NATIONAL ASSEMBLY

OFFICIAL REPORT

Thursday, 10th June, 2004

The House met at 2.30 p.m.

[Mr. Speaker in the Chair]

PRAYERS

ARRIVAL OF HIS EXCELLENCY THE PRESIDENT

(Mr. Speaker announced the arrival of His Excellency the President, the hon. Mwai Kibaki, MP)

(Hon. Members rose in their places while His Excellency the President took his seat in the Chair of State)

COMMITTEE OF WAYS AND MEANS

MOTION

THAT MR. SPEAKER DO NOW LEAVE THE CHAIR

The Minister for Finance (Mr. Mwiraria): Mr. Speaker, Sir, I beg to move that Mr. Speaker do now leave the Chair.

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

We have had many problems, including a devastating recession. In the year 2003, the real Gross Domestic Product (GDP) grew by 1.8 per cent, up from 1.2 per cent recorded in 2002. This growth lay a firm foundation on which we can build better performance. For that reason, the Government policy in the immediate and medium-term is to consolidate economic gains and accelerate growth. This endeavour will be broad-based to encompass the fight against corruption and bad governance while enhancing reforms. In addition, Kenyans will need to redouble their efforts to improve work ethics and productivity. These attributes are critical to accelerating economic recovery, reducing poverty and increasing employment.

Mr. Speaker, Sir, both regional and world economic recovery is proceeding faster than earlier anticipated. In 2004, the global economic growth is projected to rise to 4.6 per cent compared to a growth rate of 3.9 per cent in 2003. It is then expected to level off at 4.4 per cent in 2005. In sub-Saharan Africa, the economic growth is expected to strengthen at 4.5 per cent in the year 2004 and rise to 5.7 per cent in 2005. With a few exceptions, inflation is projected to remain subdued mainly below 2 per cent and to a single digit in most African countries.

However, in spite of the good news, the world economy remains vulnerable. First, the sudden surge in growth has increased demand for fuel oil, resulting in high prices. Second, due to acts of terrorism both in Europe and the Middle East, oil prices have recorded high levels. These developments have an enormous potential for spill-over. Should the situation deteriorate further, oil prices are likely to cause inflationary pressure while rising world terrorism will continue to affect growth of world travel and tourism.

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

Mr. Speaker, Sir, during the year 2003, the domestic output picked up, fuelled by 6.4 per cent growth in total domestic credit, of which the private sector grew by 1.8 per cent compared to a decline of 2.5 per cent in the year 2002. The agricultural sector grew by 1.5 per cent, up from 0.8 per cent in 2002, while the manufacturing sector grew by 1.4 per cent compared to 1.2 per cent in 2002. The service industry provided the lead with major areas of growth in mobile phone services, where active phones more than doubled in 2003, rising to over 2.7 million compared to 2002. Cargo throughput at the Port of Mombasa rose by 12 per cent, while containerized cargo grew by 24.5 per cent.

In the financial sector, commercial banks recorded a significant recovery due to measures we have taken together, with a stable macro-economic situation. As a result, the pre-tax profit in the financial sector increased by a staggering 65.9 per cent in 2003 compared to the previous year, while bad and doubtful debts reduced by about 5.8 per cent. The building and construction industry grew by 2.2 per cent and the real estate by 3 per cent, suggesting a general upturn in the economy.

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

During the year, money supply expanded by 13.2 per cent compared to 8.6 per cent in 2002, while net foreign assets grew by 19.8 per cent to Kshs125.1 billion, while the overall inflation rate remained in single digit with the average underlying inflation increasing from 2.6 per cent in 2002 to 3.6 per cent in 2003. Throughout the year, interest rates remained on a downward trend, driven mainly by the falling 91-day Treasury Bill rates which reached a record low on 22nd September, 2003, at just below 0.8 per cent. Similarly, the 182-day Bill rate fell to 1.3 per cent. This decline affected deposit and inter-bank rates with the monthly inter-bank rate falling below 1 per cent in January this year. Deposit rates declined to 3.1 per cent in January 2004, down from 4.7 per cent in January 2003. Correspondingly, average lending rates fell from 19 per cent to 13.6 per cent.

The overall balance of payments increased by Kshs31.4 billion and remained in surplus throughout the year. The current account deficit improved to a surplus of Kshs4.8 billion. This resulted from increased tourism earnings, grants and inflows from abroad. The capital account recorded an increase of a surplus of Kshs40.5 billion. These developments led to increased foreign exchange reserves of Kshs104.7 billion, equivalent to 4.2 months of imports cover. This compares favourably to Kshs74.7 billion or 3.3 months imports cover in December 2002. However, the deficit in merchandise account widened with value of imports rising by Kshs24.1 billion while exports increased by Kshs13.9 billion. It is, however, encouraging to note that the rise in imports value was mainly due to importation of capital goods, plant and machinery, transport equipment and oil products which go to production. This gives us comfort that economic recovery is firmly on the way.

Mr. Speaker, Sir, in 2003, the value of exports rose by 8.2 per cent from Kshs169.28 billion to Kshs183.15 billion. Though the volume of coffee exported rose by 18.5 per cent, prices fell by 3.9 per cent. In the case of tea, the volume declined by 3.9 per cent while prices fell by 4 per cent. The combined effect was a marginal decline in export value for both coffee and tea. However, the volume of horticultural exports increased by 31.6 per cent, but prices declined by 2.7 per cent.

As regards the exchange rates, the Shilling appreciated marginally against the dollar, but lost ground against both the Euro and the Sterling Pound thus improving competitiveness of Kenya's goods to the Euro Area and the United Kingdom (UK). In general, the Kenya Shilling depreciated moderately against major currencies.

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

Mr. Speaker, Sir, let me now address the question of our relationship with the development partners. As hon. Members will recall, when the NARC Government assumed leadership, our relations with development partners were at the lowest ebb. Following extensive consultations, we were able to reach agreement with the International Monetary Fund (IMF) on Poverty Reduction and Growth Facilities (PRGF) on 21st November, 2003, which paved the way for restoration of healthy relations with other donors. Building on the PRGF, the Government held a successful Consultative Group Meeting with development partners in late November, 2003, which was significant in many ways. First, it was the first consultative group meeting for over a decade. Second, it took place within the first year of the NARC Government taking power. Third, it was the first consultative group meeting to be attended by Kenyans from all walks of life. Finally, and more importantly, the meeting generated pledges amounting to about US$4.1 billion over a three-year term. Since then, we have worked with various partners to agree on their financing programmes and projects and, in majority of most cases, have agreed on funding levels. We, therefore, expect better resource flow in the next fiscal year and beyond.

Mr. Speaker, Sir, I invite hon. Members to join me and record our gratitude to the development partners for this support.

(Applause)

I also wish to appeal to the development partners to facilitate faster disbursement of the pledged funds to enable the Government finance the planned development programmes. On its part, the Government will ensure that this resources are properly and efficiently used to benefit the target groups of the poor. In this regard, the Government will continue to demonstrate strong political commitment to good governance, sound economic management and zero tolerance to corruption.

Mr. Speaker, Sir, that development partners are important to our development efforts cannot be over-emphasized. First, the Bretton Woods Institutions are considered the world opinion setters. Therefore, reaching a working agreement with them is necessary for attracting foreign direct investments. Second, many bilateral donors require a country to have a programme with the IMF before they can extend certain types of financial support, such as Budget support. Consequent to reaching an agreement with the IMF, the Government has successfully negotiated bilateral assistance for various projects and programmes covering wide sectors of our economy. The Government has also received some substantial assistance for human capital development, especially for health care services and the on-going free primary education programme.

Mr. Speaker, Sir, as hon. Members will agree, improving access to health care while providing free primary education will substantially improve the quality of national human capital, raise labour productivity and reduce poverty. To all those who have supported and continued to support us, we thank you most sincerely.

(Applause)

Mr. Speaker, Sir, let me now come to Fiscal Policy. The three countries of the East African Community have already agreed on the structure of a Common External Tariff (CET), which will be implemented, effective 1st January, 2005. Consequently, the Budget for the Fiscal Year 2004/2005 has been prepared against that backdrop. I have, therefore, taken the agreed principles into consideration when evaluating request for Import Duty and other tax incentives. Where the request to reduce or raise import duties were inconsistent with the agreed tariff structures, that could not be accepted. In addition, the direct revenue loss due to lowering of the top customs tariff rate from 35 per cent to 25 per cent will be high, exceeding Kshs6.4 billion a year, and not less than Kshs3.2 billion for the six months of this fiscal year. That is mainly due to applying lower tariff on import value and secondly, on account of reduced taxable value for both excise duties and Value Added Tax (VAT). The other fiscal implications of entering into a common market is the need to observe the principle of fiscal harmonisation. Already, the three countries have agreed to harmonise fiscal incentives in the region. When the structure and types of incentives acceptable in the region are agreed upon, that will, no doubt, have effect on some of our investors. For that reason, it has not been possible to add to existing fiscal incentives this year. Indeed, many of the incentives, especially those falling under the Customs and Excise Act, will need to be removed once the Draft East African Customs Management Act comes into force on 1st January, 2005. The draft law does not provide for most of the existing incentives, discretionary duty waivers and provisions relating to excise duties, which are considered as domestic taxes. Kenya will, therefore, need to enact a stand-alone Excise Act.

