REPUBLIC OF KENYA

Budget Speech

For the

Fiscal Year 2004/2005

(1st July – 30th June)

by

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(1st July, 2004 to 30th June, 2005)

Mr. Speaker Sir,

I beg to move that Mr. Speaker do now leave the chair.

INTRODUCTION

Mr. Speaker, as I present the 2nd budget of the NARC Government, let me remind this August House that the NARC Government inherited an economy that had stagnated for well over a decade; with the resultant incidence of chronic poverty, declining social and economic infrastructure, and an unfavourable international image. The last one-year has therefore been a period of laying a new foundation on which to build a better and more prosperous Kenya.

Mr Speaker, as we approach the new fiscal year 2004-2005, the economy is gradually recovering from one of the longest and most devastating recessions. In 2003, real Gross Domestic Product (GDP) grew by 1.8%, up from 1.2% recorded in 2002. This growth lays a firm foundation on which we can build better performance. For this reason, Government policy in the immediate to medium-term, is to consolidate economic gains and accelerate growth. This endeavour will be broad based to encompass the fight against corruption and bad governance while enhancing reforms. In addition, Kenyans will need to redouble their efforts to improve work ethics and increase productivity. These attributes are critical to accelerating economic recovery, reducing poverty and increasing employment.

Mr Speaker, both regional and world economic recovery is proceeding faster than earlier anticipated. In 2004 global economic growth is projected to rise to 4.6%, compared to a growth rate of 3.9% in 2003. It is then expected to level off at 4.4% in 2005. In Sub-Saharan Africa, economic growth is expected to strengthen to 4.5% in 2004 and rise to 5.7% in 2005. With a few exceptions, inflation is projected to remain subdued, mainly below 2% and single digit in most other countries. However, in spite of the good news, the world economy remains vulnerable. **First**, the sudden surge in growth has increased demand for fuel oils resulting in high prices. **Second**, due to acts of terrorism both in Europe and Middle East, oil prices have risen to record high levels. These developments have enormous potential for spillover. Should the situation deteriorate further, oil prices are likely to cause inflationary pressures while rising world terrorism will continue to affect growth of the world travel and tourism.

Mr Speaker, Sub-Saharan Africa's economic growth provides reason for optimism. For the first time in many years, the region has had few cases of armed conflict while the macro-economic environment is not only good but also improving. The rate of inflation remains low and is actually declining in the region. The New Economic Partnership for African Development (NEPAD) is making good progress in its effort to improve economic governance that, in turn, enhances the flow of resources into the continent. In East Africa, in spite of occasional setbacks, we have progress towards a Customs Union. We also expect strong growth prospects from peace initiatives in the Great Lakes and from the recent peace agreement in Southern Sudan. All these developments provide hope for accelerated economic growth in the region.

DOMESTIC ECONOMY

During the year 2003, domestic output picked up fueled by **6.4%** growth in total domestic credit, of which, credit to private sector grew by **1.8%,** compared to **2.5%** decline in 2002. Agricultural sector grew by 1.5%, up from a poor 0.8% in 2002 while manufacturing grew by 1.4% compared to 1.2% in 2002. The service industry provided the lead with major areas of growth in mobile phone services where active phones more than doubled in 2003, rising to over 2.7 million compared to 2002; cargo throughput, at the Port of Mombasa rose by 12% while containerized cargo grew by 24.5%. In financial sector, commercial banks recorded significant recovery due to measures we have taken together with a stable macro-economic situation. As a result, pre-tax profits in financial sector, increased by 65.9% in 2003, compared to 2002, while bad and doubtful debts, reduced by about 5.8% during the year. The building and construction grew by 2.2%, and real estate by 3.0%, suggesting a general upturn in the economy.

Though, tourism services continued to suffer from negative travel advisories issued by the USA on account of what they perceive as high security risks, earnings from the sector increased by 18.6% over 2002. The sector is therefore struggling to regain lost ground by promoting domestic and conference tourism to boost earnings.

During the year money supply expanded by 13.2% compared to 8.6% in 2002 while net foreign assets grew by 19.8% to Kshs.125.1 billion, while overall inflation rate remained in single digit with average underlying inflation increasing from 2.6% in 2002 to 3.6% in 2003. Throughout the year, interest rates remained on a downward trend, driven, mainly, by falling 91 day Treasury bill rates which reached a record low on 22nd

September at **0.8%.** Similarly, the 182 day bill rate fell to **1.3%.** This decline affected deposit and inter-bank rates, with the monthly inter-bank rate falling below **1%** in January, 2004. Deposit rates declined to **3.1%,** in January 2004, down from **4.7%** in January 2003. Correspondingly, average lending rates fell from **19%** to **13.6%.**

The overall balance of payments increased by Kshs.31.4 billion and remained in surplus throughout 2003, and the current account deficit improved to a surplus of Kshs.4.8 billion. This resulted from increased tourism earnings and grants inflows from abroad. The capital account recorded an increase of a surplus of Kshs.40.5 billion. These developments led to increased foreign exchange reserves of Kshs.104.7 billion, equivalent to 4.2 months of imports cover. This compares favourably to Kshs.74.7 billion or 3.3 months imports cover, in December 2002. However, the deficit in merchandise account widened with value of imports rising by Kshs.24.1 billion while exports increased by Kshs.13.9 billion. It is however encouraging to note that the rise in imports value was mainly due to importation of capital goods, plant and machinery, transport equipment and oil products, which go into production. This gives us comfort that economic recovery is firmly on the way.

Mr. Speaker, in 2003 value of exports rose by 8.2% from Kshs.169.28 billion to Kshs.183.15 billion. Though the volume of coffee exported rose by 18.5% prices fell by 3.9%. In case of tea, the volume declined by 3.9% while prices fell by 4%. The combined effect was a marginal decline in export-value for both coffee and tea. However, the volume of horticultural exports increased by 31.6% but prices declined by 2.7%. As regards the exchange rate, the shilling appreciated marginally against the dollar but lost ground against both the Euro and the sterling pound thus improving competitiveness of Kenyan goods, to the Euro Area and UK. In general, the shilling depreciated moderately against the major currencies.

Mr. Speaker, I do not intend to analyze the performance of the domestic economy any further. Hon. Members have already received their copies of the Economic Survey for 2004, which provides details on all sectors of the economy. I encourage them to read this document as it forms an important background to fiscal and economic measures, which I will be discussing later.

RELATIONSHIP WITH DEVELOPMENT PARTNERS

Mr. Speaker, As Hon. Members will recall, when NARC assumed leadership, our relations with development partners were at the lowest ebb. Following extensive consultations, we were able to reach agreement with the IMF on a Poverty Reduction and Growth Facility (PRGF**).** On November 21, 2003, which paved the way for restoration of healthy relations with other donors. Building on the PRGF, the Government held a successful Consultative Group (CG) Meeting with development partners, in late November, 2003, which was significant in many ways. **First,** it was the first CG, for over a decade; **second,** it took place within the first year of NARC Government in power; **third,** it was the first CG to be attended by Kenyans from all walks of life, **finally** and more importantly, the meeting generated pledges amounting to about US Dollars 4.1 billion, over a three year term. Since then, we have worked with various partners to agree on their financing programs and projects and in majority of most cases, have agreed on funding levels. We therefore expect better resource flows in fiscal years 2004/05.

Mr. Speaker, I invite the Hon. Members to join me and record our gratitude to the development partners for this support. I also wish to appeal to the development partners to facilitate faster disbursement of the pledged funds to enable the Government finance the planned development programmes. On its part, the government will ensure these resources are properly and efficiently used to benefit the target groups. In this regard, the Government will continue to demonstrate strong political commitment to good governance, sound economic management and zero-tolerance to corruption.

Mr. Speaker, that development partners are important to our development effort cannot be over emphasized. **First,** the Bretton Woods Institutions are considered the world opinion setters. Therefore, reaching a working agreement with them is necessary for attracting foreign direct investments. **Second,** many bilateral donors require a country to have a program with IMF before they can extend certain types of financial support, such as budget support. Consequent to reaching agreement with the IMF, the Government has successfully negotiated bilateral assistance for various projects and programmes covering wide sectors of our economy. The government has also received substantial assistance for human capital development, (especially for healthcare services, and the on-going free primary education program). As Hon. Members will agree, improving access to healthcare while providing free primary education will substantially improve the quality of national human capital, raise labour productivity and reduce poverty. To all those who have supported and continue to support us, we thank you most sincerely.

POLICY STRATEGY

Fiscal Policy Management

Mr. Speaker, the three countries of the EAC have already agreed on the structure of a Common External Tariff (CET), which will be implemented effective 1st January, 2005. Consequently, the Budget for fiscal year

2004/05 has been prepared against this backdrop. I have therefore taken the agreed principles, in consideration, when evaluating requests for import duty and other tax incentives. Where the requests to reduce or raise import duties were inconsistent with the agreed tariff structure, this could not be accepted. In addition, the direct revenue loss, due to lowering of the top customs tariff rate from 35% to 25% will be high, exceeding Ksh.6.4 billion a year, and no less than Kshs.3.20 billion for the six months of fiscal year 2004/05. This is mainly, due to applying lower tariff on import value, and **second,** on account of reduced taxable value for both excise duties and VAT.

Arising from these revenue implications and on-going expenditure commitments, I will have to operate within very hard budget constraints. I therefore have had to be very cautious when considering requests for both tax reductions or higher budgetary allocations. Under the circumstances, I have only made adjustments in those areas where the situation is desperate and needs to be addressed as a special problem. As Hon. Members will no doubt appreciate, that once a country joins a common market, fiscal flexibility on cross-border taxes gets significantly limited.

The other fiscal implications of entering into a common market is the need to observe the principle of fiscal harmonization. Already, the three countries have agreed, to harmonize fiscal incentives in the region. When the structure and types of incentives, acceptable in the region, is agreed, this will no doubt have effect on some of our local investors. For these reasons, it has not been possible to add to existing fiscal incentives. Indeed, many of the incentives, especially those falling under the Customs and Excise Act, will need to be removed once the draft East African Custom Management Act comes into force on 1st January, 2005. The draft law does not provide for most of the existing incentives, discretionary duty waivers, and provisions relating to the excise duties, which are considered domestic taxes. Kenya will, therefore, need to enact a stand alone Excise Act.

Expenditure Management

Mr. Speaker, as Kenyans will appreciate, the country faces many challenges, which require financing, but resources are severely limited, necessitating better targeting and prioritization and efficient use of the little that is available. Given the added competition from the large stock of pending bills accumulated and carried forward by the previous regime, hard choices will need to be made. In addition, the budget 2004/05 has been prepared at a time when there is heightened security concerns all over the world. As a result, countries are urged to enhance their overall security, especially in areas more prone to terrorism. In response, we have had to improve security in these areas particularly at airports and international ports and related facilities. Understandably, Recent terrorist attacks in Europe and elsewhere in the world, have pushed these security worries a notch higher. Therefore, Kenya, like all other countries has improved security in these areas to international standards and will sustain them on a continuous basis.

Mr. Speaker, in a globalized market, we cannot afford to raise the level of taxation without affecting the investor confidence. This is because investors have choices, including relocation to other common market countries, which could hurt our other policy objectives. I have taken these factors into consideration and prepared, the Budget for Fiscal Year 2004/05 with the following objectives; to: (i) consolidate and accelerate economic growth, building on achievements realized in 2003, (ii) sustain macro-economic stability, (iii) stop accumulation of pending bills and reduce them, (iv) enhance efficiency in the use of public resources, (v) sustain and expand the core poverty expenditures. To achieve these objectives, accounting officers will be required to; (a) ensure that no new expenditure arrears or pending bills are accumulated; (b) give the genuine pending bills in their ministries bills first priority; and (c) ensure provisions for core poverty programmes are maintained and increased in 2004/05. To attain these objectives we need to be more selective and efficient with the available resources. It is for these reasons that I have chosen the theme for the budget this year as "**Enhancing Efficiency for Accelerated Economic Growth**".

