NATIONAL ASSEMBLY

OFFICIAL REPORT

Thursday, 12th June, 2003

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, M.P.)

(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, the National Rainbow Coalition (NARC) took over the instruments of the Government in an environment of great expectation and excitement. The team appointed to run various Ministries was highly motivated and determined to quickly restore public confidence in the Government. As Ministers moved with gusto, reality began to dawn. Not only was the country run down and the Treasury empty but there was, and still there is, a large stock of financial obligations to sort out.

Of immediate concern is commitment on wage obligations which will be with us for several years. There is also a rapidly accumulated domestic public debt which rose from Kshs215.5 billion in December, 2001 to Kshs251.5 billion in December, 2002. This debt is sucking a large of part of revenue in form of interest payments. In addition, we have a large claim of unpaid liability, the so-called "pending bills". There is also a large stock of contracts, some of which were contracted as late as November and December, 2002, and details of which we are still unravelling. Added to these are external debts, which stood at Kshs377.7 billion as at 30th June, 2002. This means that a very large part of our financial resources is already committed. To make matters worse, the structure of public expenditure was such that nearly all revenues were used for consumption and debt servicing. Hardly any resources were spared for operations and maintenance. The little resources that were allocated for development made it impossible to complete projects on time.

Mr. Speaker, Sir, the NARC Government faces the challenge of sorting out the financial mess left behind by the outgoing Government while improving the lives of Kenyans and service delivery to them. We have to achieve this while endeavouring to reduce poverty. The NARC promises contained in its election manifesto, as has been re-stated by His Excellency the President, will remain our priority. The fiscal, monetary and economic policies that I am going to announce today have been formulated after taking into consideration the current financial and economic realities.

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

Mr. Speaker, Sir, let me now turn to the performance of the Kenyan economy. Throughout the 1990s, the economy continued to perform poorly. As a result, the economic growth averaged about 2 per cent between 1990 and the year 2001. During this period, population growth remained well above the rate of economic growth and closed the year 2000 at 2.4 per cent. As will be observed, the last ten years have been particularly difficult for Kenya; first, due to increased incidents of poor economic governance. Savings and investments declined steadily, especially after mid-1990. For example, while the level of savings and investments stood at 17.1 per cent and 21.8 per cent respectively in 1995, they declined to 7.6 and 15.8 respectively by the calendar year 2001, and are estimated to have fallen even further in the year 2002.

The situation arose from a combination of increasing poverty which rose to 57 per cent of the population by the year 2000, and declining foreign capital inflow. The situation was aggravated by withdrawal of official development assistance (ODA) due to rising incidences of poor economic governance and corruption. As a result of falling foreign direct investment and ODA, Kenya has been a net importer of capital since mid-1990. This means that Kenya has been paying more to the rest of the world than she has been receiving in form of foreign capital. It is unfortunate that this situation was allowed to continue for so long, thus draining the country of the financial resources she desperately needed.

Mr. Speaker, Sir, faced with dwindling inflow of resources and rising debt service, the previous Government resorted to increased domestic borrowing to service external debt obligations. In an attempt to remain up-to-date on external debt obligations, in the face of falling tax revenues, the Government also started to accumulate unpaid claims. The combined effect of taxation, increased domestic borrowing and accumulation of unpaid obligations squeezed the economy into recession where it is today. These factors have precipitated the worst form of crowding out of the private sector in recent years. For example, in the calender year 2001, our credit to Central Government grew by 19.8 per cent, while credit to private sector declined by 17.3 per cent. Similarly, in the year 2002, credit to the Central Government grew by 21.8 per cent, while credit to private sector grew by only 4.8 per cent.

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

Mr. Speaker, Sir, as hon. Members will have noted from the Economic Survey 2003, the

economy performed poorly in the year 2002, recording a real GDP growth of a marginal 1.1 per cent, down from 1.2 per cent the previous year. This was due to
factors such as poor state of infrastructure, poor commodity prices especially on agricultural exports, low domestic credit and political and economic uncertainties relating to the last General Elections. However, in 2002, inflation declined substantially to 2.0 per cent compared to 5.8 per cent in 2001.

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

In the social sector, the Central Government expenditure on social services increased by 18.3 per cent in the fiscal year 2002/2003 compared to 2001/2002. This was on account of additional resources availed to the Ministry of Education, Science and Technology in the second half of the financial year to implement free primary education. As a result, expenditure allocations for social services increased from Kshs79.4 billion in 2001/2002 to Kshs94 billion in 2002/2003, out of which 70.7 per cent was for the Ministry of Education, Science and Technology. The free primary education has reversed declines in gross enrolment in primary schools which currently stands at 100.5 per cent from 90.8 per cent in 2002, with Standard One to Five recording 118 per cent following introduction of free primary education in January, 2003.

(Applause)

When private schools are included, gross enrolment in primary schools stand at 104.2 per cent, which vindicates the NARC Government's decision for having taken such a bold decision. Increased enrolment also has been noted in secondary schools, tertiary colleges and at university level.

As regards health services, total hospital beds increased by 4.4 per cent in 2002 compared to 2001, while HIV/AIDS prevalence continued to drop from 13 per cent to 10.2 per cent in 2002. There were also significant increases in benefits paid by National Hospital Insurance Fund (NHIF), while contributions to the National Social Security Fund (NSSF) recorded major increases. As hon. Members, we appreciate that health and education are two areas to which the NARC Government would like to pay special attention as resources become available.

On employment, persons employed outside small-scale agriculture and pastoralism increased by 7.6 per cent from 6,366,900 to 6,851,600 in 2002 compared to 2001. Employment in modern sector grew by a modest 1.3 per cent, while private sector employment grew by 1.6 per cent.

Mr. Speaker, Sir, during the year, the Central Bank maintained a tight monetary policy, which resulted in significant drop in inflation rate; from 5.8 per cent in 2001 to 2 per cent in 2002. The money and financial markets remained fairly stable, even though banks continued to experience excess liquidity which averaged 46 per cent compared to the statutory requirement of 20 per cent. This excess persists due to reluctance by the banks to lend to private sector in preference of investing in Government securities.

Mr. Speaker, Sir, on balance of payments, weak domestic demand during the year resulted in a drop in imports. The most affected commodities being mineral fuels, machinery and transport equipment, food and live animals. However, there was significant growth in exports of horticultural produce and re-exports. Arising from these developments, trade deficit narrowed for the first time since 1996, and the current account balance recovered from a deficit of Kshs43.8 billion to a surplus of Kshs4.7 billion. But the capital account
worsened from a surplus of Kshs34.4 billion in 2001 to a deficit of Kshs4.5 billion due to a sharp reduction in capital inflows.

