

TABLE OF CONTENTS

1. INTRODUCTION	1
2. RECENT ECONOMIC DEVELOPMENTS	2
2.1 International Economic Developments	2
2.2 Domestic Economy	3
3. MACROECONOMIC FRAMEWORK FOR FY 2005/06	5
3.1 Fiscal Policy	5
3.2 Revenue	5
3.3 Expenditure	5
4. STRUCTURAL REFORMS	7
4.1 Governance and Rule of Law	7
4.2 Public Expenditure and Financial Management Reforms	8
4.3 Privatisation and Public Enterprise Reforms	8
4.4 Financial Sector Reforms	9
4.5 Local Government Reforms.....	9
4.6 Private Sector Development.....	10
5. RE-ORIENTING EXPENDITURE TO PRIORITY SECTORS	11
5.1 Health Sector Reforms	11
5.2 Education Reforms	12
5.3 Agriculture and Rural Development.....	13
5.4 Physical Infrastructure.....	14
6. OTHER SECTORAL PRIORITIES	18
7. FINANCIAL OUTTURN FOR FY 2004/2005	22
7.1 Revenue	22
7.2 Expenditure	22
8. PROJECTIONS FOR FY 2005/2006	22
8.1 Revenue	23
8.2 Recurrent Expenditure.....	23
8.3 Development Expenditure	23
8.4 External Grants	23
8.5 Deficit	23
9. TAXATION PROPOSALS	24
9.1 Customs and Excise Measures	24
9.2 VAT Measures.....	25
9.3 Income Tax Measures.....	27
9.4 Miscellaneous Measures.....	29
10. CONCLUSION	30

**SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 8TH JUNE,
2005, BY HON. DAVID MWIRARIA, E.G.H., M.P., MINISTER FOR
FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET
FOR FISCAL YEAR 2005/2006**

1ST JULY, 2005 TO 30TH JUNE, 2006

Mr. Speaker Sir,

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

1. INTRODUCTION

- 1. Mr. Speaker,** I am delighted this afternoon to present to this august House and the people of Kenya my budget proposals for the financial year 2005/06. As Hon. Members are aware, after having stagnated for more than a decade, our economy is now experiencing a strong, broad based recovery with real GDP recording a 4.3% increase in 2004 compared with 2.8% in 2003 and 0.4% in 2002. In this context, **Mr. Speaker,** my budget proposals are intended to consolidate and accelerate this economic recovery while ensuring that we address the needs of the poor.
- 2. Mr. Speaker,** given the recent economic performance, I feel confident that the country is now back on the right track and that the future of our country is more secure. However, major challenges still remain. Kenyans must therefore continue to work even harder to ensure that poverty reduction, the principal goal of our social and economic policy, is achieved.
- 3. Mr. Speaker,** to build on the recent gains, the Government will implement measures as outlined in the Budget Strategy Paper, which includes appropriate macroeconomic policies supported by structural reforms in areas such as public expenditure and financial management, the financial sector, and the parastatal sector. Equally high on our reform agenda is the strengthening of institutions for promoting good governance and the rule of law. The continued fight against corruption, together with the reforms I will be announcing later in my speech, including reform of the business licensing regime, should create an enabling environment for private sector development.

This will provide an impetus for a strong, sustainable and equitable economic growth.

4. **Mr. Speaker**, a recent Government evaluation of the effectiveness of our budgetary process revealed some weaknesses in resource allocation and utilization. To address these weaknesses, this year's budget focuses on, among other things: (i) reorienting resource allocation towards the priority sectors identified in the Economic Recovery Strategy; and (ii) improving public expenditure and financial management to ensure taxpayers get value for money. This will ensure that the Constituency Development Fund, the Local Authority Transfer Fund, and the School Bursary Fund achieve their intended developmental objectives. Because of the emphasis we are giving to the re-alignment of resource allocation, the theme of this year's budget is, "*Reorienting Expenditure to Achieve Rapid Economic Growth and Poverty Reduction*".

2. RECENT ECONOMIC DEVELOPMENTS

2.1 International Economic Developments

5. **Mr. Speaker**, allow me to give a brief summary of international economic developments during 2004. The global economy grew by 5% led by strong economic growth in the USA and Japan, which grew by 4.4% and 4.0%, respectively. China and India continued with their exceptionally rapid economic expansion of 9.2% and 7.3%, respectively. However, in the Euro area, recovery was relatively weak with real GDP growth of only 1.8% as a strong Euro adversely affected export performance.
6. **Mr. Speaker**, in sub-Saharan Africa, real GDP grew by 4.6% in 2004, spurred by improved macroeconomic stability, expansion in world trade, debt reductions under the Heavily Indebted Poor Countries (HIPC) Initiative, and improved market access in developed countries. The prospects for continued solid growth in Africa have improved with the signing of the peace deals in Sudan and Somalia, brokered by Kenya. These deals have given a ray of hope and optimism to the end of conflicts that have bedevilled the two nations for a long time.
7. **Mr. Speaker**, the global growth momentum is expected to continue in 2005, with real GDP growth estimated at 4.3%. The outlook for Africa is expected to be more favourable than it has been for a long time.

2.2 Domestic Economy

8. **Mr. Speaker**, let me now turn to the domestic economy. As I intend to be brief, I encourage Hon. Members to read the Economic Survey for 2005, which contains a detailed discussion of recent economic developments. **Mr Speaker**, as I already noted, our economy registered a real growth rate of 4.3% in 2004. This growth was achieved against a background of unfavourable weather conditions and high oil prices, which suggest that, without these exogenous factors, growth could have been much higher. **Mr. Speaker**, owing largely to the drought, the agricultural sector registered a modest growth rate of only 1.4%, down from 2.6% in 2003. However, this masked some exceptional growth performance in the tea, sugarcane, horticulture and dairy products subsectors.
9. **Mr. Speaker**, in contrast to the subdued performance of the agricultural sector, the manufacturing sector continued to grow at a brisk pace of 4.1%, led by increased output of cigarettes, cement, transport equipment, agro processing industries, and output from Export Processing Zones (EPZ). Similarly, the tourism sector registered a remarkable growth spurred by aggressive marketing, enhanced security associated with the strengthening of the Tourist Police Unit, and the opening of direct flights to some parts of Asia. As a result, earnings from tourism rose from KShs.25.8 billion in 2003 to KShs.39.2 billion in 2004, an increase of 51.9%.
10. **Mr. Speaker**, on the inflation front, we were not as successful. The 12-month overall rate of inflation rose from 5.9% in mid 2004 to about 16% in April 2005, because of the adverse impact of drought on food prices, increase in oil prices and higher expansion in money supply. Money supply expanded by 13.2% compared with a target of 8.9%, mainly driven by a strong expansion of credit to the private sector. To avoid inflation from spiralling out of control, monetary policy will need to be tightened in FY 2005/06 so as to bring credit expansion to a more sustainable pace. On exchange rate developments, the Kenya shilling remained relatively stable, ending the year at KShs.79.0 to the US \$ in December 2004 compared with Kshs.76.1 to the US \$ in December 2003.
11. **Mr. Speaker**, on the fiscal front, the good revenue performance, coupled with expenditure restraint, resulted in a fiscal surplus which permitted government to reduce its net domestic debt by about Kshs.3 billion. This good fiscal performance facilitated a return to stability in the treasury bill and bond market toward the end of the year, after

interest rates on government securities had trended up for most of the year.

