Public Disclosure Authorized

Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 15-Apr-2020 | Report No: PIDA28638

BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
Kenya	P172321	Kenya Inclusive Growth and Fiscal Management DPO 2 (P172321)	P168204
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
AFRICA	05-May-2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
REPUBLIC OF KENYA	The National Treasury		

Proposed Development Objective(s)

The program development objectives are to: (i) crowd in private investment and financing for affordable housing; (ii) enhance farmer incomes and food security; (iii) create fiscal space to allow the government to invest in key development programs; and (iv) crowd in private investment and leverage digitization to support the government's inclusive growth agenda.

Financing (in US$, Millions)

SUMMARY

Total Financing	750.00

DETAILS

Total World Bank Group Financing	750.00
World Bank Lending	750.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

As with the rest of Sub-Saharan Africa, the impacts of the COVID-19 shock on Kenya will be significant. Kenya's economy is being impacted through several external channels including disruptions in global supply chains, a sharp fall in tourism receipts, a decline in its exports (horticulture, tea), and a slowdown in remittances. In addition, the domestic restrictions imposed (social distancing guidelines, curfews, restrictions in movements in and out of some of the largest cities) to mitigate the spread of COVID-19 has brought economic activity to a crawl in major economic hubs. For the first time in over a decade, per capita GDP growth is projected to decline. The slowdown in economic activity and the need for the Government of Kenya to carry out measures to mitigate the extent of the fall has also increased fiscal pressures and led to a widening of the fiscal financing gap in 2019/20 by at least an additional 1.7 percent of GDP, and similarly a widening of the external financing gap by some 1.4 percent of GDP. While the preparation of this second Kenya Inclusive Growth and Fiscal Management Development Policy Operation has been in preparation over the last year, it comes at an opportune time to provide the government with additional fiscal space to partially blunt the economic downturn induced by the global pandemic and to help fill their financing gap. This operation thus complements the recently approved Kenya Covid-19 Emergency Response Project (P173820) which seeks to prevent, detect and respond to COVID-19 outbreak and strengthen national systems for public health emergency preparedness.

The COVID-19 outbreak is expected to lead to a significant slowdown in economic activity. Among the immediate priorities includes the need to contain the spread of the virus and care for the infected. This is exerting pressure on healthcare systems and spending. Further, the measures being taken to slowdown the rate of infection, including home confinement, travel restrictions, closure of schools and entertainment spots, and suspension of public gathering and conferences would have a direct effect on production in many sectors of the economy. Beyond this, the indirect effect include slowdown in firm level activity with a high social expectation to keep meeting wages and fixed expenses. But commercial banks are also more cautious with rising probability of a global recession and extension of credit could be constrained. While, reduced oil prices will act as a potential stabilizer (for a net importer), all other international spillovers are negative-demand shock for exports and tourism, supply chain disruptions, slowdown on remittances, among others. Taking all these into account, the World Bank has significantly marked down economic growth projections for 2020 from a Pre-COVID estimate of 5.7 percent to 1.5 percent. This will represent the first time GDP growth will lag behind population growth in a decade, suggesting a contraction in per capita incomes and with that a likely increase poverty.

Kenya's medium-term growth prospects are dampened by the COVID-19 pandemic and the attendant global uncertainty. The baseline adjusts for the negative impact of COVID-19 on Kenya's growth outlook. Accordingly, growth is estimated to moderately pick up to 3.0 percent in 2021 and 4.8 percent in 2022, before reaching Kenya's growth potential of 6.0 percent in 2023. The projections are based on the assumptions that the global economy is tipped for a recession with significant negative spillovers on Kenya; but that investor confidence and corporate incomes will be restored soon after the COVID-19 pandemic is contained and that the weather remains normal and favorable for agricultural output. Nonetheless, the COVID-19 situation is evolving very rapidly and could get worse as the partial shutdown to contain the spread of COVID-19 could be prolonged. Post-crisis, economic activity would be supported by recovery in private sector investment and improved access to credit. Further, swift and well targeted policy responses to COVID-19, including fiscal and monetary policy stimulus, are expected to support resilience. Inflation outlook is for a slight pick-up (but contained within the government's target) on the back of food supply disruptions associated with COVID-19, while the current account deficit is expected to narrow owing largely to lower oil prices and lower capital goods.

This DPO provides a much-needed fiscal financing that will allow the authorities to confront the pandemic and help meet the widening fiscal and external financing needs. The budget support (of US$ 750 million) through this DPO will further bolster Kenya's public finances to expand its response to COVID-19 and help address the associated economic fallout owing to the crisis, including protecting vulnerable households, MSMEs, and prevent layoffs and bankruptcies. The DPO complements the recently approved Kenya Covid-19 Emergency Response Project (P173820) of about US$ 50 million IDA credit to help Kenya respond to COVID-19 pandemic by strengthening health systems, including providing better access to health services to safeguard people from the epidemic, improve disease surveillance, and bolster public health interventions. As needed, the government could also consider drawing down some of the balance of the World Bank CAT-DDO and securing other contingency funds.

Relationship to CPF

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

C. Proposed Development Objective(s)

The program development objectives are to: (i) crowd in private investment and financing for affordable housing; (ii) enhance farmer incomes and food security; (iii) create fiscal space to allow the government to invest in key development programs; and (iv) crowd in private investment and leverage digitization to support the government's inclusive growth agenda.