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

Mr. Speaker, Sir, volatility in the world oil prices translated into instability in domestic prices of refined products. During the year crude oil imports declined by 24.0 per cent while refined products declined by 13.7 per cent, resulting in an overall decline of import bill by 22.6 per cent.

Mr. Speaker, Sir, I do not intend to analyze the national economy any further. Hon. Members have already received copies of the Economic Survey 2003, which gives more details. This is a useful document which hon. Members need to read.

Mr. Speaker, Sir, turning now to the policy strategy, the NARC Manifesto promised to turn the economy around, create 500,000 jobs a year, and raise the performance and credibility of the Government. On assuming power, it became obvious that the economy was so run down that major reforms were necessary in order to put the economy on a growth path. It is for this reason that the Government has just published the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC), 2003-2007, under the auspices of the Ministry of Planning and National Development. The Ministry has conducted several consultative fora, which included a wide range of economic players, including hon. Members of Parliament, Government agencies and our development partners. The measures I present to this House today incorporate the initial phase of our Economic Recovery Strategy (ERS).

Mr. Speaker, Sir, I do not intend to go into more details of the Economic Recovery Strategy for Wealth and Employment Creation. I need to mention some of the main objectives of this strategy, which include:-

(i) Reversing declines in per capita income growth,

(ii) Increasing investments, both private and public while raising productivity of capital;

(iii) Developing a foreign aid policy that targets poverty reduction, avoids crowding out the private sector; enhances transfer of technology, while strengthening and promoting domestic institutions;

(iv) Channelling more budgetary resources to growth and poverty reducing areas, while prioritizing and rationalizing resource allocation;

(v) Maintaining a stable macro-economic situation, sustainable balance of payments and public debts both local and external, and ensuring that Government borrowing is consistent with desirable monetary policy;

(vi) Creating an enabling environment and incentives for the investor; (vii) Promoting exports, and

(viii) Restoring and maintaining sound relations with development partners.

Mr. Speaker, Sir, achieving these objectives requires financial discipline, collaboration between public and private sectors and hard work over the next three years. In addition, these objectives are essential to the realisation of the NARC goal of creating 500,000 jobs a year. It is for this reason that I have chosen this year's Budget theme as "Working Together to Regain High and Sustained Economic Growth." On its part, the Government has set various macro-economic targets for the period 2003 to 2007, which include:-

(i) An annual average Gross Domestic Product (GDP) growth rate of 4.7 per cent;

(ii) Raising annual investment rate to an average of 17.7 per cent to achieve an average investment GDP ratio of 23.3 per cent;

(iii) Raising annual savings ratio from 10.7 per cent in 2002 to about 15.8 per cent in 2007;

(iv) Maintaining real private consumption growth at about 4.4 per cent; and

(v) Reducing Government consumption to GDP to a target level of 14 per cent while raising external resources inflows to at least US$2.2 billion.

Mr. Speaker, Sir, these macro-economic targets are on various sectoral targets, with the lead sector expected to be the building and construction sector, which, on average, is projected to grow at 16.7 per cent per annum, followed by the manufacturing sector, which is expected to grow at 8.6 per cent per annum. Due to a number of structural and institutional problems, agriculture is expected to grow at only 3.1 per cent per annum. Information and communications technology is expected to grow at an average rate of 5 per cent, per annum. When realised, these targets will reduce the share of agriculture from about 24.1 per cent of GDP in the year 2001 to 22.2 per cent in year 2007.

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

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

Mr. Speaker, Sir, consistent with our Economic Recovery Strategy, the management of public resources will be restructured to ensure that the tax burden is gradually reduced to a sustainable level and made more equitable.

On expenditures, the Government will seek to realise value for money on public investments. In this regard, we note with disappointment that, for many years, the Treasury has continued to release money to Ministries without assessing what the ensuing expenditures have achieved or created. This concern was confirmed by public expenditure reviews conducted in 1997 and again in 2002-2003. These reviews clearly show that the use of public resources has not achieved the desired objectives. In the first place, little prioritization was done when budgeting and no efforts were made to ensure timely and efficient implementation of public programmes and projects.

Secondly, even in cases where projects have been completed, they were hardly ever used optimally due to a combination of lack of recurrent resources and unreliability of resource flows.

Thirdly, though a Medium-Term Expenditure Framework (MTEF) was introduced in 2000/2001, which was expected to lead to more predictable allocation of resources with more predictable flows, this system appears to have been honoured only in breach. Old habits continue to dominate expenditure management.

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

(i) Include in the budget only those projects and programmes which they have capacity to implement;

(ii) Incur expenditures only on programmes and projects which are in the budget;

(iii) Be fully accountable for what they budget for, in other words, they have to be accurate;

(iv) Accounting officers to ensure they budget for all essential expenditures and services and any omitted items will not be funded under Supplementary Estimates unless they are emergencies;

(v) Treasury will not accept new projects or programmes after the Printed Estimates are finalised;

(vi) Save for restructuring the current large stock of short-term domestic debt, the Government will only borrow for investments; while short-term borrowing will be confined to closing revenue gaps arising from seasonalities in revenue collection.

Mr. Speaker, Sir, as part of improving public expenditure management, the Government will, in the course of this year, prepare modalities to institutionalise Public Expenditure Reviews (PER) and make these reviews an annual feature. In future, research allocations and sustaining of public projects and programmes will be based on how well a Ministry has used resources previously allocated to it. In addition, Ministries need to ensure that the expenditures they incur generate value for money.

Towards this end, the Ministry of Finance, in conjunction with the Ministry of Planning and National Development, will institutionalise a system of public expenditure tracking. This system will be designed to check whether allocated resources reach the intended beneficiary and with what effect.

Mr. Speaker, Sir, revenue, including Appropriations-In-Aid (A-I-A), has been growing at less than 2 per cent per annum. In order to reduce pressure on domestic borrowing, growth of public expenditures should be contained within the same range. This calls for enhanced financial discipline but more importantly, the need to prioritise expenditures.

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

To assist in improving the expenditure management, the Treasury in consultation with our development partners, is working on a programme to improve financial information management systems. This will go hand-in-hand with the operationalisation of an up-dated Country Financial Accountability Assessment (CFAA) Programme. As part of this, the Government will table before this august House, the following Bills for debate:-

The Government Financial Management Bill, 2003 and the Public Audit Bill, 2003, both of which will replace the Exchequer and Audit Act. We will also table the Procurement and Disposal of Assets Bill, 2003. When passed, these laws are expected to significantly enhance both transparency and accountability in the management of public resources.

