REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1997/98

(1st July–30th June)

by

Hon. W. Musalia Mudavadi, E.G.H., M.P.
Minister for Finance

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SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 19TH JUNE, 1997, BY THE HON. MUSALIA MUDAVADI, MINISTER FOR FINANCE, REPUBLIC OF KENYA WHEN PRESENTING THE BUDGET FOR THE FISCAL YEAR 1997/98

(1st July, 1997 to 30th June, 1998)

Mr. Speaker, Sir,

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

I. INTRODUCTION

As we move towards the end of the 1996/97 fiscal year, I am pleased to report that the economy is stable and firmly on the path of growth though at a somewhat reduced rate. This reflects the soundness of the economic reforms which we have continued to implement. Today I will report on the economic achievements we have attained and programmes which the government plans to implement during 1997/98 in order to achieve even higher growth.

Traditionally, the Budget Speech carries an assessment of the recent developments in the world economy. I will not dwell much on this subject, but I will make one key observation. The world economy grew at an average of 4.0% during 1996 and inflation remained low, generally below 3%. It is encouraging to note that the economies of sub-Saharan Africa together grew by 5% in 1996, which for the first time in more than a decade, exceeded the world average of 4%. Clearly, the benefits of economic adjustments are now evident in this region.

II. PERFORMANCE OF THE DOMESTIC ECONOMY

Mr. Speaker, I will now focus on the domestic economy. This is the fourth year since Kenya embarked on a comprehensive programme of economic reforms designed to deregulate the economy and to put it on the path of rapid employment generating growth.

Hon. Members will recall that during 1991-93, Kenya faced serious economic problems caused partly by external factors. Real national income stagnated while inflation reached triple digit levels. Gross foreign exchange reserves fell to an all time low of US$120 million and the shilling lost its value significantly. Therefore, the Government had to act swiftly to reverse the slide in production and to restore macro-economic stability in order to enhance investor confidence.

Mr. Speaker, it is possible for some of us, in the heat of political debate, to lose sight of what has already been achieved. Therefore, let me take a few minutes to outline how far we have come since those grim days of 1991/93.

We brought the economy back to a growth of 3% in 1994 and 4.8% in 1995. In 1996, we managed to achieve a growth of 4.6%, despite poor weather conditions and associated electric power shortages which affected both agricultural production and manufacturing output. Much of the impetus for growth in 1996 was provided by trade, hotel and restaurant services together with the financial services which grew by about 8% and 7%, respectively. Inflation has been brought down to 5.1% in 1995/96, from the 49.4% in 1993/94. The rise in the annual inflation rate in the first quarter of 1997 to 12.3% was due to drought-induced food price increases. The rate is expected to moderate in the coming months as the food supply situation improves. Mr. Speaker, our external payments position improved remarkably, as exports and net external capital receipts increased. As a result, gross official foreign exchange reserves increased to about US$1 billion or 4 months import cover in May, 1997, and the shilling regained its value significantly.

We also managed to control the financial operations of the Government and expansion of money supply. The Budget deficit has been reduced from 8.4% of GDP five years ago to 1.2% in 1996/97 while money supply increased by 15.9% in 1996 compared with over 37% in 1992/93.

Mr. Speaker, we have made further progress in structural reforms since the last Budget day. Privatisation proceeded well with the Government reducing its shareholding either completely or partially in an additional 18 enterprises. In total the Government has divested its shareholdings in 148 enterprises from the original 207. This leaves only 59 enterprises to be divested.

Mr. Speaker, the Government is committed to ensuring that the privatisation process remains transparent. It is for this reason that we have been publicising the decisions of the Parastatal Reform Programme Committee while bids are competitively advertised through the print media.

With respect to restructuring of public enterprises, the following measures were initiated in 1996: (1) two distinct companies were established in the energy sector, that is, Kenya Power and Lighting Company Ltd., for transmission and distribution, and Kenya Power Company Ltd., for generation; (2) two independent power producers to generate about 88 mega watts of power were licensed; (3) two bills which provide for the splitting of the Kenya Posts & Telecommunications Corporation into two entities, that is, Telcom Kenya and The Postal Corporation of Kenya were published; (4) Kenya Ports Authority contracted out the management of the Mombasa container terminal; (5) similarly, Kenya Railways contracted out the maintenance of its locomotives and privatised Magadi railway line; and finally commercialisation of the National Cereals and Produce Board (NCPB) commenced.

In the financial sector, the most important development was the amendment of the Central Bank of Kenya Act (CBK) which gave the Bank greater autonomy in the management of monetary policy. The Government also published two bills, notably, the Retirements Benefits Bill and the National Social Security Fund (Amendment) Bill and presented them to this august House. The two bills are intended to provide security and better management of the funds contributed by workers and their employers.

We have also continued to reform the Civil Service to improve its efficiency. During the period July 1996 - February 1997, a total of 6,029 employees left the Service through both natural attrition and the Voluntary Early Retirement Scheme (VERS), bringing the total number of civil servants retired since the programme began in 1993 to 54,262. This leaves 220,000 staff in Government service plus 239,500 teachers. A second phase of this programme is under preparation.

Mr. Speaker, from the summary I have just given, one can see that we have achieved a lot over the last four years. It should, however, be recognised that these achievements are the result of hard work by our farmers, industrial workers, managers and exporters, and prudent economic reforms implemented by the Government. I am also encouraged by the emergence of a broad national consensus as reflected in the stimulating debate both here in Parliament and also outside, in support of reforms. It is for this reason that I have chosen the theme for the Budget this year to be: **"Enhanced Economic Reforms for Faster Growth"**.

III. CHALLENGES AHEAD

Mr. Speaker, the country is still faced with major challenges, which make it necessary for us to redouble our efforts to consolidate our gains and push the economy to even greater heights. The most daunting challenges facing our nation today are as follows:-

(1) creation of adequate employment opportunities to absorb the large number of new entrants into the labour market;

(2) reduction of poverty levels;

(3) achievement of high and sustainable non-inflationary growth;

(4) increasing domestic investments and savings to levels sufficient to support the desired rate of growth;

(5) reduction of domestic borrowing by government to reduce domestic interest rates;

(6) improvements in the management of public finance; and finally

(7) restoring the state of our economic infrastructure to a sound level.

IV. POLICY FRAMEWORK AND STRATEGY

Mr. Speaker, let me now briefly discuss the policy framework and the strategy which the Government has adopted to deal with these challenges. The Government will endeavour to: (1) consolidate macro-economic stability; (2) strengthen public sector finance management to achieve greater fiscal discipline; (3) improve efficiency of the public sector; (4) improve delivery of infrastructural services; (5) accelerate privatisation/commercialisation; (6) address the social aspects of development through targeted poverty interventions; (7) intensify the war against corruption; and (8) remove unnecessary regulations. This strategy is geared towards improving further the environment for private sector development.

