AFRICAN DEVELOPMENT BANK GROUP

KENYA

BANK GROUP COUNTRY STRATEGY PAPER 2019-2023 AND COUNTRY PORTFOLIO PERFORMANCE REVIEW

Task Team	Zerihun G. Alemu, Chief Country Economist, ECCE (Team Leader) Samuel J. Kamara, Principal Country Program Officer, RDGE0 Susan A. Olang'o, Social Development Officer, RDGE2 Camille Karamaga, Principal Governance Officer, ECGF David Mutuku, Principal Financial and Management Specialist, RDGE0 Onesmus, W. Maina, Agricultural Expert RDGE2 Zerfu Tesemma Mammo, Chief Transport Engineer, RDGE3 George M. Adongo, Infrastructure Specialist, RDGE3 Eshetu Yimer Legesse, Chief Financial Management Officer, RDGE0 Olufunso A. Somorin, Principal Climate Change & Green Growth Officer, RDGE2 Patrick Owuori Senior National Procurement Officer, RDGE4 Stephen, Bahemuka, Senior Statistician, RDGE4 Patrick, Kanyimbo, Regional Integration Coordinator, RDGE0/RDRI Alain Niyubahwe, Private Sector Strategy Expert, PINS1 John Bosco, CPO South Sudan and Somalis, RDGE0 Abdi Younis, Consultant Social Development, RDGE Alemayehu Wubeshet, Chief Power Engineer, RDGE1 Dana Elhassan, Senior Gender Expert, RDGE2 Jasmin Jakoet, Senior investment officer Justin Ecaat, Lead Environment Safeguard Specialist

Management Team	Mr. Gabriel NEGATU, Director General, RDGE Ms. Nnenna, NWABUFO, Deputy Director General, RDGE Mr. Ferdinand BAKOUP, OIC ECCE Mr. Marcellin NDONG NTAH, Lead Economist, ECCE
Peer-Reviewers	Mr. Tilahun Temesgen, Chief Regional Economist, ECCE Yasser Ahmed, Chief Country Programme Officer, RDGN0 Mr. Oduor Jacob, Chief Country Economist, ECCE

RDGE/ECCE DEPARTMENTS

April 2019

TABLE OF CONTENTS

LIST OF FIGURES

LIST OF BOXES

Currency equivalents

February 2019

Foreign Currency		Kenya Shilling
1 UA	=	145.86 Kenyan Shillings
1 USD	=	102.42 Kenyan Shillings

Weights and measures

Metric System

1metric tonne	=	2204 pounds (lbs)
1 kilogramme (kg)	=	2.200 lbs
1 metre (m)	=	3.28 feet (ft)
1 millimetre (mm)	=	0.03937 inch (”)
1 kilometre (km)	=	0.62 mile
1 hectare (ha)	=	2.471 acres

Government fiscal year

July 1 - June 30

ACRONYMS AND ABBREVIATIONS

ADF	African Development Fund
AfDB	African Development Bank
AfCFTA	Africa Continental Free Trade Area
AFD	French Development Agency
AGOA	Africa Growth Opportunity Act
AGTF	Africa Growing Together Fund
AII	Africa Integration Index
B4	The Big Four
CBK	Central Bank of Kenya
CBR	Central Bank Rate
CCVI	Climate Change Vulnerability Index
CODE	Committee on Operations and Development Effectiveness
COMESA	Common Market for Eastern and Southern Africa
CPIA	Country Policy and Institutional Assessment
CPIP	Country Portfolio Improvement Plan
CPPR	Country Portfolio Performance Review
CRFA	Country Resilience and Fragility Assessment
CSP	Country Strategy Paper
CTF	Clean Technology Fund
DFI	Development Finance Institutions
DFID	UK Department for International Development
DO	Development Objectives
DP	Development Partner
DRC	Democratic Republic of Congo
DSA	Debt Sustainability Analysis
EA-RISP	East Africa Regional Integration Strategy Paper
EAC	East African Community
EIB	European Investment Bank
EPZ	Export Promotion Zones
ESW	Economic and Sector Work
EU	European Union
EU AITF	EU Africa Infrastructure Trust Fund
FDI	Foreign Direct Investment
FRS	Fiduciary Risk Assessment
FTA	Free Trade Area
FY	Fiscal Year
GAFSP TF	Global Agriculture and Food Security Program Trust Fund
GEF	Global Environmental Facility
GBS	General Budget Support
GCG	Government Coordination Group
GCI	Global Competitiveness Index
GDP	Gross Domestic Product
GESIP	Green Economy Strategy and Implementation Plan
GHG	Greenhouse Gas
GoK	Government of Kenya
H5	High Fives
HEST	Higher Education Science and Technology Training

HCI	Human Capital Index
HDI	Human Development Index
HIV	Human immunodeficiency virus
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFMIS	Integrated Financial Management Information System
IHBS	Integrated Household Budget Survey
IMF	International Monetary Fund
IOP	Indicative Operational Plan
JICA	Japanese International Cooperation Agency
KIHBS	Kenya Integrated Household Budget Survey
KITP	Kenya Industrial Transformation Program
KNBS	Kenya National Bureau of Statistics
LAPSSET	Lamu Port South Sudan-Ethiopia
MIC TF	Middle Income Countries Technical Assistance Fund
MOF	Ministry of Finance
MSME	Micro Small and medium Enterprises
MTP	Medium Term Plan
NASI	Nairobi All Share Index
NSE	Nairobi Stock Exchange
ODA	Official Development Assistance
PBA	Performance-based Allocation
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PMU	Project Management Unit
PSCEF	Private Sector Credit Enhanced Facility
PWD	Persons with Disabilities
RBF	Results Based Framework
RDGE	Eastern Africa Regional Development and Business Delivery Office
REC	Regional Economic Communities
SCF	Strategic Climate Fund
SEZ	Special Economic Zones
SIDA	Swedish International Development Agency
SLL	Sustainable Lending Limit
TFTA	Tripartite Free Trade Area
TYS	Ten Year Strategy
TVT	Technical Vocational Training
TVET	Technical and Vocational Education Training
UA	Unit of Account
UK	United Kingdom
UNDP	United Nations Development Program
UNFCCC	United Nations Framework Convention on Climate Change
UNEP	United Nations Environment Programme
USAID	United States Agency for International Development
USD	United States Dollars
VAT	Value Added Tax
WB	World Bank

MAP OF KENYA


35°
40°
5°
0
150
300 mi
0
200
400 km
ETHIOPIA
SOUTH SUDAN
Mandera
Lodwar
SOMALIA
Marsabit
UGANDA
Wajir
Maralal
Kitale
KENYA
Bungoma
Eldoret
Busia
Isiolo
Nyahururu Falls
Nanyuki
Meru
Equator
Kisumu
0°
Nakuru
Nyeri
Kericho
Embu
Garissa
Kisii
Murang'a
Thika
Nairobi
Machakos
Lamu
INDIAN OCEAN
Voi
Malindi
TANZANIA
Mombasa
Tanga
5°
© 2011 Encyclopædia Britannica, Inc.

EXECUTIVE SUMMARY

1**. This report proposes the Bank Group's Country Strategy Paper (CSP) for Kenya for the period 2019-2023**. Its preparation coincided with the launch of Kenya's Third Medium-Term Strategy (MTP-III) 2018-2022 and its operational priorities "The Big Four" (B4), which serve as an implementation plan for the country's long-term Vision 2030. The MTP-III/B4 identified four priorities, namely, food and nutrition security, manufacturing, affordable housing, and universal health coverage. The CSP 2019-2023 is the product of extensive consultation with the Government of Kenya (GoK), the private sector, civil society, and development partners and draws from ESW and lessons learned as identified in the previous CSP's Completion Report.

2**. The Committee on Operations and Development Effectiveness (CODE) endorsed the combined 2014-2018 Country Strategy Paper Completion Report**, the Country Portfolio Performance Review (CPPR) and the PowerPoint Presentation (PPP) on the proposed pillars of the new CSP 2019-2023 on the 21st of September 2018. The proposed pillars under the strategy's theme 'supporting structural transformation through industrialization for sustained and inclusive growth include: **(i) Pillar I: Industrialization; and (ii) Pillar II: Enhancing skills and capacity development.** Projects under each pillar will mainstream crosscutting issues, notably green growth, climate change, gender and youth employment. This will be done respectively in accordance with the GoK's *Green Economy Strategy and Implementation Plan* (GESIP) 2016-2030; and the Bank's *Gender Strategy* and *Jobs for Youth Strategy*. The new strategy benefited, among others, from lessons learnt from CSP 2014-18 Completion Report (CR). It will build on the Bank's results achieved which contributed to MTP-II. Further, the new CSP is underpinned by the Bank's Growth Diagnostics (GD) study and the Country Resilience and Fragility Assessment (CRFA). It emphasizes the existence of persistent infrastructure and skills deficits and the need to give direct support to higher value addition.

3**. The overall objective of the CSP 2019-2023 is to support structural transformation to address persistent challenges of poverty, unemployment, income inequality and spatial socio-economic disparity through industrialization**. To achieve these objectives, the Bank's intervention under Pillar I will target to *(i)* reduce the cost of doing business by investing in critical *national* and *regional* infrastructure, namely, transport, energy, and water sanitation; *(ii)* support private sector development for value addition and job creation through policy, legal, institutional and regulatory reforms; *(iii)* support SME's increased participation in value addition in the B4's priority areas (manufacturing, agro- processing, and housing).

4. The second pillar (Pillar II) on the other hand aims at supporting the GoK's objective of creating jobs for the youth and women by addressing the skills gap in existing and emerging priority sectors. The Bank's interventions under this pillar aim at *(i)* improving the employability of the youth and women through low and medium level skills development, and *(ii)* addressing capacity and knowledge gaps in identified sectors for effective policy/operation dialogue with the government. Here the Bank's action will contribute notably to the training of the youth and women; enhancing skills of the MSEs in priority areas; and supporting the upgrading and expansion of existing training centres.

5. **The CSP 2019-23 will be financed through Bank and external resources**. Public sector lending under the CSP 2019-2023 will be supported by funding from the ADB window and two ADF cycles – ADF-14 (2014-2019) and ADF 15 (2020-2022). Resources under ADB and ADF-14 are programmed in this CSP document, while resources under ADF-15 would be programmed within the context of the CSP MTR envisaged for Q4 2020. Kenya's ADF-15 allocation is expected to decrease due to its possible graduation from a Blend to ADB only status in the near future. Therefore, the number of Bank's ADF financed public sector projects is expected to decline to UA

61.6m in the new CSP period against UA 287m in the just concluded CSP. On the contrary, borrowing from the ADB window is expected to increase from UA 1b currently to UA 1.23b by the end of the new CSP period. As regards to private Sector Lending, the Bank will continue to use available resources to leverage funding from the private sector through public-private partnerships (PPP), thereby maximizing the overall financial amount from which Kenya benefits under the new CSP. . Further, the Bank's ESW under the new CSP will continue to support lending operations and underpin Government policy and decision-making. ESW will be coordinated with other DPs, and prepared together when appropriate, to reduce overlap and increase impact. Funding for ESWs will continue to be drawn largely from Trust Funds.

6**. The performance of the Bank Group's portfolio in Kenya is assessed satisfactory** with an overall assessment of 3.03 (on a scale of 1-4) in 2018. This performance is the result of enhanced dialogue and engagement with the GoK, which has resulted in reducing implementation delays. There have been aggressive efforts by the National Treasury and RDGE to speed up project implementation and improve disbursement. As of end-2018, the Bank's portfolio in Kenya is composed of 38 operations (26 public and 11 private) with a total commitment of UA 2.38 billion. The portfolio is composed of energy (27%), transport (26%), water supply & sanitation (24.4%), Finance (12.3%), Agriculture (6%), Social (4%), and multi-sector (0.3%).

I. INTRODUCTION

7**. This report proposes the Bank Group's Country Strategy Paper (CSP) for Kenya for the period 2019-2023**. Its preparation coincided with the launch of Kenya's Third Medium-Term Strategy (MTP-III) 2018-2022 and its operational priorities "The Big Four" (B4), which serve as an implementation plan for the country's long-term Vision 2030. The MTP-III/B4 identified four priorities, namely, food and nutrition security, manufacturing, affordable housing, and universal health coverage. The CSP 2019-2023 is the product of extensive consultation with the Government of Kenya (GoK), the private sector, civil society, and development partners and draws from ESW and lessons learned as identified in the previous CSP's Completion Report.

8**. The Committee on Operations and Development Effectiveness (CODE) endorsed the combined 2014-2018 Country Strategy Paper Completion Report**, the Country Portfolio Performance Review (CPPR) and the PowerPoint Presentation (PPP) on the proposed pillars of the new CSP 2019-2023 on the 21st of September 2018. The proposed pillars under the strategy's theme 'supporting structural transformation through industrialization for sustained and inclusive growth' include: **(i) Pillar I: Industrialization; and (ii) Pillar II: Enhancing skills and capacity development.** Projects under each pillar will mainstream cross-cutting issues notably green growth/climate change, gender and youth employment. This will be done respectively in accordance with the GoK's *Green Economy Strategy and Implementation Plan* (GESIP) 2016-2030; and the Bank's *Gender Strategy* and *Jobs for Youth Strategy*. The new strategy benefited, among others, from lessons learnt from CSP 2014-18 Completion Report (CR). It will build on Bank's outputs and outcomes achieved which contributed to MTP-II. Further, the new CSP is underpinned by Bank's Growth Diagnostics (GD) study, and the CRFA. It emphasizes the existence of persistent infrastructure and skills deficits and the need to give direct support to higher value addition.

9. The rest of the report is structured as follows: section II analyses the country's context with a focus on recent political and economic developments and social and cross-cutting issues. Section III strategic options, portfolio performance and lessons. Here the discussion will focus around Kenya's strategic framework, and country's portfolio performance. Section IV Bank Group strategy for Kenya for the 2019-2023 period. Section V conclusion and recommendation.

II. COUNTRY CONTEXT AND PROSPECTS

2.1 Political Context

10. Kenya has made considerable progress in recent years towards a politically stable, democratic country with the enactment of the new constitution in August 2010 and conclusion of the October 2017 elections. The heightened political tension between the ruling party and the opposition on election matters that ensued was defused thanks to the historic 'handshake' between the ruling party and the leader of the opposition paving the way towards positive political outlook. However, despite the relative political calm, the security situation in Kenya continues to be fragile, exacerbated by the long, porous borders, a large number of refugees and regional instabilities, especially in Somalia, South Sudan, and the Great Lakes Region. Kenya's performance in governance indicators has been mixed. As regards the 'Mo Ibrahim Index of African Governance', Kenya's overall score slightly improved in recent years, from 58.8 (out of 100 points) in 2014 to 59.8/100 in 2018, which reflects the upward trend in the country's ranking from 14th (out of 54 countries) to 11th/54 during the same period. While all 4 sub-components of the Index have improved during the period, the strongest improvement was recorded in "Safety & Rule of Law" and "Sustainable Economic Opportunity". Kenya best performing sub-indicator remains "Human Development", where the country is ranked 7th/54 in 2018, with a score of 68.5/100. According to the Transparency International Corruption Perception Index, Kenya's corruption continues to be relatively high. In 2018, Kenya scored 27 points out of 100 a slight decline from 28 points in 2017. It is ranked at position 144th out of 180 compared with 143rd out of 180 in 2017, and 45th in 2016 and 2014. Kenya's score is below the global average of 43 and Sub

Saharan Africa's mean of 32. Kenya's score in the past five years ranged between 25 and 26; 26 in 2016, 25 in 2015 and 2014. This indicates, according to Transparency International that efforts to fight corruption have contributed little results.

2.2 Economic Context

11. **Economic structure.** The sectoral shares of agriculture, industry, and services in Kenya's GDP have progressively changed over the last few years. The service sector constitutes more than half of Kenya's GDP (56% in 2017). The share of agriculture on the other hand progressively declined to stand at 23.5% in 2017 from 29.3% in 2000. In addition, industry only picked up from 18.2% in 2011 after a long period of stagnation to 21.0% in 2017. However, with the declining contribution of agriculture in Kenya's GDP, the share of workers employed in the agriculture sector as a percentage of the total remains high, implying that the pace of structural transformation is not in tandem with the changing sectoral share contributions. Despite evident shift in the structure of the economy from 2003, the share of employment in agriculture has remained high and unchanged particularly since 2007. The share of employment in industry on the other hand has been declining despite the increasing contribution of industry in Kenya's GDP, possibly due to increasing deployment of capital-intensive production techniques. Between 2008 and 2017, the employment share of agriculture has fallen by only 3.4% compared to a rise in employment share of services by 6.61% over the same period. Industry on the other hand has witnessed a decline in its employment share by 9.0% over the same period, despite the increasing contribution of industry in Kenya's GDP. This shows the persistence of agricultural employment. Further, within industry, manufacturing contribution to GDP has stagnated at 9% for over a decade. Manufacturing value addition is estimated at about 5%, the lowest compared with other sectors - agriculture (15%), industry (10%) and services (27%). Recognizing the slow-paced structural change, Kenya has introduced strategies, policies and programs to achieve structural transformation through industrialization. They include: Vision 2030[i]; Medium Term Plans (MTPs) [ii]; Sector program, Kenya Industrial Transformation Programme (KITP), National Trade Policy, Investment Policy and Buy Kenya Build Kenya (BKBK). The country has relatively favourable conditions to attract FDI e.g. human capital[iii], cost[iv], supplier networks[v], and domestic demand[vi]. The MTP-III and KITP identify the following activities with high potential in value addition and employment generation: textiles and apparel; leather; agro-processing; manufacture of construction materials; oil and gas and mining; fish processing, etc.

12**. Recent Economic performance**. Kenya is the 2nd largest economy in the Eastern Africa region after Ethiopia. Its economy has performed well in recent years. It grew on average by 5.7% between 2014 and 2018[vii], higher than continental average growth of 3.2%. Growth has been in the main service sector driven. Services grew on average by 6.2% contributing for about 70% of the 5.7% GDP growth followed by industry (17%) and agriculture (13%) (Fig 1). Within services, growth has come from diversified sources with the real estate, finance & insurance, wholesale and insurance, education and_transport & storage as major growth drivers (Annex 7). Further, according to Bank's Growth Diagnostics (GD) Report[viii], growth has been *factor-driven* (i.e. labor and capital) rather than efficiency-driven (i.e. productivity) (annex 12). On the demand side, growth has been domestic demand driven with households accounting for 80% of the 5.7% growth followed by private investment and government while external demand continued to be a drag to growth (Fig 3). GDP growth was the slowest in 2017 compared with other years caused by drought, weaker economic activities (due to the 2017 disputed election), slower global economic growth and lower commodity prices. Kenya's economy is expected to rebound in 2018 growing by 5.9% against 4.9% in 2017 supported by good weather, eased political uncertainties, improved business confidence, and strong private consumption.

13. **Economic outlook in general is positive.** Kenya's economy is projected to grow by 6.0% and 6.1% in 2019 and 2020, respectively. This is expected to happen on the back of good weather condition, improved business confidence, continued macroeconomic stability, and global economic performance. Overall, downside risks to growth prospects could emanate from rising oil prices, slow credit uptake by the private sector, and failure to raise external resources.

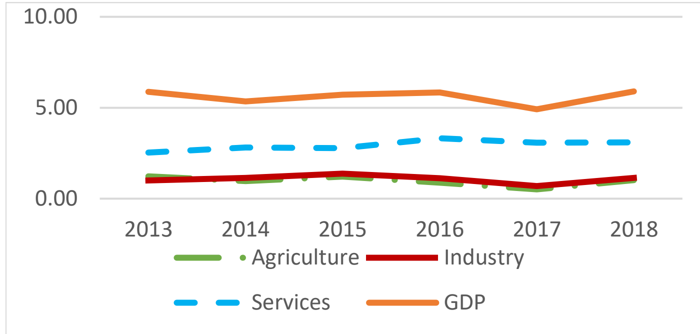


Figure: 1: Contribution to Growth

14. **<u>Macroeconomic Management</u>. Monetary policy has been consistent with the CBK's objective of price and exchange rate stability the past five years. However, the interest rate capping law is weakening monetary policy effectiveness**. The CBR fluctuated within 7.5% and 11.5% the last five years before it declined to 10% following the introduction of the interest rate capping law in September 2016. Inflation averaged 6.7% during 2013-2017 (5.7% in September 2018), within the 5± 2.5% target band of authorities and the exchange rate has remained stable. The CBK recently loosened its monetary policy stance to stimulate growth. The policy rate was reduced to 9% in March 2018 from 9.5% in July 2018. This accommodative policy stance was supported by lower core inflation, commitment to fiscal consolidation, a narrowing current account deficit and improving external positions. Nonetheless, the interest rate capping law continues to disturb monetary and financial market operations. The interest rate capping law resulted, among others, in reduced private sector credit growth (about 5%) as a result of re-allocation of credit from private to risk free public sector T-Bonds and Bills[ix] (Fig 2); distorted competition in the banking sector; reduced savings; and constrained the effectiveness of monetary policy. There are calls to remove or modify the interest rate capping law to which the GoK has heeded positively[x]. The partial removal (i.e the deposit rate) alone is expected to increase the profitability of banks but its effectiveness in increasing credit to MSMEs is doubted as long as yield on risk-free government bonds remains high. Monetary authorities are expected to continue to pursue a prudent monetary policy stance in the coming years. As such, the rate of inflation is expected to remain within the target in 2019 and 2020 and the exchange rate to continue to be stable.

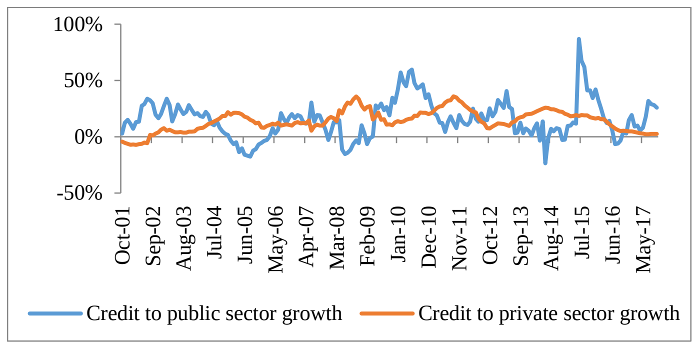


Figure 2: Credit Growth

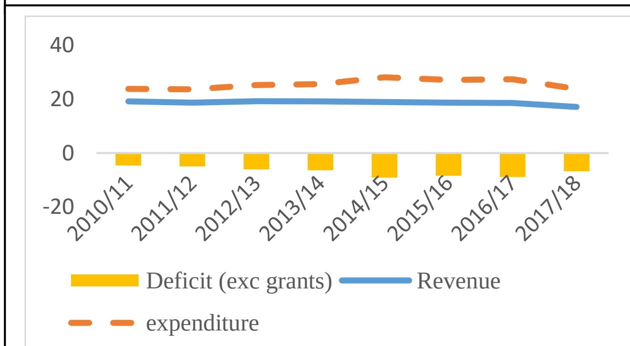


Figure 3: Revenue, Spending & Fiscal Balance;

15. Kenya's fiscal policy is anchored on fiscal consolidation. However, the GoK needs to pair fiscal consolidation with growing revenue collection in order not to stifle growth. The fiscal deficit averaged 7.5% between 2014 and 2018 (Fig 3) caused mostly by increased infrastructure spending. The tighter fiscal policy stance that ensued resulted in a reduction in fiscal deficit to 6.9% of GDP in 2017/18 from about 9%

in 2016/17[xi]. However, the improvement has little to do with revenue, which fell from 18.4% to 17.2% of GDP in 2016/17. It was rather a result of cuts in development spending. Development spending as a percentage of GDP fell to 5% from 8% in 2016/17 FY (Annex 7). According to the 2018/19 budget, the GOK envisages continuing on the path of fiscal consolidation to address rising level of fiscal deficit and stabilize public debt. The GoK has unveiled a fiscal consolidation path for the next three years. Accordingly, fiscal deficit would reduce to 5.7% in FY 2019 and fall to 3% by 2021/22. This is to be achieved on the back of revenue enhancement measures, rationalizing expenditures through zero-base budgeting and reducing cost of debt by diversifying the sources of funding for the development budget over the medium term. Downside risk could include, *inter alia*, failure to make fiscal consolidation growth friendly; fiscal slippage caused by lack of appetite to implement the proposed fiscal consolidation measures on political economic grounds; and inability to raise enough loans at affordable rates to finance planned/unplanned fiscal deficit caused by tightening global financial markets.

16. Public debt stock increased to 57% of GDP or about USD$ 50 billion as at end December 2018, a big jump compared to 42.1% in 2013. The increase could be attributed to an increase in both domestic and external borrowing to finance fiscal deficit and change in the composition of public debt portfolio towards expensive commercial and short maturity loans. Public debt is made up of domestic loan (48.3%) and external loan (51.7%). The latter has shown a marked increase over time. Domestic debt is composed of commercial banks (51.1%); non-banks (44.4%) and CBK (4.5%). The share of loans from commercial Banks has increased over time. External loan is composed of commercial bank loans (34%), multilateral (33%) and bilateral (32%). The share of commercial loans has increased while that of multilateral decreased. Public debt is expected to tick up to reach 60% by the end of 2018 because of unfinished infrastructure projects and borrowing to refinance a sizable amount of commercial debt maturing in 2019. It is expected to moderate thereafter due to narrowing fiscal deficit, stable exchange rate[xii] and resilient GDP growth. Overall, on PV terms, according to IMF's 2018 DSA, Kenya's total debt stock (domestic and external) and external debt are estimated at 48.5% and 22.5% of GDP, respectively. This is lower than the WB/IMF benchmark of 74% for all debt and 50% for external debt. Similarly, Kenya's other external debt indicators (i.e. PV of debt to export, debt to revenue, debt service to export and debt service to revenue) are all projected to remain below the sustainability thresholds in the short term under the baseline scenario. However, owing to the possibility that the thresholds could be breached especially the liquidity indicators if the economy is exposed to external shocks or abrupt changes in macroeconomic policies, the IMF increased Kenya's debt distress from low to moderate However, Kenya's rating by credit rating agencies, except by Moody, which downgraded to B2 from B1 while retaining outlook at stable, has remained unchanged.

17. <u>Financial Governance/PFM</u>. Kenya's 2010 constitution introduced significant changes to economic and financial governance, including the introduction of two levels of Government (national and county) and the sharing of revenue collected at the national level with county governments. The Public Finance Management (PFM) Act of 2012 introduced new budget planning and execution as well as auditing framework, including a Treasury Single Account. The Integrated Financial Management Information System (IFMIS), re-launched in 2012, is being rolled out to Ministries and to the sub-national levels. The 2017 PEFA report (draft) concluded that the overall PFM system performance has improved somewhat since the time of the 2012 PEFA assessment, but by not as much as anticipated at that time. There was great expectation to see significant improvement because of the 2010 constitution and the 2012 PFM Act. The

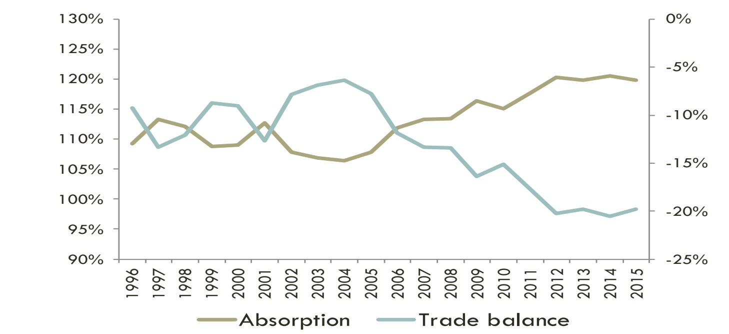


Figure 4: Domestic & Foreign Demand, % GDP; *Source: AfDB*

late effectiveness of the Financial Regulations, which was done in 2015, contributed to slow progress in the implementation of the PFM reform. The draft PEFA report mentioned slow Implementation of IFMIS and its integration with other PFM-related Information Technology (IT), mainly for technical reasons. Through the PFM Reform Strategy 2013-18, the Government of Kenya has started wide ranging initiatives in order to improve the public financial management systems across the national and country governments. The PFM Reform Strategy ended in 2018 and the Government is preparing a PFM Reform Strategy for 2019-2023 (see annex 19 for fiduciary risk assessment). In the 2016 Country Policy and Institutional Assessment (CPIA); Kenya's overall scores was 4.4 above Africa average of 3.5. The country scored 4.3 on macroeconomic management, 4.4 in structural policies, 4.4 in social inclusion, 4 on governance and 4.6 on infrastructure and regional integration. The country's score on governance has consistently been poor due to low enforcement of property rights, impartiality of laws affecting economic activity and issues raised about transparency, accountability, and corruption.

18. External position deteriorated between 2014 to 2017 in part due to the widening of merchandises trade deficit (See trend in trade balance in Fig 4)**.** However, it has shown some sign of improvement recently. Gross official reserve reached USD 8.2 billion (5.4 months of imports higher than the statutory requirement of at least 4 months of import cover) as at February 7, a 7% increase against the corresponding quarter in 2017, providing a good buffer against external shocks. This could be attributed to improved current account and financial account balances. The current account deficit narrowed supported by an increase in remittance, surplus in financial account, proceeds from the Eurobond and corporate borrowing from abroad.

19. Kenya's private sector continues to be vibrant but remains characterized by a dichotomous structure: a formal business sector, which is relatively healthy and productive but concentrated in a few firms, and a massive, informal, low-productivity small business sector, which contributes 83% of employment in the private sector. Large formal private sector entities exist mainly in financial and related services, wholesale, and horticulture, tea, coffee and sugar cane production. The bulk of agricultural production falls within the informal subsistence-oriented smallholder farming, largely concentrating in food crops and nomadic livestock rearing. Kenya's private sector has not reached its full productive capacity, mainly due to persisting infrastructure deficits, increased perception of corruption, relatively weak regulatory environment, and a shortage of appropriately trained workforce. This notwithstanding, the 2018 *Doing Business* indicators show Kenya moving upwards to rank 80 in 2017 from 92 in 2016 and 108 in 2015. Notable improvements include: starting a business made easier by reducing the time it takes to assess and pay stamp duty; reduced delays for new electricity connections by enforcing service delivery timelines and hiring contractors for meter installation; property transfers made faster through electronic document management at the land registry and introduction of unified form for registration; and improved access to credit information by passing legislation that allows the sharing of positive information and by expanding borrower coverage. Kenya also improved slightly its position of 96^{th} to 91^{st} in the 2017 Global Competitiveness Index report. The improvements are credited to the implementation of a number of policy, legal, regulatory and institutional reform facilitated by the Business Environment Delivery Unit. Kenya targets to improve its ranking further to 45^{th} by 2022. Some of the planned reform initiatives include – enacting bills that affect company registration, putting in place online systems for business registration, linking the stamp duty collection with the Kenya Revenue Authority (KRA) system, simplifying the process of land registration, reducing the time taken to connect a business to electricity and establishment of a one-stop shop centre by the Kenya investment authority to facilitate investors starting businesses and investing in the country. Annex 18 summarizes other planned policies, legal and institutional reforms by the government to support manufacturing.

20. **Financial sector developments**: The financial sector is regulated by the Capital Market Authority, the Central Bank of Kenya, insurance regulatory authority, retirement benefit authority, Sacco society regulation authority and government ministries for DFIs. The Banking sector accounts for about 60% of the total assets in the sector. The 2017 Financial Sector Sustainability report of CBK has found the banking sector to be resilient despite some challenges. The challenges included the placement of one bank under liquidation and two banks under receivership; introduction of the interest rate capping law, which severely constrained private sector credit growth; and political risk of the 2017 election. The Banking sector comprises 42 commercial banks, 1 mortgage finance company, 13 microfinance banks, 8 representative offices of foreign banks, 73 foreign exchange bureaus, 19 money remittance providers, 8 non-operating bank holding companies and 3 credit reference bureaus. As at end October 2018, NASI was 145.5 and market capitalization was at Ksh 2.1 trillion. The capital market is dominated by foreign investors, with average net foreign investor participation to total equity turnover rate of about 65% in 2017.