Mr. Speaker, Sir, the public transport system in this country continues to experience turbulent times. Attempts to remove the Transport Licensing Board (TLB), last year, saw an upsurge of illegal groups. Each of these groups has sought to take control of routes and introduce fees and their own charges. Some groups went as far as claiming to own various public roads. As a result of this, the Ministry of Transport and Communications is preparing an appropriate public transport policy and it has decided to retain the TLB. This decision has been arrived at after consultations with the relevant stakeholders. In the meantime, the fees charged under the Transport Licensing Board have been reintroduced. During the next fiscal year, the stakeholders will undertake further consultations and develop the necessary procedures for licensing, security and control which will apply to public transport operators.

Mr. Speaker, Sir, a good economic, political and socio-governance is essential for improving overall management of public affairs. Furthermore, good governance is also necessary for creating an enabling environment for private investors. It is also critical for faster growth and poverty reduction. For these reasons, the Government will spare no effort in its endeavour to achieve this goal. In this connection, the NARC Government has embarked on several policy initiatives, which have already been launched, in order to address instances of bad governance. These include the enactment of the Anti-Corruption and Economic Crimes Act together with Public Officer Ethics Act. It also includes the appointment of the Task Force on Public Collections or Harambees; appointment of the committee on Truth, Justice and Reconciliation, appointment of several commissions including the Judicial Commission of Inquiry on the Goldenberg Scandal and re-launching of the constitutional review process which was derailed towards the end of 2002.

In the coming financial year, the Government will operationalise the Anti-Corruption Commission and move forward with implementation of the Anti-Corruption and Economic Crimes Act. It will also launch full implementation of the Code of Ethics for Public Servants. In addition, the Government will address a truly independent National Human Rights Commission. The Government will also establish the Office of the Ombudsman. These measures, together with wide-ranging Judiciary reforms, will aim to ensure equality before the law and to make the rule of law supreme in this country.

Mr. Speaker, Sir, the Government is committed to improving institutional capacity of the Public Service to make it effective in the formulation and implementation of Government policies, projects and programmes. However, coming from a history of weak institutional capacity, together with unwillingness to enforce law, has created some impediments. For this reason, changes are necessary to make sure there is clear and effective capacity to perform. This is necessary to create a level playing field for economic players. It is for this reason that the Government has already established a commission to review business related laws and regulations. The commission will also review institutional aspects and recommend appropriate changes to address identified impediments. Based on the commission's findings, the Government will simplify and rationalise rules and regulations, enforcement and arbitration procedures to make this country more investor-friendly.

Mr. Speaker, Sir, this country has a large number of public enterprises, many of which engage in commercial activities. Contrary to the original expectations, majority of them depend on the Exchequer for their financial survival. Some have borrowed both locally and abroad but do not service their debts, forcing the Exchequer to pick the costs. This unfortunate situation has been encouraged by poor governance which made some of the public sector managers operate without adequate consultations. This enabled public enterprises to be treated as cash cows that even monopolies with captive markets made losses.

Mr. Speaker, Sir, my message to the management of these enterprises is short and clear. It is time each one of them proved his or her worth. The Kenyan taxpayers need a break. Accordingly, the NARC Government will not allow any of them to become an excess baggage to the Exchequer. Each of them will be required to add value to the economy or be wound up. To ensure the privatisation programme is conducted in accordance with the expectations of Kenyans, a Public Enterprises Privatisation Bill will soon be tabled before this august House for consideration and enactment. The primary objective of this Bill is to build a consensus among stakeholders and economic players while setting clear privatisation procedures. It will also provide legal procedures and modalities to underpin the privatisation process. For critical enterprises in the public utilities, the Government will seek to build public and private sector partnerships. Where necessary, the Government will promote broad-based ownership while maintaining financial viability. The Government will also hire chief officers, the CEOs, on the basis of performance contracts for two to five years. The contracts will specify the expected achievements of those appointed to head the enterprises.

Mr. Speaker, Sir, as regards energy and telecommunication services, these have been some of the most disappointing areas contrary to expected results. Enterprises in these sub-sectors have been major obstacles to private sector operators. Though they have huge investments, they have been characterised by poor quality, unreliable and high cost services. This situation continues to hurt both the private investors and the economy. The major problem here has been poor governance which the Government has already started to correct. In the coming fiscal year, the aim will be to restore the affected enterprises to financial viability. In the meantime to assist investors, I will be announcing some measures to mitigate poor services in these critical areas.

Mr. Speaker, Sir, local authorities play a critical role in economic growth and development as they provide services necessary to investors at the operating level. They also promote participatory democracy and can have significant impact on poverty alleviation if they are sufficiently run. In recognition of this importance, the Local Authority Transfer Fund (LATF) was introduced in 1998; to facilitate transfer of revenue to them. The transfer was based on the expectation that LATF resources would enable authorities to become primary vehicles of implementing successful community-based and community-driven developments. Though the transfer has had a measure of success, there is need for improvements. In particular, local authorities need to move faster and improve their revenue. As hon. Members are aware, the Draft Constitution proposes to give local authorities enormous responsibilities as part of devolution. As we await the final outcome of the constitutional review, it is obvious that many of these authorities lack the capacity to deliver quality services to the public.

Mr. Speaker, Sir, during the Financial Year 2003/2004, the Government will transfer a total of Ksh3.75 billion to local authorities through the LATF which represents a 25 per cent increase over the 2002/2003 Financial Year. It is my expectation that these Local Authority Transfer Fund (LATF) resources, in combination with own revenues, will be used to improve the livelihoods of people throughout the country. If not properly utilised, the affected authority will not access future LATF funds. In due course, the Treasury will put in place a monitoring and evaluation programme to asses how these resources have been used. This information will form a critical input in the design for future inter-governmental fiscal relations.

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

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

(Applause)

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

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

(i) Recruit and train more prosecutors, and equip them to enhance their capacity;

(ii) Decentralise public prosecution services to speed up trials;

(iii) Modernise court registries, in particular, the business registries, so that files stop disappearing;

(iv) Strengthen Law Reform Commission and improve drafting capacity;

(v) Undertake extension of court physical facilities;

(vi) Ensure that civil litigation is faster, more efficient, accessible and affordable to wananchi;

(vii) Identify and promote use of alternative dispute resolutions;

(vii) Develop and implement a framework to strengthen enforcement of judgements;

(ix) Ensure speedy and affordable commercial justice system; and

(x) Develop children's courts and institutional support.

