REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1999/2000

(1st July–30th June)

by

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Minister for Finance

SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 10TH JUNE 1999, BY HON. DR. Y.F.O. MASAKHALIA EGH, MP, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR FISCAL YEAR 1999/2000

1ST JULY, 1999 TO 30TH JUNE, 2000

Mr. Speaker Sir,

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

Mr. Speaker, speeding up the process of economic recovery, and addressing the problems of poverty and unemployment are the immediate and most important challenges facing our Nation today. To address these challenges there is need for collective and concerted effort by all Kenyans, working in an enabling environment of peace, stability and national unity, the three guiding principles advocated by our President. I therefore take this opportunity to commend H.E. the President, Hon. Daniel Toroitich arap Moi, for his continued commitment to the on-going reform process of our economy and, in particular, for his mature leadership and statesmanship in seeking solutions to our Nation's and indeed our region's economic and political problems.

Mr. Speaker, I would like to thank my colleagues in the Cabinet and all the Hon. Members of this House, for their support since I assumed the responsibilities in the Treasury. I would like also to pay tribute to my predecessors in the Treasury, for their initiatives and determined efforts to reform our economy in order to initiate sustainable economic development. Finally, Mr. Speaker, my tributes go to all Kenyans for their understanding in those periods our economy has faced difficult times.

I. INTRODUCTION

Mr. Speaker, while preparing the Budget which we table in this House today, we have taken account of the emerging trends in the global economy. The financial crisis that has adversely affected the performance of the economies of many regions of the world since 1997, sparked off a massive flight of capital from emerging markets to developed economies in what has been termed as the *flight to quality*. Net capital inflows declined by 53.4% between 1996 and 1998. Africa suffered a 33% decline in foreign capital inflows, from US$ 4.5 billion in 1997 to US$ 3 billion in 1998. Kenya has also been adversely affected as is evidenced by the reduced activity in the Nairobi

Stock Exchange. Another significant development in the world economy worth noting is the decline in the annual growth of the world trade from 9.2% in 1997 to 4.6% in 1998, leading to a general fall in commodity prices. This in turn had a significant impact on developing countries' export earnings, Kenya included. It is also important to note that prospects for the world economy are not encouraging. The rate of growth of the world economy is projected to decline further in 1999 and the declining trend of capital inflows to developing countries is also expected to continue in the year.

Mr. Speaker, whereas the debate for a new international financial architecture continues with the aim of identifying measures to prevent such massive movements of capital, it is essential that we in Kenya adopt and implement strong measures that will help us to attract and retain capital, and to reduce vulnerability such movements could have on our economy. Moreover, in view of the expected slowdown in the growth of the global economy and reduced capital inflows, it is important that we make better use of our resources and encourage domestic savings.

II. RECENT ECONOMIC DEVELOPMENTS

Mr. Speaker, let me now briefly review performance of our economy in the past year. The economy experienced a further slowdown in growth in 1998. It is estimated that real Gross Domestic Product (GDP) grew by 1.8% compared to a rate of growth of 2.7% expected when we formulated the 1998/99 Budget. Continued slowdown of the economy has been mainly attributed to the persistent slump in, tourism, manufacturing, banking, and in agricultural production. Weaknesses in our infrastructural facilities continued to adversely affect the economy, particularly the manufacturing sector. Besides, the unfavourable weather conditions and fall in world prices of coffee and horticultural products had a major toll on the agricultural sector. New investments were slow in coming as investor confidence remained subdued partly because of the relatively high domestic interest rates. Gross fixed capital formation declined to 16.1% of GDP in 1998, significantly below our target of 24%. Though interest rates generally declined during the year, this came towards the end of the year which was too late to have any impact in the year.

Mr. Speaker, we nonetheless continued to make commendable progress in sustaining a stable macro-economic environment, which is crucial for increased investments to take place. We managed to contain inflation within the single digit range with a gradual depreciation of the shilling exchange rate.

This was as a result of the tight monetary and fiscal policies we implemented in the course of the year. Money supply increased by **3.3%** and the overall fiscal position, including grants, although a small deficit of (0.6%) of GDP, marked a major improvement. Improvements in the fiscal position reflected better revenue performance due to improved tax administration, which partly offset the increased expenditure outlays. In tandem with reduced inflationary pressures and modest government borrowing requirements, lending interest rates on bank loans came down in the year, *though less rapidly than we would have desired.* The depreciation of the shilling exchange rate, which I have referred to, was partly as a result of capital outflows associated with the fall in interest rate on the 91-day Treasury bills, from 26.5% in January 1998 to about 12% in December 1998.

Mr. Speaker, with respect to the external sector, the overall balance of payments recorded a lower surplus of K£228.7 million in 1998 compared to K£336.2 million in 1997. This was due to the worsening of the current account deficit to K£1,225.4 million from K£1,107.9 million in 1997, on account of the sharp drop in export earnings. As a proportion of GDP, exports fell to 16.1% in 1998 from 18.3% in 1997. Imports, as a ratio of GDP, fell from 29.9% in 1997 to 28.5% in 1998, thus helping to stem the widening of the current account deficit. Gross official reserves as at the end of December 1998 were US$783 million, and US$694 million at the end of April 1999, enough to cover 2.6 months worth of imports.

Mr. Speaker, it is important to note that lower economic growth experienced in 1998, has worsened the problems of unemployment and poverty. Given the projected poor performance of the global economy in 1999, and reduced inflows of external resources, we will need to rely more on our own efforts and resources to reinvigorate performance of our economy. It is, therefore, imperative that we prioritize and allocate more of our budgetary resources to those areas that have the greatest impact on economic growth and the welfare of our people. This will no doubt entail making painful sacrifices, including delaying or cancelling less important projects. We will need to rededicate our commitment to sound and sustainable economic policies as the key criteria for resource allocation. We cannot afford to waste the scarce resources available to us, at a time when we need to focus more emphatically on accelerating growth and alleviating poverty. This leads me to a brief account of our policy objectives and strategies.

III. POLICY OBJECTIVES AND STRATEGY

Mr. Speaker, the principal objectives of our economic policy still remain alleviation of poverty and employment generation, in order to improve the lives of all our people. We recognise that to achieve these objectives, it is important that our economy grows at a more rapid rate than the growth of our population. This will be possible only if adequate investments, both local and foreign, are realised. Recognising the importance of the private sector as the engine of growth for our economy, the Government's effort in the 1999/2000 fiscal year, will be directed towards: **first**, improving the investment environment by maintaining a stable macroeconomic environment; **second**, deepening the reform process; **third**, upgrading and rehabilitating the infrastructure; and **fourth**, enhancing regional integration within the COMESA and East African Cooperation framework. We consider this as an appropriate strategy which can help us resuscitate growth and achieve sustained economic and social development. Therefore, the dominant theme of this year's Budget is **Economic Recovery for Sustained Economic and Social Development**.

Mr. Speaker, there has been a tendency in the past to focus on policies and programmes whose benefits are short term at the expense of our long-term development objectives. It is important that we articulate a long-term vision of the Kenya we want to see a generation ahead, and a well structured, consistent and long-term policy perspective that should guide the management of our economic affairs. We have already articulated parts of this vision in a number of policy documents, namely the Sessional Paper No.2 of 1997 on the Industrial Transformation to the year 2020 and more recently the National Poverty Eradication Plan which covers the period 1999-2015. The poverty plan seeks to improve delivery of basic social services to the poorer sections of the population, with particular emphasis on primary education and rural health services.

It is, however, necessary to integrate these initiatives in a comprehensive long-term perspective policy framework that will encompass a wide range of social and economic goals. The Government will initiate the preparation of this treatise during 1999/2000. Furthermore, the Policy Framework for Economic Reform (PFER) covering 1999/2000 - 2001/20002 period has been developed. This framework outlines measures that can effectively translate long term strategies into medium term operational plans for effective implementation. As part of this framework, we will during 1999/2000 embark on the formulation of the first phase of a three year Medium Term

Expenditure Framework (MTEF), which will outline: (i) priorities for allocation of public resources; and (ii) measures for the more effective implementation of policies and expenditure programmes. Once such an integrative framework is established, annual budgets will be formulated within a long-term framework as outlined in the MTEF.

