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EXECUTIVE BOARD MEETING

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June 30, 2023

To: Members of the Executive Board

From: The Secretary

Subject: **Kenya—Fifth Reviews Under the Extended Fund Facility and Extended Credit Facility Arrangements and Request for a 20-Month Arrangement Under the Resilience and Sustainability Facility, Requests for Extension, Rephasing, and Augmentation of Access, Modification of a Performance Criterion, Waiver of Applicability for Performance Criteria and Waiver of Nonobservance for a Performance Criterion, and Monetary Policy Consultation Clause; De Minimis Misreporting Resulting in Noncomplying Purchase and Disbursement and Breach of Obligation Under Article VIII, Section 5—World Bank Assessment Letter for the Resilience and Sustainability Facility**

Board Action:	Executive Directors' **consideration** (Formal)
Prepared By:	The staff of the World Bank
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Questions:	Ms. Teferra, AFR (ext. 37301) Mr. Amidzic, AFR (ext. 38069) Mr. Crispolti, AFR (ext. 36982) Mr. Gupta, AFR (ext. 37941) Mr. Rasmussen, AFR (ext. 35613)
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***The authorities have indicated that they consent to the Fund's publication of this paper.**

INTERNATIONAL MONETARY FUND

KENYA

June 30, 2023

FIFTH REVIEWS UNDER THE EXTENDED FUND FACILITY AND EXTENDED CREDIT FACILITY ARRANGEMENTS AND REQUEST FOR A 20-MONTH ARRANGEMENT UNDER THE RESILIENCE AND SUSTAINABILITY FACILITY, REQUESTS FOR EXTENSION, REPHASING, AND AUGMENTATION OF ACCESS, MODIFICATION OF A PERFORMANCE CRITERION, WAIVER OF APPLICABILITY FOR PERFORMANCE CRITERIA AND WAIVER OF NONOBSERVANCE FOR A PERFORMANCE CRITERION, AND MONETARY POLICY CONSULTATION CLAUSE; DE MINIMIS MISREPORTING RESULTING IN NONCOMPLYING PURCHASE AND DISBURSEMENT AND BREACH OF OBLIGATION UNDER ARTICLE VIII, SECTION 5

WORLD BANK ASSESSMENT LETTER FOR THE RESILIENCE AND SUSTAINABILITY FACILITY

A. Country Vulnerability to Climate Change Including Human, Social, and Economic Costs

1. Kenya is vulnerable to climate-induced natural disasters. The Notre Dame Global Adaptation Initiative (ND-GAIN) ranks Kenya as the 39th most vulnerable country to climate change (2020). A range of climate models forecast that Kenya's mean temperature will increase, with temperature increasing relatively more under a scenario in which there is no global decarbonization effort. Precipitation, in contrast, is forecast to fluctuate significantly, with the relative change in mean precipitation varying depending on the model. Climate change impacts vary spatially according to the biophysical conditions across the country and depend on where population and economic activities are concentrated.

2. Climate change is already a source of significant risk for Kenya. Estimates suggest that more than 70 percent of natural disasters in Kenya are attributable to extreme climatic events. These include major droughts that occur every ten years, and moderate droughts or floods every three to four years. The repeating patterns of floods and droughts in the country have had devastating socio-economic impacts. For example, the 2008–11 drought,

is estimated to have cost Kenya US$12.1 billion, including US$0.8 billion from the destruction of physical and durable assets and US$11.3 billion from losses across all sectors of the economy (Kenya Post Disaster Needs Assessment 2008-2011 Drought). Droughts have increased in frequency affecting more people with an estimated economic impact of 8 percent of GDP every five years. While droughts are often nationwide, the most severe impacts are felt in the country's highly arid zones, which encompass many of the poorest counties. Floods and droughts have resulted in episodes of acute food insecurity and loss of assets. Although Kenya's economy has grown rapidly and the incidence of poverty trending downward, one third of Kenya's population still lives under the international poverty line. This highlights that the country's development path toward reducing poverty and achieving prosperity will have to mitigate significant climate risks.