12. **Mr. Speaker**, Kenya's imports grew faster than our exports of horticultural produce, coffee and tea. However, the resulting trade deficit was covered by substantial surpluses in the services sector, especially in the tourism sector, and in the capital and financial account. As a result, by end-December 2004, the gross foreign reserves of the Central Bank had reached the equivalent of over 3-months of imports of goods and services.
13. **Mr. Speaker**, despite the strong recovery witnessed in 2004, the economy continues to face a number of constraints. These include: the high cost of energy, inadequate infrastructure, and the low level of domestic savings and investments. **Mr Speaker**, let me take this opportunity to reassure Hon. Members and all Kenyans that the Government is committed to addressing these challenges to ensure that the recovery momentum registered in 2004, is not only consolidated but accelerated. It is only through rapid and sustainable economic growth that we can meaningfully tackle poverty on a sustainable basis and make progress toward achieving the Millennium Development Goals (MDGs).
14. **Mr. Speaker**, the good economic performance we have experienced is the result of economic and structural reforms we have been implementing over the past two-and-a half years with the support of our development partners. In this regard, I am happy to report that our programme, supported by the IMF is on course, and consultations with the World Bank on a credit to support our Economic Recovery Strategy are ongoing. From our bilateral Development Partners, the Government continues to receive project grants and loans to fund programs for infrastructure, water provision, health and education.
15. **Mr. Speaker**, as I indicated during the launch of the Budget Strategy Paper, the FY 2005/06 Budget has deliberately not factored in budgetary support from bilateral Development Partners. This means that we will have to utilize our own scarce resources in the most efficient way. It is, therefore, imperative that we accelerate our reform agenda in such areas as procurement and privatization. In the event that the bilateral partners provide any budgetary support, I will use it to reduce government domestic borrowing and to upscale spending on core poverty programmes. Further, **Mr. Speaker**, to address the past challenges associated with absorbing donor project

funding, the Government is instituting coordination mechanisms among stakeholders to facilitate faster implementation of projects.

3. MACROECONOMIC FRAMEWORK FOR FY 2005/06

16. Mr. Speaker, as I mentioned earlier, consolidating and strengthening the recent economic recovery will be the government's top priority during FY 2005/06 and in the medium term. We are now forecasting a real growth rate of at least 5% in 2005 and 2006, mainly driven by private and public sector investments. **Mr. Speaker,** achieving this growth rate will require continued fiscal discipline, a sound monetary policy, and a deepening of structural reforms, especially in the area of governance. We expect this to lead to an increase in total factor productivity.

3.1 Fiscal Policy

17. Mr. Speaker, the fiscal policy for 2005/06 will continue to emphasize strong revenue collection based on improvements in tax administration while avoiding higher tax rates. The Government remains committed to containing the expansion of overall expenditures while at the same time effecting a significant shift in resources toward the social and economic sectors. In addition, **Mr. Speaker,** the Government will aim to contain the growth of domestic debt in order to reduce pressures on interest rates, reduce interest payments, and increase the availability of credit to the private sector.

3.2 Revenue

18. Mr. Speaker, a strong effort to collect revenues will be required in order to stabilize the ratio of domestic debt-to-GDP while protecting priority expenditures. Therefore, the FY 2005/06 Budget targets revenue collection of about 22.8% of GDP underpinned by: the successful implementation of tax administration reforms, including the roll out of electronic tax registers. In addition, tax collection in FY2005/06 is expected to benefit from the expansion of the tax base arising from the tax amnesty. While these measures will protect our revenue base, they will also make it possible for us to offer some tax relief to the ordinary *mwananchi* as I will report shortly.

3.3 Expenditure

19. Mr. Speaker, on the expenditure side, as indicated in the Budget Strategy Paper, the Government wage bill consumes upto 40% of our total ordinary revenues, or over 8% of GDP. The wage bill,

together with other non-discretionary expenditures such as debt service payments and pensions obligations, take up two-thirds of our revenues, leaving only a third to fund our priority areas. Therefore, the Government's expenditure policy in FY 2005/06 and the medium-term will aim to contain both the wage bill and domestic borrowing to more sustainable levels. Within the wage bill target for FY 2005/06, I have factored a wage award for civil servants of Kshs.2.1 billion and another Kshs.4.9 billion for teachers.

- 20. Mr. Speaker,** in line with this year's Budget theme of re-orienting allocation of resources toward social and economic programmes, and in the spirit of sharing the burden of fiscal discipline, the Government intends to reduce sharply expenditures on motor vehicle purchases and other transport related costs. As a first step, the number of cars at the disposal of senior government officials who are entitled to official transport, will be restricted to no more than two. In addition, the Government will reduce by 15% transfers to those parastatals that have the capacity to generate own resources, while requiring the others to strictly adhere to laid down financial regulations. We will also tighten expenditure controls on travel and accommodation, and telephone usage. With regard to telephone usage, the Government will in the coming fiscal year adopt prepaid services. In the course of the year, the Government will also issue clear guidelines on use of official transport.
- 21. Mr. Speaker,** the release of resources from these expenditure measures, will facilitate additional government expenditures on: (i) improving the road network, urban transportation, and access to water; (ii) core poverty programmes; and (iii) programmes to deal with recurrent droughts and food shortages, especially in the Arid and Semi-arid areas.

3.4 Monetary and Exchange Rate Policies

- 22. Mr. Speaker, our monetary policy** will continue to be geared toward achieving a low and stable rate of inflation, a comfortable level of international reserves, and sufficient credit to the private sector, consistent with the higher projected real GDP growth. Specifically, as indicated in the Budget Strategy Paper, monetary policy will target to (i) achieve a core inflation rate below 5%; (ii) contain growth of money supply at about 8%, while increasing credit to the private sector by about 12%; and (iii) maintain gross international reserves of the Central Bank at around 3 months of import cover.
- 23. Mr. Speaker, in the area of exchange rate policy,** the Government will continue to allow the exchange rate to be market-

determined. Therefore, Central Bank intervention in the foreign exchange market will be limited to achieving our international reserves target and smoothing out short-term fluctuations. Implementation of the monetary and exchange rate policies I have just outlined, together with an appropriate fiscal policy, should help to achieve low and sustainable interest rates, and therefore, help sustain the recent growth momentum.

4. STRUCTURAL REFORMS

24. Mr. Speaker, although macroeconomic stability is a necessary condition for sustaining our growth momentum and reducing poverty, it is by no means a sufficient condition. It needs to be supported by vigorous implementation of appropriate structural reforms. For this reason, the Government's structural reform agenda will focus on: (i) strengthening governance and the rule of law; (ii) improving public expenditure and financial management; (iii) privatisation and public enterprise reforms; and (iv) reforming the financial sector.

4.1 Governance and Rule of Law

25. Mr. Speaker, the Government recognizes that bad governance has been a major constraint to investment and growth. To reduce opportunities for corruption and to deter corrupt practices, the Government will continue to strengthen governance institutions, and enforce fully the anti-corruption laws and regulations. As Hon. Members will recall, during the Consultative Group meeting held in April this year, the Government presented an Action Plan for a comprehensive anti-corruption strategy.

26. The measures to be implemented under this Governance Action Plan include: (i) enhancing the effectiveness of anticorruption investigative agencies; (ii) building adequate prosecution capacity to handle corruption-related caseloads; (iii) making wealth declaration public in order to discourage abuse of public offices; and (iv) continuing to vigorously investigate economic crimes and to recover illegally acquired assets. In this context, **Mr. Speaker,** Government is ready to implement the recommendations of the Goldenberg Commission of Inquiry as soon as the report is completed. As Hon. Members are aware, the Government is already implementing the recommendations of the Presidential Commission on Illegal and Irregular Allocations of Public Land.