As Hon. Members will appreciate, it is important that the Government is seen to provide a clear and predictable policy direction. Investors, both local and foreign, need to be assured that reforms are not only irreversible, but will also continue in order to address new issues and obstacles as they emerge.

Macro-economic Objectives

Mr. Speaker, due to the impact of the unfavourable weather conditions in the first quarter of this calendar year, our objective is to sustain a growth rate of 4% in 1997, rising to around 6% in 1999; and to contain inflation within single digit levels. It is important to note that we have the potential to achieve higher growth even in excess of 8% provided strong reform measures are put in place to deal with the challenges I have just outlined.

Mr. Speaker, to achieve the growth targets we have set for ourselves, we need to increase investment from 20% of GDP in 1996 to 23% by 1999 and domestic savings from about 16% of GDP currently to around 19% over the same period.

Fiscal Policy

Mr. Speaker, during the coming year, I intend to maintain a tight fiscal policy stance. This is important if we are to deal decisively with the domestic debt overhang and high interest rates that have continued to haunt the economy. I know this is a subject in which Hon. Members have a keen interest. To reduce interest rates, it will be necessary for us as a country to tighten our belts. In this respect, total government expenditure will have to be constrained to around 26% of GDP by 1999. With the expected net inflow of foreign financing, we hope to keep fresh government borrowing from the domestic market to less than 2% of GDP and reduce domestic debt from 20.7% to 18.8%. To help reduce domestic debt even further, the Government is planning to float a Eurobond in 1998, and use the proceeds to retire a chunk of the Treasury Bills. This will facilitate gradual reduction in interest rates which is needed to boost private sector investment.

Monetary Policy

Mr. Speaker, monetary policy will aim to maintain price stability during the year so as to facilitate sustained reduction in interest rates. Expansion in the money supply will be contained within the level consistent with the requirements of the economy. In line with this policy stance, Central Bank intervention in the foreign exchange market will be limited to smoothening out short-term fluctuations in the exchange rate. Details of the monetary policy will be provided in the first Monetary Policy Statement to be issued by the Central Bank, which I will shortly lay before an appropriate Committee of this House, in accordance with the recent amendments of the Central Bank of Kenya Act.

Hon. Members will, however, recall that the Central Bank Act was recently amended to restrict government borrowing to 5% of latest audited revenue receipts. The law also provides for conversion of the existing overdraft into marketable securities. In compliance with these provisions, 50% of the Government's overdraft as at June 30, 1997 will be converted into Treasury Bonds while the balance will be converted into Treasury Bills, both of which the Central Bank can use for open market operations. These changes will require adjustments of both the Treasury and the Central Bank records. Accordingly some adjustments are reflected in the Financial Statement.

SECTORAL REFORMS

Mr. Speaker, I now wish to deal with some of the sectoral policy reforms which we intend to implement.

Financial Sector

As regards the financial sector, several measures will be taken to improve the money and capital markets to facilitate mobilization of financial resources. In this connection, the CMA, in collaboration with the CBK, will develop and establish a central depository system for financial securities traded in the stock exchange. This will enhance security and encourage investment in long-term financial instruments. In addition, I will be proposing measures to increase the minimum share capital for commercial banks and other deposit taking financial institutions. This will be supplemented by strict enforcement of prudential regulations in order to ensure we have a healthy financial sector.

To promote risk capital, Venture Capital Funds will be encouraged. These are important vehicles for mobilising funds needed to finance expansion of productive capacity in small and medium size firms. In September 1996, the first venture capital fund was licensed and launched. To underpin the development of Venture Capital Funds, I propose to introduce legislation, under the Income Tax Act, that will provide an appropriate regime for all qualifying venture capital companies.

Mr. Speaker, the performance of the three-year floating-interest bond and the one-year floating rate Treasury Bond, recently issued by the East African Development Bank and the Government, respectively, have been very encouraging. The Government will continue to facilitate the promotion and further development of these medium-term financial instruments in order to mobilise the much needed finance for industrial expansion.

Hon. Members may be aware that the Capital Markets Authorities of the three East African Member States, have agreed on a cross-listing of companies in their respective stock markets. To facilitate listing and ensure quoted companies have the same features in all the three countries, the Capital Markets Authority, in consultation with Central Bank of Kenya, will initiate the process of independent rating of companies already quoted in the stock exchange markets of the three states and those intending to issue or float public debt. This will increase disclosures and thereby enhance security of investments. Today, I am proposing changes, under the Income Tax Act, that will encourage the process of rating.

To modernize and develop our capital market further, there is need to inject new skills and technology, particularly in brokerage and fund management. These are important channels for foreign direct investments. They are also necessary for the development of retirement benefit schemes which we intend to promote once the Retirement Benefits Act is approved. We will, therefore, allow foreign brokerage and fund management firms to participate in this market provided they do so through locally registered companies in which there is local beneficial ownership of at least: (a) 30% in the case of fund management firms, and (b) 51% in the case of brokerage firms. The Capital Markets Authority will work out the necessary regulations.

Let me at this juncture take this opportunity to allay the fears raised in connection with the Retirement Benefits Bill. The regulatory authority which we are proposing to establish will only endeavour to monitor rather than control or administer the retirement schemes. The Authority will only step in when a scheme moves outside the prescribed bounds.

Agriculture

Mr. Speaker, let me now turn to the agricultural sector.

Agriculture remains the backbone of our economy. To achieve meaningful reduction in poverty and ensure we have enough food to feed our people, and also to support our industrialization strategy, this sector has to be attended to and adequately provided for in our budget. For these reasons, attention will be given to improvement of physical infrastructure and programmes that will support the growth of this sector. Accordingly, in the development budget, the Ministry of Agriculture, Livestock Development and Marketing has been allocated K£171.4 million or 7.3% of the development budget. Of this allocation, some K£33 million is earmarked for the agricultural and livestock extension services, K£15 million is for the horticulture export programme and K£8 million is for soil conservation. There are also allocations in other votes which will benefit farmers directly. These include K£28.4 million for agricultural and livestock research through the Kenya Agricultural Research Institute (KARI). Some K£40.1 million has been allocated under the Road Maintenance Levy and K£18.5 million under the Stabex for funding the rural access roads. Under the energy sector, rural electrification, covering mainly coffee and other rural factories, has been given additional provisions.

Co-operatives

Related to agricultural sector reforms is the co-operative movement which is an important component of our economy. Currently this movement has 7,356 societies with 2.5 million members controlling assets amounting to about Ksh.21 billion and the size of the movement is growing rapidly. The Government will initiate reforms to establish a new role which will be distinctly different from the paternalistic approach of the past. Reforms anticipated in 1997/98 will seek to: (1) reduce government involvement in day-to-day operations of the societies; (2) liberalize the co-operative movement; (3) enhance its efficiency in delivery of services to the members; (4) facilitate the movement to consolidate its current activities to be more competitive in agricultural production and marketing; and (5) finally, improve its competitiveness in harnessing savings through Savings and Credit Societies. The appropriate bill has been tabled before this House. I invite the Hon. Members to give the bill the seriousness it deserves.

