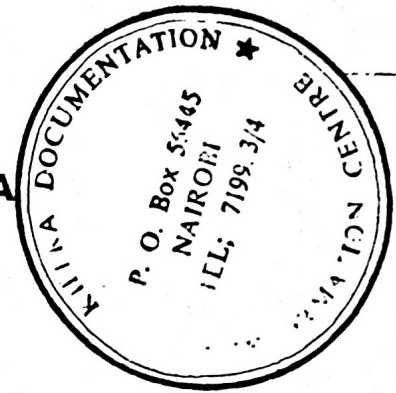




REPUBLIC OF KENYA



Budget Speech

For the

Fiscal Year 2003/2004

(1st July – 30th June)

by

**Hon. DAVID MWIRARIA, M.P.
Minister for Finance**

SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 12TH JUNE, 2003, BY HON. DAVID MWIRARIA, MP, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR FISCAL YEAR 2003/2004

(1st July, 2003 to 30th June, 2004)

Mr. Speaker Sir,

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

INTRODUCTION

Mr. Speaker, National Rainbow Coalition (NARC) took over the instruments of Government in an environment of great expectations and excitement. The team appointed to run various ministries was highly motivated and determined to move quickly and restore public confidence in government. As Ministers moved with gusto, reality begun to dawn. Not only was the country run down and the Treasury empty, there was and still is a large stock of financial obligations to sort out. Of immediate concern is commitment on wage obligations, which will be with us for several years. There is also the rapidly accumulated domestic public debt, which rose from Kshs.215.5 billion in December 2001 to Kshs.251.5 billion in December 2002. This debt is sucking a large part of revenues in form of interest payments. In addition, we have large claims of unpaid liabilities, the so called pending bills. There is also a large stock of contracts, some of which were contracted as late as November, December 2002, details of which we are still unraveling. Added to these are external debts, which stood at Ksh.377.7 billion as at 30th June 2002. This means a very large part of our financial resources is already committed.

To make matters worse, the structure of public expenditure was such that nearly all revenues were used for consumption and debt service. Hardly any resources were spared for operations and maintenance. The little that was allocated for development made it impossible to complete projects on time.

Mr. Speaker, NARC Government has the challenge to sort out the financial mess left behind by the out-going government while improving services to Kenyans. We have to achieve this feat while endeavouring to reduce poverty. As NARC promised in the Election Manifesto, and as has been restated by H.E. the President, Hon. Mwai Kibaki, this will remain our priority. The fiscal, moneta

and economic policies, which I shall announce today, have been formulated after taking into consideration the current financial and economic realities.

Taking all factors into consideration, I am convinced we have made a good start. However, it will obviously take much longer than we had anticipated to put national, financial, economic, and other public affairs in order. To do this, every Kenyan will be required to work harder and sacrifice for the welfare of all of us, especially the poor, vulnerable and marginalized.

DOMESTIC ECONOMY

Mr. Speaker, let me now turn to the performance of the Kenyan economy. Throughout the 1990s, the economy continued to perform poorly. As a result, economic growth averaged about 2% per year between 1990 and 2001. During the period, population growth remained well above the rate of economic growth and closed the year 2000 at about 2.4%.

As will be observed, the last ten years have been particularly difficult for Kenya. First, due to increased incidence of poor economic governance, savings and investments declined steadily, especially after mid 1990s. For example, while the level of savings and investments stood at 17.1% and 21.8%, respectively in 1995, they declined to 7.6% and 16.8%, respectively by calendar year 2001, and are estimated to have fallen further in 2002. The situation arose from a combination of increasing poverty, which rose to 56% of the population by the year 2000, and declining foreign capital inflows. The situation was aggravated by withdrawal of Official Development Assistance (ODA) due to rising incidences of poor economic governance and corruption. As a result of falling foreign direct investments (FDIs) and ODA, Kenya has been a net exporter of capital since mid 1990s. This means Kenya has been paying more to the rest of the world than she has been receiving by way of capital inflows. It is unfortunate that this situation was allowed to continue for so long, thus draining the country of financial resources she desperately needed.

Mr. Speaker, faced with dwindling inflow of resources and rising debt service, the previous government resorted to increased domestic borrowing to service external debt obligations. In an attempt to remain up-to-date on external debt obligations in the face of falling tax revenues, the Government also started to accumulate unpaid claims. The combined effect of taxation,

increased domestic borrowing and accumulation of unpaid obligations squeezed the economy into recession where it is today. These factors have precipitated the worst form of crowding out of the private sector in recent years. For example, in the calendar year 2001, while credit to Central Government grew by 19.8%, credit to private sector declined by 17.3%.—Similarly, in the year 2002, credit to Central Government grew by 21.8% while credit to private sector grew by only 4.8%.

Mr. Speaker, perhaps, the economy could have survived if the Government was utilizing the resources it raised through both taxes and debt, more efficiently. Unfortunately, this was not the case, which is demonstrated by the fact that in the 1990s, the Government was only able to complete 3% of its annual investment portfolio, a very poor performance by any standard. In addition, debt service continued to squeeze other essential expenditures out of the Budget. Consequently, public expenditures, net of debt repayment and interest payments, declined from 23% of GDP in 1990 to less than 20% in 2002. For these reasons the resources available to the Government have been inadequate to sustain existing productive capacity.

Mr. Speaker, as Hon. Members will have noted from the Economic Survey 2003, the economy performed poorly in 2002 recording a real GDP growth of a marginal 1.1%, down from 1.2% in the previous year. This was due to such factors as; poor state of infrastructure, poor commodity prices, especially on agricultural exports, low domestic credit and, political and economic uncertainties relating to the last General Elections. However, in 2002, inflation declined substantially to 2.0% compared to 5.8% in 2001. During the year 2002, international trade declined by 24.0% compared to 16.2% growth in 2001. This is attributed to drop in imports of crude oil, industrial machines, refined sugar, and transport equipment, among others. Overall imports declined by 11.2% while exports rose by 9.7%.

During the year 2002, growth in the agricultural sector dropped from 1.3% in 2001 to 0.7% while manufacturing recorded a modest growth of 1.2%. Tourism grew by a modest 0.8% despite rising threats of international terrorism. The transport and communications sector recorded impressive performance increasing its output by an impressive 22.5%, mainly due to fast growth of mobile phone services. Improved performance in the manufacturing sector is attributed to removal of duties on capital

equipment and basic inputs, together with removal of fish ban by European Union.

In the social sector, Central Government expenditure on social services increased by 18.3% in fiscal year 2002/03 compared to 2001/02. This was on account of additional resources availed to Ministry of Education, Science and Technology in the second half of the financial year to implement free primary education. As a result, expenditure allocations on social services increased from Kshs.79.4 billion in 2001/02 to Kshs.94.0 billion in 2002/03, out of which 70.7% was for Ministry of Education, Science and Technology. The free primary education has reversed declines in gross enrolment in primary schools which currently stands at 100.5% from 90.8% in 2002, with standard one to five recording 118.0%, following introduction of free primary education in January 2003. When private schools are included gross enrolment in primary schools stands at 104.2%, which vindicates the NARC Government's decision to take such a bold step. Increased enrolments have also been noted in secondary schools, tertiary colleges and at university level.

As regards health services, total hospital beds increased by 4.4% in 2002 compared to 2001 while the HIV prevalence rate continued to drop, from 13.0% in 2001 to 10.2% in 2002. There were also significant increases in benefits paid by NHIF while contributions to NSSF recorded major increases. As Hon. Members will appreciate, health and education are two areas in which the NARC Government would like to pay special attention as resources become available.

On employment, persons employed outside small-scale agriculture and pastoralism increased by 7.6%, from 6,366.9 thousand to 6,851.6 thousand in 2002 compared to 2001. Employment in modern sector grew by a modest 1.3% while private sector employment grew by 1.6%.

Mr. Speaker, during the year, the Central Bank maintained a tight monetary policy, which resulted in a significant drop in inflation rate from 5.8% in 2001 to 2.0% in 2002. The money and financial markets remained fairly stable, even though banks continued to experience excess liquidity, which averaged 46.0%, compared to the statutory requirement of 20.0%. This excess persists due to reluctance by the banks to lend to the private sector in preference of investing in government securities.

Mr. Speaker, on balance of payments, weak domestic demand during the year resulted in substantial drop in imports. The most affected commodities being mineral fuels, machinery and transport equipment, food and live animals. However, there was significant growth in exports of horticultural produce and re-exports. Arising from these developments, trade deficit narrowed for the first time since 1996 and the current account balance recovered from a deficit of Kshs.43.8 billion to a surplus of Kshs.4.7 billion. But the capital account worsened from a surplus of Kshs.35.4 billion in 2001 to a deficit of Kshs.4.5 billion due to sharp reduction in capital inflows.

Mr. Speaker, as explained earlier, the agricultural sector deteriorated in 2002 due to unfavourable weather and poor commodity prices in the world market. This led to deterioration in terms of trade by 3.2%, at current prices. During the same period, the value of marketed produce declined by 10.2% which affected all major commodities.

Mr. Speaker, volatility in world oil prices translated into instability in domestic prices of refined products. During the year crude oil imports declined by 24.0% while refined petroleum products declined by 13.7%, resulting in an overall decline of import bill by 22.6%. Total electricity generating capacity remained the same at 1,142.2 MW as in 2001. However, due to improved weather, actual generation increased by 5.2%, rising from 4,452.1 GWH in 2001 to 4,685.6 GWH in 2002. In total, electricity consumption increased by 7.2%, though, electricity charges to consumers remained unchanged.

Mr. Speaker, I do not intend to analyze the domestic economy any further. Hon. Members have already received their copies of Economic Survey 2003, which gives more details. This is a useful document, which Hon. Members need to read as it gives the necessary background information, essential to understanding both taxation and expenditure proposals for the next fiscal year.

POLICY STRATEGY

Mr. Speaker, the NARC Manifesto promised to turn the economy around, create 500,000 jobs a year, and restore performance and credibility of the Government. On assuming power, it became obvious that the economy was so run down that major reforms were necessary in order to put it on a growth path. It is for this reason that the Government has just published of the Economic Recovery Strategy for Wealth and Employment Creation

2003-2007, under the auspices of the Ministry of Planning and National Development.

The ministry has conducted several consultative fora, which included a wide range of economic players including, Members of Parliament, government agencies and our development partners.

The measures I present to this August House today incorporate the initial phase of our economic recovery strategy.

