (total costs US$ 1.1 million, of which IDA US$ 1.1 million). The objective of Component D is to support the GoK in managing and coordinating the Project and building its procurement, financial management, safeguards management, and monitoring and evaluation capacity through the provision of technical advisory services, training, acquisition of goods, and operating costs.

VI. Safeguard Policies (including public consultation)

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VII. Contact point

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