21. The recent financial markets index report 2018 prepared by the Official Monetary and financial institutions Forum (OMFIF) ranked Kenya as number three mainly due to improved policy on foreign exchange. Kenya had top place for access to foreign exchange but limited product diversity. A recent Brookings attributes Kenya's top ranking to increase in the rate of mobile money adoption among low-income adults and women. Similarly, according to another study by FinAccess Survey Report of 2016, financial exclusion[xiii] in Kenya dropped from 25% in 2013 to 17% in 2016, while access to formal banking increased from 66% to 75% in the same period. Success stories continue with regard to mobile money transfer, where services and usage expanded to 71% in 2016 from 28% in 2016. Despite success stories, compared to its peers, savings to GDP ratio is low at 12.9% while interest rate spread at 8% (despite a decrease) is high, indicating inefficiencies in the financial intermediation process. The introduction of caps on the lending and deposit rates in September 2016 to reduce the margin only made the problem worse with reduction in credit to the private sector as credit providers divert lending to less risky assets.

2.3. Sectoral Context

22. Infrastructure. Kenya has invested heavily in infrastructure development in recent years and the progress made has played a critical role in transforming the economy, enhancing domestic and regional connectivity and strengthening Kenya's position as a regional hub. This notwithstanding, the country is facing serious infrastructure deficits. This is exacerbated Kenya's growing need for infrastructure financing is estimated at between USD 7.4 and 8.3 billion a year. This, compared with average USD 2 to 3 billion investment a year, puts the infrastructure financing gap at USD 5 billion a year.

23. Transport: The sector lacks diversification. The country relies on roads for 90% of its freight and passenger transport. Recognizing these challenges, the GoK is investing in national and multinational projects with emphasis on roads, railways, ports and air transport sectors. As regards to road networks, it is unevenly distributed hence a constraint to growth in rural economic activities, commercial agriculture, tourism, manufacturing and others. The number of firms experiencing poor road network in their area of operation is high at 21.6% compared to South Africa 3.9%, Nigeria 17.1%, and Uganda 15.7%. The MTP-III targets to construct/rehabilitate 10,000km of roads countrywide; increase railway capacity from 5% to 50%; improve handling capacity of ports by constructing container terminals; and investing in aviation. Over the last five years, significant investment has gone into the upgrade of highways and has supported the construction of 1,304km of new roads, rehabilitation of 535km and periodic maintenance of 4,212km and routine maintenance of 154,198km. The networks upgraded form part of the key corridors for moving goods nationally and the transhipment of goods to countries in the East and Central Africa. Kenya has also made significant strides in the development of the Standard Gauge Railway, to further improve the links to neighbouring Uganda and beyond. The first phase has been completed and the country is now benefiting from cheaper and faster travel of people and cargo between Nairobi and Mombasa. Additionally, the Government has prioritized the upgrade of the Mombasa Port to improve capacity levels and logistics. The second container terminal completed in 2016 has added about 550,000 TEU of capacity. Works on ancillary infrastructure area also underway.

24. Energy: Kenya's power generation capacity reached 2,351MW as at end June 2018 from 1.768MW in 2013. Access to electricity is currently estimated at 75% thanks to increased investment in generation and distribution. However, a long way to achieving MTP-III target of 100% by 2022. Electricity generation tariff, at 6.8 US cents per KWh, is relatively the highest in the region and the number of outages experienced by firms is above Sub Saharan Africa average[xiv]. In 2017/2018, the country got energy from diversified sources- hydro (30.4%), fossil thermal (21.8%), geothermal (47%) and imports 2%. To make supply reliable and support the expected economic growth, GoK plans to increase installed capacity to 5221 Mw to meet pick demand, which is projected to reach 3207MW by 2022. Further it would invest towards modernization of transmission and distribution systems and engage in regional power markets even as it continues to support diversifying generation sources in line with GoK's program of reducing vulnerability to climate variation and fuel price fluctuation. The country (as part of its 'least-cost power development plan'), has made good progress in diversifying its energy sources. The contribution of geothermal, a cost-effective power generation option is increasing. Further, the commissioning of the wind turbines will be completed in 2019. It is expected to increase installed capacity by 310MW.

25. Water supply and sanitation infrastructure is another area where challenges persist despite GoK investing heavily to support the expansion of access to water and sanitation. Investments in the sector between 2013 and 2017 increased the share of population with access to safe drinking water from 53.3% to 58%; over the same period, the sanitation coverage rose from 67% to 74%. The investment boosted water supply for irrigation covering areas in arid and semi-arid regions for small and large-scale farming activities. As a result, area under irrigation increased from 142,000 ha in 2013 to 193,600 ha in 2016. However, to increase access, the government is planning to develop multipurpose water storage facilities. The facilities are also expected to contribute in boosting agricultural production by **irrigating** land in arid and semi-arid regions. According to data from World Development Indicator (WDI), only 0.04% of the total agricultural land is irrigated, much less than South Africa at 1.7%. Investments in irrigation are expected to support GoK plan of achieving food and nutrition security by 2022 by supporting small and large-scale production.

26. **Agriculture**. The agriculture sector contributes 24 percent of Kenya's annual GDP, 65 percent of Kenya's total exports, and 18 percent and 60 percent of the formal and total employment respectively. The Agriculture Sector Development Strategy (ASDS) targets to sustain a 7 percent agriculture sector annual growth rate in order to address poverty and food insecurity and contribute to the development of a modern and competitive sector. ASDS will also contribute to the Big 4 Agenda for the next five years. Within the B4, food and nutritional security proposes to grow agriculture value chains to achieve 100 percent food and nutrition security by 2022. Priority value chains under this Big 4 pillar are maize, potatoes, rice, leather, and fish. The ASDS Strategy focuses on four objectives: productivity and promoting commercialization and competitiveness of all crops, livestock, marine and fisheries, and forestry; promoting private sector participation in all aspects of agricultural development; developing and managing the national water resources, land resources, forestry, and wildlife in a sustainable manner; and reforming agricultural service, credit, research, regulatory, processing and manufacturing institutions for efficiency and effectiveness. Key challenges facing the sector, as articulated in the ASDS include: low production and productivity; inadequate budgetary allocations; reduced effectiveness of extension services; low absorption of modern technology; limited capital and access to affordable credit: pre- and post-harvest crop losses; heavy livestock losses to diseases and pests; low and declining soil fertility: lack of a coherent land policy; inadequate infrastructure; insufficient water storage infrastructure; inadequate storage and processing facilities and inadequate markets and marketing infrastructure.

2.4. Regional Integration and Trade

27. Kenya's regional economic cooperation is guided by its regional integration policy. It has established a Ministry responsible for East Africa Cooperation with economic, social and political directorate. The policy has the objective of enhancing Kenya's ability to maximize on opportunities in the RECs it participates in, and to enhance Kenya's ability to better integrate into the global economy. Currently Kenya is a member of the EAC, COMESA, IGAD and the TFTA negotiated between the EAC, COMESA and SADC and

recently the AfCFTA. As part of a trade facilitation drive, Kenya has invested in the improvement of the regional energy, road and rail networks. It also facilitates regional energy transmission efforts through investments in cross-border transmission lines. As a result, Kenya performs strongly in the AII across all dimensions in particularly trade integration, productive integration, infrastructure integration and movement of persons. On Movement of persons, Kenya moved from position 16 in 2016 to positon 9 in 2018 in the Africa Visa Openness Index, reflecting its recent policy reforms allowing Africans greater visa-free or visa-on-arrival access. In particular, during his inauguration speech in 2017, President Kenyatta announced that all Africans will be eligible to receive a visa at the port of entry in Kenya. Such moves are set to promote business and drive growth in tourism which accounts for nearly 10% of Kenya's economy. However, the country continues to face shortcomings in terms of physical infrastructure connectivity with its neighbours and the region. This is why Kenya is pursuing the development of the LAPSSET program, which will provide an alternative link to Ethiopia and South Sudan and further afield to the Cameroon and Central African Republic. The first of three funded by the Government will be finalized by June 2019. LAPSSET comprises several investments along the corridor in industrial parks and special economic zones, resort cities, and power plants among other projects. LAPSSET, alongside other new regional infrastructure projects such as the Malindi-Lunga-Lunga-Bagamoyo road project will play a key role in the regional integration and industrialization process and unlocking opportunities in the Blue Economy, which is receiving increased attention as a source of growth. Being a member of the EAC, it allows residents, in accordance with the protocol of the EAC, free movement of goods, services, capital and labour. The EAC passport allows EAC citizens to travel freely in the EAC region for a period of six months. Kenya's trade policy is among the most liberalized in the region. This coupled with adoption of a free-floating exchange rate regime makes it one of the strong proponent of regional integration on the continent. As EAC member, it abides by EAC Common External Tariff made up of three bands: 0% (raw materials and capital goods); 10% (intermediate goods); and 25% (finished goods). However, political instability in some of the member countries, Non-Tariff Barriers[xv] (NTBs) and other restrictions to cross-border movement of goods, services and labour and member's failure to stand as one strong entity on issues of interest to the EA community continue to pose challenges to fully exploit the opportunities regional integration brings.

2.5 Social Context and Cross-Cutting Themes

28. **Kenya has experienced economic growth over the past decade. However, growth has not been sufficiently inclusive**. The country still suffers from high level of poverty and regional disparities, limited access to basic services, inequality and unemployment, with youth, women and other vulnerable groups particularly hard-hit. The government of Kenya, recently introduced the "The Big Four" (B4) economic plan. It has the objective of achieving structural transformation to address the perennial challenges of poverty, unemployment and inequality. According to the KIHBS, the country registered reductions in poverty and income inequality between 2006 and 2016. However, regional disparity remains high[xvi]. Relative poverty decreased to 36% in 2016 from 47% in 2006. Income inequality, measured by the Gini index fell to 0.39 from 0.45 over the same period. This is be attributed to the pro-poor nature of government policies. A recent study by the WB on fiscal incidence public spending has found that social sector spending in Kenya is broadly progressive and pro-poor. The sector accounted for a third of total expenditure, with education accounting the lion's share at 20%. Further, it found that nearly half of the school-going children between the ages of 6 and 17 come from the poorest 40% of the population, which account for 14% of per capita market income. It also found that the taxing system in Kenya is broadly progressive - the poorest 40% of the population account for 14% of market income but less than one percent of direct taxes, between 12 and 14 percent of the tax burden, and 6.6% of total excise tax.

29. Enhancing skills development vital to improving enterprise productivity and address youth unemployment. According to KIHBS, 55% of Kenya's population is working age; 7.4% of the labour force is unemployed;[xvii] 85% of the unemployed are aged below 35 years while 18% are aged between15-24, more than twice the overall rate of unemployment. In terms of education attainment of the unemployed, 30% had reached primary level of education, 35% secondary, 11% college (middle level), and 9% university. Further, studies show that high vacancy rate in both public and private sectors of the economy exists side-by-side massive unemployment. This could be partly explained by the growing skill gaps and skills mismatch that is being experienced both in the existing and emerging sectors. It is therefore reflective of the need to effectively link the supply and demand sides of the labour market. The economy created 4.1 million jobs, mostly for the youth, during the MTP-II period (2013-2017); too small compared with an estimate of 1 million young people entering the labour market annually without any skills and the 155,000 TVET and University graduates. The MTP-II had a target of creating 1 million jobs annually. However, the target was not met. In 2017, the economy generated 897,800 jobs (90% being in the informal sector). Similarly, MTP-II had a target of increasing the share of the formal sector jobs from 12% to 40%. This too did not materialize; formal sector jobs contributed an average of 14% of total jobs between 2013-2016. The MTP-III recognizes the need for skilled manpower to achieve its B4 agenda. In this regards it outlines several areas of interventions. They include, among others, enhancing skills in identified priority areas (textile and apparel; leather; MSE, construction, etc.); linking industry and training institutions; launching national internship programs; investing in Technical and Vocational Education Training (TVET) institutions.

30**. The GoK has introduced a number of policies since 2010 to bridge the gender inequality gap, but more needs to be done**. The Global Gender Gap Index 2017 placed Kenya at 76 out of 142 countries. Kenya scored 0.694 (the highest possible score is 1) in 2017, lower than the 0.726 score recorded in 2014. The decline in the index had to do with a decline in sub-indices on economic opportunity and political empowerment during the period.[xviii] The index also showed some gains in education attainment and health survival sub-indices. The gains mainly arose from the free education policy in primary and secondary education and health related interventions[xix]. The country has implemented a number of policies in the economic and political spaces to bridge the gender gap. However, the benefits are yet to be realized. The notable interventions to improve gender inequality and women empowerment include the one-third gender rule of the 2010 constitution to increase the number of women in leadership positions across all political and other establishments at the national and county levels; the Public Procurement Act of 2015 that reserves 30% of public procurement opportunities for women, youth and Persons with Disabilities (PWD); the Uwezo Fund, launched by the Government in 2014, which aims to boost women's and youth economic empowerment by eradicating extreme poverty and hunger and promoting gender equality and empowering women.

31. **Climate Change and Green Growth**: Kenya is highly vulnerable to climate change caused by industrial and emerging countries. Since 2014, Kenya has developed a Climate Change Policy as well as a Green Economy Strategy and Implementation Plan (GESIP), which was supported by the Bank and launched in July 2017. The GESIP is designed to support a globally competitive low carbon development path through promoting economic resilience and resource efficiency, sustainable management of natural resources, development of sustainable infrastructure, and providing support for social inclusion (see annex 20).

III. STRATEGIC OPTIONS, PORTFOLIO PERFORMANCE AND LESSONS

3.1 Country Strategic Framework

32. The Vision 2030 remains Kenya's main developmental blueprint, and continues to be implemented by successive five-year medium term plans (MTP). The second MTP ended in 2017 and was designed to achieve an accelerated growth, transform the structure of the economy and create more quality jobs. Further, it focused on implementing devolution, national unity and identity; infrastructure development; irrigation and mechanized agriculture; value addition; poverty reduction and social protection; skills development; governance and public financial management reforms. It achieved mixed results. Over the five-year plan period the economy registered average growth rate of 5.6%, lower than the 10% target, largely attributed to

insecurity, which dampened investments and negatively impacted tourism; flood of cheaper imports that depressed growth in the manufacturing sector; severe droughts and drop in commodity prices. Moreover, unemployment and inequality remain high.

33. Despite the slow economic growth, gains were made in a number of areas, e.g., infrastructure development; financial inclusion; social sector, notably improvements in student enrolment, drop in infant mortality rates and supporting women empowerment. On the latter, a total of 49,571 women groups received loans amounting to Kshs 6.3 billion (US$ 63 million) through the women enterprise fund (WEF) and 213,636 women trained on basic accounting, business skills and formation of cooperatives. Furthermore, through the National Government Affirmative Action Fund, the Government spent Kshs 3.2 billion to Counties to support Affirmative Action Groups/Projects. Additionally, the government significantly increased its funding to cash transfer programmes to the elderly, orphans and vulnerable children. The implementation of the devolution program progressed, with advancement on several fronts, including empowering Counties on the delivery of infrastructure and social services such as health and education. It is important to note that the full benefits of the program will be realized overtime as challenges are being addressed. Key of them include: *i)* multiple regulations and enforcement, increasing in the cost of doing business[xx]; *ii)* double taxation and multiplicity of charges; *iii)* coordination between the national and county governments; and *iv)* transparency and accountability.

Box 1: The Big Four Agenda

- Supporting value addition and raising the manufacturing sector's share of GDP to 15% by 2022 to accelerate economic growth, create jobs and reduce poverty. It emphasizes the role of agro-processing recognizing that only 16% of Kenya's agro exports are processed; much lower than 27% for Tanzania and 34% for Uganda. Agro-processing has the potential of replacing USD 3.8b imports. Further, with AGOA's preferential treatment in place, Kenya textiles have 8% cost advantage compared to the other low cost countries like Bangladesh.
- Food and Nutrition Security: guarantee food security and improve nutrition to all Kenyans by 2022.
- Provision of Universal Health Coverage to guarantee quality and affordable healthcare to all Kenyans and
- Provide at least 500,000 affordable new houses to Kenyans by 2022 to improve living conditions for Kenyans. Estimates show affordable housing deficit of 200,000 units per year.

34. The Third Medium Term Plan (2018-2022): Building on the solid gains made under the MTP-II, the MTP-III aims at transforming the economy to achieve inclusive and broad based economic growth. It targets a GDP growth rate of 7%[xxi]. "The Big Four", serving as operational priority for MTP-III, identifies four areas of strategic focus for the next five years - manufacturing, food and nutrition security, universal health coverage and affordable housing. Further, emphasis will be placed on combating corruption and improving governance and accountability, deepening public sector reforms and strengthening the capacity of county governments as well as coordination between national and county governments. The MTP-III will mainstream and integrate measures to combat or mitigate the effects of climate change in the context of the Paris Agreement. The Government has already taken steps towards developing key policy documents and legislation including the Climate Change Act (2016), National Climate Change Framework Policy, National Climate Change Action Plan and National Climate Change Response Strategy. In general, it is well aligned with the global agenda, the SDG 2030; continental Agenda, Africa by 2063; nationally with Vision 2030 and the MTP III; and AfDB's Ten-Year Strategy (TYS) and the High Fives (H5s).

3.2 Aid Coordination and Harmonization

35. All the Bank financed Projects in Kenya are designed, implemented and supervised within the framework of the Paris Declaration and lately the Development Effectiveness principles agreed in Busan. All the Bank projects are identified by Government and aligned with the Government's long-term developmental plans; in particular, Kenya's Vision 2030 and the third Medium Term Plan (2018-2022). Development Partners Group (DPG) bringing together all bilateral and multilateral Agencies meets monthly to review development priorities. Parallel to this, the Government Coordination Group (GCG) brings together Cabinet/Principal Secretaries of State Departments. DPG and GCG meets at least twice a year at a Development Partnership Forum (DPF) to discuss topics of national interest and agree on actionable items. In 2015, two DPF meetings discussed

‘Devolution’ and ‘Youth Empowerment’; in 2018 the DPF discussed the Big Four Agenda. There are also Sector Working Groups that cover all sectors of interest. The Development Effectiveness Group (DEF) brings together the technical experts from both the Government and DPs and acts as the clearing house between the DPG, GCG and the Sector Working Groups. The government and Development Partners unveiled recently a Development Co-operation Strategic Plan covering the period 2017-2022. The plan will guide activities of the DEG in the next five years. The Bank has been active in supporting the government in the policy arena (e.g. the development of the “the Big Four” Agenda). It will build on its existing position as a preferred ***partner of choice*** in its engagement with the GoK during the new CSP period.

3.3 Country Challenges, Weaknesses, Opportunities and Strengths

36**. Kenya’s overarching development challenge is to make growth more transformative to address persistent challenges of poverty, unemployment, income inequality and spatial socio-economic disparity.** Kenya’s strengths and opportunities, weaknesses and challenges are discussed in detail in the preceding sections. The country’s overarching development challenge is to address persistent challenges of poverty, unemployment, income inequality and spatial socio-economic disparity through increased private sector participation in higher value-added economic activity to create productive employment. These challenges are similar to those identified in the previous CSP (see also section 3.5 and Box 2 on lessons learnt).

Box 2: Strengths, Opportunities, Weaknesses and Challenges

Strengths and Opportunities

- Sound macroeconomic policies have translated into manageable fiscal deficits and debt levels, relatively low inflation rates standing at single-digits in most years, and exchange rate stability.
- Renewed political momentum
- High potential for structural transformation through industrialization.
- 2010 constitution and devolution gives an opportunity to improve the efficiency and effectiveness of state functions.
- Strategic geographic location. The country has access to the sea, and maritime transport network.
- Business opportunities. Despite persisting challenges, the country attracts FDI for private sector investors.
- Discovery of oil, gas and coal deposits.

Weaknesses and Challenges

- Slow economic transformation and low level of industrialization. GDP share of manufacturing has remained stagnant for over a decade.
- Exposure to external shocks. Reliance on traditional tradable goods and services and heavy dependency on imports notably petrol products implies significant risks.
- Inadequate infrastructure especially transport, energy, water and sanitation and irrigation.
- A host of policy, legal, regulatory and institutional constraints to private sector development.
- Lack of skills in existing and emerging sectors.
- High (Youth) unemployment, poverty and inequality, with significant geographical variation and incidence amongst the youth and vulnerable groups of society.
- Internal/external instability and insecurity.
- Vulnerability to climate change.

3.4 Country Portfolio Performance Review

37. As of end December 2018, the Bank’s portfolio in Kenya consists of 38 operations, with a total commitment of UA 2.38bn and average project size of UA 71.6 million (public sector). Of these ongoing operations, 26 are in the public sector with a total commitment of UA 1.86bn. The sectoral distribution of the on-going commitments comprise energy (27%), transport (26%), water supply & sanitation (24.4%), Finance (12.3%), Agriculture (6%), Social (4%), and multi-sector (0.3%). The latter constitutes a MIC grant (UA 1.2m) to support the Delivery Unit of the Executive Office of the President. The 6% share in agriculture in Bank’s total portfolio represents Bank’s direct intervention in the sector. However, given Agriculture’s proven strong backward as well as forward linkages with other sectors of the economy, the indirect contribution of Bank’s intervention in the sector to Kenya’s economy is expected to be larger.

38. **The Bank’s active operations largely support Kenya’s efforts in building infrastructure to unlock country’s potential in energy and expand its economic base and strengthen its position as a regional hub.** In the power sector, the Bank’s interventions support largely the country’s efforts to increase its renewable energy mix and enhance electricity access. About 48% of the Bank's energy portfolio supports generation of renewable energy (geothermal, wind and solar), 19% for transmission and 30% for distribution. In the transport, road transport and highways constitute the greater share (90%) of the commitments in the sector portfolio. This is in line with Kenya's vision to improve national and regional networks to connect to production centres, facilitate transportation and national and regional trade. Other areas of intervention in the same sector includes airport infrastructure (10% of commitment) and telecommunications for about 0.3%.

39. The active operations are well aligned with the Bank's priorities, facilitated by the Bank's presence in Kenya, which played a critical role in in-depth dialogue with the government. Slightly over one-third of the portfolio commitments supports ***Industrialize Africa*** and contributed largely by operations in transport, power, finance and water sectors. Similarly, about a quarter of the commitments contributes to ***Quality of life***, with the expected delivery coming from all sectors. The share of the commitments supporting ***Integrate Africa*** reflects principally the operations in transport, power and agriculture operations. The operations support regional road connectivity, including the *"Trans-Africa Highway Network",* and electricity highways *("Eastern Africa Electricity Highway"),* and address drought in the Horn of Africa (HoA) and safety issues in the Lake Victoria to improve transportation and promote trade among the lake countries. Support to ***Feed Africa*** accounts for 16% of the active commitments, of which the major contributors are transport and water operations, and reflects the development approach employed in designing and implementing these operations. In particular, road projects are implemented with integrated approach to rural development involving the construction of access roads to production/agriculture centres and roadside amenities to benefit road users and roadside traders. The water sector operations adopt resource management approach to address not only the low water supply and sanitation service levels in small towns and neighbouring rural areas, but for irrigation in arid and semi-arid areas.

40. The portfolio performance for public sector projects is assessed as satisfactory with an overall assessment score of 3.09 (on a scale of 1 to 4). This performance is the result of enhanced dialogue and engagement with the Government, which has resulted in reducing implementation delays. There has also been aggressive efforts by the National Treasury and RDGE to speed up project implementation and improve disbursements. The key portfolio issues as per the Portfolio flashlight reports are signature delays (on two lines of credit and PRG), first disbursement delays (on line of credit) and slow disbursement and procurement delays. Nonetheless, as per the flashlight report, the number of red flags has gone down to 22% by end 2018 – from 44% in November 2017. The key activities include quarterly meetings on portfolio with the Government and the RDGE and follow-up by the Task Managers (TMs) with executing agencies and implementation Teams to resolve implementation issues.

41. **As of end December 2018, cumulative disbursements (excluding for operations recently approved in 2018) totalled UA 1.08bn**, corresponding to a disbursement rate of about 52% and annual disbursement has reached 18%. RDGE and the Government have taken initiatives (see annex 16) to improving disbursement rates, which are slow largely occasioned by the fiscal consolidation exercise undertaken to address the increasing country debt. The exercise has restrained the levels of release of counterpart funding critically needed for land acquisition and disbursement from Bank funding, including for making the required advanced payment to enable contractors to mobilize and fully commence operations. In turn, this has halted the execution of the main components (civil works) of large infrastructure projects[xxii]. RDGE has requested the National Treasury to take concrete actions to tackle the budget and counterpart funding bottlenecks to ensure improved disbursement performance.

42. Country Portfolio Improvement Plan: As part of the preparation of the combined Country Strategy Papers and Country Portfolio Performance Review, both the Regional Delivery Office and the Government of Kenya held joint workshops in August and November 2018 to assess the progress in the implementation of the Bank's portfolio in Kenya. The workshop brought together the Bank, GoK representatives from the

National Treasury, line ministries and project implementing teams. The participants assessed the performance of the portfolio in relation to performance indicators and recommended corrective actions articulated in the 2018 CPIP (Annex 8). Annex 16 provides summary of discussions with stakeholders.

3.5 Lessons Learned from the 2014-2018 Completion Report and 2018 CPPR

43. The preparation of this strategy benefited from the findings of the 2014-2018 CSP Completion, portfolio review exercises, guidance from CODE and preliminary results of the CFRA. The following operational and strategic lessons are drawn from the Completion Report. **For the Government**: There is need to strengthen the capacity of PITs managing operations that are implemented by Ministries. In addition to training in core project management skills, there is need to consider the option of hiring key experts to avoid high staff turn-over. Further, for projects nearing completion, to reduce commitment charges, it is important to assess and initiate well ahead of time the cancelation of undisbursed loan balances that will no longer be consumed. In addition, there has been a major challenge on the implementation of the Resettlement Action Plans (RAPs) on account of delayed payment and compensation of project affected persons (PAPs), which has been largely linked to delayed release of Government counterpart funding. **For the Bank**: Given that Country Financing Parameters (CFPs) have been developed for Kenya, there is need for the Bank to consider funding on a selective basis the total project cost (excluding taxes). In addition, to optimize the delivery of results, the Bank should continue to employ integrated approach in designing and implementing operations with a greater focus on connecting communities to production centres and jobs creation. At the level of strategy, it noted that Kenya's development context and main challenges have remained unchanged, suggesting the need for the continuity in the new CSP. This notwithstanding, during the period covered by the new CSP, the Bank will respond to some of the challenges that have emerged recently. Most importantly the Bank shall give greater attention to structural transformation through industrialization while continued support to infrastructure and skills development is indispensable for the establishment of a conducive business environment that enables transformative, private sector-led inclusive growth and job creation. In addition, it has become clear that more direct support to private enterprises engaging in higher value added economic activities especially the agriculture sector with its high yet hitherto largely untapped potential, is required. Further, the Bank should also continue to strengthen partnerships with DPs for co-financing to compliment efforts to optimize delivery of development outcomes. **For development partners**: Kenya has not embraced General Budget Support (GBS) as a form of aid delivery leading to costly parallel project preparation and implementation. Despite limited appetite for GBS, development partners should consider Sector Budget Support and related mechanisms for delivery of aid. Joint monitoring and evaluation as well as knowledge work undertaken jointly would reduce cost overheads.

IV. BANK GROUP STRATEGY 2019-2023

4.1 Rationale and Strategy Selectivity

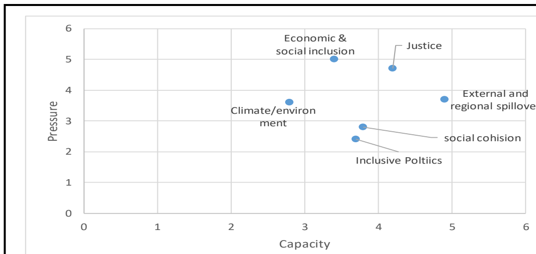


Figure 5:Country Resilience and Fragility Assessment; Source: AfDB

44. As discussed in section 3.3, Kenya enjoys many strengths and opportunities, but also faces several weaknesses and challenges. Bank's strategy for Kenya for the new CSP was informed by the following: (i) analysis of Kenya's overarching development challenges: persistent challenges of poverty, unemployment, income inequality and spatial socio-economic disparity.; *(ii)* alignment with Kenya's national development priorities/plans (MTR-III/The Big Four) and the Bank's corporate strategic framework, notably the TY[xxiii], the High5s, and Regional Integration Strategy (RISP) 2018-22 for Eastern Africa.; *(iii)* lessons learnt from the previous CSP 2014-18, which emphasizes the existence of persistent infrastructure and skills deficits and the need to give direct support to higher value addition; *(iv)* the Bank's comparative advantage wherein the Bank demonstrated capacity to make development impact in the country in areas such as investment in infrastructure development, namely, in transport (e.g. national and multinational roads construction/rehabilitation), in energy (generation, transmission and consume connection), in water and

sanitation (dams, bulk water supply, town and rural water supply, and water resources management); *(v)* analytical work including the Bank's Kenya growth diagnostics study, sector briefs, and various other publications from the Bank and other sources; and *(vi)* consultation with various stakeholders.

45. Furthermore, the CSP has been informed by the Bank's Country Resilience and Fragility Assessment (CRFA) of Kenya undertaken in 2016. The tool, using six dimensions to assess country's *capacity* to manage *pressures,* [xxiv] namely climate/environment impacts, economic & social inclusiveness, externalities/regional spill over effects, justice, social cohesion, and inclusive politics found that compared with capacity, pressure is higher in climate/environment, economic & social inclusion and justice (Fig 5). The findings imply that Bank's interventions should target improving country's capacity in economic and social inclusion, climate/environment and justice. The interventions may take the form of improving country's business environment, access to infrastructure, education and addressing income inequality, improving country's capacity in the implementation of environmental policies that are important to foster sustainable use of natural resources, disaster management, food and nutrition security.

46. In addition, the Bank conducted CSP consultation missions with the GoK and other stakeholders in four occasions in 2018 - January, March, August and November. During the first engagement with the government, the GoK requested the Bank to focus on the delivery on the B4 and the key enablers – infrastructure, private sector and skills development. Thereafter, the Bank engaged ministries; institutions (e.g. CBK and the KNBS); the Private Sector (KEPSA), a private sector umbrella organization; and DPG on the proposed pillars and sector priorities, programs and projects. Key outcomes from these engagements include sector briefs indicative pipeline and guidance on working on the private sector. The Bank also organized workshops to brief the government the outcome of the consultations with the National Treasury and line ministries and reviewed Bank's portfolio and shared lessons learnt. Key output included consolidated indicative pipeline and input into the articulation of the pillars. In general, the message received was consistent in that it required the Bank to give greater attention to structural transformation through industrialization in line with Kenya's long-term development plan (i.e. Vision 2030) and its successive medium term implementation plans (MTP-III/B4). Others included for public private partnership to finance GoK priority areas; policy, regulatory, legal and institutional reforms to attract local and foreign direct investment; capacity development for countries to deliver on the B4 agenda; and the need to support GoK export led growth strategy. Therefore, while continued support to infrastructure development to improve local and regional connectivity and skills development is indispensable for the establishment of a conducive business environment that enables transformative, private sector-led inclusive growth and job creation notably the youth, it has become clear that more direct support to private enterprises wanting to engage in higher value added economic activities, especially in the agriculture sector with its high yet hitherto largely untapped potential, is required.