4.2 Public Expenditure and Financial Management Reforms

27. **Mr. Speaker, in the area of public expenditure and financial management**, our economy has suffered for many years because of misuse and misallocation of public resources. Therefore, making the use of public resources more transparent and accountable to our people is the basis of our expenditure reforms in FY 2005/06 and the Medium-term. To this end, the Government will continue to make the budget process increasingly transparent. On this point, **Mr. Speaker**, let me point out that more than any other time in the past, the budget process this year has been transparent and has benefited from wide consultations, involving the Kenyan public, parliamentarians, the private sector, civil society, and our development partners.
28. **Mr. Speaker**, to further enhance transparency and accountability of the management of the public finances, we will: (i) ensure that those responsible for financial management strictly adhere to the financial regulations including procurement guidelines, as outlined in the Financial Management Act; (ii) implement a cash management system to ensure timely release of resources to the line ministries; (iii) carry out Public Expenditure Tracking Surveys (PETS) to improve utilization of public resources; (iv) roll out the Integrated Financial Management Information System (IFMIS) to line ministries; and (v) introduce risk-based internal audit system.
29. **Mr. Speaker**, I cannot over emphasize the importance of enactment of the Public Procurement and Disposal Bill that is before this august House.

4.3 Privatisation and Public Enterprise Reforms

30. **Mr. Speaker, in the area of public enterprise reforms**, the Government recognizes the crucial role that efficient enterprises can play in, promoting economic growth, poverty reduction, and eliminating contingent liabilities for the budget. Poor performance by key enterprises, especially in energy, telecommunications and transport, has undermined the competitiveness of Kenyan goods and services. They have also made Kenya less attractive to investors. It is this recognition that has informed the government's privatisation and public enterprises reform strategy.
31. **Mr. Speaker**, to address the problem of public enterprises, the Government has initiated various reforms, including introduction of private-public partnerships and performance contracts in the management of these enterprises. Special emphasis is being put on

key enterprises in the energy, water, transport and communications sectors. Therefore, speedy enactment of the Privatisation Bill, which is before this august House, is critical to the success of our reforms in this area.

4.4 Financial Sector Reforms

32. **Mr. Speaker, an efficient financial sector operating within a framework of sound fiscal and monetary policies**, is essential to achieve our economic growth and poverty reduction objectives. To consolidate the economic gains achieved thus far, the Government has prepared a comprehensive financial sector strategy aimed at improving efficiency in financial intermediation. As part of this strategy, state-owned banks will be restructured and privatized. We believe that these reforms will contribute to reducing the current large volume of non-performing loans, and lead to reduction in the cost of borrowing for everyone.
33. **Mr. Speaker**, micro-finance institutions and co-operative societies have continued to play an important role in mobilizing savings and providing credit to the small and medium enterprises in support of our development agenda. In order to ensure sound financial management in these institutions, a SACCO Bill is under preparation, and the Government will soon be tabling a Micro Finance Bill, to provide a legal and regulatory framework for these institutions.

4.5 Local Government Reforms

34. **Mr. Speaker**, local authorities, when efficiently run, can play a critical role in service delivery and creating the investment climate that would lead to poverty alleviation. To improve efficiency of local authorities will require deepening on-going reform efforts to improve their planning and financial management. In this regard, the local authorities will be expected to encourage greater partnership with their communities in identifying their priorities, and in designing, implementing and monitoring their social and economic programmes.
35. **Mr. Speaker**, to assist the local authorities meet their objectives, during the next financial year, the Government will disburse KShs.5.6 billion through the Local Authority Transfer Fund; Kshs.1.9 billion from the Road Maintenance Levy Fund for improving rural access and urban road network; and a further Kshs.0.8 billion for the School Bursary Fund. Together with the amounts for the Constituency Development Fund, estimated at Kshs.7.2 billion, the total amount of

resources that will go directly to the local level is estimated at an unprecedented Kshs.15.5 billion.

- 36. Mr. Speaker**, this targeted financial intervention is a clear demonstration of the Government's commitment to reduce poverty and in-equality in our society, a key objective of the ERS. It also confirms our commitment to greater decentralization and to making the Local Authorities the focal points for service delivery. We expect these resources to significantly improve the breadth and depth of service delivery at the local level. I therefore, urge stakeholders at the local level to work closely with their councils and leaders to ensure that these funds are utilised in an efficient and accountable manner to meet their needs and priorities.

4.6 Private Sector Development

- 37. Mr. Speaker**, as outlined in the Economic Recovery Strategy, the Government remains fully convinced that the private sector should play the leading role in our economic development. Therefore, in addition to privatization and public enterprise reforms, the Government will, among other things: (i) streamline the business licensing system; and (ii) review competition laws to bring them into line with regulatory best practices.
- 38. Mr. Speaker**, the bureaucratic procedures associated with licence acquisition have increased the cost of doing business and contributed to making our private sector less competitive. Currently, there are about 600 licences in Kenya that directly affect trade and investments. Therefore, the Government will review these licences with a view to eliminating those that are not justified on grounds of health, environment and safety. Accordingly, as a first step in this direction, during FY 2005/06, I propose to eliminate 17 licences which no longer serve a useful purpose, and amend 30 others. These measures should help to make the private sector more competitive and contribute to economic growth and poverty alleviation.
- 39. Mr. Speaker**, the high rate of inflation in Kenya relative to our trading partners has eroded our ability to compete and is encouraging imports at the expense of domestically produced goods. It is imperative, therefore, that in the coming fiscal year we reduce the rate of inflation not only to safeguard our competitiveness but to also stem the erosion of the purchasing power of the ordinary *mwananchi*, who is not able to hedge his earnings against inflation.

40. Mr. Speaker, I have listened carefully to complaints from the private sector regarding the delay in VAT refunds, and factored adequate funds to clear the backlog. I have also provided KRA with enough monthly resources to meet current refund claims and avoid a recurrence of this problem. I have instructed KRA to carry out an audit to ensure that only genuine claims are paid.

5. RE-ORIENTING EXPENDITURE TO PRIORITY SECTORS

41. Mr. Speaker, without rapid and sustainable economic growth, we will not achieve our objectives of reducing poverty on a sustainable basis. But even as the economy recovers and growth accelerates, a major challenge of the Government will be to ensure that the growth improves the welfare of the ordinary Kenyan. Therefore, as our revenues rise, we will allocate more resources to the social and economic sectors. As Hon. Members may have seen in the Budget Strategy Paper, the Government's medium-term expenditure framework shifts resources to the health, education, agriculture and the infrastructure sectors. Hon. Members will have noted from the Budget Strategy Paper that we are targeting to increase the share of our total expenditure going to these priority areas from about 56% in FY 2004/05 to 64% by FY 2007/08.

42. Mr. Speaker, as indicated in the Budget Strategy Paper, the new calendar for the budget process is intended to ensure that the annual budget is used effectively to achieve the Government's key strategic objectives as outlined in the Economic Recovery Strategy (ERS). With this in mind, allow me, to briefly outline the Government's plans in the key priority areas of Health, Education, Agriculture and Infrastructure.