In a significant departure from the past, the Government has, in the three year Framework for Economic Reform selected a few reform areas which we consider critical to the resuscitation of our economy and which we feel we can fully implement. The key policies and reforms emphasized in this programme include: (i) Sustaining macroeconomic stability: This entails ensuring that our expenditure programmes match revenues mobilized during the year to minimize government domestic borrowing. (ii) Improving economic governance, by among other measures, ensuring the Kenya Anti-Corruption Authority becomes operational and effective; strengthening the procurement system and the Office of the Controller and Auditor-General; and improving the judicial system. It is not debatable that efficient and transparent use of public resources, and protecting property rights and enforcing contracts are important to encouraging growth. (iii) Accelerating privatization of public enterprises as well as reforming those retained in the hands of the Government. The key service parastatals earmarked for priority reform during the new fiscal year are the Kenya Telcom Company, Kenya Railways and Kenya Ports Authority. (iv) Downsizing the public service to remove duplications and functional overlaps, including rationalization of ministries and departmental functions: This will release resources for improving efficiency in the delivery of core public services in the social sector, and for operations and maintenance of infrastructure. (v) Increased campaign to educate the public on appropriate methods to prevent contracting HIV/AIDS: This is important for safeguarding lives and ameliorating economic costs of this terrible scourge.

Mr. Speaker, one of the critical factors that has contributed to our economic stagnation and the deepening of poverty has been the decline in productivity in virtually all sectors of our economy. Experience from elsewhere shows that high rates of economic growth have always been the result of significant increases in productivity, nurtured by appropriate government policies. It is therefore important that we identify policies that will enhance productivity particularly in the agricultural, services sector and in small scale enterprises. Enhanced research support for agriculture and industry will therefore be critical elements in our strategy for enhancing the growth process. The policy direction already incorporated in the National

Poverty Eradication Plan to target research and extension services at resource-poor farmers to raise their productivity, is a clear example of this strategy. I also expect that the Commission of Inquiry into our education system to come up with clear recommendations to enhance relevance and quality of our educational services, particularly at the secondary and technical education levels, the effective implementation of which should contribute to enhanced productivity.

Let me, Mr. Speaker, emphasize that the policies in the PFER have been initiated and developed by Kenyans and not by our development partners as some people may be tempted to think. In developing these policies, we consulted closely with key players and stake holders in order to bring everyone on board with the development objectives and to facilitate effective implementation.

IV. SECTORAL REFORMS

Mr. Speaker, what I have presented so far is a broad development strategy which will guide our economic management in the next three years. I would like now to briefly touch on the specific sectoral reforms, consistent with that broad strategy, which we will implement during the fiscal year 1999/2000.

Agriculture

I will first address reforms relating to the agricultural sector. For a number of years now, the sector has performed below its potential, mainly because of low productivity. Over the last two years, the sector registered a growth of 1% per annum, compared with 5% in the period 1993-97. While unfavourable weather conditions have contributed to low productivity in this sector, instability in the major agricultural marketing organizations, the poor state of roads in the agricultural areas, poor crop husbandry, and unfair competition from subsidized agricultural imports, have also had their contribution to the poor performance of this sector.

Mr. Speaker, the sector is the backbone of the Kenyan economy supporting the majority of our population and accounting for a major share of our exports. Therefore, its improved performance is critical to the success of our strategy to eradicate poverty and unemployment. The sector has the potential to grow at more than 4% per annum. To achieve this level of growth, the sector requires high yielding and drought resistant crops, improved husbandry, adequate marketing systems and protection from unfair competition and a more enabling economic environment. It is therefore necessary to undertake reforms within the sector, and also in the supporting sectors such as the finance, the energy, and the road transport sectors.

In the fiscal year 1999/2000, planned reforms specific to the sector include restructuring of the Kenya Tea Development Authority (KTDA) to change its role to a holding company. A Bill to this effect is under discussion and awaiting approval of this House. Also earmarked for restructuring is the dairy sub-sector where the Dairy Act will be amended and the Dairy Board restructured to be a more effective regulator. With regard to the horticultural and floriculture sub-sectors, efforts will be made to encourage self-regulation through such organizations as Fresh Produce Exporters of Kenya and the Flower Council of Kenya to improve product quality and packaging. Given the growing competition, we cannot afford to compromise on product quality. To provide a helping hand to this important sector, duty on cooling equipment, targeted for horticultural purposes, will be reduced. To protect agricultural products from unfair competition, suspended duty on final agricultural imports will be retained.

Access to bank credit by small scale agricultural enterprises has been a major problem. To address this problem, a study to assess the causes and depth of the problem, and to recommend necessary remedial action, is in progress and is planned to be completed by December 1999. In addition, the Government will promote and encourage development of micro-credit providers.

Infrastructure

Mr. Speaker, let me now turn to infrastructure. The poor condition of our infrastructure has continued to constrain economic growth. In the coming financial year, reforms in this area will focus on energy, water, telecommunication services, port services, railway services and road transport.

Energy Sector

Mr. Speaker, let me start with the **energy sector**. Over the last two years, a number of actions have been taken to enhance the supply and reliability of electric power, and to improve efficiency in its delivery. Power generation was separated from its distribution by putting generation under KENGEN, which is now operational. In addition, investments by independent power producers (IPPs) expanded during 1998, resulting in the growth of installed capacity from 802 Mega Watts in 1997 to 863.3 Mega Watts, an increase of 7.6%. While this has improved the supply of electricity, it is still not adequate and reliable enough to match the current demand levels. Therefore, the Government will continue to encourage more investments in power generation and distribution. Our objective is to achieve self-sufficiency in power supply by the year 2002.

During the fiscal year 1999/2000, generation capacity will be enhanced by additional investments in Kipevu II Plant together with the Third Gitaru Plant on Tana River Basin, which are expected to provide an additional 75 MW and 80 MW, respectively. Future plans include Olkaria II and Sondu Miriu, and two additional fast track independent power producing units, of 55 Mega Watts each, in Nakuru and Eldoret. These two IPP units are expected to commence construction in the course of the fiscal year.

Water Sector

With regard to the **water sector**, it is important to note, Mr. Speaker, that currently, water supply is running way below demand, both for industrial and domestic use. Indeed, availability of water is one of the constraints to new investments. The existing public sector institutions handling water facilities have not managed them appropriately, resulting in a decline in both the quality and quantity of water. To address this problem, the Government will take the following measures: (a) amend the Water Act and restructure Ministry of Water Resources in line with the new water policy; and (b) develop criteria for selecting water projects whose management can be transferred to the beneficiaries and/or stakeholders such as local communities and authorities. In addition, the Government will initiate a study for selected major towns to assess the appropriateness of encouraging the private sector to take greater interest and participation in the management, maintenance and operation of water supply.

Telecommunication Services

Mr. Speaker, on **telecommunications services**, poor quality service and high tariffs have been a major concern to all of us. Efforts to reform the sector in 1998 did not succeed as approval of the Telecommunications Bill by this House took longer than was expected. It was also necessary to ensure the operational regulations and network plans were prepared and agreed before the reforms could start. All this has been done and the sector is now set for a major restructuring.

Mr. Speaker, following the approval of the Telecommunications Act in 1998, the KPTC has been split into three entities, namely: the Postal Corporation, Telcom Kenya Ltd, and the Communications Commission of Kenya. To improve its services, Telcom Kenya Ltd has been allowed to seek a strategic partner to take 26% of its share capital. Proceeds of the sale will be ploughed back to finance modernization and expansion of services. This will allow for a rapid increase of functional lines and reduce unit costs. Mr. Speaker, we have also established a national node for the internet, popularly known as Jambo-net, which has opened the country to electronic commerce and other data communications through the website. These changes will help improve the quality of service to the benefit of both household and business consumers.

To encourage effective competition, the country has been divided into several regions, each of which will be opened to local network operators to compete with Telkom Kenya. This will be done in an orderly manner to ensure smooth communication between the networks and consumers, operating in different regions. The necessary legal framework has been put in place to provide for modalities for interconnections, toll switches, and pricing.

Mr. Speaker, cellular telephone service has been inadequate and expensive. To address the large demand and reduce the costs, a new service provider, Safaricom, a joint venture between Telcom Kenya Ltd and Vodafone, the latter being a leading cellular provider, has already been established and will start operating by the end of this month. Safaricom has a rollout network of 50,000 lines with a bouquet of services including, telephone, fax and message receiving facilities. Safaricom will also provide fixed cellular services through wireless public telephone booths. In addition, the tender process for the second cellular provider is already in process, and licensing will be completed in the course of the year. These changes are expected to generate substantial investments in the country and help generate growth and employment.

Port Services

Mr. Speaker, as regards port services, performance of Mombasa Port has been below expectation of many investors. To restore efficiency and competitiveness of our ports, and to retain and expand their market share, for the benefit of all stakeholders, the Government has decided to offer concessions for the container terminals, inland container depots and general cargo berths so that the Kenya Ports Authority (KPA) remains a landlord only. In addition, the Government has decided to allow the private sector to develop and operate similar facilities next to the current facilities in Mombasa. Some of these policy actions are already at the tender evaluation stage.