Accumulated Arrears and Contingent Liabilities

Arrears

Mr. Speaker, the government is concerned with the large stock of unpaid arrears still outstanding. We believe it is not possible to regain overall control over public expenditure until we institute a system to capture and control these obligations. Towards this end, the Government will put in place a system to capture all forms of expenditure commitments, by the public sector, including those from the financial sector and local authorities. For this reason, commercial banks, and financial institutions will be required to report, to the Central Bank, all deposits and borrowings by the public enterprises. The Central Bank will collate this data and report to the Treasury on regular basis.

It will also be necessary to ensure that arrears arising from day to day operations, are captured and reported. It will be the responsibility of accounting officers to ensure these obligations are captured and reported across the public sector. This data will form part of regular expenditure monitoring system. Where an enterprise has borrowed money under Government guarantee, the arrears will be reported separately as part of government contingent liabilities. The information to be reported will include; (a) total loans borrowed by an enterprise, and the purpose for which taken; (b) details of non-performing loans, (c) reasons for failure to service the obligation, and actions taken to regularize the payment, (d) details of debts owed to third parties in private sector, (e) details of moneys owed to other public bodies including tax arrears and reasons why not paid, and (f) debts owed to that particular enterprise by other public bodies, the rest of the economy, and efforts taken to collect them.

Contingent liabilities

Mr. Speaker, these are financial obligations which the Government can bear arising from undetermined commitments such as guaranteed debts, unfunded public sector pensions or similar commitments. In order to plan for likely costs associated with these liabilities, Treasury is updating information on potential risks from these sources, including conducting actuarial valuations of the public pension systems. However, as salaries and wages, in the public sector, are raised, various pension systems in this sector rise too. In order to control escalation of pension costs, the Government will introduce employee pension contributions in the next financial year. In the meantime, accounting officers, and the respective chief officers of enterprises which fell under them including local authorities, will need to ensure corrective action is taken in all areas.

Mr. Speaker, the Government is seeking to prevent recurrence of expenditure arrears and minimize risks of rising contingent liabilities. Part of this strategy requires strengthening financial management across the entire public sector. The accounting officers in line ministries will have primary responsibility to ensure this is done. However, the Chief Executives of public enterprises and heads of local authorities should bear responsibility too, to ensure sound management of resources under their care. In addition, every public officer who is responsible for either revenue collection or expenditure must appreciate the fact that resources are scarce and must be managed well.

FINANCIAL SECTOR

Mr. Speaker, in my Budget Proposals last year, I introduced several measures to support reforms in the financial sector. These included; (a) reduction of the mandatory cash ratio requirement from 10% to 6% and its extension to include foreign currency deposits (b) reduction of the minimum core capital requirement to Ksh 250 million and Ksh 200 million for commercial banks and Non-Bank Financial Institutions respectively. These measures have led to significant declines in lending interest rate, from a weighted average of 19% in May last year to 12% in May this year. They have also led to increases in credit to the private sector from 5% in

May 2003 to 11% in May 2004 providing the impetus for economic growth from 1.2% in 2002 to 1.8% in 2003. I also introduced transparency and improved governance in the banking industry by invoking provisions Section 44 of the Banking Act. This has enabled the Central Bank access information on bank interests and other charges to the benefit of savers and borrowers. By publishing the lending interest rates, charges and tariffs of all commercial banks and non-bank financial institutions, this has enhanced competition among banks, and reduced costs for delivery of financial services to Kenyans.

Mr. Speaker, as will be recalled in my Budget Speech last year, I dwelt at length on the problems of the financial sector, especially cost and access to credit. I also discussed the need to strengthen this sector to enhance its contribution to our Economic Recovery Strategy, accelerate income generation, create jobs and reduce poverty. Today, I expound on a comprehensive Financial Sector Reform Strategy, which will be implemented in order to achieve key objectives of improved affordability, stability, efficiency and access. In a bill published today, I have proposed major changes to the Banking Act which include transfer of operational and licensing powers from the Minister to the Central Bank. In accordance with best practices and Basel Accord, significant shareholders will be subject to vetting by the Central Bank. Other aspects of this strategy include:

Operations of Section 44 of the Banking Act

Section 44 of the Banking Act as presently formulated only gives the Minister power to deal with approval of increases to the rate of banking and other charges but not to look into past or new charges. I propose to amend this section to enable the Minister deal with the charges more comprehensively, both the existing and introduction of new charges. In the past, failure to invoke this section led to proliferation charges. However, the proposed amendments to this section will provide a lasting solution to the problem of escalating charges. The amendment will also give the Minister power to determine whether past charges are appropriate. While interest and other banking charges will continue to be determined by market forces, all financial institutions will be required to regularly communicate all changes in interest rate and other charges to their customers before effecting any changes. The proposed amendments will ensure customers are fully informed of charges levied on them.

Central Bank of Kenya (Amendment) Act 2000

As will be recalled, the Central Bank of Kenya (Amendment) Act, 2000 was a reaction to frustrations with unreasonable escalation of bank charges. The practice of escalating penal charges when a loan stopped to perform was such that if a customer borrowed Ksh.10 million, it was possible for the debt to escalate to Ksh.100 million. Following extensive consultations, I have proposed amendments to this Act to introduce the "In Duplum" Rule, which safeguards interests of borrowers. In its purest form, this Rule seeks to stop bankers from continuing to load customers with interest charges on a debt that is clearly non-performing. It is a common law principle well established in such countries as the Netherlands, South Africa and Zimbabwe. Under this Rule, the maximum amount a bank can claim from a non-performing customer is capped and interest charges cannot exceed the principal amount outstanding at that time when the loan stopped to perform.

Mr. Speaker, in short and long term loans, interest is calculated on reducing balance, on outstanding principal, and not on the original principal. Should a debtor stop servicing the loan at some point, the in duplum rule applies to the outstanding principal at that point and not the original debt. When enacted by this August House, the "In Duplum" Rule will inhibit growth of non-performing loans and freeze interest charges so that they will not exceed the outstanding principal. The proposed amendment will address the concerns and intentions of the Central Bank of Kenya (Amendment) Act 2000, in full. It will also have the added benefit of encouraging banks and financial institutions to resolve problems of non performing debts early. Thus, the proposed amendment will not protect those who fail to pay, it will only protect them from unreasonable charges.

Mr. Speaker, in line with increased transparency, I have proposed amendments to the Central Bank Act to establish a Monetary Policy Advisory Committee.

Monetary Policy

Our monetary policy for the FY 2004/05 Budget, requires the Central Bank to implement a monetary programme that allows money supply to grow by 8%. This policy stance is predicated in underlying inflation being no more than 3.5% per annum to ensure that (i) Kenya's exports remain attractive to foreign buyers, and (ii) domestic producers are not faced with stiff competition from cheap imports. This level of money supply expansion will allow credit to the private sector to expand by around 13.5% per annum which is enough to support real GDP growth of about 3.0%. I also expect the Central Bank to maintain official foreign exchange reserves at the current level, equivalent to 4.1 months of import cover. This, is expected to allow the Government to (i) meet its official external debt service obligations, and (ii) to stem off currency speculation in the event this does occur.

The Bank Rate

In the last budget for fiscal year 2003/04, I promised to introduce a neutral instrument to replace the Treasury bill rate as the benchmark interest rate for banks and non bank financial institutions. As was indicated, a neutral bank rate was considered necessary to serve as an interest rate signal to the banking system. Following this announcement, the Central Bank commissioned a study to develop the neutral instrument and is in the process of consulting with stakeholders while reviewing experiences of other countries with similar policy. To enable the Central Bank incorporate the Bank Rate as an instrument of monetary policy, I propose to amend the Central Bank of Kenya Act to introduce Bank Rate and to set the stage ready for its implementation. When operational, I expect the bank rate to be the reference prime rate maintained by any bank, in respect of loans, advances, or other financial facilities granted to its customers. Similarly, I will expect banks, mortgage companies, and building societies to maintain their savings rates applicable to longer terms savings deposits, to be at a level which reflects a positive return against annual average underlying rate of inflation.

National Payments System:

Mr. Speaker, globalization requires us to develop our payments infrastructure to achieve an efficient, safe, and reliable national payment and settlement systems. We therefore need an appropriate legislation. Towards this end, I propose to table in this August House, the National Payments System and the Electronic Funds Transfer bills before the end of this fiscal year 2004/05. I also propose to amend the Bills of Exchange Act, Cap 27 to further enhance the payments system. This amendment will facilitate introduction of Cheque Truncation System (CTS), which enhances banks' efficiency by reducing transportation and microfilming costs of cheques. These changes are necessary to enable banks keep up with cutting-edge practices and subsequently realize improved operational efficiency in the payment system, which reduces clearing period for cheques.

Bank Restructuring

In order to accelerate the bank-restructuring programme, I intend to re-capitalise and re-structure the National Bank of Kenya for eventual privatisation and to privatise Consolidated and Industrial Development Banks. This acceleration of the restructuring programme taken together with introduction of the "In Duplum" Rule and the establishment of Credit Reference Bureaus should significantly reduce the incidence of NPLs in the banking system. I have also gazetted the regulations for the sharing of information by banks that will go a long way in reducing the risk of default as perceived by commercial banks and significantly reduce the lending interest rates.

Corporate Governance:

Mr. Speaker, improved corporate governance, integrity and competence in the running of the financial affairs is critical for safety, soundness and success of the financial sector. It is for this reason that I propose to enhance corporate governance in the banking sector by requiring continuous vetting of chief executives, directors and significant shareholders of banks and financial entities prior to assuming responsibilities. I have also proposed amendments to restrict lending to any one shareholder to no more than 25% of the core capital. In future, vetting for being fit and proper will include chief executives and members of the boards of all regulatory bodies in the financial sector.

Anti-Money laundering

Mr. Speaker, the Government is well aware of the dangers and negative effects posed by the money laundering menace. The fight against money laundering arises from the serious adverse effects this vice imposes on the economy and the people if it goes on unchecked. The problem with money laundering is that it seeks to legitimize the proceeds of crime and facilitates high-level corruption. Since commercial banks and other financial institutions are the first port of call for money launderers, strong defences against this menace must, of necessity start within the financial sector. It is for this reason that I propose to table, before this House, the Proceeds of Crime and Money Laundering (Prevention) legislation for quick enactment at the earliest date possible.

Micro Finance

In last year's budget speech, I promised to table in Parliament the Micro-Finance Bill within the fiscal year 2003/04. Unfortunately, this was not done due to unavoidable circumstances. However, we have worked on a draft, which has been availed to the Attorney General for finalization before presentation to this House.

Mr. Speaker, the measures we introduced in the last Budget have helped stabilize the financial sector and improved its capacity to service the economy. However, there is still a lot, which remains to be done in the areas of affordability, stability, efficiency and access.

Affordability

Though the cost of credit has declined, to sustain low costs on long-term basis, we need to pay special attention to increasing domestic savings. To increase savings and loanable funds, we need to maintain sound fiscal and monetary policies. For these reasons, we will continue with efforts to improve and maintain a sound financial sector so that it can expand its capacity to lend at affordable rates. Thus a healthy and profitable financial sector is key to providing affordable credit.