(Applause)

Mr. Speaker, Sir, prisons require improvement to reduce and ultimately eliminate inhuman conditions which exist today. Prison facilities need rehabilitation to make them correction centres and not dens of hardening jailed offenders. For this reasons, the Government will, both in the immediate and medium-term, undertake rationalization in the prisons management, fully implement the Community Service
Order Act, expand prisons through the construction of more space and residential housing for staff, and recruit and train more officers while retraining those already in service. This will be done in tandem with improvement of facilities for inmates.

Mr. Speaker, Sir, as hon. Members are aware, the agricultural sector continues to dominate the economy. It has also been one of the most abused sectors. Consequently, our efforts to eradicate poverty must focus strongly, on making agriculture more productive and better organised to enhance its competitiveness.

(Applause)

We recognized that, despite being so critical, the sector has experienced a number of challenges, which include;

(i) High dependence on rainfall;

(ii) Out-of-date and inappropriate technology;

(iii) Inadequate funding for research and extension with poor linkages between research findings and farming practices;

(iv) Many but outdated laws and regulations with weak regulatory capacity for managing liberalized market, going hand in hand with unfair trading practices, which include free importation of subsidized produce from developed economies;

(v) Poor governance in key agricultural institutions, including co-operatives and development finance corporations;

(vi) Poor and inadequate infrastructure, leading to high costs of production;

(vii) High incidence of HIV/AIDS which is affecting labour productivity;

(viii) Poor access to credit due to high risk; and

(ix) Poor marketing arrangements.

Mr. Speaker, Sir, of particular concern has been the effects of poor governance in this sector, especially with regard to sugar and cereals. In the past, preferred traders have been allowed to import some of these commodities free of duties and taxes and sell them cheaply at the expense of local producers. This practice has consistently driven producer prices below remunerative levels, thus undermining farmers' incomes while discouraging local production. Consequently, this is one area which the Government will give special attention in order to protect farmers.

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

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

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

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

Environment and natural resources suffered the greatest damage during the last years of the previous Government. Wanton destruction of forests was perpetrated to a point where bhang growing in forest reserves was a common practice. Forest land was also indiscriminately hived off and given as rewards to friends and relatives. This situation led to a systematic degradation of the environment, especially water catchment areas. To make matters worse, Local Authorities failed to collect and dispose garbage in towns leading to increased risk to life. To reverse the situation, the Government has already initiated measures to improve environmental conservation.

In the past, weak environmental management and failure to enforce environmental standards and regulations resulted in severe degradation of land, leading to depreciation of natural resources base. This abuse has resulted in adverse climatic conditions, characterised by drought and killer floods as rain water rushed down bare hills. It is now time to halt the damage and start rebuilding our environment.

Among the measures the Government has taken to stabilise the environmental situation are: Strict enforcement of laws against logging has already started, and operationalizing of the National Environment Management Authority (NEMA). NEMA is required to ensure that projects with potential impact on the environment go through the environmental impact assessment before they are implemented. In addition, environmental concerns will be integrated in land use and planning.

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

During my short period in the Treasury, I have received a large volume of representations, majority of which seek removal of duties and taxes. However, as hon. Members will appreciate, it is not possible to remove all fiscal charges since the Government requires revenue to render public services. However, there are only limited opportunities to reduce these charges, which need to be used sparingly. We understand these sentiments as originating from a prolonged period of economic recession.

The local industries have been through a very difficult time and are looking for ways out of it. Their problems are made worse by high costs of electricity, poor roads, insecurity and general inefficiencies in import management, such as importation of counterfeit goods together with rising labour costs. The Government appreciates these problems and is committed to ensuring that the sector plays a leading role in our economic recovery effort, together with poverty alleviation. To achieve the goals, the Government will implement the following measures, among others;

(i) Develop an export development strategy that considers all sectors and seeks to expand diversification of export markets to reduce vulnerability;

(ii) Put in place, by the year 2004, a comprehensive Industrial Master Plan to implement first phase of Kenya's industrial transformation strategy;

(iii) Benchmark key industries to international standards and structure recovery efforts for these industries around international price targets. The focus will be on the resource based industries to maximise the benefits to the rural areas; (iv) finally, ensure the monetary and exchange rate policies are consistent with our desire to maintain low and predictable interest rates, as well as appropriate exchange rates.

Mr. Speaker, Sir, in the meantime, I propose to take several fiscal measures to support local producers in their endeavour to regain their competitiveness. The measures will come later in Part IV of my Budget speech. Let me now come to micro and small-scale enterprises.

Mr. Speaker, Sir, let me now turn to micro and small-scale enterprises. These are normally called *Jua Kali* enterprises. These enterprises cut across all sectors of the economy and provide one of the most prolific sources of employment, not to mention the breeding ground for future businesses and employers. During the last decade when the economy faced serious challenges, this sector became the fastest growing. Today, these enterprises are found in every corner of this country and have great potential for creating a wide variety of jobs while generating widespread economic benefits. It is for this reason that His Excellency the President promised that the Government will develop a Sessional Paper to lay the policy foundation for development and improvement of this enterprise. The Sessional Paper which is at an advanced stage, will include a wide range of policy and administrative matters. Among the critical issues to be addressed are the legal and the regulatory framework and access to finance.

Mr. Speaker, Sir, let me now focus on tourism which is one of the key growth areas with great potential for quick income generation. The necessary infrastructure is already in place and can be used to regenerate growth. During the first four months of this year, tourist arrivals rose by 25 per cent, confirming the potential for quick recovery. Unfortunately, following negative travel advisories by both the United States of America (USA) and the United Kingdom (UK), tourism arrivals suddenly dried up. Now, the industry faces very bleak future and with this, sources of livelihood for many of our people. It will also have significant and negative impact on our balance of payments.

Mr. Speaker, Sir, the Government appreciated the dangers of terrorism and has taken a firm stand on this and will continue to take very firm action against those who perpetrate terrorism. However, we do not believe that the best way to fight terrorism is to give in to threats or to take measures which increase economic problems for the poor. If anything, such actions encourage terrorists to be more bold in the hope that people will recognise their causes. What we need is to develop collaborative efforts to fight the evil by protecting those lives and economic interests of our nation. The measures we have taken and will continue to take should demonstrate to those visiting Kenya that they are as safe, if not safer, as they would be in any part of the world, and particularly in those countries giving trouble notices.

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

(Applause)

Mr. Speaker, Sir, we all know that promoting the film industry is the most effective way effective way to market a country for tourism development. It is unfortunate that this opportunity was lost due to a clear paranoia of film makers by the previous regime. To correct this situation, the Government will give the promotion of filming the priority it deserves.

