



REPUBLIC OF KENYA

STATUS REPORT

ON

**PREPARATORY ACTIVITIES AND
WAY FORWARD FOR THE
ECONOMIC RECOVERY
STRATEGY PAPER (ERS)**

FOR

KENYA

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1. INTRODUCTION

The major challenge facing the National Rainbow Coalition (NARC) Government is how to restore economic growth, create jobs, and reduce poverty. The overwhelming support given to the new Government was a resounding indication by Kenyans that they needed radical changes in governance and improvement of general well being. Given that economic recovery is the primary vehicle through which to achieve improved access to education and health, better infrastructural services, and employment creation, economic recovery will also be the most effective strategy for halting and eventually eradicating poverty.

The Government launched in June 2003 its Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) which outlines the key aspirations for its economic and social program for 2003-07. This strategy draws heavily upon the Poverty Reduction Strategy Paper (PRSP) developed under the previous Government (although never formally submitted for Joint Staff Assessment), and broadly reflects the priorities expressed through the consultation process that guided its development. The government is currently in the process of producing an investment programme for the ERSWEC. The updated ERSWEC will reflect results of consultations with key stakeholders, establish resource requirements and include an implementation framework. This updated ERSWEC document--the Economic Recovery Strategy--will be presented to the World Bank and the IMF for a Joint Staff Assessment.

This report outlines the progress to date in developing the Economic Recovery Strategy (ERS), provides a timetable for completion of the ERS, and specifies the additional steps being taken to complete the ERS in coordination with civil society and Kenya's development partners. Also, the report highlights how the consultation process and evolving Economic Recovery Strategy have addressed the issues raised by the Fund and the World Bank in the Joint Staff Assessment of the Interim PRSP (prepared in 2000).

2. PROGRESS TO DATE IN DEVELOPING THE ECONOMIC RECOVERY STRATEGY

2.1 Participation and consultation process

A major objective of the PRSP consultations was to ensure that Kenyans of all walks of life, including the poor and the vulnerable, participated in the process of identifying their development needs and priorities in a participatory, inclusive, informative and credible manner. The key objectives were to link policy, planning and budgeting; to attain quality expenditures and efficiency gains; to institute a harmonious financing framework for equitable distribution of national resources and development initiatives; to enhance participation and ownership in a transparent, open and accountable manner; to give a voice to the poor; and to monitor and evaluate the poverty reduction and growth strategies.

The PRSP consultation framework ensured the inclusion of all stakeholders, both at the national and local levels. It involved consultations at the national, provincial, districts, thematic and sector levels. In-depth consultations were undertaken in 25 districts, while less in-depth consultations were undertaken in the other 45 districts. In addition, participatory poverty assessments were undertaken at the community level in ten selected districts.

A PRSP Government Action Plan (GAP) was developed through the participation of line ministries. The GAP benefited from discussions with the staffs of the Fund and World Bank in late November and early December 2002. The general elections of December 2002 resulted in a new popularly-elected government, which incorporated the priorities established through the PRSP process into its ERSWEC.

2.2. Issues raised in the JSA of the Interim PRSP

An important output of the consultation process between the government, development partners, private sector and civil society was the preparation of an Interim PRSP. The Interim PRSP was based on a National Poverty Eradication Plan (NPEP), which was a Kenya-led exercise involving extensive consultation and was concluded prior to the launch of the PRSP process. The Bank and Fund completed a Joint Staff Assessment (JSA) of the Interim PRSP and emphasized the following points:

- The importance of strengthening socioeconomic statistics by providing adequate resources to the Central Bureau of Statistics (CBS) -- so as to strengthen poverty analysis, undertake a more comprehensive diagnosis of the causes of poverty, and monitor the effectiveness of poverty reduction programs;
- The need to fully articulate supply-side measures to achieve the medium-term growth objectives;
- The importance of prioritizing (under the full PRSP process) expenditure, costing of identified poverty programs, strengthening the links between poverty reduction objectives and proposed policies, and incorporating them into the macroeconomic framework; in this regard, the importance of restructuring government expenditures to make room for spending in priority sectors;
- The need to continue and deepen the consultation process by, inter alia, establishing a national steering committee with the capacity to create an all inclusive stakeholder agenda encompassing the poor; and
- The need to consolidate recent progress in the governance area, as this has been identified as one of the main reasons for the failure of past poverty programs.

