



REPUBLIC OF KENYA

Budget Speech

For the

Fiscal Year 2007/2008

(1st July – 30th June)

by

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Minister for Finance

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SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 14TH JUNE, 2007, BY HON. AMOS KIMUNYA, E.G.H., M.P., MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR FISCAL YEAR 2007/2008

1ST JULY, 2007 TO 30TH JUNE, 2008

Mr. Speaker Sir,

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

Introduction

1. Mr. Speaker, once again I feel very honoured to present to this esteemed August House my second Budget as the Minister for Finance. As Hon. Members are aware this is the fifth budget of the Administration of H.E. The President, Hon. Kibaki. Hon. Members, this year's budget is intended to lay a solid foundation for transforming our country into a globally competitive and prosperous nation with a high quality of life by 2030. As we enter the fifth year of broad-based economic growth, accompanied by four years of successive increases in per capita income, and a substantial reduction in poverty within a span of only five years, it is important to reflect back on some of the key economic promises we made to Kenyans at the beginning of the current administration and the extent to which the Government has delivered on those promises.

Achievements Under the Economic Recovery Strategy (ERS): 2003 - 2007

2. Mr. Speaker, during the past 4½ years, we have implemented with determination and consistency, bold economic and structural policies that are elaborated in the Economic Recovery Strategy (ERS) launched by H.E The President in June 2003. Our development agenda as embedded in this strategy, whose implementation comes to an end in December 2007, was anchored on three key pillars, namely: (i) restoration of economic growth within the context of a stable macroeconomic environment; (ii) enhanced equity and poverty reduction; and (iii) improvement of governance. These pillars were carefully chosen to pull our economy out of a recession and to commence the journey toward the broad-based economic recovery that we are now witnessing and which is touching all sectors of our society.

3. Mr. Speaker, the score card of our efforts is now out and it is with a great sense of pride and satisfaction that I beg to inform Hon. Members and my fellow Kenyans that this Government has achieved a resounding success in all the three pillars. As a result,

investors' confidence has never been higher, our farmers are enjoying better returns on their investments and more of our rural people, especially those in arid and semi-arid areas, have access to clean water, electricity and affordable health care services. In addition, more children are now able to go to schools; and our public sector is more efficient in delivering services and on its mandate of facilitating private sector development.

4. Mr. Speaker, on the restoration of economic growth, it is gratifying to note that through continued hard work by fellow Kenyans who have literally taken to heart H.E. The President's clarion call of building "a working nation", the growth of our economy has expanded from virtual stagnation in 2002 when it expanded by only 0.5% to a high and sustainable rate of 6.1% in 2006.

The strong growth we have experienced has touched all sectors, and benefited all hard working Kenyans. In particular, Mr. Speaker;

- i. The agriculture sector growth has improved markedly from negative 3% in 2002 to 5.4% in 2006;
- ii. Manufacturing sector output expanded by 6.9% in 2006, up 0.1% in 2002;
- iii. Hotel and restaurant sector has recovered strongly from a decline of 20.3% in 2003 to a growth of 14.9% in 2006, with an annual growth rate of 37% in hotel occupancy;
- iv. With lower interest rates and increased remittances from Kenyans in the diaspora, construction has picked up substantially from negative 2% in 2002 to 6.3% in 2006;
- v. Transport and communication sector has also experienced a strong growth from the low of 3.5% in 2003 to 10.8% in 2006;
- vi. Wholesale and retail trade sector, has risen from negative 2.5% in 2002 to 10.9% in 2006;
- vii. And reflecting confidence in the economy and increased profitability of companies, the NSE Index has increased by 314%, reflecting an increase in market capitalization from KShs.112 billion in 2002 to KSh.792 billion in 2006, a compounded annual increase of 63%;
- viii. Finally, total exports have almost doubled since 2002 underpinned by strong growth in coffee, tea and horticultural exports. And reflecting the improved export and capital inflows, international reserves held by the Central Bank have more than doubled since 2002, rising from USD1.2 billion in 2002 to the highest level ever of USD.2.5 billion in 2006.

5. Mr. Speaker, as a result of this sustained economic expansion, the growth in per capita income has rebounded strongly from a decline of 2.5% in 2002 to an increase of 3.3% in 2006. The result of this growth, as reported in the most recent Integrated Household Budget Survey, is that overall poverty has declined from 56.8 percent in 2000 to 46 percent in 2006, a remarkable reduction of about 20 percent. Even more significant is the 35 percent reduction in rural poverty from 51.5 percent in 2000 to 33.7 percent in 2006.