(Applause)

Mr. Speaker, Sir, this is necessary to give the country added exposure to the rest of the world. However, filming will go hand in hand with enhanced protection of our flora and fauna, a process which has already started. In addition to improving security for tourism and tourist resorts, the Kenya Wildlife Service (KWS), will be granted fiscal incentives which are availed to other uniformed services. The industry will further benefit from the other physical incentives which I will be proposing shortly.

Mr. Speaker, Sir, let me now come to a rather sensitive issue of money and finance. As I have already indicated, the economy has been under recession since the mid-1990s. One of the contributing factors to this poor performance has been weakness in the management of monetary, fiscal and financial policies. In most cases, these policies have been part of the problem rather than solution. As can be recalled, in early the 1990s, expansionary fiscal policies were soon translated into expansionary money supply. Efforts taken to mop up the excess liquidity drew the commercial banks from lending to private sector to investing in treasury bills. Unfortunately, this process continued throughout the 1990s. When the Government decided to convert the Treasury Bills into long-term securities while still raising debts in Treasury Bills, banks and financial institutions embraced both short-term and long-term Government securities.

Mr. Speaker, Sir, given the combined effect of the economic recession and rising demand for credit by the Government, banks and financial institutions abandoned lending to the private sector. Added to this, poor lending practices, characterised by poor risk assessment and both insider and political lending brought serious problems. The end result has been very high non-performing loan portfolios in our banks. To make matters worse, some of the banks over-invested in unproductive assets, including real estates.

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

(Applause)

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

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

(Applause)

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

Mr. Speaker, Sir, Section 44 of the Banking Act requires commercial banks to seek approval from the Minister before imposing various bank charges and commissions. Unfortunately, this part of the law has been only honoured in breach. I am, therefore, directing the Central Bank of Kenya to immediately enforce compliance with Section 44 of the Banking Act.

(Applause)

This is especially necessary where there is inadequate compensation as is the case in Kenya. I have been persuaded to invoke this section in order to balance the equation in this important industry.

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

The current very low deposit interest rates are not remunerative enough to encourage savings. On the other hand, the lending rates have remained too high, giving the banks high interest rate spreads.

(Applause)

We believe this untenable situation arises from lack of adequate information on the part of the credit seeker. I will, therefore, require the Central Bank to request the banks to disclose their savings rates together with minimum and maximum lending rates. This information will be monitored closely by the Central Bank of Kenya to improve transparency in the banking industry. We believe this information is necessary and should be availed to the public.

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

(a) Those in banks where shareholding is predominantly by the Government and the Co-operative movement;

(b) Restructured and reopened banks;

(c) Those in distressed banks; and

(d) Those banks experiencing financial problems.

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

Mr. Speaker, Sir, let me talk about the Central Bank of Kenya (Amendment) Bill, 2000. That is in other words, the Donde Bill. That Act originated from what was perceived as persistent and unjustified high interest rates spreads. Therefore, passing that Act was seen as an attempt to reintroduce controls to deal with a measure of public frustration. It is for that reason that battle lines were clearly drawn, leading to severe contests touching on the constitutional validity of the Act, which is still in court. As the Minister in charge, it is now my duty to resolve the current stalemate over that Act.

As I start, I have already indicated my intention to invoke provisions of Section 44 of the Banking Act to address the problem of unilateral escalation of bank charges. That, I believe, will go a long way to address some of the concerns which led to the passing of that Act. I will also be proposing to the relevant Committee, that is, the Finance, Planning and Trade Committee of this august House and, ultimately, to this august House itself, fresh amendments to deal with concerns over that Act. In so doing, I will be guided by the need to send clear signals to the banks and financial institutions that we recognise both the shareholder and depositor interests.

In summary, I will be seeking to ensure responsible corporate governance for all concerned parties. Those efforts will include adoption of the following specific measures:-

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

(Applause)

Secondly, banks and financial institutions will be required to maintain positive savings interest rates, and also, to submit their weighted minimum and maximum lending rates to Central Bank.

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

Mr. Speaker, Sir, arising from the banking crisis of the late 1990s, coupled with incidents of bad political and economic governance, attempts were made to restrict licensing of new banks through substantial increases in paid-up capital. Arising from that, the minimum paid-up capital for banks and financial institutions was raised to Kshs500 million and Kshs375 million, respectively. The affected institutions were given five years to comply. However, good as those measures may have been, they ignored the cardinal reality that it is the asset quality of banks and non-bank financial institutions which determines the health of an institution, and not the amount of paid-up capital. For that reason, I propose to amend the Second Schedule of the Banking Act, to set paid-up capital for banks and non-bank institutions at a lower level.

Mr. Speaker, Sir, money laundering, terrorism and international crimes are closely associated. I believe everybody in this country knows the evils of terrorism, having been victims of it twice. We, therefore, need to enhance measures to combat the menace. A national task force has already prepared a draft Bill on money laundering. I intend to table that Bill before the House later in the fiscal year.

Mr. Speaker, Sir, in May, 2001, the Government embarked on debt restructuring by re-launching the bond programme. As a result, bond trading at the Nairobi Stock Exchange (NSE) increased from a monthly turnover of Kshs216.4 billion as at May, 2001, to the current level of Kshs2.83 billion, by March this year. Despite those achievements, the volume of bonds traded at the NSE is still low, compared to the total outstanding stock of domestic debt of Kshs270 billion. To address that situation, I will be proposing amendments to the Internal Loans Act, Cap.420 of the Laws of Kenya, to create the appropriate legal framework for promotion of an efficient market infrastructure, and improve trading in long-term Government securities.

Mr. Speaker, Sir, let me now make my last point on money and banking, namely, the development of our payments system. For some time now, the Kenya Bankers Association (KBA), in conjunction with the Central Bank of Kenya (CBK), has been working to develop an efficient national payments clearing and settlements system. Their efforts have reduced the time for nationwide clearance of cheques from 14 to three days. Those two institutions, namely, the KBA and the CBK, aim to modernise the national payments system (NPS) with the objective of reaching real time gross settlement system by the year 2005. To incorporate NPS into law, I intend to bring an appropriate Bill before this august House in the course of the next financial year.

Mr. Speaker, Sir, the Micro-Finance Bill is my next subject. Poverty reduction is a high priority of the Government. However, I am convinced that our efforts will continue to be frustrated unless and until we develop a pro-poor credit delivery system. A draft Bill has been prepared and discussed by the stakeholders, and is currently awaiting final touches. The Bill proposes to confer authority to the Central Bank of Kenya to license, regulate and supervise the micro-finance credit providers, especially those authorised to take deposits from the public. It will, however, be necessary to recognise and provide some regulations for institutions which, though not taking deposits *per se*, still hold money from their clients, either as security or in other forms.