Mr. Speaker, Sir, let me now refer to expenditure management. As Kenyans will appreciate, the country faces many challenges which require financing, but resources are severely limited, necessitating better targeting and prioritisation and efficient use of the little that is available. Given the added competition from the large stock of pending bills accumulated and carried forward by the previous regime, hard choices need to be made. In addition, the 2004/2005 Budget has been prepared at a time when there is heightened security concerns all over the world. As a result, countries have been urged to enhance their overall security, especially in areas prone to terrorism. In response, we have had to improve security in those areas, particularly airports, international ports and related facilities. Understandably, recent terrorist attacks in Europe, and elsewhere in the world, have pushed those security concerns a notch higher. Therefore, Kenya, like all other countries, has improved security in those areas to international standards, and will sustain them on a continuous basis.

Mr. Speaker, Sir, in a globalised market, we cannot afford to raise the level of taxation without affecting investor confidence. That is because investors have choices, including relocation to other common market countries, which could hurt our policy objective. I have taken those factors into consideration and prepared a Budget for the Fiscal Year 2004/2005 with the following objectives:-

(i) To consolidate and accelerate economic growth, building on achievements realised in 2003;

(ii) To sustain macro-economic stability;

(iii) To stop accumulation of pending bills and reduce them;

(iv) To enhance efficiency in the use of public resources;

(v) To sustain and expand the core poverty expenditures;

To achieve those objectives, Accounting Officers will be required:-

(a) To ensure that no new expenditure arrears or pending bills are accumulated;

(b) To give genuine pending bills in their Ministries first priority; and,

(c) To ensure provision for the core poverty programmes, and make sure that they are maintained and increased in the year 2004/2005.

To attain those objectives, we need to be more selective and efficient with the available resources. It is for those reasons that I have taken and chosen the theme for the Budget this year as: "Enhancing Efficiency for Accelerated Economic Growth".

Mr. Speaker, Sir, the Government is concerned with the large stock of unpaid arrears outstanding. We believe that it is not possible to regain overall control over public expenditure, until we institute a system to capture and control those obligations. Towards that end, the Government would put in place a system to capture all forms of expenditure commitments by the public sector, including those from the financial sector and local authorities. For that reason, the commercial banks and financial institutions will be required to report to the Central Bank of Kenya (CBK) all deposits and borrowing by public enterprises. The CBK will collect that data and report to the Treasury on a regular basis. It will also be necessary to ensure that arrears arising from day-to-day operations are captured and reported. It will be the responsibility of Accounting Officers to ensure that, that obligations are captured and reported across the public sector. That data will form part of the regular expenditure monitoring sector.

Where an enterprise has borrowed money under Government guarantee, the arrears would be reported separately, as part of the Government contingent liabilities. The information to be reported would include: Total loans borrowed by an enterprise and purpose for which they were taken, details of non-performing loans, reasons for failure to service the obligations and actions taken to regularise the payments, details of debts owed to third parties in the private sector, details of monies owed to other public bodies including tax arrears, reasons why not paid and, finally, debts owed to the particular enterprise by other public bodies, the effect on the rest of the economy and efforts taken to collect them.

Mr. Speaker, Sir, these are financial obligations which the Government can bear arising from undetermined commitments such as guaranteed debts un-funded public sector pensions or similar commitments.

Mr. Speaker, Sir, here, I am talking about contingent liabilities. In order to plan for likely costs associated with these liabilities, Treasury is updating information on potential rates from these sources, including conducting actuarial valuations of the public pension systems. However, as salaries and wages in the public sector are raised, various pension systems in this sector rise too. In order to control escalation of pension costs, the Government will introduce employee pension contributions in the next financial year. In the meantime, Accounting Officers and respective chief officers of enterprises which fall under them, including local authorities, will need to ensure corrective action is taken in all areas.

Mr. Speaker, Sir, in my Budget proposals last year, I introduced several measures to support reforms in the financial sector. These included reduction of the mandatory cash ratio requirement from 10 per cent to 6 per cent and its extension to include foreign currency deposits and secondly, reduction of minimum core capital requirement to Kshs250 million and Kshs200 million for commercial banks and non-bank financial institutions, respectively.

These measures have led to significant decline in lending rates from the average of 19 per cent, in May last year, to 12 per cent in May this year. They have also led to increases in credit to private sector; from 5 per cent in May last year to 11 per cent in May, this year, providing the impetus for economic growth; from 1.2 per cent in 2002 to 1.8 per cent in 2003.

I also introduced transparency and improved governance in the banking industry by invoking provisions of Section 44 of the Banking Act. This has enabled the Central Bank access information on bank interests and other charges to benefit the savers and borrowers. By publishing the lending interest rates, charges and tariffs of all commercial banks and non-bank institutions, this has enhanced competition among banks and reduced cost for delivering of financial services to Kenyans.

Mr. Speaker, Sir, as will be recalled, in my Budget Speech last year, I dwelt at length on the problems of the financial sector, especially the cost and access to credit. I also discussed the need to strengthen this sector to enhance its contribution to our economic recovery strategy and accelerate economic income generation. We also expected it to create jobs and reduce poverty.

Today, I expound on a comprehensive financial sector reform strategy which will be implemented in order to achieve key objectives of improved affordability, stability, efficiency and access. In a Bill published today, I have proposed major changes to the Banking Act, which include transfer of operational and licensing powers from the Minister to the Central Bank. In accordance with best practices and Basel Accord significant shareholders will be subject to vetting by the Central Bank. Other aspects of this strategy include the Central Bank of Kenya (Amendment) Act, 2000.

As will be recalled, the Central Bank of Kenya (Amendment) Act, 2000 was a reaction to frustration with unreasonable escalation of bank charges. The practice of escalating penal charges, when loans stop to perform, was such that if a customer borrowed Kshs10 million, it was possible for the debt to escalate to Kshs100 million or more.

Following extensive consultations, I have proposed amendments to this Act to introduce the "In Duplum Rule" which safeguards interests of borrowers.

(Applause)

In its purest form, this rule seeks to stop bankers from continuing to load customers with interest charges on a debt that is clearly non-performing.

(Applause)

It is a common law principle well-established in such countries as the Netherlands, South Africa and Zimbabwe. Under this rule, the maximum amount a bank can claim from a non-performing customer is capped and interest charges cannot exceed the principal amount outstanding at the time when the loan ceased to perform.

(Applause)

Mr. Speaker, Sir, in short and long-term loans, interest is calculated on reducing balance on outstanding principal and not on the original principal.

(Applause)

Should a debtor stop servicing the loan at some point, the "Duplum Rule" applies to the outstanding principal at that point and not the original debt.

(Applause)

When enacted by this august House, this rule will inhibit growth of non-performing loans and freeze interest charges so that they will not exceed the outstanding principal. The proposed amendment will address the concerns and intentions of the Central Bank of Kenya (Amendment) Act, 2000 in full. It will also have the added benefit of encouraging banks and financial institutions to resolve problems of non-performing debts early. Thus, the proposed amendment will not protect those who fail to pay; it will only protect them from unreasonable charges.

(Applause)

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

Mr. Speaker, Sir, let me now comment on the Monetary Policy. Our Monetary Policy for the year 2004/05 requires the Central Bank of Kenya to implement a monetary programme that allows money supply to grow at 8 per cent. This policy's stance is predicated on an underlying inflation being not more than 3.5 per cent per annum to ensure that Kenya's exports remain attractive to foreign buyers and domestic producers are not faced with stiff competition from cheap imports. This level of money supply expansion will allow credit to the private sector to expand by around 13.5 per cent per annum which is enough to support real GDP growth of about 3 per cent. I also expect the Central Bank of Kenya to maintain foreign exchange reserves at the current level equivalent to 4.1 months of import cover. This is expected to allow the Government to meet its official external debts service of obligation and to stem off currency speculations in the event this does occur.

Mr. Speaker, Sir, in the last Budget for the Fiscal Year 2003/2004, I promised to introduce a neutral instrument to replace the Treasury Bill rate as the benchmark interest rate for banks and non-banking institutions. As was indicated, a neutral bank rate was considered necessary to serve as an interest rate signal to the banking sector. Following this announcement, the Central Bank of Kenya (CBK) commissioned a study to develop a neutral instrument, and is in the process of consulting with stakeholders while reviewing experiences of other countries with similar policy. To enable the CBK incorporate the bank rates as an instrument of monitoring policy, I propose to amend the Central Bank of Kenya Act to introduce bank rates and to set the stage ready for its implementation. When operational, I expect the bank rates to be the reference prime rate maintained by any bank in respect of loans, advances or other financial facilities granted to its customers. Similarly, I will expect banks, mortgage companies and building societies to maintain their savings rates applicable to longer-terms of savings deposits to be at a level which reflects a positive return against the annual underlying rate of inflation.