Stability

Mr. Speaker, the Government is fully committed to avoiding a repeat of major macro-economic instabilities of the past which caused chronic disruptions in the financial sector that resulted in many bank failures. The major characteristics of that situation were, high fiscal deficits, excessive domestic borrowing, high inflation and political interferences in banking sector. We have now learnt our lesson well and know that whatever short-term gains and advantages the past phenomena may have provided, in the long-term, they failed miserably, to provide lasting solutions. Kenyans have paid and continue to pay a very high price, both in budgetary and economic costs, for the financial indiscipline of the 1990s. We are all familiar with the large stocks of pending bills, non-performing loans, and poor capitalization, which plagued some of our key banks and development financial institutions for a long time.
Due to these malpractices our banks have had to work harder to survive. Fortunately, **Mr. Speaker,** all is not lost, we have restored financial stability during the last eighteen months, which is unleashing a commendable competitive process. We have seen innovations in commercial banks leading to advertisement for loans, a situation which only eighteen months ago was unthinkable. We also see a range of attractive products offered to smaller producers and households which suggests that if they sustain this stability, we expect to see more benefits going to the credit seekers and the economy.

Efficiency

Recent studies by the government, in conjunction with the development partners, have shown that by international standards, many of our established institutions are largely inefficient. Consequently, their operating costs are higher than they ought to be resulting in high interest and other charges to their clients. These studies have shown that high banking costs lead to high interest rate spreads but with no "quick fix" to this problem. We therefore need several approaches to solve the problem of inefficient and high cost banks. **First,** to remove any redundant legal and other controls which raise costs on banks, but without compromising on sound regulation or the Basel Core Standards. **Second,** improve operating environment while easing on areas which raise operating costs, e.g. hindrances to enforcement of collateral. **Third,** encourage banks to be much more transparent in their charges, while simplifying the structure of charges and sharing information with their clients, and making it easier for clients to change from one bank to another. **Fourth,** encourage banks to share information more readily, with each other and regulators.

Improving Access

Mr. Speaker, in some aspects, international experts advise that, compared to most African countries, the Kenyan Financial Services are good though there is room for improvement. In particular, experts note significant contributions made by over ten thousand co-operatives and four thousand SACCOs, which have about four million members. This compares favourably with two million people with accounts in formal banking sector. Added to these is the role of the Post Bank with its million account holders. However, with a population of over thirty million people, majority of Kenyans do not have access to financial services while some areas of the country have no commercial banks outlets. Unfortunately, previous efforts by the government, to extend mainstream banking through administrative decisions had limited success and were partly responsible for poor performance of government related banks. To avoid past mistakes, there is need for a more sustainable strategy which combines, micro-finance institutions, SACCOs and Post Savings Bank as the bottom end financial institutions. Once penetration takes root, the mainstream banks will join in with appropriate products and down-stream financial services.

Mr. Speaker, enactment of the SACCO Act is expected to extend financial services and to improve their effectiveness. It is, however, critical that the operating standards, including corporate governance are improved. As is well known, SACCOs are built on public confidence and must be encouraged to maintain their credibility at all times in order to increase the level of savings. The strategy for widening and deepening financial service, to promote economic growth and reduce poverty encompasses legislation, regulation and supervision of the whole spectrum of financial services. It seeks to improve and extend the upper end of this sector, which is served by banks and non-bank financial institutions. At the lower end, it will endeavour to improve the role of micro-finance institutions and SACCOs to provide a continium and lay the foundation for a strong and vibrant financial sector capable of driving the economy forward.

Under the new strategy, while the Government may continue to own development financial institutions, such as AFC, these will be operated with greater financial autonomy and discipline. Both Chief executives and senior management will need to be professionally qualified and people of proven integrity. There should be people who can apply commercial rules with accountability, transparency, and practices which are robust in private business. Such institutions should also provide viable credit where and when needed and insist on the borrowers repaying the amount borrowed.

Mr. Speaker, in order to maintain reasonable levels of interest rates. I have proposed measures to encourage long-term tradable securities, which will enable qualified investors to float long-term bonds, which are listed in the stock market. Such securities will have several advantages; **first,** they will reduce the current practice in which investors use short-term deposits to finance long-term investments, thus eliminating the current problem of mismatches. **Second,** it will enable seekers of long-term finance to go direct to long-term savers, thus cutting out the cost of intermediation; **third,** it will give managers of long-term funds outlets for their surpluses; **fourth,** this avenue may offer a way out of non-performing loans in the mortgage industry. These securities will benefit investors in real estate, utilities, and infrastructure. These securities will be licensed under the Capital Markets Act and will be in two forms, either special purpose vehicles or dedicated programs. These instruments are incorporated in the Capital Markets (Amendment) Bill, published today. Detailed regulations will be prepared to cater for different needs of investors and functions for which the money is raised may be used. We believe these proposals will enhance the effectiveness, efficiency, governance and outreach of the financial sector while supporting the government's efforts to promote economic recovery.

As Hon. Members are fully aware, Kenyans are paying a very high price for the dishonesty of a few people. Today, every school, hospital and trading store, requires payment by bank cheque. Indeed, schools no longer accept cash for fear of robberies nor do they accept personal cheques which they fear could bounce. It has, therefore become a nightmare for people living in rural areas where there are no banks to pay school fees. Parents travel long distances to buy bank cheques at charges which are as high as a thousand shillings a cheque, money which they can ill afford. I believe majority of Hon. Members would like to save Kenyans both the trouble and the unnecessary cost of banker's cheques, I therefore, propose to amend the Penal Code to make issuing of bouncing cheques, while aware there are no funds in the drawer's account, an offence.

MANAGEMENT OF PUBLIC ENTERPRISES

Mr. Speaker, in the past, incidents of mismanagement in public enterprises have imposed heavy financial costs on both the economy and the taxpayer. As a result, the public has paid for services which were, either not rendered, or when rendered, were of low quality, or irrelevant to their needs. In general, this subsector has been largely under performing and unable to service its debt obligations, transferring most of the burden to the Exchequer. In some instances, these enterprises hired excess labour while engaging in inappropriate procurement procedures. The result has been overpriced purchases of assets, real estates, or outright theft through purchases of wrong equipment.

While public enterprises have very clear mandates, some are so poorly funded that they are only able to pay salaries. In some cases they are unable to pay statutory deductions while others, use such deductions as operating cashflow. In response to these challenges, the Government has carried out a comprehensive review of mandates of these enterprises, to establish their current status. The primary objective of the review was to assess whether these are fulfilling their mandates in delivery of services and obligations. The review also sought to establish whether their mandates are still relevant or duplicated. This information will help determine which of these enterprises can be privatized, restructured or merged. In the meantime, the Government has already reactivated the State Corporations Advisory Board, which is evaluating modalities for performance-based remunerations for the Chief Executives.

Mr. Speaker, while many public enterprises use every avenue to access financial support from Treasury when in financial trouble, once they make surpluses, they resist transferring any surpluses to Exchequer. Instead, they rush to expand their budgets, so that they can spend all the money they make. This behaviour is not prudent and will not be accepted in future. Besides, the tendency for public enterprises to build high-rise office apartments must be discouraged, they must remain focused on their core mandates.

It is important to instill financial discipline with the sector and for this reason, the Treasury has decided on the following course of action; **First,** before any public enterprise resorts to Treasury for financial support, it will have to demonstrate that it has exhausted all internal efforts, including disposing off its non-productive assets. **Second,** as provided under section 16(3) of the State Corporations Act, starting from the fiscal year 2004/05, surpluses and dividends must be paid to the Exchequer, to reflect adequate returns on investments. However, where the enterprise has a very critical mandate and needs the surplus to fulfill some very specific needs, it will be necessary for the enterprise to seek prior approval from Treasury to use the surplus. In addition, each enterprise will be required to maintain a sound investment policy.

FISCAL POLICY MANAGEMENT FOR ECONOMIC RECOVERY

Tax Policy and Administration

Mr. Speaker, recent trends have shown that the ratio of revenues to GDP, has been declining. Correspondingly, the ratio of total expenditure to GDP has declined too. These developments have been occasioned by the prolonged economic recession, which has plagued the economy since mid 1990s. Unfortunately, as revenues have shrunk, expenditure on debt and wages has remained firm. This has created serious policy conflicts where resource allocations to development or capital expenditure, and operations and maintenance, have been systematically squeezed out. This situation has made service delivery inefficient, unproductive and ineffective. As economic growth is regained, there is need to ensure revenue generation responds accordingly, to fund the supporting services. It is for this reason that the Government is seeking to improve tax policy and tax administration to expand the revenue base and increase financial resources to sustain growth of public services.

As part of revenue improvement effort, several measures have already been initiated which include; (a) reorganization of the Kenya Revenue Authority to ensure its operations are better focused on core functions and to promote greater integration, (b) developing the capacity to facilitate economic activities and trade, without sacrificing the revenue collection function. (c) improving capacity to provide cross-cutting services and deliver them more effectively, (d) making the Authority more responsive to challenges of globalization and regional integration, and (e) maximizing on utilization of available resources and information.

Mr. Speaker, during the last three years, the Government has continued to remove import duties and VAT on basic inputs, both imported or locally produced. Currently, capital goods and raw materials are duty and VAT free. This has significantly reduced tax revenues on cross-border trade. In addition, we have rationalized provisions relating to excise duties, income tax and lowered rates to promote investments and growth. Excise duties also have been harmonized, and deepened in line with international best practices and regional experience. In the next stage, the Government will harmonize fiscal incentives across the EAC region to create a level playing field for investments, within the Community. With these reforms it has become increasingly clear that however good tax policies are, they cannot succeed "unless there is effective capacity for tax administration."

Taking cognizance of the policy tax -administration nexus, the Government plans to extend tax reforms to the informal sector. This is necessary for two basic reasons; first, to ensure this rapidly growing sub-sector carries its share of fiscal responsibility to finance the facilities it needs; and second, to spread the net and discourage business from splitting their operations into small units in order to avoid taxation. Plans to implement this strategy are at an advanced stage, and will be implemented as soon as operational arrangements are completed.

As part of the strategy to improve tax administration, KRA is upgrading its IT system to facilitate integration of taxpayer data to enable the Authority conduct comparative analysis between taxpayers in similar trades. This system will also help in taxpayer recruitment. In further development, KRA will soon install scanners at the Kilindini Port to speed clearance of cargo at much reduced risks. To improve the Authority's capacity to monitor our porous borders, KRA has acquired additional vehicles and motorboats. Towards better revenue enhancement, KRA is closely coordinating relations with other enforcement agencies while improving use of intelligence information to combat tax evasion and other irregularities. Part of these efforts include joint verification and validation of cargo at borders, with revenue authorities of neighbouring countries to minimize diversion of transit goods into domestic markets of the three countries. These initiatives will soon be boosted by introduction of an electronic cargo monitoring system, which will be implemented soon. These measures should send a clear message to traders in the region, that the days when well-connected persons diverted goods into local market with impunity, are over.

SECTORAL POLICIES

Mr. Speaker, let me briefly turn to some of the sectoral issues, which continue to be of concern to Kenyans, especially the investors. As Hon. Members may recall, last year, I promised to institutionalize the annual public expenditure reviews, which has now been done. In 2003, the Government completed eight ministerial public expenditure reviews (MPERS) for fiscal year 2001/2002 while a more expanded review for fiscal year 2002/03 has been completed and the final report is under preparation. These reviews (MPERS), have enabled the Government to identify gaps between budget policy objectives and execution. The knowledge gained will facilitate shifting of resources to priority areas, within and between Ministries and sectors.

In the immediate to medium-term, our priorities will continue to be (a) improvement of the physical infrastructure, particularly roads, railway and ports; (b) provision of basic social services, i.e. health and education; and (c) improvements in safe water, energy, and security. These priorities are to be achieved within the background of hard budget constraints, which is expected to persist to the medium-term. Consequently, whatever resources are available will be shared among the many competing needs. I therefore do not expect any one sector to receive all the resources it wants, sometimes not even all it needs. It is from this background that the sectoral budgets have been prepared.