4.2 CSP Objectives and Strategic Pillars

47. The overall objective of the CSP 2019-2023 is to support structural transformation to address persistent challenges of poverty, unemployment, income inequality and spatial socio-economic disparity through industrialization. To achieve this objective, the theme of the new CSP will be *supporting structural transformation through industrialization for sustained and inclusive growth.* Accordingly, it is articulated around the following two complementary pillars[xxv] [xxvi]: **Pillar I**: supporting industrialization; and **Pillar II**: enhancing skills and capacity development. Under Pillar I, the Bank will invest in infrastructure; support policy, institutional, legal and regulatory reforms; and support SME value addition. Under Pillar II, the Bank will create jobs for the youth and women by addressing the skills gap in existing and emerging sectors. Projects under each pillar will mainstream crosscutting issues notably green growth/climate change, gender and youth employment. This will be done respectively in accordance with the *Green Economy Strategy and Implementation Plan* (GESIP) 2016-2030; the Bank's *Gender Strategy* and *Jobs for Youth Strategy*. The strategies will guide the choice and structuring of programs and target outcomes in priority sectors to maximize development impact. To ensure that this is not done in an ad hoc manner, crosscutting issues will

be identified during project design stage and the relevant institutions (e.g. TVET in the case of youth and women training) will be brought on board and tasked to deliver.

4.3 Expected Results and Targets

48. The Bank's CSP 2019-2023 is in line with Kenya's long-term plan (Vision 2030) and its medium term implementation plan MTP-III, as well as the Bank's TYS and its High-5s. To achieve the expected CSP results and targets, the Bank will use a mix of funding instruments from its public and private sector windows, including a lending program of investment projects, technical assistance, analytical work and policy advisory services. The CSP's main expected results are presented under the two pillars discussed in the following paragraphs. Annex 1 presents the outcomes and outputs expected from each pillar at mid-term in 2021 and at completion of the strategy at end-2023.

Pillar I - Supporting industrialization

49. Objective: The Bank's main objective under this Pillar is to support Government's overall target of structural transformation through industrialization. This is to be achieved through increased private sector participation in value addition. The Bank's priority under this pillar will thus include (i) enablers for industrialization which are critical *national* and *regional* infrastructure aimed at reducing the cost of doing business and policy, legal, institutional and regulatory reforms to enable private sector development[xxvii], and (ii) *S*upport SME's increased participation in value addition in the B4's priority areas (i.e. manufacturing, agro-processing and housing). It aims at value chain development for jobs creation and an increase in value added export. To further support employment, especially the youth, jobs creation will be mainstreamed in Bank's operations. The pillar is well aligned with Bank's High-5s, namely Light-up and Power Africa, Feed Africa, Industrialize Africa, Integrate Africa and Improving the Quality of Lives of Africans (see Annex 17).

Outcome 1 - Cost of doing business reduced through infrastructure development

50. Bank's interventions aim at investing in critical infrastructure to support manufacturing enterprises and households. In **energy**, Bank's interventions will support the MTP-III target of achieving universal electricity access, connecting 5m new households through grid and off-grid solutions and increasing energy-installed capacity to 5221MW from 2351MW. The Bank's energy projects will focus on power generation from geothermal, hydro, wind and solar sources, construction of national and regional transmission lines, construction of distribution networks and consumers' connections, overall energy sector performance and promoting access to clean cooking fuel and technology. In **transport**, Bank investments will aim at reducing transport cost and travel time by connecting urban/rural and regional markets with production centres thereby improving overall productivity, encouraging manufacturing high value addition and improving households' welfare. In this regard, Bank interventions will support GoK's plans to construct/rehabilitate 10,000 km of roads nationwide to enhance domestic and regional connectivity, boost rural productivity and reduce urban congestion. **In water and sanitation**, bank investment will aim at supporting GoK plan of increasing water supply and sanitation for industrial use, household consumption and for irrigation purposes. According to the plan, access to safely managed pipe water would be increased to 66% from its current level of 60% while access to sanitation services would be increased to 26% from 24%. The Bank's new projects in the sector will thus support the construction of multipurpose dams, rehabilitation and restoration of rivers, and urban water and sanitation programmes. In general, **Bank's key contributions to the achievement of national outcomes** will include (i) 145MW renewable power installed, 851km transmission lines and 32,814 km distribution lines constructed, and 2060 distribution transformers installed. (ii) 826 km of roads and 89km of rural access roads constructed/rehabilitated; (iii) 681m^3 of multi-purpose dam constructed, 1000km of water pipes laid, 500 km of sewer pipes laid and 20 water treatment plants constructed/rehabilitated. Detailed information on Bank's expected results under CSP outcome 1 are presented in Annex 1.

Outcome 2 - Private sector development fostered for value addition and job creation

51. Bank interventions to support private sector development for high value addition and job creation aims at *(i)* improving the business environment by supporting reforms; *(ii)* supporting increase in agricultural productivity to meet MTP-III target of food and nutrition security on the one hand, and increasing demand for inputs by the agro-processing sub-sector on the other. Therefore, **the key expected outcomes** include (i) manufacturing contribution to GDP increased to 15% from its current level of 9% and about 1 million manufacturing jobs created; (ii) Kenya's global ranking in WB Ease of Doing Business improved to 45^{th} from 80^{th} in 2017; (iii) small and large-scale irrigation projects and agricultural productivity enhancement programs reinforced; (iv) agricultural value addition increased from its current level of 15% to 50% of total agricultural output; (v) foreign direct investment increased by fivefold to USD 2bn; and (vi) long term financing for manufacturing increased, and food and nutrition security achieved. Detailed information on Bank's expected results under CSP outcome 2 are presented in Annex 1.

Pillar II - Enhancing skills and capacity development

52. **Main Objective**: The Bank's main objective under this pillar is to create jobs for the youth and women by addressing the skills gap in existing and emerging sectors. The Bank's operational priority under this pillar will include *(i)* improving employability, entrepreneurship and mentorship to respond to skill gaps in low and medium level skills in the labour market. Here, linking with pillar 1, the Bank's actions will seek to complement government's program of developing mid-level skills of technicians for the existing and emerging sectors and skills development of the under-educated youth for employment in labour-intensive sector; (ii) addressing capacity and knowledge gap in identified sectors for effective policy/operation dialogue with the government. Here, Bank support will seek to fill capacity and knowledge gaps identified in the implementation of activities mentioned in pillars I and II. Alignment of the pillars with the Bank's High Fives and with DPs activities in Kenya are provided in Annexes 17 and 5, respectively.

Outcome 3 - Skills shortages in existing and emerging priority sectors addressed

53. Bank interventions will aim at contributing to MTP-III objective of "providing every Kenyan with decent and gainful employment". The MTP-III targets, among others: (i) training of 50,000 youth and women in textile and apparel skills; (ii) enhancing skills in the MSE manufacturing and housing construction industries; (iii) providing apprenticeship training in the formal and informal sectors; (iv) enhancement of industrial attachment and the launching of national internship programs to address skill mismatches; and (v) Upgrading and expansion of existing training centres. In this regard, Bank support would be directed towards the establishment of new and expansion/upgrade of existing Industrial Training Centres (ITCs) and Technical Vocational and Education Training (TVET) centres. Therefore, **Key expected outcomes** include (i) contribution made towards national targets of decreasing youth unemployment to 17% from 22%; (ii) enrolment in TVET and in engineering and applied science increased by 40%**.** Detailed information on Bank's expected results under CSP outcome 1 are presented in Annex 1.

4.4 Indicative Lending Programme

54. Public Sector Lending. Bank lending to Kenya under the new CSP will be supported by two ADF cycles (ADF-14 and ADF-15) and ADB funding to which Kenya gained access in 2015. While resources under ADB will be programmed in the CSP, resources under ADF-15 would be programmed within the context of the CSP MTR envisaged for Q4 2020. The MTR will allow a review of progress made in implementing the CSP and results achieved. As regards to private sector lending, Kenya has continued to expand lending to the private sector following her gaining access to the ADB window in 2015. The Bank will continue to use available resources to leverage funding from the private sector through public-private partnerships (PPP), thereby maximizing the overall financial amount from which Kenya benefits under the new CSP.

4.5 Non-Lending Activities

55. The Bank's non-lending activities will consist of demand driven knowledge production and technical assistance in the Bank's priority areas to bridge knowledge gap and drive reform and speed up economic growth and development. The following were identified as gaps with potential for Bank's support. (i) Policy- relevant knowledge products to inform the Bank's dialogue with authorities to hasten structural transformation. In this regard, the Bank dialogue highlighted the need to improve the capacity of the government on *budget planning and forecasting.* Support in this area could narrow variations between revenue collection targets and actual revenue collections. It is one of the contributors to higher expenditure, rising fiscal deficits and public debt. (ii) Technical assistance. Three projects are flagged here - *supporting government policy, legal, regulatory and institutional reform agenda to improve Kenya's ranking in WB doing business indicator; improving government capacity to implement the B4 agenda by capacitating the Presidential Delivery Unit (PDU) in the President Office to deliver on the Big Four Agenda; and supporting government plan to adopt an integrated approach to urban water management*. (iii) The need to conduct operationally useful studies/seminars/workshops to complement the IOP and assist in project implementation. (iv) The need to organize, where feasible, knowledge exchange forums on topics relevant for the Bank's operations by inviting outside experts; and (vi) The need to coordinate with other DPs to undertake joint studies. Here based on preliminary discussions with other DPs *support for Public Private Partnership (PPP) is identified as potential project*. The activities will be financed out of various funding sources, among others, ECCE budget, MIC Grants and Trust funds. Annex 2 presents some of the planned non-lending activities.

4.6 Financing the CSP

56. The CSP 2019-2023 will be financed through Bank and external resources. Public sector lending under the CSP 2019-2023 will be supported through funding from the ADB window and two ADF cycles – ADF-14 (2014-2019) and ADF 15 (2020-2022). Resources under ADB and ADF-14 are programmed in the new CSP document, while resources under ADF-15 would be programmed within the context of the CSP MTR envisaged for Q4 2020. Kenya's ADF-15 allocation is expected to decrease following completion of 5- year transition to ADB only status. As a result, Bank's ADF commitment is expected to decline to UA 61.6m in the new CSP compared with UA 287m in the just concluded CSP. This underscores the need for innovating financing mechanisms. Annexes 4 and 5 provide alignment between Bank's strategy and that of DPs and possible co-financing opportunities. On the contrary, public sector borrowing from the ADB window is expected to increase from UA 1b currently to UA 1.23b by the end of the new CSP period. As regards to private Sector Lending, the Bank will continue to use available resources to leverage funding from the private sector through PPP, thereby maximizing the overall financial amount from which Kenya benefits under the new CSP. Further, the Bank's ESW under the new CSP will continue to support lending operations and underpin Government policy and decision-making. ESW will be coordinated with other DPs, and prepared together when appropriate, to reduce overlap and increase impact. Funding for ESWs will continue to be drawn largely from Trust Funds.

57. Annex 2 presents the Bank's preliminary indicative assistance program for Kenya for the period 2019-2023, alignment with the High Fives, and harmonization with DPs, respectively. The program contains projects to be funded by the Bank's ADB and ADF windows. The program totals UA 1.7bn (sovereign and non-sovereign, but excluding the Bank's regional operations window and private sector). Much of the total planned commitment goes to Pillar I projects. However, the reader should take note that all the infrastructure projects under Pillar I incorporate some element of training and capacity development therefore contribute in some way to Pillar II - skills development. Projects under Pillar II represent standalone projects focusing on addressing skills gaps both in emerging and existing sectors. They, together with ongoing projects, and additional financing requests expected to be received from the Government, are expected to increase Bank's contribution to capacity and skills development identified as one of the main enablers for the B4 economic plan. The CSP preparation mission has discussed the indicative assistance program as well as the RBF with

the Government. The RBF in Annex 1 discussed the results (outputs/outcomes) expected to be achieved by each proposed project and outline their contribution to the Bank's objectives.

4.7. CSP Monitoring and Evaluation

58. The Result-based-framework (RBF) will provide the basis for the monitoring and evaluation of the CSP 2019-2023 presented in Annex 1. The RBF is anchored on Kenya's MTP-III. It presents outputs and outcomes envisaged by mid-term and upon completion of the strategy in 2023. The tracking of progress on the CSP will be done by Bank's regular portfolio performance review exercises (the CPPRs and CPIP) will assist in tracking implementation progress during the CSP period. In addition, the exercise will be coordinated and undertaken with the National Treasury and Planning who are in the process of preparing the national outcome indicators as well with the President's Delivery Unit (PDU) in the Executive Office of the President. The PDU was established in 2015. It is tasked with the coordination of National Government flagship programs as well as monitor, evaluate and report on progress made on key development priorities. Recent country portfolio reviews revealed increased government's capacity in implementing Bank-funded projects and in delivering non-lending operations.

4.8 Country Dialogue

59. The Bank will continue to dialogue with GoK and key stakeholders on issues critical for achieving the CSP 2019-2023 under broad topic of policy and portfolio management. Key areas for dialogue, among others, would thus include dialogue on country's graduation from a Blend to ADB only status (a Bank's inter-departmental mission for sensitization and credit worthiness assessment is envisaged to be carried out in Nairobi in 2019), industrialization, private sector development, skills development, macroeconomic management namely the interest rate capping law, domestic resource mobilization and public debt, gender mainstreaming, environment and climate change, and portfolio performance namely business development, PPP and co-financing. Annex 4 and 5 give summary of donor activities in Kenya. They are developed to support Bank's dialogue with the GoK and DPGs

4.9 Risk and Mitigation Measures

60. **Uncertainty in political dispensation and failed devolution**. Following the election of October 2017, a new Government has been formed. However, continued political impasse implies a certain risk of political stability, which may have an impact on Bank program for Kenya. In addition, the process of devolution still remains weak due to low funding and capacity. The Bank proposes to mitigate this risk through comprehensive support to the devolution process and enhanced dialogue.

61. **Vulnerability to exogenous shocks**. Changes in oil and food prices globally and impact of climate change will continue to pose risks for Kenya's development agenda. Interventions by the DPs combined with enhanced access to enlarged regional markets, and Government commitment to maintain adequate levels of development expenditure, are expected to diversify the economy and increase resilience. **Macroeconomic risk**. Rising level of public debt estimated at 57% of GDP could pose debt sustainability risk, which could limit the GoK ability to finance infrastructural projects. Public debt continues to be sustainable. The government has continued with its fiscal consolidation which takes the form of prioritization of public spending, income tax revision, enhancing tax administration measures and debt management policies to reduce fiscal deficit and stabilize public debt.

V. CONCLUSION AND RECOMMENDATIONS

62. Kenya continues to face high levels of poverty, unemployment, income inequality and spatial socio-economic disparity, which are mainly attributable to the slow pace of structural transformation and low level of industrialization. To address these persistent challenges, the government recently refocused its efforts to channel its interventions into sectors with proven high value addition and job creation potential to assist industrialization and thereby achieve the needed structural transformation and improve the welfare

of Kenyans. In view of changes in country's policy direction and consideration of Bank's TYS and High Five priorities, the theme of Bank's new strategy for Kenya is articulated around "*supporting structural transformation through industrialization for sustained and inclusive growth*". It is made up of two complementary pillars each made up of two operational priorities: pillar I- *Supporting industrialization through value addition by reducing cost of doing business & pillar II - enhancing skills and capacity development*. Management recommends that the Boards of Directors approve the proposed CSP 2019-23 for Kenya.

ANNEX 1: CSP RESULTS-BASED FRAMEWORK

Country Development Goals	Issues and Constraints hindering achievement of desired outcomes	Final Indicators (by end 2023)		Mid-term Indictors (by end 2021)		Bank Interventions during CSP period (On-going and proposed)
		Outcomes	Output	Outcomes	Outputs	
STRATEGIC PILLAR I – SUPPORTING INDUSTRIALIZATION						
COST OF DOING BUSINESS REDUCED THROUGH INFRASTRUCTURE DEVELOPMENT						
Energy						
Improve generation and distribution of electricity and enhance its affordability and accessibility	• Limited power generation, transmission and distribution network • High cost of electricity • High loses in distribution systems.	• Share of population with access to electricity at national level increased from 75% to 100%. • Energy-installed capacity increased to 5221MW from 2351MW. • 5 million new households, 15,739 public facilities connected to electricity using grid and off-grid solutions. • The cost of off-peak power to heavy industries reduced by 50%. • Power supply reliability improved by at least 20%. • Share of renewable energy increased from 66.6% currently to 87.5%. • Electricity losses through transmission, distribution and collection decreased from 20.5% to 15.5%.	• 145MW of renewable power installed. • 651454 customers connected. • 851.1 km of HVDC and HV transmission lines constructed. • 32814 km of MV and LV distribution lines constructed. • 2 substations constructed. • 2060 distribution transformers installed. • 826 people trained through Bank operations. • 20 direct jobs created. • 2916 indirect and induced jobs created	• Share of population with access to electricity increased from 75% to 95%. • Electricity-installed electricity capacity excluding imports increased to 3278MW from 2351MW.. • Share of renewable energy increased from 66.6% currently to 83.25%. • Electricity losses through transmission, distribution and collection decreased from 20.5% to 17.55%.	• 70MW of renewable power installed. • 539889 customers connected. • 626 km of HVDC and HV transmission lines constructed. • 30754 km of mv and LV distribution lines constructed. • 1 substation constructed. • 0 distribution transformers installed. • 526 people trained through Bank operations. • 12 direct jobs created. • 816 indirect and induced jobs created	**Ongoing** • ADF PRG Menengai • ADF-PRG for Turkana T-Line • Kenya-Last mile connectivity project 1. • Kenya-Last mile connectivity project 2. • Menengai geothermal development project. • Ethiopia-Kenya electricity highway project • Kenya-Tanzania interconnection project. • Lake Turkana wind power EKF • Lake Turkana wind power project • Lake Turkana wind power project – Sub-debt tranche • Thika thermal power project Quantum Power Menengai 35 MW Geothermal IPP • Kopere 40 MW Solar PV IPP **Proposed operations** • Transmission Network Improvement Project • National Electricity Access Project • Menegai Geothermal: Drilling and Steam Gathering System
Transport						
National transport network in good condition and travel time and cost of travel reduced.	• High maintenance backlog • High transport cost and travel time within the country and between neighboring countries • High congestion in urban and rural areas. • Improved security in Lake Victoria.	• Reduced travel time and cost. • Congestion in urban roads and major cities and towns reduced. • Improved regional trade flows. • Improved connectivity at JKIA	• 826 km of roads constructed/rehabilitated. • 89km of rural access roads constructed/rehabilitated • 33,200 trees planted. • 32 roadside amenities. • 190000 direct jobs created (in person-months). • 1120 people formally trained through bank transport operations. • 120km road constructed/rehabilitated. • 84 km road constructed/rehabilitated.	• Travel time and cost reduced. • Congestion in urban roads and major cities and towns reduced. • Improved regional trade flows. • Improved connectivity at JKIA	• 530 km of roads constructed/rehabilitate. • 89km of rural access roads constructed/rehabiltated. • 33,200 trees planted. • 32 road side amenities. • 75,000 direct jobs created (in person-months). • 1120 people formally trained through bank transport operations. • 60km road constructed/rehabilitated. • 40km roads constructed/rehabilitated.	**Ongoing** • Nairobi outer ring road project improvement • Mobmassa-Mariakani road highway project • Sirari corridor accessibility & road safety improvement project. • Multinational: Arusha-Holili/TAVETA-VOI road • Mombassa-Nairobi-Addis Ababa corridor phase III • Kapchorwa-Swam-Kitale and Eldoret bypass road project. • Kenya-Lake Victoria maritime communications and transport **Proposed operations** • Multinational: Malindi - Lunga Lunga - Bagamoyo Road (Phases I-III) • Kenol-Sagana-Marua • Kipsaos-Kimwarer-Emsea-Biretwo-Tot Road (95Km). • Lesseru-Kitale (54Km). • Nairobi Mass and Bus Rapid Transit System (MRTS/BRTS) Jogoo Road. • Impact assessment of Investment in the road sector.

			• 45km road constructed/rehabilitated. • 30 km roads constructed/rehabilitated. • N/A		N/A	• Guideline for Gender mainstreaming in Transport. • Capacity assessment of the domestic construction industry.
Water and Sanitation						
Access to clean environment and adequate safe drinking water and sanitation enhanced.	• Inadequate investment in provision of water and sanitation • Weak capacity for management of water facilities within the urban, peri-urban and rural areas. • Lack of resilience to climate shocks. • Inadequate investment in maintenance of water systems.	• The number of people connected to safe pipe water increased to 66% from 60%. • The number of people connected to sanitary increased to 26% from 24%. • Improved water storage capacity to 22MCM.	• 1000 km of water pipes laid • 20 water treatment plants constructed/rehabilitated. • 17 intake structures constructed/rehabilitated. • 500km of sewer pipes laid. • 17 waste water treatment plants constructed/rehabilitated. • 67 ablution blocks constructed/rehabilitated. • Thwake (multi-purpose) dam with 681m3 storage constructed. • 800 people trained through Bank operations. • 8000 direct permanent and temporary jobs created. • 10,000 indirect and induced jobs created.	• The number of people connected to safe pipe water increased to 63% from 60%. • The number of people connected to sanitary increased to 25% from 24%. • Improved water storage capacity to 22MCM	• 300 km of water pipes laid. • 10 water treatment plants constructed/rehabilitated. • 8 intake structures constructed/rehabilitated. • 200 Km of sewer pipes laid. • 9 water water treatment plants constructed/rehabilitated. • 25 ablution blocks constructed/rehabilitated. • 200 people trained through Bank operations. • 1000 direct permanent and temporary jobs created. • 5000 indirect and induced jobs created.	**Ongoing** • Kenya Towns Sustainable Water Supply & Sanitation Program. • Thwake multipurpose water development program • Nairobi Rivers Rehabilitation and Restoration Program- Sewage Improvement Project Phase II. **Proposed operations** • National Urban Water and Sanitation Program. • Integrated Urban Water Management (Technical Assistance)
PRIVATE SECTOR DEVELOPMENT FOSTERED FOR VALUE ADDITION AND JOB CREATION						
The contribution of manufacturing to GDP and employment increased.	• Business environment. • Lack of high value addition	• Kenya's WB Doing Business ranking improved to 45th by 2022 from 80th currently. • The contribution of manufacturing to GDP increased to 15% from 9% currently. • FDI increased by fivefold to $2 billion. • 1 million jobs created in manufacturing; • Manufacturing export increased from – to -.	• Policy, legal, regulatory and institutional reforms. • Food hub and agro park established at Nakuru and Taita Taveta; fish plant established; 7 new international markets identified; agro-processing entrepreneurs trained. • Special Economic Zones in Dongo Kundu established; Navash industrial park developed; . • 47 SME parks/industrial parks rolled out; 290 support programs established; . • MSME centers of excellence established	• Kenya's WB Doing Business ranking improved to 67th from 80th currently. • The contribution of manufacturing to GDP increased to 12% from 9% currently. • FDI doubled to $0.8 billion. • 0.5 million jobs created in manufacturing; • Manufacturing export increased from – to -. •	• Policy, legal, regulatory and institutional reforms	**Ongoing** • Commercial Bank of Africa Limited • Diamond Trust Bank LOC I • Equity Bank (KENYA) Limited • Kenya Commercial Bank Limited • Commercial Bank of Africa - LOC **Proposed operations** • Kenya Mortgage Refinance Company (KMRC) • Technical assistance to the president delivery unit- the Big Four • Support for Public Private Partnership. • Supporting GoK's policy, legal, regulatory and institutional reforms. • A study on governance.
Food and nutrition security reached 100% by 2022 Value addition in agriculture increased from 15% to 50%	• High food poverty and nutrition insecurity • Low farm productivity • Lack of employment opportunities for rural dwellers	• Average crop yield (ton/hectare) increased from 2.7 to 18. • Average net farmers income (Ksh/households) increased from 150000 to 225000. • Farmers income from value added crop marketed from 15% to 50%	• Land areas brought under irrigation increased to 7735. • 400km feeder roads built/rehabilitated. • 75 income generating groups supported • 35 agro-market centers constructed.	• Average crop yield (ton/hectare increased to 9.. • Average farmers income (Ksh/household) increased from 150000 to 180000. • Farmers income from value added crop marketed increased from 15% to 20%. • Farmers incomes from value added livestock products	• Land area brought under irrigation increased 2500 • 100km feeder roads built/rehabilitated • 35 income generating groups supported. • 20 agro-market centers constructed. • 1100 ha pasture/rangeland established.	**Ongoing** • Small Scale Irrigation & Agriculture Value Chain Development • Kenya-Drought Resilience & Sustainable Livelihood Program • Multinational –GEF Rural Livelihoods Adaptation To Climate Change • Enable Youth Kenya • Green Zones Development Support Project-Phase 2 **Proposed operations**

		• Farmers' incomes from value added livestock products marketed increased from 2% to 50%. • People benefiting from improvements in agriculture increased from 6000 to 148000 • Land with improved water management (ha) increased from 3173 to 7908. • Volume of water stored increased from (m3) increased from 70000 to 225000. • 1200 youth agribusinesses established.	• 2100 ha Pasture/range land established. • 25 livelihood groups formed. • The number of marketable commodities increased. • People trained through bank operation increased (TBD). • The number of marketable commodities increased to 25. • 8000 direct jobs created. • 15000 indirect/induced jobs created	marketed increased from 2% to 25%. • People benefiting from improvement in agriculture increased from 6000 to 75000. • Land with improved water management (ha) increased from 3173 to 4700. • Volume of water stored increased from 70000 to 110000. • 600 youth agribusinesses established	• 15 livelihood groups formed. • People trained through Bank operation increased (TBD) • The number of marketable commodities increased to 15. • 4000 direct jobs created. • 7000 indirect and induced jobs created.	• Multinational – Kocholia Irrigation Development & Watershed Management. • Kimira-Oluch Smallholder Farm Improvement Project - II • Drought Resilience & Sustainable Livelihood Program – Phase II
PILLAR II – ENHANCING SKILLS AND CAPACITY DEVELOPMENT						
SHILLS SHORTAGES IN EXISTING AND EMERGING SECTORS ADDRESSED						
Industry-led technical and vocational education and training colleges and universities improved and expanded.	• High youth unemployment rate • Inadequate relevant skills at TVET and University levels for emergence sectors such as oil, Gas, Minerals and the Blue Economy • Inadequate infrastructure and equipment for research, higher education and training institutions especially for physical sciences. • • Mismatch between skills and labour market demands	• Youth unemployment decreased from 22% to 17%. • 60% of TVET graduates employed. • Enrollment in TVET increased by 40%. • Number of students enrolled in TVET (disaggregated by sex and special needs) increased to 1.5 million from 212,000. • % of University students enrolled in engineering and applied science (Disaggregated by sex) increased to 30,000. • % of TVET students enrolled in engineering and applied science (Disaggregated by sex) increased to 40%. •	• 5 entrepreneurship incubation centers established in TTIs • 1500 youth received financial support for enterprise development. • 10 functional MoUs singed between industries and TTIs. • 20 TTI's established/rehabilitated. • 70 TTI workshops equipped. • 5 'Special needs' TTIs rehabilitated and equipped. • 1500 TVET Trainers trained in Competency Based Education and Training Curriculum. • 3 Centers of Excellence Established. • 16engineering departments in Universities rehabilitated/equipped. • 700 students trained at Masters and PhD level. • East Africa Kidney Center of Excellence established and operationalized. • 400 health specialists trained through Bank operations	• Youth unemployment decreased to 19.5%. • 50% of TVET graduates employed. • Enrollment in TVET increased by 20%. • Number of students enrolled in TVET (disaggregated by sex and special needs) increased to 0.5 million from 212,000. • % of University students enrolled in engineering and applied science (Disaggregated by sex) increased to 20,000. • % of TVET students enrolled in engineering and applied science (Disaggregated by sex) increased to 30%. •	• 5 entrepreneurship incubation centers established in TTIs • 500 youth received financial support for enterprise development. • 5 functional MoUs singed between industries and TTIs. • 10 TTI's established or rehabilitated. • 35 TTI workshops equipped. • 3'Special needs' TTIs rehabilitated and equipped. • 600 TVET Trainers trained in Competency Based Education and Training Curriculum. • 1 Centre of Excellence Established. • 8 engineering departments in Universities rehabilitated/equipped. • 350 students trained at Masters and PhD level. • East Africa Kidney Center of Excellence established and operationalized. • 240 health specialists trained through Bank operations Number of Health specialists trained through Bank operations.	**Ongoing** • Support to Higher Education Science And Technology To Enhance.. • Support to TVET and Training For Relevant Skills Development. • East African Centers of Excellence Kenya **Proposed Operators** • TVET Phase III • Wangare-Mathai Institute –Equipment • Capacity Building to Budget, fiscal and economic affairs (technical assistance) •

ANNEX 2: INDICATIVE PIPELINE – SOVEREIGN LENDING (UA MILLION)

Indicative Board Approval Year	Sector	Project Name	Pillar	ADB	ADF	Total
2019	Energy	(i) Menegai Geothermal: Drilling and Steam Gathering System	Pillar I	53.2		53.2
	Social	(ii) Kenya Mortgage Refinance Company (KMRC)	Pillar I	70.9		70.9
		(iii) Wangare -Mathai Institute-Equipment	Pillar II		1.5	1.5
		(iv) Technical Education and Youth Entrepreneurship Project	Pillar II		24.9	24.9
	Transport	(v) Dualing of Kenol-Marua-84Km	Pillar I	219.9		219.9
		(vi) Multinational: Malindi - Lunga Lunga - Bagamoyo Road (Phase I)	Pillar I	141.8	21.3	163.1
	Water Supply & Sanitation	(vii) National Urban Water and Sanitation Program	Pillar I	219.5		219.5
Sub Total				***705.3***	***47.7***	***753.0***
2020	Agriculture	(viii) Kimira-Oluch Smallholder Farm Improvement Project - II	Pillar I		13.9	13.9
	Energy	(ix) National Electricity Access Project	Pillar I	70.9		70.9
		(x) Transmission Network Improvement Project	Pillar I	35.5		35.5
	Transport	(xi) Lesseru-Kitale (54Km)	Pillar I	46.5		46.5
		(xii) Upgrading of Karen-Ngong Road	Pillar I	28.4		28.4
		(xiii) Nairobi Mass and Bus Rapid Transit System (MRTS/BRTS) Jogoo Road	Pillar I	141.8		141.8
Sub Total				***323.1***	***13.9***	***337.0***
2021	Agriculture	(xiv) Kocholia-Amoni-Amogoro-Horticulture and Food Crop Value Chain Development Project	Pillar I	24.8		24.8
2022	Agriculture	(xv) Drought Resilience & Sustainable Livelihood Program – Phase II	Pillar I	25.7		25.7
	Transport	(xvi) Kipsaos-Kimwarer-Emsea-Biretwo-Tot Road (95Km)	Pillar I	49.5		49.5
Sub Total				***75.2***		***75.2***
Sovereign Total				**1,128.4**	**61.6**	**1,190.0**

*The planned commitment is indicative. A waiver for over programming will be requested should planned commitment in a given year exceeds headroom.