Mr. Speaker, I do not intend to go into more details of the Economic Recovery Strategy for Wealth and Employment Creation. Hon. Members have had occasion to participate in the consultative process and are aware of its contents. Besides, these documents will be distributed to them. However, I need to mention some of the main objectives of this strategy, which include;

- (i) reversing declines in per capita income growth,
- (ii) increasing investments, both private and public while raising productivity of capital,
- (iii) developing a foreign aid policy that targets poverty reduction, avoids crowding out the private sector; enhances transfer of technology while strengthening and promoting domestic institutions,
- (iv) channeling more budgetary resources to growth and poverty reducing areas, while prioritizing and rationalizing resource allocation,
- (v) maintaining stable macro economic situation, sustainable balance of payments and public debt both local and external, and ensuring government borrowing is consistent with the desirable monetary policy,
- (vi) creating an enabling environment and incentives for investors,
- (vii) promoting exports, and
- (viii) restoring and maintaining sound relations with development partners.

Mr. Speaker, achieving these objectives requires financial discipline, collaboration between public and private sectors and hard work over the next three to four years. In addition, these objectives are essential to the realization of the NARC goals of creating 500,000 jobs a year. It is for this reason that I have chosen this year's Budget theme as "Working together to regain high and sustained Economic Growth." On its part, the Government has

set various macro-economic targets for the period 2003 to 2007, which include;

- (i) an annual average real GDP growth rate of 4.7%,
- (ii) raising annual investment rate to an average of 17.7% to achieve an average of investment/GDP ratio of 23.3%,
- (iii) raising annual savings ratio from 10.7% in 2002 to about 15.8% in 2007 and export growth on annual basis to an average of 5.8%, during the recovery period,
- (iv) maintaining real private consumption growth at about 4.4% and ensuring a decline in consumption/GDP ratio, and
- (v) reducing Government consumption to GDP to a target level of 14% while raising external resources inflows to at least US\$2,221 million a year to cover the savings and investment gap over the next five years.

Mr. Speaker, these macro-targets are based on various sectoral targets with the lead sector expected to be building and construction, which, on average is projected to grow at 16.7% per annum, followed by manufacturing with a projected growth rate of 8.6% per annum. Due to a number of structural and institutional problems, agriculture is expected to grow by 3.1% per annum. Information and Communication Technology is expected to grow by an average rate of 5.0% per annum. When realized, these targets will reduce the share of Agriculture from about 24.1% of GDP in 2001 to 22.2% in 2007.

Mr. Speaker, to realize these targets the Government will need to implement appropriate policies in a consistent and sustainable manner. In this context, the need for enhanced fiscal discipline and committed management cannot be over emphasized. To support the key economic players in the private sector, the Government will need to play its facilitative and regulatory role more efficiently and impartially. In this connection, every public officer will be required to perform his or her functions impartially. Favouring friends and relatives through their public offices will be prohibited. The recently enacted Anti-Corruption and Economic Crimes Act and the Public Officers Ethics Act, 2003 are expected to address this particular concern and ensure Public Servants serve the public and not vested interests.

Mr. Speaker, based on the strategy outlined in the Economic Recovery, various reforms are planned as detailed under each of the sectors. In my speech today, I can only highlight some sector reforms.

MANAGEMENT OF FISCAL POLICY

Mr. Speaker, consistent with our Economic Recovery Strategy, the management of public resources will be restructured to ensure that the tax burden is gradually reduced to a sustainable level and made more equitable. On expenditures, the Government will seek to realize value for money on public investments. In this regard, we note with disappointment that for many years, the Treasury has continued to release money to ministries without assessing what the ensuing expenditures have achieved or created. This concern was confirmed by Public Expenditure Reviews conducted in 1997 and again in 2002/03. These reviews show clearly that the use of public resources has not achieved the desired objectives. In the first place, little prioritization was done when budgeting and no efforts were made to ensure timely and efficient implementation of public programmes and projects. Secondly, even in cases where projects have been completed, they were hardly ever used optimally due to combination of lack of recurrent resources, and unreliability of resource flows. Thirdly, though a Medium Term Expenditure Framework (MTEF), was introduced in 2000/01 which was expected to lead to more predictable allocation of resources with more predictable flows, this system appears to have been only honoured in breach. Old habits continue to dominate expenditure management.

Mr. Speaker, the combined effects of inappropriate allocation of resources and unreliable resource flows to spending units, together with indiscipline in financial management, have all led to the wastage we see today. Stalled public projects can be seen in every major town. These projects, which are at various stages of implementation, stand out as a testimony of our past financial mismanagement. They also represent a large volume of sunk costs, which continue to be used by crafty contractors to make more money from the overburdened taxpayer through penalty charges.

Mr. Speaker, as part of our Economic Recovery Programme, the NARC Government will pay special attention to quality public expenditure management. The gap between expenditures and available resources will be narrowed in order to reduce pressure on domestic borrowing. This is necessary to make budgeting and budget execution more predictable. I am therefore putting the line ministries on notice. They must observe the following:-

- (i) include in the budget only those projects and programmes which they have capacity to implement;
- (ii) incur expenditures only on programmes and projects, which are in the budget;
- (iii) be fully accountable for what they budget for, in other words, they have to be accurate;
- (iv) accounting officers to ensure they budget for all essential expenditures and services, any omitted items will not be funded under supplementary estimates unless they are emergencies;
- (v) Treasury will not accept new projects or programmes, after the Printed Estimates are finalized; nor will it tolerate creation of new pending bills;
- (vi) save for restructuring the current large stock of short-term domestic debt, the Government will only borrow for investments; while short-term borrowing will be confined to closing revenue gaps arising from seasonalities in revenue collection.

Mr. Speaker, as part of improving public expenditure management, the Government will in the course of this year, prepare modalities to institutionalize Public Expenditure Reviews (PERs), and make these reviews an annual feature. In future, resource allocations and sustaining of public projects and programmes will be based on how well a ministry has used resources previously allocated to it. In addition, ministries need to ensure the expenditures they incur generate value for money. Towards this end, the Ministry of Finance, in conjunction with Ministry of Planning and National Development, will institutionalize a system for public expenditure tracking. This system will be designed to check whether allocated resources reach the intended beneficiaries and with what effects.

Mr. Speaker, revenue including A-in-A, has been growing at less than 2% p.a. To maintain an appropriate fiscal balance and reduce pressure on domestic borrowing, growth of public expenditures should be contained within the same range. This calls for enhanced financial discipline but more importantly, the need to prioritize expenditures. The problem of financial indiscipline has been worsened by unpredictable flow of external resources resulting in negative impacts on projects and programme implementation. All these concerns will need to be addressed to improve budget execution.

Mr. Speaker, I cannot over emphasize the need to prioritize expenditure composition based on the need to maximize social/economic rate of return. In this regard, every public officer needs to appreciate that the only way we can hope to improve services rendered to the public and pay public servants better is through increased economic growth. For this reason, expenditures with the highest returns should come first.

To assist in improving the expenditure management, Treasury, in consultation with our development partners, is working on a program to improve financial information management system. This will go hand in hand with operationalization of an updated Country Financial Accountability Assessment (CFAA) programme. As part of this, the Government will table before this August House the following bills for debate: the Government Financial Management Bill, 2003 and the Public Audit Bill 2003, both of which will replace the Exchequer and Audit Act, and Procurement and Disposal of Assets Bill, 2003. When passed, these laws are expected to significantly enhance both transparency and accountability in management of public resources. However, we need not wait until these bills are enacted into law, improvements should start today, if not yesterday, tomorrow may be too late.

Mr. Speaker, labour costs have significant impacts on the cost of doing business in a country. For this reason, the Economic Recovery Strategy, recognizes that the existing wage policy and guidelines are inappropriate in a liberalized market economy. The reason is that they target employees as a group and do not take into consideration productivity either at national or firm level. Therefore, their operations may be responsible for making Kenya one of the most expensive labour cost countries in the region. This has adversely affected our competitiveness in the international markets and has ultimately hurt growth of formal employment. I am therefore proposing a thorough review of the current wage policy in the country. The review will culminate in initiating the necessary reforms to wage policy to make it consistent with a liberalized market economy. It will also make Kenya comply with international best practices.

Mr. Speaker, the public transport system in this country continues to experience turbulent times. Attempts to remove the Transport Licensing Board (TLB) last year saw an upsurge of illegal groups. Each of these groups has sought to take control of routes and introduce own fees and charges. Some groups went as far as

claiming to own the various public roads. As the sector ministry prepares the appropriate public transport policy, it is necessary to retain the TLB. This decision has been arrived at after consultations with the relevant stakeholders. In the meantime, the fees charged under the Transport Licensing Board have been reintroduced. During the next fiscal year, the stakeholders will undertake further consultations and develop the necessary procedures for licensing, security, and controls, which will apply to public transport operators.

SECTORAL POLICIES IMPROVING GOVERNANCE IN MANAGEMENT OF PUBLIC AFFAIRS

Mr. Speaker, good economic, political, and social governance is essential to improving overall management of public affairs. Furthermore, good governance is also necessary for creating an enabling environment for private investors. It is also critical to faster economic growth and poverty reduction. For these reasons, the Government will spare no efforts in its endeavour to achieve this goal. As Hon. Members are aware, we have already started. Since the formation of the NARC Government, several policy initiatives have been launched to address instances of bad governance. These include:-

- (i) enactment of Anti-Corruption and Economic Crimes Act, together with the Public Officers Ethics Act,
- (ii) appointment of a Task Force on Public Collections or Harambees,
- (iii) appointment of a Committee on Truth, Justice and Reconciliation,
- (iv) appointment of several commissions, including a Judicial Commission on the Goldenberg Scandal, and
- (v) re-launching of the Constitutional Review process which was derailed and stalled in the run up to the 2002 General Elections, to name but a few.

In the coming financial year, the Government will operationalize Anti-Corruption Commission and move forward with implementation of the Anti-Corruption and Economic Crimes Act. It will also launch full implementation of the Code of Ethics for public servants. In addition, the Government will establish a truly independent National Human Rights Commission. The Government will also establish the office of the Ombudsman. These measures together with wide ranging Judicial Reforms, will aim to ensure

equality of all before the law and to make, rule of law supreme in this country.