Railway Transport

Mr. Speaker, on railway transport, continued deterioration of the financial position of Kenya Railway and its poor service delivery continue to worry all of us. To enhance the competitiveness of our goods and services and maintain the competitiveness of the Northern transport corridor against alternative corridors, Kenya needs an efficient railway system. Mr. Speaker, in its current form, Kenya Railways cannot efficiently deliver its services. To address this problem and improve its financial performance, the Government has opted for an operational and management contract as a fast track to restore the railway system to viability, and to prepare it for concessioning.

Road Transport

Mr. Speaker, road transport is the most important mode of transport in the country. However, our road network has suffered substantial degradation as a result of poor workmanship and lack of well planned maintenance programmes. The condition of the network was worsened by the *El Nino* rains which caused considerable damage last year. Since then, efforts have been made to rehabilitate it, but with limited success. The *El Nino* Project, one of such efforts, experienced some teething problems at the beginning. However, it is now ready for take off and contracts have been approved for several roads in Nairobi, Voi, Mombasa, Garissa, Kisumu, and Malindi. A number of donors have expressed interest to support this rehabilitation, including the Roads 2000 and other access road projects.

To speed up rehabilitation of roads financed under the Road Maintenance Levy Fund, the level of funding has been increased from Kshs.6.3 billion in 1998/99 to Kshs.7.7 billion in fiscal year 1999/2000. Out of this amount, classified roads will receive Kshs.6.1 billion while the balance of Kshs.1.6 billion will go to roads under the local authorities. To improve operational procedures for contracting and achieving greater accountability, new rules have been published today which govern the management of the Fund. As regards the Mombasa-Nairobi Road, rehabilitation work has been

done on some sections under both the fuel levy fund and donor assistance. For those sections that require complete reconstruction, preparatory work is continuing, with construction scheduled to start later in the year. Rehabilitation of other urban roads will be undertaken under the Kenya Urban Transport Investment Project (KUTIP). All these efforts are intended to restore the quality of our road network. In the course of the fiscal year, the Government will finalize the establishment of the Kenya Roads Board.

Mr. Speaker, while still on road transport, I wish to touch on the issue of road safety. This problem continues to worry many Kenyans as the quality of the vehicles plying our roads deteriorate endangering lives and the quality of our environment. To improve safety, we need to maintain a reasonable balance between the quality of the fleet and a safe environment. While the compulsory Third Party Insurance was expected to improve road safety, this has not worked due to incidents of fake insurance certificates and lack of linkage between the quality of the vehicle and the insurance. To correct this situation, the Government, through the Ministry of Transport and Communication, will increase the capacity and quality of motor vehicle inspection by involving competent private sector organizations. It will also provide more effective linkage between the compulsory third party insurance and the quality of the vehicles through a prescribed mode of inspection. In the course of the year, the Ministry will gazette the requirements for facilities and qualifications of enterprises which may be considered and approved as vehicle inspectors.

Tourism

Mr. Speaker, I will now address myself to tourism. As Hon. Members are aware, performance of this sector deteriorated further in 1998 compared to 1997. Arrivals fell by 10.6% and bed occupancy by 42.7% due to negative publicity overseas, poor physical infrastructure, especially roads, and insecurity. The situation was particularly bad along the Coastal tourist hub. This has resulted in many tourist enterprises reducing their staff. To reverse this trend, our focus in 1999/2000 will be on promotion of tourism. To facilitate this, at least 50% of the Catering Training and Tourism Development Levy revenues should be spent on promotion. In addition, the Government will continue to improve security not only in the tourist hubs but also in the other areas. The efforts and resources directed to road rehabilitation and improvement will provide an impetus to the tourism sector. We also appeal to the private sector, especially the Kenya Tourism Board and the Kenya Tourism Federation, to focus private sector marketing efforts on areas of

greatest impact to the sector. They also need to give more emphasis on domestic tourism to supplement foreign tourism, especially during the low season. To complement these efforts, VAT on hotel and restaurant services and the Catering Training and Tourism Development Levy will be restructured to be more enabling to the industry. Finally, in view of the bad state of this important sector, the Government has suspended visa fees for visitors who stay for upto 30 days.

Environment

Mr. Speaker, as we consolidate our economic reforms, it is necessary to ensure the resulting developments do not impact negatively on the environment. In this connection, the Government has published the Environmental Management and Co-ordination Bills, 1999 which, in due course, will be tabled for debate and approval by this House. The Bill aims at establishing: (a) legal and institutional framework for the management of the environment and (b) the legal and administrative mechanisms for co-ordinating various sectoral environmental initiatives. This will also enable us to comply with our commitments under Agenda 21 of the Rio Earth Summit, among others. It will also help us create capacity for home driven institutional capacity necessary to achieve sustainable environment.

Manufacturing

Mr. Speaker, manufacturing contributes significantly to our gross domestic product. In 1998, the manufacturing sector growth dropped to 1.4% from 1.9% in 1997. While the poor state of road infrastructure, power supply shortages and high cost of credit adversely affected the sector, increased competition, both in local and regional markets, has worsened the situation. Also aggravating the situation is unfair competition from substandard imports that have come into the country.

This sector has great potential for generating employment and has a crucial role to play in our poverty alleviation strategy. However, it cannot recover without a supportive environment that includes consumer loyalty. Kenyans must appreciate that every time they opt for imported goods, they export jobs while keeping our labour force idle. Consequently, if we want to retain jobs in Kenya, we must consume more of Kenyan made goods. We must also redouble our efforts to regain and increase exports. To support the recovery of this sector, the Government will take the following measures: (i) disallow goods declared to be substandard, by the Kenya Bureau of

Standards, or unfit on health grounds, from entering the country; (ii) limit the period which traders can be allowed to keep goods in transit or goods destined for bonded warehouses within the port to prevent such goods being diverted into the local market without payment of duties and taxes; (iii) take appropriate retaliatory measures, within the provisions of our international commitments, on any country that uses unfair or restrictive practices to hinder entry of Kenyan exports into that country. These measures are intended to complement measures taken to improve service delivery by our public entities.

V. PUBLIC SECTOR REFORM

Central Government Reforms

Mr Speaker, it is now well recognized that there is an urgent need to reform the public sector, both at the central and the local governments levels. The Government currently spends close to 30% of GDP, which is a very large proportion considering our low income levels. Moreover, the productivity of the public sector has been below our expectation. Therefore, our strategy for rapid economic growth and poverty alleviation will critically depend on the improvements in the quality and productivity of the public sector. Private sector investment and business activity, the prime mover of growth, need the support of adequate infrastructure and efficient public services. Moreover, enhanced efficiency of the public sector will facilitate reduction of taxes and release resources for productive investments. It is for these reasons that the public sector reforms will be the centre piece of our medium term policy framework and development strategy.

The rationalisation of ministries and government departments, which is part of the second phase of the Civil Service Reform Programme, will be finalised in 1999/2000. To facilitate this exercise, guidelines have been released to all ministries on core functions, and on modalities for staff reductions and right sizing in the civil and teachers' services. In addition, pension reforms have been initiated on vesting and deferment for officers who either voluntarily quit or are compulsorily retrenched or dismissed before the age of fifty. These changes will introduce greater flexibility and equity into civil service employment conditions. In subsequent years, further reforms are planned to improve the benefit structure, and to introduce full funding of the public pension scheme.

Local Government Reforms

Mr Speaker, local authorities provide services such as roads, water supply, sewerage, and waste disposal which are essential to the economy. However, these levels of government have been unable to provide these services effectively. To strengthen local authorities, the Government will take a number of measures. **First,** the share of funds allocated to local authorities under the Road Maintenance Levy Fund will be increased by 33% to supplement their efforts in maintaining and rehabilitating roads under their jurisdictions. Out of this amount, over Ksh.300 million will be allocated to support routine maintenance activities in line with the Kenya Urban Transport Infrastructure Project (KUTIP). This component will be expanded to other local authorities as funding increases. The criteria for allocating funds to the local authorities will be published soon while new contracting rules have been published today that seek to ensure Kenyans receive value for money used in road maintenance under this Fund.

Second, the simplified business licensing system, that was approved last year, will be implemented in full by 1st January 2000, when all local authorities will be required to issue a Single Business Permit. Already, thirty local authorities have implemented the new licensing system, effective from January 1999. Their revenue collections have improved significantly, benefitting from the well organized business registers and simple, but effective collection modalities. New financial management information systems have been successfully piloted in selected authorities to support their revenue collection systems and will be extended to cover all local authorities over the coming years.