Public Administration

Mr. Speaker, the government is committed to creating a leaner, more efficient, motivated, and productive public service, not only in central government but in the whole public sector. Accordingly, the Government will continue to deepen reforms in civil service, Local Authorities and public enterprises, to improve delivery of services, and to encourage private sector investments to facilitate job creation. The reforms currently under implementation aim to ensure line ministries carry out their mandates without undue interference from other government agencies. However, they need to conduct their operations in a transparent and accountable manner. This process entails decentralizing public services to bring decision making closer to where problems are. On the proposed down-sizing, let me repeat for the sake of clarity, the Government wishes to achieve this through voluntary early retirement.

Privatization of Public Enterprises

Mr. Speaker, the privatization process suffered a major setback when the Privatization and Sale of Assets Bill was not enacted last year. However, in the area of corporate governance, we continue to make good progress such that public enterprises, which were making losses, have improved and made profits or reduced losses, as is the case with banks and some sugar companies. However, while gains have been made in this area, mobilization of capital for expansion, modernization and rehabilitation of some of our parastatals remains a challenge. Privatization is therefore considered an alternative option for raising the much needed financial and management resources. In this respect, a privatization programme has been prepared which targets a number of commercial public enterprises for privatization or concessioning. This will include enterprises in the agricultural, tourism and financial sectors as well as major parastatals like Telkom Kenya, KenGen, KPA, concessioning of Kenya Railways Corporation, and reduction of government's shareholding in Kenya Commercial Bank. However, the privatization process can only move fast enough after the enactment of the necessary law, which is already pending before this August House.

Mr. Speaker, while carrying out this programme, the Government will develop appropriate regulatory regime and encourage competition to provide for consumer protection. It will also build in affirmative actions necessary to ensure domestic participation and safety nets for workers. I would also like to assure this House that when implementing the programme, national interests will be protected. In particular, Kenyans will be expected to play key roles in ownership and leadership during the privatization process.

Public Safety, Law And Order

Mr. Speaker, as I pointed out in my Budget Speech last year, the Government is fully committed to maintaining the rule of law, peace and security. This requires an efficient and well-motivated police force together with strong good governance institutions to sustain the fight against corruption. In this regard Government will continue to strengthen the capacity and co-ordination of public safety and law and order institutions. With respect to judiciary, efforts have been made and more will follow, to improve capacity and efficiency of the judiciary to speed up determination of disputes and other cases. Towards this end, the Government has appointed more judicial officers and will embark on rehabilitation of law courts. To free the courts from petty cases, the Government plans to establish small claims courts together with traditional courts. The Ministry of Justice and Constitutional Affairs plans to table a Bill in this August House, to introduce such courts.

Other initiatives under implementation, in this area, include; (i) improving training of police officers; (ii) providing the force with modern equipment and technology; and (iii) improving living conditions while strengthening specialized police units. With regard to prisons, the government will reduce overcrowding in prison cells by improving institutional coordination between, the judiciary, the Office of the Attorney General, prisons, the police, the children's, and probation departments. In addition, petty offenders will be punished through community service with enhanced corrective supervision.

Agriculture and Rural Development

Mr. Speaker, the agricultural sector continues to dominate the economy and contributes substantially to GDP. It also accounts for 80% of rural employment, 60% of export earnings, and, about 45% of annual government revenues. This situation is likely to persist in the foreseeable future. During the year 2003, this sector grew by a modest 1.5%, which was attributed to, favourable weather leading to increased production of maize, wheat, coffee, tea, cotton, and, dairy produce which recorded an increase of 15.3% in value. As regards cereals there was significant decline in market value, amounting to about 14.5%, mainly due to poor quality maize. Overall, the value, of agricultural outputs, at current prices, rose by 5.6%, compared to increase in value of imports of 4.9%. Unfortunately, the terms of trade index for the agricultural sector continued to deteriorate, dropping from 83.3 in 2002 to 77.2 in 2003, which compares unfavourably with an index of 105.2 in 1999.

Mr. Speaker, it is critical to improve products in this sector in order to achieve the multiple socio-economic objectives, as detailed in the Economic Recovery Strategy. The sector is
key to improved food security, raising rural incomes, poverty reduction, development of agro-industries, increased export earnings, employment creation, and general improvement of wealth of this nation. It is therefore necessary to restructure and facilitate the sector to be more responsive to changing needs of our people. Among the areas where additional support is needed are, (i) improving access to credit, not just increase of volume, but also at appropriate terms; (ii) more reliable power supply; (iii) affordable but quality inputs; (iv) access to appropriate technology in usable forms; and (v) market access at remunerative prices.

It is for these reasons that the sector Ministry has prepared a Blue Print Code named "Strategy for Revitalization of Agriculture"(SRA) to improve contribution of this sector to economic recovery, which will be implemented over the next ten years. SRA will provide guidance to reforms to modernize and "to transform agriculture into a profitable, commercially oriented, and internationally and regionally competitive economic activity". SRA will seek to create an enabling environment for the private sector led growth by identifying priority activities that need to be undertaken to raise and sustain growth in this sector. The fast track activities of this strategy include:

(i) reviewing and harmonizing the legal, regulatory, and institutional framework; (ii) improving delivery of, research, extension, and advisory support services; (iii) restructuring and privatising non-core functions of the Ministry and public enterprises under it to improve, efficiency, accountability, and effectiveness; (iv) increasing access to quality farm-inputs and financial services; (v) formulating food security policies and programmes; ***and*** (vi) improving market access, with special emphasis to rural access roads, and levies and other fiscal charges.

In the context of the (SRA), a sector-wide, Kenya Agricultural Productivity Project (KAPP), has been initiated to support such essential services as, research, extension and farmer or client empowerment. The project is designed to modernize agriculture and improve livelihoods through the development, acquisition and application of improved technologies and information. It will be funded by the Government with support of the World Bank. The first, three-year phase, has been negotiated and funding level agreed at US$ 40 million, of which US$13 million is a grant. The project will be implemented by the Ministries of Agriculture, and Livestock and Fisheries Development, and Kenya Agricultural Research Institute (KARI).

Other reforms in this sector will include restructuring and rationalization of agricultural research institutes to consolidate their operations with those of the Kenya Agricultural Research Institute. With regard to extension services, the government will review alternative modalities for service delivery and seek ways to encourage more active role for the private sector.

Mr. Speaker, as Hon. Members may be aware, price movements in the local agricultural input markets do not reflect international market conditions. Inputs experience erratic price movements, which suggest serious governance issues in this market. Which has continued to affect investment, production and farmers' profitability. The government has identified reforms, which will enhance competition in inputs distribution and marketing. It will also enforce the law against fraudulent practices of input suppliers and marketing agents. Through the on-going reforms in the cooperative movement, the agricultural production and marketing cooperatives are expected to improve their capacity to supply inputs. They are also expected to be more transparent in their marketing and financial operations, which should make farming more remunerative to farmers.

PHYSICAL INFRASTRUCTURE

Energy sector

Mr. Speaker, Hon. Members may recall that in the Budget proposals last year, I introduced fiscal incentives for power producers, distributors, investors and consumers. These incentives resulted in some reduction of the power tariff, however, the quality and reliability of our power system is still wanting. We continue to experience incidents of blackouts, sometimes for long periods. The Government has therefore, been forced to take measures to restore sound financial status to the company. The restructuring, which has been done, has assisted the KPLC to restructure and regain net worth through an annual injection of about Kshs.2 billion, reduction of bulk electricity cost, from KenGen by Kshs.0.60 per KWH and transferring the same to KPLC.

The total amount involved in balance sheet restructuring was about Ksh.17.1 billion which comprised of waiver of interest penalties amounting to Kshs.1.2 billion on the outstanding debts to KenGen, and conversion of Kshs.15.9 billion, outstanding debts to the Government, into preference shares. This support has enabled KPLC to embark on a comprehensive programme of self-renewal. The company has already started a program to procure critical components needed to improve quality and reliability of its power supply system. In addition, between now and September 2004, the Government expects to conclude a financing package, with development partners, amounting to over US$250 million, most of which will go to KPLC for revamping the distribution system.

Mr. Speaker, in next financial year, the Government with the support of the development partners, will take several initiatives, primarily to reduce power system losses. The aim of these efforts will be to bring our system losses to levels consistent with those expected in other well-managed utilities of similar sizes, operating under comparable environment. Benefits accruing from these changes will be shared with consumers through tariff reductions.

Mr. Speaker, in the petroleum subsection, we have encountered several challenges, including (i) dumping of export fuels in the domestic market, and (ii) adulteration of motor fuels with kerosene by unscrupulous traders. To combat these vices, the Government has taken firm corrective measures, which are yielding large benefits. **Firstly,** conducts random checks at market outlets to identify and penalize retailers for either selling diverted or adulterated products. **Secondly,** cancellation of licences for adulterators and dealers in diverted products, is helping weed out unfair competition with genuine traders. These efforts are rebuilding confidence in the economy and rewarding genuine investors while protecting government revenue.

Mr. Speaker, the long term solution to irregularities in the petroleum sub sector, lies in improving integrity of all business operators so that enforcement is only necessary where operators find it difficult to comply voluntarily. We hope to get better compliance after the energy bill which provides for stringent penalties, currently under preparation, is tabled and enacted by in this August House, later in the year.

Among the measures I am introducing today will be substantial enhancement of penalties and fines. It is anticipated that the combined effect of new regulations, more vigorous surveillance, and the proposed energy bill, will significantly discourage those of our business people who still think they can only succeed if they take short-cuts.

Road transport

Mr. Speaker, the Government is well aware that the roads are the arteries of a nation, just like blood vessels are to a human body. When blood vessels get clogged, the result is high blood pressure, stress and ultimately a heart attack, so does a failed road network. A vibrant road network makes the economy vibrant while poor state of roads suffocates economic growth. Consequently, to promote economic recovery, the Government will continue to accelerate rehabilitation of the road network together with the other complementary transport facilities. One way to speed up this process is to bring in participation of the private sector in the maintenance and reconstruction of road infrastructure. As part of this effort, during the next financial year, the Government will commence implementation of major road works, including;

1. Reconstruction of major sections of Northern Corridor, which is an improvement project, jointly financed by the Government with a 60% IDA Credit, of US$275 million. This project is part of the regional road network and involves improvements of some 368 kilometers, with major civil works on various sections of Mombasa-Nairobi-Malaba Highway. Among the sections to be improved are, Sultan Hamud-Machakos Turnoff, and Machakos Turnoff-Athi-River-Embakasi. Other works will cover Lanet-Njoro Turnoff, then Njoro Turnoff-Mau Summit-Timboroa, and Mau Summit-Kericho-Kisumu. These works will be in addition to the on-going E.U. financed improvements on the same road.

2. Construction of new roads, including, the Processional Way, in Nairobi and Kangonde-Kitui;

3. Resealing, recarpeting, repair and reconstruction of several roads, among them, Ndori-Luanda Cotieno, Rangala-Siaya-Bondo, Embu-Thuchi-Nkubu, Machakos-Turnoff- Masii-Kitui; Katito-Kendu Bay; Ruiru-Kiambu-Roysambu-Muthaiga; Nairobi-Thika and

4. Kisumu-Kakamega-Webuye.

Several other roads, spread throughout the country have been earmarked for upgrading to gravel standards. It is expected that repair and upgrading of rural roads will improve market access for agricultural produce. In addition, a number of new donors, among them KFW SIDA, EC, ADB, and AFD, have come on board, each covering a number of districts.