(a) PUBLIC ADMINISTRATION

Mr. Speaker, the government ~~is committed~~ to improving the institutional capacity of the public service to make it more effective in formulation and implementation of Government policies and programmes. However, coming from a history of weak institutional capacity together with unwillingness to enforce law has created some impediments. For this reason changes are necessary to make sure there is a clear and effective capacity to perform. This is necessary to create a level playing field for all economic players. When this is done, it will give opportunity to investors to maximize returns from their investments. In addition, the Government has already established a commission to review business-related laws and regulations. The Commission will also review institutional aspects and recommend appropriate changes to address identified impediments. Based on commission findings the Government will simplify and rationalize rules and regulations, enforcement and arbitration procedures, to make this country more investor friendly.

Mr. Speaker, the Government will continue with the Ministerial Rationalization Programme. The primary objective of this programme is to reduce duplication and to make public sector more focused, efficient, and effective, in service delivery. This, as emphasized by H.E. the President during the official opening of the 9th Parliament, will involve undertaking detailed ministerial reviews, and developing a criteria for assessing productivity in public service.

As part of this reform the Government, in collaboration with development partners, will design skills development and training strategy to improve quality of public services.

(b) PUBLIC ENTERPRISES

Mr. Speaker, this country has a large number of Public Enterprises many of which are engaged in commercial activities. Contrary to original expectations, majority of them depend on the Exchequer for their financial survival. Some have borrowed, both locally and externally, but do not service their debts forcing the Exchequer to pick the costs. This unfortunate situation has been encouraged by past bad governance, which made some of the Public Sector managers operate without adequate consultation.

This enabled public enterprises to be treated as cash cows such that even monopolies with captive markets made losses.

Mr. Speaker, my message to management of these enterprises is short and clear, "It is time each one of them proved his or her worth, ~~the Kenyan taxpayers need a break~~". Accordingly, NARC Government will not allow any of them to be excess baggage to the Exchequer. Each of them will be required to add value to the economy or be wound up. Towards this end, the Government will conduct a comprehensive review of public enterprises with a view to reforming those, which are still needed in the public sector. For those no longer necessary and which need to be privatized, their sale will be conducted in a transparent and accountable manner. In all cases, where privatization is needed, Kenyans will be given the first opportunity to buy a stake through floatation in the local stock exchange.

Mr. Speaker, to ensure the privatization programme is conducted according to expectations of Kenyans, a Public Enterprises Privatization Bill will soon be tabled before this August House for consideration and enactment. The primary objective of this Bill is to build a consensus among stakeholders and economic players while setting clear privatization procedures. It will also provide legal procedures and modalities to underpin the privatization process. For critical enterprises in the public utilities, the Government will seek to build public and private sector partnerships. Where necessary the Government will promote broad based ownership, while maintaining financial viability. The Government will also hire chief officers (CEOs) on basis of performance contracts of two to five years. These contracts will specify the expected achievements of those appointed to head public enterprises.

As part of public sector reforms, the Government will be seeking to restructure all aspects of these enterprises, whether operational, institutional or financial. In the meantime, managers of public enterprises will be expected to give reasonable returns on investments under their care. In the case of enterprises in health and education services, the focus will be on improvement of quality of services provided.

As regards the Energy and Telecommunication services, these have been some of the most disappointing areas. Contrary to expected results, enterprises in these sub-sectors have been major obstacles to private sector operators. Though they have

huge investments, they have been characterized by poor quality, unreliable, and high cost services. This situation continues to hurt both the private investors and the economy. The major problem here has been poor governance which the Government has already started to correct. In the coming fiscal year, the aim will be to restore ~~the affected~~ enterprises to financial viability. In the meantime, to assist investors, I will be announcing some fiscal measures to mitigate poor services in these critical areas. I must however, hasten to add that I do not believe the solution to inefficient public enterprises is to give them duty and tax exemptions. Where this has been done in the past, such exemptions have tended to increase obscurity, or lack of transparency, in their operations.

(c) LOCAL AUTHORITIES

Mr. Speaker, Local Authorities play a critical role in economic growth and development as they provide services necessary to investors at operating level. They also promote participatory democracy and can have significant impacts to poverty alleviation if they are efficiently run. In recognition of this importance, a Local Authority Transfer Fund (LATF) was introduced in 1998 to facilitate transfer of revenues to them. The transfer was based on expectation that the LATF resources would enable the authorities become primary vehicles for implementing successful community based and driven development. Though the transfer has had a measure of success, there is need for improvements. In particular Local Authorities need to move faster and improve their revenue bases.

As Hon. members are aware, the Draft Constitution proposes to give Local Authorities enormous responsibilities, as part of devolution process. As we await the final outcome of the Constitutional Review, it is obvious that many of these authorities lack the capacity to deliver quality services to the public. However, irrespective of the outcome of the Constitutional Review, the Government is fully committed to further strengthening of Local Authority capacity to deliver essential services. This is critical to generating economic growth throughout the country. For this, the Government will seek to develop greater partnership between local authorities and their communities so that they can initiate and implement local level economic and social development programmes. One area where urgent action is required is in improvement of their financial and institutional viability to make these authorities agents of social change.

Mr. Speaker, during the Financial Year 2003-2004, the Government will transfer a total of Kshs.3.75 billion to Local Authorities through LATF, which represents a 25% increase over 2002/03. It is my expectation that these LATF resources, in combination with own revenues, will be used to improve the ~~livelihoods of people~~ throughout the country. Since the amounts allocated to each authority is published in press, I would like to encourage residents of the recipient local authorities to follow keenly on how the money is used.

Mr. Speaker, the governance of institutions, which the NARC Government has established, such as Anti-Corruption Authority, will assist and improve use of the transferred resources. However, the responsibility to ensure proper use lies with the recipients. If not properly utilized, the affected authority will not access future LATF funds. In due course, Treasury will put in place a monitoring and evaluation programme to assess how these resources have been used. This information will form a critical input in the design of future inter-governmental fiscal relations.

(d) PUBLIC SAFETY, LAW AND ORDER

(i) Agents of Law and Order;

Mr. Speaker, the Government recognizes the critical role played by effective maintenance of law and order in the socio-economic and political life of this country. Without security, there can be no economic growth or poverty reduction. The situation has now become more important with increased threats of terrorism. We therefore need to improve the capacity of our agencies of law and order to deal with any threat to peace and stability, irrespective of its origin. Unfortunately, they have been neglected for many years and will take time to reverse the trend. It has also been compounded by incidents of bad governance leading to serious under funding and inappropriate procurements of their basic needs.

It is for these reasons that the NARC Government undertook early reorganization of the police force to make it more focused and effective. In this endeavour, we believe the starting point should be in improvement of the quality of personnel who join these agencies or departments. The recent transparent recruitment of new officers, is but the beginning of a long journey aimed at improving both the calibre and the image of our force. We will continue with reforms,

but in so doing, I would like to assure Hon. Members that the Government will be fair and transparent, in enforcing the law. As part of these efforts, the government has allocated additional resources to start implementing a medium-term programme on operations and maintenance, housing and equipment modernization. These measures will be enhanced to equip our police force and develop the capacity to meet both the existing and emerging challenges.

(ii) Judiciary

Mr. Speaker, fair and expeditious dispensation of justice, that is accessible by all, is a necessary component of economic growth and poverty reduction. Already the Government has started reforms in the Judiciary, which will be deepened and expanded to enable it clear the large backlog of cases currently pending in our courts. Needless to say, delays in hearing cases have been one of the major injustices in this country, which we must address openly and honestly. To improve the situation, the Government will, over the next three years, take several measures, among them, to;

- (i) recruit and train more prosecutors, and equip them to enhance their capacity;
- (ii) decentralize public prosecution services to speed up the trials;
- (iii) modernize court registries, in particular, the business registries;
- (iv) strengthen Law Reform Commission and improve drafting capacity;
- (v) undertake extension of court physical facilities;
- (vi) ensure civil litigation is faster, more efficient, accessible, and affordable;
- (vii) identify and promote use of alternative dispute resolutions;
- (viii) develop and implement a framework to strengthen enforcement of judgments;
- (ix) ensure speedy and affordable commercial justice system; and
- (x) develop children's courts and institutional support.

(iii) Prisons

Mr. Speaker, improvements in our prison system, to reduce and ultimately eliminate inhuman conditions are necessary and urgent. Prison facilities need rehabilitation to make them correction centres and not dens for hardening jailed offenders. For these reasons, the government will, both in the immediate and

undertake rationalization of the prisons

management, fully implement the Community Service Order Act, expand prisons through construction of more space and residential housing for staff, and recruit and train more officers while retraining those already in service. This will be done in tandem with improvements of facilities for the inmates.

AGRICULTURE AND RURAL DEVELOPMENT

Mr. Speaker, as Hon. Members are well aware, agricultural sector continues to dominate the economy. It has also been one of the most abused sectors. Consequently, our efforts to eradicate poverty must focus strongly, on making agriculture more productive and better organized to enhance its competitiveness. We recognized that, despite being so critical, the sector has experienced a number of challenges, which include;

- (i) high dependence on rainfall,
- (ii) out-of-date and inappropriate technology,
- (iii) inadequate funding for research and extension with poor linkage between research findings and farming practices;
- (iv) many but outdated laws and regulations with weak regulatory capacity for managing liberalized market, going hand-in-hand with unfair trading practices, which include free importation of subsidized produce from developed economies;
- (v) poor governance in key agricultural institutions, including the cooperatives and development finance corporations;
- (vi) poor and inadequate infrastructure, leading to high costs of production ,
- (vii) high incidence of HIV/AIDS which is affecting labour productivity,
- (viii) poor access to credit due to high risk; and
- (ix) poor marketing arrangements.

Mr. Speaker, of particular concern has been the effects of poor governance in this sector, especially with regard to, sugar, and cereals. In the past, preferred traders have been allowed to import some of these commodities, free of duties and taxes and sell them cheaply at the expense of local producers. This practice has consistently driven producer prices below remunerative levels, thus undermining farmers' incomes while discouraging local production. Consequently, this is one area, which the Government will give special attention in order to protect farmers. In this connection, no trader will be allowed to import commodities free of

but in so doing, I would like to assure Hon. Members that the Government will be fair and transparent, in enforcing the law. As part of these efforts, the government has allocated additional resources to start implementing a medium-term programme on operations and maintenance, housing and equipment modernization. These measures will be enhanced to equip our police force and develop the capacity to meet both the existing and emerging challenges.

