Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 29-Mar-2019 | Report No: PIDA26715

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kenya	P168204	Inclusive Growth and Fiscal Management Development Policy Operation (P168204)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
AFRICA	31-May-2019	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
The Republic of Kenya	The National Treasury		

Proposed Development Objective(s)

The objective of this programmatic Development Policy Operation is to (i) crowd in private sector investment and financing for the delivery of affordable housing ; (ii) enhance farmer incomes and food security; (iii) create fiscal space to support the government's inclusive growth agenda; and (iv) crowd in private investment and leverage digitization to support the government's inclusive growth agenda.

Financing (in US$, Millions)

SUMMARY

Total Financing	750.00

DETAILS

Total World Bank Group Financing	750.00
World Bank Lending	750.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. Economic growth of the Kenyan economy has been robust over the last decade. Since 2010, GDP growth has averaged 5.6 percent, which is 1.8 percentage points higher than the average for Sub-Saharan African countries during this period (3.8 percent) and two percentage points higher than the growth rate of the Kenyan economy in the previous decade (3.6 percent). Thanks to the robust growth performance and declining fertility, GDP per capita has accelerated in recent years from $920 in 2009 to $1,508 in 2017, thereby enabling Kenya to attain middle-income status.

2. The pick-up in growth in recent decades has been broad-based. On the supply side, though all sectors have contributed to the increase in growth, the rapid increase in services sector (especially information and communications technology and financial sub sectors) has accounted for more than half of the increase in GDP growth, followed by industry and to a lesser extent the agriculture sector, reflecting productivity challenges in the sector. On the demand side, rising incomes, robust remittance inflows and improved access to credit has driven private consumption - the main demand side driver of growth. Increased public spending in recent years (both on recurrent and development spending on infrastructure) has also provided a lift to economic growth. Further, macroeconomic stability, improvements in the security environment, relatively stable political transitions and policy reforms to the business environment (between 2014 and 2018, Kenya improved from 136 to 61 on the World Bank's Ease of Doing Business Index) have supported the recent pick-up in growth.

3. Kenya's robust growth performance has translated into a reduction in poverty. At the international poverty line of $1.90/day, poverty headcount declined from 43.7 percent in 2006 to 36.8 percent in 2015 (latest data). With consumption growth among households at the bottom of the income distribution (3-4 percent) outpacing growth among higher income households, economic growth in Kenya has been pro-poor. Further, robust consumption growth in rural areas has led to a more pronounced decline in poverty among rural households relative to their urban counterparts. Gains in monetary poverty reduction were accompanied by progress along several dimensions of non-monetary poverty. Kenya's Human Development Index (HDI), which aggregates education, inequality and life-expectancy indicators, rose by 0.07 points between 2002 and 2015. The latest World Bank Human Capital Index places Kenya with the third highest human capital in Sub-Saharan Africa, after Seychelles and Mauritius**.**

4. Notwithstanding progress, there still remain significant development challenges. With a third of Kenyans still living under a $1.90 a day, poverty levels remain high. Further, the translation of the higher economic growth to poverty reduction in Kenya has been less rapid than its regional peers. Given the pre-dominance of poverty in rural areas and the pre-dominance of the agricultural sector in rural economies reforms to boost output in the agriculture sector should help to increase farmer incomes and enhance food security, thereby accelerating the pace of poverty reduction.

Relationship to CPF

5. **The Development Policy Operation (DPO) is consistent with the World Bank Group (WBG) Country Partnership Strategy (CPS) FY14-FY20 for Kenya** which supports the country's longer-term Vision 2030 and aligns with the WBG twin goals of eliminating extreme poverty and boosting shared prosperity. The CPS has three domains of engagement: (i) competitiveness and sustainability – growth to eradicate poverty; (ii) protection and potential – human resource development for shared prosperity; and (iii) consistency and equity – delivering a devolution dividend. Good governance was seen as an enabler of the three focus areas. This DPO will help achieve some specific goals set in the CPS. Policies to enhance the business environment when combined with sector specific interventions (Agriculture and affordable housing) will support sustainable economic growth and competitiveness, shared prosperity and reducing poverty. The DPO's policy actions geared towards creating fiscal space by enhancing the efficiency of public spending also supports the objective of consistency and equity by enhancing public financial management, transparency and good governance. In addition, the proposed DPO focuses on crowding-in the the private sector and leveraging on digitization to unleash sector specific potential reinforcing th WBG's engagement in these sectors.