Telecommunications Sector Reforms

Mr. Speaker, without an efficient and effective telecommunications sector, the impact of the other reforms we are taking will be limited. Efficient telecommunication services will enable local businesses to compete in the global market place. To improve these services the Government has decided to open 30% of Telcom Kenya to private capital through either floatation of its shares on the Nairobi Stock Exchange and/or invitation of a strategic partner to participate in the new company. In addition, a second cellular operator will be licensed by end-November, 1997.

Kenya Railways

Mr. Speaker, continued deterioration in the financial performance of the Kenya Railways (KR) and its services, is a cause for grave concern. To address this problem, the Government will open up the railways to private sector participation through privatisation or concessioning, that is, limiting KR's involvement to owning and regulating lines while leasing locomotives to the private sector operators. The management of KR will be required to develop, by end-1997, a specific programme to increase private sector involvement.

Cereals Sector Reforms

Mr. Speaker, in the Cereals Sector, the Government recently adopted the operating rules to effect the commercialization of the National Cereals and Produce Board. Preparation of draft amendments to the NCPB Act to bring the legislation in line with the Board's new role is at an advanced stage. For the remainder of 1997, work will proceed to effect the financial restructuring of NCPB and complete the commercialization of its operations.

Road Transport

Mr. Speaker, the road network continues to impose unnecessary costs on the economy which seriously affects productivity. A plan to address the activities to be financed by the road maintenance levy has already been approved. However, funds generated from this levy have not been sufficient to fully finance the maintenance programmes of our road network. It is therefore necessary to progressively raise the levy rate in order to increase the funding to a more appropriate level. In addition, the Government will review the existing institutional framework for road management to achieve effective management and accountability for these funds.

Local Government Reforms

Mr. Speaker, local authorities have not been given much emphasis in the past in spite of the fact that they provide basic services, which affect operations of businesses and attraction of new investments. However, it is now clear to most Kenyans that the majority of local authorities are not performing. Garbage remains uncollected, roads are in bad shape, water and sewerage services are inadequate, while regulatory services remain unenforced leaving residents to the dangers of poorly designed structures. This deterioration must be reversed and services improved.

To address this problem, the Government, through the Kenya Local Government Reform Programme and the Kenya Urban Transport Infrastructure Project (KUTIP), has established two reform vehicles. These reforms will address the following issues: (1) revenue mobilisation; (2) eliminating inefficient expenditure practices; (3) rationalising staff; (4) updating and auditing accounts; (5) rehabilitating infrastructure; and (6) development of human capacity.

To supplement these efforts, I am proposing amendments to the Road Levy Fund Act to allocate part of the funds for maintenance of roads under local authority jurisdiction. An inter-ministerial committee chaired by the Ministry of Local Government will be established to prepare modalities, rules and regulations of operating these funds.

Mr. Speaker, I will be announcing later other measures to supplement local authority resources. Needless to say, urgent efforts are required to raise and efficiently utilise these resources. One key concern is the poor state of accounts. Hon. Members should note that some local authorities have not prepared books of account for over 20 years. Consequently, they have also not been audited. My Ministry has drawn the attention of the Controller and Auditor-General to this matter and remedial action is being taken. Another area of fiscal responsibility that needs addressing is the failure by many local authorities to service loans provided by or guaranteed by the Government. The burden has effectively been passed on to the Treasury and ultimately to the taxpayers. As we enhance revenues for local authorities, they too must appreciate and honour their financial obligations. Consequently, I am proposing measures under the Local Government Act, that will enable the Government to appoint agents to collect service charges consumed so that these debts can be serviced. Effective collection of charges is critical to local authorities establishing their credit worthiness to finance infrastructural developments, particularly for water supply.

TRADE REFORMS

Mr. Speaker, let me now turn to trade reforms.

Export Promotion

Over the years the Government has continued to institute measures to promote exports as the pillar of our growth strategy. The reforms we have put in place over the last three years, have helped the export industry as local producers have had access to raw materials at low rates of duties and taxes. These measures, in conjunction with our macro-economic reforms, have generally boosted exports.

Mr. Speaker, one of the incentives in place to promote exports is the Duty/VAT Remission under the E.P.P.O. Programme. Although the programme has been relatively successful, I continue to receive complaints from its users. The major complaints arise from delayed verifications which force exporters to retain customs bonds for longer periods than is necessary, and also delays in bond cancellation once verifications are completed. To speed up processing of verifications and bond cancellation under the E.P.P.O programme, I have decided to transfer this responsibility to a special unit in the Customs & Excise Department with immediate effect. Approvals for exemptions will, however, remain with the Ministry of Finance.

Transhipment of Third Country Goods

Mr. Speaker, we have received complaints regarding transhipment of goods which are disguised as exports originating from Kenya. The consequences of this can be disastrous to our development efforts. Our textile industry has been a victim of this transhipment problem, which made the United States impose quotas on Kenyan textile exports. We hope the American Government will reconsider this decision soon. In the meantime, to deal with this transhipment problem, I am today proposing measures which will make it illegal for a person to bring goods into Kenya, label or repack them and subsequently re-export such goods as "Kenyan made". Customs and Excise officials are under instructions to ensure that all goods shipped as "Kenyan made" meet the necessary domestic content requirements under the rules of origin. Goods misdeclared as originating from Kenya will be subject to customs penalties including seizure.

Anti-Dumping and Anti-Subsidies Legislation

Mr. Speaker, there has also been a general feeling that our liberal trade policy has resulted in increased imports and weakened our economy. To address this concern, I am proposing amendments to the provisions of the Customs and Excise Act that relate to anti-dumping. The new legislation will clearly define how to determine dumping margins and export subsidies and the circumstances under which an investigation can be initiated. Detailed regulations will be issued later.

The basic objective of these provisions will be to ensure that legitimate protection is granted to local industry suffering injury by imposing additional duty to the extent of dumping margins or subsidies following appropriate investigations. This will ensure that imports are not sold at artificially low prices. In the course of this fiscal year, we will also prepare legislation on safeguards which should complement these provisions.

Diversion of transit goods

Mr. Speaker, diversion of transit goods into the domestic market has of late become a serious problem. Diverted transit goods are harmful to the country. First, the country is denied its rightful share of tax revenue. Second, it subjects domestic industries to unfair competition as imports sell at artificially low prices. The sugar industry has, in particular, suffered greatly as a result of such diversion. While we have already taken measures to deal with this problem, I will later be proposing additional measures to tighten controls on transit cargo.

In similar vein the three East African countries have agreed to harmonise tax procedures and administration in order to improve compliance and eliminate diversion of transit goods. In the coming year, the three countries are expected to adopt a Common Transit Bond System that will specify the address, physical abode of the importer, and a common anti-smuggling mechanism. Other measures include exchanging of information on pre-shipment inspection and transit goods and a common threshold value for Pre-shipment Inspection at US$2,000. However, the long-term solution is harmonisation of customs duties and procedures together with electronic data exchange. The three governments have started work towards this harmonisation.