Mr. Speaker, Sir, as hon. Members are aware, many countries around the world have granted their central banks more powers and autonomy to supervise and regulate the financial systems and, particularly, banking operations. In order to harmonise our banking laws with those of the other partner states of the East African Community (EAC), I will propose amendments to the Central Bank of Kenya Act in the course of the next financial year, to cede to CBK powers for the bank licensing and de-registration of financial institutions. The amendments will enhance further, a supervisory effectiveness of the Central Bank of Kenya.

Mr. Speaker, Sir, the retirement benefits schemes provide one of the most effective vehicles for mobilising long-term domestic tradings. For that reason, those schemes will continue to be cornerstones of our economic recovery strategy. The enactment of the Retirement Benefits Act No.3 of 1997 has brought substantial improvements on the local tradings. To protect accrued employee benefits when a company becomes insolvent, I propose to amend Section 311 of the Companies Act to give priority to unpaid retirement benefits contributions, as is currently given to accrued pre-paid wages or salaries. I also propose to increase the current payments maximum ceiling per employee from Kshs4,000 to Kshs20,000. Mr. Speaker, Sir, to protect earned benefits, I propose to reduce the vesting period for employer contributions from five years to three years of commencing the pensionable service. In addition, I propose to remove the requirement for defined contribution schemes to undertake actuarial valuations every five years. However, the Retirement Benefits Authority will continue to monitor returns on investments to ensure that scheme funds grow at reasonable rates.

Mr. Speaker, Sir, due to the limited investment opportunities for small schemes, with fund value below Kshs5 million, I propose to allow such schemes to invest up to 100 per cent in Government securities.

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

Mr. Speaker, Sir, as has been emphasized in my Speech, the Government is committed to economic recovery and poverty alleviation. For that reason, despite the hard Budget constraints I am faced with, I have shifted some resources to areas with higher socio-economic returns. Those priority areas include; improvement of the physical infrastructure, particularly roads, health, education, safe water, energy and security.

As hon. Members are aware, our national road network continues to impact negatively on local production, especially due to poor workmanship and inadequate funding. As a first step towards reversing this trend, I have increased provisions for the road network from Kshs13.3 billion in the year 2002/2003, to Kshs16.9 billion in 2003/2004. The main increase is in the development budget, which has been raised from Kshs4.9 billion to Kshs8.3 billion.

Mr. Speaker, Sir, with regard to basic social services, I have focused more particularly on education, health, water and security. An additional Kshs500 million has been availed for health sector, especially for procurement of drugs. In addition, the Government has accessed Kshs1.5 billion from the Special Global Fund to fight HIV/AIDS scourge. As part of efforts to address the need of the vulnerable in the society, the Government has increased funding for strategic grain reserves, drought and disaster relief, campaign against drug abuse, development of housing and rehabilitation of street children.

Mr. Speaker, Sir, on education, the Government has already made substantial commitment and investment on free primary education. This noble effort has been supported by development partners. I invite hon. Members to join me in expressing our gratitude to them. To carry the free primary education through the next fiscal year, the government has increased its contribution from Kshs2.8 billion to Kshs9 billion.

(Applause)

Mr. Speaker, Sir, in the energy sector, the Government recognises the need for cost effective and reliable electricity supply. To support investment in generation and distribution of electrical energy, I shall propose various tax incentives. In addition, I have provided Kshs500 million for rural electrification, which will supplement funds raised through the Rural Electrification Levy, which is charged as part of the electricity bills. Mr. Speaker, Sir, safe water is essential for improving quality of life. Unfortunately, this has been grossly neglected and needs to addressed. Accordingly, the Printed Estimates tabled before this House have provided for increased provision from Kshs2.3 billion to Kshs4.5 billion, which represents an increase of about 96 per cent.

Mr. Speaker, Sir, security is critical in improving the investment climate, income generation and poverty reduction. It is for this reason, I have provided Kshs300 million for the police force to enhance law enforcement.

Mr. Speaker, Sir, as many hon. Members are aware, from personal experience, our prisons are in a deplorable state.
There is congestion in the prisons, while the prison wardens live in poor conditions. As part of the necessary reforms, the Government will soon intensify the implementation of Community Service Order Act. Meanwhile, the Government has increased the provisions for prisons by Kshs400 million in order to improve food and rations, clothing, beddings, and other facilities for the inmates.

Mr. Speaker, Sir, as His Excellency the President has emphasized on several occasions, the Arid and Semi Arid Lands (ASALs) rank high in the NARC Government's development agenda. They represents a large portion of this nation with high levels of poverty. For this reason, the Government, with the assistance of development partners, has provided Kshs755 million under the Arid Lands Resource Management Project (ALRMP), during the year 2003/2004. Several other projects including the Roads 2000 Programme, Community Development Trust Fund, Garissa Water Project and Ewaso Nyiro North Development Programme which is scheduled to start in 2004/2005 after necessary studies have been completed, will all benefit ASAL areas. In addition, we have increased funding for the School Feeding Programmes and we will continue with the special grants to boarding schools in these areas.

(Applause)

Mr. Speaker, Sir, water is of special concern to ASAL areas. In recognition of this, the Government has increased budgetary provisions from Kshs551.78 million in the fiscal year 2002/2003 to Kshs1.024 billion in the fiscal year 2003/2004. This allocation, in fact, indicates the Government's commitment to deal with key concerns of our people, particularly the vulnerable and the disadvantaged.

Hon. Members will recall that the Supplementary Estimates recently approved by this House indicated that gross expenditure for the financial year 2002/2003 increased by Kshs18.8 billion. This was mainly on account of implementation of the free primary education programme, harmonisation of doctors' allowances, upgrading of teachers in accordance with their scheme of service, increase in salaries and allowances for Members of Parliament and general increase in expenditure in the Ministries and Departments. Initially, Gross Recurrent Expenditures were estimated to be Kshs167.3 billion, while the Gross Development Expenditures were projected to be Kshs46.5 billion. In the Supplementary Estimates, the House approved a gross increase of Kshs15 billion for the Recurrent Expenditure and Kshs3.3 billion for Development Expenditure. Appropriations-in-Aid in Recurrent Expenditure increased by Kshs3.4 billion, while those in the Development Expenditure increased by Kshs2.7 billion.