3. Kenya contributes less than 0.1 percent of global greenhouse gas emissions annually. In 1995, GHG emissions were estimated 56.8MTCO2e and increased to 93.7MT CO2e in 2015 and is projected, in Kenya's draft Long-Term Strategy, to reach 300MTCO2e by 2050 in a scenario of no intervention. Agriculture is the leading source of emissions (40 percent) due largely to enteric fermentation, followed by land use and land use change and forests (38 percent), transport (12 percent), energy (excluding transport) (6 percent), industrial processes (3 percent), waste (3 percent) and electricity (1 percent).

B. Government Policies and Commitments for Climate Change Adaptation and Priority Areas to Strengthen Resilience

4. Kenya's National Determined Contribution (NDC) embodies ambitious adaptation goals. With respect to adaptation, the NDC identifies water, agriculture, land use, forestry, energy, health, and infrastructure as priority sectors to focus adaptation efforts. the NDC also aims to ensure a climate-resilient society through mainstreaming climate change adaptation in the Medium-Term Plans (MTPs) and County Integrated Development Plans (CIDPs).

5. Kenya has developed a strong climate-related policy framework to deliver on its NDC. The main elements of this framework are: (i) the National Climate Change Response Strategy (2010), (ii) the National Climate Change Action Plans, (iii) the National Drought Management Authority Act (2016), (iv) the Green Economy Strategy and Implementation Plan (2016-2030), (v) the National Adaptation Plan (2017), and (v) the National Climate Change Act (2016). The Climate Change Act provides a framework for promoting climate resilient and low carbon economic development and establishes the key institutions in charge of monitoring and implementing the climate change agenda. The act also describes the measures and mechanisms that shall be included in the National Climate Change Actions Plan, whose overarching objective is to pave the way for sustainable, low-carbon, climate-resilient development.

6. Kenya is well placed to further strengthen the institutional framework for resilience. Kenya ranks 154th out of 181 countries in terms of readiness to leverage investments and convert them to adaptation actions (ND-GAIN, 2020), which highlights the scope of challenges that Kenya needs to address. The main focus areas for further institutional strengthening include: i) improved fiscal financing for adaptation projects (including through operationalization of the Climate Change Council and the National Climate Change Fund) with a focus on sectors that are underfunded, such as agriculture, forestry and land

use, transport, and water management; ii) improved alignment between the MTPs and CIDPs regarding the mainstreaming of the climate agenda to ensure integration between sectoral goals and county development priorities; iii) understanding better the risk exposure of local communities, engaging them in strengthening resilience, making adaptation a core component of CIDPs, and prioritizing the resilience of local communities in national and county-level development planning and implementation; iv) improving coordination arrangements to integrate the National Environmental Management Authority and the National Drought Management Authority into the consultation and coordination process, and eliminating overlaps in mandates across entities and levels of government (such as significant overlap in mandates and duplication of efforts between regulatory state-owned enterprises in key climate-related sectors, which hampers the effectiveness of the climate change strategies).

7. Going forward, several actions that are feasible and can generate relatively more climate and development benefits in short- to medium-term warrant prioritization. Actions related to agricultural productivity, expansion of irrigation, climate-proofing critical infrastructure links, health, waste management, forest resource management and restoration are expected to substantially support the country's resilient growth and development objectives.

C. Government Policies and Commitments in for Climate Change Mitigation and Priority Areas to Reduce Greenhouse Gas Emissions