Mr. Speaker, Sir, globalization requires us to develop our payment infrastructure to achieve an efficient, safe and reliable national payment and settlement system. We, therefore, need an appropriate legislation. Towards this end, I propose to table in this august House, the National Payment System and the Electronic Funds Transfer Bill before the end of this Fiscal Year. I also propose to amend the Bills of Exchange Act Cap. 27 to further enhance the payment system. These amendments will facilitate introduction of cheque transaction system which enhances banks' efficiency by reducing transportation and micro-filming costs of cheques. These changes are necessary to enable banks keep up with cutting edge practices and subsequently realise improved operational efficiency in the payment system.

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

Mr. Speaker, Sir, improved corporate governance, integrity and competence in the running of the financial affair is critical for safety, soundness and success of the financial sector. It is for this reason that I propose to enhance corporate governance in the banking sector by requiring continuous vetting of chief executives, directors and significant shareholders of banks and financial entities prior to assuming responsibility. I have also proposed amendments to restrict lending to any one shareholder to not more than 25 per cent of the core capital.

(Applause)

In future, vetting for being fit and proper, will include chief executives and members of boards of all regulatory bodies in the financial sector.

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

(Applause)

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

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

On affordability, though the cost of credit has declined to sustain low costs on long-term basis. We need to pay special attention to increasing domestic savings if we want really to have a developing economy.

To increase savings and loanable funds, we need to maintain sound fiscal and monetary policies. For this reason we will continue with efforts to improve and maintain a sound financial sector so that it can expand its capacity to lend at affordable rates. Thus a healthy and profitable financial sector is key to providing healthy credit.

Mr. Speaker, Sir, with regard to stability, the Government is fully committed to avoiding a repeat of major macro-economic instability of the past, which caused chronic disruptions in the financial sector and resulted in many bank failures. The major characteristics of that situation were high fiscal deficits, excessive domestic borrowing, high inflation and political interference in the banking sector. We have now learnt our lesson well and we know that whatever short-term gains and advantages the past phenomena may have provided, in the long-term, we failed miserably to provide lasting solutions. Kenyans have paid and continue to pay a very high price both budgetary and economic costs for the financial indiscipline of the 1990s. We are all familiar with the large stocks of pending bills, non-performing loans and poor capitalization which plagued some of our key banks and development financial institutions for a long time. Due to these malpractices, our banks have had to work harder to survive.

Mr. Speaker, Sir, on efficiency, recent studies by the Government, in conjunction with the development partners, have shown that by international standards, many of our established institutions are largely inefficient. Consequently, their operating costs are higher than they ought to be, resulting in high interests and other charges to their clients. These studies have shown that high banking costs lead to high interest rates spreads with no "quick fix" to this problem. We, therefore, need several approaches to solve the problem of inefficiency and high cost banks. First, to remove any redundant legal and other controls which raise costs on banks, but without compromising on sound regulation, or the Basel Core Standards.

Secondly, to improve the operating environment while easing on areas which raise operating costs, for example, hindrances on the enforcement of collateral. Third, encourage banks to be much more transparent in their charges, while simplifying the structure of charges and sharing information with their clients, and making it easier for clients to change from one bank to another if they are unhappy with the charges. Fourth, encourage banks to share information more regularly with each other and the regulators.

Mr. Speaker, Sir, on improving access, in some aspects international experts advise that compared to most African countries, the Kenyan financial services are good, though there is room for improvement. In particular, experts note significant contribution made by over 10,000 co-operatives and 4,000 Savings and Credit Co-operative Societies (SACCOs) which have about four million members. This compares favourably with two million people with accounts in the formal banking sector. Added to this, is the role of the Postbank with its one million account holders. However, with a population of over 30 million people, majority of Kenyans do not have access to financial services while some areas of the country have no commercial bank outlets.

To avoid past mistakes, there is need for a more sustainable strategy which combines micro-finance institutions, SACCOs and the Postbank savings as the bottom-end of the financial institutions. Once penetration takes root, the mainstream banks will join in with appropriate products and downstream financial services. Enactment of the SACCO Act is expected to extend financial services and improve their effectiveness. It is, however, critical that the operating standards including corporate governance are improved. As is well known, SACCOs are built on public confidence and must be encouraged to maintain their credibility at all times in order to increase the level of savings.

Mr. Speaker, Sir, in order to maintain reasonable levels of interest rates, I propose measures to encourage long-term tradeable securities which will enable qualified investors to float long-term bonds which are listed in the stock market. Such securities will have several advantages. First, they will reduce the current practice in which investors use short-term deposits to finance long-term investments, thus eliminating the current problem of mismatch. Secondly, it will enable seekers of long-term finance to go directly to long-term savers, thus cutting out the cost of intermediation. Third, it will give managers of long-term firms outlets for their surpluses. Fourth, this avenue will offer a way out of the non-performing loans in the mortgage industry. This security will benefit investors in real estates, utilities and infrastructure. This security will be licensed under the Capital Markets Act and will be in two forms; either special purpose vehicles or dedicated programmes. These instruments are incorporated in the Capital Markets Amendment Bill published today. Detailed regulations will be prepared to cater for different needs of investors and functions of which the money is raised may be used.

As hon. Members are fully aware, Kenyans are paying a very high price for the dishonesty of a few people. Today, schools, hospitals and trading stores require payments by bank cheques. Indeed, schools no longer accept cash for fear of robberies nor do they accept personal cheques which they fear could bounce. It has, therefore, become a nightmare for people living in rural areas where there are no banks to pay school fees. Parents travel long distances to buy bank cheques at charges which are as high as Kshs1,000 a cheque, money which we can ill-afford. I believe the majority of hon. Members would like to save Kenyans both the travel and the unnecessary cost of bankers cheques. I, therefore, propose to amend the Penal Code to make issuing of bouncing cheques, while aware there are no funds in the drawer's account, an offence.

(Prolonged applause)

Mr. Speaker: Order, hon. Members! I think this tickles you! I understand why.
Please, proceed, Mr. Mwiraria!

(Laughter)

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

While public enterprises have very clear mandates some are so poorly funded that they are only able to pay salaries. In some cases, they are unable to pay statutory deductions while others use such deductions as operating cash-flow. In response to these challenges, the Government has carried out a comprehensive review of mandates of these enterprises to establish their current status.

The primary objective of the review was to assess whether those were fulfilling their mandate in delivery of services and obligation. The review also sought to establish whether their mandates are still relevant or duplicated. That information will help determine which of those enterprises will be privatised, restructured or merged. In the meantime, the Government has already reactivated the State Corporations Advisory Board which is evaluating modalities for performance-based remunerations for the chief executives.

(Applause)

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

(Applause)

It is important to instill financial discipline within the sector and, for that reason, the Treasury has decided on the following course of action:-

First, before any public enterprise resorts to the Treasury for financial support, it will have to demonstrate that it has exhausted all internal efforts, including disposing of it's non-productive assets.

(Applause)

Secondly, as provided for under Section 16(3) of the State Corporations Act, starting from the next fiscal year, surpluses and dividends must be paid to the Exchequer to reflect adequate returns on investments. However, where the enterprise has a very critical mandate and needs the surplus to fulfil some of those specific needs, it will be necessary for the enterprise to seek prior approval from the Treasury to use the surplus. In addition, each enterprise will require to maintain a sound investment policy.

Mr. Speaker, Sir, on fiscal policy management and economic recovery, I will say a few words on the tax policy and administration. Recent trends have shown that the ratio of revenue in Gross Domestic Product (GDP) has been declining. Correspondingly, the ratio of total expenditure to GDP has also declined. Those developments have been occasioned by the prolonged economic recession, which has plagued the economy since mid-1990s. Unfortunately, as the revenues have shrunk, expenditure on debts and wages has remained firm. That has created serious policy conflict where resource allocation to development of capital expenditure and operations and maintenance have been systematically squeezed out. That situation has made service delivery inefficient, unproductive and ineffective.

As economic growth is required, there is need to ensure revenue generation responds accordingly; to fund the supporting services. It is for that reason that the Government is seeking to improve tax policy and tax administration, to expand the revenue base and increase financial resources, to sustain growth in the public sector.

Mr. Speaker, Sir, during the last three years, the Government has continued to remove import duties and Value Added Tax (VAT) on basic inputs, both imported and locally-produced. Currently, capital goods, raw materials and other implements are duty and VAT-free. That has significantly reduced tax revenues on cross border trade. In addition, we have rationalised provisions related to excise duties, Income Tax and lowered rates to promote investment and growth. Excise duties have also been harmonised and deepened in line with international based practices and regional experience.

In the context of our next stage of development, the Government will harmonise fiscal incentives across the East African Community (EAC) region to create a level-playing field for investments within the community. With those reforms, it has become increasingly clear that, however good a tax system and its policies are, they cannot succeed, unless there is effective capacity for tax administration. Taking cognisance of the policy tax administration measures, the Government plans to extend tax reforms to the informal sector. That is necessary for two basic reasons. First, to ensure that, that rapidly-growing sub-sector carries its share of fiscal responsibility to finance the facilities it needs. Secondly, to spread the net and discourage businesses from splitting their operations into small units in order to avoid taxation. Plans to implement that strategy are at an advanced stage, and will be implemented as soon as operational arrangements are completed.

