Program Information Document (PID)

Concept Stage | Date Prepared/Updated: 06-Mar-2023| Report No: PIDC35651

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kenya	P180339	Fiscal Sustainability and Inclusive Green Growth (FIGG) Development Policy Operation (P180339)	
Region	**Estimated Board Date**	**Practice Area (Lead)**	**Financing Instrument**
EASTERN AND SOUTHERN AFRICA	May 31, 2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	**Implementing Agency**		
The Republic of Kenya	National Treasury		

Proposed Development Objective(s)

The program development objective is to enhance sustainable, inclusive, and green growth by: (i) creating fiscal space in a sustainable and equitable manner; (ii) increasing competitiveness to boost exports in agriculture, and (iii) improving governance to facilitate inclusive private sector led development.

Financing (in US$, Millions)

SUMMARY

Total Financing	1,000.00

DETAILS

Total World Bank Group Financing	1,000.00
World Bank Lending	1,000.00

Decision

The review did authorize the preparation to continue

B. Introduction and Context

Country Context

1. **Kenya's economy has demonstrated impressive growth and resilience to shocks, but the challenges are vast.** These include the lasting economic effects of the COVID-19 pandemic, the global impacts of the Russian invasion of Ukraine, and increasingly frequent climate shocks, such as the ongoing drought. In addition, Kenya's growth has been largely driven by

the public sector resulting in rising debt vulnerabilities. As a result, fiscal consolidation is a priority as is creating conditions for private sector driven growth. This requires both supporting the development in those sectors where Kenya has comparative advantage, such as agriculture, as well as de-emphasizing the government's role in the economy to create a space for the private sector to expand and create jobs. To restore confidence of the private sector and unleash its potential, the government is committed to making significant steps to improve transparency, accountability, and combat corruption. Finally, equity issues continue posing a persistent constraint on development in Kenya, as poor and vulnerable are most exposed to climate shocks, and the progress in female empowerment remains insufficient.

2. **Though sustained economic growth has translated into improved living standards and a steady reduction in poverty, a series of successive shocks has reversed this trend**. The share of the population living below Kenya's national poverty line decreased from 47 percent in 2005 to 34 percent in 2019, an average decline of about one percentage point per year. The COVID-19 pandemic, however, dealt a heavy blow to Kenya's services-dependent economy, leading to a sharp increase in poverty due to large jobs and earnings losses, concentrated in urban areas. [1] While the strong economic rebound in 2021 was on course to bring poverty rates down to their pre-COVID-19 levels, the recovery was interrupted by a severe drought across many parts of Kenya. [2] This includes emergency food insecurity levels in the northern pastoral areas and a sharp spike in food prices linked to the war on Ukraine, pushing up poverty rates, especially in rural areas.

Relationship to CPF

3. **The DPO supports several objectives and High-Level Outcomes (HLOs) of the WBG Country Partnership Framework (CPF) FY23-FY28 for Kenya.** Both the DPO and the CPF are underpinned by Kenya's Vision 2030 agenda, as operationalized through the respective MTPs. The DPO helps to advance the HLOs and objectives set out in the CPF. The proposed DPO supports HLO1 ("faster and more equitable labor productivity and income growth") and HLO3 ("greater resilience and sustainability of Kenya's natural capital"). Within HLO1, the CPF objective 1 "boost fiscal and debt sustainability" is supported by the proposed reforms under Pillar 1 of the DPO (the phasing out of fuel subsidies, the measures to expand the revenue base, the amendments to the Public Financial Management Act) and the reform of NCPB under Pillar 2 (the elimination of administratively determined maize prices above the market price). CPF objective 2 ("strengthen the efficiency and transparency of public spending") is also supported by several of the reforms proposed under Pillar 1, Pillar 2 (the NCPB reform) and Pillar 3 (access to information, the Conflict-of-Interest Bill). The phytosanitary and food safety systems reforms also contribute directly HLO1 by securing and expanding access to international markets for Kenya's farmers. Within HLO3, several proposed reforms support the sixth CPF objective of "increasing household resilience to, and national preparedness for, shocks". The NSNP reform under Pillar 1 protects safety net transfers and hence strengthens household resilience to climate shocks, while the adoption of the NASMP under Pillar 2 strengthens the resilience of landscapes and soils and improves national preparedness for shocks by facilitating the establishment of an accurate climate early warning system.

C. Proposed Development Objective(s)

4. The program development objective is to enhance sustainable, inclusive, and green growth by: (i) creating fiscal space in a sustainable and equitable manner; (ii) increasing competitiveness to boost exports in agriculture, and (iii) improving

[1] The number of unemployed more than doubled from 0.8 million in Q2 of 2019 to 1.8 million by Q2 2020. Employment decreased by almost two million (Kenya National Bureau of Statistics, 2020).
[2] National Drought Management Authority (NDMA). *National Drought Early Warning Bulletin.* January 2023. Retrieved from: https://www.ndma.go.ke/index.php/resource-center/national-drought-bulletin/send/39-drought-updates/6778-national-monthly-drought-updates-january-2023

governance to facilitate inclusive private sector led development.

Key Results

5. Pillar 1 reforms will bring about significant public expenditure savings, boost revenue collection, and support a decline in public debt. While reinforcing fiscal consolidation, the reforms under this pillar will at the same time ensure timely and protected cash transfers to the most vulnerable. Pillar 2 reforms will require competitive procurement of the National Food Reserves and promote competitiveness¸ paving the way for increased exports through, inter alia, a reduced rate of rejection of Kenyan agro-food exports for not meeting importing countries’ regulations. Pillar 3 reforms will usher in increased transparency of public officials' income and assets, greater ease of exiting commercial investments by the state, and better integration of private sector and citizen concerns in climate-change related measures. They will also significantly increase financial inclusion of the underserved segment of the population and for MSMEs, while doing so through market based mechanisms and in a fiscally sustainable manner. Together, these reforms will pave the way for more private sector led growth.