5.1 Health Sector Reforms

43. Mr. Speaker, in the health sector, the Government is fully focused on attaining the Millennium Development Goals. Towards this end, the Government will raise spending on health care by 30% in FY 2005/06. This will increase the sector's share in total government expenditure from the current 8.6% to 9.9% in FY 2005/06. Over the next three years, the amount of resources going to this sector is programmed to increase from Kshs. 24.7 billion in FY 2004/05 to about Kshs. 43 billion by FY 2007/08, an increase of 74%. Consequently, the share of total government expenditure going to health will rise to about 11% by FY 2007/08.

44. Mr. Speaker, this level of funding will enable the Government to effectively address most of the challenges facing the health sector, including improving health facilities countrywide. It will also help achieve the core indicators identified in the Economic Recovery Strategy and in the Budget Strategy Paper. In this regard, the Government will in FY 2005/06 put in place measures to: (i) increase immunization coverage to about 75%; (ii) reduce child and mother mortality rate; (iii) reduce malaria in-patient mortality to 15% as a share of total patient mortality; (iv) put in place strategies to reduce HIV prevalence and improve access to affordable drugs; (v) improve health service delivery through decentralization of health care services; and (vi) increase expenditure on preventive and basic health services.

5.2 Education Reforms

45. Mr. Speaker, turning to education, our free primary school programme is now firmly on course. The future of **over one million children** who joined the programme in January 2003 is now secured. Indeed, it is only through education that our children will unlock future opportunities and improve their welfare. I wish, therefore, to request all stakeholders in the education sector to demand quality service given the huge investment the Government has made and continues to make in this vital sector. On its part, the Government will continue to allocate the bulk of its resources, amounting to over 28% of total government expenditures, to this sector.

46. Mr. Speaker, in the coming financial year, the Government will focus its attention on specific priorities, such as: (i) ensuring equitable access to education by targeting disadvantaged areas, particularly ASAL, and vulnerable groups, such as street children and the girl child; (ii) reviewing implementation of the bursary scheme to ensure only deserving children from poor households benefit; (iii) improving quality and internal efficiency through teacher training and redeployment; (iv) decentralizing decision-making to district and school-level administrators; (v) redefining the roles of local authorities; and (vi) reforming university education to promote its quality in order to ensure that we are globally competitive. We also need to prepare our Universities to become more self-reliant and to reduce their dependence on the Exchequer. These interventions, together with the on-going reforms in the sector, will contribute significantly to our long-term productivity for the benefit of all Kenyans.

5.3 Agriculture and Rural Development

47. **Mr. Speaker, let me now turn to agriculture** and rural development where majority of our people live. This sector remains the single most important vehicle for reducing poverty and eliminating hunger. In line with agricultural policy as articulated in the Economic Recovery Strategy, the Government has taken a number of measures to improve the performance of the agricultural sector. These include: injection of Kshs. 1.5 billion to the Agricultural Finance Corporation for provision of credit to farmers; and revival of farmers' institutions that are key to agricultural growth, such as the Kenya Farmers Association and the Kenya Cooperative Creameries. In addition, steps are being taken to strengthen agricultural research and extension systems through the implementation of the Kenya Agricultural Productivity Project, with support of the World Bank.
48. **Mr. Speaker**, although overall agricultural growth was subdued in 2004, some sub-sectors recorded significant growth of at least 10% for tea and sugarcane, and as much as 24.7% and 35% for horticulture and dairy products, respectively. These are clear signs that we are on the right path. To build on this success, the Government proposes to increase resources to this sector by about 74% over the next three years, or from, Kshs. 16 billion in FY 2004/05 to Kshs 27.8 billion by FY 2007/08. Therefore, the share of resources going to this sector will rise from 5.6% of total government expenditure in FY 2004/05 to almost 7% by FY 2007/08.
49. **Mr. Speaker**, to strengthen further the agricultural sector, the Government will, in the coming fiscal year, begin to implement in earnest, policies contained in the Strategy for Revitalization of Agriculture (SRA). This strategy aims at transforming agriculture into a profitable, commercially oriented and internationally competitive activity. As part of this strategy, the Government will undertake major reforms to improve productivity in the coffee, pyrethrum and cotton sub-sectors, with a view to increasing the share of final receipts that ultimately go to farmers.
50. **Mr. Speaker**, the Coffee Act, requires amendments to reflect current developments in this industry, particularly with regard to marketing. The reforms include: restructuring of the Coffee Board of Kenya to separate the non-regulatory functions, streamline licencing procedures, and allow direct sale of Coffee outside the auction.

- 51. Mr. Speaker,** in the pyrethrum sub-sector, the Government plans to amend the Pyrethrum Act to separate regulatory and commercial roles of the Board. The Board will remain with only the regulatory function, while a separate company, owned by stakeholders, will be formed to deal with the commercial functions.
- 52.** As Hon. Members are aware, under the Africa Growth Opportunity Act (AGOA), beneficiary countries are expected to create capacity to produce their own cotton. For this reason, the Government will support initiatives to promote cotton production. The revival of the cotton industry is key to poverty reduction in semi-Arid areas. I am, therefore, proposing to allocate Kshs.250 million to facilitate revival of this sector.
- 53. Mr. Speaker,** livestock keeping is the lifeline of our people living in the Arid and Semi-Arid areas. Although not fully exploited, the sector has a high growth potential and is important to subsistence farmers and pastoralists alike. To harness this potential, the Government has initiated development of disease control programmes for the establishment of disease-free zones in strategic areas of the country. This will enhance our capacity to produce quality beef for export. The Government will also introduce a single permit system for cattle movement, review options for decentralized and privately owned slaughterhouses, expand access to water sources, and improve security.

5.4 Physical Infrastructure

- 54. Mr. Speaker,** the Government accords priority to infrastructure sector to facilitate rapid economic growth. To consolidate the gains from the on-going economic recovery, we will address comprehensively the challenges facing this sector. These challenges include mobilizing resources for maintenance, rehabilitation of existing facilities, and expansion of the road network; curbing wastage; ensuring adherence to standards; and decongesting ports.
- 55. Mr. Speaker,** as I noted earlier, if the private sector is to become competitive and play its rightful role in helping to develop our country, then it is absolutely critical that we improve our physical infrastructure. For this reason, the amount of resources I propose to allocate to this sector will increase by about 86% over the next three years, which is more than any other sector. During FY 2005/06 alone, I propose to increase resources allocated to this sector by over 36%. The increase

in resource allocation from Kshs. 44.6 billion in 2004/05 to Kshs. 82.8 billion in 2007/08 will raise the share of total government expenditure allocated to infrastructure from 15.6% to 20.5% during the same period.

- 56. Mr. Speaker,** the NARC Government inherited many projects that had been started but not completed. In the current financial year, I allocated KShs. 1.0 billion for the completion of these projects. I am sure that Hon. Members have seen the work going on at the National Youth Service buildings on Thika road, the Nyanza Provincial Headquarters in Kisumu, and 251 dispensaries around the country, among others. For the coming year, I propose to allocate a further KShs. 2.0 billion, but only for projects that are 75% completed and that are consistent with our ERS priorities.