As part of the strategy to improve tax administration, the Kenya Revenue Authority (KRA) is upgrading its Information Technology (IT) system to facilitate integration of taxpayer data, to enable the authority conduct comparative analysis between taxpayers in similar trades. That system will also help in taxpayers recruitment. To improve the Authority's capacity to monitor our porous borders, KRA has acquired additional vehicles and motor boats. Towards better revenue enhancement, KRA is closely coordinating relations with other enforcement agencies, while improving the use of intelligence information to combat tax evasion and other irregularities. Part of those efforts include: Joint verification of cargo at borders with revenue authorities of neighbouring countries to minimise diversion of transit goods into the domestic markets of the three countries. Those initiatives will soon be boosted by the introduction of an electronic cargo monitoring system, which will be implemented soon.

Mr. Speaker, Sir, let me now turn to sectoral policies. Hon. Members may recall that, last year, I promised to institutionalise the annual public expenditure reviews, which have now been done. In 2003, the Government completed eight Ministerial Public Expenditure Reviews (MPERs) for fiscal years 2001/2002, while more extended review for fiscal years 2002/2003 has been completed, and the final report is under preparation. Those reviews have enabled the Government to identify gaps between Budget, policy objective and execution. The knowledge gained will facilitate shifting of resources to priority areas within and between Ministries and sectors.

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

Mr. Speaker, Sir, on privatisation of public enterprises, the process suffered a major setback when the Privatisation and Sale of Assets Bill was not enacted last year. However, in the area of corporate governance, we continue to make good progress, such that public enterprises which were making losses have improved and made profits. Those which were making losses too have reduced them as is the case with banks and some sugar companies. However, while gains have been made in this area, mobilisation of capital for expansion, modernisation and rehabilitation of some of our parastatals remains a major challenge. Privatisation is, therefore, considered an alternative option for raising the much needed financial and management resources. We shall, therefore, not hesitate to privatise. In this respect, a privatisation programme has been prepared, which targets a number of commercial public enterprises some of which will be eligible for concessioning. These will include enterprises in the agricultural, tourism and financial sectors, as well as major parastatals such as Telkom Kenya, KenGen, KPA, Kenya Railways and the reduction of Kenya Government shareholding in Kenya Commercial Bank. However, the privatisation process, and I want to emphasise this, can only move fast enough after the enactment of the necessary law, which is already pending before this august House.

Mr. Speaker, Sir, while carrying out this programme, the Government will develop appropriate regulatory regimes and encourage competition to provide for consumer protection. It will also build in affirmative action necessary to ensure domestic participation and safety nets for workers.

(Applause)

I would also like to assure this House that when implementing this programme, national interests will be protected. In particular, Kenyans will be expected to play key roles in ownership and leadership during the privatisation process.

(Applause)

Mr. Speaker, Sir, as I pointed out in my Budget Speech last year, the Government is fully committed to maintaining the rule of law, peace and security. This requires an efficient and well motivated police force, together with strong, good governance institutions to sustain the fight against corruption. In this regard, the Government will continue to strengthen the capacity and co-ordination of public safety and law and order institutions.

Mr. Speaker, Sir, with respect to the Judiciary, efforts have been made and more will follow to improve capacity and efficiency of the Judiciary, to speed up determination of disputes and other cases. Towards this end, the Government has appointed more officers and will embark on rehabilitation of the law courts. To free the courts from petty cases, the Government plans to establish small claims courts, together with traditional courts.

(Applause)

The Ministry of Justice and Constitutional Affairs plans to table a Bill in this august House to introduce such courts. Other initiatives under implementation in this end include improving training of police officers, providing the force with modern equipment and technology, and improving living conditions while strengthening specialised police units.

Mr. Speaker, Sir, in the agricultural and development sector, the agricultural sector continues to dominate the economy and contributes substantially to the Gross Domestic Product (GDP). It also accounts for 80 per cent of rural employment, 60 per cent of export earnings, and about 45 per cent of the annual Government revenues. This situation is likely to persist in the foreseeable future. During the year 2003, this sector grew by a modest 1.5 per cent which was attributed to favourable weather, leading to increased production of maize, wheat, coffee, tea, cotton and dairy produce, which recorded an increase of 15.3 per cent in value.

As regards cereals, there was significant decline in market values amounting to about 14.5 per cent, mainly due to poor quality of maize. Overall, the value of agricultural outputs at current prices rose by 5.6 per cent compared to increase in value of 4.9 per cent in the previous year.

Unfortunately, the terms of trade index for the agricultural sector continued to deteriorate, dropping from 83.3 in the year 2002 to 77.2 for the year 2003, which compares very unfavourably with an index of 105.2 in 1999.

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

It is for these reasons that the sector Ministry has prepared a blueprint code named "Strategy for Revitalisation of Agriculture" (SRA) to improve contribution of this sector to economic recovery, which will be implemented over the next ten years. SRA will provide guidance to reform, modernise and to transform agriculture into a profitable commercially-oriented and internationally and regionally competitive economic activity. SRA will seek to create an enabling environment for the private sector-led growth by identifying priority activities that need to be undertaken to raise and sustain growth in this sector. The fast track activities of this strategy include reviewing and harmonising the legal regulatory and institutional framework, improving delivery of research extension and advisory support services, restructuring and privatising non-core functions of the Ministry and public enterprises, and to improve efficiency, accountability and effectiveness, increasing access to quality farm inputs and financial services, formulating food security policies and programmes, and improving market access with special emphasis to rural access roads and levies and other fiscal charges. In the context of the SRA a sector-wide, Kenya Agricultural Productivity Project (KAPP), has been initiated to support such essential services as research, extension and farmer or client empowerment. The project is designed to modernise agriculture and improve livelihoods through the development, acquisition and application of improved technologies and information. It will be funded by the Government with the support of the World Bank. The first three-year phase has already been negotiated and funding level agreed at US$40 million, of which US$13 million is a grant. The project will be implemented by the Ministries of Agriculture, Livestock and Fisheries Development and Kenya Agricultural Research Institute (KARI). Other reforms in this sector will include the structuring and rationalisation of agricultural research institutes to consolidate their operations with those of KARI. With regard to extension services, the Government will review alternative modalities for service delivery and seek ways to encourage more active role for the private sector.

Mr. Speaker, Sir, as hon. Members may recall, in the Budget proposals last year, I introduced fiscal incentives for producers of electricity, distributors, investors and consumers. These incentives resulted in some reduction of some power tariff. However, the quality and reliability of our power system is still wanting. We continue to experience incidents of blackouts, sometimes for very long periods.

(Applause)

The Government has, therefore, been forced to take measures to restore sound financial status to the company. The restructuring which has been done has assisted KPLC to restructure and regain net worth through an annual injection of about Kshs2 billion, reduction of bulk electricity cost from KenGen by 60 cents per kilowatt hour and transferring the same to KPLC.

The total amount involved in balance sheet restructuring was about Kshs17.1 billion, which comprised of waiver of interest penalties amounting to Kshs1.2 billion on the outstanding debts to KenGen and conversion of Kshs15.9 billion outstanding debts to the Government into preference shares. This support has enabled KPLC to embark on a comprehensive programme of self-renewal. The company has already started a programme to procure critical components needed to improve quality and reliability of its power supply system. In addition, between now and September, 2004, the Government expects to conclude a financing package with development partners amounting to US$250 million, most of which will go to KPLC for revamping the distribution sector.

(Applause)

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

Mr. Speaker, Sir, in the petroleum sub-sector, we have encountered many challenges, including dumping of export fuels in the domestic market and adulteration of motor fuel with kerosene by unscrupulous traders. To combat these vices, the Government has taken firm corrective measures which are yielding benefits. First, the Government conducts random checks at market outlets to identify and penalise retailers who are selling diverted or adulterated products. Secondly, cancellation of licences for people who are adulterating products and dealers of diverted products. These efforts are rebuilding confidence in the economy and rewarding genuine investors, while protecting Government revenue.

Mr. Speaker, Sir, the Government is well aware that roads are the arteries of a nation, just like blood vessels are to a human body. When blood vessels get clogged, the result is high blood pressure, stress and ultimately, a heart attack.

(Laughter)

A vibrant road network makes the economy vibrant, while a poor state of roads suffocates economic growth. Consequently, to promote economic recovery, the Government will continue to accelerate rehabilitation of the road network together with other complementary transport facilities. One way to speed up this process is to bring in participation of the private sector in the maintenance and construction of road infrastructure. As part of these efforts, during the next financial year, the Government will commence implementation of major road works including: Reconstruction of major sections of the Northern Corridor, which is an improvement project, jointly financed by the Government with a 60 per cent, IDA credit of US$275 million. This project is part of the regional road network and involves improvement of some 368 kilometres, with major civil works on various sections of the Mombasa-Nairobi-Malava Highway.