Public Expenditure Reforms

Mr. Speaker, as regards public expenditure, the government has just concluded a comprehensive review of public expenditures. The review which focused on assessing the appropriateness and composition of public expenditures has confirmed that in certain instances allocation of our financial resources has neither effectively reflected our priorities nor adequately promoted growth. Moreover, new projects are introduced even when available resources are not adequate to fund on-going projects fully, while provisions for operations and maintenance have been insufficient. The end result of this has been an accumulation of a large stock of incomplete or non-performing projects, pending bills and deterioration of public infrastructure. This is costly to the economy.

In line with the findings of this review and given our financial position, and the state of our infrastructure, the Government will improve on its expenditure programmes giving priority to operations and maintenance, and on-going projects that will facilitate private sector development and reduce poverty. No new major projects will be initiated in fiscal year 1997/98. This position will continue in the next two financial years, after which it will be reviewed.

Civil Service Reform Programme

Mr. Speaker, the Civil Service Reform Programme will enter a new phase in the coming year. It will build on the gains that I have already outlined. The Programme will focus more on measures that will improve productivity and professionalism of the public service. This will have to be done in the context of a government-wide approach. Accordingly, the first step will be the development of a payroll adjustment plan by the end of 1997. The programme will detail how the Government can achieve wage improvements over a three-year period while constraining the wage bill to manageable levels consistent with our macro-economic framework. The Government will be seeking donor support to assist in financing costs of this adjustment effort both at central government and also local authority levels.

Financial Accountability and Change

Mr. Speaker, following the liberalisation of our economy, it has become clear that our current cash-based accounting and financial reporting system does not adequately meet present day management and user requirements. For instance, the system does not provide for asset accounting neither does it provide for methods and systems for measuring performance against set objectives. For these reasons, the Government will re-examine its accounting and financial reporting system and consider the appropriate changes. Similarly, the Government will review laws relating to preparation of accounts together with the institutional arrangements and consider the necessary modifications to make them more suitable to present needs and operations. This is necessary in order to ensure the Government focuses more appropriately on expenditures and available resources while encouraging greater financial discipline to maximise outputs and achieve objectives.

V. FINANCIAL OUTTURN 1996/97

Mr. Speaker, I shall now briefly go over the financial out-turn for the financial year ending 30th June, 1997.

Recurrent Expenditure

Mr. Speaker, our financial performance in 1996/97 has been marked by two difficult developments. Firstly, domestic interest rates remained high throughout the year contrary to earlier expectations. Secondly, the Government had to incur priority supplementary expenditures for the importation of famine relief maize. I also had to finance increases in salaries and allowances for the armed forces and foreign service allowances. In addition, I had to finance voter registration and security expenses. Though revenues are expected to be in line with the budget estimates, it was not possible to raise additional revenues to cover these supplementary expenditures. Moreover, there was also a substantial shortfall in external receipts, mainly because funds expected from the Structural Adjustment Credit could not be disbursed during this financial year. Mr. Speaker, to contain the budget deficit, we had to enforce strict expenditure controls during the year.

As Hon. Members will recollect, the recent Supplementary Appropriation Bill, authorized additional expenditures of K£287.5 million. Out of this amount, K£62.9 million was reallocated from other areas, resulting in a net increase of K£224.5 million over the budgeted recurrent expenditures. As a result, I now expect the net recurrent issues for the year to be about K£4,372.8 million compared to the Printed Estimates of K£4,148.3 million. Including Appropriations-in -Aid, gross recurrent expenditures will be K£4,743.7 million.

Payments under the Consolidated Fund Services will increase to K£2,017.0 million compared to the budgeted amount of K£1,642.9 million, mainly due to higher than planned domestic interest payments. Consequently, I expect gross recurrent expenditures for the year to be K£6,760.7 million compared with expected total recurrent revenue and Appropriations-in-Aid of K£7,756.7 million, resulting in a net surplus balance of K£996.0 million.

Development Expenditure

Mr. Speaker, during the current financial year net development expenditure authorizations increased by K£159.6 million. This was mainly accounted for by additional expenditures for financing purchase and distribution of maize seeds for drought stricken areas, purchase of lorries to distribute relief food, and additional provisions for clearing some of the pending bills. Part of this increase was financed by savings from other areas in the development vote amounting to K£71.6 million, resulting in a net supplementary vote of K£87.9 million. I therefore expect net development issues to be K£1,017.5 million compared to the budget of K£929.6 million. In addition, I have to finance Excess Votes amounting to K£26.1 million pertaining to 1990/91 and 1991/92 fiscal years.

FORECAST OUT-TURN FOR 1997/98

Mr. Speaker, I now turn to my forecast out-turn for 1997/98.

Expenditure

When planning for the expenditure levels for 1997/98, I had to take into account two very important factors. These are, the prevailing large domestic debt and high interest rates and the slow-down in the pace of economic activity, during the first quarter of 1997, which reduces the amount of revenues I can mobilise to finance expenditures. For these reasons I recognise the need to give the economy a major boost in order to achieve the desired growth.

I have already explained the measures I intend to take to deal with the problem of escalating domestic interest rates. However, it will be necessary to promote real savings in the public sector so that domestic debt can be reduced and interest rates brought down. It is in this context, that the Government will aim for a budget surplus in the medium-term. Savings must also be realized within the parastatals and other public institutions which depend on the national budget. These measures will help the economy attain higher growth rates.

Mr. Speaker, it is important that the Government achieves a substantial real reduction in expenditures as the current high level of 28% of GDP, is not sustainable. This is an important medium-term economic management challenge which must be met so that the economy can take full advantage of the reform measures already in place.

In the 1997/98 budget, I intend to maintain the overall deficit, excluding grants but on a commitment basis, at around 1.7% of GDP while ensuring that the allocations will achieve our overall objective of economic growth with social justice. This requires a major reallocation of public expenditures so as to concentrate them on improving and maintaining physical infrastructure, security, social services, primary education, basic and preventive health care, and rural water supply. Other claims on our resources will have to be given less priority. In view of the changing pattern of our public expenditures, it will be necessary for each spending agency to carefully plan and prioritize their expenditure requirements.

Mr. Speaker, while the proposals I am submitting to-day reflect some significant changes in expenditure priorities, I must hasten to add that the desired changes cannot be brought about in one year. However, we have clear directions for change arising from the recent Public Expenditure Review together with the Policy Framework Paper. As for the 1997/98 budget, I must finance some extraordinary expenditure requirements such as expenditures for elections, salary increases for civil servants, the police and the prison services, teachers and university lecturers, and payments for famine relief maize. These expenditures require a total of K£365 million which will entail sacrifices elsewhere in the budget.