Mr. Speaker, Sir, let me now briefly review the financial out-turn for the fiscal year 2002/2003. The projected Budget deficit on a commitment basis and before grants was 4.6 per cent of the Gross Domestic Product (GDP). This compares unfavourably with a deficit of 3.1 per cent of the GDP in 2001/2002.

Mr. Speaker, Sir, total revenues, including the Local Authorities Transfer Fund (LATF), were originally estimated at Kshs218.9 billion, or about 21.8 per cent of the GDP, comprising of Kshs198.6 billion in ordinary revenue and Kshs20.3 billion in Appropriations-in-Aid. Due to uncertainty associated with last year's general election, and subdued economic growth, total revenues are now expected to be about 4 per cent below target. I now expect a total of Kshs190.6 billion in ordinary revenue and Kshs21.86 billion in Appropriations-in-Aid which add to Kshs212.5 billion.

Let me now turn to the 2003/2004 Budget. The total revenue target for the fiscal year 2003/2004 is Kshs240 billion, or 22.3 per cent of the GDP. This is composed of Kshs215 billion of ordinary revenue, Kshs19.4 billion of Recurrent Appropriations-in-Aid, Kshs3.5 billion of Development Appropriations-in-Aid and Kshs2 billion in transfer. As hon. Members have already noted from their copies of the Printed Estimates, Gross Recurrent Expenditures for the year 2003/2004 are estimated at Kshs334.1 billion. This includes Ministerial Recurrent Expenditures of Kshs203.9 billion and Consolidated Fund Services of Kshs130.3 billion. The Ministerial Expenditures include Kshs19 billion to be financed through Appropriations-in-Aid.

Gross Development Expenditures for 2003/2004 are estimated at Kshs59.5 billion out of which Kshs35.9 billion will be financed from external sources as follows: project loans -Kshs14.8 billion and project grants - Kshs21.1 billion. The balance of Kshs23.7 billion will be financed from domestic sources. As hon. Members may be aware, the Budget for 2003/2004 aims at creating an enabling environment for private sector growth. It also recognises the fiscal challenges inherited from previous years such as debt overhang and expenditure commitments. The Budget also aims at putting the economy back on a growth path to respond to great expectations of the Kenyan people. To meet these challenges, we expect to run a deficit equivalent to about 6.5 per cent of the Budget. I, however, hope to reduce the deficit in coming years through expenditure adjustments and revenue mobilisation.

Mr. Speaker, Sir, total revenues, including Appropriations-in-Aid, amount to Kshs234.5 billion. Based on current macro-economic focus for the year 2003/2004 and the current taxation levels, we expect to realise total revenue of Kshs226.5 billion, of which Kshs207.1 billion will be in ordinary revenue and Kshs19.4 billion of Recurrent Appropriations-in-Aid. This leaves a revenue gap of Kshs8 billion which I propose to finance as detailed below.

I have proposed wage adjustments for teachers and civil servants, which will result in an additional Kshs1.7 billion to the
Exchequer in Pay-As-You-Earn (PAYE). We also expect to licence a third mobile phone operator and raise about Kshs3.9 billion in fees. In addition, I expect those state enterprises which suddenly stopped loan repayments and other remittances to the Exchequer to come on stream in the year 2003/2004, out of which I expect to raise Kshs640 million. This leaves me with an unfinanced gap of Kshs2 billion.

Mr. Speaker, Sir, the rest of my speech outlines the tax measures that I intend to take in order to bridge the gap. So, I request that the remainder of my speech be regarded as a notice of Motion to be moved before the Committee of Ways and Means. I will first address the changes I intend to introduce with regard to Import and Excise Duty. So, let me now turn to the amendments I intend to make to the Customs and Excise Act, which have direct implications on revenue.

First, in order to encourage investment and support economic recovery efforts, I propose to grant duty waiver on capital goods, plant and equipment for investment. This facility will also include equipment for generation and distribution of electricity. Second, in order to encourage farming of macadamia nuts and cashew nuts, I propose to remove Export Duty which is currently imposed on these nuts. This measure is expected to benefit farmers of these crops. Third, in order to support livestock farmers and encourage value addition to hides and skins, I propose to reduce the Export Development Levy, which was introduced in the last Budget, on export of raw hides and skins from 20 per cent to 15 per cent. Similar rates are being imposed in the other East African countries.

Fourth, in order to promote poultry farming and production of poultry products, I propose to remove Import Duty on fertile eggs for hatching. Fifth, in order to reduce the cost of production for export and promote investment for economic recovery, I propose to reduce the Import Declaration Form fees on goods imported and the Tax Remission for Export Office (TREO) from 2.5 per cent to Kshs5,000. I expect this measure to make our goods competitive in the international market. Sixth, our sportsmen and sportswomen have earned this country not only international fame, but also foreign exchange. In order to encourage and promote development of sports in Kenya, I propose to grant exemption to sports goods donated to sports groups through the Ministry in charge of sports or purchased by the Ministry in charge of sports. Seventh, in order to encourage development of information technology, and further reduce the cost of manufacturing, I propose to remove Import Duty on computers, computer accessories and a variety of other raw materials.

Mr. Speaker, Sir, I will now turn to Excise Duty measures. First, in order to encourage the local assembly of motor vehicles and make the Kenyan motor vehicle industry competitive, I propose to remove Excise Duty on locally assembled vehicles. This measure is expected to give impetus to the vehicle assembly industry and to encourage development and fabrication of vehicle components and spares. Second, in order to reduce tax evasion and avoidance, improve effective tax rates and subsequent revenue yields while encouraging investment in quality cigarette products for export, I propose to introduce a specific duty regime on four bands, equivalent to an effective rate of 110 per cent to replace the current *ad valorem* rate.

Third, in order to simplify tax collection and promote investment forquality and affordable alcoholic beverages, I propose to introduce a specific Excise Duty regime on beers of three bands, namely, malt beers, stout beers and non-malt beers. Also, I propose to remove the current *ad valorem* rate.

(Laughter)

Mr. Speaker: Order! Order, hon. Members! The Minister will explain to you what "*ad valorem*" means.

The Minister for Finance (Mr. Mwiraria): Mr. Speaker, Sir, "*ad valorem*" means "as a percentage of the cost". On a serious note, I thought that hon. Members were wondering whether this measure will result in an increase in the price of beer or not.

Hon. Members: Yes!

The Minister for Finance (Mr. Mwiraria): Well. The price will not change very much.

Fourth, in order to reduce the cost of power to industrialists and *wananchi*, and make Kenyan products more affordable and competitive, I propose to reduce Excise Duty on fuel oils by 50 per cent. Fifth, the Ministers of Finance in the East African Community have agreed to harmonise taxation on most items, particularly on the mobile phone airtime. Accordingly, I propose to increase Excise Duty on mobile phone airtime from the current 5 per cent to 10 per cent.