(Applause)

Among the sections to be improved are: Sultan Hamud-Machakos Turnoff, and Machakos Turnoff-Athi River-Embakassi. Other works will cover Lanet-Njoro Turnoff, Njoro Turnoff-Timboroa and Mau Summit-Kericho-Kisumu. These works will be in addition to the on-going European Union (EU) finance improvements on the same road. Construction of new roads, including, the

Processional Way in Nairobi and Kang'onde-Kitui Road. Resealing, recarpeting, repair and construction of roads will be done, among them, Ndori-Luanda-Kotieno, Rang'ala-Siaya-Bondo, Embu-Thuci-Nkubu, Machakos Turnoff-Masii-Kitui, Katitu-Kendu Bay, Ruiru-Kiambu-Roy Sambu-Muthaiga, Nairobi-Thika and Kisumu-Kakamega-Webuye.

(Applause)

This is just to mention but a few.

(Loud consultations)

Mr. Speaker: Order! Order! Order, Members!

The Minister for Finance (Mr. Mwiraria): Mr. Speaker, Sir, I want to assure hon. Members that several other roads spread throughout the country have been earmarked for upgrading to gravel standards. It is expected that the repair and upgrading of rural roads will improve market access for agricultural produce. In addition, a number of new donors, among them KFW SIDA, European Union (EU), African Development Bank (ADB) and AFD of France have come on board, each covering a number of districts.

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

Mr. Speaker , Sir, to protect and preserve the road network, the Ministry of Roads, Public Works and Housing is currently maintaining 24 static weighbridges, mainly located on the Northern Corridor. Plans are at an advanced stage to introduce static weighbridges at all border posts. To ease the movement of the goods at the port, a weighbridge will be introduced at the port, while mobile weighbridges will be introduced along all major roads. As part of our efforts to facilitate faster movement of cargo through the main transport arteries, the weigh-in-motion systems will also be introduced in Mariakani, Athi-River and later on at Gilgil. Mr. Speaker, Sir, the Government has already started on a policy to improve road transport in accordance with the National Road Transport Policy. No doubt, Kenyans are enjoying more sanity in the public transport following the introduction of the new regulations. As is already noticeable, road accidents have reduced drastically. With plans to transport more cargo by railways, the number of heavy trucks on highways will decrease, leading to increased safety for other road users.

For those of us who are living in Nairobi, decongesting of the City traffic is a major concern. So, currently, most of our major urban centres are heavily congested, with the problem being particularly bad in Nairobi. To address this situation, the Government, with the support of the Government of Japan, is in the process of conducting a six-month study, on the basis of which it will formulate a Master Plan for Urban Transport in Nairobi metropolitan area for the target year, 2025.

(Applause)

The study will include a pre-feasibility on priority areas---

(Loud consultations)

Mr. Speaker: Order, now! Order! Order!

The Minister for Finance (Mr. Mwiraria): The study will include a pre-feasibility on priority areas and carry out relevant technology transfer to local countepart personnel. As part of the decongesting efforts, the Government will build by-passes in Nairobi, Mombasa, Kisumu, Nakuru and Eldoret.

(Applause)

In Nairobi, three by-passes, namely the Southern, Eastern and Northern will be built.

(Applause)

Mr. Speaker, Sir, let me now turn to the National Housing Policy. Recently, the Government reviewed the National Housing Policy, which is before this august House, for approval. This policy will be implemented through the National Housing Development Programme, together with the private sector. This programme is expected to facilitate the construction of 150,000 housing units annually. Other Government initiatives in the housing sector include the Kenya Slum Upgrading Programme, under which the Kenya Slum Upgrading and Low-Cost Housing Infrastructure Trust Fund has been established. Site and service schemes have also been established as have the Urban Redevelopment Rental Housing, Tenant Purchase Schemes, Mortgage Schemes and the Civil Servant Housing scheme. Though the Government will play its part, it will also seek to provide and maintain sound macro-economic stability, to provide a conducive environment for private sector investments. In this connection, promotion of special purpose vehicles will assist in the housing development. For this reason, the Government, through the Capital Markets Authority, will encourage and popularize the development of secondary mortgage market.

(Applause)

Mr. Speaker, Sir, the Government recognizes the important role an efficient railway system plays in the development of a nation. Rather than compete, railways and roads complement each other. A well developed railway system reduces road damage, environmental pollution, improves safety and lowers the cost of transportation. For these reasons, we need to improve the carrying capacity and reliability of the railway system to protect the road network and also to speed up the movement of cargo to and from the port. The Government expects to complete the ongoing restructuring of the Kenya Railways Corporation through a long-term concessioning and transportation of both passengers and cargo. Already, the Governments of Kenya and Uganda have agreed on a joint concessioning for which prequalification bids are expected to be out by September this year, with completion dates of August, 2005. In the meantime, efforts to improve the railway system will continue. Already, 12 locomotives are under rehabilitation in Uganda, which will significantly increase the carrying capacity of our system.

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

Mr. Speaker, Sir, there are clear signals that we need to move fast. In 2003, the tonnage of cargo, as I said earlier, handled through the Port increased by nearly 13 per cent, or from 10.56 million tonnes in 2002, to 11.93 million tonnes, while container cargo increased by nearly 25 per cent.

As peace in the Great Lakes and Southern Sudan consolidates, we expect significant growth to cargo through our port, railway and roads. To cope with this volume and maintain competitiveness of the Northern Corridor, key decisions have been taken to co-ordinate operations of the Kenya Ports Authority (KPA) and the Kenya Railways Corporation (KR), leading to introduction of block trains which load cargo direct from the ship onto railway for transportation to the inland container depots. This has enabled containers to move from the ship to Embakasi Inland Container Depot within 20 hours, and three to four days for Kisumu and Kampala. Cargo documentation has also been moved from Mombasa to Nairobi, and the KPA has commissioned a business evaluation for development of cruise, passenger terminal at berths 1 and 2. Finally, KPA is moving ahead with procurement of new equipment to improve its cargo handling capacity.

Mr. Speaker, Sir, in order to speed up movement of cargo through the port, I have directed the KRA to harmonise the customs working hours with those of the KPA. I am also putting importers, who use the port as a storage facility, on notice that if they continue with this habit, they should not expect sympathy when they apply for waiver of customs warehouse rates. Finally, shortly, I will be proposing measures to reduce the number of days which cargo can be retained in the port.

Mr. Speaker, Sir, on telecommunications, efficient and cost-effective information and communication technology (ICT) has become essential to economic growth and development. For this reason, the Government has consulted with stakeholders and prepared an ICT Policy, which will be ready soon. This policy will provide guidelines on the use of internet and other forms of telecommunications, while increasing access to ICT at much lower costs. As the current monopoly enjoyed by the Telkom Kenya comes to an end by the end of this month, we will need to move faster on liberalisation, especially with regard to creating a reliable and cost-effective international gateway. In the meantime, we expect the second fixed line operator, together with the third mobile phone provider, to be licensed soon.

Mr. Speaker, Sir, on the social sector, the Government will continue with the health sector reforms in order to enhance access and affordability of basic health services with special emphasis on the poor and vulnerable. In addition, the Government will step up efforts to increase coverage of immunisation, reduce mortality rate amongst children under the age of five years, reduce HIV/AIDS prevalence and increase the access and availability of essential drugs at our hospitals and other facilities. Improvement of health service delivery for the under-privileged rural and urban slums will be a priority. As the Government focuses more on promotive, preventive and basic health services, it will also enlist additional capacity through partnership with the civil society, faith-based and private sector organisations. Of special interest is the need to enhance and improve cross-sectoral co-operation to strengthen ties and collaboration with critical areas of water and sanitation, reproductive health, gender, HIV/AIDS, nutrition and school health, among others.

The Government will improve on co-ordination and collaboration to achieve synergy and reduce inefficiency of various stakeholders in the health care industry. This will include development and implementation of a joint national health sector, strategic plans, monitoring and evaluation framework and mechanisms for animal health sector programmes in use and a Medium-Term-Expenditure Framework (MTEF) and annual sectoral public expenditure reviews.

Mr. Speaker, Sir, on education, the NARC Government introduced free primary education which enabled over one million children, who were previously out of school, to enrol in primary schools. This policy has brought the total enrolment to 7.2 million children in our primary schools. To finance the free primary education, the Government invested an additional Kshs12.6 billion comprising of both Recurrent and Development Expenditure. A large part of this money has been provided by our development partners, for which we are truly grateful.

In an effort to improve education further, the Ministry of Education, Science and Technology held a successful National Education Conference, which brought together all stakeholders. The conference brought many issues on the table, among them, how to provide quality education and training at all levels, how to address past inequities and disparities, increase access and improve education for all, and improve safety in learning institutions. As a result of the conference, useful outputs were provided to the Government which will improve the quality of education and access to education. This will be done in a participatory approach in partnership with other stakeholders in the sector.

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

We now live in the information age, where access to information and communication technology is critical to success, not only within the Government, but also in commerce and production. For this reason, the youths will continue to require proper training in information and communication technology. It is, therefore, imperative that education and training facilities become the natural platforms to provide appropriate ICT skills.