Recurrent Expenditure

Mr. Speaker, payments for Consolidated Fund Services will amount to K£3,237.1 million in 1997/98, of which K£1,072.2 million is accounted for by redemption payments on external loans. Foreign interest payments are projected to cost K£455.6 million. Domestic interest payments will amount to K£1,078.4 million which is about 9% lower than payments for the current year. This reflects the anticipated gradual decline in domestic interest rates.

Recurrent expenditures for Ministries will amount to K£5,344.5 million, of which K£414.9 million will be financed by Appropriations-in-Aid. Non-wage operating expenses in the recurrent vote will increase by 15.3% from the current level to K£1,890.4 million, reflecting Government policy of increasing allocations for operations and maintenance. The Government will also continue to implement the on-going Voluntary Early Retirement Programme as an important component of the Civil Service Reform Programme for which K£50 million has been allocated.

Mr. Speaker, I would like to highlight some of the more important allocations in the recurrent budget that will contribute to our objective of growth with social justice. The budget proposals reflect substantial allocations for rebuilding our physical infrastructure, particularly the road network. The allocation for road maintenance and improvement projects financed by the Road Maintenance Levy will be increased by 28% to K£204.25 million. In addition, a part of this levy is being earmarked specifically to improve roads under the local authorities. These efforts will supplement other infrastructure projects included in the development budget to create an impact on the condition of our road network.

Mr. Speaker, recurrent expenditures include an allocation of about K£331.4 million spread over a number of Ministries for broad-based programmes that will directly benefit the poor. In the education sector, K£30 million has been allocated for school milk and feeding programmes, provision of books and equipment to the disadvantaged areas. This represents an increase of 25% over this year's level. Funding for the secondary school bursary programme has been increased to K£25 million. Allocations have also been made for special programmes implemented by the Ministry of Education to address the problem of declining primary school enrolment. In the health sector, the operating funds allocated to preventive and rural health services will increase by 8%. I have also allocated K£26.7 million for improved maintenance of water projects in rural areas and K£40 million for rural access roads in order to accelerate development of rural Kenya where the majority of our people live.

Mr. Speaker, we are giving high priority to food security for the vulnerable sections of our population. In this regard, K£50 million has been set aside.

Development Expenditure

Mr. Speaker, the 1997/98 Development Estimates amount to K£2,355.5 million, out of which K£1,361.5 million will be financed by Appropriations-in-Aid for projects and programmes supported by multilateral and bilateral donors.

The development budget also includes substantial allocations for physical infrastructure. A total investment of K£272.0 million has been earmarked in the budget for improvements and expansion of the road network, financed by the Government and donors. Some of the major projects which will start next fiscal year, include the Nairobi-Mombasa road rehabilitation project with an allocation of K£33.5 million and the on-going Kenya Urban Transport Infrastructure Project with an allocation of K£38.7 million.

Mr. Speaker, I must also mention the planned public sector investments in the energy sector which will improve power supply within the next three years. An initial allocation of K£40 million has been earmarked in the development budget to start implementing the energy sector programme. This is in addition to the investments programmed under the Kenya Power Company Limited together with the private sector. These investments should increase both the availability and reliability of our power supply.

The development budget also contains K£13 million earmarked for food assistance to primary and pre-primary school children in arid areas, and K£10 million for the National Women Development Programme. In addition, an amount of K£15.2 million has also been set aside for implementing special programmes for arid areas.

Mr. Speaker, I would like to take this opportunity to highlight two significant developments that will influence the management of our economic affairs in the next three years. First, is the updated Policy Framework Paper which the Government has prepared covering the period 1997 - 1999. This will provide firm directions for economic management over the next three years. Second, with broad agreement and the active support of a large number of donors, we hope to secure additional funding for general budget support which we intend to use to reduce our domestic debt.

EXTERNAL FINANCING

Mr. Speaker, we have continued to maintain good relations with the donor community. The Government is particularly grateful to the donors who supported us during the recent drought. However, during the closing fiscal year, due to a variety of reasons, external financing is likely to result in a net outflow of some K£138.7 million. For 1997/98, I expect a net inflow of foreign financing of about K£88.3 million based on the existing commitments.

DOMESTIC BORROWING

Mr. Speaker, I have already appraised the House on the tight fiscal and monetary policies the Government intends to maintain over the next fiscal year. I have also indicated that I intend to keep government domestic borrowing below 2% of GDP. These measures are consistent with the policy of maintaining single-digit inflation. In view of this, net domestic borrowing will be limited to K£221.1 million.

ORDINARY REVENUE

Mr. Speaker, to finance the planned expenditure programme for 1997/99 I will need to raise K£7,994.2 million in ordinary revenue and K£583.3 million in Appropriations-in-Aid. At current tax rates, I expect to raise K£7,970.8 million in ordinary revenue. This leaves me with a gap of K£23.4 million. The rest of my speech will outline how I intend to close this gap.

7. TAXATION PROPOSALS

Mr. Speaker, before I turn to my detailed taxation proposals, allow me to make a few observations. The major world economies have in the context of restructuring their budgets substantially reduced their budgetary allocations to international or multilateral organizations and also for bilateral aid. Therefore, as we go into the new millennium, aid will increasingly be replaced by foreign direct investments. I must emphasise here that experience shows that foreign direct investments can only flow to countries with sound political stability and low taxation.

Mr. Speaker, last year, I promised to ease the tax burden as the economy stabilizes. Although the drought conditions have affected revenue flows for the 1996/97 financial year, I intend to live up to this commitment. I expect the ratio of ordinary revenue to GDP to decline from 28% in 1995/96 to around 26% in 1996/97 and 25% in 1997/98. This will enable the private sector retain more resources for investment and job creation. In order to encourage this process, I will continue to lower the marginal rates, broaden the tax base and restructure the tax rates.

Mr. Speaker, in keeping with tradition, I would now request that the remainder of my speech be regarded as a Notice of Motion to be moved before the Committee of Ways and Means.

Mr. Speaker, let me briefly deal with technical matters and subsequently turn to measures that have revenue implications.

(1) Kenya Revenue Authority Act

First, to enhance efficiency in the Kenya Revenue Authority, it has become necessary to better define the functional responsibilities in the Authority. It is also necessary to define the role of the Board in matters that may require its intervention in operations of specific departments. Technical issues arising in the administration of each of the tax laws need to be specifically dealt with within that particular law. The specified legal responsibilities should, therefore, remain with the individual Commissioner responsible under that particular Act. For these reasons, I propose to amend sections 11 and 23 of the Kenya Revenue Authority Act to make it clear, that (1) the Commissioner-General's responsibilities include general supervision of the Commissioners; and (2) the functional responsibilities of specified Commissioners under their respective acts, shall remain delegated to individual Commissioners.

Second, detection of tax frauds can be greatly assisted by intelligence supplied by the public. To encourage greater co-operation, I propose to amend the KRA Act to provide for rewards for correct identification of tax fraud cases by members of the public. Such information will be treated with strict confidentiality.