Third, the Local Authority Transfer Fund Act will come into effect on 1st July, 1999 and the first quarterly disbursements will be made in January 2000. The Fund will receive 2% of the income tax collections in its first year, estimated at Ksh. 1.2 billion, but in subsequent years, the contribution rate will rise to 5%. The initial contribution rate has been scaled down, firstly, because of a substantial slow down in revenue growth due to poor economic performance; and secondly, because of the expected delay in disbursement for the first year as authorities develop capacity and modalities to absorb these resources. Regulations for operation of the Fund and its Advisory Committee will be published shortly. The Fund will have two major accounts, a service delivery account which will receive a minimum of 60% of the contributions, and a performance account to receive the balance. Funds will be allocated across local authorities based on population, but adjustments will be made to:

(i) provide a minimum transfer amount; (ii) reflect the higher service delivery demand for urban areas; and (iii) to provide higher transfers for authorities in districts with the highest poverty levels as measured by objective poverty indices. These criteria will result in the Local Authority Transfer Fund becoming an important instrument in the Poverty Alleviation Programme. To qualify for these resources, a local authority will be required to: (a) allocate 50% of its own resources to infrastructural investments and service delivery; (b) maintain and produce audited basic accounts; (c) make all current year statutory payments; and (d) make arrangements to clear, within five years, debts relating to statutory payments and arrears of guaranteed loans. The performance account will provide incentives for local authorities to achieve basic levels of improvement in financial management. The amounts available for disbursement to each local authority will be published in a timely fashion to allow local authorities to adjust their budget estimates accordingly.

Fourth, the existing Local Authority Service Charge will be phased out. Effective 1st January 2000, fees payable by businesses will be cancelled. However, the payroll tax component will be retained for one year and cancelled from 1st January 2001.

Mr Speaker, with these broad-based reforms, the landscape of the local authorities should change to serve Wananchi better. However, the local authorities must ensure that the substantial resources being released to them by the Central Government are fully accounted for and used for the specific purposes for which they are intended. Mr. Speaker, with these reforms, we do not see why Nairobi City, in particular, cannot restore its esteemed status of a **Green City in the Sun** which it acquired in 1950.

Improving Economic Governance

Mr. Speaker, good economic governance, defined simply as better and transparent management of public resources, is, as I mentioned earlier, essential for the realization of growth and poverty reduction objectives. Lack of good governance, and in particular corruption, distorts resource allocation, thereby inhibiting growth. For investors, corruption constitutes an additional tax that leads to higher costs of operating their businesses. For these reasons, the Government is determined to make corruption intolerable in order to improve the quality of public expenditure and delivery of public goods and services.

Mr. Speaker, Hon. Members have frequently called upon the Government to take effective follow up action on instances of misuse of public financial resources reported by the Public Accounts and Public Investment Committees of Parliament. In this regard, effective from 1st July, 1999, I am establishing an adequately staffed Follow Up Unit in the Ministry of Finance, directly under the Permanent Secretary, which will be responsible for continuous liaison with the relevant Accounting Officers to ensure that effective punitive actions are initiated in all such cases. Working closely with the Accounting Officers, and the Office of the Attorney General, this Unit will also publish quarterly reports on actions initiated.

Mr. Speaker, as Hon. Members are aware, the Ministry of Finance is already publishing Quarterly Budget Reviews, covering all fiscal developments in the quarter, such as the actual realization of revenues, expenditures incurred, and details of foreign and domestic debt servicing. To further enhance transparency and accountability, all Ministries and Departments will, with effect from the financial year 1999/2000, publish, on a half yearly basis, performance and financial reports showing expenditures incurred, and services or programmes implemented compared to their physical targets. These reports will also indicate in brief details the scope and value of the contracts awarded, the company or the persons awarded, and the time limit for execution. Such reports will be widely circulated, and copies made available to Members of Parliament.

Mr. Speaker, the Tender Boards have already been strengthened and reconstituted with a view to improve the quality of adjudication of tenders to ensure the Government realizes full value for its money. The Treasury is also revising the Procurement Procedures and the Tendering System with a view to making them transparent and fool proof and to enhance competition in the supply of goods and services to the public sector.

Mr. Speaker, the government ministries have over the past years accumulated substantial pending bills. I will explain later the action I propose to take to settle these debts. To avoid the recurrence of pending bills, measures will be put in place to control expenditures and commitments, strictly within the limits approved by Parliament. In this connection, the Government has now approved the new scheme of service for Finance Officers in all Ministries and Departments and the creation of the posts of Chief Finance Officers at a sufficiently senior job group for each vote. This measure will be operational during the first quarter of 1999/2000 and will assist in the professionalization of financial management in all Ministries for better control of expenditures and commitments. In addition, a review of the Office of the Controller and Auditor General will be conducted in the year with a view to strengthening its operations and effectiveness. We are also strengthening government accounting systems by computerizing all financial operations in the Government.

To improve the quality of debate in Parliament, the Government will provide office accommodation and library facilities for Members of Parliament.

Mr. Speaker, improvement in the administration of justice which is an aspect of good governance, is an important part of our development agenda. With this in mind, the Government recently appointed Commissioners of Assizes to help clear the backlog of cases pending in courts. Arrangements are also in place to computerise operations of the Judiciary in order to improve delivery of judicial services.

Regional Cooperation

Mr. Speaker, in a globalized market economy, countries need bigger markets to attract adequate investments, both local and foreign. Therefore, we have accepted the principle of regional markets and are fully committed to expand and make the East Africa Cooperation, the COMESA and IGADD successful vehicles of our economic development. We will cooperate with our partners to harmonize policies and strategies in accordance with our commitments with these bodies. In so doing, we will seek to ensure there are fair and transparent trading practices.

Under the E.A. Cooperation, our commitments include the need to harmonize: (i) fiscal and monetary policies, as well as laws and procedures relating to licensing and supervision of banks; and (ii) infrastructural development to ensure smooth communications within the region. Indeed, some of the proposals presented today, are in fulfillment of some of our commitments. As was recently categorically stated by H.E. the President, we are fully committed to elimination of tariff barriers and also subscribe to a common external tariff, both for E.A. Co-operation and COMESA.

Towards this end, we will seek to harmonize investment rules, tax exemptions and incentives in order to promote East Africa as a common investment area. Last month, we reduced our tariffs on imports from COMESA countries to only 10% of their regular rates. This harmonization will require us to promote institutions which will bind us together. These include a mechanism for settling disputes to ensure compliance with agreed decisions and policies by all member states. We must also pay special attention to areas of divergence which can create strains in our common endeavour.

Millennium Bug

Mr. Speaker, I have so far in my Speech focused on economic matters which we need to attend to. But, as Hon. Members are aware, we are about to cross into the Next Millennium, which offers many challenges and opportunities, especially in the area of information technology. The major challenge to overcome is the so called **millennium bug or the Year 2000 (Y2K) compliance problem.** The problem is real and failure to comply can be disastrous to many business operations and the economy as a whole. Every one of us must therefore appreciate and accept that the 31st December, 1999 deadline for this compliance is absolute and is not subject to extension. We should not take any chances with it. All enterprises using computer based information systems must meet the deadline.

Mr. Speaker, in recognition of the importance of being Y2K compliant, the Government in 1998 established a National Steering Committee, composed of members from the public and the private sectors, to coordinate and advise on appropriate actions needed to overcome this problem. The Government has also issued regulations, requiring all computers imported into Kenya to be Y2K compliant.

Mr. Speaker, I am happy to report to this House that we have made good progress to be compliant in all key sectors including banking, energy, health, civil aviation, revenue administration and in Government.

VI. FISCAL POLICY

Mr. Speaker, I now turn to Fiscal Policy. Our strategy to alleviate poverty and unemployment will critically depend on the quality of taxation and expenditure policies which we implement in the medium term. Sound fiscal and financial policies are also crucial to Kenya's ability to withstand negative effects of global financial and economic crises. Therefore, the objective of fiscal policy in the medium term is to keep public expenditure in line with public revenues so as to eventually achieve a surplus and begin to repay the large stock of domestic debt. This is important if we are to sustain low interest rates and also the growth momentum.

Mr. Speaker, in the coming fiscal year, we plan to continue to maintain a tight fiscal stance. In line with this, domestic borrowing will be reduced to the minimum, in order to reduce pressure in the domestic money markets and on interest rates.

Taxation Policies

Mr. Speaker, to achieve our fiscal objectives, we will need to deepen reforms in tax policy and administration to maximize revenue receipts. So far, we have made significant achievements in restructuring the tax system in the last few years, reducing levels of the duty and tax rates. This process has gone hand in hand with improved revenue administration, which has in the last years enabled us to realize revenue targets even as economic activity declined. We will continue with the reforms to reduce the tax burden on those already in the tax net. KRA on its part, is modernizing its information technology in order to improve further tax administration and combat tax evasion. As part of this effort, KRA will introduce in 1999/2000 Electronic Data Interchange on inward international trade.