Mr. Speaker, Sir, there have been misconceptions and deliberate distortions of Government intention with regard to retrenchment. What has not been said is that when the Government cedes some of its functions to the private sector, this goes hand-in-hand with staff adjustments. If this process is well managed, it creates more jobs in the private sector. The Government will undertake a review of the legal and judicial environment to identify causes of inefficiencies that lead to a high rate of unemployment and high labour costs in our economy. It will develop an inventory of available skills and propose reforms to improve labour market flexibility. In addition, it will seek ways to strengthen the links between education, training and industry demands, to make education and training demand-driven.

In the area of industrial and labour conflict management, the Government will reform the current system to speed up dispute settlement and strengthen the tripartite committee secretariat. Other reforms in the labour sector will fortify labour information, inspection services and reduce the backlog of workmen dispute cases. The ultimate objective of these reforms will be to improve the economic environment, to enhance the capacity of the private sector to create new jobs.

Turning to manufacturing, in my Speech last year I introduced several measures to improve competitiveness of the local industry. These included reduction of VAT from 18 to 16 per cent, allowing investors to access free of duty and VAT, capital equipment, plant and machinery for new investments, and also for expansion of existing facilities.

Many investors have taken advantage of these incentives. However, the administration of this scheme has had some problems such as the clearance of these goods in small consignments, waiting until goods arrive at the airport before filing applications, and filing applications without adequate details, leading to unnecessary delays and time-wasting in clearance of such goods. These practices have made the incentives expensive, both for the Government and the investors. The Treasury has been forced to write to investors, seeking details, which causes further delays. In addition, this incentive was not expected to be a permanent feature. Rather, it was intended to assist manufacturers and other processors during the period of recession. Once the economy picks up and investors start to make money, they should be in a position to afford the full cost of such equipment, including duties and taxes.

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

When the United States of America (USA) introduced the AGOA facility, it was intended to support local investors and producers. It was not intended to open an avenue for unscrupulous individuals to abuse and make easy money. Already, we have had unsuccessful attempts to abuse this facility, but this will not be tolerated. On the contrary, very serious action will be taken against any person who seeks to access this or any other of our export promotion schemes dishonestly through deceit.

I have, therefore, proposed amendments to the Customs and Excise Act, to provide for immediate censure of any person caught cheating on any of our export schemes. Once caught, the incentive facility will be closed immediately to such individuals. I believe these measures are necessary to support genuine investors. Indeed, the Government will continue to improve the operating environment for honest investors and seek new markets for genuine producers.

Let me now turn to the financial out-turn. In my Budget proposal I projected to receive total revenue, including Local Authorities Transfer Fund amounting Kshs240 billion, or 20.7 percent of the GDP. This was composed of Kshs215.1 billion of ordinary revenue, Kshs21.4 billion of Recurrent Appropriations-in-Aid and Kshs3.5 billion of Development Appropriations-in-Aid. The ordinary revenue was to be comprised of Kshs63.5 billion from Customs and Excise Duty, Kshs74.6 billion from Income Tax and Kshs58.9 billion from Value Added Tax, while Kshs16.6 million was to come from other revenues.

Based on actual collection to date, ordinary revenues are likely to exceed the target by Kshs2 billion. I expect Customs and Excise Duty to under-perform by about Kshs126 million, while VAT on imports and other revenues are expected to fall below target by Kshs2.2 billion. Fortunately, this shortfall will be offset by more receipts from Income Tax and other investment revenues, which will over-perform by Kshs4.1 billion and Kshs1.6 billion respectively.

Let me come to Recurrent Expenditure. Hon. Members will recall that the Supplementary Estimates for the fiscal year 2003/2004 recently approved by this House had a gross Recurrent Expenditure of Kshs333.9 billion. This included Kshs22.9 billion financed through Appropriations-in-Aid and payments financed directly from the Consolidated Fund Services amounting to Kshs130.2 billion. This left Kshs180.8 billion for discretionary expenditure. As of the end of May, a total of Kshs142.6 billion had been released. Based on this trend, and on the ongoing commitment, it is expected that the total amount in the Budget will be spent.

Mr. Speaker, Sir, the Consolidated Fund Services for the financial year comprise of Kshs28.3 billion for domestic interest payments, Kshs6.4 billion for foreign interest, Kshs12.5 billion for pensions and gratuities, Kshs1.4 billion for constitutional offices and Kshs133 million for subscription to international organisations. Furthermore, Supplementary Estimates indicated that Kshs24.8 billion would finance external redemption, while domestic redemption totalled Kshs55.2 billion.

On Development Expenditure, the Gross Development Expenditure for the year 2003/2004 is estimated at Kshs54.9 billion, including Kshs13.7 billion as project grants, Kshs8.4 billion as project loans and Kshs3.5 billion to be financed from local Appropriations-in-Aid (A-i-A). Therefore, Kshs33.9 billion was to be financed from the Exchequer. This amount was reduced to Kshs32.5 billion during the Supplementary Estimates. Out of this amount, Kshs18.9 billion had already been spent by May, 2004.

Mr. Speaker, Sir, I will now turn to the forecast for the year 2004/2005. Given the fact that we cannot outstretch resources beyond the logical point, the following expenditure decisions have had to be made: First, on the purchase of vehicles and transport operating expenses.

(Applause)

In the past, the Government purchased many vehicles, both from its own resources and external resources, but without any regard to standardisation or cost containment. As a result, some of the procured vehicles have contributed to high transport costs. Accordingly, from the next financial year, there will be need to rationalise procurement of official transport, to keep costs down. Specific regulations will be issued, which the line Ministries will be required to observe when purchasing vehicles, whether locally or externally-funded. As a matter of fact, no provision has been made in the current Budget for purchase of vehicles.

(Applause)

Therefore, there will be need for re-distribution of available vehicles from non-core to core areas of operation. For externally-funded projects, vehicle purchases will need to conform to agreed standards. In addition, the Government will soon release regulations on use of available transport in order to reduce the misuse of official transport. For this reason, provisions on this item have been reduced by 60 per cent.

(Applause)

Mr. Speaker, Sir, the cost of travel and accommodation has been rising to a level where controls have become necessary. From the next financial year, the number of journeys outside office will be curtailed. Even where such journeys are externally-funded, no supplementary allowance will be given by the Government. These restrictions apply to all levels of Government officers, including those in public enterprises. For this reason, provision for these items have been adjusted downwards to the most bearable minimum.

(Applause)

As part of cost containment, adjustments have been made in a lot of other areas where there is potential for wastage. This includes purchase of consumables, stationery, equipment and contracted professional services. Ministries are expected to exercise restraint and prudent management of the available resources. Further instructions will be released in the course of the year to cover areas where the current structures are found to be wanting.

As a Budget rationalisation exercise, we also propose to rationalise our missions abroad. The current number of missions abroad have been a major burden to the Budget. As such, the Government is committed to reducing costs related to these missions, while at the same time ensuring that there is reasonable representation. The Government will conduct a review of establishment of overseas missions to rationalise them together with their staffing levels.

(Applause)

Mr. Speaker, Sir, let me now turn to revenue. The total revenue target for the fiscal year 2004/2005 is Kshs271.03 billion. This is composed of Kshs233 billion of ordinary revenue or 20.1 per cent of the GDP, and Kshs38 billion in A-i-A, which is composed of Kshs23.9 billion on Recurrent and Kshs14.1 billion on Development.

I will now turn to Recurrent Expenditure. As hon. Members have noted from their copies of the Printed Estimates, the Gross Recurrent Expenditure for 2004/2005 is estimated at Kshs353.9 billion. This includes Kshs23.8 billion to be financed through A-i-A, and payments to be financed directly from the Consolidated Fund Services, amounting to Kshs132.8 billions, leaving Kshs197.2 billion for discretionary expenditure. The Consolidated Fund Services comprises of Kshs28.1 billion for domestic interest, Kshs5.3 billion for foreign interest, Kshs17.8 billion for pensions and gratuities, Kshs1.1 billion for constitutional offices, and Kshs133 billion for subscription to international organisations. In addition, I expect to finance external redemptions amounting to Kshs18.9 billion while domestic redemptions will amount to Kshs60.7 billion.

Mr. Speaker, Sir, on Development Expenditure, gross development expenditures for 2004/2005 are estimated at Kshs86.7 billion. Out of this amount, Kshs32 billion will be financed through Appropriations-in-Aid, composed of direct project financing of Kshs12.2 billion in loans, Kshs17.8 billion in grants and Kshs2 billion in local Appropriations-in-Aid. Consequently, I expect to finance net Development Expenditures of Kshs54.8 billion from the Exchequer.

Mr. Speaker, Sir, I will now turn to how I will finance this Budget. I have received commitments for Budget support amounting to Kshs4.7 billion, project grants of Kshs25.4 billion and project loans amounting to Kshs20.6 billion from both bilateral and multilateral development partners. Thus, I expect to receive a total of Kshs50.7 billion from external sources. This leaves me with an overall deficit of Kshs57.9 billion to finance. From the domestic sources, I target to finance Kshs22 billion through domestic borrowing, leaving a balance of Kshs35.9 billion. I expect to finance most of this remaining amount through programme support from the on-going discussions with development partners and privatisation proceeds realized in the course of the financial year. Let me stress that if additional resources are not realized, the Government will not hesitate to adjust its expenditure. What I am saying is that we will not increase domestic borrowing.