6. Mr. Speaker, the strong economic performance reflects the Government's pursuit, since 2003, of reforms as well as prudent monetary and fiscal policies aimed at ensuring a stable macroeconomic environment, which is necessary to encourage private sector investment, growth and job creation. Arising from consistent implementation of these measures, inflation and exchange rates have stabilized, while the average lending rate of commercial banks has declined from about 19% in 2002 to about 13% currently. Similarly, the ratio of domestic debt to GDP has declined from 22.9% in 2002 to 18.0% in 2006 and this has provided room for non-inflationary expansion of credit to the private sector for productive activities.

7. Mr. Speaker, on the fiscal front, despite a reduction in the VAT rate from 18% to 16% in 2003 and the lowering of EAC customs tariffs following the implementation of the EAC common external tariff (CET), revenue collection has been kept above 20% of GDP, which has enabled us finance about 95% of our budget from our own resources. Indeed, Mr. Speaker, one of the most remarkable achievements of this administration has been the ability to sustain fiscal discipline in the absence of significant external budgetary support. This is indeed a significant achievement, and we are committed to continue on this path to ensure that our budgetary framework is not subject to the unpredictability associated with external budgetary financing. With strong revenue effort and expenditure restraint, net domestic borrowing has largely been contained, falling from 3.6% of GDP in 2002/03 to about 1.8% of GDP in 2006/07.

8. Mr. Speaker, based on the structural reforms we have implemented so far, Kenya recently received positive ratings by independent international institutions.

i. From the Standard and Poor's (S&P) rating agency, we received a favourable initial sovereign credit rating of "B+" for foreign currency debt and "BB-" for local currency long-term sovereign debt. Within sub-Saharan Africa, only mineral-rich countries such as Botswana, South Africa and Nigeria have a higher sovereign rating from S&P;

ii. From the Global Integrity , which assesses the existence and effectiveness of anti-corruption mechanisms that promote public integrity, we received a moderate rating along with such countries as Argentina and Brazil, among others; and

iii. From the World Bank's Country Policy and Institutional Assessment (CPIA), Kenya's rating on policy implementation has improved significantly, from 5th and bottom Quintile in 2002 to 2nd Quintile by 2005. And we expect further improvements by the end of this year.

9. Mr. Speaker, turning to the second pillar, on enhancing equity and poverty reduction, a key pre-requisite in addressing these twin issues is having a rapidly expanding economy, which we have achieved. However, in order to ensure that the growth is shared among our fellow citizens, this Government has implemented a number of targeted fiscal interventions, structural reforms and regional development initiatives aimed at reducing poverty and inequality in our society. And as all Hon Members and Kenyans are aware, this government has:

- i. Introduced Universal Free Primary Education, which has increased enrolment by over 1.5 million pupils since 2003, thereby assuring them of a secured future and relieving their parents of school fees burden. This in turn has helped parents increase their disposable income.
- ii. It has also increased the share of resources allocated towards priority development areas of agriculture and rural development, provision of infrastructure and human development, including core poverty programs, thereby underscoring the importance this Government attaches to laying a firm base for economic prosperity and reducing income inequality;
- iii. Implemented various structural reforms in the agriculture sector, including the dairy, sugar, coffee, tea, pyrethrum, and the co-operative sectors, with a view to improving productivity and income earnings of Kenyans working in these sectors;
- iv. Reformed the public sector to improve efficiency and effectiveness, including removing administrative barriers to trade, privatizing and restructuring of key public entities, and streamlining of licences aimed at reducing the cost of doing business. We have also introduced performance contracting in the public sector. and enhance private sector participation in our economy so as to create more jobs;
- v. Increased resources targeted at promoting regional development and reducing poverty in rural and urban areas. For instance, the Government has increased the Constituency Development Fund allocation more than

eight-fold from KShs.1.2 billion in 2003/04 to KShs.10.0 billion in 2006/07 and 2007/08, while budgetary allocation under LATF more than doubled from KShs.3.0 billion in 2002/03 to KShs.6.5 billion in 2006/07 and is projected to rise to Kshs.9.2 billion in 2007/08;

- vi. Facilitated construction of more than 1,000 dispensaries and deployed personnel and medical supplies to make these facilities operational and improve access to medical care; and
- vii. We have deliberately targeted expenditures and development programmes to improve the quality of life in Arid and Semi Arid lands (ASALs), the only Government to do this since independence. Other key initiatives implemented by the Government include: sinking of boreholes and reviving and making operational the Kenya Creameries Cooperative and Kenya Meat Commission to generate income earning opportunities for livestock farmers.