(2) Customs and Excise Act

Mr. Speaker, I now turn to measures under the Customs and Excise Act.

First, the Cargo Control System being implemented by the Kenya Revenue Authority in collaboration with the Kenya Ports Authority has progressed well. To improve this system further, I propose to make changes which will facilitate electronic submission of documents.

Second, following the recent extension of Pre-Shipment Inspection Services through 1999, the minimum value for inspection has been raised to US$2,000. Import Declaration Forms will still be required for goods below this threshold. Customs verifications, audit and reconciliation will be tightened to detect those who may be tempted to split shipments to avoid inspection or misdeclare goods, with the intention of avoiding payment of correct duties and taxes.

Third, local businesses, particularly industries, have made strong representations for the need to relax PSI requirements on urgently needed spare parts and essential inputs, which are airlifted through courier services. To speed up these deliveries, I propose to raise the value of airlifted goods, not subject to PSI, to a maximum of US$10,000. This facility will not be open to final consumer goods. Furthermore, any courier company committing irregularities using this facility will be excluded from the facility forthwith and all its parcels subject to all import formalities.

Fourth, as Hon. Members are aware, problems associated with transit cargo have of late intensified. While the Government has already taken some control measures to deal with this problem, I am proposing the following additional measures:

- with immediate effect, every agent handling transit cargo will be required to account for such goods within seven days after the end of the transit period;
- the transit period will be reduced from 45 to 30 days;
- a credibility assessment will be conducted on senior management and directors of clearing and forwarding firms to ensure they have clean records with the Customs and Excise Department before they are licensed;
- if goods are not accounted for within the transit period, the Commissioner will realize the bond security within fourteen days;
- penalties under section 12 of the Act will be enhanced to Kshs. 500,000 or to imprisonment for a term not exceeding three years. The offender will remain liable to a fine of upto three times the value of the goods under section 195(2) of the Act;
- any vehicle used to convey transit goods anywhere else other than to a licensed transit bonded warehouse or to the final destinations will be liable to forfeiture; and
- finally, petroleum products will be exported in licensed vehicles which must be clearly marked in oil paint with the words "for export only".

Fifth, section 20 of the Act requires a master or agent to file a report within 24 hours of arrival of the aircraft or vessel. This report is usually in hard copy. I propose to amend the relevant Regulation to make it possible for documents to be filed electronically provided a hard copy of the same is submitted to Customs within 24 hours of arrival. This will pave the way for faster clearance of cargo through our ports.

Sixth, as Hon. Members will recall, last year this House passed an amendment to section 34 of the Act to make forfeiture mandatory for goods not entered and delivered from customs within 21 days. A number of genuine cases have been brought to my attention such as where (i) goods are not entered due to mistakes of either the exporter or the shipping agent resulting in wrong names or descriptions of goods appearing in shipping documents; or (ii) the importer falls sick or dies before goods arrive. In all these circumstances, the goods cannot be cleared within the specified period. I propose to amend the law to provide for release of such goods to the owners, provided the Commissioner is satisfied that failure to remove the goods was due to physical impediments beyond the control of the importer. In all cases, appropriate duties and taxes will remain payable.

Seventh, as explained earlier, I propose to repeal section 125 of the Act and insert a new section that will provide for imposition of anti-dumping duties and the necessary modalities to be followed. Similarly, I propose to repeal section 126 and replace it with a new section that defines dumping and provides details of what constitutes dumping.

Eighth, section 139 of the Act allows remission of duty on spirits delivered from a distillery or warehouse for use in the fortification of wine or in industry. However, it excludes spirits used in manufacture of other alcoholic beverages. I propose to amend the law to allow remission of duty on such spirits provided they are delivered for the manufacture of excisable goods.

Ninth, currently section 158B of the Act provides for waiver of duties where the Commissioner is of the opinion that attempts to collect such duties would be too expensive or difficult to enforce, but this provision does not include penalties. This is anomalous in that, if the principal amount cannot be collected, it is also unlikely that penalties would be collected. It is also inconsistent with the other two revenue acts, i.e., Income Tax and VAT Acts, both of which allow for waiver of penalties in addition to the principal tax. To remove this anomaly and harmonise the three revenue acts, I propose to amend section 158B and provide for waiver of penalties, provided the Commissioner will only waive up to Kshs.100,000 in any one case. Where the penalties exceed this amount, it will be referred to the Minister for approval. This limit will apply to all revenue Commissioners. In addition, the Commissioners will be required to make quarterly reports to the Minister on amounts waived.

Tenth, item 27 of Third Schedule Part A allows returning Kenyan diplomatic personnel to import, free of duty, vehicles which they owned while in overseas service. However, the law is silent on the period within which the vehicle has to be imported. This is inconsistent with similar provisions regarding other categories of privileged persons who are required to import their vehicles within three months of arrival or such longer period, not exceeding 360 days, as the Commissioner may allow. I propose to amend the law to remove this anomaly.

Eleventh, item 1 of Part B, of the Third Schedule, allows scheduled airlines to import specialized equipment duty free. In practice, airlines contract services to local firms. I propose to amend the law to allow such firms to import, free of duty, specialized equipment for loading and off-loading, servicing and maintenance of aircrafts, provided the equipments remain within the international airports at all times.

Mr. Speaker, I now turn to customs proposals that have direct revenue consequences.

First, the tariff structure will be rationalized down to three positive duty rates, namely, 5%, 15% and 25%. This will be achieved by reducing the 35% rate to 25%. Mr. Speaker, Hon. Members may be aware that last week Uganda reduced her top import duty rate to 20%.

Second, to reduce the costs of industrial inputs, most industrial intermediate inputs in the 25% tariff band will be reduced to 15% and a few Basic raw materials in the 15% rate band will be reduced to 5%. In cases where domestic producers will require some assistance as they adjust, I propose to provide temporary protection through the imposition of additional suspended duties of 5% to 10%. This will apply to certain products including paper and paperboard, flat rolled iron and steel, resin, yarn, cars, minibuses, pickups, tyres and dry cells. To assist the local printing and packaging industry, the import duty on a number of categories of unprinted plastic sheets, films and foils will be reduced to 15% while the printed versions will remain in the 25% tariff band. With the reduction of the top rate of duty to 25%, the need to keep final goods in bonded warehouses is substantially reduced. I will, therefore, exclude a number of final goods from customs bonds.

Third, Mr. Speaker, declines in world prices of major agricultural commodities continue, from time to time, to cause difficulties to our farmers. While the regular import duty rates for milk, maize, rice, sugar and wheat will all be in the 25% rate band along with the equivalent alternative specific duty rates, I propose to provide suspended duties of 70% that will allow for quick imposition of higher duties in the event of major down swings in world prices of these commodities. For the same reasons, I propose to impose a 10% suspended duty on imports of apples, pears, grapes and oranges.