(Applause)

Mr. Speaker, Sir, let me now focus on the taxation proposals. The total revenue including Appropriation-in-Aid amount to Kshs271 billion of which Kshs232.9 billion is ordinary revenue. Based on the proposed macroeconomic focus for the fiscal year 2004/2005 and the current taxation structure, we will realise total ordinary revenue amounting to Kshs223.5 billion in the coming financial year.

This leaves a revenue gap of Kshs9.4 billion. In line with the NARC Government's agreement with both teachers and lecturers, I have proposed wage adjustments, which will result in Pay As You Earn (PAYE) revenue gain of Kshs1.3 billion to the Exchequer.

(Laughter)

I also expect to receive licence fees from the telecommunication sectors, namely the third mobile telephone provider and the second fixed line provider, amounting to Kshs5.9 billion. This leaves me with a gap of Kshs2.2 billion.

The rest of my speech outlines the measures I intend to take to raise revenue to bridge the remaining gap of Kshs2.2 billion. I, therefore, now request that the remaining part of my speech be regarded as a Notice of Motion to be moved before the Committee of Ways and Means.

Mr. Speaker, Sir, our tax laws are based on the concept of self-assessment. To a very large extent, the success of duty and tax administration depends on voluntary compliance based on the integrity of taxpayers. Indeed, our success in revenue mobilisation this year has been principally on account of improved administrative efficiency. Before I go into details of specific measures, I wish to take this opportunity to record the Government's appreciation of the excellent effort made by the board, management and the staff of the Kenya Revenue Authority (KRA) during this financial year.

(Applause)

In addition, I wish to thank the taxpayers who have co-operated with the KRA to facilitate the authority achieve its purpose. Let me also emphasize that the major focus of measures I am proposing today will be on improving integrity and accountability of our taxpayers and tax administration systems.

First, on tax amnesty; for the first time in many years revenue performance will exceed the target this financial year. This is a clear manifestation of the combined effects of improved efficiency by the KRA and renewed goodwill amongst the taxpayers. However, a number of Kenyans, while willing to comply remain, outside the tax net for fear of being heavily penalised on undisclosed amounts, should they reveal themselves. In order to broaden the tax net and encourage voluntary compliance, I propose to implement a tax amnesty on penalties and interest accruing under the three revenue Acts, namely, Income Tax, Value Added Tax (VAT), and Customs and Excise Duty.

(Applause)

The tax amnesty will be subject to full and voluntary disclosure of undisclosed amounts and will be applicable over the period 11th June, 2004, to 31st December, 2004. I encourage all taxpayers to take full advantage of this facility and ensure their tax matters are in order and brought up to date. The KRA has embarked on a programme to bring into the tax net all people who are currently required to file records and pay duty and taxes, but are not paying. The KRA is aggressively implementing a restructuring and modernisation programme. This will facilitate identification of people who have not complied. Therefore, those who do not take advantage of this facility will only have themselves to blame once the law catches up with them.

Mr. Speaker, Sir, let me now turn to my last item; the taxation measures. The Customs and Excise Act provides for a surcharge of 2.5 per cent on goods sold in the domestic market by enterprises operating in the Export Processing Zones (EPZs). As hon. Members are aware, such enterprises enjoy generous fiscal and economic incentives, including duty and VAT-free access for both machinery and inputs. They also have a ten-year income tax holiday not available to other local enterprises. It is for those reasons that the local producers have been complaining of the unfair competition, when the EPZ enterprises compete with them in the domestic market. To mitigate some of the many advantages enjoyed by EPZ enterprises when they compete against domestic producers in the local market, I propose to invoke the provisions of the law which makes a 2.5 per cent surcharge become payable.

(Applause)

Secondly, in the calendar year, 2003, the volume of cargo through the Port of Mombasa grew at faster rates than the world average. With the consolidation of peace in the Great Lakes and Southern Sudan, we expect much higher growth in 2004 and beyond. For that reason, unless measures are taken to speed up the processing of cargo through the port, more serious problems of congestion will occur. Today, I will be proposing several measures to facilitate faster movement of cargo through the port. Accordingly, I propose to amend Section 9 of the Act to allow the consolidation of cargo in transit sheds outside the port, but only by persons who will meet very stringent criteria of integrity, volume and Government revenue. Initially, and in order to make the measure cost effective, that facility will only be open to persons who generate over Kshs100 million a month in Government revenue.

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

Fourth, when goods are abandoned to Customs, Section 34 of the Act requires the Commissioner to issue two notices in the gazette to owners of such goods to the effect that, if they do not clear their goods, they would be sold by auction. When the goods fail to be sold in the auction, the law is silent on whether a notice should be given in respect of the goods when offered for sale in subsequent auctions. Recently, the Commissioner was challenged in court for attempting to sell goods which could not be sold in the first auction. Repeated publication of public notices is expensive. In addition, holding such goods in the port and other customs facilities leads to congestion. I am, therefore, proposing to amend that section, so that goods which are not sold after two public notices, shall be offered for sale in subsequent public auctions without further notices.

Fifth, when goods are entered for warehousing, the Customs and Excise Act allows the importer 21 days within which to deposit the goods in a bonded warehouse. That period is too long and allows dishonest importers to interfere with the goods before reaching the earmarked warehouses. To address that problem and minimise the risk of such goods being diverted into the local market, I propose to reduce that period to seven days, with the option of one further extension of seven days.

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

Seventh, under Section 72, the Commissioner may licence premises for use as transit godowns. In order to improve the management of those Customs facilities, I propose to amend the

Act to provide for specific actions and types of goods which may be deposited in such facilities. In particular, only bulk goods will be stored in transit godowns.

Eighth, I now turn to custom measures that have direct revenue implications. But before doing that, I would like to make two short comments. Firstly, the common external tariffs for the East African Community which the three countries have recently approved, specifies both the tariff rates and the items which should fall under each tariff category. That leaves no room for individual member States to introduce local tariff categories. Secondly, with the attendant revenue loss that Kenya will suffer by lowering the maximum tariff rate from 35 per cent to 25 per cent, I cannot afford to give away much ground on available tax base. For those reasons, I have been forced to make some adjustments, especially in those areas where the customs tariff is more than 25 per cent, and where we have suspended duties.

Mr. Speaker, Sir, our ladies, led by the women hon. Members in this House, have spoken loudly and clearly in favour of cheaper sanitary towels.

(Applause)

I have heard the message and, therefore, propose to amend the tariff classification under which those items fall, to create a specific tariff number and move them from tariff rates of 35 per cent to 25 per cent. I have already indicated that goods coming from outside, are subject to a common external tariff for the whole of East Africa. However, since I have no restriction on how much VAT I can charge, I propose to remove VAT on them. I expect the producers and importers of these towels to lower prices and pass the benefits of these measures to the consumers.

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

Mr. Speaker, Sir, we have had an explosion of charities, NGOs and religious organisations, all of which continue to seek and receive duty and VAT waivers on a wide range of goods. Arising from the agreement under the EAC, it has been decided that the three countries harmonise exemptions under the proposed East African Customs Management Act. Accordingly, I propose to amend the provision relating to duty waivers to restrict remissions to items used to alleviate human suffering, especially for the needy and the destitutes. I also propose to include education and medical services under this remission.

(Applause)

However, the qualifying goods will be restricted to basic items. In case of passenger motor vehicles, saloons, vans, station wagons, et cetera, many of them will not be eligible except for specified categories. In case of sensitive items such as foodstuffs, clothes, whether new or old, these will only qualify during periods of civil strife, natural calamities or disasters or when destined to homes for children and the aged people. When the EAC Customs Management Act comes into force on the 1st January, 2005, these restrictions will be tightened further.

Under Section 202 of the Act, when a person commits a customs offence to warrant seizure or condemnation of goods and customs seize such goods, the owner is required to claim them.

Where the goods have been claimed, the Commissioner is required to advise the owner in writing within 60 days to commence proceedings for recovery of the goods. This Section has been misused by dishonest people to make sure the 60 days expire before commencing proceedings. Thereafter, they rush to court, seeking orders for release of goods together with financial compensation from the KRA. In order to protect the revenue and domestic producer, I propose to amend Section 202 to require any person whose goods are seized under this Section to commence proceedings within 60 days, failure to which the goods shall be condemned and sold by auction.

(Applause)

Finally, there has been an acrimonious debate on the merits and demerits of exporting raw hides and skins and scrap metal. Attempts to discourage export of these items and to promote local processing have been frustrated by under-valuations of exports, which are subject to ad valorem rates of export duty. I have received a flood of petitions and proposals which in many cases are more emotional than factual.

However, in order to encourage local processing of these items, I propose to amend the Fourth Schedule of the Customs and Excise Act to introduce specific rates of export duties as follows: For raw hides and skins, these will attract a rate of duty of Kshs10 per kilogramme. For scrap metal, a rate of duty of Kshs3 per kilogramme. These measures under customs tariffs will generate an additional Kshs363 million for the Exchequer.