C. Proposed Development Objective(s) [1]

6. **The objective of this programmatic Development Policy Operation is to**: (i) crowd in private sector investment and financing for the delivery of affordable housing ; (ii) enhance farmer incomes and food security; (iii) create fiscal space to support the government's inclusive growth agenda; and (iv) crowd in private investment and leverage digitization to support the government's inclusive growth agenda.

Key Results

7. **The key results of the operation include:** (i) an increase in the delivery of affordable housing units though enhancing the availability of long-term financing to improve housing affordability and removal of key regulatory constraints to building at scale; (ii)) increase value-addition in the agriculture sector; and enhance farmers income and food security by reducing post-harvest losses; (iii) enable farmers access to finance; and enhanced climate resilience through support to irrigation; (iv) Advance digitization to support inclusive growth and enhanced delivery of government services; (v) create fiscal space and crowd in private investments and improve the investment climate.

D. Project Description

8. **The proposed Development Policy Operation (DPO) is the first of a two-series programmatic development policy financing in support of the Government of Kenya's (GoK) inclusive growth agenda.** After the elections in late 2017, the current administration spelt out its strategic priority development areas for the next five years. These are reflected in the Third Medium Term Plan (MTP III) 2018-2022. The four main priority areas (otherwise referred to as the "Big Four") are: ensuring that all citizens enjoy food security and nutrition; the delivery of at least 500,000 affordable housing units; achievement of universal health coverage; and raising the share of manufacturing to 15 percent of GDP (it has averaged 9.4 percent since 2013). Implementation of these four priority areas is expected to support higher and inclusive economic growth, faster job creation, and a reduction in the cost of living affecting the poor. The government recognizes that these objectives will be achieved through sustaining economic growth and macroeconomic stability in addition to implementing reforms aimed at providing an enabling environment for all stakeholders to play their role towards achieving the " Big

[1] The proposed development objectives, results, concept description, and poverty and social and environmental impacts are preliminary, and will be updated during the further preparation of the operation.

Four" development plan. The proposed DPO lends support to this agenda by seeking to crowd in private investment and enhance the public sector's capacity to deliver on the government's inclusive growth agenda.

9. The proposed operation is directly linked to the Governments "Big Four" inclusive growth agenda. The policy and institutional reforms under this DPO are clustered under four policy and institutional reform pillars that are foundational to creating an enabling environment for the delivery of the GoK's inclusive growth agenda. These are: (i) crowd in private sector investment and financing for the delivery of affordable housing; (ii) enhance farmer incomes and food security; (iii) create fiscal space to support the government's inclusive growth agenda; and (iv) leverage digitization and crowd in private investment to support the government's inclusive growth agenda. Two of the pillars of the proposed operations are directly linked to two of the "Big Four" priorities (affordable housing - pillar 1; and farmer incomes and food security– pillar 2), whereas the other pillars address a foundational issue that underpins the achievement of the "Big Four" and the broader inclusive growth agenda. The choice of the two pillars of direct focus in the proposed operation reflects a combination of factors including potential impact on the poor, available analytical evidence to underpin reforms, level of existing World Bank engagement in the respective areas, including complementarity with other World Bank projects, appropriateness of instruments to address the identified challenges, and reform momentum by the client.

10. The third and fourth pillar of this proposed operation are foundational and will be critical for all four of the government's priority areas and the broader inclusive growth agenda. Given the narrowing of the fiscal space in recent years, the absence of fiscal consolidation could undermine macroeconomic stability, thereby reversing the growth and poverty reduction gains of recent years. Hence the prior actions to improve revenue mobilization, efficiency of spending and debt management will enhance the government's capacity to deliver on the "Big Four". Further the fiscal measures are complemented by other non-fiscal measures (e.g. advancing digitization and improving investment policy) towards the common objective of crowding in private investment and enhancing the government's capacity to deliver on its inclusive growth agenda.

11. The DPO complements other interventions by the World Bank and other ongoing development partners programs. This operation complements other interventions by the World Bank including the proposed Kenya Affordable Housing Finance Project; Kenya Climate-Smart Agriculture Project; and the Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya. The operation also complements interventions by other development partners in support of the "Big Four" agenda including the European Union (EU) budget support linked to the public financial management (PFM) reform strategy and a potential IMF precautionary financing to the GoK. Several other partners, including France, Great Britain, Japan, Sweden, the African Development Bank, in coordination with the World Bank, are providing financial and non-lending support in several areas covered by the operation (public investment management - PIM, PFM, Revenue mobilization, Agriculture, Affordable housing). The pillars of these operations and actions have been based on a consultative process with development partners and other stakeholders. Specifically, the World Bank hosted meetings to discuss this operation with the Development Partners' Group in February 2018, August 2018, February and March 2019 and held several bilateral meetings with other partners (EU, United Kingdom's Department for International Development -DFID, Sweden and Germany). Overall, the feedback from stakeholders has been positive.