(ii) Judiciary

Mr. Speaker, fair and expeditious dispensation of justice, that is accessible by all, is a necessary component of economic growth and poverty reduction. Already the Government has started reforms in the Judiciary, which will be deepened and expanded to enable it clear the large backlog of cases currently pending in our courts. Needless to say, delays in hearing cases have been one of the major injustices in this country, which we must address openly and honestly. To improve the situation, the Government will, over the next three years, take several measures, among them, to;

- (i) recruit and train more prosecutors, and equip them to enhance their capacity;
- (ii) decentralize public prosecution services to speed up the trials;
- (iii) modernize court registries, in particular, the business registries;
- (iv) strengthen Law Reform Commission and improve drafting capacity;
- (v) undertake extension of court physical facilities;
- (vi) ensure civil litigation is faster, more efficient, accessible, and affordable;
- (vii) identify and promote use of alternative dispute resolutions;
- (viii) develop and implement a framework to strengthen enforcement of judgments;
- (ix) ensure speedy and affordable commercial justice system; and
- (x) develop children's courts and institutional support.

(iii) Prisons

Mr. Speaker, improvements in our prison system, to reduce and ultimately eliminate inhuman conditions are necessary and urgent. Prison facilities need rehabilitation to make them correction centres and not dens for hardening jailed offenders. For these reasons, the government will, both in the immediate and medium-term, undertake rationalization of the prisons

management, fully implement the Community Service Order Act, expand prisons through construction of more space and residential housing for staff, and recruit and train more officers while retraining those already in service. This will be done in tandem with improvements of facilities for the inmates.

AGRICULTURE AND RURAL DEVELOPMENT

Mr. Speaker, as Hon. Members are well aware, agricultural sector continues to dominate the economy. It has also been one of the most abused sectors. Consequently, our efforts to eradicate poverty must focus strongly, on making agriculture more productive and better organized to enhance its competitiveness. We recognized that, despite being so critical, the sector has experienced a number of challenges, which include;

- (i) high dependence on rainfall,
- (ii) out-of-date and inappropriate technology,
- (iii) inadequate funding for research and extension with poor linkage between research findings and farming practices;
- (iv) many but outdated laws and regulations with weak regulatory capacity for managing liberalized market, going hand-in-hand with unfair trading practices, which include free importation of subsidized produce from developed economies;
- (v) poor governance in key agricultural institutions, including the cooperatives and development finance corporations;
- (vi) poor and inadequate infrastructure, leading to high costs of production ,
- (vii) high incidence of HIV/AIDS which is affecting labour productivity,
- (viii) poor access to credit due to high risk; and
- (ix) poor marketing arrangements.

Mr. Speaker, of particular concern has been the effects of poor governance in this sector, especially with regard to, sugar, and cereals. In the past, preferred traders have been allowed to import some of these commodities, free of duties and taxes and sell them cheaply at the expense of local producers. This practice has consistently driven producer prices below remunerative levels, thus undermining farmers' incomes while discouraging local production. Consequently, this is one area, which the Government will give special attention in order to protect farmers. In this connection, no trader will be allowed to import commodities free of

duties and taxes, unless such commodity is duty-free in the tariff. Secondly, I will shortly propose measures to deal with both substandard goods and diversion of transit goods, two of the most notorious conduits of illegal imports.

Mr. Speaker, on low productivity, the government will institute legal and institutional reforms in the sector, with special attention going to proliferation of out of date statutes which hinder operations in the sector. In addition, resources will be availed for increased investments in infrastructure, extension services, input access, research and training, among others. The Government will also encourage and promote greater collaboration between research institutions and other service providers. Besides, resources will be allocated for rural access roads to promote market access and reduce cost of inputs to farmers.

Mr. Speaker, other measures aimed at enhancing productivity in agricultural sector include:

(i) rationalization of the roles and functions of key agricultural institutions to minimize duplication; (ii) harmonization of government interventions; (iii) enhancement of collaboration with the private sector and development partners, to implement and monitor programmes and projects in the agricultural sector; (iv) improvement of good governance in the management of agricultural cooperatives, particularly in coffee subsector; many of which have been run down to the disadvantage of farmers, and (v) revival and strengthening of farmers' support institutions such as AFC, and KCC.

Mr. Speaker, lately, the country has experienced severe flooding, particularly in Lake Victoria Basin. This has affected agricultural production in that region which will require extensive attention. It will, therefore, be necessary to take flood control measures. These will include construction of dams and dykes along the flood prone areas to direct some of the water to wells and pans. To further support development of agriculture, the Government will; (i) finalize review of the Irrigation Act to facilitate greater participation of farmers in irrigation schemes, (ii) rehabilitate neglected irrigation schemes and increase production of crops, such as cotton and rice; and (iii) develop an irrigation and drainage master plan that will facilitate coordinated irrigation and drainage expansion.

Mr. Speaker, in the cash crop sub-sector, serious problems exist, particularly with regard to such crops as sugar, pyrethrum, coffee, tea and cashew nuts. To deal with the problems in this area, the Government will take a multi-pronged approach to improve earnings from this sector. These will include, construction of additional tea factories where needed, review of the Coffee Act to facilitate quality improvement and encourage more agro-processing, and more rigorous enforcement of quality and residue standards on horticultural exports. The Government will also encourage diversification of export crops to increase export earnings. In case of sugar, work is already in progress to find solutions to current problems. The ultimate objective of these measures is to enhance productivity and increase incomes to reduce rural poverty.

Mr. Speaker, the Cooperative movement is a major vehicle for improving farmers' income. When well run, they are effective channels through which farmers can access quality farm inputs at reasonable prices. They are also effective channels for delivery of credit to farmers. They also give farmers negotiation force when they act together. For these reasons, the Government will give attention to restoring good governance, efficiency and financial viability to the cooperative movement. Consequently, the Government will, in consultation with the relevant development partners, explore the possibility of writing off non-performing loans advanced to the Co-operative movement by the Co-operative Bank. The Government will also encourage farmers to form cooperatives where they do not exist in order to improve their market force.

As we promote micro-finance, there can be no better channel for farmers, to access credit than through a stronger, better run and more transparent cooperative movement. As part of this initiative, I am proposing a major shift, in the taxation of cooperatives, under the Income Tax Act. In so doing, I expect the cooperatives to remain focused in their core businesses. In that case, they will enjoy full tax benefits, but only when they pass the benefits to their members.

Other measures planned for this sector include buying back KCC 2000 and restoring its ownership to farmers, and restructuring of Agricultural Finance Cooperation (AFC). The Government will also enact a Micro-Finance law to increase farmers' access to credit and to create savings vehicles to fill the vacuum created when commercial banks closed branches in rural areas.

ENVIRONMENT AND NATURAL RESOURCES

Mr. Speaker, Environment and Natural resources suffered the greatest damage during the last years of the previous Government. Wanton destruction of forests was perpetrated to the point where bhang growing in forest reserves was a common practice. Forestland was also indiscriminately hived off and given as rewards to friends and relatives. This situation led to a systematic degradation of environment especially water catchment areas. To make matters worse local authorities failed to collect and dispose garbage in towns leading to increased risks to life. To reverse the situation the Government has already initiated measures to improve environmental conservation. In the past, weak environmental management and failure to enforce environmental standards and regulations, resulted in severe degradation of land leading to depletion of the natural resource base. This abuse has resulted in adverse climatic conditions characterized by droughts and killer floods, as rain water rushed down bare hills. It is now time to halt the damage and start rebuilding our environment.

Mr. Speaker, among the measures the Government has taken to stabilize the environmental situation, are; (i) strict enforcement of laws against logging has already started; and (ii) operationalizing the National Environmental Management Authority (NEMA). NEMA is required to ensure that projects with potential impacts on the environment go through an Environmental Impact Assessment (EIA) before they are implemented. In addition, environmental concerns will be integrated in land use and planning. The Government is also working on a new Land Use Policy which will be announced later and which will incorporate environmental issues and concerns.

In the meantime, the Government is taking measures to protect forestlands, water catchment areas, and marine ecosystems. Attention is being given to our lakes and rivers, to minimize encroachment and to control all forms of environmental degradation and pollution, whether from agro-chemicals, industrial wastes, emissions, and, or other effluents. It will also initiate reforestation programmes to repair the damage and increase forest cover. In this regard, the Government will work with other stakeholders, especially the communities living in affected areas to restore and sustain appropriate bio-diversity to sustain livelihoods of the local communities. To support measures to increase forest cover, it is necessary to promote alternative energy sources such as wind, solar, and biogas. This will help ease pressure on wood fuel as an energy source. As part of this effort, rural electrification

programme will be provided with additional funds and efforts intensified to give rural communities an alternative energy source.

Mr. Speaker, the National Meteorological service is an important ~~partner in both~~ environmental conservation and promotion of the agricultural sector. Consequently, its capacity will be enhanced to better serve the economy, especially the agricultural sector. In this connection, the Government will; (i) expand the present network of 35-24 hour observing stations, (ii) improve and modernize its communication systems; (iii) increase the early warning capabilities; (iv) improve its operating environment by reviewing the legal, institutional and regulatory framework; and (iv) facilitate export of quality meteorological services.

Mr. Speaker, as regards the mining industry, Kenya has operated without an elaborate mining policy for a long time. This has contributed to under development of this industry and enabled its misuse making it inappropriate to deal with the current challenges. Consequently, the Government has commissioned work to develop a national mining policy for the development of this sub-sector. This policy will include compensation for people displaced by mining activities, environmental protection, value addition, technology transfer, and determination of royalties to the Government. It is expected that this policy will encourage growth in the sub sector to ensure the local residents and other Kenyans enjoy benefits from mining activities.

INDUSTRY

(i) Manufacturing

Mr. Speaker, during my short period in the Treasury, I have received a large volume of representations, majority of which seek removal of duties and taxes. However, as Hon. Members will appreciate, it is not possible to remove all fiscal charges since the Government requires revenue to render public services. However, there are only limited opportunities to reduce these charges which need to be used sparingly. We understand these sentiments as originating from a prolonged period of economic recession. The local industries have been through a very difficult time and are looking for ways out of it. Their problems are made worse by high costs of electricity, poor roads, insecurity, and general

inefficiencies in import management such as importation of counterfeit goods together with rising labour costs.