5.4.1 Road Transport

- 57. Mr. Speaker,** no economy can grow and sustain a strong growth momentum without paying special attention to the condition of its road network. An efficient road system facilitates private sector development, promotes increased productivity and creates linkages between products and markets. To ensure our road network plays its role in accelerating our economic recovery, I propose a 44% increase in resource allocation for public works during FY 2005/06. Although steps have been taken to minimize bureaucratic delays at the Ministry of Roads and Public Works, more effort is required to fully streamline the procurement procedure in order to improve the sector's capacity to absorb these substantial resources. The Government will also continue to strictly enforce standards and quality specifications for all road maintenance and reconstruction works, in order to ensure durability of the road network and reduce maintenance costs.
- 58. Mr. Speaker,** to improve rural road maintenance, the Government will implement the Roads 2000 programme in 34 districts, with the participation of local communities. The upgrading of a large number of rural roads to gravel standards will give a boost to productive activities in the rural areas. The challenge, however, is to roll out this programme countrywide and create more impetus for our economic recovery and poverty alleviation efforts. On behalf of the people of Kenya, I wish to extend our gratitude to all our Development Partners who are supporting this programme. On its part, the Government will strengthen the legal, institutional, and regulatory capacity of the agencies responsible for road development to encourage participation of the private sector in road sector development.

Rail, Air Transport and the Mombasa Port

- 59. Mr. Speaker,** as we continue with the reconstruction of our road network, it is equally important that we pay due attention to the development of our railway network to improve efficiency and reduce damage to our roads. To raise investment funds necessary to improve rail services, a joint process to concession the Kenya and Uganda Railways is ongoing and is expected to be completed by December 2005. In the meantime, the Government is committed to ensuring that the Kenya Railways Corporation is run efficiently. In addition, the Government will, in partnership with the private sector, explore the possibility of constructing railway links between Kenya and Sudan and between Kenya and Ethiopia in order to expand trade between our neighbouring countries.
- 60. Mr. Speaker,** as part of the Government's efforts to make Nairobi the regional hub for air transport and to facilitate trade and tourism, improvement of security and airport facilities will continue to be top on the reform agenda. In addition, a major modernization programme for Jomo Kenyatta International Airport is in progress. The Government is also exploring the potential for public-private partnership in the development and management of our international airports. In the next fiscal year, I propose to allocate KShs.2.0 billion for refurbishment and expansion of our international airports.
- 61. Mr. Speaker,** the Port of Mombasa is an important regional gateway. Therefore, to maintain the Port's competitive edge, we will accelerate reforms to convert it to a landlord port in line with the Authority's Master Plan for the Port. This will facilitate further private sector participation in such areas as container terminal, bulk handling and conventional cargo.

Energy Sector

- 62. Mr. Speaker,** while energy plays a critical role in our economy, electricity supplies have been largely inadequate, unreliable and expensive, thereby increasing the cost of production and making our products uncompetitive. This has arisen because of past weak and inefficient management of key utility institutions, wasteful procurement procedures, and lack of investment in system reinforcement. In addition, our hydro-electricity power resource base has been exhausted. In the future, the potential to generate additional capacity for electric power will come from other sources, principally geothermal.

- 63. Mr. Speaker**, we are making efforts to ensure the geothermal power potential is fully developed and exploited in order to improve power supply and reliability. With regard to expanding generation capacity, Sondu Miriu hydro-power and Olkaria Geothermal extension projects, with an additional capacity of 95MW, are being implemented. Regarding distribution, a major investment is underway to expand and improve the grid and the distribution system.
- 64. Mr. Speaker**, as part of the ongoing parastatal reforms, the Government will continue with the current restructuring of KPLC and KenGen. These reforms include contracting management to help turn around KPLC **and divesting 30% of Government shareholding in KenGen** through an Initial Public Offer (IPO). Following past successful IPOs, such as for Kenya Airways, the Kenya Commercial Bank, Mumias Sugar Company and TPS Serena, I would like to encourage Kenyans to take advantage of this opportunity to buy shares in KenGen.

Water and Sewerage Services

- 65. Mr. Speaker**, provision of clean and safe water for all Kenyans is an important objective of the Government. With this in mind, the Government has implemented structural reforms to make water and sanitation services autonomous. As a result, Water Service Boards, Water Services Regulatory Board and the Water Services Trust Fund have been established under the Water Act, 2002 to effectively separate the functions of policy formulation, service delivery and regulation of the water and sanitation sector. During FY 2005/06, the Government will enter into partnerships with community-based organizations to expand services to the urban poor and rural communities.
- 66. Mr. Speaker**, the Government is rehabilitating existing irrigation systems and building new ones to improve our food security. In addition, the Government will continue to sink boreholes, construct wells and water pans to increase water supply in ASAL areas. In flood prone areas, we will construct dams and rehabilitate dykes to protect our people. For these reasons, **I propose to spend Kshs.1.5 billion in FY 2005/06 Budget for construction of boreholes and dams.** These funds will enable every district in the ASAL areas to construct at least four boreholes in addition to rehabilitating existing ones.

5.4.5 Information, Communication and Technology

67. Mr. Speaker, embracing Information and Communication Technology is critical to improve productivity and to access market information. In this regard, the Government will facilitate development of adequate ICT capacity in the country and encourage improved ICT usage. Efforts will also be made to complete implementation of e-government during FY 2005/06 to improve service delivery and promote accountability. This will enable citizens to access Government services and information efficiently through the use of internet and other channels of communication.

6. OTHER SECTORAL PRIORITIES

68. Mr Speaker, having covered the Government's objectives in the four key sectors highlighted in the BSP and in the ERS, allow me now to indicate the Government's objectives in the remaining sectors.

6.1 Public Administration

69. Mr. Speaker, the public sector reforms will focus on financial and human resources management and the delivery of core government functions. This will include: rationalizing the functional structure of the central government to contain costs; institutionalising results based management in the public service to improve efficiency and accountability; and contracting out non-core functions and services to enhance public service performance and capital investment.

6.2 Public Safety, the Police Force, and Prison Services

70. Mr. Speaker, improving security is not only important for the safety of our people, but it is also critical in establishing an enabling environment for private sector investment and economic growth. Towards this end, the Government will continue to implement reforms to ensure law and order is maintained. These reforms will include: (i) improving capacity for crime prevention, investigation and prosecution; (ii) rolling out community policing to other urban centres, and (iii) building housing facilities to improve the living conditions of police officers. In this regard, I propose to spend KShs.1.5 billion for police reforms, of which Ksh.750 million will go towards police housing. I also propose to spend Kshs. 500 million for Prison Warders houses. By the end of the FY 2005/06, I expect that at least 500 units of housing will have been completed for both the police and prison

warders. This will improve their working conditions and boost their morale.

6.3 Reforms Under the Judiciary

71. Mr. Speaker, as Hon. Members are aware, a majority of Kenyans are not able to access judicial services because the courts are inadequate and where they exist, the cost is prohibitive. To make judicial services accessible, especially to the poor, the Government will implement measures to facilitate speedy and efficient disposal of cases. Consequently, the Government will recruit more Magistrates and Kadhis to cope with the increased cases, train staff to improve efficiency, and automate court registries to enhance information flows. Plans are also underway to rehabilitate the law courts country-wide to facilitate access to justice.

6.4 Environment and Wildlife Conservation

72. Mr. Speaker, adequate management of environmental resources is key for long-term sustainable economic growth. Towards this end, the Government will complete the natural resource inventory and valuation, implement the Forestry Development Policy, and promote private sector participation in afforestation and management of forest plantations. As regards wildlife management, the Government is strengthening Kenya Wildlife Service to enhance its capacity to work with the local communities. It is also implementing measures to contain human-wildlife conflicts, and to improve benefit sharing.

73. Mr. Speaker, while still on the subject of the environment, allow me to take this opportunity to pay tribute to Hon. Prof. Wangari Mathai, for being awarded the Nobel Peace Prize. As the first lady in Africa to win this prize, she has done Kenya and Africa as a whole proud. We take pride in her achievements and commitment to environmental conservation and urge Kenyans to follow in her footsteps.