ANNEX 2: INDICATIVE PIPELINE – NON-SOVEREIGN

Indicative Board Approval Year	Sector	Project Name	Sum of ADB
2019	**Energy**	Sosian IPP Menengai	17.7
		Ormat IPP Menengai	18.0
		BBOXX Pay-As-You-Go Solar Systems to Increase Access to Electricity	6.5
	Water Supply & Sanitation	Mombasa Desalination Plant PPP	134.8
	Manufacturing	Devki Steel Mills expansion project	32.1
	Finance	Cooperative Bank of Kenya	35.7
		Stanbic Bank Kenya	0.0
2019 Total			**244.8**
2020	**Energy**	KenGen Asset backed Securitization Program	50.0
		Umeme	60.6
		Kaptis 15MW Small hydropower	9.2
		50MW Corner Baridi Wind Project	21.3
		Northern power WIND FARM	25.1
		SUSWA GEOTHERMAL	0.0
	Water Supply & Sanitation	Sewer Reticulation Project In Nairobi	22.7
2020 Total			**188.9**
2021	**Energy**	Olkaria 6 PPP	57.1
2021 Total			**57.1**
2022	**Water Supply & Sanitation**	Thuci Dam	141.8
2022 Total			**141.8**
Grand Total			**632.6**

ANNEX 2: INDICATIVE PIPELINE – NON-LENDING (UA Million)

Indicative Board Approval	Project	Pillar	ADF	ADB	MIC-TAF	Others
2018	Technical Assistance to the Presidential Delivery Unit- The Big Four	Pillar I			0.9	
2019	A study on governance	Pillar II				1
2019	Impact Assessment of Investment in the Road sector	Pillar II	0.24			
2019	Guideline for Gender Mainstreaming in Transport Sector Projects	Pillar II	0.19			
2019	Supporting GoK's policy, legal, regulatory and institutional reforms.	Pillar I			0.9	
2020	Support for Public Private Partnership	Pillar I				2
2020	Transport Infrastructure Gap Assessment and Development of Transport Strategy					0.714
2020	Integrated Urban Water Management (Technical Assistance)	Pillar I				2
2020	Capacity building to Budget, fiscal and economic affairs (National Treasury) on budget planning & forecasting.	Pillar II			1	
2021	Capacity Assessment of the Domestic Construction Industry					0.66
Total			**0.43**		**2.8**	**6.37**

ANNEX 3: ALIGNMENT BETWEEN PIPELINE PROJECTS AND HIGH-FIVES

Operation	Sector	Light-up and Power Africa	Feed Africa	Industrialize Africa	Integrate Africa	Improve the Quality of Life for Africans
A. Lending Operations						
Pillar I: Supporting industrialization						
Multinational: Malindi - Lunga Lunga - Bagamoyo Road (Phase I)	Transport			●	●	●
Nairobi Mass and Bus Rapid Transit System (MRTS/BRTS) Jogoo Road.	Transport			●		●
Upgrading of Ngong -Kiserian Road	Transport			●		●
Kipsaos-kimwarer-Emsea-Biretwo-Tot Road	Transport			●		●
Lesseru-Kitale				●	●	●
National Urban Water and Sanitation Program	Water & Sanitation			●		●
Menegai Geothermal: Drilling and Steam Gathering System	Energy	●		●		●
Transmission Network Improvement Project	Energy	●		●		●
National Electricity Access Project	Energy	●		●		●
Multinational: Kocholia-Amoni-Amogoro-Horticulture and Food Crop Value Chain Development Project	Agriculture		●	●		●
Kimira-Oluch Smallholder Farm Improvement Project - II	Agriculture		●	●		●
Drought Resilience & Sustainable Livelihood Program – Phase II	Agriculture		●	●		●
Kenya Mortgage Refinance Company (KMRC)	Social			●		●
Pillar II: Enhancing skills and capacity development						
Technical Education and Youth Entrepreneurship Project	Social			●		●
Wangare-Mathai Institute-Equipment				●		●
B. Non-lending Operations						
Technical Assistance to the Presidential Delivery Unit- The Big Four	Social		●	●		
Support for Public Private Partnership	All	●	●	●	●	
Integrated Urban Water Management (Technical Assistance)	Water & sanitation			●		●
Capacity building to Budget, fiscal and economic affairs (National Treasury) on budget planning & forecasting.	All					●
Supporting GoK's policy, legal, regulatory and institutional reforms.	Industry			●		

ANNEX 4: DONOR'S MATRIX

	DP/ Sec	IDA	Sida	DANIDA	Japan	Italy	Belgium	KFW	China	EDF	ADB	GIZ	AFB	Finland	Netherlands	USAID	DFID	CIDA	BADEA	EIB	Kuwait	OPEC	Spain	Saudi	BCM	Switzerland	Abhu Dhabi	GEFT	India	Total
1	Tou																													0
2	Agric	X	X		X			X		X	X	X				X														8
3	Man	X			X																									2
4	ICT	X																												1
5	PFM	X	X	X		X				X	X	X	X	X		X	X	X												12
6	E&T				X		X	X			X					X					X	X								7
7	Hea	X		X	X	X		X			X	X			X	X			X		X	X		X	X					16
8	EWS	X	X	X	X	X		X		X	X	X	X	X		X			X		X	X				X		X		17
9	LYH	X		X		X			X	X	X				X															7
10	PUH	X	X			X		X		X			X																	6
11	GJL	X		X						X		X				X														5
12	Tra					X				X	X						X		X				X							6
13	SPB		X																											1
14	PSR	X		X	X		X		X																					5
15	Ener	X			X		X		X		X		X						X	X		X	X	X					X	12
16	Roa	X			X			X	X	X	X		X						X		X	X		X			X			12
17	Trans	X			X						X																			3
18	NMD	X																												1
19	STI								X		X				X															3
20	Lan	X	X																											2
Total		15	6	6	9	6	3	6	5	8	11	5	5	2	3	6	2	1	5	1	4	5	2	3	1	1	1	1	1	

Sectors: **Tou**-Tourism, **Agri**-Agriculture, **Tr**a-Trade, **Man**-Manufacturing**, ICT**-Information, Communication and Technology, **PFM**-Public Financial Management, **EaT**-Education and Training, **Hea**-Health, **EWS-**Environment, Water and Sanitation, **LYH**-Labour, Youth and Human Resources**, PUH-**Population, Urbanisation and Housing, **GJL**-Governance, Justice and Legal Reforms, **SPB**-Security, Peace Building and Conflict Management, **PSR**-Public Sector Reforms, **Ener**-Energy, **Roa**-Roads, **Trans**-Transport, **NMD**-Nairobi Metropolitan Development, **STI-**Science Technology and Innovation, **Lan**-Lands

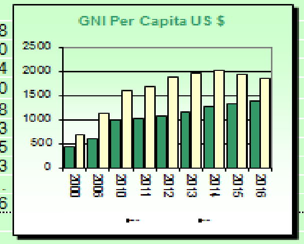
ANNEX 5: DONOR ACTIVITY VS BANK'S PILLAR ALIGNMENT

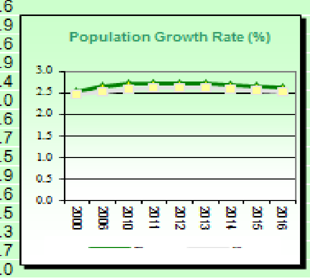
	DP/ Sec	IDA	Sida	DANIDA	Japan	Italy	Belgium	KFW	China	EDF	GIZ	AFB	Finland	Netherlands	USAID	DFID	CIDA	BADEA	EIB	Kuwait	OPEC	Spain	Saudi Arabia	BCM	Switzerlandd	Abhu Dhabi	GEFT	India	Total
Pillar I (transport, water & sanitation, energy, agricutlure, finance)	Agri	X	X		X			X		X	X				X														7
	Man	X			X																								2
	Tra	X				X				X						X		X				X							6
	EWS	X	X	X	X	X				X	X	X	X		X			X		X	X						X		14
	PUH	X	X			X		X		X		X																	6
	Ener	X			X		X		X									X	X		X	X	X					X	10
	Roa	X		X	X			X	X	X		X						X		X	X		X			X			12
	Trans	X		X	X							X																	4
Pillar II (skills development)	E&T	X		X			X	X							X					X	X								7
	LYH	X	X			X			X	X				X		X													7
	STI								X					X															2
Total		10	4	4	4	4	4	4	4	4	4	4	4	4	4	4		4	1	3	3	2	2			1	1	1	

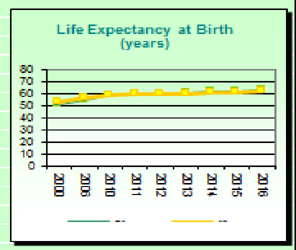
Sectors: **Agri**-Agriculture, **Tr**a-Trade, **Man**-Manufacturing**, EaT**-Education and Training, **EWS-**Environment, Water and Sanitation, **LYH**-Labour, Youth and Human Resources**, PUH-**Population, Urbanisation and Housing, **Ener**-Energy, **Roa**-Roads, **Trans**-Transport, , **STI-**Science Technology and Innovation

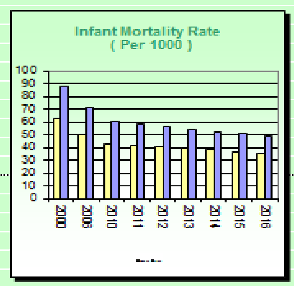
ANNEX 6: SOCIO-ECONOMIC INDICATORS

	Year	Kenya	Africa	Develo-ping Countries	Develo-ped Countries
Basic Indicators					
Area ('000 Km²)	2017	580	30,067	94,716	35,018
Total Population (millions)	2017	48.5	1,244.8	6,252.1	1,190.0
Urban Population (% of Total)	2017	26.9	40.5	49.2	81.4
Population Density (per Km²)	2017	85.2	42.4	66.0	34.0
GNI per Capita (US $)	2016	1 380	1 836	4 442	41 208
Labor Force Participation *- Total (%)	2017	67.1	65.8	62.3	60.3
Labor Force Participation **- Female (%)	2017	62.4	55.3	47.8	52.5
Sex Ratio (per 100 female)	2017	99.9	100.2	107.5	105.3
Human Develop. Index (Rank among 187 countries)	2015	146	...	...	...
Popul. Living Below $ 1.90 a Day (% of Population)	2013	...	...	12.7	0.6
Demographic Indicators					
Population Growth Rate - Total (%)	2017	2.6	2.5	1.3	0.6
Population Growth Rate - Urban (%)	2017	4.3	3.5	2.4	0.9
Population < 15 years (%)	2017	41.4	40.8	27.9	16.6
Population 15-24 years (%)	2017	19.4	19.2	16.7	11.9
Population >= 65 years (%)	2017	2.9	3.5	6.8	17.4
Dependency Ratio (%)	2017	79.5	79.6	54.6	52.0
Female Population 15-49 years (% of total population)	2017	24.5	24.0	25.6	22.6
Life Expectancy at Birth - Total (years)	2017	63.1	61.9	70.2	80.7
Life Expectancy at Birth - Female (years)	2017	65.2	63.3	72.3	83.5
Crude Birth Rate (per 1,000)	2017	33.0	33.9	20.6	10.9
Crude Death Rate (per 1,000)	2017	7.6	9.0	7.5	8.6
Infant Mortality Rate (per 1,000)	2016	35.6	49.3	33.1	4.5
Child Mortality Rate (per 1,000)	2016	49.2	72.6	44.3	5.3
Total Fertility Rate (per woman)	2017	4.1	4.4	2.6	1.7
Maternal Mortality Rate (per 100,000)	2015	510.0	444.1	237.0	10.0
Women Using Contraception (%)	2017	63.7	37.6	62.1	...
Health & Nutrition Indicators					
Physicians (per 100,000 people)	2005-15	19.9	41.6	121.6	293.5
Nurses and midwives (per 100,000 people)	2005-15	86.8	120.9	211.3	873.4
Births attended by Trained Health Personnel (%)	2010-16	61.8	55.9	76.6	98.9
Access to Safe Water (% of Population)	2015	63.2	71.6	89.4	99.5
Access to Sanitation (% of Population)	2015	30.1	39.4	61.5	99.4
Percent. of Adults (aged 15-49) Living with HIV/AIDS	2016	5.4	3.6	1.1	...
Incidence of Tuberculosis (per 100,000)	2016	348.0	221.7	163.0	12.0
Child Immunization Against Tuberculosis (%)	2016	99.0	82.1	84.9	95.8
Child Immunization Against Measles (%)	2016	75.0	74.4	84.0	93.7
Underweight Children (% of children under 5 years)	2010-15	...	18.1	15.3	0.9
Prevalence of stunding	2010-15	26.0	33.3	25.0	2.5
Prevalence of undernourishment (% of pop.)	2015	19.1	17.5	12.3	2.7
Public Expenditure on Health (as % of GDP)	2014	3.5	2.6	3.0	7.7
Education Indicators					
Gross Enrolment Ratio (%)					
Primary School - Total	2010-16	109.0	101.7	103.8	102.6
Primary School - Female	2010-16	108.7	98.8	102.2	101.8
Secondary School - Total	2010-16	...	51.8	...	106.6
Secondary School - Female	2010-16	...	49.7	...	106.4
Primary School Female Teaching Staff (% of Total)	2010-16	50.2	46.0	51.3	81.0
Adult literacy Rate - Total (%)	2010-16	78.7	68.6	...	...
Adult literacy Rate - Male (%)	2010-16	83.8	76.0	...	...
Adult literacy Rate - Female (%)	2010-16	74.0	61.7	...	...
Percentage of GDP Spent on Education	2010-16	5.3	4.9	4.1	5.2
Environmental Indicators					
Land Use (Arable Land as % of Total Land Area)	2015	10.2	8.0	11.3	10.1
Agricultural Land (as % of land area)	2015	48.5	37.4	38.1	35.1
Forest (As % of Land Area)	2015	7.8	21.0	31.4	28.8
Per Capita CO2 Emissions (metric tons)	2014	0.3	1.1	3.5	11.0









Sources : AfDB Statistics Department Databases; World Bank: World Development Indicators; *last update : January 2018*
UNAIDS; UNSD; WHO, UNICEF, UNDP; Country Reports.

*Note : n.a. : Not Applicable ; ... : Data Not Available. * Labor force participation rate, total (% of total population ages 15+)*
*** Labor force participation rate, female (% of female population ages 15+)*

ANNEX 7: MACROECONOMIC INDICATORS

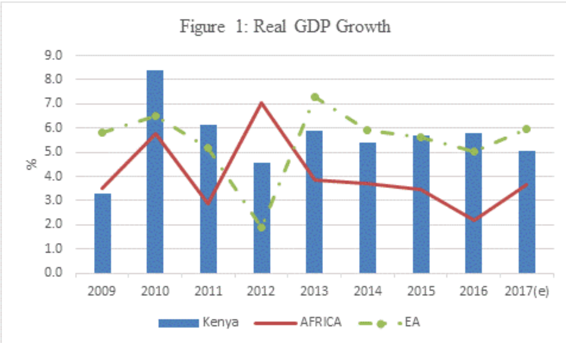


Figure 1: Real GDP Growth

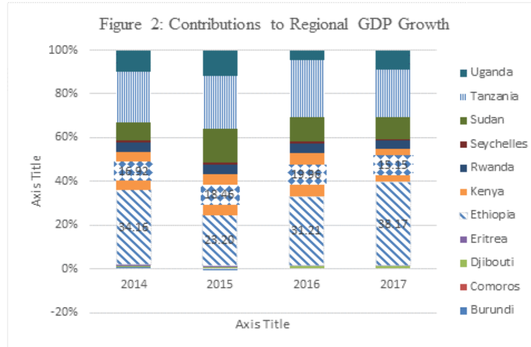


Figure 2: Contributions to Regional GDP Growth

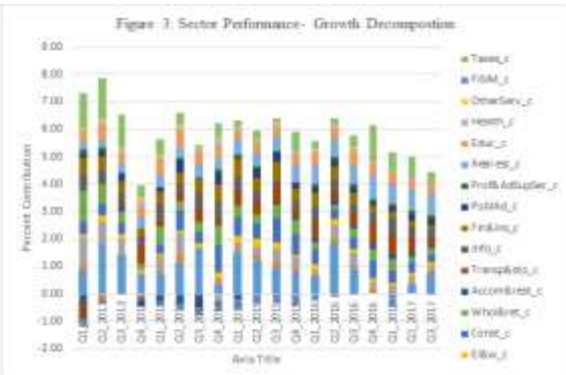


Figure 3: Sector Performance- Growth Decomposition

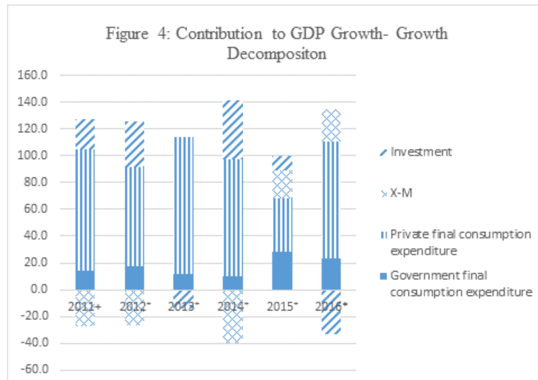


Figure 4: Contribution to GDP Growth- Growth Decompositon

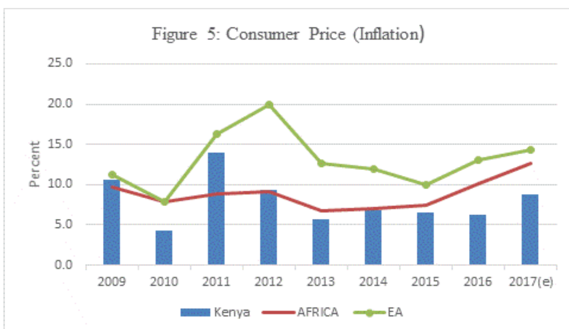


Figure 5: Consumer Price (Inflation)

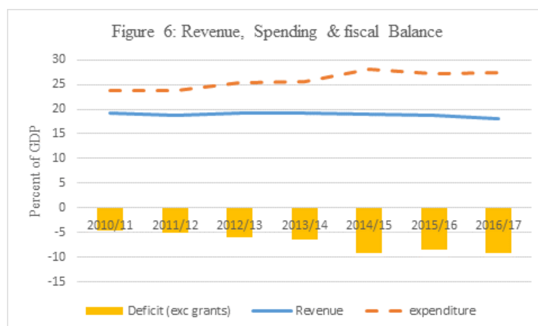


Figure 6: Revenue, Spending & fiscal Balance

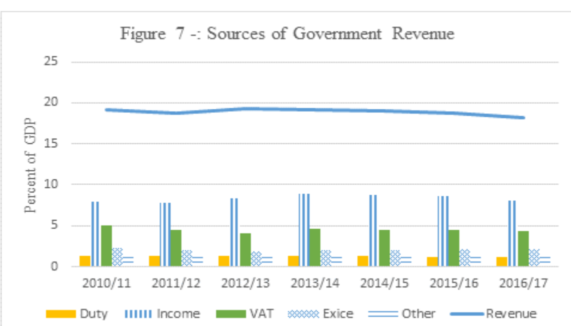


Figure 7 -: Sources of Government Revenue

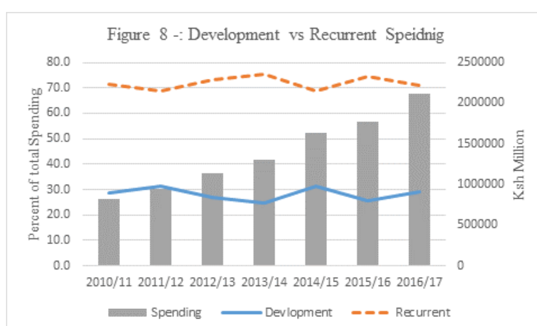


Figure 8 -: Development vs Recurrent Speidnig

Source: Based on KNBS and AfDB data

ANNEX 8: REVIEW OF THE IMPLEMENATION OF THE 2017 CPIP

Issue	Required Action to resolve the issue/problem	Implementing Authority	Measurable Indicator	Baseline (Mar. 2017)	Time frame	Target	Implementation Status
a) Government contributions or counterpart funds							
Mis-prioritization of budgeting for counterpart funds in Implementing Ministries	To dialogue with Principal Secretaries and Senior Ministry Chief Finance Officers (CFOs) on the need for them to make adequate provision for contribution for projects and prioritize budgeting for government contribution.	The National Treasury/PITs	The Number of meetings held with CFOs	0	September 2018	6	**Partially implemented**: Four meetings were held by PITs of three projects. Even so, 10 projects experienced issues with government counterpart funding.
Inadequate budgeting by Ministries for counterpart funding	To prioritize budgeting counterpart funding	Ministries/PITs	The number of project experiencing issues with counterpart funds	3	Continuous	0	**Partially implemented**, as 10 operations experienced issues with government counterpart funding.
	RDGE Management to engage the Principal Secretaries (PS) or Senior Government Officials on the need for the PS to make adequate provision for government contribution to projects	AfDB	The number of meetings that RDGE Management holds with PS or Senior Government Officials on government contribution	0	September 2018	4	**Fully implemented**: Four meetings held: two with the National Treasury to address the budgeting for Thwake Multipurpose Water Dev. Program; one to discuss the slow procurement on DRSLP and Kenya Towns Sustainable Water Supply and Sanitation Program.
b) Weak Project Management							
PITs do not closely monitor the performance of contractors	To monitor the performance of the contractors more closely and exercise the penalties provided for in the contracts if required.	PITs	No. of projects reporting contractors delays	2	Continuous	0	**Target achieved**. As at the portfolio meeting in November 2018, no project reported contractor delays.
The National Treasury (TNT) and Ministries do not adequately monitor project implementation	Revitalize Project Steering Committee and Quarterly Portfolio Meetings	TNT/ Ministries	Number of Portfolio Meetings organized by TNT	1	Yearly	4	**Target achieved**, covers portfolio meetings, three of which were combined with the workshops on CSP preparation.
			No. of Steering Committee Meetings	5	October 2018	10	Target achieved.

	Provide accurate work plans and procurement plans to TNT and AfDB	PITs	No. of submissions of quality work plans	15	Yearly	60	**Partially implemented**: While all project Teams submitted work and procurement plans to the Bank, they often failed to send copies to the National Treasury.
	RDGE Management to engage Principal Secretaries (PS), Senior Ministry and PIT Officials on the need for effective portfolio management	AfDB	The Number of meetings that RDGE Management hold with Ministries and	0	October 2018	4	**Fully implemented**. RDGE Management held more than four meetings to discuss portfolio issues. Few of the meetings were with the Cabinet Secretary, the National Treasury. Another was with the Principal Secretary, Ministry of Health, to seek ways to speed up the procurement of a contractor for the Kidney Institute.
a) Delays in processing disbursement applications							
Long hold-up of disbursement applications with PITs and in Ministries	Follow up with Contractors and Ministries on the preparation or speed up the processing of invoices to avoid delays	PITs	Number of days it takes to process disbursement applications (with no issues)from PITs to TNT		October 2018	30	**Target not achieved**: As at the last portfolio meeting in November 2018, average lapse time was 110 days. The delay was largely attributed to the fiscal consolidation exercise, which regulated budgetary provision for disbursements.
Inadequate budgetary provision required for invoice processing	The National Treasury to help speed up the approval of authority to incur expenditure where budget is lacking or inadequate.	TNT	Number of working days TNT takes to approve authority to incur expenditure	7	October 2018	5	**Target not achieved**. The fiscal consolidation exercise controlled the level of budgets for expenditures.
b) Start-up delays							
Delays in submitting legal opinion and Subsidiary Agreement	To initiate the preparation of legal opinion and/or subsidiary agreement immediately after Loan negotiation or approval.	TNT	Avg. time-lapse from approval to 1st disbursement (months)	9.2	Continuous	6	**Target not achieved**: for operations approved subsequently, namely, ENABLE Youth and JKIA Second Runway. The delays on ENABLE resulted because of GoK changes in the implementation arrangements, which in turn delayed the signing of the loan agreement. For JKIA Second Runway, shifts in GoK's priorities affected the implementation of the project.
c) Strengthen Procurement Process							

Strengthen compliance of evaluation reports with bidding documents, resulting in delays in clearance of the reports by the Bank	To train project staff on Bank's procurement policies and procedure.	AfDB	No of participants trained	0	October 2018	35	**Target achieved**. Over 60 project staff were trained and assisted by RDGE Procurement Experts.
PITs to timely initiate procurement process	Closely monitor procurement plans	AfDB/PIT	% of activities completed on schedule	0	Continuous	75%	Target achieved.

ANNEX 8A: 2019 COUNTRY PORTFOLIO IMPLEMENATION PLAN

Issue	Required Action to resolve the issue/problem	Implementing Authority	Measurable Indicator	Baseline (Nov. 2018)	Time frame	Target
a) **Limited budgetary provision for operations in the national budget**						
Limited budgetary provision for operations in the national budget causing disbursement and project implementation delays	The National Treasury to adequately provide of operations in the national budget	The National Treasury (TNT)	No. of projects experiencing implementation delays because of lack or inadequate budget	9	October 2019	0
	The National Treasury to provide "authorization to incur expenditures" to temporarily allow disbursement on projects that lack or are not adequately provided for in the national budget	TNT/PITs				
b) Government contributions or counterpart funds						
Inadequate budgeting by Ministries for counterpart funding causing delays, especially on land acquisition and compensation of project affected persons	To prioritize budgeting counterpart funding	Ministries/PITs	The number of project experiencing issues with counterpart funding	10	Continuous	0
c) Weak Project Management Oversight						
The National Treasury (TNT) and Ministries do not adequately monitor project implementation	Revitalize Project Steering Committee and Quarterly Portfolio Meetings	PITs	No. of Portfolio Meetings organized by TNT/Ministries	4	October 2019	4
	The PITs to involve Ministry Accountants in project management					
Lack of regular and quality provision of work and procurement plans	Provide accurate and regular work plans and procurement plans to TNT and AfDB	PITs	No. of quality work/procurement plans submitted		Yearly	2 per project
d) **Delays in processing disbursement applications**						
Long hold-up of disbursement applications in PITs and Ministries	Follow up with Contractors and Ministries on the preparation or speed up the processing of invoices to avoid delays	PITs	Number of days it takes to process disbursement applications (with no issues)from PIT to the Bank	110	October 2019	30

Lack of or inadequate budgetary provision required for invoice processing	The National Treasury to speed up the approval of authority to incur expenditure for projects that lack or with inadequate budget.	TNT	Number of working days TNT takes to approve authority to incur expenditure	>14	October 2019	<10
Delays by Ministries in transferring funds from special accounts to project accounts	Ministries to speed up the transfer of special account funds to project accounts	Ministries	No. of projects experiencing funds transfer delays	2	October 2019	0
e) Tax Exemption Delays						
Delays by TNT in providing tax exemption to contractors/consultants	TNT to speed up the approval of tax exemption requests;	TNT	No. of operations experiencing tax exemption delays	5	October 2019	0
	PIUs to alert the Desk Office for follow up on tax exemption requests	PITs				

ANNEX 9: ONGOING PUBLIC SECTOR PORTFOLIO (31 DECEMBER 2018)

Sector Name	Long name	Loan Number	Funding Source	Approval Date	Date Entry Into Force	Completion Date	Loan Amount (UA Million)	Disb. Ratio (%) /1	Age of Project in Years
Agriculture	SMALLSCALE IRRIGATION & AGRICULTURE VALUE CHAIN DEVELOPMENT	2000130014530	ADB	11/18/2015	42536	06/30/2022	28.5	14.2%	3.2
		5570155000751	GAFSP TF	11/18/2015	2/4/2016	06/30/2022	16.4	4.7%	3.2
	KENYA-DROUGHT RESILIENCE & SUSTAINABLE LIVELIHOOD PROGRAM IN	2100150028345	ADF	12/19/2012	5/5/2013	12/31/2020	37.4	32.7%	
	MULTINATIONAL-GEF RURAL LIVELIHOODS ADAPTATION TO CLIMATE CH	5550155001201	GEF	12/15/2016	5/19/2017	05/31/2021	2.0	2.7%	2.1
	ENABLE YOUTH KENYA	2100150038895	ADF	01/11/2018	11/26/2018	06/30/2022	21.3	0.0%	1.0
	GREEN ZONES DEVELOPMENT SUPPORT PROJECT-PHASE 2	2000200003402	ADB	12/03/2018		12/30/2025	4.3	n.a.	0.1
		2100150040546	ADF	12/03/2018		12/30/2025	29.7	n.a.	0.1
Agriculture Total							**139.3**	**16.2%**	
Power	ADF PRG MENENGAI	2100140000151	ADF	10/22/2014		12/31/2020	9.2	n.a.	4.3
	ADF - PRG FOR TURKANA T-LINE	2100140000101	ADF	10/02/2013	12/8/2014	03/15/2019	16.4	0.0%	5.3
	KENYA - LAST MILE CONNECTIVITY PROJECT	2100150032195	ADF	11/19/2014	10/2/2015	12/31/2019	90.0	75.4%	4.2
	LAST MILE CONNECTIVITY PROJECT - 2	2000200000152	ADB	06/27/2016	5/5/2017	12/31/2022	97.1	32.6%	2.6
	MENENGAI GEOTHERMAL DEVELOPMENT PROJECT	2100150026101	ADF	12/14/2011	7/10/2012	12/31/2018	80.0	95.7%	7.2
		5565130000101	SCF	12/14/2011	7/10/2012	12/31/2018	5.4	71.2%	
		5565155000401	SCF	12/14/2011	3/12/2012	12/31/2018	12.6	72.6%	
	ETHIOPIA-KENYA ELECTRICITY HIGHWAY(KENYA)	2100150027845	ADF	09/19/2012	3/1/2013	12/31/2018	75.0	67.5%	6.4
	KENYA - TANZANIA INTERCONNECTION (KENYA)	2100150032846	ADF	02/18/2015	11/13/2015	12/31/2019	27.5	18.9%	3.9
Power Total							**413.2**	**60.6%**	

ANNEX 9: ONGOING PUBLIC SECTOR PORTFOLIO (2 DECEMBER 2018)

Sector Name	Long name	Loan Number	Funding Source	Approval Date	Date Entry Into Force	Completion Date	Loan Amount (UA Million)	Disb. Ratio (%) /1	Age of Project in Years
Social	SUPPORT TO HIGHER EDUCATION SCIENCE AND TECHNOLOGY TO ENHANC	2100150027993	ADF	11/14/2012	2/19/2013	06/30/2019	28.0	85.3%	6.2
	SUPPORT TO TVET AND TRAINING FOR RELEVANT SKILLS DEVELOPMENT	2100150033295	ADF	07/01/2015	12/10/2015	06/30/2021	41.0	32.5%	3.6
	EAST AFRICA CENTERS OF EXCELLENCE KENYA	2100150031997	ADF	10/03/2014	7/7/2015	12/31/2019	25.0	11.4%	4.3
Social Total							**94.0**	**42.6%**	
Transport	NAIROBI OUTER RING ROAD PROJECT IMPROVEMENT PROJECT	2100150030144	ADF	11/13/2013	5/8/2014	12/31/2018	77.0	77.8%	5.2
		2100155026117	ADF	11/13/2013	9/26/2014	12/31/2018	0.6	79.0%	
	MOMBASA-MARIAKANI ROAD HIGHWAY PROJECT	2100150032743	ADF	03/11/2015	10/29/2015	06/30/2021	80.0	20.9%	3.9
	SIRARI CORRIDOR ACCESSIBILITY & ROAD SAFETY IMPROVEMENT PROJ	2000130015238	ADB	03/30/2016	8/18/2016	12/31/2021	164.4	25.0%	2.8
		5580155000451	EU AITF	03/30/2016	5/13/2016	12/31/2021	8.2	6.9%	
	MULTINATIONAL: ARUSHA-HOLILI/TAVETA-VOI ROAD (KENYA)	2100150028894	ADF	04/16/2013	10/18/2013	12/31/2018	75.0	74.2%	5.8
	MOMBASA -NAIROBI-ADDIS ABABA CORRIDOR PHASE III - KENYA	2100150025546	ADF	11/30/2011	6/29/2012	12/31/2018	120.0	76.0%	7.2
	KAPCHORWA - SUAM - KITALE AND ELDORET BYPASS ROADS PROJECT (	2000200001052	ADB	03/29/2017	8/22/2017	12/31/2022	59.1	13.0%	1.8
		2100150037300	ADF	03/29/2017	8/22/2017	12/31/2022	35.1	12.9%	
	KENYA - LAKE VICTORIA MARITIME COMMUNICATIONS AND TRANSPORT	2100150036247	ADF	10/24/2016	3/23/2017	04/30/2021	3.8	0.4%	2.2
Transport Total							**623.2**	**44.6%**	

ANNEX 9: ONGOING PUBLIC SECTOR PORTFOLIO (2 DECEMBER 2018)