The Government appreciates these problems and is committed to ensuring that the sector plays a leading role in our economic recovery efforts, together with poverty alleviation. To achieve these goals, the government will implement the following measures, among others:-

- (i) develop an export development strategy that considers all sectors and seeks to expand diversification of export markets to reduce vulnerability;
- (ii) put in place, by 2004, a comprehensive Industrial Master Plan to implement first phase of Kenya's industrial transformation strategy;
- (iii) benchmark key industries to international standards and structure recovery efforts for these industries around international price targets. The focus will be on resource-based industries to maximize the benefits to the rural areas; and
- (iv) ensure the monetary and exchange rate policies are consistent with our desire to maintain low and predictable interest rates as well as appropriate exchange rate.

In the meantime, I propose to take several fiscal measures to support local producers in their endeavour to regain their competitiveness. The measures, which will include changes in all the three major taxes; Customs, VAT and Income Tax, will be investor-based. I will also be proposing a measure of general relief to all taxpayers in order to improve purchasing power in the country. But I must hasten to add that where tax reductions are granted to producers to reduce costs but the producers do not pass the benefits to consumers, I will not entertain any further requests from the industries concerned. In addition, I will reserve the option to withdraw the incentive at an appropriate time. As part of these measures, I am also proposing to introduce very strict and time based measures to deal with all forms of counterfeit and substandard goods.

(ii) Micro and Small Scale Enterprises (MSE)

Mr. Speaker, these enterprises cut across all sectors of the economy and provide one of the most prolific sources of employment, not to mention the breeding ground for future businesses and employers. During the last decade when the

economy faced serious challenges, this sector became the fastest growing. Today, these enterprises are found in every corner of this country and have great potential to create a variety of jobs while generating widespread economic benefits. It is for this reason that His Excellency the President, promised that the Government will develop a Sessional Paper to lay the policy foundation for development and improvement of these enterprises. The Sessional Paper, which is at an advanced stage, will include a wide range of policy and administrative matters. Among the critical issues to be addressed are, the legal and regulatory framework and access to finance.

Mr. Speaker, there is little doubt that a well functioning policy on micro, small and medium scale enterprises is critical to spreading investments into the rural areas. In particular, they are needed in agro-processing, which needs such skills and service providers, within easy reach. The Government will therefore seek to promote these enterprises on cross-sectoral basis. This is necessary in order to create jobs, promote new and appropriate technologies.

TOURISM DEVELOPMENT

Mr. Speaker, tourism is one of the key growth areas with great potential for quick income generation. The necessary infrastructure is already in place and can be used to regenerate growth. During the first four months of this year, tourist arrivals rose by 25% confirming the potential for quick recovery. Unfortunately, following negative travel advisories by both USA and UK, tourist arrivals suddenly dried up. Now the industry faces a very bleak future, and with it sources of livelihoods for many of our people. It will also have significant negative impact on our balance of payments.

Mr. Speaker, Government appreciated the dangers of terrorism and has taken a firm stand on this and will continue to take very firm action against those who perpetrate terrorism. However, we do not believe that the best way to fight terrorism is to give-in to threats or to take measures, which increase economic problems for the poor. If anything, such actions encourage terrorists to be more bold in the hope that people will recognize their causes. What we need is to develop collaborative efforts to fight the evil by protecting both lives and economic interests of our people. The measures we have taken and will continue to take,

should demonstrate to those visiting Kenya that they are as safe, if not safer, as they would be in any part of the world.

Mr. Speaker, we have already established an anti-terrorism police unit, which is being supplemented by a re-organized police force. We have made plans to better equip and supply the force to improve overall security situation in the country. In addition, other security agencies have been fully appraised on their roles in fighting this evil. This will be a continuous process in which our police officers will be retrained to improve their relations with the public who provide the first line of defence. The general public has a critical part to play in fighting terrorism, especially when they freely give information on suspicious individuals and incidents to the police. I therefore appeal and invite our partners in tourism to work with us in the war against terrorism. In the meantime, I strongly think they should withdraw all the negative travel advisories on Kenya.

Mr. Speaker, we all know that promoting filming industry is the most effective way to market a country for tourism development. It is unfortunate this opportunity was lost due to unclear paranoia of film makers by the previous regime. To correct the situation, the Government will give promotion of filming the priority it deserves. This is necessary to give the country added exposure to the rest of the world. However, filming will go hand in hand with enhanced protection of our flora and fauna, a process which has already started. In addition, to improve security in tourism resorts, the KWS will be granted fiscal incentives which are availed to other uniformed services. The industry will further benefit from the other fiscal incentives which I will be proposing shortly.

MONEY AND FINANCE

Mr. Speaker, as I have already indicated, the economy has been under recession since mid-1990s. One of the contributing factors to this poor performance has been weakness in management of monetary, fiscal and financial policies.

In most cases, these policies have been part of the problem rather than solution. As can be recalled, in early 1990s, expansionary fiscal policies were soon translated into expansionary money supply. Efforts taken to mop up the excess liquidity drew the commercial banks from lending to private sector to investing in Treasury Bills. Unfortunately this process continued

throughout the 1990s. When the Government decided to convert the Treasury Bills into long-term securities, while still raising debt in Treasury Bills, banks and financial institutions embraced both, short-term and long-term government securities. Given the combined effect of economic recession and rising demand of credit by Government, banks and financial institutions abandoned lending to the private sector. Added to this was poor lending practices characterized by poor risk assessment and both insider and political lending. The end result has been very high non-performing loan portfolios in our banks. To make matters worse, some of the banks over invested in unproductive assets, including real estate.

Mr. Speaker, all these factors have continued to deny credit to the real sectors of the economy. When pressure was put on banks to improve returns on their lending and reduce non-performing loans, they responded by withdrawing from most of the rural areas. Currently, they concentrate in high value urban areas and investments in Government securities. Consequently, if the Government has to raise the rate of economic performance to over 5%, more credit must be channeled to the real sectors of the economy i.e. agriculture, industry, tourism, etc.

Mr. Speaker, in line with our Economic Recovery Strategy, monetary policy will be expected to change and play a critical and essential role in development of our economy. In accordance with this strategy money supply will be expected to reach 7%, while maintaining inflation rate at a single digit, below 5%. At the same time Government domestic borrowing, from the banking sector, will be maintained at 12%. Other measures to support this strategy will include development of a bank rate to be used for management of monetary policy.

- (i) Promoting neutral instrument for open market operations (OMO)

Mr. Speaker, the need to promote a neutral base rate, which will provide an essential interest rate signal to commercial banks, is necessary and urgent. Hon. Members will appreciate that currently, banks use the Treasury Bill rate as the reference base rate. I consider it risky and unreasonable to use the demand for credit by the Government, to set base rate for the commercial lending. The stock of Treasury Bills, at any time depends on the short-term Government need for money and has no relationship to economic fundamentals. It is for this reason that the Central Bank

will develop a neutral instrument and use it to influence the interest rates charged by commercial banks.

(ii) Cash ratio

Mr. Speaker, the cash ratio is currently used as a surgical instrument. It is used when quick results are needed but does not promote development of sustainable solutions since it does not address causes of the problem but simply removes the excess liquidity. Accordingly, the Central Bank will initiate a process to phase out the cash-ratio so that management of monetary policy is increasingly conducted through the open market operations. During the fiscal year 2003/04, measures will be put in place to reduce cash ratio to a range of 8% to 6%. However, this will apply to all deposits, including foreign currency deposits. The decision to extend cash ratio to all deposit liabilities is essential to bringing the best practices into CBK operations.

(iii) Banking Charges;

Mr. Speaker, section 44 of the Banking Act requires commercial banks to seek approval from the Minister before imposing various bank charges and commissions. Unfortunately, this part of the law has been only honoured in breach. I am therefore directing the Central Bank to immediately enforce compliance with section 44 of the Banking Act. This is especially necessary where there is inadequate competition as the case is in Kenya. I have been persuaded to invoke this section in order to balance the equation in this important industry.

(iv) Exchange Rate Management

Mr. Speaker, an appropriate market determined exchange rate is essential for assuring policy credibility and confidence in monetary policy management. For this reason, the shilling exchange rate will continue to be determined by forces of demand and supply. The Central Bank intervention will be limited to instances where and when the movement is identified as being inconsistent with economic fundamentals.

(v) Low Savings and High Lending Interest Rates

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The current very low deposit interest rates are not remunerative enough to encourage savings. On the other hand, the lending rates have remained too high giving the banks high interest rate spreads. We believe this untenable situation arises from lack of adequate information on part of credit seekers. I will therefore require the Central Bank to request banks to disclose their savings rates together with minimum and maximum weighted lending rates. This information will be monitored closely by the Central Bank to improve transparency in the banking industry. We believe this information is necessary and should be availed to the public.

(vi) Non-performing loans (NPLs)

Mr. Speaker, the problem of non-performing loans in the banking sector continues to persist. I have no doubt the situation can be significantly improved with more responsible behaviour all round. The current problem of non-performing loans can be classified into four categories, namely;

- (a) those in banks where shareholding is predominantly by the Government and the Co-operative movement;
- (b) restructured and reopened banks;
- (c) those in distressed banks; and
- (d) those banks experiencing financial problems.

The main causes of NPLs are poor risk management, depressed economy, ineffective and poor administration of justice, and, external pressure by dominant shareholders. However, as Hon. Members will appreciate, NPLs contribute to high bank lending interest rates. It is, therefore urgent and necessary to find an early solution to the problem. It is for this reason that I will require the Central Bank to explore the feasibility of forming a Non-Performing Loans Agency to help clean up bank balance sheets and also consider using a tribunal with judicial powers to deal with the loans.

The two measures will facilitate early recovery of the amounts outstanding.

(vii) Central Bank of Kenya Amendment Act 2000

Mr. Speaker, this Act originated from what was perceived as persistent and unjustified high interest rate spreads. Therefore

passing this Act, was seen as an attempt to reintroduce controls to deal with a measure of public frustration. It is for this reason that the battle lines were clearly drawn leading to severe contests touching on constitutional validity of this Act.

Mr. Speaker, as the ~~Minister in charge~~, it is now my duty to resolve the current stalemate over this Act. As I start, I have already indicated my intention to invoke provisions of Section 44 of the Banking Act to address the problem of unilateral escalation of bank charges. This, I believe, will go a long way to address some of the concerns, which led to passing this Act. I will also be proposing to the relevant Committee, and ultimately this August House, fresh amendments to deal with concerns over this Act. In so doing, I will be guided by the need to send clear signals to banks and financial institutions that we recognize both the shareholder and depositor interests. In summary, I will be seeking to ensure responsible corporate governance for all concerned parties. These efforts will include adoption of the following specific measures.