6.5 Trade, Industry, and Tourism

6.5.1 Manufacturing, Trade and Investment.

74. Mr. Speaker, the continued solid growth of the manufacturing sector suggests that policy reforms implemented over the past two years have begun to pay dividends. In order to lock-in this momentum, the Government intends to remove the barriers to investment. With regard to small and medium size enterprises, the Government is keenly aware of the important role they play in our

economic development. To encourage further growth in this critical sector, the Government, in partnership with the World Bank, is implementing the Micro, Small, and Medium Enterprises (MSMEs) Competitiveness Project. This project aims to improve access to finance, strengthen enterprise skills, and improve the business environment.

To ensure a more rapid expansion of exports, Kenya's external competitiveness will have to improve. It is therefore, important that we contain our wage costs, maintain an appropriate exchange rate policy, and most importantly, improve our infrastructure in order to enhance our regional and global competitiveness.

6.5.3 Regional Integration

75. **Mr. Speaker, regional integration** is critical for our economic recovery. The EAC region is our main export destination, after the European Union, accounting for about a quarter of Kenya's total exports. For this reason, the Government is working closely with our EAC partners to deepen our economic integration. As part of this process, the three EAC countries began implementing the Common External Tariff (CET) in January 2005. The creation of the Customs Union should facilitate increased trade between the three partner states, as well as attract an increased volume of foreign direct investments into the region. I, therefore, invite our private sector to take advantage of the new business opportunities created by the implementation of the customs union, as well as the new markets in Southern Sudan and Somalia.
76. **Mr. Speaker,** the EAC Partner States have recently agreed to harmonize the exemptions regime and eliminate discretionary exemptions granted by the Finance Ministers. The new system requires budgetary provision for the payment of duties in respect of goods donated to deserving Non-Governmental Organizations and Charitable Institutions in specified areas. These organizations will be encouraged to **cooperate and integrate their programmes with** the relevant Ministries. In the meantime, the Government is working on modalities to implement the new system. In addition, with regard to exemptions under other laws, the Government is developing criteria for granting various waivers in order to minimize the level of discretion. This is in line with the commitment of EAC States to harmonize fiscal policies and incentives.

6.5.4 Tourism

77. **Mr. Speaker**, as I noted earlier, growth in the tourism sector has been impressive. This growth reflected the success of marketing our tourist attractions and diversifying sources of tourists to Kenya. Other measures being implemented, to support the sectors include encouraging domestic tourism and facilitating local small-to-medium investments in the sector. In view of the importance of this sector, **I propose to allocate Kshs.2.3 billion to the sub-sector in FY2005/06.**

6.6 Labour and Employment

78. **Mr. Speaker**, Kenya's labour productivity has been low and declining since 2000, while real wages have been increasing, thus making our exports costly and less competitive. To address these challenges and to create employment, it will be important to ensure that wage increases in the future, whether in the private or public sector, are based on improvements in Productivity. To this end, the Productivity Centre of Kenya (PCK) will be revamped to enable it to develop appropriate sectoral productivity indices to be used in determining public sector wages. To avoid loss of jobs to our competitors, henceforth, the minimum wage will be adjusted once every two years in line with productivity increases. With these changes in the wage policy, Kenyan firms will become more competitive and create more business and employment opportunities.

6.7 Land, Shelter and Housing

79. **Mr. Speaker**, a majority of our population in urban areas live in deplorable conditions. Therefore, in line with the objectives of the Economic Recovery Strategy, the Government has started the implementation of slum upgrading in partnership with UN-HABITAT and other development partners at Kibera, which will result in the construction of 600 housing units. In this regard, the Government has established the Slum Upgrading and Low Cost Housing and Infrastructure Trust Fund to serve as a depository for funds mobilized for the program. I propose to allocate KShs.500 million during FY2005/06 for this important project. To encourage construction of more houses, the Government has recently reviewed the National Housing Policy and will submit to Parliament during FY 2005/06 a comprehensive Housing Bill.

7. FINANCIAL OUTTURN FOR FY 2004/2005

7.1 Revenue

80. **Mr. Speaker**, the total revenues (including LATF) were originally estimated at **KShs.258.8 billion** or 20.0% of GDP, which was composed of **KShs.233 billion** of ordinary revenue, and **KShs.25.8 billion** of Appropriations-In-Aid. This was, however, revised upwards in the course of the year to **KShs.277.8 billion**, comprising of **KShs.256.0 billion** and **KShs.21.8 billion** in ordinary revenue and Appropriations-In-Aid, respectively. **Mr. Speaker**, taking into account the tax amnesty, which resulted in **KShs.4.8 billion** additional revenue; administrative measures implemented by the Kenya Revenue Authority; and the annual nominal GDP, I now expect to collect a total of **KShs.293.4 billion** in revenue, or 22% of GDP, comprising of **KShs.267.5 billion** in ordinary revenue and **KShs.25.9 billion** in Appropriation-In-Aid by June 2005.

7.2 Expenditure

81. **Mr. Speaker**, the Supplementary Estimates recently approved by this House reflected an increase of **KShs.6 billion** in recurrent expenditures and a gross reduction of **KShs.14.8 billion** in development expenditures. Recurrent expenditures increased mainly on account of additional expenditure requirement for drought related expenses and wage adjustments for the civil service. Development budget was scaled down to reflect **trends in donor disbursement and progress in project implementation**.

82. **Mr. Speaker**, initially, gross recurrent expenditures were estimated to be **Kshs.221.1 billion**, including expenditures financed through Appropriations-In-Aid amounting to **KShs.23.9 billion**, while Consolidated Fund Services were estimated at **KShs.132.8 billion**. The gross development expenditures were initially estimated at **KShs.86.8 billion**, with approximately **KShs.32 billion** financed through Appropriations-In-Aid. The Supplementary Appropriation Bill adjusted these expenditures to **KShs.227.1 billion** and **KShs.72.0 billion** for recurrent and development expenditures, respectively.

8. PROJECTIONS FOR FY 2005/2006

83. **Mr. Speaker**, let me now turn to the FY 2005/2006 Budget.

8.1 Revenue

84. **Mr. Speaker**, the total revenue target for FY 2005/06 is **KShs.326.1 billion** or 22.8% of GDP. This is composed of **KShs.296.1 billion** of ordinary revenue, and **KShs.30.0 billion** of Appropriations-In-Aid.

8.2 Recurrent Expenditure

85. **Mr. Speaker**, as Hon. Members have already noted from their copies of the Printed Estimates, gross recurrent expenditures for FY 2005/2006 are estimated at **Kshs.404.3 billion**. This includes **KShs.27.1 billion** which will be financed through Appropriations-In-Aid. Ministerial expenditures are estimated at **KShs.257 billion**, while **KShs.147.3 billion** is for Consolidated Fund Services. The latter consists of **KShs.26.9 billion** for domestic interest; **KShs.9.0 billion** for foreign interest; **KShs.23.4 billion** for pensions, and gratuities; **KShs.5.3 billion** for salaries, allowances and operational expenses for constitutional offices; and, **KShs.133 million is for contributions to international organizations**. I also expect to finance debt redemptions amounting to **KShs.87.9 billion**.