Key Results

The key results of the operation include: (i) an increase in the delivery of affordable housing units though enhancing in the availability of long-term financing to improve housing affordability and removal of key regulatory constraints to building at scale; (ii)) increased farmer incomes through improving productivity in the agriculture sector, reducing post-harvest losses, improving farmer access to finance; (iii) rebuilding of fiscal buffers to support the Big Four by boosting domestic revenues and ensuring value for public expenditures, especially in public procurement; (iii) improving the business environment to boost private investment.[1]

D. Project Description

This DPO proposes to support selected priorities within the government's medium-term plan. The policy and institutional reforms under this DPO are clustered under four policy and institutional reform pillars that are foundational to creating an enabling environment for the delivery of the government's inclusive growth agenda. These are: (i) crowd in private sector investment and financing for the delivery of affordable housing; (ii) enhance farmer incomes and food security; (iii) create fiscal space to support the government's inclusive growth agenda; and (iv) crowd in private investment and leverage digitization to support the government's inclusive growth agenda. This operation complements other interventions supported by the World Bank that support the government's "Big Four" agenda: proposed Kenya Affordable Housing Finance Project (P165034); Kenya Climate Smart Agriculture Project (P154784); National Agricultural and Rural Inclusive Growth Project (P153349); proposed Kenya Marine Fisheries and Socio-economic Development Project (P163980); and the Program to Strengthen Governance for Enabling Service Delivery and Public Investment in Kenya (P161387). The operation also complements interventions by other development partners in support of the "Big Four" agenda.

The overall impacts of the policy and institutional reforms under this proposed programmatic DPO series is expected to be largely positive. The poor are expected to disproportionately benefit from interventions on affordable housing, improvements to agricultural value-added and resilience, and increased coverage of broad band services. Further, increased access to affordable houses is likely to have significant positive economic impacts. Beyond the economic benefits, studies have found that there is a positive correlation between improved housing conditions and human capital outcomes. In addition, the net impact of fiscal reforms is expected to be positive [the quantification of the impacts is ongoing]. The expenditure reforms supported under this operation should help bring bout fiscal savings and improve the efficiency of spending. Revenue measures are progressive and should contribute to improving fiscal space.

E. Implementation

Institutional and Implementation Arrangements

The National Treasury and Planning will be the coordinating institution for monitoring and evaluation among all the participating ministries for this DPO. The institutional and policy reforms supported by the programmatic DPO series fall under the purview of 11 ministries and agencies. These are: Competition Authority of Kenya; Central Bank of Kenya; Ministry of Agriculture, Livestock, Fisheries and Irrigation; Ministry of Lands and Physical Planning; Ministry of Transport, Infrastructure, Housing, Urban Development and Public Works; The National Treasury and Planning; Ministry of Information, and Communication Technology; Ministry of Education, Science and Technology; Ministry of Interior and Coordination of National Government; Ministry of Industry, Trade and Co-operatives and the Public Procurement and Regulatory Agency. The National Treasury and Planning has chaired the multi-sector coordinating committee established for overseeing the preparation of the operation. This committee will remain in place during the implementation of the program. The committee will also be responsible for monitoring of results indicators and evaluation activities.

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

Poverty and Social Impacts

The overall impacts of the policy and institutional reforms under this proposed programmatic DPO series is expected to be largely positive. The poor are expected to disproportionately benefit from interventions on affordable housing, improvements to agricultural value-added and resilience, and increased coverage of broad band services. Further, increased access to affordable houses is likely to have significant positive economic impacts. Beyond the economic

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Environmental, Forests, and Other Natural Resource Aspects

The policy actions and institutional reforms to be supported by this DPO are not likely to cause significant effects on the environment, Forests, and other natural resources in Kenya. Improvements in policies and institutions reforms for managing public resources, attracting and retaining foreign and domestic investors, enhanced resilience of the agriculture systems through increased water harvesting and irrigation, and improving the quality of housing and management of e-waste as proposed cannot in themselves have any direct negative impacts on the environment. However, it is possible that indirectly, the budget support to be provided could be spent on activities that have potential to damage the environment. It is observed that the national environmental framework in Kenya is broadly aligned with the International Standards, the implementation and of this framework can further be strengthened through enhanced supervision and compliance. In Kenya, the Ministry of Environment and Forestry is responsible for setting up policy guidelines on environmental, forest, protection and conservation of the natural environment, while the National Environment Management Authority coordinates the environmental management activities undertaken by lead agencies and promotes the integration of environmental considerations into development of policies, plans, programmes and projects.

G. Risks and Mitigation

The overall program risk rating has been increased to substantial due to the broader impact of the corona virus pandemic. While the GoK has shown remarkable progress in pursuing its reform agenda and coordinating the reforms supported by this operation over the past 12 months, the uncertain depth and duration of the COVID-19 shock represents the single most significant risk that could undermine the attainment of the program's objectives (most residual risks remain moderate). The COVID-19 shock is having a large negative impact on the Kenyan economy. Consequently, GDP growth has been significantly downgraded, and there has been a significant widening of the fiscal and external financing gaps. Nonetheless, with the fluidity of developments, the extent to which COVID-19 will impact this operation remains fully unknown.

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APPROVAL

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