8. The updated NDC targets a 32 percent reduction in GHG emissions by 2030 relative to a business-as-usual scenario of 143MtCO2e, compared to 30 percent in the first NDC. It identifies energy, industrial processes and product use, agriculture, forestry, waste, and land use as key sectors where mitigation efforts will be focused. Overall, estimates of Kenya's carbon intensity are lower than that of many other countries in sub-Saharan Africa and have been relatively constant between 2010 and 2019. Kenya is well on its way to achieving a fully green grid by 2030. It already has a diversified, low-carbon power generation mix, with about 93 percent of electricity being generated from clean sources, including geothermal, hydro, and wind. Installed power generation capacity currently stands at 3,121MW compared to peak demand of 2,128 MW. Fossil fuel-based generation (thermal capacity) has been declining from about a third of the installed capacity (contributing to about 20 percent of generation in 2015) to about a fifth of the installed capacity and contributing only to around 10 percent of generation. Development of geothermal, wind, and solar power generation has enhanced energy security and significantly reduced the weather-induced supply shortages typical in systems with a large share of hydro. Kenya is now also connected to regional hydropower resources with the commissioning of the Kenya-Ethiopia Interconnector, giving impetus to regional energy trading through the Eastern Africa Power Pool. At current costs Kenya has a unique opportunity to meet its electricity needs almost entirely from green energy sources and at affordable costs soon which significantly contributes to maintaining a low-carbon development path.

9. Going forward, the bulk of Kenya's emissions reduction target under its NDC will be achieved by increasing forest cover. The government has introduced a program to increase tree cover to 10.6 million hectares, up from the current level of 7.2 million hectares. Based on an analysis of restoration potential, this new target is achievable and could position Kenya to not only meet its NDC commitments,

but also use landscape restoration to move closer to a net-zero target and potentially offer carbon credits on international markets. Notwithstanding these benefits, several key measures will need to be in place to ensure that forest restoration results in sustainable gains, including improving agriculture productivity, lowering demand for biomass-based energy for cooking, boosting security of tenure, and putting in place incentives and mobilizing financing for these activities including via carbon markets. With respect to biomass-based energy, a more concerted and accelerated effort is needed to transition households to more sustainably produced and cleaner fuel options. Kenya's reforestation efforts also require improved agricultural practices as conversion of forests for agricultural expansion and livestock grazing significantly contribute to forest degradation. Integration of climate considerations into the implementation of the Agricultural Sector Transformation and Growth Strategy 2019–2029 can augment the agriculture sector's resilience and productivity while contributing to Kenya's emissions reduction target.

10. Ensuring that emerging and expanding cities maintain a low-carbon footprint is another priority in Kenya's mitigation agenda. Kenya would benefit from developing a comprehensive enabling national urban transport policy framework that can define the government's role in public transport management, address a clear direction to manage urban mobility in the country, and guide the financing framework for urban mobility. Furthermore, a low-carbon development path should be well articulated in the updated National Integrated Transport Policy. Availability of green and reliable public transport system and safe and secured walking environment in urban areas will have a strong impact on GHG reductions. Low-carbon transport system in urban areas should prioritize developing an integrated multi-modal public transport system and network/ improving public transport and non-motorized transport (sidewalk and bicycle lane), shifting from a car-centric to people-centric approach. Adopting battery electric vehicles (BEV) in conjunction with the development of mass rapid transit will contribute significantly to Kenya's decarbonization agenda. In addition to the transport sector, efforts to apply low-carbon approaches in supplying affordable housing in urban areas is another priority. Importantly, more resilient, and greener cities will require high levels of human, technical and financial resources and should ensure they institutionalize knowledge and support participatory governance

D. Other Challenges and Opportunities

11. Strengthening Policy and Institutional Structures for Addressing Climate Change. Kenya has developed a strong climate policy framework, including a Climate Change Act. Institutionalizing this effort requires fully operationalizing the climate policy planning and implementation framework and making the existing institutional coordination mechanisms fully functional. Key actions for operationalizing a whole-of-government approach to implementing the climate policy framework are: (i) incorporate the NDC targets into the MTPs, sectoral plans, and urban plans; (ii) provide guidance in Budget Circulars for aligning proposed programs and projects with the NDC targets; and (iii) streamline and strengthen the monitoring and evaluation of climate targets. Advancing implementation of the established institutional coordination platforms to address implementation challenges related to limited horizontal (between government agencies) and vertical coordination mechanisms (particularly for sectors decentralized as part of the Constitution) would benefit from: (i) operationalizing the National Climate Change Council and Climate Change Units and (ii) elaborating the governance, resource mobilization, and investment arrangements for the National Climate Change Fund and the County Climate Change Fund.