Road Concessioning:

To accelerate road development and rehabilitation the Government, in conjunction with World Bank, commissioned a Road Concessioning Study with two main objectives. **First**, to conduct an assessment of concessioning potential; and **second,** to prepare a design for concessioning framework. The study concluded that road concessioning in this country is viable, provided it is limited to Northern Corridor with conventional road tolling in areas where average daily traffic is more than 500 vehicles. Though the financial costs of concessioning are high, the economic benefits of involving private sector far exceed the additional costs. For this reason, the Government plans to proceed with concessioning, on experimental basis, on part of the Northern Corridor, on basis of Build-Operate-Transfer (BOT). If successful, the program will be expanded to other sections.

Management of Weighbridges:

Mr. Speaker, to protect and preserve the road network, the Ministry of Roads, Public Works and Housing, is currently maintaining 24 static weighbridges, mainly located on the Northern Corridor. Plans are at an advanced stage to introduce static weighbridges at all border posts. To ease the movement of goods at the Port, a weighbridge will be introduced in the port while mobile weighbridges will be introduced along all major roads. As part of our efforts to facilitate faster movement of cargo through main transport arteries, weigh-in-motion systems, will be introduced at Mariakani, Athi River and later on at Gilgil.

Road Transport Policy

Mr. Speaker, the Government has already started on a policy to improve road transport in accordance with a National Road Transport Policy. No doubt Kenyans are enjoying more sanity in public transport following the introduction of new regulations. As is already noticeable, road accidents have drastically reduced. With plans to transport more cargo by railways, the number of heavy trucks on the highways will decrease leading to increased safety for other road users.

Decongesting the major Urban Centres:

Mr. Speaker, currently our major urban centers are heavily congested, with the problem being particularly bad in Nairobi. To address this situation, the Government, with support of Government of Japan, is in process of conducting a six month study, on the basis of which, it will formulate a Master Plan for Urban transport in Nairobi metropolitan area for target year 2025. The study will include, a pre-feasibility on priority areas and carry out relevant technology transfer to local counterpart personnel. As part of decongesting efforts, the Government will build by-passes in Nairobi, Mombasa, Kisumu, Nakuru and Eldoret. In Nairobi, three by-passes, namely, Southern, Eastern and Northern, will be built.

National Housing Policy:

Mr. Speaker, recently, the Government reviewed the National Housing Policy which is before this August House for approval. This policy will be implemented through the National Housing Development Programme together with the private sector. This programme is expected to facilitate construction of 150,000 housing units, annually. Other Government initiatives, in the housing sector, include, the Kenya Slum Upgrading

Programme under which the Kenya Slum Upgrading and Low Cost and Housing Infrastructure Trust Fund has been established, Site and Service Schemes, Urban Redevelopment Rental Housing, Tenant Purchase Schemes, Mortgage Schemes and the Civil Servant Housing Scheme. Though the Government will play its part, it will also seek to provide and maintain sound macro-economic stability to provide a conducive environment for private sector investments. In this connection, promotion of special purpose vehicles will assist housing development. For this reason, the Government, through the Capital Markets, will encourage and popularize development of the secondary mortgage market.

Rail transport

Mr. Speaker, the government recognizes the important role an efficient railway system plays in the development of a nation. Rather than compete, railways and roads complement each other. A well-developed railway system reduces road damage; environmental pollution, improves safety, and lowers the cost of transportation. For these reasons, we need to improve the carrying capacity and reliability of the railway system to protect the road network and also to speed the movement of cargo to and from the port. The government expects to complete the ongoing restructuring of Kenya Railways Corporation through a long-term concession covering transportation of both passengers and cargo. Already, the Governments of Kenya and Uganda have agreed on a joint concessioning for which prequalification bids are expected to be out by September this year with completion date of August 2005.

In the meantime, efforts to improve the railway system will continue. Already twelve (12) locomotives are under rehabilitation in Uganda which will significantly increase its carrying capacity.

Ports

Recently, Kilindini Port was in the news due to a notice issued by the shipping fraternity to impose a delay surcharge of US$ 70 per tonne per day, which would have substantially raised costs of exports and imports. Fortunately, the Government was able to mobilize the concerned agencies and cleared the congestion ahead of the deadline for the proposed surcharge. However, much work remains to be done to re-equip, modernize and expand the port facilities to cope with both domestic and transit cargo.

Mr. Speaker, there are clear signals that we need to move fast. In 2003, the tonnage of cargo handled through the port increased by 12.9%, or from 10.56 million tonnes in 2002 to 11.93 million in 2003, while, container cargo increased more dramatically by 24.5% in 2003, compared to a worldwide increase of 8.6%. As peace in Great Lakes and Southern Sudan consolidates, we expect significant growth of cargo through our ports and roads. To cope with this volume and maintain competitiveness of the Northern Corridor, key decisions have been taken to coordinate operations of the Kenya Ports Authority (KPA) and the Kenya Railways Corporation (KRC) leading to (i) introduction of block trains which load cargo direct from the ship onto railway for transportation to Inland Container Depots (ICDs). This has enabled containers to move from the ship to Embakasi within 20 hours and 3 to 4 days for Kisumu and Kampala; (ii) moved cargo documentation from Mombasa to Nairobi; (iii) KPA commissioned a business evaluation for development of a cruise passenger terminal at berths 1 and 2; (iv) KPA is moving ahead with procurement of new equipment to improve its cargo handling capacity.

Plans have been finalized for block trains to other inland container depots with test runs already in operation. To assist this process, I have directed the KRA to harmonize the customs working hours with those of KPA. I am also putting importers, who use the Port as a storage facility, on notice, if they continue with this habit, they should not expect any sympathy when they apply for waiver of Customs warehouse rents. Finally, shortly, I will be proposing measures to reduce the number of days which cargo can be retained in the port.

Telecommunications

Mr. Speaker, efficient and cost effective information and communication technology has become essential to economic growth and development. For this reason, the government has consulted with stakeholders and prepared an ICT policy which will be ready soon. This policy will provide guidelines on use of internet and other forms of telecommunications while increasing access to ICT at much lower costs. However, we still have much ground to cover before achieving a reasonable level of connectivity and cost effectiveness in telecommunication services. We urgently need to increase stock of fixed lines, and make them reliable and cost effective. As the current monopoly, enjoyed by Telkom Kenya, comes to an end at the end of this month, we will need to move fast on liberalization, especially with regard to creating a reliable and cost effective international gateway. In the meantime, we expect the second fixed-lines operator together with third mobile phone provider to be licenced soon.

On its part, the Postal Corporation has installed Vsat in more than 500 facilities throughout the country to supplement its facilities in all district headquarters. This will expand its penetration beyond its current level of being the provider with the most widespread internet connectivity in the country. This service is critical to electronic trade and information sharing. Already, over 60 internet service providers have been licensed, 31 of whom are operational, but, more are needed, not just in Nairobi and Mombasa, but whole country including schools and colleges. As Hon. Members are now well aware, ICT service providers have created many jobs and continue to create more. This means the liberalization of telecommunications continues to create more jobs than those Telkom Kenya may lose as a result of privatization.

SOCIAL SECTOR

Mr. Speaker, in accordance with Government commitment to increase funding for pro-poor services, resource allocations for the Social Sector, during the fiscal year 2003/04, increased from Kshs.93.97 billion in 2002/03 to Kshs.109.71 billion or 16.7% increase. Out of this increase, education sub-sector recorded the highest increase of 20.8% while health allocations rose by 9.2%. In 2003, there was a marginal increase in health facilities and hospital bed capacity increased by 4.5

Health Sector

Mr. Speaker, the Government will continue with health sector reforms in order to enhance access and affordability of basic health services with special emphasis on the poor and vulnerable. In addition, the Government will step up efforts to increase coverage of immunization, reduce mortality rate among children under five years, reduce HIV prevalence, and increase the access and availability of essential drugs. Improvement of health service delivery for the underprivileged rural and urban slums will be a priority. As the Government focuses more on promotive, preventive and basic health services it will also enlist additional capacity through partnerships with civil society, faith based, and private sector organizations. Of special interest is the need to enhance and improve cross-sectoral cooperation to strengthen ties and collaboration with critical areas of water and sanitation, reproductive health, gender, HIV/AIDS, nutrition, and school health, among others. The Government will improve on coordination and collaboration to achieve synergy and reduce inefficiencies, of various stakeholders in of healthcare industry. This will include: (i) development and implementation of a joint National Health Sector Strategic Plan; (ii) monitoring and evaluation framework and mechanisms for annual health sector program reviews; (iii) a medium term expenditure framework and annual sectoral public expenditure reviews. All these efforts will help evaluate the effectiveness of actual expenditures against the predetermined objectives of this sector.

Education:

Mr. Speaker, in January 2003, the NARC Government introduced free primary education (FPE), which enabled over one million children, who were previously out of school, to enroll in primary schools. This policy has brought the total enrolment to 7.2 million children. To finance the FPE, the Government invested an additional Kshs.12.6 billion, comprising of both recurrent and development expenditures. A large part of this money has been provided by our development partners, for which we are truly grateful.

In an effort to improve education further, the Ministry of Education, Science and Technology held a successful National Education Conference, which brought together all stakeholders. The conference brought main issues on the table, among them; how to (i) provide quality education and training, at all levels, (ii) address past inequities and disparities, (iii) increase access and improve education for all, especially youth, and (iv) improve safety in learning institutions. The conference provided useful input, which the Government will use to improve quality and access to education. This will be done in a participatory approach and partnership with other stakeholders in the sector.

Mr. Speaker, with increased primary school enrolment there is urgent need to improve higher levels of education. This requires additional facilities and openings, in high schools, tertiary colleges, and universities. The challenge to all of us, particularly the leaders, is to mobilize resources to build the required facilities and provide learning and teaching materials. However, given the resource constraints facing the Government, the bulk of financial responsibility for post primary education will fall on the private sector. The role of the Government, in this area will be mainly facilitation of a conducive environment and maintenance of quality and standards.

Mr. Speaker we now live in the information age where access to information and communication technology is critical to success, not only within Government but also in commerce and production. For this reason, the youth will continue to require proper training in information and communication technology (ICT). It is therefore imperative that education and training facilities become the natural platforms to provide appropriate ICT skills. In this connection every Kenyan who has the capacity to contribute to improvement of ICT training should feel challenged to do so.

LABOUR AND EMPLOYMENT

Mr. Speaker, there have been misconceptions and deliberate distortions of Government intentions with regard to retrenchment. What has not been said is that when government cedes some of its functions to the private sector, this goes hand in hand with staff adjustments. If this process is well managed, it creates more jobs in the private sector. This is what happened in case of telecommunications sector where the private sector created many quality jobs. For this reason, what Government should do is to create a conducive environment for private sector to generate employment. Recently, the government completed a review of the labour laws, out of which various policy recommendations have been made. These are being considered for implementation, particularly in such key areas as increasing labour productivity and dispute resolution. The **Productivity Centre of Kenya,** has been created which will develop productivity policies and measurements.

The government will also undertake a review of the legal and judicial environment to identify causes of inefficiencies that lead to high unemployment and high labour costs in the economy; develop an inventory of available skills, and propose reforms to improve labour market flexibility. In addition, it will seek ways to strengthen the links between education, training and industry demands to make education and training demand driven. In the area of industrial and labour conflict management, the Government will reform the current system to speed dispute settlements and strengthen the tripartite committee secretariat. Other reforms will fortify the labour inspection services, and reduce the backlog of workmen dispute cases. The ultimate objective of these reforms will be to improve economic environment to enhance the capacity of the private sector to create new jobs.

TRADE AND INDUSTRY:

Manufacturing

Mr. Speaker, in my speech last year, I introduced several measures to improve competitiveness of local industry. These included reduction of VAT from 18% to 16%, allowing investors to access, free of duties and VAT, capital equipment, plant and machinery for new investments and also for expansion of existing facilities. Many investors have taken advantage of these incentives. However, administration of this scheme has had some problems such as the clearance of these goods in small consignments, waiting until goods arrive at the port before filling applications, and filing applications without adequate details, leading to unnecessary delays in clearance of such goods. These practices have made the incentive expensive, both to the Government and investors. Treasury has been forced to write to investors seeking for more details, which causes further delays. In addition, this incentive was not expected to be a permanent feature, rather, it was intended to assist manufacturers and other processors during the period of recession. Once the economy picks, and investors start to make money, they should be in a position to afford full cost of such equipment, including duties and taxes.