Sector Name	Long name	Loan Number	Funding Source	Approval Date	Date Entry Into Force	Completion Date	Loan Amount (UA Million)	Disb. Ratio (%) /1	Age of Project in Years
Water Sup/Sanitation	KENYA TOWNS SUSTAINABLE WATER SUPPLY AND SANITATION PROGRAM	2000200000501	ADB	11/09/2016	4/4/2017	12/31/2021	274.9	1.1%	2.2
		2100150036294	ADF	11/09/2016	4/4/2017	12/31/2021	5.1	4.5%	
		2100155033467	ADF	11/09/2016	1/9/2017	12/31/2021	0.5	20.8%	
		5500155011104	MIC TF	11/09/2016	3/3/2017	12/31/2021	1.2	8.7%	
	THWAKE MULTIPURPOSE WATER DEVELOPMENT PROGRAM	2100150029993	ADF	10/30/2013	5/28/2014	12/31/2019	61.7	86.2%	5.3
		2100155025973	ADF	10/30/2013	1/27/2014	12/31/2019	1.2	58.9%	
	THWAKE MULTIPURPOSE WATER DEVELOPMENT PROGRAM I - ADDITIONAL	2000200003351	ADB	11/14/2018		12/31/2022	158.0	n.a.	
		5050200000501	AGTF	11/14/2018		12/31/2022	35.4	n.a.	
	NAIROBI RIVERS BASINS REHABILITATION RESTORATION: SEWERAGE II	2000200003407	ADB	12/11/2018		12/30/2023	48.7	n.a.	
		2100150040550	ADF	12/11/2018		12/30/2023	2.9	n.a.	
Water Sup/Sanit Total							**589.7**	**16.7%**	
Multi-Sector	MIC-TAF-TECHNICAL ASSISTANCE TO THE PRESIDENT DELIVERY UNIT	5500155012902	MIC	07/18/2018		12/31/2020	1.2	16.1%	0.4
Total Public Sector Operations							**1,861.0**	**40.5%**	

ANNEX 10: ONGOING PRIVATE SECTOR PORTFOLIO (29 MAY 2018)

Sector Name	Long name	Loan Number	Funding Source	Approval Date	Date Entry Into Force	Completion Date	Loan Amount (UA Million)	Disb. Ratio (%) /1	Age of Project in Years
Finance	EQUITY BANK (KENYA) LIMITED	2000130013731	ADB	11/05/2014	07/03/2015	12/31/2024	106.7	100.0%	4.2
	COMMERCIAL BANK OF AFRICA LIMITED	2000130017482	ADB	01/25/2017		12/31/2019	36.1	0.0%	2.0
	DIAMOND TRUST BANK LOC I	2000130016784	ADB	11/18/2016		05/20/2020	36.1	0.0%	
		2000130016785	ADB	11/18/2016	09/28/2018	05/20/2020	18.0	100.0%	2.2
	COMMERCIAL BANK OF AFRICA - TFLOC	2000130019630	ADB	01/25/2017		10/06/2019	28.8	0.0%	2.0
	KENYA COMMERCIAL BANK LIMITED	2000130018280	ADB	10/25/2017	03/23/2018	02/01/2025	72.1	100.0%	1.2
Finance Total							**297.8**	**66.1%**	
Power	LAKE TURKANA WIND POWER EKF	2000130011534	ADB	04/26/2013	3/24/2014	01/19/2028	16.4	100.0%	5.8
	LAKE TURKANA WIND POWER PROJECT	2000130011533	ADB	04/26/2013	3/24/2014	03/23/2029	94.4	100.0%	
		5060140000063	PSCEF	11/04/2015		03/23/2029	28.1	0.0%	3.2
	LAKE TURKANA WIND POWER PROJECT - SUB DEBT TRANCHE	2000130010533	ADB	04/26/2013	3/24/2014	01/19/2028	4.1	100.0%	5.8
	THIKA THERMAL POWER PROJECT	2000130008130	ADB	12/07/2011	10/19/2012	05/30/2027	23.1	100.0%	7.2
		5060140000062	PSCEF	11/04/2015		05/30/2027	4.8	0.0%	3.2
	QUANTUM POWER MENENGAI 35 MW GEOTHERMAL IPP	2000130019431	ADB	06/06/2018		04/27/2023	21.3	n.a.	0.6
		5560130000951	CTF	06/06/2018		04/27/2023	14.4	n.a.	0.6
	KOPERE 40 MW SOLAR PV IPP	2000130019981	ADB	11/27/2018		01/14/2028	13.1	n.a.	0.1
Power Total							**219.7**	**80.7%**	
Total Private Sector Operations							**220.7**	**80.4%**	

ANNEX 11: CPIA SCORES 2013-2016

Clusters / Criteria	2014	2015	2016
	Score	Score	Score
Overall CPIA	4.3	4.3	4.4
Economic Management	4.5	4.3	4.3
Fiscal Policy	4.5	4.5	4.5
Monetary Policy	4.5	4.0	4.0
Debt Policy	4.5	4.5	4.5
Structural Policies	4.3	4.4	4.4
Financial Sector Development	5.0	5.0	5.0
Trade Policy	4.5	4.5	4.5
Business Regulatory Environment	3.5	3.8	3.8
Social Inclusion/Equity	4.3	4.3	4.4
Gender Equality	4.3	4.3	4.3
Equity of Public Resource Use	4.5	4.5	4.5
Building Human Resources	4.3	4.3	4.5
Social Protection and Labour	4.6	4.6	4.6
Environmental Policies and Regulations	3.5	3.5	4.0
Governance	3.9	3.9	4.0
Property Rights and Rule-based Governance	3.6	3.8	3.9
Quality of Public Administration	4.0	4.0	4.0
Quality of Budgetary and Financial Management	4.0	4.0	4.1
Efficiency of Revenue Mobilization	4.5	4.5	4.8
Transparency, Accountability and Corruption in the Public Sector	3.2	3.2	3.2
Infrastructure & Regional Integration	4.6	4.6	4.6
Infrastructure Development	4.8	4.8	4.8
Regional Integration	4.3	4.3	4.3

ANNEX 12: GROWTH DIAGNOSTICS REPORT

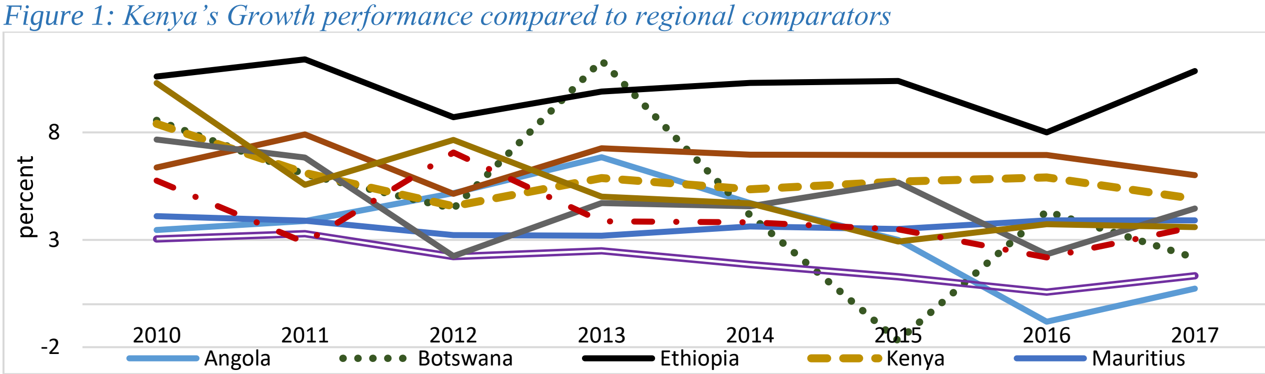
1. Despite Kenya's impressive growth averaging 5.2% between 2007 and 2017, long-term growth target of 10% envisaged in the vision 2030 has been elusive. With stagnating GDP per capita growth, weak external demand as well as a negative contribution of factor productivity, sustaining long-term growth will be difficult for the country. We use the traditional growth diagnostics approach proposed by Hausmann et al (2005) to identify and quantity the critical binding constraints to Kenya's long-term growth. We also complement the discussion with results from the decomposition of total labor productivity as proposed by McMillan and Rodrik (2011).

2. The findings show that election-related conflict and transparency are major binding constraints to Kenya's growth. Cost of finance is not the main binding constraint but structural bottlenecks that prevent the efficient intermediation in the domestic financial markets. The results show that structural transformation has lagged behind in Kenya with total labor productivity growth mainly coming from within-sector productivity changes, suggesting that the country needs to improve between-sector labor reallocation towards high valued-added sectors in order to achieve sustained long-term growth. Ventura (1997) for instance shows that such reallocation may be beneficial in countries like Kenya that have low capital stock, provided labor is relocating to high productivity sectors. The results further show that improvements in industrial GDP (growth) has a greater potential for inclusive growth through employment creation compared to a similar improvement in the service sector growth. This finding underscores the importance of focusing on industrial-led growth for long-run sustainable and inclusive growth in Kenya. Improvements in agriculture sector GDP on the other hand are associated with reduced employment, mainly attributed to increased agriculture mechanization and use of more capital-intensive technology in the sector. The rest of the paper is structured as follows. Section 2 highlights some of the important characteristics of GDP growth in Kenya. This will be followed by section 3 where factors constraining growth are summarized. Finally section 4 conclusion and gives policy recommendation.

II. GDP Growth Performance

3. **Missed growth targets.** Although Kenya's growth performance has been above the African average over the last 10 years, averaging 5.2% between 2007 and 2017 (Fig. 1) growth has been significantly lower than the 10% targeted in the Vision 2030.

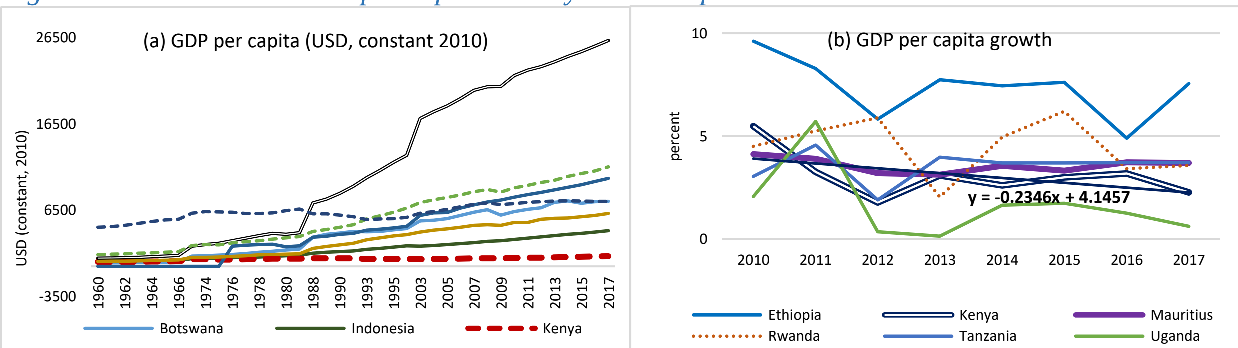
Figure 1: Kenya's Growth performance compared to regional comparators



Source: AfDB Statistics Department

4. **Declining per capita growth**. Real per capita income has stagnated (in USD, constant 2010) since independency and a declining growth of the same in the recent past (Fig 2).

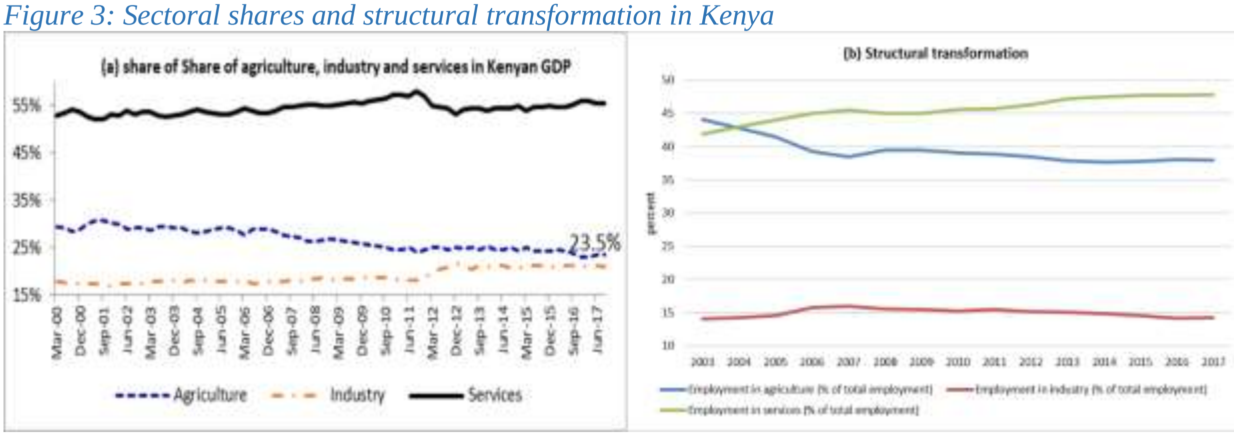
Figure 2: Trends in real GDP per capita in Kenya and comparator countries



Source: AfDB Statistics Department

5. **Slow pace of structural transformation**. The sectoral shares of agriculture, industry and services in Kenya's GDP have progressively changed over the last few years. However with the declining contribution of agriculture in Kenya's GDP, the share of workers employed in the agriculture sector as a percentage of the total remains high, implying that the pace of structural transformation is not in tandem with the changing sectoral share contributions (Fig 3).

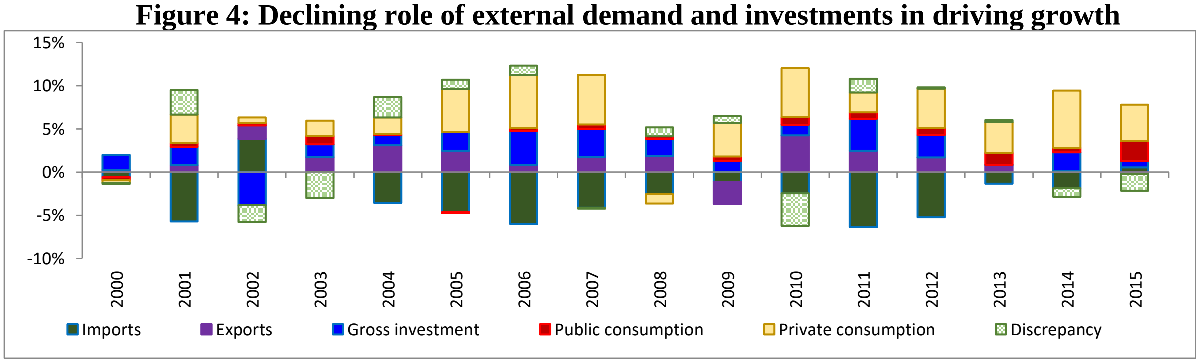
Figure 3: Sectoral shares and structural transformation in Kenya



Source: KNBS (2018)

6. **Weak role of external demand and investments in driving growth**, and limited productivity growth. Decomposition of the demand components contributions to growth shows that, while Kenya's growth has been mainly anchored on strong domestic demand (public and private consumption), the role of external demand is declining, reaching negative in 2017 (Fig. 4).

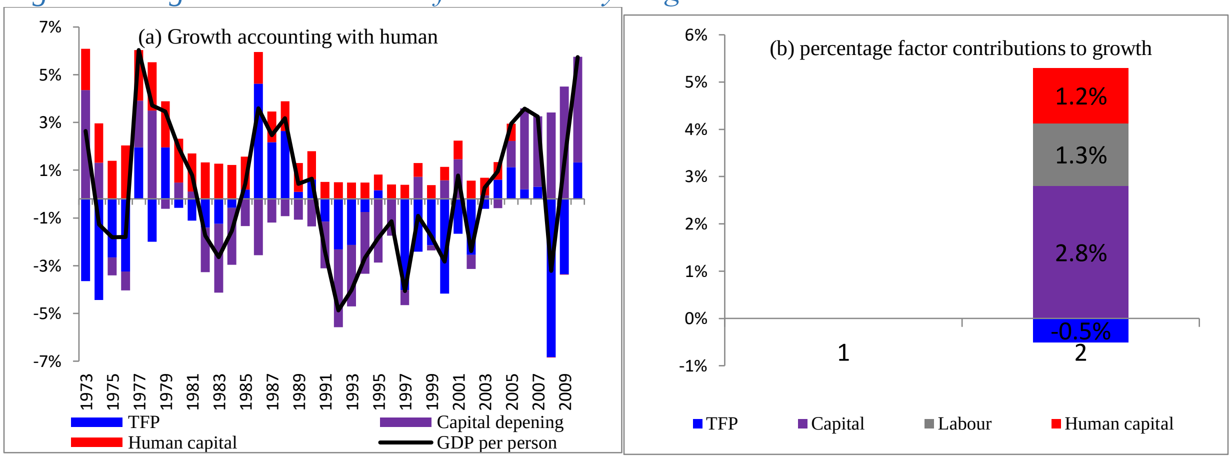
Figure 4: Declining role of external demand and investments in driving growth



Source: Kenya National Bureau of Statistics (KNBS) Statistical Abstract, various years.

7. **Limited productivity growth**. Physical capital accumulation has contributed the biggest proportion to Kenya's growth, accounting for 48.3% of the 4.8% average growth that Kenya enjoyed over that period. Human capital accounted for 25% of the growth and labor accounted for 27.1% of the growth compared to a negative contribution of 10.4% coming from Total Factor Productivity (TFP). The results suggest that the ability of Kenya to sustain high growth rates is severely constrained by the weak factor productivity (Fig 5).

Figure 5: Negative contribution of TFP to Kenya's growth



Source: Authors' computations based on data from the African Development Bank

III. Constraints to Growth

8. A number of workhorses are available in the empirical literature to determine factors constraining growth. In this study, the Hausemann, Rodrick and Velasco (2005) approach was adopted which is a different framework to diagnose growth. It aims at identifying binding constraints, which if removed, would allow growth to accelerate. The approach starts from the premise that not all constraints are binding at the same time and identifies those that when relaxed will deliver the biggest impact on growth. Table 1 gives some of the major constraints identified by Haussmann et al (2005) growth diagnostic decision tree and results found.

Table 1: Major constraints to GDP Growth

Possible constraints to growth	**Summary of findings**
Access to and cost of finance	Kenya has witnessed a rapid increase in financial inclusion over the past 10 years measured in terms of access to financial services in both urban and rural areas (e.g. nationally percentage of those not using any formal service reduced from 41.3% in 2006 to 17.4% in 2016). However, compared to its peers, saving to GDP ratio at 12.9% is low while the interest rate spreads (between lending and deposit rates) has remained very high, a sign of repression in the financial system, indicating inefficiencies in the financial intermediation process. The wide spread is caused by among others high operating costs, default rates, the level of non-performing loans and market structure (lack of competition). Kenya's access to external finance has been impressive the last few years even though ODA has declined since 2013. Both FDI and remittances have been increasing since 2018. The proportion of external debt as a percentage of the total has progressively increased and currently accounts for a higher percentage of total debt. This shows that attracting external finance is not a problem for Kenya and therefore has not been a constraint to growth.
Complementary factors (e.g. human capital, infrastructure, appropriability of returns, and governance).	Returns to education is relatively low in Kenya compared to the regional comparators and is lowest for primary level of education, secondary and tertiary. The low shadow price of extra education training implies that ***lack of human capital is not a constraint to Kenya's growth.*** The poor quality of ***road*** network and unevenly distributed road network is a major constraint to growth in rural economic activities, commercial agriculture, tourism, manufacturing among others. There has been

	improvement in domestic road network and electricity provision in the country. However, the number of firms experiencing poor road network in their areas of operation is as high as 21.6% in Kenya compared to South Africa 3.9%, Nigeria 17.1%, and Uganda 15.7%. As such, there is still poor market access which is a constraint to firms as they face the difficulty of access to raw materials and delivery of output to markets. In the rural areas, farmers face difficulties to sell their output and access inputs needed for efficient production as much of agriculture is undertaken in rural areas. While the government has deepened ***electricity*** access, the number of outages experienced by firms is way above Sub Sahara Africa average. At least 89.4 percent of firms have experienced load shading in Kenya compared to countries like Rwanda 62.5 percent. Similarly, water as a basic commodity for human consumption and use by firms in the production process, is also inadequate. Lack of access to ***water*** at the firm level hinders production process and thus reduces the level of output and revenue generated. Of the firms surveyed, 33.7 percent have insufficient water supply which is way above SSA and Kenya's neighbor's Uganda, Rwanda and Tanzania. In terms of ***investment efficiency***, Kenya ranks lower than most of its regional competitors including South Africa, Rwanda and Ghana. Low investment efficiency may imply a high degree of bureaucracy, which is a hindrance to growth. Results from correlation and causality tests conducted between governance indicators and growth in Kenya show that there is positive relationship between all measures of governance and institutional quality. Results on causality show that tighter controls on corruption have significant positive impact on growth supporting the sides of evidence that argues that corruption adversely affects growth.
Labor market externalities and impact on growth.	By calculating employment elasticity of growth to determine whether the recent growth experience has been ***employment*** creating or not, we find that industrial and service sector GDPs have significant positive effects on employment with the highest employment effect coming from growth in ***industrial*** sector followed by the service sector implying that accelerating industrialization may have greater potential for employment creation compared to other sectors.
Binding constraints to growth.	Regressing growth acceleration (defined as episode as a period when growth was positive for three consecutive years) on a number of growth drivers to assess what factors are supporting that sustained growth episode, we found that increased accountability and human capital development accelerates growth. On the other hand, political violence and macroeconomic management are binding constraints. The regression shows that property rights were a binding constraint between 1960 and 2017 but not in the 2000-2017 sample period implying that respect of property rights have improved in the past but have not reached a point of being an accelerator to growth. Similarly, terms of trade shocks are becoming less of a binding constraint with the effect not significantly different from zero in the 200-2017 period compared to the period between 1960 and 2017. Improvements in terms of trade have become more of growth accelerators in the post 2000 period rather than a growth constraint.
The role of structural change	The literature provides that countries that manage to pull out of poverty and get richer are those that are able to diversify away from agriculture and other traditional products. As labor and other resources move from agriculture into modern sectors, overall productivity rises, raising income. The literature further notes that the speed with which structural transformation takes place is the key factor that differentiates successful countries from unsuccessful ones. A decomposition of the labor productivity shows that between-sector productivity growth (structural transformation) has lagged behind in Kenya with a higher proportion of the labor productivity growth coming from within-sector productivity growth. Within-sector labor productivity growth on the other hand has increased implying that the increase in labor productivity witnessed in Kenya since the early 2000 has mainly come from within-sector productivity growth and not structural transformation. On the other hand, productivity gap between agriculture and the non-agriculture sector has progressively increased since the early 1990, surpassing the average for Africa. It implies that the productivity of the traditional sector has progressively improved as labor is drawn from the sector to the modern sectors.

IV Conclusion and Recommendations

The following are some of the conclusions derived from the study. (i) With stagnated GDP per capita growth, weak external demand as well as a negative contribution of factor productivity, achieving and sustaining long-term growth will be difficult for the country. (ii) Election-related conflict, governance accountability are major binding constraints to Kenya's growth. (iii) Contrary to popular belief, cost of finance is not the main binding constraint but structural bottlenecks that prevent the efficient intermediation in the domestic financial markets. (iv) Structural transformation has lagged behind with total labor productivity growth coming from within-sector productivity changes.

The following are some of the policy recommendations. (i) Policy measures to deal with cyclical election-related violence are needed. They may include deliberate measures aimed at reconciling communities; particularly in the periods leading to elections. (ii) Industrial sector growth has the biggest potential for employment creation, technology spill over, improving country's terms of trade compared to the other sectors. Industrial-led growth can be achieved by focusing on skills development for industry, improving the quality of infrastructure, and improving the business environment.

ANNEX 13: MDG ACHIEVEMENTS

Goal/Target for 1990 - 2015	Key Indicators	Baseline 1990 (others)	Latest	Target 2015	Current Status on MDG
1. **Eradicate Extreme Poverty and Hunger.**	Proportion of population living below the national poverty line (%)	43.3	36 (2015/16)	21.7	
	Poverty gap ratio (%)		12.2 (2009)	9.6	Not met
	Share of poorest quintile in national consumption (20%)	4.8	10.4 (2015/16)	3.09	
	Employment-to-population ratio (%)		71(2015/16)		
	Proportion of own-account and contributing family workers in total employment (%)		64.3 (2009)		
	Prevalence of underweight children under five years of age (%)	22.3	20.3 (2009)	11.1	
	Proportion of population below minimum level of dietary energy consumption		51 (2005)		
2. **Achieve Universal Primary Education.**	Net enrolment ratio in primary education (%)	80.0	91.2 (2017)	100	On track
	% pupils starting grade 1 who reach grade 5	63 (1986)	80 (2013)	100	
3. **Promote Gender Equality & Women Empowerment**	Ratio of girls to boys in primary, secondary and tertiary education	Primary (.95)	Primary (.97 - 2017)	1	Not met
		Secondary (.75)	Sec. (.95 2017)	1	
		Tertiary (0.63-2000)	Tertiary (0.87 - 2017)	1	
4. **Reducing Child Mortality**	Under-five mortality rate (per 1000 births)	91	52 (2017)	32	Not met
	Infant mortality rate (per 1000 births)	60	39 (2017)	22	
	Measles vaccine (%)	83.8	80 (2012)	100	
5. **Improve Maternal Mortality**	Maternal mortality ratio (per 100,000)	590	362 (2017)	147	Not met
	Proportion of delivery by skilled health personnel (% of births)	45.4	43 (2009)	90	
	Contraceptive prevalence rate	27	46 (2009)	70	
	Adolescent birth rate	152	103 (2009)	90	
6. **Combat HIV/AIDS**	HIV prevalence among 15-24 year-old pregnant women (%)	3.6 (2003)	5.6 (2017)	2.1	Not met
	Condom use rate of the contraceptive prevalence rate (%)	Female (15.6 -1998) Male (44 – 1998)	Female (35.3 – 2009) Male (61.5 – 2009)		
7. **Ensure Environmental Sustainability**	Proportion of population with sustainable access to an improved water source	(54.8 -2009)	(52.6 -2009)	78	Tentative
	Proportion of population with access to improved sanitation	(45 - 2009)	(61 - 2009)	77	
8.**Global Partnership for Development**	Debt service as a percentage of exports of goods and services	14.5	(4.9 -2013)		Tentative
	Internet users per 100 population	(3- 2003)	(31.7- 2013)		
	Telephone lines per 100 population	(1- 2003)	(0.5 – 2013)		
	Cellular subscribers per 100 population				

ANNEX 14: CODE RECOMMENDATIONS ON THE CSP 2014-2018 COMPLETION REPORT

No	CODE Recommendations	ACTION TAKEN
1	CRFA and its application in three RMC cases will be presented at ADF-14 review meetings in Kigali. Thereafter, CODE will determine whether CRFA should be approved by the Board of Directors before rolling it out beyond its current pilot phase.	This is well noted. A paragraph on analysis of CRFA for Kenya is added to show alignment with the new CSP. See paragraph 30.
2	The two pillars proposed for Kenya's CSP 2019 – 2023 are supported.	Thank you.
3	Management is urged to emphasize and mainstream agri-business and development of productive value chains across both pillars,.	Agri-business and development of value chain is part of Bank's priority. This is provided in paragraphs 53 and 56.
4	Address inclusive growth and social cohesion through supporting SMEs in the creation of enterprises and new private sector jobs,	Bank's strategy supports SMEs. See paragraph 53.
5	Amplify support to low carbon and green economy in line with the Government's Green Economy Strategy and Implementation Plan (GESIP),	Thanks.This is provided in paragraph 51.
6	Provide more analysis on business environment and framework conditions that are necessary for private sector development	One of the operational priorities of the first pillar is to support government in its effort to improve its DB ranking to 45th by 2022 from its current level of 80th. The government has identified a number of policy, legal, regulatory and institutional reform areas. These are discussed in paragraphs 33, 34, 35, 53, 54 and 56.
7	Management to provide the requisite resources to support a policy dialogue and better portfolio performance in Kenya.	Thank you. Paragraph 61 elaborates Bank's planned activities in this area.
8	At the end of the deliberations, the Committee expressed general support for the two pillars of the Bank's Country strategy 2019 – 2023 for Kenya and urged Management to take into account CODE's recommendations in preparing the new CSP that is due to be submitted to the Board before the end of 2018.	Thank you. Attempt is made to take into account CODE's recommendations. The New CSP could not be delivered by December due to late launch of the 3rd Medium Term Plan (23rd of November) which is one of the reference document for the implementation of the Big Four Economic Plan of the Government.

ANNEX 15: KEY PERFORMANCE INDICATORS FOR ONGOING PORTFOLIO

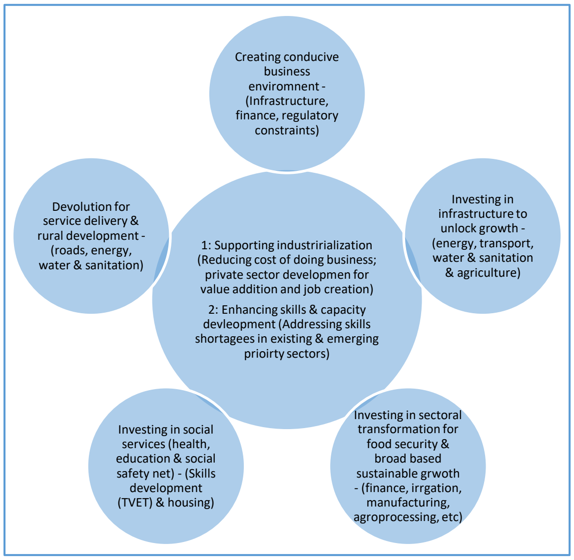
Indicator	2015	2016	2017	Nov 2018
Active Projects (#)	37	35	32	37
Public Sector	32	29	23	26
Private Sector	5	6	9	11
Commitments (UA m)	1,865	2,174	2,125	2,294
Average Project size (UA m)	50.4	62.1	66.4	62.0
Ageing projects (#)	0	1	0	0
Average age (Public Sector) (years)	5.0	4.0	3.1	3.7
Annual Disbursement Rate (%)	20.4	16.0	23.0	16.0
Commitments-at-Risk (%)	0	0	0	0
Projects at Risk (%)	0	0	0	0
Approval to 1st disbursement(months)	9	11	6.5	3.2
Approval to Signature (months)	2.9	2.7	1.9	1.6
Average Overall Rating	3.46	3.18	3.19	3.03
Implementation Progress (IP)	3.23	3.06	3.17	3.00
Development Objective (DO)	3.58	3.30	3.21	3.07

ANNEX 16: SUMMARY OF DISCUSSIONS WITH STAKEHOLDERS

Box 2: Summary of discussions with stakeholders

- *Government Counterpart funding*: The constrained revenue environment is affecting the timely and adequacy allocation of the exchequer for compensation of PAPs and land acquisition. In light of this, PIUs were urged to develop accurate and realistic work plans and procurement plans as well as reasonable budget estimates for government contribution. The National Treasury also was urged to develop ways to better manage counterpart funds so as to guarantee the availability of the resources, generally and for compensation.
- *Effectiveness delays*: Delays within the Government system often has resulted in prolonged issuance of subsidiary agreements, affecting the timely fulfilment of conditions precedent (CPs) for first disbursement. It was agreed to initiate the preparation of legal opinions and/or subsidiary agreement immediately after loan negotiation or approval. In addition, the Bank was called upon to consider removing the provision of subsidiary agreements a prerequisite for first disbursement.
- *Project management*: Participants emphasized the need for the National Treasury (TNT) to revive the Project Steering Committee meetings and ensure that each operation holds at least one meeting a year and work closely with implementing agencies/project implementing teams in monitoring the project performance and taking appropriate measures to address portfolio implementation challenges. Further, RDGE Management was requested to intensify its engagement with the higher organs of the government on ways to enhance effective portfolio management.
- *Delays in disbursement*: Project Coordinators and Project Accountants were urged to continue to systematically follow up with Contractors and Ministries on the preparation and processing of invoices to avoid disbursement delays.