12. Climate change as a cross-cutting public finance issue. There has been progress in aligning the budget with climate change strategies and providing information on climate-related objectives, but specific climate targets and indicators could be further incorporated into the performance contracts of public sector budget units and public entities in charge of implementing climate-related programs. More work is needed on systems of internal controls to ensure compliance with climate-related expenditure, particularly in the Integrated Financial Management Information System. Although the public investment management framework requires environmental and social impact assessments for public investment projects, it does not integrate provisions for climate disaster risk screening. And although the authorities are developing a Sustainable Procurement Framework, it has not yet been integrated into procurement regulations. The public procurement framework does not include climate-responsive procurement guidelines and principles, and there is no comprehensive data to inform understanding the extent to which public procurement advances or impacts climate and sustainability objectives.

13. Accessing carbon markets for expanded green finance. Several sectors of Kenya's economy could generate credits for carbon markets, including forestry, blue economy, agriculture, buildings, energy, and transport. Further, enabling carbon credits of high quality could favorably position Kenya in carbon markets. At COP27, Kenya announced its commitment to scaling voluntary carbon markets. Kenya is one of the African countries expected to benefit from the new Africa Carbon Markets Initiative, which aims to support the rapid growth of carbon credit generation and associated jobs. Bilateral carbon trades under the Paris Agreement could potentially provide substantial revenues for Kenya, particularly if prices reflect the opportunity cost of additional mitigation action. Through a recent amendment to the Climate Change Act, Kenya has outlined a framework for decision-making related to participation in carbon markets. Capitalizing on carbon markets, however, will require the Government of Kenya to finalize the formulation of a robust legal framework to provide the necessary legal basis for carbon markets and to operationalize the legislation. In parallel, to benefit from the potential in carbon markets, Kenya will need to ensure the environmental integrity of its carbon credits. This will require development of the necessary infrastructure for measurement, reporting, and verification systems and registry infrastructure.

E. World Bank Engagement

14. The World Bank has an active portfolio of financing and technical assistance to help Kenya in implementing its climate commitments. The climate elements in the World Bank's portfolio span a range of key sectors from agriculture to blue economy, energy, urbanization, water management, and social protection. The World Bank is providing financing through a mix of project finance and budget support. The World Bank is also supporting the strengthening of the government program that enables devolution of climate action via the Financing Locally Led Climate Action Program for Results.

15. There are several other projects under preparation that include significant climate elements. This includes projects in the transport sector, energy, landscape restoration, and health. The World Bank is providing analytical and technical assistance of a range of climate change related issues including on greening the PPP pipeline, carbon markets and climate finance, landscape restoration, irrigation expansion, green jobs, greening housing development, etc.

16. The World Bank is also finalizing the Country Climate and Development Report for Kenya. The report integrates climate change and development considerations to help to prioritize the most impactful actions for boosting adaptation and maintain low emissions, while delivering on broader development goals.

Table 1. Kenya: Active Operations Producing More Than 20 Percent Climate Co-Benefits

- Kenya Urban Support Program
- Kenya: Off-grid Solar Access Project for Underserved Counties
- KenGen Guarantee Program
- Marine Fisheries and Socio-Economic Development Project
- Kenya Social and Economic Inclusion Project
- E-National Ag. and Rural Inclusive Grow
- Kenya-Climate Smart Agriculture Project
- Second Kenya Informal Settlements Improvement Project
- Accelerating Reforms for an Inclusive and Resilient Recovery DPF
- Financing Locally Led Climate Action Program
- Additional Financing for Coastal Region Water Security and Climate Resilience Project
- Accelerating Reforms for an Inclusive and Resilient Recovery DPF 2
- National Agricultural Value Chain Development Project (NAVCDP)