For these reasons, I have proposed changes to this scheme to make it easier for both Treasury and investors. New regulations will require investors to apply for all their equipment together, giving full details of the investment, but they will be able to clear imports or purchases on consignment basis as they are shipped. However, those who benefit from the scheme should expect to be audited by KRA to make sure the equipment is actually used for investment. I have also put a sunset to this scheme, which will be 31st December, 2006. It is therefore in the best interest of investors to finalise their investments at the earliest opportunity.

Mr. Speaker, when the United States of America introduced the AGOA facility, it was intended to support local investors and producers. It was not intended to open an avenue for unscrupulous individuals to abuse and make easy money. Already, we have had unsuccessful attempts to abuse this facility but this will not be tolerated. On the contrary very serious action will be taken on any person who seeks to access this or any of our export promotion schemes dishonestly through deceit. I have therefore, proposed amendments to Customs and Excise Act to provide for immediate censure of any person caught cheating on any of our export schemes. Once caught, the incentive facility will be closed to such persons immediately.

Mr. Speaker, local producers have had a hard time competing with counterfeit and substandard goods. To raise the war against such goods a notch higher in protection of both producers and government revenue, I have today proposed amendments to the Standards Act to give authority to the KEBs to, (a) enter premises, vehicles, aircraft and other vessels in course of their duties, (b) seize and destroy condemned goods, and (c) raise fines under the Act from Ksh.500,000 to Ksh1,000,000 and Ksh.20,000 to Ksh.100,000. However, in this era of transparency and good governance, I have also proposed amendments to establish a Standards Tribunal to hear and determine disputes.

Mr. Speaker, I believe these measures are necessary to support genuine investors. Indeed, the Government will continue to improve the operating environment for honest investors, and will continue to seek new markets for genuine producers. In this connection, the Ministry of Trade and Industry will soon lay a Sessional Paper in Parliament on ways to improve investor environment. It will also review the institutional structure of organization, which support the industry to improve their efficiency.

FINANCIAL OUTTURN 2003/04

Revenue

Mr. Speaker, in my budget proposals last year, I projected to receive total revenue (including LATF) amounting Khs.240 billion or 20.7% of GDP, which was composed of KShs.215.1 billion of ordinary revenue, KShs.21.4

billion of recurrent Appropriation-In-Aid, and KShs.3.5 billion of Development Appropriation-In-Aid.

Mr. Speaker, the ordinary revenue was to be comprised of Ksh.63.5 billion from customs and excise duty Ksh.74.6 billion of income tax, Ksh.58.9 billion from VAT, and Ksh.16.6 billion of other revenues. Based on actual collections todate, ordinary revenues are likely to exceed target by about Ksh.2.0 billion while appropriations-in-aid will remain slightly below target. I expect customs and excise duties to under-perform by about Ksh.126 million. However, I expect VAT on imports and other revenues to fall below target by about Ksh.2.2 billion and Ksh.2.2 billion respectively. Fortunately, these shortfalls will be offset by more receipts from other Income Tax and Investment revenues which will over-perform by Ksh.4.1 billion and Ksh.1.6 billion, respectively.

We attribute poor performance of consumption taxes to lower than projected economic growth while other revenues under-performed due to delays in finalizing licensing of the Third Mobile Phone provider.

Expenditure

Recurrent Expenditures

Mr. Speaker, Hon. Members will recall that the Supplementary Estimates for fiscal year 2003/04 recently approved by this House had gross recurrent expenditures of **Kshs.333.9billion.** This included **Ksh. 22.9 billion** financed through appropriations–in–aid and payments financed directly from the Consolidated Fund Services, amounting to Ksh. 130.2 billion. This left Ksh. 180.8 billion for discretionary expenditures. As of end of May a total of Ksh.142.6 billion had been released. Based on this trend and on going commitments, it is expected that the total amount in Budget will be spent.

Mr. Speaker, the Consolidated Fund Services for the financial year comprised of KSh.28.3 billion for domestic interest; Ksh. 6.4 billion for foreign interest; Ksh. 12.5 billion for pensions and gratuities; Ksh. 1.4 billion for Constitutional Offices and Ksh. 133 million for subscriptions to international organizations. Furthermore, the supplementary Estimates indicated that Kshs. 24.8 billion would finance external redemptions while domestic redemptions totalled Ksh 55.2 billion.

Development Expenditure

Mr. Speaker, the gross development expenditures for the year 2003/04 are estimated at Ksh. 54.9 billion, including Ksh.13.7 billion as project grants and Ksh.8.4 billion as project Loans and Ksh.3.5 billion to be financed from local A-in-A. Therefore, Ksh.33.9 billion was to be financed from the Exchequer. This amount was reduced to Ksh.32.5 billion during the supplementary billion out of amount Ksh.18.9 billion had already been spent by May this year.

FORECAST FOR 2004/2005

EXPENDITURE EFFICIENCY MEASURES.

Mr. Speaker, given the fact that we cannot stretch resources beyond a logical point, the following expenditure decisions have had to be made.

Purchase of vehicles and Transport operating expenses

Mr. Speaker, in the past, the Government purchased many vehicles both from its own resources and external resources but without any regard to standardization or cost containment. As a result, some of the procured vehicles have contributed to high transport costs. Accordingly, starting next financial year, there will be need to rationalize procurement of official transport to keep costs down. Specific regulations will be issued which line Ministries will be required to observe when purchasing vehicles, whether locally or externally funded. As a start, no provision has been made in the recurrent budget for the purchase of vehicles. Therefore, there will be need for redistribution of available vehicles from non-core to core areas of operations. For externally funded programmes, vehicle purchases will need to conform to agreed standards. In addition, Government will soon release regulations on use of available transport in order to reduce the misuse of official transport. For this reason, provisions on this item have been reduced by 60%.

Traveling and Accommodation.

Mr. Speaker, cost of travel and accommodation has been rising to a level where controls are necessary. Starting next financial year, the number of journeys outside office will be curtailed and where externally funded, no supplementary allowance will be given by the Government. This restriction applies all levels of Government officers including those in public enterprises. For these reasons, provisions for this item have been adjusted downwards to the bare minimum.

Other Expenditures

As part of cost containment, adjustments have been made in a lot other areas where there is potential for wastage. This includes purchase of consumables, stationery, equipment, and contracted professional services.

Ministries are expected to exercise restraint and prudent management of the available resources. Further instructions will be released during the course of the year to cover the areas where the current structures are found to be wanting.

Rationalization of missions abroad

Mr. Speaker, the current number of missions abroad have been a major burden to the budget. As such, the Government is committed to reducing costs related to these missions while at the same ensuring there is reasonable representation. The government will conduct a review of establishments of overseas missions to rationalize them together with their staffing levels.

Revenue

Mr. Speaker, the total revenue target for fiscal year 2004/05 is KShs.271.03 billion. This is composed of KShs.233.0 billion of ordinary revenue, or 20.1% of GDP and KShs.38.0 billion in appropriations-in-aid, which is composed of Shs.23.9 billion appropriations-in-aid, recurrent and KShs.14.1 billion of development appropriations-in-aid.

Expenditure

Recurrent Expenditure

Mr. Speaker, as Honourable Members have noted from their copies of the Printed Estimates, gross recurrent expenditures for 2004/2005 are estimated at Ksh. 353.9 billion. This includes Ksh. 23.8 billion to be financed through appropriations–in–aid, and payments financed directly from the Consolidated Fund Services, amounting to Ksh. 132.8 billion, leaving Ksh.197.2 billion for discretionary expenditures. The Consolidated Fund Services comprises of KSh.28.1 billion for domestic interest; Ksh. 5.3 billion for foreign interest; Ksh. 17.8 billion for pensions and gratuities; Ksh. 1.1 billion for constitutional offices and Ksh. 133 million for subscriptions to international organizations. In addition, I expect to finance external redemptions amounting to Ksh. 18.9 billion while domestic redemptions will amount to Kshs. 60.7 billion.

Development expenditure

Gross development expenditures for 2004/2005 are estimated at Ksh. 86.7 billion. Out of this amount, KSh.32.0 billion will be financed through appropriations–in–aid, composed of direct project financing of KSh.12.2 billion in loans, KSh.17.8 billion in grants and Ksh.2.0 billion in local

Appropriation-in-aid. Consequently, I expect to finance net development expenditures of Ksh. 54.8 billion from the Exchequer.

Financing

External Financing

Mr. Speaker, I have received commitments for budget support amounting to Ksh.4.7 billion, project grants of Ksh.25.4 billion, and project loans amounting to Ksh.20.6 billion from both bilateral and multilateral development partners. Thus, I expect to receive a total of Ksh.50.7 billion from external sources.

Deficit

Mr. Speaker, this leaves me with an overall deficit of KShs.57.9 billion to finance. From the domestic sources, I target to finance KShs.22.0 billion through domestic borrowing, leaving a balance of KShs.35.9 billion. I expect to finance most of this amount through programme support from the on-going discussions with Development Partners and privatisation proceeds realised in the course of the financial year. If additional resources are realized the Government will need to adjust its expenditure.

TAXATION PROPOSALS

Mr. Speaker, total revenues including Appropriation-in-Aid amount to KShs.271.0 billion of which KShs.232.9 billion is ordinary revenue. Based on the proposed macroeconomic forecasts for the fiscal year 2004/2005 and the current taxation structures, we will realize total ordinary revenues amounting to Kshs.223.5 billion in 2004/2005.

Mr. Speaker, this leaves a revenue gap of **Kshs.9.4 billion**. In line with the NARC Government agreement with both teachers and lecturers, I have proposed wage adjustments, which will result in Pay As You Earn (PAYE) revenue gain of KShs.1.3 billion to the exchequer. I also expect to receive licence fees from the telecommunication sector, namely third mobile telephone provider and the second fixed line provider, amounting to Ksh.5.9 billion. This leaves me with a gap of Ksh2.2 billion.

Mr. Speaker, the rest of my speech outlines the measures I intend to take to raise revenues to bridge the remaining gap of **KShs.2.2 billion**. I therefore, now request that the remainder of my Speech be regarded as a Notice of a Motion to be moved before the Committee of Ways and Means.

Mr. Speaker, our tax laws are based on the concept of self-assessment. To a very large extent, the success of duty and tax administration depends on voluntary compliance based on integrity of taxpayers. Indeed, our success in revenue mobilization this year has been, principally, on account of improved administrative efficiency. Before I go into details of specific measures, I wish to take this opportunity to record the Government's appreciation of the excellent efforts made by the Board, Management and staff of the Kenya Revenue Authority this year. In addition, I wish to thank the taxpayers who have cooperated with the KRA to facilitate the Authority achieve its target. Let me also emphasize, that the major focus of measures I am proposing today will be on improving integrity and accountability of our taxpayers and the tax administration systems.

Tax Amnesty

Mr. Spêaker, for the first time in many years revenue performance will exceed the target this financial year. This is a clear manifestation of the combined effect of improved efficiency by the KRA and renewed goodwill among our tax payers. However, a number of Kenyans, while willing to comply, remain outside the tax net for fear of being heavily penalized, on undisclosed amounts, should they reveal themselves. In order to broaden the tax net and encourage voluntary compliance, I propose to implement a tax amnesty on penalties and interest accruing under the three main revenue acts, namely, Income Tax, VAT, and Customs and Excise Acts. The tax amnesty will be subject to full and voluntary disclosure of undisclosed amounts and will be applicable over the period 11th June, to 31st December, 2004.