ANNEX 17: ALIGNMENT OF CSP PILLARS WITH ENABLERS FOR THE "THE BIG FOUR" ECONOMIC PLAN AND THE "HIGH FIVES"



The inner circle in both figures represent Bank's pillars and operational priorities. The outer circles on bold represent enablers for the "The Big Four" economic plan (on the left) and the High Five priorities (on the right). Those in the inner circles in brackets represent CSP envisaged outcomes.

ANNEX 18: PLANNED POLICIES, LEGAL AND INSTITUTIONAL REFORMS TO SUPPORT MANUFACTURING

Policy Reforms

Finalization of intellectual property rights policy;
Development of the quality and standards policy;
Review of MSEA policy;
Development of Kenya Leather Development Policy;
Finalization of the Kenya Investment Policy;
Development of the Buy Kenya Build Kenya Policy;
Finalization of the iron and Steel Policy; and
Finalization of development of the incubation and sub-contracting policies.

Legal Reforms

Enact the Kenya Accreditation Services Bill 2017;
Develop the Kenya Leather Development Bill;
Enact the KIRDI Bill 2017; and
Review the legal framework for Micro and Small Enterprises Authority (MSEA);

Institutional Reforms

Transformation of KIRDI into a world class research institution;
Set up Conformity Assessment Bodies; and
Transformation of KITI to be a Centre of Excellence.

ANNEX 19: KENYA COUNTRY FIDUCIARY RISK ASSESSMENT

Executive Summary

The Kenya Vision 2030 aims to transform Kenya into a newly industrialized middle-income country providing a high quality of life to all its citizens by 2030 in a clean and secure environment. In order to meet the Government vision, a good PFM system is a prerequisite. A good PFM system promotes transparency, accountability, equity, good fiscal discipline and an efficient use of public resources for service delivery and economic development. Significant progress has been registered in the last few years in the Kenya's PFM arena with all the key legislation being put in place. Even though IFMIS is not being used optimally, it has been rolled out to all key sectors, accounting standards use has been harmonised across all MDAs and now Government financial statements are being consolidated.

The overall fiduciary risk is substantial after taking into account the mitigation measures, which are being undertaken by the Government. The 2017 PEFA report (draft) concluded that the overall PFM system performance has improved somewhat since the time of the 2012 PEFA assessment, but by not as much as anticipated at that time. There was great expectation to see significant improvement because of the 2010 constitution and the 2012 PFM Act. The late effectiveness of the Financial Regulations, which was done in 2015, contributed to slow progress in the implementation of the PFM reform. The draft report mentioned slow Implementation of IFMIS and its integration with other PFM-related IT, mainly for technical reasons. Through the PFM Reform Strategy, the Government of Kenya has started wide ranging initiatives in order to improve the public financial management systems across the national and country governments. The current PFM reform strategy ends by the end of 2018 and the Government is preparing a PFM Reform Strategy for 2019-2023.

Kenya has progressively made some reforms aimed at improving public procurement to meet the principles of equity, transparency and integrity with the enactment of Public Procurement and Asset Disposal Act (PPADA) 2015. The country has also recorded strengthened procurement performance as the outcome of the 2017 PEFA report shows, attributable to reforms made in other aspects of the PFM framework. According to the Bank's Fiduciary Risk Assessment 2015, the overall risk rating for procurement was 'substantial', with a 'neutral' trajectory of change. The new procurement law has provided clarity in the institutional framework for management of public procurement functions, with provisions for enhancing transparency and accountability.

Summary of Fiduciary Risk

Dimension	2018	2015
Budgeting	**Moderate**	**Substantial**
Management of assets & liabilities	**Substantial**	**N/A**
Accounting, recording and reporting	**Substantial**	**High**
External scrutiny and audit	**Substantial**	**High**
Procurement	**Substantial**	**Substantial**
Overall fiduciary risk	**Substantial**	**Substantial**

Introduction

The Country Fiduciary Risk Assessment (CFRA) is an update of the CFRA carried out in 2015 by DFID and the AfDB. This updated CFRA is prepared as an input to the Kenya CSP 2019-2021. The preparation of the updated CFRA follows the Bank's Country Fiduciary Risk Assessment guidelines of 2014. The updated assessment covers the main PFM components of the Government of the Republic of Kenya, namely Budget planning and execution, Treasury management, Accounting and Reporting, Internal Control, Procurement, Governance and External Audit. The assessment of the PFM systems is largely based on the results of Public Expenditure and Financial

Accountability Assessment (PEFA) 2017-draft and CFRA 2015 reports, the latest reports on the Public Finance Management Reform Program, and walk through tests conducted during discussions with Government Officials. Other documents used in the assessment are PEFA 2018 for six(6) pilot counties, the Kenyan Constitution of 2010, The World Bank CPIA and the AfDB CPIA of 2017, the Mo- Ibrahim Index of African Governance(2017), Corruption Perception Index(CPI),the Global Competiveness Index (GCI) Report 2017,World Governance Indicators(WGI) of 2017.

2. Assessment of the Public Financial Management Systems

2.1 Budget Reliability

Budget reliability reflects the Government's ability to maintain fascial discipline while adhering to the approved budget. As per the 2017 draft PEFA report, actual revenues and external grants fell short of budgeted amounts in FYs 2013/14, 2014/15 and 2015/16). In the interests of preserving macro-fiscal sustainability, the National Treasury adjusted aggregate expenditure downwards in response to the resource shortfalls during the three fiscal years, as it did during the period covered by the 2012 PEFA assessment. The adjustments focus on the development budget, which comprises about 30% of the total budget. This is easier to cut than for the recurrent budget, as the spending is all discretionary and the capacity to implement development projects on time tends to be over-estimated each year.

The 2017 draft PEFA report further states that the way in which budget is prepared and executed raises some issues: I) Some MDAs appear to have their budgets adjusted upwards each year, while some have their budgets adjusted downwards; II) the annual approved budget is effectively a semi-annual budget; and III) the original approved budget is viewed as a starting off point for the new fiscal year.

2.2 Transparency of public Finance

Transparency has improved to some extent since the 2012 PEFA assessment (PEFA 2017 report). The weakest area in 2012 was the transparency of extra-budgetary operations and it remains the weakest area in 2017. Another weak area is the timeliness of provision of information to county governments on the amount of fiscal transfers each will receive for the next financial year. Programme Budgets were established in FY 2013/14, so budgets and budget execution reports can be shown according to programme and sub-programme, with economic classification under each sub-programme.

2.3 Management of Assets and Liabilities

The main issue under Public Asset Management is insufficient information on the stock and value of non-financial assets held by MDAs due to inadequately maintained fixed assets registers (PEFA 2017). Addressing this issue is a high priority if GoK plans to introduce IPSAS-based accrual accounting in the near future, which would seem to be premature. IPSAS-based cash accounting was only established in FY 2013/14. State-owned enterprises and county governments do not file their financial statements on timely basis as stipulated in the Government Financial Regulations.

2.4 Policy-based Fiscal Strategy and Budget

The 2017 draft PEFA report states that a medium-term perspective to budgeting is nominally in place, as it was at the time of the 2012 PEFA assessment. The annual budget preparation process appears to work well and continues to strengthen. The main element missing is a meaningful medium term perspective facilitating strategic resource allocation decisions. The approved budget appears to be considered as a starting point for the year and not as a plan for the whole year. The priorities would seem to be: (i) continue to strengthen macro-fiscal forecasting; and (ii) strengthen annual budgeting in terms of realism, efficiency and effectiveness, perhaps through the introduction of periodic spending reviews outside the budget preparation calendar.

2.5 Predictability and control in budget execution

Budget execution refers to the implementation of activities in which parliament and county assemblies have done budget appropriation. Efficiency in budget utilisation has improved only marginally and remains as work-in-progress; a good example is cash management, which has not been working effectively. Frequent cases of lack of liquidity have resulted into delayed disbursement of cash to MDAs and counties. Delays in the implementation of the single treasury account have also affected the advantage, which was to be gained of centralising and minimising idle cash balances. Commitment control is another issue that affects budget credibility with MDA’s spending based on approved budgets. The exchequer releases do not always meet the approved budget provisions as they are based on available cash, raising the amounts of pending bills. The issue pending bills can be dealt with by ensuring that all spending commitments are processed through the IFMIS with MDA’s requirements being entered based on cash availability. MDAs’ work plans also need to be improved to be with in budgets to improve on budget execution.

The PFM Act of 2012 requires each MDA to prepare a cash flow forecast, plan at the beginning of each year, and submit them to the National Treasury and the Controller of Budget. The National Treasury should then consolidate these forecasts and compare with annual expected revenue inflows. However, these forecasts have generally not been followed and in practice, budgets were executed in two equal quarters of the first half-year following which a supplementary budget was prepared. This has resulted into poor cash management with delays of cash releases to MDAs.
The PFM Act 2012 also provides for the establishment of a Treasury Single Account (TSA). Although the TSA has not been fully established, structures were being put in place through a decision by CBK management and just-in-time funding of MDAs payments accounts is already happening. Two legal impediments namely the constitutional role of the Controller of budget-who legally should approve all withdraws from the exchequer and revenue collections outside the consolidated fund have also slowed the establishment of the TSA.

The National Treasury is currently preparing a tool for more efficient cash planning with more automation of cash management with inflows and outflows and then establish monthly cash management limits. Introduction of Internet banking will also provide online and up-to-date information on MDAs cash balances and pending balances. Pending bills will also be eliminated by ensuring spending commitments are processed through IFMIS based on cash availability.

While staff list, personnel database and the payroll are not yet integrated, any changes in the personnel database are keyed into the HR system leading to direct changes in the payroll. Prior to running the current monthly payroll, it is checked against the previous and changes made to it. Personnel records and payroll are updated at least every two months with these changes being restricted and an audit trail generated. The integrity of data is high but still there are weaknesses as highlighted by the OAG report of 2014/2015 financial year. While payroll is decentralised, the HR system is yet to be integrated with IFMIS.

There is segregation of duties throughout the expenditure cycle with the replacement of manual system with IFMIS being key. Expenditure commitment controls against budget are in existence but they are based on actual cash spending rather than projected cash availability, each accounting department of an MDA checks cash availability before making a payment. The PFM Act 2015 has also made payment rules and procedures clear with IFMIS rejecting any payment requests if they are not accompanied by Authority to incur expenditure against exchequer releases.

The Internal Audit Department is also operational covering all MDAs although capacity building strengthening is required to improve its quality of work. According to the Internal Auditor General, the internal quality assurance function which is housed in his office will be affected if internal auditors in MDAs will cease to report to him effective July 2017 as had been suggested. Although audit committees in MDAs had been established, they were not operational as they were not independent of the senior management of the respective MDAs. This has already been clarified by a Kenya Gazette notice of April 2016 with a pronouncement of members being drawn from outside the respective MDAs. These audit committees are now being established

2.6 Accounting, recording and reporting

Although bank reconciliations are prepared on a monthly basis, they are still being done outside IFMIS, as the auto bank reconciliation has not been functional. Data for up to 2015/2016 indicate that over 93% of the MDAs prepared and submitted bank reconciliations on time. These improvements have been noted due to, among other things, the easy submission of bank statements due to the expansion of internet based banking. The auto bank reconciliation module, which was to be launched during the 2017/2018 financial year, will ensure daily reconciliations possible. Clearing of suspense accounts is also being done monthly and outstanding balances have dropped. However, there remains very huge balances of staff advances and imprests with delayed accountabilities despite clear rules on how long all these advances should remain outstanding.

The 2015/2016 Government Financial Statements (GFSs) have been produced but not in their final form. These statements have provided detailed expenditures for all MDAs but no information on budgeted and actual domestic revenues. Assets and liabilities are shown but no information on public debt. MDAs are required to submit financial statements to the National Treasury (NT) within three months of the financial year (with the NT submitting to the Office of the Auditor General (OAG) within one month of receipt of the same). According to the OAG, MDAs are complying with these deadlines although there are many revisions, which follow the submission therefore making final financial statements being ready within six months. These revisions are mainly due to errors caused by continued use of manual methods in addition to IFMIS by MDAs. MDAs and country governments are now in compliance with the preparation of financial statements in accordance with IPSAs cash accounting.

2.7 External Scrutiny and audit

MDAs financial statements connected to the IFMIS system are audited by the OAG every year in conformity with the Public Audit Act and the International Standards of Supreme Audit Institutions with National security institutions being audited periodically. The OAG is supposed to receive final FSs within three months of the closure of the financial year but because of several revisions, the OAG has been unable to audit and prepare its report within the required six months deadline. Because of these delays, the OAG over the last few years has been submitting the audit reports to parliament after twelve months. The Government's 2015/2016 and 2016/2017 financial year audit reports had not been submitted to parliament by November 2017.

The 2015 Public Audit Act has prescribes procedures on entry meetings, exit meetings and audit findings responses which has made the audit follow up mechanism more formalised. Audit findings has continued to recur in the following years and their follow up has been slow over previous audited periods.

In terms of audit opinions, in the last five financial years up to 2014/2015, 47% of the MDAs financial statements had qualified opinions compared to 25% unqualified opinions. The rest had adverse and disclaimer opinions. There has been an improvement over the years with the adverse/disclaimer opinions falling sharply, qualified opinions also reduced marginally.

There is delayed review and clearance of audit reports by the Parliament Accounts Committee with the 2013/2014 and 2014/2015 financial year audits still under review. Past statistics show that it takes on average a year to clear one financial year audit.

Overall, audit laws have been strengthened over time and the OAG has increased the use of audit software's in its work with the audit exercise now being formalised and its coverage wide. The weakest link remains follow up of audit findings within Government and delayed review of audit reports by Parliament

2.8 Main Laws, Proclamations & Regulations issued to improve Public Financial Management

The Government of Kenya has over the years enacted laws in order to improve the public financial management systems in the country. Key legislations include the Constitution of Kenya 2010, the Public Financial Management Act 2012, and the Public Audit Act 2015. These provide the framework for enacting subsidiary legislation most of which were identified under the fifth schedule of the constitution. These subsidiary legislations cover areas like public participation, revenue funds for counties, contingency funds, loans guarantees, financial controls, accounts and audit of public entities and procurement of goods and services. The public procurement and assets disposal Act 2015 has also been enacted in order to strengthen public assets management.

2.9 Credible program to improve the PFM system

Through the PFM Reform Strategy, the Government of Kenya has started wide ranging initiatives in order to improve the public financial management systems across the national and country governments. The current PFM reform strategy ends by the end of 2018 and the Government is preparing a PFM Reform Strategy for 2019-2023.

The Public sector accounting standards board was set up with the adoption of the International Public Sector Accounting standards (IPSASs) cash basis of accounting for Ministries and county annual financial reporting. The standard chart of accounts has been revised to provide for coding of projects and unified chart of accounts has been adopted. The electronic project management information system to better capture development partners funding and non-financial data has been introduced although it is yet to be linked to IFMIS.

On performance information for service delivery, the GoK has adopted a program based budget structure including a five-year strategic plan. Tax administration has been modernised and an integrated tax administration system has been implemented at KRA. Procurement module has now been connected to IFMIS with the e procurement now operational although there are still some pending issues to be dealt with.

The Government internal audit has been strengthened with the introduction of a training manual, the introduction of TEAMMATE software and Computer aided audit techniques.

2.10 Strengths and opportunities

Although with delays, key PFM legislations have been passed bringing a lot of clarity on all areas of PFM. IFMIS re-engineering and roll out has been done with focus on proper usage and sustainability, which enable the Government to strengthen controls. Mobilisation of revenue resources has improved significantly as well as success in preserving aggregate fiscal discipline. The Government has also been able to strategically allocate resources consistent with medium to long-term development goals instead of relying only on medium term plans. Overall and over time, service delivery has improved.

2.11 Recent Development in Aid Coordination/harmonization and use of country systems

The Paris Declaration and the subsequent aid-effectiveness declarations encourage donors to increase the use of country systems that are of sufficient quality, and to work with partner countries to strengthen the PFM systems that are currently weak. Some of the elements of the country PFM systems are being used in implementing Bank-financed projects at the national and county levels.

2.12 Bank Group Strategy on PFM

The Bank, working with other development partners and national and county governments, will push the agenda for a coordinated approach in the implementation of the PFM reforms in the country. The main area of concern is managing and reporting the financial resources at the county levels, and the social sector (education and health). The Bank will work with the Government and other development partners to address the identified issues. The Government is preparing a PFM Reform Strategy for 2019-2023 and the Bank continue the dialogue in filling the financing gap of implementing the proposed Strategy.

2.13 Potential Risks and mitigation measures

Human resource capacity is the main impediment in implementing the various PFM reforms and sustaining the results achieved through the PFM reforms. To mitigate the risk, the Bank will work with other development partners, and the National and County Governments to address the identified risk. The Bank’s intervention could be in the area of capacity building in order to increase accountability and good governance. The specific areas of focus could be on improving the quality of PFM systems in general at all levels of the Government-National, County and Sectors; and specifically focusing on financial reporting, auditing and corruption. Depending on the specific risk assessment of each future project, the Bank may include a component for building the financial management system of a project.

3. Procurement

3.1 Legislative and Regulatory Framework

Kenya has generally made progress in developing the legal and regulatory framework for public procurement. Following promulgation of the new constitution for Kenya in 2010, the country amended the procurement law to be in line with the new constitution. The Public Procurement and Asset Disposal Act (PPADA) 2015, which became effective in January 2016, describes the institutional framework, methods of procurement, procedures, rules and ethical behavior for public sector procurement. All public entities are required to comply with this law when conducting procurement operations. The Act envisaged Regulations to be made within one year from commencement in order to make some components of the law operational. However, the regulations have not yet been finalized although they have been prepared and are in draft form pending clearance by parliament. Procurement of Public Private Partnerships is regulated through a separate law, Public Private Partnerships Act, 2013. In addition, the Supplies Practitioners Management Act (SPMA) of 2007 forms part of the legal framework to professionalize the procurement functions in the country. SPMA 2007 provides a framework for promoting integrity and professionalism in public procurement in the country through training and accrediting procurement professionals.

One of the key improvements made in the Legislative and Regulatory Framework during the 2014-2018 CSP period relates to transparency and accountability. The PPADA 2015 now requires all procuring entities to submit procurement data routinely, report all operational procurement information to the Public Procurement Regulatory Authority (PPRA), including information on contract awards, and publish their procurement plans. The new law has also provided for a framework for introduction of e-procurement, streamlined the selection process of consultancy services and expanded the range of procurement methods to include Two-Stage Tendering, Design Competition, Force Account and Electronic Reverse Auction. However, the PPADA still excludes classified procurements and disposals for National security organs and other procuring entities that deal with procurements of classified nature.

In addition, the Act aligns with the provisions of the Public Finance Management Act, 2012, which sets out framework for effective management of public finances. Thus, the procurement law now links procurement planning processes to the budget preparation process. The Act under Section 26 requires Procuring Entities to ensure that all procurement is done within budget through annual procurement plans. Section 44 of the Financial Regulations (2015) further reinforces this by requiring incorporation of procurement plans into cash flow forecasts prepared by MDA's. A strong linkage between procurement planning and the budget preparation process provides assurance that funds will be used for the intended purpose, minimizing opportunities for diversion of resources and enhancing likelihood of achievement of project objectives. The introduction of multi-year procurement plans also allows procurement processes to buttress implementation of projects under the MTEF framework thus allowing for more long-term cash flow forecasting.

The latest PEFA Assessment undertaken in 2017 (draft report), points to better procurement performance, with the score for PI-24 on Procurement improving from "C" to "B+". According to the assessment, 93.06% of procurements in FY 2015/16 were done through Open Tenders. This information was not available in the 2012 PEFA. The 2012 PEFA, established that the transparency, comprehensiveness and competition in the legal and regulatory framework indicator met five of the six required criteria while the complaints review system met six out of the seven criteria. In the 2017 PEFA, the indicators for Public access to procurement information and Procurement complaints management met all the six respective dimensions. Improvements in availability of data on procurement, particularly on use of open competition, allows for better monitoring of procurement processes and enhances transparency and adherence to proper procurement methods and procedures, thus minimising instances of waste, corruption and inefficient procurement.

The key issue noted with the legal and regulatory framework is the delay in the finalization of regulations. While the National Treasury has stated that regulations made under the Public Procurement and Disposal Act of 2005 (which preceded and was repealed by PPADA 2015), are still effective as part of the transitional provisions, there is still a challenge in the sense that not all provisions under PPADA 2015 have prescribed elements mirrored under the PPDA 2005 law. Some of the provisions under PPADA 2015 affected by lack of regulations include Procurement Management System, Powers of Investigators, debarment, low value procurement, procurement and asset disposal planning, form of bid security, tender initiation procedures, procurement under Design Contest and Force Account procedures as well as framework agreement. Contract management aspects affected include methodology for computation of liquidated damages, administration of performance security and provisions for technology transfer for items not manufactured in the country. These aspects therefore remain un-operationalised, awaiting the new regulations.

The effect of this is that some of the aspects introduced by the new law to enhance transparency and accountability have not been effected therefore the procurement legal framework may not provide adequate checks against malpractice.

3.2 Institutional Framework and Management Capacity

The PPADA 2015 has reinforced the institutional framework established previously under PPDA 2005. The Act has made a number of material modifications of the national procurement system by first separating and clarifying the roles for policy and regulation. The responsibilities of the National Treasury include development of procurement policy as well as guidelines for the National and county governments, providing technical assistance on procurement and administering the scheme of service for procurement professionals in the public service. The Public Procurement Regulatory Authority (PPRA), which previously existed as the Public Procurement Oversight Authority (PPOA) under PPDA 2005, is the regulator of procurement in all public procuring entities. PPRA is responsible for monitoring the public procurement system to ensure compliance with the Act, setting, monitoring and enforcing procurement standards including implementation of the preference and reservation schemes by procuring entities, as well as developing and managing the state portal on procurement and asset disposal and a database on various issues such as debarred entities and complaints. The PPADA has also retained the Public Procurement Administrative Review Board (PPARB). In order to mitigate involvement of oversight institutions in procurement transactions, PPADA 2015 has provided for establishment of a Public Procurement and Asset Disposal Services Agency (PPADSA) to be responsible for procurement of common user items for PEs at national level.

The Act has also modified the way procuring entities (PEs) manage public procurement. Under the Act, Accounting Officers or Chief Executive Officers of the PEs are primarily accountable for the procurement decisions within their organizations, with the Head of Procurement Function providing technical guidance. All PEs are supposed to have a Procurement Function with professional procurement staff, ad hoc tender Evaluation Committees as well as ad hoc Inspection and acceptance committees. The Act has abolished the permanent Tender and Procurement Committees, which adjudicated tender evaluations under the repealed PPDA 2005, thus eliminating administrative bottlenecks created by these committees in the procurement process. This has introduced flexibility in tender processing and established accountability for bid evaluations.

The Supplies Practitioners Management Act (SPMA) of 2007, on the other hand, established the Kenya Institute of Supplies Management (KISM) to promote professional standards through certification and licensing. KISM runs various professional courses and has an active program for continuous professional development. SPMA also established the Kenya Institute of Supplies Examination Board (KISEB) which administers exams for certification of procurement professionals.

One of the challenges identified previously was a lack of specialized procurement expertise in the procuring entities. The skills and competencies issue persists as exemplified in the 2015 Evaluation of Public Procurement in Kenya by the Ethics and Anticorruption Commission, (EACC). The evaluation revealed that while there were several heads of procurement sections in PEs with only college level education and less than 5 years' experience, and some with "O" or "A" level education, but having more than 11 years' experience. A number of graduate officers involved in procurement were neither procurement heads nor officers/assistance – some with up to 20 years' experience. The PPOA Annual Report for FY2014/2015 has also cited inadequate procurement professionals as one of the common findings from procurement assessments in PEs. Considering that there are an estimated 47,000 Procuring Entities (PEs), that include about 28,500 primary and secondary schools and 4,500 health facilities, the regulatory scope of PPOA, which has about 50 staff, is substantial. There is still no data available on the number of practitioners working in the public sector as procurement professionals. KISM has approximately 6000 practitioners working in both the public and private sectors. Low staffing levels at PPOA has an impact on its effectiveness to monitor compliance in all PEs and provide adequate capacity building. Data on staffing levels in procurement entities was only available for the 36 procurement reviews conducted to date by the Compliance Department of PPOA.

The weaknesses in the institutional framework and management capacity has an impact on the ability of the national procurement framework to transparently monitor the adherence to proper procurement methods, which risks encouraging instances of waste, corruption and inefficient procurement.

3.3 Procurement Operations and Market Practices

The PPADA under Part IX prescribes open tendering as the default mode of procurement. The Act has also allowed for Sector-specific procuring and disposal agencies, consortium buying and use of procuring agents or asset disposal agents. It has expanded the scope of the law to better align procurement planning with the budget cycle and streamline contract administration.

The 2012 PEFA Report indicated that out of the 184 contracts reported to PPOA by the PEs, 68 percent (by number) was for national competitive bidding, 18 percent for international competitive bidding, 11 percent was for request for proposals, and 3 percent was for restricted tender. On the other hand, the draft 2017 PEFA reports that contracts awarded through open competition (including restricted tendering) during FY 2015/16 was close to 100% of the total value of contracts.. Under the existing procurement framework, PEs are required to report to PPOA on procurements above KES 5million and on the use of direct procurement valued at over KES 0.5million. PPOA, through its audits and inspections, is also able to verify whether reporting requirements are met and has indicated that although the level of compliance with this reporting requirement is improving, a substantial number of MDAs have not complied. However, as reported in the 2012 PEFA, PPOA still does not have a consolidated report published with this information therefore it was not possible to verify whether PEs that have awarded contracts by methods other than open competition, have provided the necessary justifications in accordance with the law.

Generally, Kenya has a well-established private sector with considerable participation in competing for public sector procurement opportunities. However, no hard data was available from the GoK on the distribution of tenders in terms of enterprise type, volumes and values. From studies by the Kenya Institute of Supplies Management (KISM), it is estimated that about 55% of the value of procurement occurs on larger infrastructure-based and project specific procurement while the balance is with Small and Micro Enterprises (SMEs), who are engaged mainly on the multiple small procurements that take place for consumable items. It is estimated that about 90% of the total number of small value transactions in a fiscal year are with the SME sector. Given that infrastructural procurement is lumped with other item procurements, it is difficult to estimate the competitiveness of the Kenyan private sector in public procurement, in terms of volumes and values of procured goods. Nevertheless, about 80% of the contracts under Bank-Financed projects procured through Open Competitive Bidding (OCB) with international advertising have been awarded to Kenyan firms which, represents about 20% of the total value of contracts awarded though OCB. Only about 28% of the goods procured through OCB are sourced locally. There are also sectoral variances in the nature, value and complexity of contracts that influences the nature of competition and procurement lead-time under Bank-financed projects. For instance, the agriculture and social sectors tend to have numerous low to medium-value goods and works contracts, with few consulting assignments and less technical complexity that is attractive to local suppliers, contractors and experts. Large numbers of medium to high value works and studies, with moderate to high complexity, characterizes the water sector in Kenya. This typically attracts a mix of local and foreign contractors and consulting firms while the energy and transport sectors usually have a small number of high value, technically complex projects which predominantly attract foreign firms.

Despite having a vibrant competitive private sector, there are other constraints also which inhibit the private sector from accessing the market and these relate to serious capacities issues in core business areas. For instance, even though access to credit is relatively easy in Kenya, the private sector, particularly SMEs, is faced with lack of credit facilities including high interest rates applied by commercial Banks – an issue that has been exacerbated by the 2016 law capping interest rates. Contract management also remains an issue for most PEs. Recent PPOA reports have raised weaknesses in contract management, which shows that, there is still a need to reinforce the capacity of staff in contract management, especially as it relates to large value and complex contracts. This is despite having provisions in the law and in the conditions of contracts in Standard Bidding Documents (SBDs) relating to procedures for acceptance of final products and issuance of amendments including change orders, contract amendments as well as inspection and tests, which are generally consistent with international best practices (e.g. Sections 48, 150 and 154 of the PPADA 2015).

Another challenge facing suppliers and contractors is delayed payments that has led to increase in pending bills, some running over multiple financial years. The problem is also prevalent in the private sector where there is an estimated over KES40bn outstanding payments for goods delivered to large retailers, with some payments delayed for between 180 and 240 days. In response to this, the government is preparing regulations to introduce Prompt Payments for the Retail Trade Sector while for the public sector; government has also requested parliament to review the public Procurement laws to allow the government to pay suppliers within 60 days. The late payment challenge has affected performance of contractors and suppliers who end up suffering from the soaring debts and has negatively affected businesses and implementation of planned activities.

The risk posed by payment delays is that procurement processes may fail to obtain value for money in the end as suppliers factor in costs delayed payment when bidding.

3.4 Integrity and Transparency

Under the PPADA, PPRA has the mandate to inspect and audit procurement contracts, with powers to ensure compliance under Part IV (Sections 34-40). PPRA has been carrying out this function under PPDA 2005 and has published procurement review reports for various PEs on its website. However, PPRA is thinly staffed, with only about 30 technical officers to cope with the 42,000 procuring entities thus the need for strengthening of technical capacity. PPRA publishes the results of procurement reviews for PES on its website. However, while PPRA is mandated to submit annual reports on the performance of the procurement system, its predecessor (PPOA) last published the report for FY 2014/2015. In the report, the Authority indicated that some of the challenges faced in carrying out compliance audits included access to Procure-2-Pay module, high employee turnover inadequate financing and loss of records.

The Procurement Law defines fraud and corruption in procurement and has a provision under Section 62 for bidders to make a declaration not to engage in corruption fraud, conflict of interest, and unethical behavior. Section 41 specifies debarment by PPARB on the recommendation of a law enforcement organ with an investigative mandate. However, the provisions on fraud and corruption are not standardized across all standard bidding documents (SBDs). The Ethics and Anticorruption Commission, (EACC) is mandated by law to spearhead the anti-corruption efforts in the country, and to cooperate and partner with other agencies.

Fraud and corruption issues have had a considerable impact on procurement in Kenya. Many of the publicly reported cases of fraud and corruption seem to be perpetrated in procurement or contract payment processes through either conflict of interest, bribery, collusion and or coercion. The EACC evaluation of corruption in procurement indicates as some of the suppliers and procurement officers reported being aware of procurement decisions being influenced by external persons such as suppliers, politicians and senior civil servants. The report also shows that some suppliers were able to access confidential information such as the PEs estimated prices and were aware of firms owned by public officers doing business with government. Most cases of corruption in procurement go unreported due to fear by suppliers of losing business opportunities.

3.5 Procurement Risk Rating

As in the 2015 FRA, the overall risk rating for procurement is still considered to be '**substantial**' on aggregate, with a '**neutral**' trajectory of change. This is because of the following:

(i) While changes have been made to the Legislative and Regulatory Framework that have the potential of enhancing transparency and accountability, these provisions cannot be operationalised due to lack of supporting regulations. Therefore, the procurement legal framework may not provide adequate checks against malpractice. The fiduciary risk posed by the incomplete Legislative and Regulatory Framework is therefore, considered "high".

(ii) The new procurement law has provided clarity in the institutional framework for management of public procurement functions, in particular with regard to responsibility for policy, regulatory and qualification certification. However, the understaffing of the regulatory function, weaknesses in deployment of qualified and experienced procurement personnel in PEs and the influence external parties on procurement decisions undermine professionalism in the discharge of procurement functions and is likely exacerbate the current situation. The fiduciary risk posed by the Institutional Framework and Management Capacity is therefore also considered to be "substantial".