Fourth, to reduce the energy costs, import duty rates on heavy diesel and residual fuel oil will be lowered by Kshs.1 and Kshs.0.2 per litre, respectively. This will give local industries a substantial reduction in their energy costs. I am also proposing to lower the current suspended duty rate of Kshs.0.5 per litre on selected refined products by 50% but expand the protection of the refinery by including automotive diesel under the suspended duty.

Fifth, duty exempt motor vehicles are not only a source of revenue loss but also consume excessive amounts of administrative time. To defray the costs of screening and processing applications for duty waiver, I am proposing a processing fee of Kshs.10,000 per duty exempt vehicle.

The measures proposed under import duties will cost the Exchequer K£ 59.5 million in revenue loss, and will come into effect from midnight tonight.

(3) Excise Duties

Mr. Speaker, the excise duty has continued to contribute a significant share of government revenue over the last five years as a result of the rationalization of the structure of indirect taxes. The measures that I propose today will continue this process on selected goods.

First, to simplify the collection of domestic excises, and prevent mis-declaration of imported cigarettes, I am proposing to rationalize excise duty rates on cigarettes to a uniform rate of 135%.

Second, in order to reduce the movement away from high value to low value alcoholic beverages, I propose to reduce the duty difference between the two items. Excise duty on malt beers will be reduced by 5% to 100% while excise duty on non-malt beer and stout will be increased by 5% to 60%. The 60% rate will also apply to other fermented beverages. In addition, excise duty on opaque beer will also be increased by 5% to 15%. This excise duty rate will also apply to powdered beer.

Third, compliance problems have been experienced with the collection of excise duties from imported matches. To improve the competitive market position of local manufacturers, I am proposing to eliminate excise duty on matches.

Fourth, I propose to rationalize excise duty on passenger motor-cars by lowering the rate on vehicles with an engine capacity of between 1800 cc and 2000 cc from 20% to 10%. For vehicles with an engine capacity between 2500 cc and 3000 cc excise duty will be reduced from 40% to 20%. Other rates will remain unchanged.

Fifth, double-cab and king-cab pick-ups are classified under the Harmonized Code as passenger cars. As a result, these goods carrying vehicles with large engine capacities have been subject to excise duties like large luxury cars. I propose to introduce new classification codes for these pick-ups and remove excise duty.

Finally, petroleum products are generally subject to specific duty rates. This requires occasional increases in the duty rates to maintain the revenue yields. Accordingly, I propose to raise the excise duty rates on petrol and automotive diesel by Kshs.1.05 per litre. To prevent unintended diversion of demand to kerosene, I am obliged to increase the excise duty rate by Kshs.0.85 per litre. The price increases in these products should be only half the average annual rate of inflation.

The measures proposed under the excise duties will have a net revenue effect of K£61.9 million. These excise duty rate changes will come into effect from mid-night tonight.

(4) Value Added Tax Measures

Mr. Speaker, I would now like to turn to value added tax.

VAT has been in operation for just over seven years during which time a number of changes have been made to rationalize the rate structure and to simplify and strengthen administration with a view to curbing tax evasion and enhance VAT revenue. I propose to continue this process.

First, to move the rate structure closer to a single rate, I propose to raise the lower rate from 8% to 10%.

Second, to simplify VAT administration, I propose to replace specific rates of tax on residual fuel oils, petroleum gases, petroleum bitumen and heavy industrial diesel oil with the standard *ad valorem* rate of 15%.

Third, I am proposing to expand the tax base by including arbitration services, investigation services and goods handling warehousing and storage services in the tax net.

Fourth, in order to harmonize the taxation of goods at the retail level, I propose to designate powdered beer to be taxed at retail level like other alcoholic beverages.

Fifth, to reduce risks to loss of revenue, the Commissioner has the powers to demand payment of tax immediately it is received by a registered trader. I am proposing to amend the law to make it clear that early payment demands only apply during the period before the tax is normally payable. The VAT remains payable by the 20th day of the month following the taxable supply being made whether or not the tax was collected.

Sixth, to streamline the collection of tax on imported taxable services, I propose to amend the law to provide that the importer declares the taxable services imported by him to the Commissioner.

Seventh, to harmonize the refund of tax paid in error with the provision under the Customs and Excise Act, I propose that no refund of tax shall be made unless the claim is lodged within twelve months.

Finally, Mr. Speaker, to reduce the backlog of VAT refunds and at the same time maintain the payment of current VAT refunds, I propose to increase refund payments to at least K£300 million.

The measures I have proposed under the VAT Act will have a net revenue gain of K£32.7 million, and will come into effect from mid-night tonight.

(5) Income Tax Measures

Mr. Speaker, I now turn to measures under the Income Tax Act.

As Hon. Members are aware the tax burden arising from direct taxation can be increased substantially as a result of inflation. This burden can be particularly punitive to low income earners. For these reasons, I propose to take several measures to ease this burden.

First, in 1996, I combined all personal reliefs into a uniform personal relief of Kshs.7,200. In order to maintain the real value of this relief for the taxpayers, I propose to increase this relief by 10% to Kshs.7,920.

Second, I also propose to widen the tax brackets by 10% to protect taxpayers against inflation-induced bracket creep. The combined effect of these measures will raise the minimum monthly income subject to tax to Kshs.6,600 This effectively removes some 152,000 individuals from the income tax net.

Third, at the same time, I propose to lower the highest rate of individual tax from 35% to 32.5%. Individuals will now reach the highest rate of tax on attaining a salary of Kshs. 37,600 per month.

Fourth, I propose to lower corporate tax from the present 35% to 32.5%, while the rate of foreign branches will be lowered to 40% from 42.5%. Resident corporations will, therefore, pay tax at the same marginal rate of tax as the individuals.

Fifth, to continue bridging the gap between the limits for pension contributions and tax deductible contributions, I propose to increase the deductible contribution limits for registered pension, provident, and registered individual retirement funds from Kshs. 90,000 per year to Kshs. 120,000 per year.

Sixth, currently the Income Tax Act accommodates normal rental arrangements for vehicles, equipment and real estate, but discourages development of longer-term leases which include distinct financing arrangements. I am proposing to amend the law and introduce regulations that will clarify the tax treatment of different types of leases to allow the growth of the leasing sector.

Seventh, on the same theme of promoting the capital market, I propose amendments to exempt from tax, income of a registered venture capital company, consisting of dividends and gains arising from holding or sale of shares in qualifying venture companies, during the first ten years from the date of the first investment.

Eighth, insurance companies have continued to complain that taxation of gains realised from their trading in quoted stocks inhibits their participation in the stock market. To address this concern and give the capital market a shot in the arm, income from insurance companies arising from trading in shares in the Nairobi Stock Exchange will now be tax exempt. However, to offset the revenue loss arising from this measure, I propose to increase the insurance premium tax rate from 1% to 1½%.