Mr. Speaker, I encourage all taxpayers to take full advantage of this facility and ensure their tax matters are in order and brought upto date. The Kenya Revenue Authority has embarked on a programme to bring into tax-net all people who are currently required to file records and pay duties and taxes but are not paying. The Authority is aggressively implementing a restructuring and modernisation programme, which will facilitate identification of non-filers. Therefore, those who do not take advantage of this facility will only have themselves to blame once the law catches up with them.

TAXATION MEASURES

Customs Tariff

First, Mr. Speaker, The Customs and Excise Act provides for a surcharge of 2.5% on goods sold into domestic market by enterprises operating in the Export Processing Zones. As Hon. Members are aware such enterprises enjoy generous fiscal and economic incentives, including, duty and VAT free access for both Machinery and inputs. They also have a ten-year income tax holiday not available to other local enterprises. It is for these reasons that the local producers have been complaining of unfair competition when the EPZ enterprises compete with them in the domestic market. To mitigate some of the many advantages enjoyed by EPZ Enterprises when they compete against domestic producers in the local market, I propose to invoke the provisions of this section such that the 2.5% surcharge becomes payable.

Second, Mr. Speaker, in calendar year 2003, the volume of cargo through the Port of Mombasa grew at a faster rate than the world average. With Consolidation of peace in Great Lakes, and Southern Sudan, we expect much higher growth in 2004 and beyond. For this reason, unless measures are taken to speed processing of cargo through the Port, more serious problems of congestion will occur. Today. I will be proposing several measures to facilitate faster movement of cargo through the Port. Accordingly, I propose to amend section 9 of the Act to allow consolidation of cargo in transit sheds outside the Port, but only by persons who will meet very stringent criteria of integrity, volume, and government revenue. Initially, and in order to make the measure cost effective, this facility will only be open to persons who generate over Kshs.100 million a month, in government revenue.

Third, Mr. Speaker, of late, there have been instances of requests to amend the cargo manifests, mainly to change the Port of Clearance from Kilindini to inland sheds. Looking at majority of these cases, there are no compelling reasons for such requests and changes. In order to minimize abuse of such changes, I propose to amend Section 20 to require that goods will be cleared at the first port of entry or the port declared in the cargo manifest.

Fourth, Mr Speaker, when goods are abandoned to customs, Section 34 of the Act requires the Commissioner to issue two notices in the gazette, to owners, of such goods, to the effect that if they do not clear their goods, they will be sold by auction. When the goods fail to be sold in the auction, the law is silent on whether a notice should be given in respect of the goods when offered for sale in subsequent auctions. Recently, the Commissioner was challenged in court for attempting to sell goods which could not be sold in the first auction, in subsequent auctions without further public notices.

Repeated publication of public notices is expensive. In addition, holding such goods in the port and other customs facilities leads to congestion. I am, therefore proposing to amend this section so that goods which are not sold after two public notices, shall be offered for sale in subsequent public auctions, without further notices.

Fifth, Mr. Speaker, when goods are entered for warehousing, the Customs & Excise Act allows the importer twenty-one days within which to deposit the goods in a bonded warehouse. This period is too long and allows dishonest importers to interfere with the goods before reaching the earmarked warehouse. To address this problem and minimize the risk of such goods being diverted into local market, I propose to reduce this period to seven days with the option for one further extension of seven days.

Sixth, Mr. Speaker, Section 51 of the Customs & Excise Act provides for licensing of bonded warehouses. It also allows the Commissioner to refuse to issue a licence without giving any reasons. In the spirit of transparency, I propose to amend this section to require the Commissioner to publish performance conditions which licensees of bonded warehouses will be required to comply with and which may form the basis of Commissioner's refusal to grant a licence.

Seventh, Mr. Speaker, under Section 72, the Commissioner may license premises for use as Transit godowns. In order to improve the management of these customs facilities, I propose to amend the Act to provide for specific conditions and types of goods, which may be deposited in such facilities. In particular, only bulk goods will be stored in transit godowns.

Eighth, Mr. Speaker, I now turn to Customs measures that have direct revenue implications, but before doing that, I would like to make two short comments: **Firstly**, the Common External Tariff for East African Community, which the three countries have recently approved, specifies both the tariff rates and the items which should fall under each tariff category. That leaves no room for individual Member States to introduce local tariff categories. **Secondly,** with the attendant revenue loss that Kenya will suffer by lowering maximum tariff rate from 35% to 25%, I cannot afford to give away much ground on available tax base. For these reasons, I have been forced to make some adjustments, especially in those areas where, (a) the customs tariff is more than 25%, and (b) where we have suspended duties.

Mr. Speaker, our ladies have spoken loudly and clearly, in favour of cheaper sanitary towels. I have heard the message and therefore propose to amend the tariff classification, under which these items fall to create a specific tariff number, and move them from the tariff rate of 35% to 25%. However, since I have no restrictions on how much VAT I can charge, I propose to remove VAT on them. I expect the producers and the importers of these towels to lower prices and pass the benefits of these measures to consumers.

Mr. Speaker, a few greedy individuals have, in the recent past, put our exports in serious jeopardy, when they attempted to import ready-made goods, especially garments, with the sole purpose of re-exporting them as Kenyan made. Other manufacturers have attempted to divert goods intended for export into the domestic market. The dangers of these irregularities cannot be over emphasized. Consequently, since such dishonest people pose enormous risks to genuine investors. I propose to amend the law to immediately exclude, any investor who grossly abuses the privilege granted under any of our export schemes. This means, such persons will not access any more fiscal privileges.

Mr. Speaker, we have had an explosion of charities, NGOs and religious organizations all of which continue to seek and receive duty and VAT waivers on a wide range of goods. Arising from the agreement under the EAC, it has been decided that the three countries harmonize exemptions under the proposed E.A.C Customs Management Act. Accordingly, I propose to amend the provisions relating to duty waivers to restrict remissions to items used to alleviate human suffering, especially for the needy and destitute, and for education and medical services. However, the qualifying goods will be restricted to basic items only. In case of passenger motor vehicles, saloons, vans, station wagons etc these will not be eligible for exemption. In case of sensitive items such as foodstuffs, clothes, whether new or old, these will only qualify during periods of civil strife, natural calamities or disasters or when destined to homes for children or old people. When the EAC Customs Management Act comes into force on 1st January, 2005, these restrictions will be tightened further.

Mr. Speaker, under section 202 of the Act, where a person commits a customs offence to warrant seizure or condemnation of goods, and customs seize such goods, the owner is required to claim them. Where the goods have been claimed, the Commissioner is required to advise the owner, in writing, within 60 days to commence proceedings for recovery of the goods. This section has been misused by dishonest people to make sure the 60 days expire before commencing proceedings. Thereafter, they rush to court seeking orders for release of goods together with financial compensation from KRA. In order to protect the revenue and domestic producers, I propose to amend Section 202 to require any person, whose goods are seized under this section to commence proceedings within sixty days failure to which the goods shall be condemned and sold by auction.

Finally, **Mr. Speaker,** there has been an acrimonious debate on merits and demerits of exporting raw hides and skins, and scrap metal. Attempts to discourage export of these items and to promote local processing have been frustrated by under-valuations of exports, which are subject to advalorem rates of export duty. I have received a flood of petitions and proposals which in many cases are more emotional than factual. However, in order to encourage local processing of these items, I propose to amend the Fourth Schedule of the Customs and Excise Act and introduce specific rates of export duties as follows:

(a) raw hides and skins will attract a rate of duty of Ksh.10 (ten shillings) per kg; and
(b) scrap metal will attract a rate of duty of Ksh.3 (three shillings) per kg.

The measures, under the Customs tariff, will generate an additional Ksh.363 million for the Exchequer.

Excise Measures

Mr. Speaker, the amendments proposed under the Customs and Excise Act aim to improve administration of the excise duties, both with regard to excisable goods and excise factories.

As Hon. Members are aware, we have a serious problem of alcoholic drinks packed in sachets, which are frequently finding their way into school bags. As part of efforts to discourage packing of spirits in sachets, I propose to introduce a requirement to limit the minimum packing of alcoholic spirits to 200 millilitres.

I also propose to prohibit offsetting of excise duty rebates unless there is prior approval by the Commissioner.

In order to control adulteration of petroleum products, I propose to amend the law to authorize the Commissioner, working in consultation with the Ministry of Energy, to set operational standards for dealers in petroleum products.

Mr. Speaker, among other measures I have introduced today are, requirements that;

(a) spirits will not be warehoused before payment of duties,
(c) duty on imported spirits will be paid at the point of entry; and
(d) in case of locally manufactured spirits, duties will be paid before delivery from the distillers warehouses. These restrictions are intended to minimize availability of cheap spirits, which end up in wrong hands and are subsequently used to manufacture illicit drinks.

Mr. Speaker, with regard to excise measures, with direct revenue effects, I propose to make the following changes –

(a) as will be recalled, in the last Budget Proposals, I adjusted excise rate on natural and artificial juices from 15% to 10%. Since then, I have received representations from producers of carbonated drinks and mineral waters to the effect that this reduction has made the business environment uneven for them. In order to restore the level playing field, I propose to equalize the rate of excise duty for these products at 10%.

(b) to protect revenue and maintain the desired economic objectives, I propose to transfer customs tariff, in excess of 25%, on motor vehicles and load the same amount on excise. This change is revenue neutral and will not affect the overall duty payable on these items.

The measures proposed under the excise tariff will add additional **Ksh.333 million** to the exchequer

VAT Measures

Mr. Speaker, let me turn to changes under the VAT Act. **First,** with expansion of information and communication technology, it is now possible for businesses to supply goods and services, across national borders, without opening permanent offices in every country. This has made taxation of such supplies very difficult. The challenge to KRA is therefore to identify a specific person who can deduct and pay tax on such taxable supplies. To address this problem, I propose to amend the VAT Act to authorize the Commissioner to appoint agents in situations where he deems it fit to do so.

Second, Mr. Speaker, in a number of cases, we have come across numerous suppliers who have no fixed business premises, all they have are business cards, mobile phones and e-mail addresses. When such people make taxable supplies to registered persons and include VAT in their invoices, there is little hope that the tax will be remitted to KRA. In such circumstances, the tax is much safer when withheld by the registered person and paid to the Commissioner direct. Accordingly, I propose amendment to Section 17 of the VAT Act and introduction of a new Section 19A, to enable the Commissioner to require such persons, as he may specify, to withhold and pay VAT directly to him, at the time when he pays his customer or on such other times as the Commissioner may require.

Third, Mr. Speaker, during the past one year, I have noticed an escalation of charitable organizations seeking waivers from the value added tax. Though many of these organizations have been registered as such, there is little evidence of their activities on the ground. In addition, the most popular items, for VAT waivers, have been passenger motor vehicles, food items, clothes and other high value consumer goods. To protect both the revenue and local producers, I propose to amend Section 23 of the VAT Act and remove eligibility of these items, from qualifying for VAT waiver. I also propose to exclude passenger motor vehicles together with foods, such as wheat, maize, edible oils, rice and textiles, on which VAT will only be waived under special circumstances, such as where there is civil strife or natural disasters or where the food is destined to orphanages and institutions serving the destitute.

Fourth, Mr. Speaker, introduction of withholding tax into the VAT Act, may affect persons who are not eligible to register. In order to enable such persons to register and claim refunds, where applicable, I propose to amend the Sixth Schedule to the VAT Act to allow any person who wishes, to apply for registration.