The preparations of the Economic Recovery Strategy has fully taken into account the issues raised in the JSA on the Interim PRSP. First, steps are being taken to upgrade the CBS to meet the challenge of producing detailed socioeconomic statistics to strengthen poverty diagnosis and analysis. Resources will be allocated over the medium-term to ensure that such a capacity is fully developed and this will be complemented by technical assistance from development

partners. As a matter of priority, an Integrated Household Based Survey Program is being put in place in order to harmonize and standardize poverty and other data to facilitate more comprehensive and detailed analysis.

Second, the ERS analyzes supply side constraints to growth and articulates policy reforms and programs to facilitate the achievement of a higher growth trajectory. Third, as discussed later, the ERS spells out clearly the need to restructure government expenditure to permit higher spending on pro-poor priorities, and the resource allocation in the MTEF budget will fully reflect these priorities. Fourth, as regards the consultation process, plans are already well advanced to establish the National Social and Economic Council (NESC) that will have representation from all social partners, thereby ensuring the development and implementation of an inclusive stakeholder agenda. Finally, the new government has placed the fight against corruption and the strengthening of democratic governance institutions at the center of public policy and the recent enactment of the two governance bills is a manifestation of the priority the government attaches to the area of governance.

2.3 The Economic Recovery Strategy for Wealth and Employment Creation

The Economic Recovery Strategy for Wealth and Employment Creation was the outcome of a consultative process and presents the new road map for economic recovery over the next five years. This ERSWEC is anchored on four pillars: achieving rapid economic growth in an environment of macro economic stability, strengthening the institutions of governance, rehabilitating and expanding the physical infrastructure, and investing in the human capital of the poor.

The ERSWEC recognizes that economic recovery will primarily come from improvements in the productive sectors of the economy, such as agriculture, tourism, trade and industry. It also outlines specific policies and institutional reforms that will be implemented in order to revive the various productive sectors and emphasizes the removal of various regulatory impediments that increase the cost of doing business. Interventions proposed for the productive sector include:

- **Agriculture:** provide for one enabling legislation, and empower poor farmers through increased smallholder access to credit, increased institutional efficiency and strengthened of extension services. Also, revamping the co-operative movement by reviewing the Cooperative Societies Act will improve governance in the sector.
- **Manufacturing:** interventions in the manufacturing sector will be built around an industrial master plan, which will lay the groundwork for the first phase of Kenya's industrialization strategy and restore the sector to a rapid growth path.
- **Tourism:** increased funding for marketing, upgrade the tourist police force, and diversification of markets, both in terms of geographical distribution and customer base.
- **Investment code:** to provide for a one-stop office for investment promotion activities.

- **Export promotion:** an export promotion strategy will be developed to ensure maximum export earnings at minimum promotional costs.
- **Promotion of small and medium size enterprises:** a sessional paper focusing on employment creation and formalization of informal activities will be finalized and implemented.
- **Financial sector reform:** a Financial Sector Assessment Program (FSAP) will be developed to focus on reducing interest rate spread; enhancing investor confidence and consumer protection; establishing effective financial sector regulator; dealing with Non Performing Loans (NPLs); and creating an independent insurance regulator.

Wide-scale consultations on the ERSWEC have been held with key stakeholders. These consultations will be strengthened and institutionalized through continuous dialogue with stakeholders in the PRSP Sector Working Groups (SWGs) and Thematic Groups (TGs). Consultations are being held to guide the implementation of the ERSWEC, to prepare the investment program, and to ensure that the priority pro-poor government policies and actions are linked to a medium-term expenditure framework (MTEF) and the budget. The Ministry of Planning and National Development has embarked on the process of strengthening the SWGs. It is envisaged that the review and preparation of sector reports will start immediately (September 2003) and that SWGs and TGs will hold monthly meetings in order to ensure that the priorities are clearly specified at the start of the budget preparation exercise. The Macro Working Group (MWG) will take the lead in setting the stage by specifying the macroeconomic and national priorities that will guide the work of the sectors.