Mr. Speaker, in the tax proposals laid before the House today, modest tax reductions have been made both in VAT and the income tax. As will be recalled, in the past, the combined effect of VAT and Catering Training and Tourism Development Levy, imposed heavier burden on tourism than the other services. This has now been rationalized for greater equity. Furthermore, in light of the difficulties facing local producers, we do not propose any tariff reductions except for a few selected items involving raw materials and intermediate goods. This position will be reviewed as and when the economies of our major trading partners strengthen. For agricultural produce, we have noted with concern the tendency for some local traders to continue importing farm produce, which are abundantly available locally. Such imports have hurt our farmers unnecessarily. Accordingly, duties on these items have been reviewed and adjusted upwards.

Mr. Speaker, requests for duty and tax waivers take too much time of our staff in the Treasury and the KRA. Although the tax laws provide for some exemptions to charitable organizations, a very unhealthy trend has emerged. Many of these organizations are now writing to the Minister stating clearly that goods, especially vehicles, are donated on condition that the

Government will waive duties and taxes. We find this practice unacceptable. Those who donate goods must do so genuinely and purchase their donations on duty and tax paid basis.

We have also had instances when NGOs have submitted fake donation certificates purporting the goods to have been donated from outside the country. We have checked some of these donations and found the external donors do not exist. The KRA, working with appropriate organizations, has intensified its intelligence gathering system to counter-check information given by importers, particularly where the goods appear suspicious. I wish to emphasize that where the donations are found to be fake, all duties and taxes payable and penalties will be demanded, not withstanding prior authority to exempt them.

Expenditure Policies

Mr. Speaker, let me turn to the expenditure programme for 1999/2000 fiscal year. Our key priorities include: (a) upgrading and rehabilitating of economic infrastructure, particularly the road network and power supply; (b) improved provision for basic social services such as education, health and water; (c) improved security and administration of justice; and (d) targeted poverty alleviation programmes.

Mr. Speaker, to ensure better utilization of available financial resources and promote growth, the Government will give priority to completion of on-going projects, particularly those that are at advanced stage of implementation. Special attention will be given to a selected number of housing projects earmarked for police and prison departments in order to improve housing for these essential services.

Mr. Speaker, consistent with the poverty eradication plan, targeted budgetary allocations have been provided to improve access and retention of children from poor families in primary and secondary schools. Similarly, increased funding has been made for purchase of school equipment and feeding programmes. More specifically, in the recurrent budget, Kshs.924 million has been provided to finance supply of school equipment, school feeding programme, and bursaries for poor children. For rural health services, funding has been increased from Kshs.1.55 billion in 1998/99 to Kshs.1.80 billion in the fiscal year 1999/2000. Additionally, Kshs.735 million has been provided for improvements of rural water supply. Besides Kshs.32.6 million has been availed under the Office of the President, for the establishment of the **Poverty Eradication Unit** that will coordinate poverty related activities.

Mr. Speaker, to institutionalize the fight against poverty, the Government will establish the Anti-Poverty Trust Fund with an initial capital of Shs.20 million. In addition, the Government will establish fifteen demonstration projects across the country. These projects will be implemented under the supervision of the Poverty Eradication Commission which will ensure they conform with geographical and the sectoral priorities according to the Plan. The Commission will seek to establish appropriate linkages and support from other partners. Other donor supported initiatives which will benefit the poor, include Kshs.3.39 billion for improvement of rural health services, family planning, aids control, supply of medical equipment and water supply enhancing projects.

To improve project completion at district level, the Government has increased the amount of financial resources available to the District Treasuries. However, to ensure prudent financial management and avoid diversion of project funds, accounting procedures will be restructured and expenditure monitoring and reporting systems strengthened.

Mr. Speaker, the *Jua Kali* sector has and continues to play a significant role in our economy and has become the main source of employment for many Kenyans. As part of the strategy to fight poverty, the Government will seek to create a conducive environment to promote *Jua Kali* as a source of productive employment opportunities in order to improve incomes of the poor. To achieve this, we need to remove obstructive regulations which hinder growth of informal businesses where the poor are concentrated. Consequently, reforms at the local authority level are already under way to improve the regulatory and licensing environment, and to strengthen performance in delivery of services.

Pending Bills

Mr. Speaker, as I informed the House two months ago, ministries and government departments have accumulated pending bills amounting to about Kshs.14 billion. Delays in payment of this amount has not only hurt those who provided services to the Government, but also the banks which granted such businesses financing facilities. Besides, failure to pay on time encourages providers of goods and services to load risk premiums which inflate costs of government projects. Consequently, the Government commissioned a Task

Force, in 1998, to scrutinize and validate the stock of pending bills and advise on the way forward.

Mr. Speaker, based on the Task Force Report, the Government intends to settle by cash payment those bills which are less than Kshs.1 million. For larger debts, the Government will issue to the creditors special Treasury Bonds which can be traded in the financial market. While securitization of pending bills will increase the stock of domestic debt, it is prudent to settle the debts in order to help the affected enterprises regain financial viability. As regards debts owed to utility providers, namely, KPT&C and KPLC, I am happy to inform the House that debts amounting to Shs.5.65 billion, have been offset against some of the claims the Government had against these Corporations.

In future, it will be necessary to ensure the Government does not accumulate any pending bills. Consequently, all ministries must operate within the budget approved by Parliament. The tendency to spend more than available resources hurts the economy by:- (i) pushing interest rates upwards, thus making credit expensive; (ii) attracting short-term capital inflows that lead to currency appreciation and volatility; and (iii) crowding out the private sector. These factors are detrimental to long term investment and growth. The Government should only borrow when necessary and use such funds to finance productive investments that play a catalytic role to economic growth and development. For now, the Government needs to start repaying the current stock of short-term debt, in order to generate growth. As for external debt, the Government should only contract concessionary debt.

VII. MONETARY POLICY AND FINANCIAL SECTOR REFORMS

Monetary Policy

Mr. Speaker, let me now address Monetary Policy and Financial Sector Reforms. Monetary policy during the financial year will aim at achieving price stability with sustainable growth. In this context, the underlying inflation will be contained at the single digit, preferably at about 5%. To achieve this, growth of money supply will be limited to 10% in the year. The Central Bank will actively use open market operations to contain expansion in money supply. Concomitantly, credit expansion is expected to increase by no more than 8% in the year. Consistent with these objectives, the Central Bank will, in the year, seek to maintain foreign exchange reserves at about three months of import cover.

Financial Sector Reforms

Mr. Speaker, Hon. Members will agree with me that the role of financial institutions in promoting economic development cannot be over emphasized. However, for them to effectively play this role, it is important that they are managed prudently and efficiently. Recent bank failures have caused real concern to the Government as they threaten the sector's ability to mobilize financial resources that we need to achieve the desired growth, generate employment and alleviate poverty. It is therefore necessary to take further institutional and regulatory reforms to improve the soundness of this sector.

To further strengthen the financial sector, I have laid before the House amendments to the Banking Act which seek to enhance the Central Bank's capacity to supervise banks and enforce prudential standards in conformity with the internationally agreed practices. The amendments provide for: raising the gearing ratio from 7.5% to 8%; tightening lending limits, particularly lending to insiders and single borrowers; and raising the paid up capital required to start a new bank. The Central Bank will also intensify its on-and off-site inspection and surveillance, while the number of judges to deal with commercial cases will be increased. Other proposals in the Banking Act seek to harmonize prudential regulations within our region in the spirit of the East African Co-operation. They also seek to allow: (i) voluntary liquidation of solvent institutions; and (ii) banks under statutory management to offset deposits against loans held by one person in the same bank. In the course of the year, the Banking Act will be amended to allow establishment and sharing of information with a sectoral credit reference bureau operated by the Kenya Bankers Association. Similarly, consultations are in progress to amend the appropriate law to make issuing of bouncing cheques a criminal offence in order to reduce cash transactions, a practice which is not only risky, but out of date.

As Hon. Members are aware, traditionally building societies focus primarily on mobilizing deposits for mortgage finance. These societies have emerged as alternative avenues of financial intermediation akin to commercial banks. However, currently these institutions are not effectively supervised, which puts at risk the depositors' moneys placed with them. Changing financial circumstances require they be properly operated to avoid contagion effects in case of problems. To ensure these institutions are properly managed, with adequate risk assessment and proper credit administration along sound banking principles, various amendments are proposed under the

Building Societies Act as well as under the Mortgage Companies Act. These will provide for key prudential ratios and also give the Central Bank legal authority to supervise building societies.

As regards the capital markets, dealers who are the market makers, will be encouraged to enter the market in order to reduce market fluctuations in the Nairobi Stock Exchange. To achieve this, the Capital Markets Authority will, by the end of this year, publish guidelines on the licensing of dealers.