First, banks will be required to implement the "in duplum rule" so that once there is adequate evidence the loan or advance cannot perform, there will be a limit to interest recoverable on outstanding amounts;

Second, banks and financial institutions will be required to maintain positive savings interest rates, and also, to submit their weighted minimum and maximum lending rates to Central Bank for publication in the local press; and

Third, establish an independent Monetary Policy Advisory Committee to advise the Central Bank on appropriate monetary policy, taking into account key economic indicators such as, economic growth, exchange rate, inflation, stability of financial markets, and effects of fiscal policy.

(viii) Core capital requirements

Mr. Speaker, arising from the banking crisis of the late 1990s, coupled with incidents of bad political and economic governance, attempts were made to restrict licensing of new banks through substantial increases in paid up capital. Arising from this, the minimum paid up capital for banks and financial institutions was raised to Kshs.500 million and Kshs.375 million, respectively. The

affected institutions were given five years to comply. However, good as these measures may have been, they ignored the cardinal reality that it is the asset quality of banks and non-bank financial institutions which determine the health of an institution and not the amount of paid up capital. For this reason, I propose, to amend the second schedule of the Banking Act to set paid up capital, for banks and non-bank financial institutions, at a lower level of Kshs.250 million and Kshs.200 million, respectively. The Central Bank will enforce full compliance with the asset/liability ratios and other quality based standards.

(ix) Anti-Money Laundering Measures

Mr. Speaker, money laundering, terrorism, and international crimes, are closely associated. I believe everybody in this country knows the evils of terrorism having been victims of it twice. We, therefore, need to enhance measures to combat the menace. Already a National Task Force has prepared a draft bill on money laundering. I intend to table this bill before the House later in the fiscal year.

(x) Deepening of Financial Markets

In May 2001, the Government embarked on debt restructuring by re-launching the bond programme. As a result, bond trading at the Nairobi Stock Exchange increased from a monthly turnover of Kshs.216.4 million, as at May 2001, to the current level of Kshs.2.83 billion by March 2003. Despite these achievements, the volume of bonds traded at the Nairobi Stock Exchange is still low compared to the total outstanding stock of domestic debt of Kshs.270 billion.

To address this situation, I will be proposing amendments to the Internal Loans Act Cap. 420 Laws of Kenya, to create the appropriate legal framework for promotion of an efficient market infrastructure and to improve trading in long term government securities. I will also request the Central Bank to develop a market-based secondary trading system to improve efficiency and enhance liquidity of government securities. In addition in the course of the year, the Capital Markets Authority will consult players in this

market with a view to preparing regulations for issuance of asset backed bonds.

(xii) Development of payments system

Mr. Speaker, for sometime now, the Kenya Bankers Association (KBA) in conjunction with the Central Bank of Kenya (CBK), has been working to develop an efficient national payments, clearing and settlements system (NPS). Their efforts have reduced the time for nation-wide clearance of cheques from 14 days to the present 3 days. These two institutions (KBA and CBK) aim to modernize the NPS system with the objective of reaching Real Time Gross Settlement System (RTSGS) by 2005. To incorporate NPS into law, I intend to bring an appropriate bill before this August House, in course of the next financial year. I also propose to bring an Electronic Fund Transfer (EFT) Bill, to the House. Meanwhile, I propose to amend the Central Bank of Kenya Act in order to give CBK oversight powers over the national payments system.

The primary objective of these laws will be to lay the legal foundation for modernized national payments and settlements system, which will include electronic settlements and transfers. The law, when enacted, will provide the legal framework together with rights and responsibilities of participants and players in these transactions.

(xiii) Micro-Finance Bill

Mr. Speaker, poverty reduction is a high priority of Government. However, I am convinced that our efforts will continue to be frustrated unless and until we develop a pro-poor credit delivery system.

A draft bill has been prepared and discussed by the stakeholders and is currently awaiting final touches. The Bill proposes to confer authority to the Central Bank to license, regulate and supervise the micro-finance credit providers, especially those authorized to take deposits from the public. It will, however, be necessary to recognize and provide some regulations for institutions, which, though not taking deposits per se, still hold money from their clients, either as security or in other forms. However, no attempt will be made to convert these institutions into formal financial institutions. The Central Bank will develop appropriate MFI performance criteria and regulations to suit the

operating circumstances. I plan to table before the House the micro-finance institutions bill in course of the next Financial Year.

(xv) Banking Supervision

As Hon. Members are aware, many countries around the world have granted their Central Banks more powers and autonomy to supervise and regulate the financial systems and particularly banking operations. In order to harmonize our banking laws with those of other countries within the East Africa Community, I will propose amendments to the CBK Act in the course of next financial year to cede to CBK powers for the Bank licensing and deregistration of financial institutions. The amendments will enhance further the supervisory effectiveness of the Central Bank.

(xvi) Retirement Benefits Schemes

Mr. Speaker, the retirement benefits schemes provide one of the most effective vehicles for mobilizing long-term domestic savings. For this reason, these schemes will continue to be the cornerstones of the economic recovery strategy. Following enactment of the Retirement Benefits Act No. 3 of 1997, substantial improvements have been noted but much remains to be done. To protect accrued employee benefits, when a company becomes insolvent, I propose to amend Section 311 of the Companies Act to give priority to unpaid retirement benefit contributions as is currently given to accrued but unpaid wages or salaries. I also propose to increase the current payment maximum ceiling per employee from Kshs.4, 000 to Kshs.20, 000 per employee.

Mr. Speaker, to protect earned benefits, I propose to reduce the vesting period for employer contributions from 5 years to 3 years of commencing the pensionable service. In addition, I propose to remove the requirement for defined contribution schemes to undertake actuarial valuations every 5 years. However, the Retirement Benefits Authority will continue to monitor returns on investments to ensure scheme funds grow at reasonable rates.

Mr. Speaker, due to the limited investment opportunities for small schemes, with fund value below Kshs.5 million, I propose to allow such schemes to invest up to 100% in Government securities.

(xvii) Insurance Industry

Mr. Speaker, I am proposing a number of amendments to the Insurance Act in order to reduce the cost of compliance and to strengthen the regulatory capacity of the Insurance Commission. I also propose to shorten the period for preparation and submission of audited accounts from six (6) to four (4) months in order to harmonize the accounting period with the rest of the financial sector.

EXPENDITURE REALLOCATIONS AND TARGETING FOR 2003/2004

Mr. Speaker, as has been emphasized in my speech, the government is committed to economic recovery and poverty alleviation. For this reason, despite the hard budget constraints I am faced with, I have shifted some resources to areas with higher social-economic returns. These priority areas include; improvement of the physical infrastructure, particularly roads, health, education, safe water, energy and security.

As Hon. Members are aware, our national road network continues to impact negatively on local production especially due to poor workmanship and inadequate funding. As a first step towards reversing this trend, I have increased provisions for the Road Network from Kshs.13.3 billion in 2002/2003 to Kshs.16.9 billion in 2003/2004. The main increase is in the development budget, which has been raised from Kshs.4.9 billion to Kshs.8.3 billion.

Mr. Speaker, with regard to basic social services, I have focused more particularly on education, health, water and security. An additional Kshs.500 million has been availed for the health sector, especially for procurement of drugs. In addition, the Government has accessed Kshs.1.5 billion from the Special Global Fund to fight the HIV/AIDS scourge. As part of efforts to address the needs of the vulnerable in the society, the Government has increased funding for strategic grain reserves, drought and disaster relief, campaign against drug abuse, development of housing, and rehabilitation of street children.

Mr. Speaker, on Education, the Government has already made substantial commitment and investment on Free Primary Education. This noble effort has been supported by our development partners. I invite the Hon. Members to join me in expressing our gratitude to them. To carry the free primary

education through the next fiscal year, the Government has increased its contribution from Kshs.2.8 billion to Kshs.9.0 billion.

Mr. Speaker, in the Energy Sector, the Government recognizes the need for cost effective and reliable electricity supply. To support investments in generation and distribution of electrical energy, I shall today propose various tax incentives. In addition, I have provided Kshs.500 million for rural electrification, which will supplement funds raised through the rural electrification levy which is charged as part of the electricity bills.

Mr. Speaker, safe water is essential for improving the quality of life. Unfortunately, this has been grossly neglected and needs to be addressed. Accordingly, the Printed Estimates tabled before the House have provided for increased provision from Kshs.2.3 billion to Kshs.4.5 billion which represents an increase of about 96%.

Mr. Speaker, security is critical to improving the investment climate, income generation and poverty reduction. It is for this reason that I have provided an additional Kshs.300 million for the police force to enhance law enforcement.

Mr. Speaker, as many Hon. Members are aware from experience, our prisons are in a deplorable state. There is congestion in the prisons, while the prison wardens live in poor conditions. As part of the necessary reforms, the government will soon intensify implementation of the Community Service Order Act. Meanwhile, the Government has increased the provisions by Kshs.400 million in order to improve food and rations, clothing, beddings, and other facilities for inmates.

Mr. Speaker, as His Excellency the President has emphasized, on several occasions, that ASAL areas rank high in NARC Government's development agenda. It represents a large portion of this nation with high levels of poverty. For this reason, the Government, with the assistance of development partners, has provided Kshs.755.0 million, under the Arid Lands Resource Management Project (ALRMP) during 2003/2004. Several other projects including, Roads 2000 programme, Community Development Trust Fund, Garissa Water Project and Ewaso Ngiro North Development Programme which is scheduled to start in 2004/05 after the necessary studies have been completed, will also benefit ASAL areas. In addition, we have increased funding for the School Feeding Programme and will continue with the special grants to Boarding Schools in these areas.

Mr. Speaker, water is of special concern in ASAL areas. In recognition of this, the Government has increased budgetary provisions from Kshs.551.78 million in fiscal year 2002/03 to Kshs.1.024 billion in fiscal year 2003/04. These allocations illustrate the government's commitment to deal with key concerns of our people, particularly the vulnerable and disadvantaged.

FINANCIAL OUTTURN FOR 2002/2003

Mr. Speaker, Hon. Members will recall that the Supplementary Estimates recently approved by this House indicated that gross expenditure for the financial year 2002/2003 increased by Kshs.18.8 billion. This was mainly on account of implementation of free primary education programme, harmonization of doctors' allowances, upgrading of teachers in accordance with scheme of service, increase in salaries and allowances for MPs and general increase in expenditure in the ministries/departments.