E. Implementation

Institutional and Implementation Arrangements

12. The National Treasury will be the coordinating institution for monitoring and evaluation among all the participating ministries for this DPO. The institutional and policy reforms supported by the programmatic DPO series fall

under the purview of ten ministries and agencies. The National Treasury chairs a Development Policy Financing (DPF) Coordinating Committee established for overseeing the preparation of the operation. This Committee will remain in place during the implementation of the program and until completion of the DPF series. The committee will also be responsible for monitoring of results indicators and evaluation activities.

13. Data availability and quality are appropriate to monitor progress towards the achievement of the expected results of the DPO. The National Treasury will be responsible for the overall coordination and monitoring of the reform program supported by the DPO and will furnish information to the World Bank, as required, to monitor outcomes in the results framework. Most of these results indicators are based on routinely published information by the GoK. For those that are not, the National Treasury will liaise with focal points in the other ministries involved as needed to provide such information at a frequency and in a format satisfactory to the World Bank. The World Bank may provide implementation support and periodic monitoring and dialogue with the relevant line ministries and other stakeholders to ensure timely implementation and adequate monitoring of indicators and outcomes of the program.

F. Poverty and Social Impacts and Environmental Aspects

Poverty and Social Impacts

14. The overall impacts of the policy and institutional reforms under this proposed programmatic DPO series is expected to be largely positive. The poor are expected to disproportionately benefit from interventions on affordable housing, improvements to agricultural value-added and resilience, and increased coverage of broadband services. Further, the net impact of fiscal reforms is expected to be positive. Beyond the economic benefits of increased access to affordable housing, studies have found that there is a positive correlation between improved housing conditions and human capital outcomes. In addition, the net impact of fiscal reforms is expected to be positive. The expenditure reforms supported under this operation should help bring about fiscal savings and improve the efficiency of spending. Revenue enhancement measures supported by this operation have a minimal impact on both household consumption and poverty and should contribute to improving fiscal space. As broadband coverage expands in Kenya it will be beneficial to consumers governments and firms.

Environmental Aspects

15. The policy actions and institutional reforms to be supported by this DPO are not likely to cause significant effects on the environment, Forests, and other natural resources in Kenya. The policy actions, institutional reforms and supporting legislations proposed under this DPO are expected to contribute to overall significant positive effects on the environment, forests and other natural resources. However, it is noted that the proposed policy actions and institutional reforms in irrigation sector could potentially result in negative effects on the environment if relevant mitigating actions are not implemented. Improvements in policies and institutions reforms for managing public resources, attracting and retaining foreign and domestic investors, cannot in themselves have any direct negative impacts on the environment. However, it is possible that indirectly, the budget support to be provided could be spent on activities that have potential to damage the environment. It is observed that the national environmental framework in Kenya is broadly aligned with the International Standards, the implementation and of this framework can further be strengthened through enhanced supervision and compliance. In Kenya, the Ministry of Environment and Forestry is responsible for setting up policy guidelines on environmental, forest, protection and conservation of the natural environment, while the National Environment Management Authority coordinates the environmental management activities undertaken by lead agencies and promotes the integration of environmental considerations into development of policies, plans, programmes and projects. However, given that Kenya's environmental institutional framework is aligned with international good practices

and requires that government, donor and private sector proponents undertake full environmental impact assessments (EIA) for new projects and that EIA reports are submitted to National Environmental Management Agency (NEMA) prior to being issued a license, it is anticipated that the projects under this program will be screened and the requisite environmental assessments carried out.

G. Risks and Mitigation

16. The overall program risk rating is moderate. The GoK has shown remarkable leadership in pursuing its reform agenda and coordinating the reforms supported by this operation. The improvement in the overall political environment following the presidential election of October 2017 has mitigated political and governance risks to implementing reforms in Kenya; however, pockets of vulnerabilities remain. Furthermore, macroeconomic risks associated with weak revenue performance, upcoming external refinancing risks and ongoing weaknesses in private sector credit remain substantial. The breadth of critical reforms supported by this program also raises moderate technical and institutional design risks. In addition, some of the reforms to increase the supply of affordable housing and agriculture outputs can have moderate environmental and social implications, notwithstanding the expected substantial benefits discussed above.

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APPROVAL

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