I. Introduction and Context

Country Context

1. Macroeconomic performance. From 2000–2009 Kenya’s economy experienced strong but uneven growth, with an average annual growth rate of 3.7 percent. However, growth slowed significantly during 2008–09 due to the 2008 post-election violence, the global economic crisis, and a severe drought in 2009. These events had a negative impact on trade flows and receipts from tourism, remittances, and foreign direct investment. Growth slowed to 1.6 percent in 2008 but recovered slightly to 2.6 percent in 2009. Growth picked up significantly in 2010 to 5.6 percent, a moderately strong recovery given the global economic crisis, which exceeded the sub-Saharan African average of 4.7 percent. However, a severe drought and rising oil prices slowed economic growth in 2011 to an estimated 4.3 percent. In the absence of external shocks and improved macroeconomic stability, growth was expected to reach 5.0 percent in 2012.
2. Structural transformation. Growth has been driven primarily by services (particularly tourism, transport, communications, and financial services) and by industry (primarily construction). Services and industry accounted for 75 percent of gross domestic product in 2010. However, despite the strength of Kenya’s private sector, the economy continues to perform below its potential due to infrastructure bottlenecks, an uninviting investment climate, and outdated agricultural and trade policies. In the coming decade, the structural transformation of the Kenyan economy will continue, coupled with rapid demographic growth, an increasing population and economic density.

Sectoral and Institutional Context

3. Until recently, Kenya had no known commercial reserves of petroleum, despite 50 years of exploration. In March, 2012 Tullow Oil announced an oil discovery (northwestern Kenya) and continued exploration to establish the size of the discovery continues. Current oil resources are estimated at 300 million barrels. There is rapidly growing private sector interest to continue onshore and offshore oil exploration, also influenced by commercial oil discoveries in neighboring Uganda. 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. The feasibility for Kenya to be a transit country for oil from South Sudan and Uganda (Lamu project) is also being considered. The Government of Kenya (GoK) further considers capitalizing on the recent natural gas discoveries in Tanzania for the development of its own gas pipeline network and gas fired power generation capacities. Recent oil and gas discoveries may have a substantial transformational impact on the Kenyan economy.

4. The petroleum legal and regulatory framework (1986) was developed prior to the oil or gas discoveries and is no longer suited to manage the current private sector interest in the sector. The GoK intends to modernize its legal and regulatory framework in preparation for developments in the sector. Current contractual and fiscal terms were not designed to suit the production of natural gas and require adaptation. Other aspects that require updating include compensation for property, revenue sharing, Corporate Social Responsibility, modalities for abandonment and decommissioning of petroleum operations, reference to the Local Government Act, assignments and transfer of PSC interests, capital gains tax, local content and employment of Kenyan citizens. A World Bank supported review of the petroleum legal, fiscal and contractual framework has just been completed.

5. 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. The National Oil Corporation of Kenya (NOCK) is mainly focused on the petroleum downstream (covering crude oil refining and distribution of final products). The responsibility for State participation in petroleum licenses is not specified in the law. The oil and gas discoveries in Kenya have triggered new developments, which require a re-design of the institutional set up to effectively govern the petroleum sector with clearly defined roles and responsibilities.

6. 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 strongly 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.

7. There is a strong interest from Development Partners (DPs) to provide support to the emerging extractive industries sector in Kenya, both petroleum and mining, with the World Bank leading the development of a support program for the sector based on scoping studies, in coordination with other DPs. The main elements of this program of support have been agreed with GoK. A process of consultations is underway with DPs to elaborate the specifics of the program and define their contributions to it, either jointly or separately.

Relationship to CAS

8. The proposed project is in line with the World Bank Group’s Country Partnership Strategy (CPS) for Kenya 2010-2013 (Report # 52521-KE). Over the CPS period, the World Bank Group (WBG) aims to contribute to achieving more inclusive growth by supporting activities aiming to (i) unleash Kenya's growth potential; (ii) reduce inequality and social exclusion; and (iii) address resource constraints and environmental challenges. The proposed project supports outcome 1.1 of the CPS, namely “Improved business environment and competitiveness” and outcome 3.1 “Improved management of key natural resources”. Preparation of a new CPS, which is expected to be delivered in Q1 2014, recognizes the growing role of the extractive industries sector in Kenya and the relevance of the proposed project. In addition, the proposed project supports the Bank’s Africa Strategy, which identifies governance and public sector capacity as its foundation, as well as the Africa Extractive and Natural Resource agenda, led by SEGOM and Africa PREM. The GoK intends to make extractives the 7th sector under Vision 2030’s economic pillar.

II. Proposed Development Objective(s)

Proposed Development Objective(s) (From PCN)

The project development objective (PDO) is to strengthen the capacity of the GoK to manage its extractive industries sector for sustainable development impacts.

Key Results (From PCN)

Key outcome indicators to be used to measure progress on the project objective over its life-time will be:

- Policy, legal and regulatory acts, prepared under the project, approved and under implementation by relevant sector ministries.

- Staff of petroleum sector management institutions trained to regulate, manage and monitor compliance in the sector.

- Percentage of petroleum production and transmission projects per year subject to formal environmental and safety inspections following good international practices set under the project.

- Number of investment projects whose planning, formulation, allocation and supervision benefiting from a robust PIM system developed under the project.

III. Preliminary Description

Concept Description
COMPONENT 1: Petroleum Sector Reforms and Capacity Building
Through the activities grouped under Component 1, 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 2: Revenue and Investment Management Reforms and Capacity Building
Through the activities grouped under Component 2, 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 3: Project Management.
The Project proceeds would also be used for the management and coordination of the Project and for building GoK’s procurement, financial management, safeguards management, monitoring and evaluation capacity through the provision of technical advisory services, training, acquisition of goods, and operating costs.

The activities under this proposed project, as described above, will be performed at the central government level and any procurement of goods and services will be targeted to the onshore areas of Kenya as well as a limited set of offshore locations ("exploration blocks") which are not subject to any dispute.

IV. Safeguard Policies that might apply

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V. Financing (in USD Million)

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VI. Contact point

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