Mr. Speaker, a healthy insurance industry is a necessary component of the financial sector. Consequently, amendments are proposed to the Insurance Act to raise the minimum paid up share capital for: (i) brokers to Ksh 1 million; (ii) life insurance businesses to Ksh 50 million; and (iii) general insurance business to Ksh 100 million. Existing companies will have 3 years, from June 10, 1999, within which to comply with these changes. To save costs of providing guarantees by brokers, it is proposed the Commissioner of Insurance accepts long term government securities as an alternative to bank guarantees. To prevent unnecessary risks to insuring public, insurance agents will be required to pay the policy premiums to the insurers before commencement of the cover. To enhance proficiency in the insurance industry, investigators, like agents, will be required to pass an examination in insurance law and practice.

Mr. Speaker, we have noted incidents of external reinsurance companies flying in for a couple of days to solicit business and fly out with deals after a few days, a practice that needs to be discouraged. We will therefore consult with the industry with a view to requiring all companies seeking to conduct reinsurance business to be locally incorporated. Finally, I continue to receive requests to raise the limit on transfers of surpluses from the long term funds. While I have some sympathy on insurers with non-participating policies, I am advised such an increase could hurt businesses with participating policies and would be detrimental to the industry. To address this matter, I will request the Insurance Advisory Board to consider the subject and advise on the best way of separating long term businesses between participating and non-participating policies to allow greater access to surpluses on non-participating business.

Mr. Speaker, while still on the financial sector, let me touch on **micro-financing** which we feel should be promoted more rigorously because it is well suited for informal or small-scale and *Jua Kali* businesses. As Hon. Members are aware, small scale enterprises receive inadequate attention from the formal banking sector which perceives them as high risk borrowers. Given the role the small scale enterprises can play in the fight against poverty, there is need to improve their access to credit. To meet these objectives, the Government, in conjunction with the Central Bank, will endeavour to improve the environment for micro-finance institutions. As a start, the Central Bank will: (a) establish a unit, within its Banking Department, to monitor operations of micro-finance institutions and to assist them in their development; (b) encourage micro-finance institutions to co-ordinate their operations and co-operate with the formal banking sector; (c) assist the newly formed Association of Micro-Finance Institutions (AMFI) to streamline their legal and regulatory framework as well as accounting procedures.

Mr. Speaker, I have explained the institutional and legal changes which we are to implement in the year to improve the soundness of our banking industry. It is however important to emphasize that a sound financial sector needs more than appropriate laws. Those entrusted to manage banks must be honest and public-minded people. Banks must ensure good management systems are in place not because the Central Bank is looking over their shoulders but because they believe in doing what is right.

Mr. Speaker, it is equally important that we, as borrowers, change our attitudes and moral values. While the recent slack in economic activity may have made it difficult for some borrowers to honour their financial obligations, we must do our very best to repay our loans. The significant proportion of non-performing loan portfolio of banks is a real concern and has somewhat contributed to liquidity problems for some banks. I wish to appeal to all Kenyans that as we strive to develop business through borrowing, let us do it in a manner that does not jeopardise the stability of our financial sector.

VIII FINANCIAL OUT-TURN FOR 1998/99

Revenues

Mr. Speaker, let me now briefly review the financial outturn for 1998/99 fiscal year. As I indicated earlier, the rate of economic growth was much lower than we expected when the Budget was formulated. Consequently, ordinary revenues are now estimated to be 1.5% below the target. Originally, ordinary revenues were estimated at **K£8,659.2 million** plus Appropriations-in-Aid (A-in-A) of **K£769.7 million**, making a total of **K£9,428.9 million**. I now expect a total of **K£8,527.7 million** in ordinary revenues and **K£1,135.4 million** in A-in-A, including K£282.6 million from settlement of mutual debts. Arising from lower profits, income tax will have a shortfall of K£117.5 million, which is made up of a fall of K£199.7 million in other income tax and an increase of K£82.2 million from PAYE. From the other major taxes, I expect over-performance by K£100.8 million, composed of K£53 million excess in import duties, K£45.7 million from VAT and K£2.1 million from excise duties. This is as a result of improved revenue administration by the Kenya Revenue Authority. From other revenues, I expect a shortfall of K£136.4 million arising from declines in investment income of K£53.4 million and K£83.0 million in revenue from other minor sources.

Recurrent Expenditures

Mr Speaker, the expenditures for the year had to be adjusted to, accommodate, the need for Exchequer intervention to ameliorate the crisis in the banking industry, accommodate interest payments on past overdrafts with the Central Bank of Kenya, and other additional expenditures, all of which were detailed in Supplementary Estimates recently approved by this House. As a result, total expenditures, for the year have increased by 5.3%. Initially, the net recurrent expenditures for the year were projected at K£5,106.9 million, plus Appropriations-in-Aid of K£639.7 million. Consolidated fund services (CFS) were to take K£2,120.7, bringing the total recurrent expenditure to K£7,867.3 million. The Supplementary Appropriation Bill recently approved by this House, includes additional recurrent expenditure amounting to K£217.1 million, of which, K£54 million was reallocated from the already approved recurrent budget leaving a net increase of K£163.1 million.

Consolidated fund services payments will increase from K£2,120.7 million to about K£2,305 million, reflecting an additional K£184.3 million over the Printed Estimates.

Development Expenditures

Mr Speaker, Printed Estimates for 1998/99 projected gross development expenditure of K£1,913.7 million, including Appropriation-in-Aid of K£1,347.6million. I now expect these estimates to increase by K£213 million to finance supplementary expenditures for the year. Out of this sum, K£44.4 million was reallocated from the already approved provisions, leaving a balance of K£168.6 million over the net development issues in the Printed Estimates of K£565.7 million. In addition, I have to finance excess votes for

1993/94 and 1994/95 amounting to K£73.5 million, which form part of the overdraft with the Central Bank as of 31st December,1997.

The cumulative effect of these developments will be to increase domestic borrowing requirement in 1998/99 to **1.5%** percent of the GDP compared to the original target of a balanced budget. However, including an expenditure of K£421.5 million carried forward from the previous year, the budget deficit for 1998/99 will be 2.6% of the GDP.

IX. FORECAST OUT-TURN FOR 1999/2000

Mr. Speaker, let me now turn to the 1999/2000 Budget, and I begin with recurrent expenditure.

Recurrent Expenditure

As Hon. Members have already noted from their copies of Printed Estimates, gross recurrent expenditures for 1999/2000 will be K£8,154.4 million. This includes Appropriation-in-Aid of K£750.9 million. Payments for the Consolidated Fund Services will take K£1,823.1 million, leaving K£6,331.4 million to be provided for gross recurrent expenditures of Ministries. The CFS payments includes, K£991 million for domestic interest; K£457.6 million for foreign interest; K£86 million for guaranteed loans; and K£288.5 million for pensions, salaries and contributions to international organizations. In addition, I have to finance external redemptions amounting to K£1,607.6 million and domestic redemption of K£2,445.2 million. Total recurrent expenditure will therefore amount to K£12,207.1 million.

Development Expenditure

Mr Speaker, turning to Development Expenditure, gross development expenditures amount to K£2,706.1 million, including K£1,932.3 million financed by Appropriations-in-Aid. These includes direct project financing of K£752.6 million in loans and K£483.4 million in grants. I will also realize K£526.9 million as the A-in-A proceeds from the Special Treasury Bonds to be issued for settlement of pending bills. Thus, I will have to finance a net development expenditure of K£773.7 million during the year. I shall now briefly go into how I propose to finance these expenditures.

External Financing

Mr. Speaker, turning to External Financing, I do not intend to factor any programme finance for budget support during the Fiscal Year 1999/2000. Should any such finances become available. I will use it to reduce the domestic debt. However, I expect to receive project grants worth K£582.3 million from both multilateral and bilateral sources to finance the development budget, and project loans amounting to K£1,124.5 million. In total, I expect K£1,706.8 million from external sources. External loan redemption payments, however, are expected to exceed disbursements by K£483 million which will have to be financed by domestic borrowing.

Internal Revenue

Mr. Speaker, addressing internal revenue, during the fiscal year 1999/2000, I expect the economy to grow by about 2.5 to 3%. Based on this and at the current rates of tax, I would expect to raise K£8,968.7 million in ordinary revenues and K£1,326.8 in A in A. However, given the current state of economy and the need to restructure the tax system, I now plan to raise K£8,730.2 million in ordinary revenue and K£1,447.3 in A-in-A. This will reduce the overall tax burden by some K£118.1 million. I expect to receive K£ 75 million from privatisation which will reduce the domestic borrowing requirement to K£608 million or 1.5% of the gross domestic product. The rest of my speech outlines the tax measures I intend to take to achieve these results.

Taxation Proposals

Mr Speaker, before turning to the detailed taxation proposals, a few introductory remarks are appropriate. First, I wish to reiterate that restarting economic growth to create jobs and alleviate poverty, remains our priority. Consequently, reduction of tax rates, and selective protection of domestic industry, are the key changes presented to the House today as incentives to the private sector. Overall, the tax ratio will be brought down close to 24% of GDP compared with 25.4% in 1998/99 fiscal year when mutual debt settlement and pending bill A-in-A are excluded. This will leave room for the private sector to grow while the public sector will make every effort to nurture that growth.