8.3 Development Expenditure

86. **Mr. Speaker**, the gross development expenditures for FY 2005/2006 are estimated at **Kshs.104.2 billion**, inclusive of **KShs. 34.9 billion** financed by Appropriations – in – Aid. The Appropriations – in – Aid includes direct project financing of **KShs. 13.6 billion** in loans, **KShs.18.4 billion** in **project grant** commitment and **KShs. 2.9 billion** which will be realized from domestic sources. This means that I will finance net development expenditures to the tune of **KSh.69.3 billion** during the fiscal year.

8.4 External Grants

87. **Mr. Speaker**, I have received commitments amounting to **KShs. 27.9 billion** in project grants.

8.5 Deficit

88. **Mr. Speaker**, the fiscal deficit after grants will amount to **KShs.66.6 billion**. I am expecting net external financing from both bilateral and multilateral development partners of **Kshs.23.4 billion**, securitization of domestic arrears and bank restructuring costs **Kshs. 9.9 billion** (net), **KShs.8 billion** from privatization proceeds and

KShs.25.3 billion of domestic borrowing. This means, **Mr. Speaker**, that our fiscal program is fully funded and that there is no financing gap. For this reason, my tax proposals are broadly revenue neutral, yielding only Kshs.0.4 billion, and are mainly to improve efficiency of tax administration.

9. TAXATION PROPOSALS

89. Mr. Speaker, the rest of my speech outlines measures I intend to take to enhance efficiency of tax administration. These measures will result in additional revenue of Kshs.0.4 billion. I therefore, request that the remainder of my Speech be regarded as a Notice of a Motion to be moved before the Committee of Ways and Means.

9.1 Customs and Excise Measures

90. Mr. Speaker, let me start with the amendments proposed under the Customs and Excise Act aimed to improve administration of customs and excise duties.

9.1.1 Customs Measures

91. Mr. Speaker, let me start with measures under the East African Customs Management Act, that have direct revenue impact. The protocol establishing the East African Customs Union came into force in January, 2005. Since then I have received various representations from stakeholders to review the Common External Tariff.

92. Mr. Speaker, in consultation with the Ministers of Finance in Uganda and Tanzania, we agreed to take measures designed to improve the welfare of our people, reduce cost of production, and offer some protection to our infant industries as follows:- (i) that duty on used clothing be 45% or US 30 cents per kg, whichever is higher; (ii) remove import duty on pharmaceuticals, diapers and sanitary pads, and liquid petroleum gas (LPG); (iii) remove import duties imposed on coal, media containing computer software, safety belts, speed governors, crude palm stearin and splints for manufacture of matches; (iv) provide, under a special incentive scheme (duty remission schemes), paper for printing educational material, inputs for manufacture of agricultural equipment and for use in horticulture; and (v) exempt refrigerated trucks and hotel equipment from duty.

93. Mr. Speaker, these measures will result in additional **KShs.126 million** to the Exchequer and the proposed changes will take effect immediately after publication by the East African Legislative Assembly.

9.1.2 Excise Measures

94. Mr. Speaker, let me now turn to excise measures. Currently, excise duty on petroleum products is collected at various customs bonded facilities spread around the country. This system is administratively expensive and exposes revenue to risk. In order to address this problem and enhance accounting for revenue, I propose to change the tax point for all petroleum oil to the point of importation. **Mr. Speaker,** this measure is tax neutral and I do not expect petroleum dealers to use it as an excuse to increase prices.

95. Second, Mr. Speaker, we introduced specific taxes on beer in 2003 and since that time, we have not adjusted the bands for inflation. To safeguard the revenue base, I propose to adjust the excise duty by 10% to account for inflation. I also propose to make a similar 10% adjustment for cigarettes.

96. Third, Mr. Speaker, manufacturers of spirits are currently required to pay KShs.90 per proof litre in excise duty at the distillery and the balance of KShs.10 after compounding the spirits. In order to improve compliance, I propose to consolidate the excise duty on neutral spirits to **KShs.100 per proof litre at the distillery or point of importation.**

97. Fourth, Mr. Speaker, as Hon. Members may be aware, currently excise duty on motor vehicles ranges from 20% to 60%. However, duty collection at the higher rates has been characterised by undervaluation, and falsification resulting in revenue loss. To safeguard revenue and simplify the excise duty on motor vehicles, I propose to adopt a single rate of 20% on all excisable motor vehicles regardless of engine capacity.

98. Mr. Speaker, the excise measures I have proposed will generate an additional **KShs.1,942 million** to the Exchequer.

9.2 VAT Measures

99. Mr. Speaker, let me turn to changes under the VAT Act. First, in the interest of equity, I propose to amend Section 11 of the VAT Act by introducing a new Section 11B to enable registered persons who **acquire exempt goods** under Part II (i) of the Second Schedule as

goods in stock to deem the price at which they acquire them to be inclusive of VAT, for purposes of input tax deduction.

- 100. Second, Mr. Speaker,** the VAT Act requires a registered person who ceases to make taxable supplies, to furnish the Commissioner with details of materials and other goods in stock. However, currently the law does not require such a person to declare other taxable assets for which he may have claimed input tax prior to ceasing to make taxable supplies. This has created a loophole for loss of revenue. Therefore, I propose to amend the law to provide that a registered person, who ceases to make taxable supplies, provides the Commissioner with a return giving details and value of his **taxable assets**.
- 101. Third, Mr. Speaker,** the VAT Act requires a person who disposes off a business as a going concern to another registered person, to provide the Commissioner with details of the transactions thereof. Where the Commissioner does not notify the registered person of any risk to revenue **within seven days**, the registered person can transfer the business without payment of tax. The period of seven days has been found to be inadequate for the Commissioner to arrive at a conclusive decision. Therefore, I propose to increase the number of days to **fourteen**.
- 102. Fourthly, Mr. Speaker,** following the introduction of the withholding tax system last year, some withholding agents have not complied with the regulations. To address this problem, I propose to introduce a penalty of **Kshs.10,000** or 10% of the tax due, whichever is higher, for appointed agents who fail to:- (i) withhold and remit tax; (ii) issue a withholding tax certificate; or (iii) submit a return.
- 103. Fifth, Mr. Speaker,** there are persons who, not being appointed withholding tax agents, hold themselves as such and withhold VAT but do not remit the same to the Commissioner. To deter such practices, I propose to introduce a penalty of **Kshs.10,000** or 10% of the tax withheld, whichever is higher, on any person who acts as a tax withholding agent while he is not registered by the Commissioner.
- 104. Sixth, Mr. Speaker,** Hon. Members will recall that the Finance Act, 2004 **exempted LPG and sanitary towels from VAT**. The exempt status, however, meant that the goods would not enjoy the input tax deduction. This dampened the impact on the price of these goods. To make these products affordable and within reach of many Kenyans, and remove any effects of inbuilt VAT into the prices of

these commodities, I propose to zero rate LPG and sanitary towels for VAT purposes.

105. Lastly, Mr. Speaker, maize flour, milk and kerosene are VAT exempt, which means they do not benefit from deduction of input tax. Therefore, an element of VAT is inbuilt into their selling price. To make these commodities affordable to Kenyans, I propose to zero-rate them to remove VAT altogether. Registered persons who sell such goods will be expected to reduce the prices of these basic commodities, failure to which, I will not hesitate to reverse this policy.