Fifth, Mr. Speaker, the Seventh Schedule of the VAT Act requires business operators to keep very specific tax records, including full and true records of all business transactions. With increased use of computerized business transactions, this requirement is no longer practical. Traders cannot issue tax invoices or keep full details on individual transactions in a computerized system. To deal with this problem, KRA has consulted on the matter, both in the region and internationally, in search of best practices. Based on successful best cases, elsewhere, many countries opt for an electronic Tax Register. This is a small device with indelible and irremovable features and which can record, store and preserve all transactions conducted at the front office or through the cashier. I therefore propose an amendment to the Seventh Schedule to the VAT Act to provide for introduction of an electronic Tax Register for specified VAT registered persons.

To ensure those required by the Commissioner to use the Tax Register have enough time to prepare, this measure will be effective on 1st January 2005. In addition, a reasonable cost of purchase of this device will be deducted from the VAT payable.

Mr. Speaker, turning to the VAT with direct and immediate revenue impacts, Hon. Members are well aware of the dangers of deforestation to burn charcoal for fuel. We do not only need to reverse the current rate of consumption of wood fuel but also to reverse the trend and increase forest cover. This is essential for both environmental and energy reasons. Accordingly, it is necessary to lower the cost of liquefied propane gases (LPG). For this reason, I propose to make the cooking gases (LPG) VAT exempt.

Mr. Speaker, From the measures under the VAT, I expect to realize an addition Ksh.1.7billion.

Income Tax Act

I now turn to Measures proposed under the Income tax Act.

First, Mr. Speaker, Income Tax Act brackets have not been adjusted since 2002 and though inflation has remained low, it is necessary to make some adjustments in order to protect low income earners from inflation induced bracket creep. Accordingly, I propose to increase personal relief by 10% and also to widen the tax brackets by 5% .The combined effect of those two measures is to raise the minimum income at which tax will apply from Kshs. 10,267/= to Kshs.11,135/= per month.

Second, Mr. Speaker, last year, I adjusted the tax free amount of commuted pension from Kshs.360,000/= to Kshs.480,000/= but left the tax free monthly pension at Kshs.12,500/=. To further support pensioners, I propose to increase the tax free monthly pension from Kshs.12,500/= to Kshs.15,000/= , or Kshs.180,000 per year.

Third, Mr. Speaker, lack of clarity on taxation of compensation for loss of employment accruing to company directors with controlling interest have become a convenient avenue for tax avoidance. Under the current law, where a contract does not provide for a specified period and does not provide for compensation on termination of the contract, any compensation paid, is only taxed for three years, at the rate of latest annual earnings. Similarly, where the contract period is specified, the compensation taxed is limited to the earnings that would have been received over the unexpired period. In both cases, most of the benefits escape taxation, which, I consider inequitable. Accordingly, I propose to amend the Income Tax Act to make it clear that:

(a) where the contract is for a specified period, the full amount of compensation paid will be spread evenly over the remaining contract period and taxed as appropriate; and

(b) where the contract is for an unspecified period and does not provide for compensation, any compensation paid will be deemed to be income earned over the next three years, following the date of termination and taxed accordingly upon payment.

Fourth, Mr. Speaker, currently, where a taxable person makes a contribution, on behalf of his employee to a non-registered scheme, or contributes more than the maximum deductible amount, the excess is disallowed and taxed on the employer. However, where the contributions are made by a non-taxable employer, the law is silent. This has allowed retirement contribution schemes to transfer large tax-free benefits to senior executives. To close this loophole, I propose to amend the law to make the excess contributions taxable on the employee.

Fifth, Mr. Speaker, currently, the maximum contributions to registered employer based pension schemes, by both employer and employee, is limited to 30% of employee's pensionable income. However, the limit for registered individual retirement schemes is a maximum of 20% of pensionable income. As Retirement Benefits Authority (RBA) has sought to enforce regulations to improve management of these scheme funds, many small employer-based schemes have been forced to convert to individual schemes in order to cut costs. This means the converting schemes are now forced to make lower contributions than they had before the conversion. To correct this situation and eliminate the apparent inequity, I propose to raise the level of contributions to approve individual retirement schemes to 30% of the individual's pensionable income.

Sixth, Mr. Speaker, the Income Tax Act requires persons making payments of specified incomes to withhold and pay the tax so withheld to the Commissioner. Unfortunately, the law does not provide for penalties where the person paying fails to withhold and pay the tax. To correct this omission, I am proposing an amendment to the Income Tax Act to provide for appropriate penalties where the person deducting defaults. I have also proposed to provide for appeals against such penalties, provided the principal tax is paid in full.

Seventh, Mr. Speaker, the Income Tax Act gives the Commissioner powers to waive penalties accrued under the Act. I am proposing an amendment to exclude the waiver of penalties for cases relating to fraud.

Eighth, Mr. Speaker, the Income Tax Act requires taxable persons to make self-assessments and pay the appropriate tax due to the Commissioner. However, disputes have arisen as to the due date for payment of tax where, a taxpayer omits part of income and the Commissioner raises additional tax. To maintain equity and discourage understatement of incomes, in self-assessment returns, I propose to amend section 92A to make it clear that the due date, of additional assessment, will be the same as the date of self-assessment.

Ninth, Mr. Speaker, the current provisions regarding abandonment of taxes under the VAT and Customs and Excise Act require the Commissioners to seek Minister's approval before they can abandon any tax. However, the Income Tax Act allows the Commissioner to abandon the tax and then inform the Minister. To harmonize the treatment of abandonment in the three Acts, I propose to amend the Income Tax Act and harmonize it with the other two Acts. This will standardize the procedure for abandonment of taxes and duties.

Tenth, Mr. Speaker, Currently, the law only allows investment deduction to investors who own and use machinery for manufacturing purposes. I have, however, received representations to the effect that many financiers are willing to finance plant and machinery on leasing basis provided, they are allowed to claim investment deduction. I am persuaded that this proposal is worth consideration. Accordingly, I propose to amend the Income Tax Act to allow lessors, of machinery which is used for manufacturing, to claim investment deduction, provided the users do not claim capital deductions on the same.

Eleventh, Mr. Speaker, In line with the spirit of East African Community, consultants who are citizens of the partner states will now enjoy a lower non-resident withholding tax rate of 15% on consultancy fees. This rate is five percentage points lower than the existing rate applicable to non-residents and will encourage use of local professionals in the three East African partner states.

Mr. Speaker, the changes I have proposed under the Income Tax Act will come into effect on 1st of January 2005 and will cost the exchequer Ksh.208 million.

MISCELLANEOUS

Mr. Speaker, let me now turn to changes I have proposed under miscellaneous category of the Bill.

Civil Aviation

Mr. Speaker, the Kenya Revenue Authority (KRA) collects revenues on behalf of the Civil Aviation Board. However, under the current provisions, KRA cannot issue an agency notice to collect money from those who fail to pay, neither can it attach property of defaulters. To speed up revenue collections for the Civil Aviation Board, I propose to amend the Civil Aviation Act to make it possible, for KRA to appoint agencies or attach property of persons who fail to pay money, legally payable for this Board.

The Kenya Revenue Authority Act, Cap 469

Mr. Speaker, when the KRA was formed in 1995, it was expected to integrate various revenue departments to lower both cost of enforcement, by the Authority, and compliance by taxpayers. In line with this objective the Board has embarked on a strategy to reorganize its operations to improve efficiency. To facilitate the on-going reorganization, it is now necessary to amend the law to ensure that any new administrative structures are consistent with the law. These changes require new definition of the commissioner and also functional heads. For these reasons, I have proposed amendments to Sections 2, 5A and 13 of the Act.

Second, in view of the need to make the Authority more responsive to the changing economic environment, I propose to amend Section 23 of the Act to make it possible for Board, working with the Commissioner General, to delegate functions, within the Authority, as and when situations necessitate. However, where such changes involve transfer of functions from one department to another, Minister's approval will be necessary.

Air Passenger Service charge Act

Mr. Speaker, KRA has had difficulties collecting revenues from air operators when they fail to collect money already paid to them by passengers. To assist KRA speed up revenue collections from uncooperative operators, I propose to amend the Act to give the commissioner legal authority to appoint agents and also attach money belonging to defaulters.

Second, Mr. Speaker, I propose to provide authority for attachment of property belonging to a defaulter.

Capital Markets Authority Act

Mr. Speakers, as Hon Members will recall, there has been a long debate with regard to issue of long-term securities. One of the concerns which I have had is whether the current law has adequate provisions to safeguard interests of people who may buy such securities.

Mr. Speaker, while many people continue to advocate for free licensing of such securities, whether in form of bonds or any other type, Kenyans are all too familiar with stalled projects that dot this country. To avoid a repeat of past mistakes and the investors' funds in such project, we need to provide for a reasonable measure of protection. Accordingly, I propose the following measures,

(i) to amend the Capital Markets Authority to license issuance of long-term securities;

(ii) where an investor seeks to issue long-tem bonds for a specific purpose, the Capital Markets Authority will approve the issue as earmarked, such that the issuer will be required to deposit the money in a ring-fenced account to be used for the specified purpose under CMA supervision; and

(iii) with regard to special purpose vehicles which use asset-backed securities, the CMA will be required to ensure the money is used for the purposes specified by the issuer of the bond.

The Insurance Act

Mr. Speaker, the Insurance Act prohibits offering of rebates to induce an insurer to give an insurance contract. Inspite of this prohibition, suspicions persist to the effect that rebates continue to be given. To discourage this practice, I propose to amend the law to increase fines under Section 73 from Ksh.500,000 to Ksh.1,000,000 and Ksh.5,000 to Ksh.200,000.

Export Processing Zones Act

Mr. Speaker, Kenyans are aware of the recent attempts by unscrupulous Export Processing Zone Enterprises, to import ready garments for re-labeling as Kenyan made. Had this scheme succeeded, it would have exposed genuine investors in textile subsector to dangers of being locked out from the AGOA facility. These risks are particularly high when commercial and manufacturing zones are mixed under one roof. To minimize opportunities for transshipment of goods made elsewhere through Kenya, I propose to amend Section 19 of the Export Processing Zones Act to require the Authority to consult with the KRA before licensing commercial activities so that commercial zones are adequately separated from those engaged in manufacturing. In addition, goods from Export Processing Zones will require prior approval of the Minister responsible for trade before they are off-loaded into the domestic market.

Conclusion

Mr. Speaker, the road to poverty reduction is a long one. The budget proposal I have presented today provides the necessary ingredients towards that goal. The policies I have outlined aim to consolidate economic gains in the short to medium-term to accelerate economic growth in the longer term.

Mr Speaker, as I predicted last year, it has taken the NARC Government much longer than anticipated to put economic and public affairs in order. However, the progress we have made in one and half years is there for all to see. For us to succeed and realize the full potential of our nation we must all work harder together, in unity. Let us all take the motto " a working nation" to our hearts and practise it. For this is surely and honestly, the surest way we can attain prosperity and economic justice.

Mr. Speaker, as I conclude, let me remind Hon. Members of the Budget theme for this year, namely***, "Enhancing Efficiency for Accelerated Economic Growth"***. This is a challenge to all Kenyans, especially the leaders, to improve use of resources under their care and achieve better results. Now that we have established the Constituency Development Fund (CDF) and provided Ksh.4.5 billion in the coming fiscal year for this

Fund, what better leadership could we offer to our people than to use the CDF funds efficiently to address the urgent needs of the poor and vulnerable in our constituencies. Let us show by action that the projects we select for funding are pro-poor and address the most urgent basic needs such as provision of water, building of classrooms and health facilities, etc. In all we do, let us always remember **that "Leadership is action, not position".**

Mr. Speaker, my appeal to Hon. Members, indeed to all Kenyans is, let us reason together on how to rebuild this nation for ***"United we stand, divided we fall."*** For the sake of our electorate and generations to come, we cannot afford to fall.

Mr. Speaker, I beg to move.