2.4 Logical framework matrix and the monitoring and evaluation process

The process of completing a logical framework matrix that specifies targets, monitorable indicators, and means of verifying indicators for all the major economic and social sectors is well underway. It will form a key element of the monitoring and evaluation framework for the ERSWEC, and will also be used to assess progress towards achieving the Millennium Development Goals. A comprehensive monitoring and evaluation action plan has been prepared that will be implemented during the next few years with the support from donors and other stakeholders. Among other initiatives, a Statistical Capacity Building Project -- to be supported under the Bank's STATCAP -- will provide considerable resources to strengthen the statistical, monitoring and evaluation capacity. Details of this action plan, the timetable over which it will be implemented, and its expected outcomes will be included in the ERS.

2.5 Poverty diagnostics

Kenya has produced three poverty reports using the Welfare Monitoring Survey (WMS) data of 1992, 1994 and 1997. To improve poverty diagnostics, a poverty mapping has led to revised poverty profiles for all the districts. The poverty maps for all districts will be launched by the end of 2003. To improve on prior weaknesses of the WMS type of surveys, an Integrated Household Based Survey Program is already being put in place in order to harmonize and standardize poverty and other data for the purpose of comparability. The

survey program will ensure the regular supply of data needed to measure and monitor poverty.

(a) Determinants of Poverty and their evolution over time

Some of the characteristics of poverty include location (rural/urban), household size, level of education of head of household, gender (male vs. female headed households), agricultural output (cash crop farmers, subsistence farmers), access to land, ownership of livestock, selected durable farm tools. Other determinants that have been highlighted in participatory studies as impacting on household consumption include: low agricultural productivity and poor marketing; market distortions; insecurity; bad governance; corruption/exploitation by the more powerful; unemployment and low wages; land issues; poor infrastructure and inadequate roads; lack of resources and opportunity to access basic services; the cost of social services; the cost of education; HIV/AIDS; vulnerability; gender imbalance and disability; social and personal factors; natural/environmental factors; cultural and traditional beliefs; and unpredictable weather. Corruption--mismanagement and its pervasiveness, particularly in the 1990s--emerges as a major cause of poverty.

The Government, however, recognizes that there is still much to be done in terms of understanding the cause-effect relationships connected to poverty, and how successful interventions can be planned using poverty results.

(b) Gender Dimensions of Poverty

Social factors and cultural norms emphasize the unequal power status of men and women. Some traditions favor male dominance, resulting in low social status, and hence the need to empower women to make them less vulnerable to social ills and HIV infection.

Efforts are ongoing to mainstream gender in the Economic Recovery Strategy. Constraints, however, include lack of gender disaggregated analysis -- except for the fields of basic education and some areas of healthcare. Also, gender specific targets for defining improvements in the economic, social and legal situation are still lacking. The macroeconomic framework that forms the core of the Economic Recovery Strategy is analyzed in gender-neutral terms.

3. ALIGNING THE NATIONAL BUDGET PROCESS TO THE ECONOMIC RECOVERY STRATEGY

The government's public sector priorities are identified in the Letter of Development Policy (LDP) issued by the Minister for Finance. At the macro level, the overall policy framework focuses on achieving sustainable deficits at a revenue/GDP ratio of 22 percent, containing inflation below 5 percent, reducing the public sector wage bill and restructuring public expenditure to increase the share allocated to core poverty expenditures and development expenditures. The government is already taking actions aimed at improving the governance framework by focusing on judicial reforms and the implementation of the Anti-Corruption and Economic Crimes Act and the Public Officer Ethics Act and by passing and

implementing the Audit Bill, the Financial Management Bill and the Procurement and Disposals Bill among others.

Public sector reforms will focus on enhancing private sector participation, including setting a clear framework for privatization, while public sector reforms will continue to focus on rightsizing, pay reform, pension reform, and capacity building. At the same time, public expenditure reform will focus on institutionalizing an annual public expenditure review (PER), deepening the MTEF process, and ensuring that funds allocated to the core poverty programs are protected.

3.1 Public Expenditure Review

A comprehensive PER initiated in February 2003 to (i) assess how well the recommendations of the 1997 PER have been implemented, (ii) review expenditure trends for the fiscal years 1997/98 to 2001/2003, and (iii) highlight key issues in public expenditure efficiency and service delivery was finalized and published in July 2003. The 2003 PER covered eight ministries identified for their potential role in the poverty reduction function and the size of their budget. The outcome of the 2003 PER is being assessed to determine how well these can be translated into actions that will lead to initiating new public expenditure reforms, and current experience and lessons learnt will be utilized to roll out PER to all Government ministries during the 2003/04 financial year. The PER process will be institutionalized with a view to (i) evaluate the budget strategy and performance and (ii) undertake key analytical work required to further strengthen the public expenditure management system and operationalize the expenditure priorities of the ERS.