Second, the Kenya Revenue Authority has performed well, and achieved the revenue targets over the past year, despite difficult economic circumstances. I therefore propose to assign to the KRA the responsibility to collect the Catering Training and Tourism Development Levy, Betting and Casino Taxes, and Stamp Duties. I expect this change to result in increased revenue yields at lower costs. Funds collected under the Catering Training and Development Levy will be paid direct to the Trustees.

Third, Kenya needs to adjust her taxation in accordance with our international and regional commitments, such as COMESA and E.A. Co-operation, which accord Kenyan goods access to a larger market. Indeed, harmonization of tax policies has increasingly become a requirement in order to gain the benefits of trade from economic integration and co-operation.

Taxation Measures

Mr. Speaker, in keeping with tradition, I now request the rest of my Speech be regarded as a Notice of a Motion to be moved before the Committee of Ways and Means. First, I will deal with changes that have no direct revenue implications.

Customs and Excise Duty Measures

First, we are proposing various amendments under the Customs and Excise Act in accordance with our commitments under the World Trade Organisation, particularly on Customs Valuation under the GATT rules, which will become effective from 1st January 2000.

Second, with the privatisation of Transit Sheds and Container Depots, it is now necessary to require private operators to put up bond securities.

Third, to ease congestion at the Port, it is proposed that transit goods which are not cleared and removed from the Port within 30 days of entry be removed to Customs Warehouses.

Fourth, to reduce the risks of diversion of goods on transfer from the port to an inland bonded warehouse, proposals are introduced to require warehousing to be completed within 21 days.

Fifth, currently, the law requires persons operating in Customs areas be competent and of integrity. This does not, however, apply to subsequent change of ownership. It is proposed that this requirement be extended to require prior approval by the Commissioner, for change of directors or ownership of these facilities.

Sixth, it is now clear that some of our trading partners use unfair and restrictive trading practices to hinder entry of Kenyan exports into their markets. To deal with such situations, I propose to amend the Customs and Excise Act to enable the Government, in accordance with our commitments under international agreements, to take retaliatory action against imports from such countries.

Mr. Speaker, I will now turn to Customs Measures with direct revenue implications.

Mr Speaker, local businesses have gone through a difficult period. The Asian economic crisis has led to a decline in the international prices of many imports. While the recent decline in interest rates and the weakening of the Kenya shilling exchange rate are making business prospects more attractive, however, until rapid growth is regained, the additional protection provided through suspended duties will be retained. In addition, for selected sectors, I propose to strengthen protection to domestic businesses to sustain and nurture their activities. The following are the measures I propose to take: (i) First, to assist the agricultural sector, the bedrock of our economy, I propose to raise import duty from 15% to 25% on a wide range of agricultural, livestock and horticultural products, including all fruits and vegetables, as well as certain prepared foods. (ii) Second, farmers growing barley for the beer industry are threatened by a downturn in world prices and export subsidies provided to European farmers on barley and malt. To correct this situation, I propose to impose 25% suspended duty on barley and malt imports. (iii) Third, Kenyan farmers grow soft wheat, while hard wheat is imported for blending purposes. Accordingly, I propose to split the wheat tariff to distinguish between hard and soft wheats. This will allow for lower suspended duty to be charged on hard wheat, but its imports will be closely monitored to ensure a desirable result is obtained to serve interests of all stake holders. (iv) Fourth, to assist the manufacturing sector, duty on a wide range of imported intermediate inputs, including crude palm oil, vitamins, dyes, essential oils, some stainless steel products and some basic chemicals is proposed to be lowered to 10%. At the same time, duty on selected domestic manufactures, including certain rolled metal products, will be increased, and a suspended duty of 10% imposed on commercial vehicles to encourage local assembly. (v) Fifth, to rationalize duty rate structure for the clothing and textile industry, it is proposed that duty on yarns be 15%, except for domestically produced yarns, which will be raised to 25% with suspended duties. Duty on textiles will be raised from 25% to 30% by imposition of a 5% suspended duty, while duty on clothing items remains at its current rate of 35%. This structure also allows for adjustment of alternative minimum specific rates on textiles. (vi) Sixth, to help revive the assembly business, I propose to lower import duty rates on unassembled radios, and household refrigerators and washing machines to 10%. (vii) Seventh, to assist energy-intensive industries such as paper and cement, duty rate on residual fuel oil will be lowered by 50 cents per litre. (viii) Eighth, Mr Speaker, there has been a tendency to increasingly use kerosene as a substitute for diesel by industry. It is also used to dilute diesel in motor vehicles with adverse environmental consequences. With the increase in the Road Maintenance Levy on petrol and diesel by one shilling a litre, duty on kerosene will also be raised by the same amount to avoid revenue losses from substitution of kerosene for diesel. (ix) Ninth, to assist the rapidly growing information technology sector, duty on software will be lowered from 15% to 5%, same tax level as for computers. This will remove any confusion between duty rate on the media and the message! (x) Tenth, Mr. Speaker, we continue to receive requests for duty waivers on vegetable oils, electronic audio-visual equipment, and spare parts which are difficult to monitor and control diversion. Consequently, to protect revenue leakage and improve equity, these items will no longer qualify for discretionary exemption. In addition, duty and VAT remissions on all other qualifying goods will be limited to no more than 50% of the amount payable. Full exemptions will continue on donations made through organisations specified in the law or where official agreements exist or in circumstances of a national disaster.

(xi) Finally, a number of areas require targeted assistance. First, the existing exemption for power generation plants and equipment are scheduled to expire on 31st December, 1999. This has been extended through 31st December 2000 to encourage private sector investment in power generation. Second, specialised equipment for cargo handling at the port will be exempted from duty and VAT, as already applies for similar equipment at airports. Third, minimum duty rate for capital equipment imported for foreign exchange earnings or for investment in excess of Kshs.10 million, will be lowered from 10% to 5%. This will also apply to specialized cold storage equipment used by farmers.

To reduce the gap in the taxation of beer between Kenya and our neighbours, it is proposed excise duty on malt beer be lowered from 95% to 90%.

While these tax measures will result in a *small loss* of revenue to the Exchequer amounting to K£ 7 million, we consider them a worthwhile investment. Mr. Speaker, these tax measures will come into effect from midnight tonight.

Value Added Tax Measures

Mr Speaker, over the past two years, the standard rate of VAT had to be raised to cover increased revenue needs. However, given the state of the economy, and in line with the objective of reducing the tax burden, I propose to roll back the standard rate of 16% to 15%. To complete the process of simplifying the VAT rate structure to a single positive rate, the 12% rate will be raised to 15%, with exception of restaurant and accommodation services which will be charged a rate of 13% plus 2% for the Catering Training and Tourism Development Levy. These two taxes will now be collected by the VAT Department so that hotels and restaurants will effectively face a flat 15% tax rate and deal with only one tax collection agency rather than two.

Second, to prevent small businesses getting caught up in the costs of VAT registration and compliance, it is proposed the threshhold for compulsory VAT registration be raised from Ksh 2.4 million to Ksh 3.6 million. The same turnover level will apply for registration under the Catering Training and Tourism Development Levy. However, to discourage businesses from splitting to remain below the compulsory registration limit, new rules are proposed that will require businesses to register if their turnover together with the turnover of other closely associated businesses exceeds the limit.

Third, to give the coffee exports similar treatment to tea exports, I propose to make supplies of coffee to the coffee auction zero rated. However, to allow for discussions with the key players on modalities of implementing this change, this measure will become effective on 1st October, 1999.

Fourth, amendment is proposed to the classification of different types of bread so that *all types* of ordinary bread are exempt from VAT.

Fifth, it is proposed that clearing and forwarding services be designated to bring VAT registration in line with the requirement under the Customs and Excise Act, that all clearing and forwarding agents be registered for VAT purposes.

Sixth, in order to curtail cases of fraudulent input tax deductions by newly registered traders, I propose to limit input tax deduction to goods purchased twelve months prior to registration.

Finally, I propose to allow the Commissioner of VAT to appoint agents with specific skills who may be required to undertake specialised investigations or audits in such areas as electronic commerce, where the department may not have in-house skills.

Mr. Speaker, except where specified, the proposed VAT rate changes will come into effect from midnight tonight and will cost the Exchequer K£ 124.2 million in revenues.

Income Tax Measures

Mr Speaker, business investments and activities need a boost. Accordingly, I propose to reduce the top tax rate from 32.5% to 30% for both resident companies and individuals. This will also harmonise the top tax rate on business activities with our partners in the E.A. Cooperation and make Kenya a more attractive place to do business.