Excise Measures: The amendments proposed under the Customs and Excise Act aim to improve administration of the excise duties both with regard to excisable goods and excise factories.

We have a serious problem of alcoholic drinks packed in sachets which are frequently finding their way into school bags.

(Applause)

As part of efforts to discourage packing of spirits in sachets, I propose to introduce a requirement to limit the minimum packing of alcoholic spirits to 200 millilitres.

(Applause)

I also propose to prohibit off-setting of excise duty rebates unless there is prior approval by the Commissioner. In order to control adulteration of petroleum products, I propose to amend the law to authorise the Commissioner, working with the Ministry of Energy, to set operational standards for dealers in petroleum products.

Mr. Speaker, Sir, among other measures I have introduced today, are requirements that spirits will not be warehoused before payment of duties. Duty on imported spirits will be paid at the point of entry and in case of locally manufactured spirits, duties will be paid before delivery from distillers' warehouses. These restrictions are intended to minimise availability of cheap spirits which end up in wrong hands and are subsequently used for manufacture of illicit drinks.

(Applause)

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

(a) As will be recalled in the last Budget proposals, I adjusted excise rates on natural and artificial juice from 15 per cent to 10 per cent. Since then, I have received representations from producers of carbonated drinks, i.e sodas and mineral water to the effect that this reduction has made the business environment uneven for them. In order to restore the level playing field, I propose to equalise the rates of excise duty for these products at 10 per cent.

(Applause)

To protect revenue and maintain the desired economic objectives, I propose to transfer customs tariff in excess of 25 per cent on motor vehicles and load the same amount on excise duty. This change is revenue-neutral and will not affect the overall duty payable on these items. The measures proposed under the excise tariff will add additional Kshs333 million to the Exchequer.

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

Secondly, in a number of cases, we have come across numerous suppliers who have no fixed business premises. All they have are business cards, mobile phones and e-mail addresses.

(Laughter)

When such people make taxable supplies to registered persons and include VAT in their invoices, there is little hope that the tax will be remitted to the KRA. In such circumstances, the tax is much safer when withheld by the registered person and paid to the Commissioner direct. Accordingly, I propose an amendment to Section 17 of the VAT Act and an introduction of a new Section 19(a) to enable the Commissioner to require such persons as he may specify, to withhold and pay VAT directly to him at the time when he pays his customers or on such other times as the Commissioner may require.

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

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

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

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

(Applause)

Mr. Speaker, Sir, from the measures under the VAT, I expect to realise an additional Kshs1.7 billion.

I now turn to measures proposed under the Income Tax Act. Income tax brackets have not been adjusted since the year 2002 and though inflation has remained low, it is necessary to make some adjustments in order to protect low income earners from inflation induced bracket creep. Accordingly, I propose to increase personal relief by 10 per cent and also to widen the tax bracket by 5 per cent. The combined effect of these two measures is to raise the minimum income at which tax will be applicable from Kshs10,267 to Kshs11,135 per month.

Secondly, I adjusted the tax free amount on commuted pensions from Kshs360,000 to Kshs400,080 but left the tax free pension at Kshs12,500. To further support pensioners, I propose to increase the tax free monthly pension from Kshs12,500 to Kshs15,000 or Kshs180,000 a year.

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

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

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

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

Fifth, currently, the maximum contribution to registered employer-based pension schemes by both employer and employee is limited to 30 per cent of the employee's pensionable income.

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

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

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

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

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

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

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

The changes I have proposed under the Income Tax Act will come into effect on 1st January, 2005 and will cost the Exchequer Kshs280 million.

Let me now turn to changes I have proposed under miscellaneous category of the Bill. The Kenya Revenue Authority (KRA) collects revenues on behalf of the Civil Aviation Board. However, under the current provision, KRA cannot issue an agency notice to collect monies from those who fail to pay, neither can it attach property of defaulters. To speed up revenue collection for the Civil Aviation Board, I propose to amend the Civil Aviation Act to make it possible for KRA to appoint agencies, or attach property of persons who fail to pay monies legally payable for this board.

When the KRA was formed in 1995, it was expected to integrate various revenue departments to lower both the cost of enforcements by the authority and compliance by the tax payers. In line with this objective, the Board has embarked on a strategy to reorganise its operations to improve efficiency. To facilitate the on-going reorganisation, it is now necessary to amend the law to ensure that any new administrative structures are consistent with the law. These changes require a new definition of the Commissioner, and also, the functional heads. For this reason, I have proposed amendments to Sections 2, 5A and 13 of the Act.

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

Regarding, Air Passenger Service Charge Act, the Kenya Revenue Authority (KRA) has had difficulties collecting revenues from air operators, when they fail to collect money already paid to them by the passengers. To assist KRA speed up revenue collections from uncooperative operators, I propose to amend the Act to give the Commissioner legal authority to appoint agents and also attach money belonging to defaulters.

Mr. Speaker, Sir, secondly I propose to provide authority for attachment of property belonging to a defaulter. As hon. Members will recall, there has been a long debate with regard to the issue of long term securities by the Capital Markets Authority. One of the concerns which I have had is whether the current law has adequate provisions to safeguard interests of the people who may buy such securities. While many people continue to advocate for free licensing of such securities, whether in form of bonds or any other type, Kenyans are all too familiar with stalled projects that dot this country. To avoid a repeat of past mistakes, and safeguard the investors' funds in such projects, we need to provide for a reasonable measure of protection. Accordingly, I propose the following measures:-

(i) To amend the Capital Markets Authority (CMA) Act to license issuance of long term securities.

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

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

Mr. Speaker, Sir, the Insurance Act prohibits offering of rebates to induce an insurer to give an insurance contract. In spite of that prohibition, suspicions persist to the effect that rebates continue to be given. To discourage that practice, I propose to amend the law to increase fines under Section 73, from Kshs500,000 to Kshs1 million, and Kshs5,000 to Kshs200,000.

(Applause)

Mr. Speaker, Sir, Kenyans are aware by the recent attempts by unscrupulous Export Processing Zone (EPZ) enterprises to import ready garments for re-labelling as Kenyan made. Had that scheme succeeded, it would have exposed genuine investors in the sector or sub-sector, to dangers of being locked out from the African Growth and Opportunity Act (AGOA) facility. Those risks are particularly high when commercial and manufacturing zones are mixed under one roof. To minimise opportunities for trans-shipment of goods made elsewhere through Kenya, I propose to amend Section 19 of the Export Processing Zones Act to require the Authority to consult with the KRA before licensing commercial activities, so that commercial zones are adequately separated from those engaged in manufacturing. In addition, goods from processing zones will require prior approval of the Minister responsible for trade, before they are off-loaded into the domestic market.

(Applause)

Mr. Speaker, Sir, in conclusion, the road to poverty reduction is a long one. The Budget proposals I have presented today provide the necessary ingredients towards that goal. The policies I have outlined aim to consolidate economic gains in the short to medium term, and to accelerate economic growth in the long term.

Mr. Speaker, Sir, as I predicted last year, it has taken the NARC Government much longer than anticipated to put economic and public affairs in order. However, the progress we have made in one and a half years is there for all to see.

(Applause)

For us to succeed and realise the full potential of our nation, we must work hard together in unity.

(Applause)

Let us all take the motto: "A working nation", to our hearts and practise it, for that is surely and honestly the surest way we can attain prosperity and economic justice.

Mr. Speaker, Sir, as I conclude, let me remind hon. Members of the Budget theme for this year namely: Enhancing Efficiency for Accelerated Economic Growth. This is a challenge to all Kenyans, especially the leaders, to improve use of resources under their care and achieve better results.

(Applause)

Now that we have established the Constituency Development Fund (CDF) and provided Kshs4.5 billion in the coming fiscal year for that Fund, what better [The leadership could we offer to our people, than to use the CDF funds efficiently, to address the urgent needs of the poor and vulnerable?

(Applause)

Mr. Speaker, Sir, let us show by action that the projects we select for funding are pro-poor and address the most urgent basic needs, such as provision of water, building of classrooms and health facilities.

(Applause)

Mr. Speaker, Sir, in all we do, let us always remember that "leadership is action and not position".

(Applause)

My appeal to hon. Members and, indeed, to all Kenyans is let us reason together on how to rebuild this nation for "united we stand, divided we fall".

(Applause)

For the sake of all Kenyans and generations to come, we cannot afford to fall.

Mr. Speaker, Sir, I beg to move.

(Applause)

The Vice-President and Minister for Home Affairs (Mr. Awori) seconded.

DEPARTURE OF HIS EXCELLENCY THE PRESIDENT

Mr. Speaker: Order! Hon. Members, it is now the pleasure of His Excellency the President to take his leave.

(Hon Members rose in their places while His Excellency the President left the Chamber)

ADJOURNMENT

Mr. Speaker: Order, hon. Members! That concludes our business for today and the House is, therefore, adjourned until Tuesday, 15th June, at 2.30 p.m.

The House rose at 6.10 p.m.