D. Concept Description

6. ***Pillar 1: Creating fiscal space in a transparent and equitable manner.*** Reforms will build on recent improvements in domestic revenue mobilization (*inter alia,* supported by measures in previous DPO) by pursuing measures to broaden the tax base given the changing structure of the economy (e.g., taxation of an increasingly digitized economy, capturing of advances in the use of financial derivatives), and ensuring compliance by multinational companies by reducing base erosion and profit shifting. Other reforms enhance fiscal space by rationalizing expenditures, especially through phasing out regressive fuel subsidies. The operation will support improved debt sustainability by making the debt management framework more transparent and by requiring the government to engage with the parliament on actionable steps to reduce debt. At the same time, the program supports measures to prioritize and improve timeliness of the cash transfers to the most vulnerable, including female-headed households and those affected by climate shocks.

7. ***Pillar 2: Enhancing competitiveness to boost exports in agriculture*. **Under this pillar, policy reforms will support interventions in agriculture where Kenya has competitive advantage. These reform areas are also critical for Kenya to enhance its resilience to climate change. First, the reforms under this pillar will boost competition in agricultural output markets and encourage private sector participation in value chains by eliminating administrative price-setting for publicly procured cereals. Second, the measures supported by this pillar will secure access to international markets for Kenyan farmers by facilitating their compliance with importers’ food safety and phytosanitary requirements. At the same time, it is worth noting that incidences of food safety issues are high in Kenya, and disproportionately affect lower income households; consequently, the domestic market will also be positively affected by the food safety reforms. Finally, the reforms under this pillar will increase smallholder productivity and resilience to climate change through improved soil and water management practices.

8. ***Pillar 3: Improving governance and financial inclusion to foster private sector led growth model.*** Transparency, accountability, and good governance reforms will help level the playing field between public and private actors, thus facilitating the transition to a private sector-led growth model. The operation supports conflict-of-interest legislation, which will promote impartiality in official decision making and ensure that the integrity of decision makers is not compromised by private interests. Moreover, legislative amendments will greatly streamline the process for the government to exit commercial investments by facilitating the identification and processing for sale of select state-owned enterprises. Furthermore, to increase the transparency and participation in climate action, the government will further expand the scope in which private sector and civil society provide input into climate policy. Finally, the government will

establish the Financial Inclusion Fund (aka Hustler Fund), which will greatly expand access to credit among the most underserved strata of the population and encourage their participation in the economy.

E. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

9. **The overall medium- to long-run poverty and social impacts of the reform package supported by the proposed operation are expected to be positive.** Prior Action 4 under Pillar 1, which classifies National Safety Net Program payments as essential budget expenditures and regularizes disbursement to beneficiaries according to a pre-determined timeline, will have direct benefits for extremely poor and vulnerable households by ensuring that safety net transfers are protected and disbursed in a timely manner even during a fiscal crunch (so that a repeat of the 2022 situation, during which safety net transfers to poor households were delayed by many months in the midst of a severe drought, can no longer happen). The other proposed reforms under Pillar 1 have the potential to benefit the poor and vulnerable indirectly by creating the fiscal space to support the government's inclusive growth agenda. The prior actions under Pillar 2 are expected to raise productivity and resilience of agriculture in the medium-term and secure markets for Kenya's agricultural products, benefiting the income growth and income stability of households that derive their livelihoods from agriculture. Under Pillar 3, the establishment of the Financial Inclusion Fund is expected to improve access to finance for informal micro-enterprises and low-income households, with positive effects on incomes and household welfare (e.g., nutrition) in the medium term. The other proposed reforms under Pillar 3 are not expected to have significant distributional impacts in the short run. The team recommends however that potential government divestments from commercial activities resulting from the Privatization Act (Prior Action 8) be subject to social impact assessments to inform appropriate mitigation measures.

Environmental, Forests, and Other Natural Resource Aspects

10. **The proposed operation supports the environment and management of climate change.** Prior action #6 supports reforms aiming to strengthen the national phytosanitary policy and food and safety bill, expected to strengthen the phytosanitary system for effective pest risk mitigation and management by enhancing safety and integrity of the agri-food produce throughout the export value chain. Similarly, the adoption of the Agricultural Soil and Management Policy (ASMP) under PA#5, expected to promote sustainable soil management practices, will be crucial for raising agricultural productivity while preserving the environment. It will promote efficient use of inorganic fertilizers by farmers, training the farmers to use the right types and application of fertilizers, with emphasis on soil analysis to establish the soil nutrient status and corrective nutrient replenishment. The phasing out of the fuel subsidies (PA#1b) will significantly contribute to reduced air pollution, traffic congestion in the urban areas, and improvement of human health. Appropriate pricing will reduce excessive consumption of motor fuels as well as vehicle accidents, as result of reduced vehicle use. Climate Change Act regulations (PA#9) will further improve transparency and accountability of government climate action and increase public participation in it.

CONTACT POINT

World Bank

Aghassi Mkrtchyan, Jana Kunicova
Senior Economist

Borrower/Client/Recipient

The Republic of Kenya
Chris Kiptoo
Permanent Secretary
pstnt@treasury.go.ke

Implementing Agencies

National Treasury
DG Sirima
Director General
lesirimahm@gmail.com

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Aghassi Mkrtchyan, Jana Kunicova

Approved By

Country Director:	Keith E. Hansen	10-Apr-2023