106. Mr. Speaker, the measures I have proposed under the VAT will cost the Exchequer **KShs.650 million in revenue loss.**

9.3 Income Tax Measures

107. Mr. Speaker, I now turn to Income Tax measures. I will first deal with measures that have no revenue implication.

108. First, Mr. Speaker, gazettelement of the Income Tax (Leasing) Rules, in the year 2002, has improved leasing activities in the country. However, the Income Tax Act is not clear on the treatment of motor vehicle benefit where such a vehicle is on hire or lease. I propose to amend the Income Tax Act to specifically provide that the benefit in case of hire or lease shall be, the higher of the cost of hiring/leasing or the prescribed rate of benefit.

109. Second, Mr. Speaker, the tax deductible limits for both registered pension or provident funds as well as registered individual retirement funds have remained at **Kshs.210,000/=** since the year 2000. In order to provide further incentives to retirement savings, I propose to increase the tax-deductible limits in both cases to **Kshs.240,000/=** per annum.

110. Third, Mr. Speaker, currently the income of a married woman living with her husband is assessed on the husband but a married woman may opt to file a separate return on certain sources of income. In order to reduce the overall household tax burden, I propose to amend the Income Tax Act to allow a married woman who opts to file a separate tax return to report all her sources of income without exception.

111. Fourth, Mr. Speaker, to improve tax administration and reduce the delay occasioned by prolonged dispute resolution process, I propose to reduce the period within which an objection to an

assessment should be filed with the Commissioner from the current “sixty days” to “thirty days”.

- 112. Ninth, Mr. Speaker,** to ensure that former students who have benefited from the university education loans repay so that others may also benefit, I propose to amend both the Income Tax Act and the Higher Education Loans Board Act to enable the Board to obtain addresses of borrowers or their employers from Kenya Revenue Authority to improve loan recoveries.
- 113. Mr. Speaker,** I now turn to measures with direct revenue implications under Income Tax Act.
- 114. First, Mr. Speaker,** currently a benefit, advantage or facility enjoyed in respect of employment or services rendered is taxable when the aggregate value is Kshs.24,000 or more in a year. In order to reduce the tax burden, I propose to increase the limit to Kshs.36,000 per annum.
- 115. Second, Mr. Speaker,** in order to support our farmers and make our farm produce competitive in the International market, I propose to exempt from withholding tax, farm audit fees for analysis of Maximum Residue Limits (MRL) paid to non-resident laboratories and auditors.
- 116. Third, Mr. Speaker,** as an incentive to encourage more investors at the Nairobi Stock Exchange, I propose that newly listed companies pay corporation tax at a lower rate of 20%, for a period of 5 years, provided these companies offer at least 40% of their shares to the Kenyan public.
- 117. Fourth, Mr. Speaker,** securitization based on bankable assets and ability to generate cash has become a viable alternative in most emerging markets, particularly for institutions providing infrastructural services to raise long-term capital. In this regard, to encourage such institutions to set up Special Purpose Vehicles (SPVs) for purposes of issuing asset backed securities, I propose to exempt investment income of the SPVs from income tax.
- 118. Fifth, Mr. Speaker,** provision of shelter and housing is a key ingredient of welfare. To encourage home ownership, I propose to increase mortgage interest relief from Kshs.100,000 to Kshs.150,000.
- 119. Sixth, Mr. Speaker,** currently, the capital expenditure on private motor vehicles for purposes of computing wear and tear, for income tax purposes is deemed not to exceed Kshs 1 million. This limit was

last reviewed in 1998. I propose to increase the limit to Kshs.2 million to recognize the increase in the cost of motor vehicles.

120. Seventh, Mr. Speaker, currently, the value of any medical services provided by the employer to a full time employee and full time service directors of a company are not taxed as benefits while medical services provided to directors who own more than 5% of the share capital or voting power of the company, are taxed. To ensure equity in our tax system, I now propose that this benefit be extended to other directors subject to a maximum limit to be prescribed by the Minister.

121. Eighth, Mr. Speaker, in order to encourage planting of trees and to conserve our environment, I propose to declare Eucalyptus, Pine and Cypress as permanent crops so that capital expenditure incurred by the owner or tenant of agricultural land on clearing that land or clearing and planting such crops is, tax deductible.

122. Mr. Speaker, these measures will cost the Exchequer **Kshs.798 million** in revenue loss.

9.4 Miscellaneous Measures

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

124. First, Mr. Speaker the retirement benefit's sector has registered remarkable growth, which has made it an important participant in the mobilisation of long term savings. To sustain the growth momentum and address emerging challenges in the sector, there is need to improve the management of retirement benefit schemes. I, therefore, propose to:

- (a) require all internal and external scheme administrators to be registered;
- (b) address the cause of low benefits available to the employee upon retirement by locking the employers contribution to the retirement benefit scheme and making them available to the employee upon attaining the retirement age;
- (c) allow smaller schemes to pool and form one umbrella scheme for purposes of investment and compliance;
- (d) criminalize and introduce penalties for non-remittance of employee contributions to schemes by employers;

- (e) make performance of trustees much more effective by requiring defined contribution schemes to have a minimum of four trustees, where 50% of the trustees are nominated by scheme members;
- (f) gazette regulations to govern the process of conversion of schemes from one benefit scheme to another e.g defined benefit to defined contribution;
- (g) make appropriate amendments to the RBA Act to require that in the event that member's benefits have not been paid within ninety days of retirement, members would be entitled to continue earning interest on their dues.

125. Second, Mr. Speaker, to encourage technological development and improve efficiency in the banking sector, I propose to amend the Bills of Exchange Act on cheque transactions to provide for electronic cheque clearance through the cheque transaction system.

126. Third, Mr. Speaker, to enable proper functioning of the Policy Holders' Compensation Fund, I propose to amend Section 179 of the Insurance Act to enable the setting up of the Fund as a corporate body and empower the Fund to levy contributions.

127. Fourth, Mr. Speaker, to ensure consistency with International Accounting Standards and apply the law in accordance with prudential supervisory intentions, I propose to amend the section of the Banking Act that restricts the insider lending to include companies in which the insiders have shareholding in excess of 20%.

128. Fifth, Mr. Speaker, The multiplicity of licences has increased the cost of doing business. For this reason, I propose to abolish 17 licences including the following; (i) Trade licence; (ii) Stock traders Licence; (iii) Hides, skins and leather licence; (iv) Imports and Exports licences; and (v) Horticultural Crops Development Authority Order Licences.

129. Mr. Speaker, these measures will cost the exchequer Kshs.234 million in revenue loss.

10. CONCLUSION

130. Mr. Speaker, in conclusion, since coming to power two-and-a-half years ago, the NARC Government has returned the country back on a firm path of economic growth, restored discipline in the management

of public resources, strengthened institutions of governance and enhanced respect for individual freedoms.

131. Mr. Speaker, The proposals I have outlined in my budget today are aimed at building on these achievements and accelerating the pace of the reforms set out in our Economic Recovery Strategy. To achieve the targets we have set for ourselves requires the active participation of all of us. I, therefore, call upon all Kenyans to heed our President's clarion call of a "**Working Nation**".

132. Mr. Speaker, our legislative agenda contains important Bills that are necessary to support our reforms. These include the Procurement and Privatization Bills and the Amendment to the Public Officer Ethics Act. I call upon Hon. Members to enact these bills at the earliest opportunity. May I also take this opportunity, **Mr. Speaker** to urge Hon. Members not to overly focus on the past but provide leadership in economic development bearing in mind the fact that our task now is not to continue blaming the past but to chart the course for the future. To quote the late President of the United States of America, John F. Kennedy;

*"Our task is not to fix blame for the past
but to fix the course for the future."*

Let us tone down our politics and get down to work.

Mr. Speaker, I beg to move.