(iii) Kenya has an established private sector that generates considerable participation in competing for public sector procurement opportunities, particularly for standard, low and medium-value goods, works and services. While the fiduciary risk for such a competitive environment may be considered to be moderately low, sectoral differences in the nature, value and technical complexity of goods, works and services, would require additional data which is currently lacking. As such, it would be recommended that the additional fiduciary risk assessments be done at sector, project and PE level in order to provide a project-specific risk profile for Procurement Operations and Market Practices.

(iv) Despite having a robust legal and institutional anticorruption framework, Kenya's public procurement is still affected considerably by corruption therefore, the fiduciary risk of the Integrity and Transparency framework in the country is "high" due to prevalence in reported malpractices.

4. Governance and Anti-corruption

4.1 Introduction

The Governance analytical brief explores the recent governance trends in Kenya across political, economic, public sector and private sector dimensions. The analysis has been informed by the most recent theoretical and empirical literature on governance including; PEFA 2017 for Central Government; PEFA 2018 for six (6) pilot counties, the Kenyan Constitution of 2010, The World Bank CPIA and the AfDB CPIA of 2017, the Mo- Ibrahim Index of African Governance (2017), Corruption Perception Index(CPI), the Global Competiveness Index (GCI) Report 2017,World Governance Indicators(WGI) of 2017, to mention but a few. Its primary objective is to enrich Kenya's CSP 2019-2023 with additional information on key aspects of governance in Kenya. Specifically the brief aims to: (i) to highlight key sector achievements; (ii) to identify strengths of the sector; (iii) to diagnose key sector challenges, and (iv) to identify sector opportunities for CSP 2019-2023.

Kenya has been ranked third in Sub-Saharan Africa in the 2017 World Bank Ease of Business Index, moving up 12 places to a global ranking of 80. The World Bank Report, which assesses among other factors, the processes required to start a business, placed Kenya third in Sub-Saharan Africa behind Mauritius and Rwanda. For the second year running, Kenya was among the top 10 improvers in the world and has delivered the highest number of business reforms in all of Africa, and the authorities are targeting to be in the top 50 countries in the world in the next couple of years. The country implemented reforms in five Doing Business areas including: i)starting a business that was made easier by removing the stamp duty fees required for nominal capital, memorandums, and articles of association ii)eliminating the requirement to sign the compliance declaration before a commissioner of oaths iii) a reorganization procedure and regulations for insolvency practitioners were introduced in the area of resolving insolvency, and : iv) the process for getting electricity was streamlined by reducing the time for grid connection by almost two weeks. The business reforms would not only benefit foreign and large-scale investors, but also small and medium enterprises. Based on firm policy stance, the government continues to avoid state intervention in the form of direct subsidies or price controls in the manufactured goods markets, though some price controls are still in place. Largely, the productive sector operates on free-market terms with minimal controls to guarantee the quality of the products

The Bank's Country Policy and Institutional Assessment 2016 CPIA ranks Kenya in 3rd position out of a total of 38 countries that were surveyed. The overall rating is 4.4 which is higher than the SSA average. The ratings for Kenya indicate that the Governance cluster was the lowest performing (weak link) with a score of 4.4. According to the World Bank CPIA (2016) Kenya's overall score was 3.8 which was similarly above the SSA average of 3.1 for the same period. Although no overall change was noted from the previous year(2015), the WB report shows that the highest performing clusters were "Economic Management" with a score of 4.3, while the lowest scoring cluster(weak link) was the " Public Sector Management and Institutions" with a score of 3.4 for the year 2016.

Assessments from both institutions indicate that challenges persist in the governance aspects related to public sector management and accountability. Additionally, a number of governance reports show that these problems have deep-rooted causes in accountability (or lack thereof), including vested interests, elite capture, and weaknesses in institutions of accountability that encompass the legal and judicial system and enforcement agencies. But in some respects it is the vibrancy, openness, and international connectivity of the media and civil society in Kenya that bring these issues to the attention of a much wider audience than perhaps is experienced by other countries with similar patterns of corruption.

4.2 Political Governance

Kenya's political governance is underpinned by the 2010 Constitution, that introduced a bicameral legislative house, devolved county government, an independent Judiciary,and an electoral body.The Constitution has a Bill of Rights that covers civil, political, economic, social, environmental and cultural rights. Various enabling pieces of legislation have been enacted following the enactment of the Constitution. Alignment of various policies with the Constitution and the new governance architecture is work-in-progress. Devolution remains the biggest gain from the August 2010 constitution, which ushered in a new political and economic governance system. The creation of 47 new county governments effectively created a new devolved system of political power with clear constitutional mandates and responsibilities. It is transformative and has strengthened accountability and public service delivery at local levels.

Kenya has achieved many democratic milestones; among them being the five-year multiparty electoral cycles that characterize Kenya's democratic dispensation. However, Presidential elections results have been fiercely contested in the last two elections, first in 2007, and the most recent one of 2017. In each case, prolonged political uncertainty in the country has destabilized the country's political and socio-economic landscape, in varying degrees. In 2017, political tensions spiked following annulment of the August 8, 2017 presidential results by the Supreme Court on September 1,2017 and overtly threatened to destabilize the country's political and socio-economic landscape. The country has stabilized since then after the country's top leadership and main opposition party took bold steps to meet, discuss and address inherent issues pertaining to the political uncertainty that manifest themselves during electoral cycles.

The 2010 Constitution and the new legal framework for devolution place strong emphasis on transparency, accountability, and citizen participation as a means of accelerating development and enhancing local service delivery. Kenya's fast evolution to open governance has been accompanied by a rapid growth in civil society networks and groups. However, the general observation is that there is room for improvement to achieve effective access to regulations and meaningful consultation during the regulatory process. For example regarding preparation of laws and regulations, and in comparison to other some sub-Saharan countries, the existing regulatory governance system does not is not embedded with practical mechanisms that would ensure meaningful stakeholder consultations during the development of draft laws and regulations.

4.3. Economic and Financial Governance

4.3.1 Quality of Budgetary and Financial Management

Kenya's public financial management architecture is underpinned by modern PFM legislation that covers budgetary and financial management aspects at both the central and sub-national government levels. The legislations enshrines good international of public financial management notably on openness, accountability, public participation, and equitable sharing of revenues, prudent management of public money, and clear fiscal reporting. The enactment of the Public Finance Management Act 2012 and other PFM related legislations expanded the demand for PFM institutional reforms, which, among other things formed the foundation upon which the 2013-2018 PFM Reform Strategy was formulated.

Implementation of the provisions of the legal framework are supported by a medium-term PFM Reform Strategy(2013-2018) that clearly lays out critical reform areas. A review of the PFM strategy(2013-2018) that was concluded in March 2016, indicated that significant progress had been registered in implementing many reform actions, that were likely to be completed by the end of the Strategy in 2018. However, there were also many areas where implementation of the reforms had been slow and likely to affect the achievement of the Strategy objectives, notably institutional reforms at the National Treasury, introduction of the Treasury Single Account (TSA) at national and county government levels, payroll and pension reforms, and expansion and integration of PFM systems. A successor reform strategy covering the period 2019-2023 is under preparation to address gaps identified in the preceding strategy including County PFM reforms, additional reforms in strategic planning and budget formulation, investment programme management, cash management and other budget execution efficiency reforms, and reforms to make Kenya's PFM systems gender responsive.

According to the findings of the PEFA(2017),the Quality of Kenya's budgetary and financial governance has been improving since the last PEFA assessment in 2012. The report notes that the government has been successful in maintaining aggregate fiscal discipline which is essential ingredient for achieving budget credibility, and macroeconomic stability, although this has not always been easy in the face of revenue shortfalls and spending pressures from MDAs. The report notes, however, that it has been challenging to adopt a medium term strategic perspective to budgeting in the face of both maintaining aggregate fiscal discipline over the short term and the challenges in budgeting on an annual basis. These challenges are being addressed through the use of Medium Term Expenditure Frameworks(MTEF) processes that have been put in place in recent years. The continuous effort to improve the alignment between the MTEF and the Medium Term Plans(MTPs) indicate that the mechanisms are in place for achieving a strategic allocation of resources consistent with medium and long terms development plans embedded in Vision 2030 and the “Big Four” agenda.

4.3.2 County PFM legal and regulatory framework

The Fourth Schedule of the Constitution lists County Government functions, which are much wider in scope than those of the defunct Local Governments (LG), whose basic sources of revenues the County Governments have inherited. The Constitution is supplemented by other ordinary laws that backstop Kenya’s devolution framework notably the Public Finance Management Act (2012)and the County Government Act(2012). The Commission on Revenue Allocation’s (CRA) is charged with designing and implementing an equitable resources sharing mechanism in collaboration with the Treasury notably the Office of the Controller of Budget (OCOB).

The 2018 County PEFA finding on six (6) counties indicate that although implementation of the PFM systems in the counties is still in its formative stages, considerable achievements have been made in many areas. Notable achievements include the establishment of various PFM structures, and timely preparation of budget documents including County Fiscal Strategy Papers, County Budget Review and Outlook Papers, and budget estimates as per the PFM Act 2012 guidelines and timelines. The report notes that these measures, together with the implementation of the IFMIS, have facilitated timely and systematic budget preparation and execution by County governments.

4.3.3 Transparency accountability and corruption in public sector

Kenya has improved according to Transparency International (TI) latest index which shows the country was ranked 143 out of 180 countries sampled. This is a marginal improvement in the annual corruption perceptions index because in 2017, Kenya was position 145 out of 180. In the just released 2017 findings, Transparency International (TI) awarded Kenya a score of 28 per cent, a slight improvement from 2016 when the country earned 26 per cent. Kenya's score is below the 32 per cent average score for Africa. However, corruption in Kenya seems to be gaining momentum with more and more corruption scandals becoming known every day. According to the Ethics and Anti-Corruption Commission, Kenya is losing an estimated KES 608 billion to corruption yearly, which is about 7.8% of Kenya’s GDP.

4.4 The major areas of concern with regard to corruption in Kenya today

1. **Fund Misappropriation:** Resources that are budgeted for particular initiatives and programs are often embezzled. This has had adverse effects both on the quality, quantity and timeliness of delivery of various projects and programs in the country. The embezzlement of public funds has also caused foreign donors to engage cautiously with the authorities, and in some instances suspend foreign aid hitherto planned for the country.
2. **Public Procurement:** - Most of the corruption scandals in Kenya today are associated with nefarious public procurement practices. According to the Global Competitiveness Report 2017-2018, companies report that bribes and irregular payments are highly prevalent in the process of awarding public tenders.

3. **Public Service:** The competitiveness of Kenya's business environment is impeded by rampant public service corruption. Complying with administrative requirements takes a lot of time and is plagued by red tape where bribes have to be given to get licenses.
4. **Land Administration:** There is a very high risk of corruption in Kenya's land administration. According to Transparency International Kenya Annual Report 2014, Kenyans report a high likelihood of bribery demands in meetings with land service officials, and corrupt practices reportedly occur in almost 20% of all interactions. Possession of a land title does not guarantee property ownership, making land grabbing and seizures by powerful elite common as a result of pervasive corruption and impunity. Fake land title deeds are frequently used and disappearances of title deeds from the Registrar's office are common; houses built on illegally acquired property are often demolished without prior notice, and,
5. **Customs Administration:** Companies face a high risk of corruption in Kenya's Customs administration. According to the Global Enabling Trade Report 2016, rampant corruption at Kenya's ports and border points is the most problematic factor for international trade, followed by tariffs, burdensome import procedures and crime. Corruption at the points of entry have serious consequences, and as a result, many counterfeit goods enter the market affecting trade. More recently goods that are not fit for human consumption are also finding their way through our borders as a result of corruption which is hazardous to the Kenyan population.

4.5 significant strides by instituting legislation criminalizing corruption, including the following pieces of legislations:

1. **Anti-Corruption and Economic Crimes Act 2003** and **Penal Code** criminalize corruption, active and passive bribery, bribing of foreign officials, money laundering, abuse of office, extortion, conflict of interest, bid rigging and bribery involving agents.
2. **Bribery Act of 2016** criminalizes primarily private sector bribery, broadly defined as "offering, promising, or giving a financial or other advantages to another person", which may include facilitation payments. The Act imposes a duty on public and private entities to have appropriate anti-bribery procedures in place.
3. **Public Officers Ethics Act 2003** sets rules for transparency and accountability, as well as gifts and hospitality. Every public officer is required to declare their income, assets and liabilities every two-years.
4. **Public Procurement and Disposal Act** prohibits corruption in public procurement.
5. **Finance Act 2006** provides for measures against tax fraud and guidelines on tax administration; it also provides sanctions on corrupt practices.
6. **Service Commissions Act** has a Code of Regulations for civil servants that requires meritocratic recruitment and promotion of public officials.
7. **Access to Information Act 2016** provides a framework to facilitate access to information held by private bodies and promote routine and systematic information disclosure by both public service and private service.

4.6. Institutional framework

Kenya has shown great commitment by strengthening its institutions to fight corruption. The country has already established a multi-agency framework that brings together relevant law enforcement agencies in its fight against corruption. The multi-agency framework on corruption in Kenya includes: Asset Recovery Agency, Directorate of Criminal Investigations; Ethics and Anti-Corruption Commission; Central Bank of Kenya; Financial Reporting Center; Kenya Revenue Authority; Directorate of Public Prosecution, and; Office of Attorney General.

The Kenyan Government, while strengthening its mechanisms for crime detection and prosecution, has also empowered its citizens in addressing and reporting corruption issues. The **Anti-Corruption and Economic Crimes Act** and the **Witness Protection Act** provides for protection of whistle-blowers and forbids any disciplinary action to be taken against any private or public employee who assists an investigation or discloses information for such an investigation. The government through the multi-agency and multidisciplinary approach also seeks to introduce into the education curricula of the country studies on leadership, ethics and integrity for all its citizens. Accordingly, all new civil servants will receive education on corruption and economic crimes while being inducted into service. The government is also working on the ratification of UNCAC through the International Anti-Corruption Academy (IACA) to pave way for advanced training of anti-corruption officers, judicial officials as well as prosecutors to effectively deal with the vice of corruption.

4.7 Challenges in the fight against corruption

As can be seen from the preceding paragraphs, Kenya has a myriad of laws, regulation, frameworks and agencies required to combat corruption. However, various reports indicate that the graft czars in the country are enjoying the proceeds of the runaway corruption because they have nothing to fear due to the failure of the responsible authorities to take tough retributive measures. Transparency International(Kenya) officials point to the fact that the law enforcement mechanism to curb the malpractice in Kenya is lucklustre, compared to other countries, example Rwanda (position 48),whose score stood at 55 per cent.

According to the Ethics and Anti-Corruption Commission 2016-2017 annual report, the challenges faced in the fight against corruption include the following:

1. *Lack of sufficient political will and leadership* to fight corruption and unethical vices in the country
2. *Inadequate financial capacity and budget constraints*. Since the EACC relies on funding from the government, the money allocated to the commission to carry out its activities is not adequate to meet the demand for the commissions' services country wide;
3. *Inadequate capacity in terms of human resources* as to further devolve the commissions services to respond to an increasing number of corruption reports countrywide. The shortage of staff was also aggravated by a high staff turnover attributed to the remuneration package that is not competitive on the labor market. It is cited that the commission's personnel emoluments have not been enhanced over the last 13-years;
4. *A slow judicial process and adverse court decisions*. The judicial process and the adjudication of cases is still slow, with some corruption cases stretching back more than 10 years. EACC was affected by adverse judicial decisions that stopped investigations or prosecutions. This results in the cases investigated by the commission taking too long to be heard in court or having investigations or prosecutions terminated by the courts;
5. *Weak legal framework,* such as the Ethics and Anti-Corruption Commission Act, 2011, and the Leadership and Integrity Act, 2012, that have been watered down by legislators.;
6. *The absence of overarching National Policy on Anti-corruption*: as it has not been finalized, which has made the efforts of the commission and other organization uncoordinated and varied. Areas that would have benefited from an integrated approach such as investigations and asset recovery are affected;
7. *Commission's lack of powers to enforce implementation of its corruption prevention recommendations.* including the inability to enforce codes of conduct in the public service has made it difficult to curb corruption in the public sector;
8. *Entrenched corruption and unethical culture in the public service*;

Nonetheless, the fight against corruption has recently been reinvigorated and public awareness on the adverse effects of the vice seems to be on the rise. Combined with renewed political will and support from the top leadership of the land as well as public outcry, the war on graft is likely to be taken to another level in the medium-term. The Kenyan President, Uhuru Kenyatta, has been vocal in his appeal to Kenyans to join efforts in the fight against corruption and has also recently taken decisive steps to combat corruption. He has essentially changed leadership at all the key law enforcement agencies that are responsible for fighting corruption. This year he called for a lifestyle audit of all public servants including himself and the Deputy President, William Ruto. He also directed all procurement officers in public entities to step aside and undergo fresh vetting. The Kenyan President also directed the relevant institutions mandated with investigating and prosecuting economic crimes to do a thorough job and ensure those found culpable are held accountable. This shows that the President is focused on the fight against corruption. The political will to fight corruption seems stronger than at any other time in the country's history.

4.8 The quality of public administration

The 2016 Bank's Country Policy and Institutional Assessment (CPIA) rating on the quality of Kenya's public administration stood at 4.0 out which is above the EAC member states and SSA averages of 2.1 and 3.1, respectively. The Kenyan authorities recognize that there is plenty of room to improve the performance of the public sector so as to enhance its contribution to the realization of the "Big Four" objectives as well as the long-term goals of the Vision 2030. The authorities recognize that public administration has, for many years, been characterized by poor performance, resulting in inadequate delivery of public services, which continues to hinder achievement of sustainable economic growth. Some of the factors that adversely affect the performance in the public sector include: blatant mismanagement of public resources, duplication/overlaps in mandates of various government agencies, frequent political interference and a bloated staff establishment. In spite of the recognized downsides, the World Competitive Index(2016-2017) shows that Kenya is among emerging and developing economies countries that are striving to improve the future skillset of their workforce. Other countries include Brazil, China, Colombia, and Rwanda.

To improve performance, the government has continued to undertake a number of reform measures including streamlining functions at central and county government level through the devolution process, introduction of performance contracts, computerization of government services and continuous personnel training.

4.9 Property rights and rule based governance

Since the advent of the 2010 Constitution, Kenya has made significant strides in improving regulatory environment driven by the implementation of Vision 2030. However, according the World Bank Regulatory Quality Indicator (2017), the overall impact is still to be felt. Based on the general and recent economic performance of the country, four areas do deserve more attention: i) land tenure system, ii) judicial processes, iii) coordination between regulatory authorities, and iv) effectiveness of business regulatory infrastructure and systems. Several regulatory and legal challenges–most of them intertwined—stand in the way of fostering sustainable growth. Moreover, regulatory barriers and corruption related to their enforcements are central obstacles for the formalization of the informal sectors.

Kenya ranked 129 out of 180 in the 2017 Index of Economic Freedom, being an improvement in its rank of 135/180 in 2016 on property rights and rule based governance. The highest score registered on the "Tax Burden" cluster (78.5),while the lowest score was 24.7 for the cluster " Government Integrity". However, there is still room for improvement. In 2018, Kenya is still in the164th position in effectiveness of enforcing contracts and 125th in Registering Property. Doing Business data indicates that Kenya is nearly half way to the achievements of the Rwanda system. Moreover, these indicators are based on data gathered in Nairobi and using assumptions such a property already registered in the land registry or cadastre, and without any title disputes, a situation that might not mirror the context in rural setting or SMEs

4.10 The efficiency of revenue mobilization

The Bank's CPIA(2017) rating on efficiency of revenue administration ranks Kenya highest with a score 4.8 compared to the average of 3.2 for the East African Community member countries and an average of 3.8 for SSA countries. This good performance reflects, among other things, continuous improvements in the country's revenue administration system that has generally strengthened over the past decade. Legal and institutional arrangements have been streamlined to improve tax compliance levels, both in the volume and in quality of tax returns, as well as levels of revenue collections. Improvements in revenue administration include:) streamlining of tax legislation through the Tax Procedures Act ii)introducing up-to-date tax guides on KRA website iii) Operationalization of a comprehensive taxpayer education system by KRA iv) Operationalization of most modules of the iTax making it easier for taxpayers to obtain information and submit returns v) strengthening of KRA's risk management for both Domestic Tax Department and Customs Border Control Department, and ;v) computerization of most of KRA's operations. A combination of these, and other reform measures will ensure government attains its sustainable fiscal policy path, that aims to grow revenues progressively from the 2016/2017 level of 18.3 percent /GDP to 20.3 percent/GDP in 2020/2021.

4.11 Business Enabling Environment

Kenya has been ranked third in Sub-Saharan Africa in the 2017 World Bank Ease of Business Index, moving up 12 places to a global ranking of 80. Kenya is still one of the most competitive country in SSA behind Mauritius and Rwanda and the third most overall consistent reformer in Africa for the last three(3) years. This achievement is a reflection that Kenya has made great strides in improving the business regulatory environment. In the last two years alone, the government has enacted several laws enabling a business-friendly environment and transition to a modern economy.

According to the World Bank Doing Business Report(2018),the following reforms have been undertaken:

Starting a Business: Kenya made starting a business easier by merging procedures required to start-up and formally operate a business.
Dealing with Construction Permits: Kenya made dealing with construction permits less expensive by eliminating fees for clearances from the National Environment Management Authority (NEMA) and the National Construction Authority.
Getting Electricity: Kenya improved the reliability of electricity by investing in its distribution lines and transformers and by setting up a specialized squad to restore power when outages occur.
Getting Credit: Kenya improved access to credit information by starting to distribute data from two utility companies.
Paying Taxes: Kenya made paying taxes easier by implementing an online platform, iTax, for filing and paying corporate income tax and the standards levy.
Trading across Borders: Kenya reduced the time for import documentary compliance by utilizing its single window system, which allows for electronic submission of customs entries.
More gains and improvements in the business enabling environment are expected from the ongoing and future reforms as evidenced by the progress achievements from the last couple of years.

The Global Competitiveness Index(2016–2017) ranked Kenya at position 96 out of 138 countries surveyed, which is a slight improvement over the previous year 2015-2016,where Kenya stood at position 99 out of 144 countries surveyed. According to the report, the five(5)most problematic factors hampering fair business competition are (in order of ranking): i) Corruption ii) Tax rates iii) Access to financing iv) Inefficient government bureaucracy, and; v) Inadequate supply of infrastructure.

The report also indicates that the quality of institutions (Pillar 2)in Kenya is compromised by some aspects whose ranking is not always favorable to the final scores. These aspects(in order of poor ranking) include: i) Business costs of terrorism; ii) Business costs of crime and violence iii) Organized crime ;iv) Irregular payments and bribes; v) Reliability of police services, and ;vi) Favoritism in decisions of government officials.

Furthermore, based on the general and recent economic performance of the country, several regulatory and legal challenges–most of them interlinked—still stand in the way of fostering conditions necessary for fostering inclusive and sustainable growth. In particular, concerted attention is needed to address bottlenecks in key four(4) areas that constitute an impediment to enabling business environment notably: i) land tenure system, ii) judicial processes, iii) coordination between regulatory authorities, and iv) effectiveness of business regulatory infrastructure and systems.

Table 1: Detailed Fiduciary Risk Assessment

Elements	Score using PEFA ratings	Initial Risk Assessment	Mitigation measures	Residual Risk
BUDGET RELIABILITY PI-1 Aggregate expenditure outturn PI-2 Expenditure composition outturn PI-3 Revenue outturn	**2.0** 2 2 2	**Moderate**	The Government has been implementing PFM reform since 2013 and reforms are getting results. The Government is preparing a new PFM Reform Strategy for 2019-2023 taking into account the lessons learned from the 2013-2018 strategy.	**Moderate**
TRANSPARENCY OF PUBLIC FINANCE PI-4 Budget classification PI-5 Budget documentation PI-6 Central government operations outside financial reports PI-7 Transfers to sub-national governments PI-8 Performance information for service delivery PI-9 Public access to fiscal information	**1.2** 3 0 0 1 1 2	**Substantial**	The main components of the PFM strategy is transparency of the Public finance. The next strategy will focus on financial reporting and monitoring at the county and sector level	**Substantial**
MANAGEMENT OF ASSETS & LIABILITIES PI-10 Fiscal risk reporting PI-11 Public investment management PI-12 Public asset management PI-13 Debt management	**1** 0 1 0 3	**Substantial**	This is new addition to the PFEA element and the Government will continue to improve the management of assets and liabilities.	**Substantial**
POLICY-BASED FISCAL STRATEGY AND BUDGET PI-14 Macro-economic and fiscal forecasts PI-15 Fiscal strategy PI-16 Medium-term perspective in expenditure budgeting PI-17 Budget preparation process PI-18 Legislative scrutiny of the budget	 **2** 2 2 2 3 1	 **Moderate**	There has been good progress on this pillar and the government will consolidate the results in the next PFM reform period.	 **Moderate**

PREDICTABILITY AND CONTROL IN BUDGET EXECUTION PI-19 Revenue administration PI-20 Accounting for revenue PI-21 Predictability of in-year resource allocation PI-22 Expenditure arrears PI-23 Payroll controls PI-24 Procurement PI-25 Internal controls on non-salary expenditure PI-26 Internal audit	**1.6** 1 1 1 2 2 2 2 2	**Moderate**	There has been good progress on this pillar and the government will consolidate the results in the next PFM reform period.	**Moderate**
ACCOUNTING, RECORDING AND REPORTING PI-27 Financial data integrity PI-28 In-year budget reporting PI-29 Annual financial reports	**1.3** 1 1 2	**Substantial**	This is the area where the Government is spending resources and efforts. The financial reporting and monitoring at the county and sector levels will be strengthened. The 2019-2023 PFM Reform Strategy will pay particular attention to the pillar.	**Moderate**
External Scrutiny and Audit PI-30 External audit PI-31 Legislative scrutiny of audit reports	**1.5** 1 2	**Substantial**	Efforts are being made to improve the audit of public finance and the subsequent review of external audit reports by the parliament. Recent evidence shows that this area is being strengthened by the Government	**Moderate**
Overall Fiduciary Risk	**1.52**	**Moderate**		**Moderate**

Risk Assessment based on the average PEFA score	
Below 0.75	**High**
Between 0.76 and 1.50	**Substantial**
Between 1.51 and 2.50	**Moderate**
Between 2.51 and 3.00	**Low**

Table 2-2017 PEFA ratings

		Over-all
PI-1	Aggregate expenditure outturn	***B***
PI-2	Expenditure composition outturn	***B+***
PI-3	Revenue outturn	***B***
PI-4	Budget classification	***A***
PI-5	Budget documentation	***D***
PI-6	Central government operations outside financial reports	***D****
PI-7	Transfers to sub-national governments	***C+***
PI-8	Performance information for service delivery -	***C+***
PI-9	Public access to fiscal information	***B***
PI-10	Fiscal risk reporting	***D+***
PI-11	Public investment management	**C+**
PI-12	Public asset management	***D+***
PI-13	Debt management	***A***
PI-14	Macro-economic and fiscal forecasts	***B***
PI-15	Fiscal strategy	***B***
PI-16	Medium-term perspective in expenditure budgeting	***B+***
PI-17	Budget preparation process	***A***
PI-18	Legislative scrutiny of the budget	***C+***
PI-19	Revenue administration	***C+***
PI-20	Accounting for revenue	***C+***
PI-21	Predictability of in-year resource allocation	***C+***
PI-22	Expenditure arrears	***B***
PI-23	Payroll controls	***B***
PI-24	Procurement	***B+***
PI-25	Internal controls on non-salary expenditure	***B+***
PI-26	Internal audit	***B+***
PI-27	Financial data integrity	***C***
PI-28	In-year budget reporting	***C+***
PI-29	Annual financial reports	***B***
PI-30	External audit*(M1-WL)*	***C+***
PI-31	Legislative scrutiny of audit reports	***B***

ANNEX 20: SECTOR BRIEFS

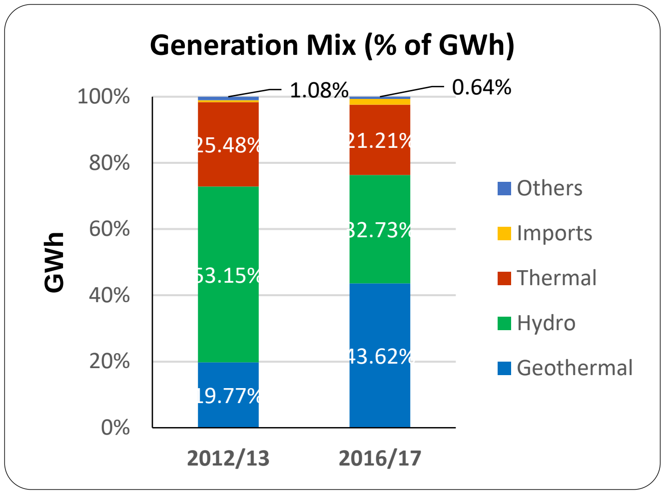
1. Energy: Kenya's energy sources consist of fossil fuels, hydro, geothermal, solar and wind power but most of the renewable energy resource potential remains untapped. Currently, Kenya depends on biomass 68%, hydrocarbons 22%, electricity 9% and other forms of energy 1% for its energy needs, with petroleum and electricity dominating commercial energy. The government has been involved in the expansion of the electricity sub-sector under the domain of "Project 5000+MW" a project aimed at boosting power supply in anticipation of the expected demand surge from Vision 2030 projects and the impact of investments arising from devolution to the 47 counties. To satisfy the national electricity demand, the government has prioritized the development of geothermal identified as a cost-effective power generation option in Kenya's Least Cost Power Development Plan. Wind, coal and solar resources could add to the 'least-cost' approach.

2. Power sector development in Kenya is built on the strategy laid out in Vision 2030, which is Kenya's development plan covering the period 2008 to 2030. Vision 2030 identifies energy and electricity as a key element of sustained economic growth and transformation for the country. The strategy also considers the importance of regional power interconnections for providing cost-effective, affordable and an adequate quality of power to customers. The Second Medium Plan 2013-2017 of Vision 2030, identified energy as one of the infrastructure enablers for Kenya's transformation into "a newly-industrializing, middle-income country providing a high quality of life to all its citizens in a clean and secure environment.

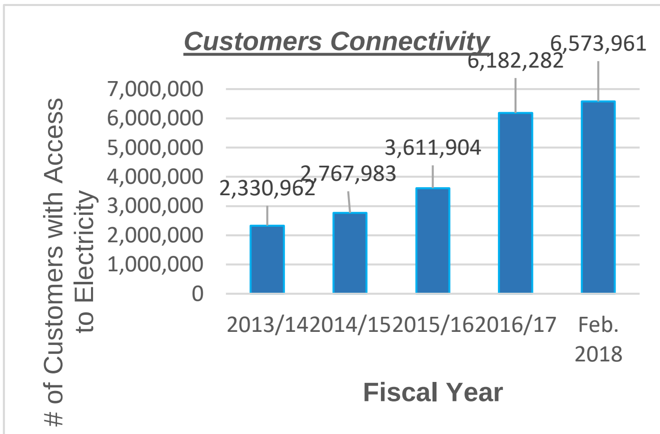
3. The energy generation and transmission system planning is undertaken on the basis of a 20 year rolling Long-Term Plan (Master Plan). According to the current master plan (2015-2035), the 2,213 MW generation capacity and 9,453 GWh of electricity consumption (in 2015) are planned to increase to 9,521 MW and 38,742 GWh (in 2035), respectively. The optimal development plan includes geothermal, hydro, wind, imports, thermal, coal and nuclear energy sources. The government has also formulated strategies whose objectives are to rapidly expand installed electricity capacity, expand and upgrade the transmission and distribution networks, and develop renewable sources of energy such as geothermal, solar, wind, biomass and small hydro power, among others. For example, the VAT (amendment) Act 2014 provides that certain solar products will be exempted from VAT, which is an effort to encourage investment, particularly in the field of on-grid generation.