Ninth, to boost liquidity of the stock market and enhance price stability, I propose to exempt from income tax, sole purpose licensed dealers, in shares and stocks, subject to regulations issued by the Capital Market Authority. To discourage unnecessary retention of the stocks by these dealers, only gains on stocks and shares sold within twenty-four months from the date of their acquisition will be tax exempt. Where the dealers hold stocks for more than twenty-four months, their profits will become taxable. The dealers will be required to meet a pre-determined monthly turn-over.

Tenth, in many developed and emerging markets, deposit taking financial institutions and companies quoted on a stock market or wishing to issue public debt, are required to be rated by an independent agency. To encourage listed companies to be rated, and assist investors to make more informed decisions, I propose to make expenses related to rating of such businesses deductible under the Income Tax Act.

Eleventh, to widen the tax base and improve tax compliance, I propose to introduce provisions to require personal identification numbers for all business transactions with the Government, and other public institutions.

Twelfth, for the purposes of estimating instalment tax, I propose to change the base to the lesser of 110% of the previous year's tax assessment or the tax payable on the current year's income. This will allow for income growth and provide for a fairer basis for determining current year tax.

Thirteenth, to encourage submission of more accurate audited accounts and increase compliance, I propose to increase the period within which audited accounts may be submitted to the Income Tax Department by two months. Audited accounts will now be due within six months following the end of business fiscal year. The instalment tax and final returns due dates remain unchanged. To ensure this measure is not abused, the penalty for late submissions of returns will be increased to 20% of the tax payable.

Fourteenth, to deal with employers who deduct and illegally retain P.A.Y.E., I propose to increase the penalty under section 37 to 25% of the tax due or a minimum of Kshs.10,000. I also propose to remove the requirement for submission of final return by individuals with Personal Identification Numbers (PIN) in cases where all the tax due has been recovered under P.A.Y.E. This requirement is unnecessary and expensive. I propose to amend the law to correct this anomaly and save the compliance costs involved.

Fifteenth, I propose to amend the law on the value of benefits to clarify that the value of living quarters provided by the employer shall only be determined in accordance with the provision relating to quarters and not subject to the general overriding provision.

The measures proposed under income tax will cost the Exchequer K£1.1 million in revenue loss.

(6) Other Measures

Mr. Speaker, I will now turn to measures under the miscellaneous category.

First, in accordance with our commitment, the road maintenance levy collections should increase by some 28% to raise K£204 million in 1997/98. To meet this target, I propose to increase this levy by Kshs.0.5 per litre on petrol and automotive diesel with effect from midnight tonight. This is expected to contribute an additional K£34.5 million for the road maintenance levy in the coming fiscal year.

Second, I am proposing to introduce a programme of revenue sharing between the central government and local authorities with effect from the next fiscal year. This programme will have three components:-

(a) 20% of the Road Maintenance Levy will be set aside for roads under the local authorities. This will be raised gradually to a maximum of 50%, in subsequent years, as their capacity to absorb additional funds is developed.

(b) I propose to establish a Local Authority Transfer Fund with effect from fiscal year 1998/99. To launch this fund 5% of annual income tax collections will be dedicated to this fund. An appropriate bill detailing the operational modalities of the fund is under preparation and will be tabled soon in this august House. When the fund is operational, it will replace the cumbersome local authorities service charge by January, 1999, and

(c) Finally, contributions in lieu of rates will be raised from about K£8.5 million in the current fiscal year to K£20 million in 1997/98 financial year.

Fourth, as an initial step towards reducing the number of licenses required for a business, I propose to amend the Trade Licensing Act to discontinue the collection of trade licence fees for revenue purposes by the Central Government with effect from January, 1998. Agents of Central Government will only be concerned with regulatory approvals. In the course of the year, the Local Government Act will be amended to enable local authorities to issue only one business permit automatically to a business upon payment of the required fee. However, businesses will continue to observe all regulations dealing with health, environment and safety, etc.

Fifth, to rationalize penalties chargeable under the various revenue acts, I propose to amend the Rating Act to increase the interest on late payments of rates to 3% per month.

Sixth, in order to instil fiscal discipline in local authorities, I propose to amend the Local Government Act to enable the Government to appoint finance managers where a local authority fails to service its debt obligations to the government or government guaranteed debt. The agent will collect the revenues and service the loan. Upon redemption of the loan or restoration of financial discipline, the local authority will resume its responsibility. I believe, with these measures, we have established the basis for central government support to local authorities. I would like to stress that local authorities which show marked improvements in their financial management are likely to benefit more from this relationship.

Seventh, to enable businesses to raise capital cheaply from the financial sector, I propose to (i) reduce stamp duty rates by 60% for primary securities, and (ii) 50% for other securities registered as collateral.

Eighth, I am proposing amendments to the Hotel and Restaurants Act to allow the Catering Training Levy to be used more generally to support the development of the tourism sector. This should help to address concerns of the tourism industry.

Ninth, to make effective use of the Petroleum Development Levy, I am proposing amendments to the Petroleum Development Fund Act to allow funds from this levy to be used for other energy sector development projects. Consequently, local Appropriations-in-Aid for energy related projects will increase by K£13.2 million from K£15 million in fiscal year 1996/97 to K£28.2 million in 1997/98 financial year. Out of this amount K£13.2 million will go to rural electrification while K£15 million will be used to develop the LPG handling facility in Mombasa.

These other measures that I have announced are expected to raise an additional K£47.5 million in Appropriations-in-Aid, while the Exchequer will experience a loss of K£10.6 million.

8. CONCLUSION

Mr. Speaker, as I come to the end of my presentation let me reiterate the Government's commitment to the reform process.

On 16th February, 1996, for the very first time, the Policy Framework Paper was launched by H.E. the President as a public document. It enunciates policies intended to enhance the environment for private sector development. In my speech today, I have given a wide range of measures the Government has taken in fulfillment of that commitment. We have continued to implement these reforms without parochial political party interests.

Mr. Speaker, I would like to assure Kenyans that the reforms we have been implementing are our own initiatives driven by the desire to see our country grow faster and become an emerging market. The primary focus has been, as it should always be, the need to secure the best long-term interests for this nation and its people. I invite all Kenyans, both individual and corporate, to underpin these reforms through increased savings and investments, and more importantly, to the consumers to give Kenyan goods the necessary support. The measures I have presented today are realistic and built on previous efforts. They are targeted to deal with the challenges which I enumerated. Specifically, they aim to spur savings and investments, promote industrialization and create jobs.

Finally, Mr. Speaker, given that the second multi-party general elections will be held in the coming financial year, my appeal to all Kenyans, including the Hon. Members, is to nurture the economic and political harmony that prevails in our growing democracy. We should guard against anything that might threaten the macro-economic stability that has taken us years and a lot of sacrifice to achieve. Therefore, our utterances and actions should not be for mere political expediency. Elections, like individuals come and go, but this beloved country will live forever. As Hon. Members debate these measures, let us remember the repeated calls by H.E. the President that **"Kenya will be built by Kenyans themselves". It is our sweat and sacrifices that will see us through.**

Mr. Speaker, I beg to move.