Second, to reduce the tax burden and the risk of low income earners being caught in the tax net, I propose to increase the personal relief and widen tax brackets by 10%. This will raise the minimum monthly taxable income from Kshs7,260 to Kshs8,000 per month.

Third, I propose to increase the tax deductible limit by Ksh 30,000 to Ksh180,000 for contributions to Registered Pension or Provident Funds and Registered Individual Retirement Funds. This brings the tax deductible limit equal to the contribution limit to these registered funds. Mr Speaker, this amendment marks the end of a ten-year phasing in of tax deductible pensions. This means that from the year 2000 onwards, all allowable contributions to registered pension funds will be tax deductible. I therefore look forward to pension funds providing a growing pool of savings to finance investments to promote economic growth. The Retirement Benefits Authority is now in place to ensure the pension sector develops in a more organised manner.

Fourth, review of tax administration and compliance costs by farmers to meet the accounting requirements for filing income tax returns, are high. KRA is also experiencing difficulties collecting quarterly income tax from cash crop farmers. Consequently, it is to the benefit of all parties to reinstate the

presumptive income tax on selected farm produce. It was temporarily suspended in 1999 because of loss of production caused by the *El Nino* rains. To alleviate problems the farmers are experiencing, it is proposed the presumptive income tax be reinstated at a rate of 2%, effective 1st January 2000.

Fifth, to harmonize tax payment date in all KRA departments, I propose to change the payment date for withholding taxes from the 30th to the 20th day of the month following the deduction of the tax.

Sixth, for a number of years, the income of a wife has been taxed separately from her husband's where it is derived from employment, professional or self-employment income. But the income tax return has been filed through the husband. Some husbands are finding it difficult to obtain the necessary information from their wives to file the return on their behalf. To liberate the husbands from this situation, I propose to give the wives the option to file their own returns.

Seventh, where a taxpayer fails to submit a return of income, a 5% penalty is charged on the tax payable, but no credit is given for the tax already paid. I propose to remedy this and allow taxes already paid to be netted out before calculation of additional tax.

Eighth, income tax restricts depreciation deductions on vehicles used for private use, with exception of businesses selling or hiring motor vehicles. This exception gives unfair advantage to these businesses and has been abused. I propose to close this loophole by restricting depreciation deductions to vehicles directly used for hire or as stock in trade.

Ninth, to assist industry improve quality and productivity, I propose to expand the definition of machinery under the investment deduction provisions to include workshop machinery, which are required to maintain machines used in a manufacturing process.

These income tax measures are estimated to result in revenue loss amounting to K£ 57.6 million.

Other Miscellaneous Measures

Mr. Speaker, on other miscellaneous measures, first, I will deal with the Road Maintenance Levy. We need to raise additional resources for the rehabilitation of our road infrastructure. Consequently, I propose to increase the funding for road maintenance by 19% or Ksh.1.2 billion. This necessitates raising the Road Maintenance Levy on petrol and automotive diesel by one shilling per litre.

Second, Mr. Speaker, some employers continue to import labour at a time when we have a surplus. Besides, the cost of providing services by the Immigration Department has increased substantially as cases of forgery rise. To discourage employers from importing labour and recover part of the processing costs, fees and security bonds under the Immigration Act have been increased by between 50% and 100%, excluding those for foreign students. Visa fees have been unified to ease administration and compliance. Increases have also been made on citizenship and naturalisation fees and passport charges.

Third, Mr. Speaker, last year, the Local Authorities Transfer Fund Act was approved to allow for transfer of a share of income tax collections to local authorities. We propose to amend this Act to allow for phasing in transfer in the next fiscal year. Contributions will start at 2%, but be enhanced to 5% in subsequent years. In addition, amendments are proposed, under the Local Authorities Service Charge Act, to cancel the fixed business fee component as of 1st January, 2000, and the payroll tax component by 1st January, 2001.

Fourth, Mr. Speaker, improved stability, health and integrity of our financial institutions has become an urgent concern. Our banks, financial institutions, mortgage companies and building societies are venturing into the East African region. However, to compete effectively, they must be strong and well managed. I am therefore proposing a range of amendments to the relevant Acts to enhance the Central Bank supervisory powers and thereby strengthen the sector. The proposals include amendments to the Banking Act to: (i) define core and supplementary capital in line with internationally accepted practices; (ii) adjust the capital to lending ratios in accordance with the new definitions; (iii) raise the minimum core capital to Ksh.500 million for, banks and mortgage finance companies, Ksh.375 million for non-bank financial institutions, and Kshs.150 million for building societies. The existing institutions will be allowed three years to comply. Proposals are made to: (a) limit investments in real property in to capital; and (b) clarify restrictions on ownership of banks through nominees and associated persons.

Following the 1995 Amendments to the Banking Act, commercial banks have tended to refuse KRA to access information necessary for collection of taxes, citing provisions of this Act. I propose to reinstate KRA's right to information required for revenue collection. Other amendments to the Banking Act aim to: (a) strengthen supervisory role of the Central Bank; and (b) to enable the Central Bank obtain group information in case of related companies and supervise the group on a consolidated basis.

Under the Building Society Act, amendments are proposed to bring these institutions in line with the desire for a healthy and strong financial sector. The proposed amendments include: (i) the definitions of capital and liquid assets; (ii) setting benchmarks on lending to single and insider borrowers; (iii) setting limits on deposit and lending levels relative to capital; (iv) provisions to vet competence and integrity of directors and managers; (v) requirements for prudential standards on operations of building societies; and (vi) imposition of penalties where there is breach of the Act or its regulations.

Fifth, as an additional measure to improve the financial sector, proposals are made to amend the Mortgages (Special Provisions) Act to enable mortgage companies to take vacant possession of a property sold by public auction, following failure to service the mortgage facility. This will bring all mortgage companies to a level playing field with the Housing Finance Company of Kenya which enjoys this right.

Sixth, Mr. Speaker as explained earlier, the Retirement Benefits Act requires pension benefits be vested after five years of pensionable service. Accordingly, amendments are proposed to the Pensions Act, for public servants to: (i) vest pension benefits after five years of service; and (ii) provide for deferment of pension benefits until age 50 for those who may wish to retire before 50 years old. These provisions will help bring the public pension scheme in line with pension standards required of registered private sector pension schemes.

Mr. Speaker, I propose to amend the Stamp Duty Act to exempt the transfer of real property between husband and wife from stamp duties.

Finally, Mr. Speaker, a considerable amount of land revenue, due to the Government, is held up in long drawn appeal cases under the Government Lands Act. To solve this problem, amendments are proposed to the Government Lands Act to: (i) enable the Minister establish a Land Arbitration Tribunal to hear and determine these cases to facilitate collection of outstanding rents and penalties; and (ii) to raise the penalty on late payment of rents to 2% per month. These amendments will allow the prosecution of land rent defaulters, and generally enhance land rent collections.

These other measures, taken together, will decrease revenues to Exchequer by K£49.9 million, but increase the estimated receipts of Appropriations-in-Aid by K£ 120.5 million.

VII. CONCLUSION

Mr. Speaker, before concluding, I would once again like to express sincere thanks, on behalf of all of us in the Government, to H.E. the President for his commendable and wise stewardship of our Nation.

Mr. Speaker, we will require His Excellency's support even more as we prepare to cross into the new millennium. The new millennium and the rapid process of economic globalization, presents major challenges particularly to economies of the developing countries. While we in Kenya will strive to maintain an open and liberalised trade regime, we expect our trading partners to reciprocate by opening their markets for our goods and maintain fair trading practices. Furthermore, I would like to stress the need for us to strengthen our relations with our development partners which can facilitate improved flow of external resources into our economy. This will complement our own resources and enhance the recovery process of our economy.

Mr. Speaker, the measures and expenditure programmes I have presented to this august House today should go along way to strengthen performance of our economy. I know we have not provided for all the requests the Ministries put to us, but we have provided what the Kenyan economy and taxpayers can afford. Consequently, spending units should not expect any more resources. However, we are convinced that if they spend what is at their disposal responsibly, focusing on the priority areas, they can maximise delivery of public goods and services to improve the quality of life of our people. In so doing, they need the support of all leaders. I therefore urge all of us to exercise the greatest care in the use of resources at our disposal, so as to optimize their utility for the development of our economy.

Mr. Speaker, I wish to emphasize that, in the end, the destiny of our country is in our own hands as Kenyans. The speedy recovery of our economy is a challenge to all of us, and needs to be addressed in a concerted manner. Therefore, let us all as Kenyans join hands and work together in the spirit of Harambee to improve the welfare of our people. It is my hope that

the Budget just presented to this House will foster an enabling environment needed for enhanced productivity by the Kenyan farmer, industrialist, businessman, professional, public servant, and Kenyans of all walks of life.

Mr. Speaker, I beg to move.

Thank you.