4. Total installed generation capacity increased by 33% from 1,765.6 MW in 2012/13 to 2,354 MW in 2016/17. The growth is largely attributed to the increased generation capacity from renewable energy sources, notably hydro, wind and geothermal. During the last 5-years (2012/13 to 2016/17), the power supply, demand and the system peak demand continued to grow significantly. The average annual growth is 6.01% (8,087 GWh to 10,205 GWh including imports) for energy purchased by distribution companies, 5.97% (6.550 GWh to 8,250 GWh) for national electricity consumption and 5.18% for system peak demand (1,354 MW to 1,656 MW).

5. The current energy mix by source comprises 43.62% geothermal, 32.73% hydro, 21.21% thermal, 0.62% wind, 0.1% solar, 0.1% biogases and 1.8% imports. The contribution of geothermal for electricity supply has increased year to year by commissioning a number of plants from 2012/13 to 2016/17, adding about 422.5 MW nominal (396.78 MW effective capacity) to the total installed capacity and playing a major role in displacing thermal power plants. However, the aggregated average generation tariff and the end-users customers' tariffs are not substantially reduced.



6. The Government of Kenya is committed to increasing electricity access to Kenyans, particularly low income groups. One of the strategies is the Last Mile Connectivity which is designed to use the existing distribution transformers and extend the low voltage network to customers located in the vicinity of these transformers. Strong Government support to KPLC contributed to the connection of additional 3,851,320 customers in 2012/13 – 2016/17 financial years. Currently, as end of February 2018, the number of customer with electricity access stood at 6,573,961. The national access to electricity increased from 23% in 2012/13 to 72% at end of February 2018.



7. Challenges: (i) The energy sector requires substantial capital for financing of new projects and rehabilitate and upgrade the existing infrastructure. (ii) Right-of-way for transmission lines and site acquisition are the main challenges affecting project implementation and causing major delay on project completion. Populations in project areas do not always accept property valuations and refuse to relocate from line route corridors or project sites. (iii) *High tariffs:* Most of the IPP power generation projects were unsolicited and ended up with negotiated tariffs and commercial terms and conditions that were not necessarily in the best interests of the country or its rate payers. Future project's procurements shall be acquired through international competitive bids or through auction among interested IPPs, to avoid unacceptable high tariffs under long-term take or pay contracts from unsolicited IPPs. (iv) Load growth and demand for electricity is lagging behind projected additions to new capacity that were predicated upon reference growth scenario of the long-term plan (2015-2035). The consumption was forecasted to grow by an annual average of 7.3% per year, but 6.01% has been registered in the last 5-years, which is at the lower side.

8**. <u>**Transport**</u>**: Kenya has experienced generally steady economic growth since 2002 and the economy is expected to double between 2015 and 2030 with a corresponding increase in GDP per capita by about 63 percent. The implications for the transport sector will be increased demand for private vehicle ownership and an increased ability to pay for transport. Further, Kenya's population is forecast to rise by 32 percent by 2030, and a further 33 percent by 2050. Rural populations will decrease from 75 to 65 percent by 2030, and to drop to about half by 2050. By 2030, the rural population will have increased by 16 percent, with urban population growth at 80 percent. Nairobi alone is expected to have a population of 10 million by 2030, and 14.3 million by 2040, representing up to 22 percent of the population of Kenya, and 64 percent of the urban population. The implications of the demographic trends for the transport sector are the need to continue addressing rural transport, and the growing scale of challenges affecting urban transport, particularly in Nairobi.

*9. Road***:** Kenya's network is estimated to be 161,000 km with only 2 percent of rural roads and 17 percent of urban roads are paved. The ongoing and planned expansions is driven by the need to enhance domestic and regional connectivity, boost rural productivity, and reduce urban congestion in order to improve transport efficiency, facilitate growth and enhance standards of living. In terms of the region, the Kenyan government has improved numerous regionally connecting roads but there is still considerable scope for strengthening regional transport network connectivity.

10. Urban Transport: The Nairobi population is estimated to hit 10 million by 2030 with increases in trips by private automobiles and on foot at 69 percent and 47 percent respectively. Opportunities exist to meet some of this demand by mass transit, in the form of Bus Rapid Transit (BRT), light rail and commuter rail. Even though walking as a mode of transport has declined, the envisaged absolute growth in walking point to the need to address pedestrian infrastructure facilities.

11. The Government has recognized the need for modern transit and 5 lines of BRT systems are at advanced design stages for Nairobi in addition to plans to rehabilitate and expand the commuter rail network in Nairobi. Road improvements in Nairobi are currently focussed on the Northern and Eastern bypasses while a Western bypass. However, current road development programme in Nairobi on its own will not solve urban congestion and the implementation of all 5 BRT lines by 2030 will not meet public transport needs without additional mass transit lines, probably of a higher capacity than BRT is capable. A mix of physical infrastructure provisions and use of ICT technology must be explored as a means to sustainably address the growing demand for transport.

12. Transport and Logistics: Turnover of the logistics industry in Kenya reached US$9.4 billion in 2015, and increased at a compound annual growth rate of 13 percent between 2010 and 2015. However, existing logistics operations are strained by port congestion, falling reliability levels, challenged road transport capacity, the inability of railways to meet demand, and increasing user demand for reliable and predictable services. While Mombasa will continue to be the most attractive port for eastern Africa due its connectivity to the major markets in Nairobi and Uganda, it needs to continue to expand in order to maintain this position and meet future expected demand. In addition, the feasibility of a dry port outside Mombasa needs to be investigated to address capacity and efficiency of throughput issues, while land-side connections to Lamu port need improving.

13. Road maintenance needs of the whole network are estimated at 2.5 percent of the GDP, or KES 110 billion. KeNHA's envisaged resources of KES 12.1 billion for the financial year 2017/18 is inadequate. Further, road maintenance is still significantly under-funded. Government is attempting to fill the financial gap through the deployment of PPP mechanisms where the private sector will be contracted to manage to design, build, finance and operate some infrastructure at

both national and sub-national levels.

14. *Challenges:* (i) Weak Domestic Construction Industry: Domestic firms are typically small businesses, which are not managed professionally and less competitive. Thus, international companies are preferred due to their better qualifications and skills of their personnel. Access to financing remains a challenge for domestic players and hinders their participation in major infrastructural projects. (ii) Poor Budget Execution: Lack of government capacity in infrastructure construction continues to undermine funds absorption. Infrastructure departments lack employees with appropriate skills needed to review designs, costs, and work under contract terms. This prolongs the contracting process and is partly responsible for the escalation in unit costs of infrastructural works. (iii) poor Governance: The Corruption Perceptions Index by Transparency International indicates that Kenya has dropped from 136th out of 177 countries in 2013, to 145th out of 176 countries in 2016. While the governments has made a series of reforms seeking to address corruption, the pace of change remains slow.

15. *Opportunities:* (i) growing Private Sector: The government recently floated infrastructure bonds which were over-subscribed, inferring Kenya has the potential to raise significant resources to bridge the infrastructure financing gap. Further, the capital market in Kenya is growing and relatively deep. This can be strengthened by developing more innovative instruments, broadening corporate bond markets and the development of regulatory frameworks that foster greater participation of institutional investors. (ii) enabling Legislative Framework: The recently crafted road tolling policy for Kenya presents an opportunity to raise user-charges (toll) from road users. This should help raise additional revenues for maintenance of road infrastructure and expansion of the network. It is feasible that PPP schemes will help complement government budgetary resources in the development and maintenance of transport infrastructure.

16. *Recommendations:* The Bank's focus should remain on the roads sub-sector where the Bank has gained significant experience and is a leader. Given, our pioneering study on mass rapid transit systems (MRTS) for Nairobi, the Bank should urgently consider a flagship BRT project in Nairobi. While some DFIs are hesitant to get into this space, the Bank can forge funding alliances with those how are willing (EU, JICA or Korean Exim Bank) through a co-financing scheme and set the pace for the other DFIs. The fast-mover advantage would endear AfDB to the Government as a partner of choice.

17. <u>Agriculture</u>. The agriculture sector contributes 24 percent of Kenya's annual GDP, 65 percent of Kenya's total exports, and 18 percent and 60 percent of the formal and total employment respectively. As a result, agriculture has been identified in Kenya's Agricultural Sector Development Strategy (ASDS) as one of the key sectors to deliver the 10 per cent annual economic growth rate envisaged in Kenya Vision 2030. A key target of the ASDS is to sustain a 7 percent agriculture sector annual growth rate in order to address poverty and food insecurity and contribute to the development of a modern and competitive sector. ASDS will also contribute to the Big 4 Agenda, which is a focus area for government for the next five years. Food and nutritional security is one of the Big 4 pillars and purposes to grow agriculture value chains to achieve 100 percent food and nutrition security by 2022. Priority value chains under this Big 4 pillar are maize, potatoes, rice, leather, and fish. The ASDS Strategy (2010-2020) focuses on four objectives: increasing productivity and promoting commercialization and competitiveness of all crops, livestock, marine and fisheries, and forestry; promoting private sector participation in all aspects of agricultural development; developing and managing the national water resources, land resources, forestry, and wildlife in a sustainable manner; and reforming agricultural service, credit, research, regulatory, processing and manufacturing institutions for efficiency and effectiveness

18. Key constraints and challenges facing the agriculture sector in Kenya as articulated in the ASDS include: low production and productivity; inadequate budgetary allocations; reduced effectiveness of extension services; low absorption of modern technology; limited capital and access to affordable credit: pre- and post-harvest crop losses; heavy livestock losses to diseases and pests; low and declining soil fertility: lack of a coherent land policy; inadequate infrastructure; insufficient water storage infrastructure; inadequate storage and processing facilities and inadequate markets and marketing infrastructure.

19. In spite of these challenges and constraints, many opportunities and advantages exist that can be exploited to build a robust and dynamic agricultural sector in Kenya. These include: abundant and underused human resources; new and expanding domestic, regional and international markets; potential for increasing production; vast irrigation potential; potential for increasing suboptimum yields and high potential for value addition.

20. Bank interventions in agriculture sector under next CSP should be aligned with the Big4 agenda, which resonates well with the Bank's High 5s, Feed Africa Strategy and its flagship programs such as Technologies for African Agricultural Transformation (TAAT) initiative. TAAT is focused on the deployment of appropriate technologies to farmers to raise agricultural productivity and production, and conduct crop\livestock\aquaculture outreach campaigns for effective delivery of technologies to farmers. Other areas to consider for Bank intervention include value addition with a focus on products such as maize, tea, coffee, pyrethrum, hides and skins, milk and beef, fruits and vegetables. Further developments in the fisheries and aquaculture sectors should be considered in the context of an overall "Blue Economy" approach.

21. Regional integration: Kenya is the biggest economy in the East African Community (EAC), accounting for 46 percent of the region's GDP. However, Kenya's GDP growth rates have recently lagged behind the EAC average. Regional integration has a critical role to play to realize Kenya's Big 4 priorities especially manufacturing, affordable health care and food security. For manufacturing, regional integration is critical to ensure access to the East African Community market of over 180 million consumers. For Access to Affordable Health Care, regional integration can play a role through setting standards for cross-border trade in pharmaceutical products, regional health insurance, and investments in regional specialized treatment centres. On food security, regional integration is vital to ensure better management of shared natural resources and addressing barriers to cross-border trade in food products.

22. Kenya is a founding Member of the World Trade Organization and within Africa, Kenya is a member of the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA), Intergovernmental Association on Development (IGAD), the Tripartite Free Trade Area (COMESA-EAC-SADC) and the Continental Free Trade Area. Kenya has implemented a number of initiatives towards furthering regional integration including investing in regional infrastructure, the establishment of LAPSSET Corridor Development Authority, and implementing the East Africa Single Visa.

23. Regional Trade*: In 2016, three of Kenya's top 10 export destinations were EAC Partner states (Uganda, Tanzania and Rwanda) and approximately 18 percent of Kenya's total exports were the EAC region. Kenya enjoys a positive trade balance with the region indicating that the EAC contributes positively to its balance of payments current account position. However, the trade balance with the EAC has stagnated at a positive but relatively low level and exports to the EAC regional market are growing but at a slower pace compared to exports to the rest of the world.*

24. *Challenges:* (i) Regional development is constrained by inadequate infrastructure; (ii) EAC countries have a narrow basket of value-added exports and do not produce enough of what other

countries want; (iii) Coordination challenges for regional projects such as LAPSETT between EAC countries as well within government ministries and departments, and between the public and private sectors. (iv) Persistence of non-tariff barriers Kenya is accused of imposing such as: cumbersome customs and administrative documentation procedures; cumbersome inspection requirements; police road blocks and weighbridges; varying trade regulations; cumbersome, and costly transiting procedures; duplicity in the functions of agencies involved in verifying the quality, quantity, and dutiable value of imports and export cargo; and business registration and licensing; (v) Non-implementation of regional commitments such as a lack of recognition of Rules of Origin certificates among EAC Partner States; (vi) Fragility issues around the EAC

25. *Opportunities:* (i) Strategic geographical location: Due to its strategic location as a coastal country, Kenya's road transport sector provides a transit for neighboring countries and carries about 85 per cent of all cargo and passenger traffic; (ii) Existence of regional frameworks and regional priority projects approved by Heads of Government which will facilitate alignment and implementation of priorities; (iii) New resource discoveries such as oil will provide opportunities for further integration through regional oil pipelines and generating resources to finance regional projects; (iv) Competitive business environment in Kenya that as attracted many international firms to establish their regional hubs in Kenya; (v) Existence of shared resources such as Lake Victoria, which provides an incentive for cooperation at a regional level; (vi) Private sector active in pushing for regional reforms that provides an opportunity to scale up private sector participation in regional integration, both in terms of informing reforms or investing in priority projects under PPP arrangements; and (vii) Existence of robust research institutes such as University of Nairobi and the African Economic Research Consortium that can guide government in regional policy

26. Issues: Kenya joined 5 other EAC leaders to approve 17 EAC Infrastructure Flagship Projects of which 6 involve Kenya. There is need for government to indicate what role it envisages for the Bank as follows: (i) Construction of the Standard Gauge Railway of Mombasa-Nairobi-Malaba-Kampala-Kigali line with a Malaba-Nimule-Juba spur. Kenya has invested heavily on sections of this railway, but benefits will be enhanced if Uganda, Rwanda and South Sudan also participate. What role does government envisage for the Bank and including in cooperation arrangements with the neighboring countries? (ii) Phase II construction of the 2nd Container Terminal- Kipevu West at Mombasa Port: This project will increase the capacity and efficiency of the port and make it more attractive for both national and regional traffic**:** What role does the government envisage for the Bank in this project? (iii) LAPSSET Corridor: Kenya has invested close to half a billion US Dollars on the project. The Bank has financed some elements of this project. What further role does government envisage for the Bank? (iv) Mombasa-Nairobi-Malaba-Jinja Expressway: What is the status of this project on the Kenya side and what role is envisaged for the Bank? (v) Rehabilitation, expansion and construction of new airports and EAC Upper Flight Information Region. What is the status of this project for Kenya, and what is the envisaged role for the Bank, (vi) Lake Victoria and Lake Tanganyika Transport Program (Kenya, Rwanda, Tanzania, Burundi, Uganda): What is the status of this project on the Kenya side and what role is envisaged for the Bank? (vii) Regional Integration Strategy Roll Out: Kenya is in the process of finalizing its Regional Integration Strategy whose objective is to facilitate a common government-wide approach to regional integration. What roles does government envisage for the Bank in rolling out its Regional Integration Strategy? (viii) Private Sector Participation: How will the CSP boost participation by the private sector in regional integration, both in terms of guiding reforms or investing in priority projects under PPP arrangements?

27. Social Development: The Kenyan government puts emphasis on the development of a reliable pool of human capital with the necessary skills and competences to act as the key drivers of the goals of Vision 2030. Some of the improvements in social indicators that the country has made in recent years include: a decline in fertility rates from 4.4 in 2010 to 3.9 in 2015; decrease in infant mortality from 52 per 1000 live births in 2009 to 39 per 1000 in 2017; decrease in under-five mortality from 72 to 52 per 1000 during the same period; decrease in maternal mortality from 488 per 100,000 live births in 2009 to 362 per 100,000 live births in 2017; increase in immunization coverage from 77% to 83.5%; reduction in malaria incidence from 32 to 22%; and a decline in HIV prevalence rate from 6.3% to 5.6%. These improvements are attributed to the free maternal services program in public health facilities and the provision of free anti-retroviral drugs to prevent transmission of HIV/AIDS transmission.

28. In education, between 2012 and 2016 primary school Net Enrolment Ratio increased from 88.1% to 89.2%; the Pupil Completion Rate increased from 81.7% to 83.5%; and Primary to Secondary Transition Rate increased from 64.5% to 81.3%. At the secondary level, during the same period, the Gross Enrolment Ratio increased from 50.5% to 66.7% and Net Enrolment Ratio increased from 33.9% to 55.3%. Enrolments in TVET (excluding enrolments in technical universities) increased from 121,629 in 2012 to 142,248 in 2015; and University student enrolment increased from 361,379 in 2013 to 564,507 in 2016, an increase of over 56%.

29. *Challenges:* Access to functional health facilities in rural areas is still poor, malaria is prevalent, fertility rate is relatively high, HIV/AIDS is still a problem, and maternal health care cost is still high. Regional disparities in the provision of education, unemployment and under employment among the youth, skills mismatch between demand and supply, weak linkage between industry and training institutions, and skills shortages in some critical areas within the labour market all remain to be challenges that need overcome.

30. *Strategy***:** The strategies for addressing the challenges facing the country's social sector are outlined in the Third Kenya Vision 2030 Medium Term Plan (MTP 2018-2022). The plan prioritizes policies, programs and projects which generate broad based inclusive economic growth, as well as faster job creation, reduction of poverty and inequality, and meeting the Sustainable Development Goals (SDGs). This is in line with the Bank's fifth High 5, Improve the Quality of Life for Africans.

31. *Opportunities:* The GoK is keen in continuing its collaboration with the ADB in the social sector, particularly in the areas of skills development for the youth and the resourcing of technical vocational education and training. The GoK would therefore like to see that a third TVET project is included in the pipeline of projects under 2019-2023 CSP cycle.

32. Gender: Kenya's Vision 2030 referred to in the second Medium Term Plan 2013-2017 (MTP II) highlights progress made by the country on gender equality. Some of the gender-related international and regional obligations and commitments made by Kenya include the Millennium Development Goals, United Nations Convention on Elimination of All forms of Discrimination against Women and the Protocol to the African Charter to the Human and Peoples Rights on the Rights of Women in Africa.

33. The National Gender and Development Policy of 2011 is yet to be revised and effectively implemented, and systems to monitor compliance put in place. Key strategies utilized to achieve the policy objectives were: institutional strengthening; formulation of measures to identify and address gender-specific vulnerabilities; institutionalize the collection of gender disaggregated data; review and enhance existing strategies for capacity building in gender mainstreaming; ensure reporting and accountability mechanisms for gender mainstreaming are put in place; and establishment of the gender research and documentation centre.

34. The Ministry of Public Service, Youth and Gender Affairs is responsible to promote gender equality and women's empowerment in Kenya. The National Gender Equality Commission (NGEC) is a constitutional entity established by an Act of Parliament in 2011 whose over-arching goal is to contribute to the reduction of gender inequalities and the discrimination against all; women, men, persons with disabilities, the youth, children, the elderly, minorities and marginalized communities.

35. *Legal and Regulatory Framework:* The Government of Kenya's efforts to promote gender equality and fight against Gender Based Violence (GBV) are reflected in the ratification of international conventions and instruments such as the Convention on Elimination of Discrimination Against Women (CEDAW), the Beijing Declaration and Platform for Action, United Nations Security Council Resolutions 1325 and 1820, and the Universal Declaration of Human Rights. Nationally, gender responsive laws and policies, including the National Gender Policy (2006) and the Law on the Prevention and Punishment of GBV have been enacted. Kenya is also an active member and partner in regional bodies such as the African Union (AU), Common Market of East and Southern Africa (COMESA), the inter-Governmental Authority on Development (IGAD), the Southern African Development Community (SADC), and the East Africa Community (EAC), that have established mechanisms for the promotion of gender equality and women's empowerment. Further, article 27 (8) of the 2010 Constitution requires progressive realization of the enforcement of the two-thirds gender rule or requires this to be implemented during general elections. Women's participation in leadership, governance and decision-making has increased from 20.5 percent in 2008 to 38.6 percent in 2012 due to the affirmative action measures.

36. Issues identified: Some of the issues that have a defining influence on the state of gender equality in Kenya include access to finance; women's predominance in agriculture which is undercompensated; women being less predominant in the formal sector and with lower wages; women's constitution of almost half of micro and small business owners; poor implementation of the legal and regulatory framework; negative socio-cultural norms and attitudes; high levels of gender-based violence; gender disparities in education; and poor health indicators.

37. Some of the concerns that need to be addressed include mainstreaming gender into the selected pillars of the CSP; identified entry points for gender-focused operations with greater impact to reduce inequality; economic sector work to backup possible interventions; and the provision of economic sector work for technical support to critical institutions.

38. **Climate Change and Green Growth Sector:** Kenya faces numerous climate change related impacts and vulnerability. The Economics of Climate Change study (2010) projected that the impacts of climate change on Kenya's economy might be close to 3 percent of GDP per year by the year 2030 and potentially reach 5 percent of GDP per year by 2050. Some of the climate change impacts experienced in the country include: frequent occurrences of extreme events, particularly droughts and floods; decreased water resources; reduced energy generation potential, particularly from hydropower generation systems; increases in mean temperatures; community conflicts driven by competition for water and pasture resources; destruction of habitats and biodiversity; destruction of infrastructure and transport systems by floods and landslides; and negative effects on production systems due to reduced availability of raw materials, limited water supply, disruption to transportation systems and irregular electricity supply.

39. Kenya has created a strong policy and legal framework to govern climate change response measures evidenced in Article 42 of the Constitution of Kenya 2010, Vision 2030, the National

Climate Change Action Plan (2013-2017), the Climate Change Act (2016), the Green Economy Strategy and Implementation Plan, the National Climate Change Framework Policy, the National Adaptation Plan 2015-2030, the National Climate Finance Policy and the National Green Climate Fund Strategy. More recently, the government launched the Big 4 Strategy focused on Food Security, Universal Health, Affordable Housing and Manufacturing. The Food Security pillar can only be attained through sustained environmental protection, restoration and conservation, and reducing reliance on rain-fed agriculture. Affordable Housing and Manufacturing pillars depend on natural resources for raw materials and can only thrive under efficient resource use and sustainable environmental management.

40. The following are the Bank's key mitigation and adaptation actions in Kenya: On *Mitigation* (i) National Appropriate Mitigation Actions seeks to attract investment for biogas, clean cook stoves and solar lighting, geothermal and waste initiatives. (ii) Geothermal Power projects which generate clean and renewable energy. (iii) Wind Power Projects: These include the Lake Turkana Wind Power Project and Ngong Hills Wind Farm; pipeline projects include Kajiado and Lamu Wind Farms. (iv) Installation of Green Mini-Grids: Hydro and solar installations that serve rural communities not connected to the main electricity grid. On *Adaptation* (i) Adaptation Fund project implemented by the National Environment Management Authority: Builds community resilience to climate change with a focus on food security, water management, coastal ecosystem management, and environmental management. (ii) Galana/Kulalu Food Security Project: Aims to develop 500,000 acres of irrigated land. (iii) Kenya Adaptation to Climate Change in Arid and Semi-Arid Lands Phase 2 project: strengthens climate risk management knowledge and invests in communities' priorities in sustainable land and water management, and alternative livelihoods. (iv) Ending Drought Emergencies Programme: Support to the Common Programme Framework which operationalises a commitment to end drought emergencies by 2022. (v) Kenya Water Security and Climate Resilience Project: Aims to increase availability and productivity of irrigation water and build capacity of water sector institutions.

---

[i] Vision 2030 has as one of its objectives the creation of a diversified and competitive manufacturing sector by boosting production, expanding to the regional markets and taking advantage of global market niches

[ii] The MTP-III target increasing manufacturing share of GDP to 15% by 2022 from 9% currently by increasing value addition

[iii] A diagnostic report on Kenya concluded that returns to education is relatively low compared to regional comparators and is lowest for primary, secondary and tertiary level of education. The low shadow price extra education training implies that human capital is not a constraint to Kenya's growth. Further, Kenya scored 0.52, hence ranked 94th globally, 4th in Africa and 1st in Sub-Sahara Africa in a new Human Capital Index (HCI) recently launched by the World Bank. The index measures "the amount of human capital a child born today can expect to attain by age 18". A score of 0.52 means that "a child born in Kenya today will be 52% as productive when she grows up as she could be if she enjoyed complete education and full health".

[iv] According to the GCI, Kenya is among the top ranked countries in Africa in infrastructure (80th globally) and in pay versus productivity (39th globally). The latter measures the relationship between pay and employee productivity.

[v] Kenya has abundant resources that can be exploited to meet priority sectors' input demands. Its manufacturing sector has strong forward and backward linkages; it can capitalize on international and regional agreements, among others, the EAC Industrialization Policy 2012-2023; the EAC Industrialization Strategy 2012-2032; EAC Vison 2050; African Union Agenda 2063. In addition, the launch of the African Continental Free Trade Area (AfCFTA) in March 2018 aims, among other objectives, to unlock manufacturing potential and facilitate industrialization. Further, Kenya has a well-developed financial sector and is Africa's hub in mobile technology.

[vi] Kenya is a middle-income country with per capita income of USD $2,926; its economy has grown consistently above continental average for over a decade driven by household consumption; and it is a country rapidly urbanizing.

[vii] The authorities did not release 4th quarter GDP at the time of writing this report. Therefore, a GDP growth estimated of 5.9% which made use of the first three quarters of 2018 is used.
[viii] The CSP preparation was preceded by a Growth Diagnostics (GD) Study. Summary of the GD study is attached to this report.
[ix] Private sector credit growth fell from its peak 25% in mid-2014 to average of 2.3% compared with 15% for the National Government in 2017. This can be attributed to the implementation of the interest rate cap. Other additional factors might have also contributed for the decline in private sector credit growth such as the liquidity shock in 2015/16, liquidation of three commercial banks, the rise in the non-performing loan, and inability of small banks to borrow in the interbank market. The WB estimates the cap probably cut the 2017 economic growth by 0.4 percentage points. Its estimate further shows that private sector investment impact on growth fell to -0.7 percentage points of GDP in the four year to 2017 from 1.3 percentage point in the four years to 2013 attributed to, among others, drop in government spending, election related uncertainty and private sector credit made worse by the interest rate caps.
[x] For example, a Finance Bill Act 2018 was introduced by the Parliament recently. It resulted in the removal of the cap on deposit rate. In addition, expectations are high that the capping law could be scrapped altogether following the recent ruling by the High Court to suspend the law on constitutional grounds for a period of twelve months during which time the National Assembly is given the opportunity to consider the provision
[xi] Kenya has been on IMF program between March 2016 and September 2018. It had the objective of reducing fiscal deficit and removal/modification of the interest rate capping law. Some success has been realized in the fiscal policy front in reducing deficit in line with the fiscal consolidation path. However, the interest rate capping law is still intact. Following the expiration of the program in September 2018, the government is in negotiation with the IMF for a new program
[xii] About 70% of external loan is denominated in USD.
[xiii] Financial exclusion refers to exclusion of people of low and moderate incomes directly and indirectly from the formal financial system and denied access to mainstream retail financial services.
[xiv] 89.4% of firms have experienced load shading in Kenya compared to countries Like Rwanda 62.5%.
[xv] Examples of non-tariff barriers include: cumbersome customs and administrative documentation procedures; inspection of transit cargo, cumbersome inspection requirements, police road blocks and weighbridge queues can take between one to two hours at each of the weighbridges along the north corridor, varying trade regulations, cumbersome and costly transiting procedures, etc…
[xvi] Poverty is high in the North Eastern and Coastal regions while it is significantly lower in Nairobi and central regions of the country.
[xvii] In terms of labor underutilization, the rate shoots up to 26.4%. It is measured by combining the unemployed, time related under-employed and potential labor force which is the Not employed population, but "potential supply of labor' seeking but not available to work and Not seeking but available and wanting to work. Kenya adopts a 28 hour-threshold in a week as a measure of underemployment. The highest rates of underutilization are observed in the youth age groups 15-29 and the age group category 55-64.
[xviii] The scores for sub-indices for economic participation and political empowerment declined respectively from 0.810 and 0.197 in 2014 to 0.720 and 0.147 in 2017. In education, while there is near gender parity in primary school enrolment, disparities remain in education. Boys outnumber girls in enrolment at all levels of education, with gender disparity increasing as the level of education increases. The tertiary level has the highest level of inequality regarding the ratio of girls to boys, and in national examinations performance, boys overall perform better than girls**.**
[xix] The scores for sub-indices education and health increased from 0.923 and 0.973 in 2014 respectively to 0.929 and 0.980 in 2017. In health, indicators highlight gender disparities in Kenya with statistics on access to health showing mixed results. While males do better than females in infant mortality and HIV/AIDS, women do better than men in the other indicators. More female than male children below one year are likely to die before their first birthday, but for the under-five mortality rates, more male than female children are likely to die before their fifth birthday. Life expectancy has also improved since 2008 for both sexes: women are likely to live longer than men. The maternal mortality rates have reduce from 488 per 100,000 live birth in 2008 to 400 in 2013. Also, antenatal care and birth attendance by skilled provider, and overall numbers of births occurring in a health facility have improved over the period 2003 to 2014. With respect to HIV/AIDS, the prevalence is higher among females compared to males.
[xx] The State Department of Planning is working with the Council of Governors and other stakeholders in developing the right policies and capacity building programs for local governments on the harmonization of regulations, inclusivity and service delivery.
[xxi] The economic pillar of Vision 2030 had a 10% GDP growth per annum target. The GoK in MTP-III revised country's annual growth potential to 7%.
[xxii] The operations affected include *"Mombasa Mariakani", "Thwake Multipurpose Water Development Program", "Sirari Corridor Accessibility & Road Safety Improvement Project", "Kapchorwa - Suam - Kitale and Eldoret*

Bypass Roads Project", "Last Mile Connectivity Project – 2" and "Kenya-Tanzania Interconnection". Together, these projects accounted for about 31% of the total commitments.

[xxiii] Bank's Ten Year Strategy (TYS) is made up of five operational priorities: infrastructure development, regional economic integration, private sector development, governance and skills development. It is also made up of cross-cutting aspects such as gender, promotion of green growth, youth employment and issue of fragility.

[xxiv] Security, one of the dimensions was not assessed for lack of data.

[xxv] The proposed focus areas are aligned to all the five enablers for the "The Big Four" economic plan namely creating conducive business environment for investment and job creation, investing in infrastructure to unlock growth potential, investing in sectoral transformation for food security and broad based sustainable growth, investing in quality and accessible social services (health, education and social safety net), and consolidating gains in devolution for services delivery and enhanced rural development.

[xxvi] The new focus areas are aligned with WB's support to Kenya in 10 sectors.

[xxvii] One of the enablers identified for the achievement of the Big Four plan is that of creating conducive business environment for investment and job creation. Important under this is maintaining macroeconomic stability to create conducive environment for private sector investment. This will be achieved through continued application of prudent fiscal and monitory policies. The Monetary policy will target keeping inflation within National Treasury's target band, keeping interest rate low and stable, keep the exchange rate stable, strengthen the reserve positon, and ensuring that credit to the private sector increases. The fiscal policy on the other hand will continue to be anchored on fiscal consolidation by prioritizing development spending and mobilizing revenue to lower fiscal deficit and stabilize public debt. In addition, improving the business regulatory reform is identified as important component of improving business environment. Kenya improved its ranking to 80 in 2017 from about 92 in 2016 according to the WB Doing Business Report. This was caused by improvement in 6 of the 11 indicators of easing doing business. Therefore, noting this, the government will build on the rapid progress by taking measures such as cutting the number and cost of permits and licenses at both National and County levels. These together with other initiatives are expected to improve Kenya's ranking to 45^{th} by 2022.