3.2 Pro-poor policies and the medium term expenditure framework

The government recognizes the need to re-orientate expenditures from consumption to investment (i.e., reduction from recurrent spending with a corresponding shift to development or capital formation related expenditures). In addition, the ERSWEC has indicated that for the economy to move into a sustainable growth pattern necessary to create employment and generate income leading to poverty reduction, there has to be heavy investment in physical infrastructure supported by good governance. The government also recognizes the need for provision of basic social services of which priority will be the provision of free primary education and basic healthcare services. The bulk of the poor live in the rural areas and their major source of income is from agriculture related activities, hence the need for support for agricultural activities through creation of a viable environment for the sector to grow. Accordingly, the resource allocation for the MTEF budget ranked the sectors as follows: physical infrastructure human resource development and agriculture and rural development, followed by others. The table below indicates the distribution of development resources by sector.

Table A: Development Budget (indicative sector shares)

Sector	Ranking	Percent Share 2003/2004	Projected Share 2004/2005	Projected Share 2005/2006
Physical Infrastructure	1	34.2	39.00	44.00
Agriculture & Rural Development	2	18.7	18.00	17.00
Human Resource Development	3	10.9	11.00	11.00
Others	4	36.2	32.00	28.00
Grand total		100.0	100.00	100.00

On the recurrent budget for the MTEF period, priority will be given to the provision for basic social services, particularly the provision of free primary education. Thus, *the* bulk of the resources will be to human resource development; (including the huge wage bill for teachers and doctors); followed by public safety, law and order; and agriculture and rural development. It should be noted, however, that although the physical infrastructure sector is the highest priority in the medium term, the recurrent activities of road maintenance are met directly through earmarked funds.

To safeguard the needs of the poor, who may be excluded from immediate gains of economic growth, measures have been taken to allocate and ring fence budgetary allocations that directly contribute to poverty reduction. In this respect, a comprehensive criteria for selection of core poverty programs has been developed and it includes measures that (i) increase incomes for the poor -- e.g., minor roads/access roads, agriculture services, and access to credit and financial services; (ii) improve the quality of life -- e.g., healthcare services, water, primary education, and environment management; (iii) improve security and governance, including protection of human rights; (iv) enhance administration of law and justice; (v) reduce wastage (accountability); (vi) strengthen security of people and property; and (vii) improve equity and equality, including access to employment opportunities as well as empowerment programs.

4. NEXT STEPS

The following are the key steps the Government expects to follow in the reform process:

- **Setting up the National Social and Economic Council (NESC) --** : which will serve as an advisory and/or monitoring body for the Economic Recovery Strategy and other policies.
- **Investment program for the ERSWEC --** : which will break down the activities identified in the implementation matrix of the ERS into more detailed activities that are designed in a logical framework to be monitored on a quarterly basis. The investment program will also include funding requirements that will enable the estimation of resource requirements and, hence, the financing gaps.
- **Adjustment of the macroeconomic framework --:** which will be adjusted to reflect expected priority shifts in the area of core poverty programs and investment projects with the overall thrust of macro policy focusing on stability. The current macroeconomic framework is consistent with that underpinning the proposed PRGF-

supported program and any revisions to current plans will be incorporated into the framework underpinning the PRGF-supported program.

The MTEF, adopted in 2000/01, will continue to guide the resource allocation process. To further strengthen the MTEF process, a review is planned in the month of September 2003. To increase the participation of all stakeholders, efforts have been put in capacity building, and participation of members of parliament (MPs) as well as parliamentary committees have been included in the MTEF calendar.

TIMETABLE TO COMPLETION

- Consultation with development partners on the ERS September 2003
- Consultative Group discussion on the ERS and donor pledging of support Nov/Dec 2003
- Finalization of the ERS, based on discussions at the CG meeting December 2003
- Submission of the final ERS to the World Bank and the IMF for joint staff assessment. December 2003