Mr. Speaker, initially, gross recurrent expenditures were estimated to be Kshs.167.3 billion, while the gross development expenditures were projected to be Kshs.46.5 billion. In the Supplementary Estimates, the House approved a gross increase of Kshs.15 billion for the recurrent expenditures and Kshs.3.3 billion for development expenditures. Appropriations in Aid in recurrent expenditures increased by Kshs.3.4 billion, while those in development increased by Kshs.2.7 billion.

Mr. Speaker, overall, the Supplementary Appropriation Bill, which was approved by this House reflected a net increase of Kshs.12.2 billion, which was made up of Kshs.11.6 billion for recurrent expenditure and Kshs.0.6 billion for development expenditure.

Mr. Speaker, Let me now briefly review the financial outturn for the fiscal year 2002/03. The projected budget deficit, on a commitment basis and before grants, was 4.6% of GDP. This compares unfavourably with a deficit of 3.1% of GDP in 2001/2002.

Revenues

Mr. Speaker, total revenues (including LATF) were originally estimated at Kshs.218.9 billion or about 21.8% of GDP, comprising of Kshs.198.6 billion in ordinary revenue and Kshs.20.3 billion in Appropriations-in-Aid. Due to uncertainties associated with the last year's General Elections and subdued economic growth, total

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revenues are now expected to be about 4% below target. I now expect a total of Kshs.190.6 billion in ordinary revenues and Kshs.21.86 billion in Appropriations-in-Aid, which adds to Kshs.212.5 billion.

FINANCIAL OUTTURN FOR 2003/2004

Mr. Speaker, let me now turn to the 2003/2004 budget.

Revenue

Mr. Speaker, the total revenue target for fiscal year 2003/04 is Kshs.240 billion or 22.3% of GDP. This is composed of KShs.215.1 billion of ordinary revenue, Kshs.19.4 billion of recurrent Appropriations-In-Aid, Kshs.3.5 billion of Development Appropriations-in-Aid, and Kshs.2.0 billion of transfers.

Recurrent Expenditures

Mr. Speaker, as Hon. Members have already noted from their copies of the Printed Estimates, gross recurrent expenditures for 2003/2004 are estimated at Kshs.334.1 billion. This includes ministerial recurrent expenditures of Kshs.203.9 billion and Consolidated Fund Services of Kshs.130.3 billion. The ministerial expenditures include Kshs.19.4 billion to be financed through Appropriations-in-Aid.

Development Expenditures

Mr. Speaker, gross development expenditures for 2003/2004 are estimated at Kshs.59.5 billion out of which, Kshs.35.9 billion will be financed from external sources as follows, project loans Kshs.14.8 billion, and project grants Kshs.21.1 billion. The balance of Kshs.23.7 billion will be financed from domestic sources.

Mr. Speaker, as Hon. Members may be aware, the Budget for 2003/2004 aims at creating an enabling environment for private sector led growth. It also recognizes the fiscal challenges inherited from the previous regime, such as debt overhang and expenditure commitments. The Budget also aims at putting the economy back on a growth path to respond to great expectations of our people. To meet these challenges, we expect to run a deficit equivalent to about 6.5% of GDP which will be financed from domestic borrowing and external Budget support. I however hope to reduce the deficit in coming years through expenditure adjustments and revenue mobilization.

TAXATION PROPOSALS

Mr. Speaker, total revenues including Appropriation-in-Aid amounts to Kshs.234.5 billion. Based on current macroeconomic forecasts for the fiscal year 2003/2004 and the current taxation levels, we expect to realise total revenue of Kshs.226.5 billion of which Kshs.207.1 billion will be in ordinary revenue and Kshs.19.4 billion of recurrent Appropriations-in-Aid. This leaves a revenue gap of Kshs.8.0 billion which I propose to finance as detailed below.

Mr. Speaker, I have proposed wage adjustments for teachers and civil service which will result in additional Kshs.1.7 billion to the exchequer in PAYE. We also expect to license a third mobile phone operator and raise about Kshs.3.7 billion in fees. In addition, I expect those State Enterprises, which suddenly stopped loan repayments and other remittances to exchequer to come on stream in 2003/2004 out of which I expect to raise Kshs. 640 million. This leaves me with unfinanced gap of Kshs.2.0 billion.

Mr. Speaker, the rest of my speech outlines the tax measures I intend to take to bridge this gap.

I 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.

Customs and Excise Duties

Import Duty Measures

Mr. Speaker, let me now turn to amendments to the Customs and Excise Act that have direct revenue implications.

First Mr. Speaker, In order to encourage investment and support economic recovery efforts, I propose to grant duty waiver on capital goods, plant and equipment for investments. This facility will also include equipment for generation and distribution of electricity.

Second, Mr. Speaker, to encourage farming of Macadamia nuts and Cashew nuts, I propose to remove export duty which is currently imposed on these nuts. This measure is expected to benefit farmers of these crops.

Third, Mr. Speaker, to support livestock farmers encourage value addition on hides and skins, I propose to reduce the export development levy, which was introduced in the last Budget, on export of raw hides and skins, from 20% to 15%. Similar rates have been imposed in the other EAC countries.

Fourth, Mr. Speaker, to promote domestic poultry farming and production of poultry products, I propose to remove import duty on fertile hatching eggs imported by specified hatcheries.

Fifth, Mr. Speaker, in order to reduce cost of production for exports and promote investments for economic recovery, I propose to reduce IDF fees on goods imported under Tax Remission for Export Office (TREO) from 2.75% to Kshs.5,000. I expect this measure to make our goods competitive in the international markets.

Sixth, Mr. Speaker, our sportsmen and women have earned this country not only international fame but also foreign exchange. To encourage and promote development of sports in Kenya, I propose to grant exemption to sports goods donated to sporting groups through the Ministry in charge of Sports or purchased by the Ministry incharge of sports.

Seventh, Mr. Speaker, to encourage development of information technology, and further reduce cost of manufacturing, I propose to remove import duty on computers, computer accessories, and a variety of other raw materials.

Excise Duty Measures

Mr. Speaker, let me now turn to amendments to the Customs and Excise Act relating to Excise Duty that have direct revenue implications.

First, Mr. Speaker, in order to encourage local assembly of motor vehicles and make the Kenyan motor vehicle industry more competitive, I propose to remove excise duty on locally assembled motor vehicles. This measure is expected to give impetus to motor

vehicle industry to encourage development and fabrication of vehicle components, and spares

Second, Mr. Speaker, to reduce tax evasion and avoidance, improve effective tax rate and subsequent revenue yield while encouraging investments in quality cigarette products for export, I propose to introduce a specific duty regime, based on four bands equivalent to effective rate of 110%, to replace the current ad valorem rate.

Third, Mr. Speaker, to simplify tax collection and promote investment for quality and affordable alcoholic beverages, I propose to introduce a specific excise duty regime on beers at three bands; i.e. on (i) malt beer, (ii) stout beers; and (iii) non-malt beers, and remove the current ad valorem rate.

Fourth, Mr. Speaker, in order to reduce the cost of power to industrialists and households and make Kenyan products more affordable and competitive, I propose to reduce excise duty on fuel oils by 50%.

Fifth, Mr. Speaker, the Ministers of Finance in the East African Community have agreed to harmonize taxation of mobile phone airtime. Accordingly, I propose to increase excise duty on mobile phone airtime from the current 5% to 10%.

Sixth, Mr. Speaker, to broaden the tax base, improve equity in our tax system and enhance regulatory capacity of casinos and gambling, I propose to introduce a 10% excise duty on casinos and gambling services. I also propose to introduce excise duty on jewellery.

Seventh, Mr. Speaker, in order to address some of the challenges facing tourism industry and encourage growth of local pilot training and air operators, I propose to remove excise duty on avgas for use in light aircraft engines.

Eighth, Mr. Speaker, to encourage consumption of soft drinks and develop the sub-sector, I propose to reduce the current excise duty from 15% to 10% to make soft drinks affordable to Kenyans.

Mr. Speaker, these adjustments in Customs and Excise Duties will raise an additional Kshs. 1,407 million to the exchequer.

Mr. Speaker, allow me to turn to measures I propose to take under Customs and Excise Act that have no direct revenue

implications but which will improve administration of Customs and Excise Tariff.

First, Mr. Speaker, to curb abuse on transit of goods, goods intended for regional markets and temporary imports, which have had adverse effects on government revenues and local production, I propose to amend the law to impose a surcharge of 10% on goods falling in any of these categories if they are converted to domestic market. In addition, I propose to amend the law to require that any goods, which are subject to request for conversion to domestic market be deposited with customs first.

Second, Mr. Speaker, transit sheds have become conduits of leakage of unaccustomed goods into domestic market. To close this loophole and safeguard public revenue, while protecting local producers, I propose to tighten the regulations governing transit sheds and provide for specific conditions and qualifications for transit sheds and their operators. Existing sheds, which do not meet these conditions will be given time to comply. Similarly, qualifications will be gazetted for bonded warehouses and duty free shops.

Third, Mr. Speaker, importation of prohibited goods, both substandard and counterfeit, has continued to undermine local production. To control this menace, I propose to amend Section 34 to provide that any goods certified as prohibited must be destroyed or re-exported within 30 days of being determined as prohibited.

Fourth, Mr. Speaker, currently the period within which goods must be declared in an import entry varies depending on where they are destined. This has encouraged abuse of import procedures and diversion of transit goods into domestic market. To harmonize the period for declaration of goods to Customs, regardless of destination, I propose to limit the period of declaration for customs entry to 21 days from date of commencement of discharge from the importing vessel.

Fifth, Mr. Speaker, Section 91 of the Act allows manufacturers of excisable goods to make only one class of goods. This creates disincentives for manufacturers who are not able to take advantage of economies of scale to reduce cost of production. I propose to amend this Section to make it possible for manufacturers to manufacture more than one class of excisable goods.

Sixth, Mr. Speaker, diversion of export petroleum products into domestic market has been a major problem for a long time. To discourage this practice, Ministers of Finance from the EAC have agreed to tighten procedures relating to this commodity. Accordingly, with immediate effect, exporters of petroleum products will be required to deposit cash equal to duty payable which they can claim on confirmation of exportation.

Seventh, Mr. Speaker, despite requirement under Section 96 of the Act that manufacturers of excisable goods submit returns to the Commissioner, default in submission of returns has continued. To discourage this habit and protect revenue, I propose to impose a late penalty of 10% where those required to submit returns fail to do so.