Hon. Members: Aah!

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

The Minister for Finance (Mr. Mwiraria): Mr. Speaker, Sir, in order to broaden the tax base, improve equity in our tax system and enhance regulatory capacity of casinos and gambling, I propose to introduce a 10 per cent Excise Duty on casinos and gambling services. Also, I propose to introduce Excise Duty on jewellery.

(Loud Consultations)

Mr. Speaker: Order! Order! Hon. Members, unless you listen to the Minister, you will not hear what he is increasing.

The Minister for Finance (Mr. Mwiraria): Mr. Speaker, Sir, in order to address some of the challenges facing the tourism industry, and encourage growth of local pilot training and air operators, I propose to remove Excise Duty on aviation gas for use in light aircraft engines. Eighth, in order to encourage the consumption of soft drinks and develop the sub-sector, I propose to reduce the current Excise Duty from 15 per cent to 10 per cent to make soft drinks affordable to Kenyans. These adjustments in Customs and Excise duties will raise an additional Kshs1,407 million to the Exchequer.

Mr. Speaker, Sir, allow me now to turn to measures that I propose to take under the Customs and Excise Act which have no direct revenue implication but which will improve the administration of Customs and Excise Tariff. First, to curb abuse on transit of goods, goods intended for regional markets and temporary imports, which have had adverse effects on Government revenues and local production, I propose to amend the law to impose a surcharge of 10 per cent on goods falling in any of these categories if they are converted to domestic market. In addition, I propose to amend the law to require that any goods which are subject to request for conversion to the domestic market be deposited with the customs first.

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

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

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

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

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

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

Eighth, Mr. Speaker, Sir, as hon. Members will appreciate, there is a growing problem of illicit drinks, which are dangerous, not only to life but to our economy. To control handling of alcoholic spirits, I propose to amend the law to require denaturing of alcoholic spirits, whether imported or from a distiller before such spirits are released from customs. Hon. Members may be wondering what "denaturing" means. It means putting substances in it so that it can be consumed by human beings.

(Applause)

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

(Applause)

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

Mr. Speaker, Sir, NARC in its manifesto promised to reduce the tax burden for all Kenyans. After examining all taxes, I have come to the conclusion that VAT is the best suited tax to fulfil this commitment. The measures I am proposing are to create impetus for economic recovery, encourage investment for both domestic production and exports, while making goods and services affordable to the consumer. Accordingly, to make goods and services affordable, particularly to the mwananchi, and to boost consumption demand in the economy, I propose to reduce the current VAT rate from 18 per cent to 16 per cent. Given the low inflation rate, I expect this measure to confer significant benefit to consumers and improve their welfare.

(Applause)

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

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

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

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

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

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

Mr. Speaker, these adjustments to VAT rates and measures taken, will raise additional revenue of Kshs300 million to the Exchequer.

(Applause)

Mr. Speaker, Sir, let me now turn to proposed amendments under the Income Tax Act. First, I have already provided fiscal incentives to investors under the Customs and VAT Acts. However, it is the investors who hold the key to our sustained economic recovery and poverty reduction. Consequently, to further encourage investments, I propose to increase the investment allowance from 60 per cent to 100 per cent under the Income Tax Act.

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

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

Fourth, to give retirees a favourable tax treatment after their long dedicated service to the nation, I propose to increase tax free lump sum payments from Kshs240,000 and Kshs360,000 to Kshs480,000 for provident funds and pensions schemes respectively. Further, to encourage retention of savings in pension schemes, I propose to provide for a lower rate of tax for those who hold their funds in the schemes longer.

Fifth, to ease the tax burden on employees' meal benefits, I propose to increase the minimum taxable aggregate value of benefits granted by employers to employees from Kshs12,000 to Kshs24,000 per annum.

(Applause)

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

Seventh, in order to make Kenyan flowers more competitive in the international flower market, I propose to remove the 20 per cent withholding tax on commissions paid to non-resident agents in overseas auctions that has hitherto adversely affected our flower exporters.

Eighth, the potential role of our co-operative movement in rural development remains largely untapped. To make co-operative societies more effective towards economic recovery and poverty alleviation, I propose to restructure taxation of all co-operatives including Savings and Credit Co-operatives (SACCOs) as follows:

(i) Producer co-operatives:

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

(ii) On Investment incomes;

(a) Where a co-operative society, including SACCOs, invest in real property and generate rental income, that income will be treated in the same manner as that of any other landlord,

(b) Dividend and interest income, will be treated like that of any other investor and will be subject to withholding tax.

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

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

On the Miscellaneous Measures, I am proposing the following changes:

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

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

(Applause)

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

(i) Amend Section 31, to provide for regulations relating to credit reference bureaus;

(ii) Amend Section 35 to enable Deposit Protection Fund Board to liquidate failed institutions without the need to seek court approval first. However, any aggrieved party will remain free to challenge any measures the Board takes, in the high Court;

(iii) Amend Section 35A to free the Board from requirements to deposit money when litigants file suits against it in the High Court. This practise ties too much money in court, a practice which inhibits the capacity of the Board to carry out its mandate.

(iv) Replace the Second Schedule of the Banking Act to maintain minimum paid up capital for banks at Kshs250 million and for non-bank financial institutions at Kshs200 million from the present Kshs500 million and Kshs375 million respectively.

(Applause)

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

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

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

Seventh, unscrupulous traders have hurt local producers, genuine traders and undermined government revenue. To enable courts to mete out deterrent fines, I propose to raise the fine provided under Section 15 of the Trades Descriptions Act from Kshs500,000 to Kshs2 million.

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

(i) To amend the Third Schedule of the Kenya Roads Board Act to include municipalities with technical capacity as agents; and,

(ii) To Provide legal authority to amend the schedule and include other agents as and when need arises.

These miscellaneous adjustments will raise an additional sum of Kshs200 million.

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

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

Mr. Speaker, Sir, we must send a clear and unequivocal message to those who have formed the habit of living like economic predators. It is time they changed and learnt to live on their sweat.

(Applause)

For those who do not and continue raiding public resources, our judicial system must show no mercy. They need to be fairly but quickly tried and punished so that they can be bad examples to others.

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

Mr. Speaker, Sir, I beg to move.

The Minister for Education, Science and Technology (Prof. Saitoti) 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, Members! That concludes our business for today and the House is, therefore, adjourned until Tuesday, the 17th of June at 2.30 p.m.

The House rose at 5.35 p.m.