Eighth, Mr. Speaker, as Hon. Members will appreciate there is a growing problem of illicit drinks, which are dangerous not only to life but to our economy. To control handling of alcoholic spirits, I propose to amend the law to require denaturing of alcoholic spirits, whether imported or from a distiller, before such spirits are released from customs.

Ninth, Mr. Speaker, in recent years, Section 138 was amended to restrict waiver of duties, requiring Ministries to pay duties on donor financed projects. This prohibition has made it difficult for sector Ministries to access donations. I propose to amend the law to allow the Minister to waive duties when such waivers are in public interest.

Tenth, Mr. Speaker, under the Third Schedule of Customs and Excise Act, officers returning from overseas services are allowed to import personal effects, including motor vehicles free of duty. While this measure was intended to assist officers who had vehicles for use in their overseas stations, it has become an avenue for duty evasion. To reduce the abuse, I propose to restrict the duty free facility, only to vehicles, which are registered in the name of the officer, in the country of service.

VAT Measures

Mr. Speaker, NARC in its manifesto, promised to reduce tax burden for all Kenyans. After examining all taxes, I have come to the conclusion that VAT is the best suited tax to fulfil this

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commitment. The measures I am proposing aim to create impetus for economic recovery, encourage investments for both domestic production and exports, while making goods and services affordable to consumers. Accordingly, to make goods and services affordable, and boost consumption demand in the economy, I propose to reduce the current VAT rate from 18% to 16%. Given the low inflation rate, I expect this measure to confer significant benefit to consumers and improve their welfare.

Second, Mr. Speaker, in order to reduce cost of electricity to both consumers and producers, I propose to zero-rate bulk electricity imported from Uganda and connected to the national grid for distribution by Kenya Power and Lighting Company. In addition, I propose to remit tax on capital goods, plants, and equipment purchased or imported for power generation and distribution.

Third, Mr. Speaker, to promote investment and support our economic recovery programme, I propose to grant VAT remission on capital goods, including plants and machinery and equipment, for new investment, expansion of investment and replacement.

Fourth, Mr. Speaker, to improve exporters cash-flow and enhance competitiveness of their goods in the regional and international markets, I propose to allow VAT remission under TREO system.

Fifth, Mr. Speaker, in order to assist coffee farmers and encourage them to invest more in quality improvements, I propose to zero-rate raw coffee so that farmers can claim tax paid on inputs used in the coffee industry.

Sixth, Mr. Speaker, to improve business during the hard times in tourism and, I propose to zero-rate aviation spirits, purchased by light aircraft owners and operators.

Seventh, Mr. Speaker, to make drilling boreholes and treatment of water cheaper, I propose to zero-rate water drilling services together with water treatment chemicals. This measure will enable many Kenyans access safe drinking water.

Mr. Speaker, these adjustments to VAT rates and measures taken, will raise additional revenue of KShs.300 million to the Exchequer.

Income Tax Measures

Mr. Speaker, let me now turn to proposed amendments under the Income Tax Act.

First, Mr. Speaker, I have already provided fiscal incentives to investors under the Customs and VAT; however, it is the investors who hold the key to our sustained economic recovery and poverty reduction. Consequently, to further encourage investments, I propose to increase the investment allowance from 60% to 100% under Income Tax Act.

Second, Mr. Speaker, to support investments in medium size industries, increase productive capacity and create more jobs, I propose to reduce capital expenditure qualifying for import duty set off from the current USD 5,000,000 to USD 70,000. This measure will enable medium size investors improve their cash flow and consequently their productive capacity.

Third, Mr. Speaker, in order to revitalize local and regional air travel, while making Kenya a prime pilot training centre, I propose to remove the current 20% withholding tax of aircraft leasing.

Fourth, Mr. Speaker, to give retirees a favourable tax treatment after their long dedicated service to the nation, I propose to increase tax free lump sum payments from Kshs.240,000 and Kshs.360,000 to KShs.480,000 for provident funds and pensions schemes respectively. Furthermore, to encourage retention of savings in pension schemes, I propose to provide for a lower rate of tax for those who hold funds in schemes longer.

Fifth, Mr. Speaker, to ease the tax burden on employees' meal benefits, I propose to increase the minimum taxable aggregate value of benefits granted by employers to employees from KShs.12,000 to Kshs.24,000.p.a.

Sixth, Mr. Speaker, to address cash flow problems associated with high withholding tax on contractual, consultancy and agency fees, and enhance effectiveness of these service providers, I propose to reduce the withholding tax on these payments to resident persons, in respect of consultancy and agency fees from 10% to 5% and for contractual fees from 5% to 3%.

Seventh, Mr. Speaker, in order to make Kenyan flowers more competitive in the international flower market, I propose to remove the 20% withholding tax on commissions paid to non-resident

agents in overseas auctions that has hitherto adversely affected our flower exporters.

Eighth, Mr. Speaker, the potential role of our co-operative movements in rural development remains largely untapped. To make Co-operative Societies more effective towards economic recovery and poverty alleviation, I propose to restructure taxation of all cooperatives, including SACCOs as follows:

(i) **Producer cooperatives:**

All payments to members, both primary and corporate, will be allowed free of tax. Similar treatment will be given to payments made to individual members by primary societies while societies will only be taxed on the surplus they retain after allowing their operating expenses. Where a member reaches the tax threshold, he/she will be taxed as an individual, and, where cooperative societies engage in general business, such activities will be treated like other businesses in similar lines.

(ii) **On Investment incomes; where a**

- (a) cooperative society, including SACCOs, invest in real property and generates rental income, that income will be treated in the same manner as that of any other landlord,
- (b) dividend and interest income, will be treated like that of any other investor and will be subject to withholding tax.

Mr. Speaker, the proposed changes will give the cooperative movement substantial tax benefits with regard to core function. They will also give the societies the advantages due to an investor.

Mr. Speaker, these adjustments in Income Tax will be revenue neutral to the Exchequer.

Miscellaneous Measures

Mr. Speaker, turning to miscellaneous measures, I am proposing the following changes.

First, Mr. Speaker, a number of miscellaneous charges and fees, have not been adjusted for a long time, including those under the Bankruptcy Act, Companies Act, Trade Union Act, Societies Act and Transport Licensing Board. These charges and fees have been adjusted to reflect the current costs.

Second, Mr. Speaker, in a liberalized market, it is not equitable for one operator to have licensing powers. I therefore propose to amend the Kenya Broadcasting Corporation Act to remove KBC's power to impose licences on both consumers and operators in information and broadcasting services.

Third, Mr. Speaker, under the Banking Act, I propose to make several changes;

- (i) amend Section 31, to provide for regulations relating to credit reference bureaus;
- (ii) amend section 35 to enable Deposit Protection Fund Board to liquidate failed institutions without the need to seek court approval first. However, any aggrieved party will remain free to challenge any measures, the Board takes, in high court;
- (iii) amend section 35A to free the Board from requirements to deposit money when litigants file suits against it in High Court. This practice ties too much money in courts, a practice which inhibits the capacity of the Board to carry out its mandate;
- (iv) replace the Second Schedule to the Banking Act to maintain minimum paid up capital for banks at Kshs.250 million and for non-bank financial institutions at Kshs.200 million.

Central Bank of Kenya Act

Fourth, Mr. Speaker, as explained earlier, the country needs to develop a national payments and settlements system. I therefore propose to amend Section 4 of the Act to introduce and define this system.

Fifth, Mr. Speaker, though the Deposit Protection Fund is authorized to borrow from Central Bank, there is no provision for the Bank to lend to DPF. To correct this anomaly, I propose to amend this Act to allow the Central Bank to lend to DPF.

Sixth Mr. Speaker, the Catering Levy Trustees has been experiencing obstacles collecting Catering and Tourism Development Levy from uncooperative operators. To make it easier for them, I propose to amend the Hotel and Restaurants Act to give the Trustees authority to destrain defaulters and also raise the penalty paid on default from 3% to 5%.

Seventh, Mr. Speaker, unscrupulous traders have hurt local producers, genuine traders and undermined government revenue. To enable courts to mete out deterrent fines, I propose to raise the fine provided under section 15 of Trade Descriptions Act, from Kshs.500,000 to Kshs.2,000,000.

Eighth, Mr. Speaker, the Kenya Roads Board Act does not designate local authorities as agents even though they maintain a large portion of roads. To correct this anomaly, I propose to;

- (i) amend the Third Schedule of Kenya Roads Board Act to include municipalities with technical capacity as agents; and,
- (ii) to provide legal authority to amend the schedule and include other agents as and when need arises.

Mr. Speaker, These miscellaneous adjustments will raise an additional Kshs. 200 million.

CONCLUSION

Mr. Speaker, the measures I have announced today are but a first step in a long journey. We have a long way to go before we can restore this great nation to prosperity, a position she enjoyed during the first two decades of independence. At the time, Kenya stood proudly, shoulder to shoulder with the fast growing countries of South East Asia. We can do it again but only if we rededicate ourselves to work hard together, selflessly and with unity of purpose.

Mr. Speaker, we have previously made mistakes, especially our leaders. Too much focus was laid on self and partisan interests. However, we must neither allow ourselves to live in history nor repeat the same mistakes. I urge the Hon. Members, and indeed all Kenyans, to turn a new leaf and create a new environment for socio-political development of this great nation. A nation, which recognizes the ideals of hard work for each and every one of us. But also, a nation where we recognize there are limited opportunities and capacity for many of those around us. Many of our people work extra hard but still live in poverty. These are the people the leaders, working with the Government, must help to break the vicious cycle of poverty that keeps many of our people in miserable conditions.

Mr. Speaker, we must send a clear and unequivocal message to those who have formed the habit of living like economic predators. It is time they changed and learnt to live on their sweat. For those who do not and continue raiding public resources, our judicial system must show no mercy. They need to be fairly but quickly tried and punished so that they can be bad examples to others.

Mr. Speaker, the Budget I have presented today attempts to break from the past. It combines measures, both on taxation and expenditure, which seek to address both social needs, especially on health and education and to spur economic growth. However, the greatest challenge, we face lies in its implementation. Those charged with making sure the measures are implemented need to do so with dedication. For those not involved, these are both beneficiaries and overseers. It is your duty to ensure what is promised is delivered. None of us can afford to be an observer.

Mr. Speaker, I beg to move.