10. Mr. Speaker other pro-poor programmes we have been implementing include rural electrification in the entire country (Kshs 13.4 billion over the last four years), rural access roads under the road 2000 programme, Rural health services (Kshs 18.3 billion over the last four years) and the Youth Fund that started in the current fiscal year aimed at empowering our youth for the future.

11. Mr. Speaker, as I mentioned earlier, as a result of these deliberate and bold policy interventions, the incidence of poverty has declined from 56.8% in 2000 to 46% currently. Indeed, more Kenyans living in urban and rural areas are living generally a better life today than they did six years ago. The anti-poverty interventions we have implemented since 2003 have also reduced divergence in the incidence of poverty across regions thereby reducing inequality in development and income distribution. For example, the largest reductions in poverty incidence outside Nairobi was recorded in Nyanza, Eastern and Western provinces where the poverty incidence declined by 33%, 23% and 21%, respectively. This is an indication that our policies have had a positive impact in all corners of Kenya. Hon. Members may wish to refer to the publication “on Delivering Development To All Kenyans” which has been circulated to all members and has more information on development programmes of the government.

12. Mr. Speaker, these milestones in our development front have not come by accident but from careful planning, focused reforms and effective economic management. They have also been accomplished through hard work and the palpable confidence of the Kenyan people that their future is in safe hands under the dependable leadership of H.E. The President, Hon. Mwai Kibaki.

Reforms in Governance

13. Mr. Speaker, In regard to the governance pillar, the Government has implemented a number of reforms since 2003 mainly to: (i) reduce corruption, improve efficiency and ensure effective service delivery in public sector; and (ii) create an enabling environment for increased private sector participation in growth and poverty reduction. In particular, several reform measures aimed at improving governance in the areas of prevention, investigation and prosecution have been implemented demonstrating the Government's commitment to fight against corruption. The Government firmly believes that the legal framework to fight against corruption is now in place and the investigative bodies have been strengthened. To strengthen the prosecutorial capacity, initiatives are ongoing to increase the number of prosecutors, magistrates and judges of the High Court. Hon. Members may wish to refer to the Budget Strategy Paper (BSP) 2007, which has been circulated to members for more details on the government's actions in the area of governance.

14. Mr. Speaker, with the continued support so generously extended to this Government by Hon. Members, private sector players and Kenyans at large, we have found over the last four and half years, the strength and inspiration to improve the lives of our fellow Kenyans and to move toward achieving the Millennium Development Goals. Thankfully, Mr. Speaker, successive annual achievements have motivated us to strive to continue working harder in order to lock in this success which is so necessary for building a prosperous future for all Kenyans. I am, therefore, happy to report that this Government has now completed the task of laying a solid socio-economic foundation, complete with the building blocks for our future prosperity.

15. Mr. Speaker, in moving forward, the Government would like to further expand the opportunities available to Kenyans of all walks of life so that they can participate in their own wealth creation while at the same time helping build the new and better Kenya. This is indeed the spirit of the National Vision 2030 whose formulation has involved consultations with many Kenyans, including Hon. Members. Like the ERS before it, the Vision 2030 has three key pillars, namely;

- i. The Economic pillar which aims to achieve a high and sustained non inflationary, economic growth, steadily rising to 10% by 2012 and maintaining that rate thereafter;
- ii. A social pillar which aims at achieving a just and cohesive society enjoying equitable social development; and
- iii. A political pillar which seeks to achieve an issue-based, people-entered, and accountable democratic political system.

16. This budget which straddles the period of the ERS, which ends this December, and the start of the Vision 2030 in January 2008, is intended to define the path to facilitate and harness the participation of all Kenyans in helping build a strong economy and thereby help us achieve the Vision 2030 objectives.

Accordingly, Mr. Speaker, the theme of this year's budget is "Vision 2030 -- Working Together, on the Path to Prosperity".

LAYING THE FOUNDATION FOR ACHIEVING VISION 2030

Overview

17. Mr. Speaker, our country is now poised for accelerated development. With this in mind, the Vision 2030, though encompassing the objectives of the ERS, is much more ambitious and requires a radical transformation of our economic, social, and political systems. In laying the foundation for the economic pillar of the Vision, we must build an enabling environment for the private sector in order to fully unlock its potential and to become globally competitive. Achieving this in the medium term will require that we:

- i. Continue to maintain a stable macroeconomic environment underpinned by prudent fiscal and monetary management, supported by key structural reforms;
- ii. Accelerate the rehabilitation and expansion of our infrastructure and basic amenities;
- iii. Develop quality human capital to raise our productivity and to enhance our global competitiveness ;
- iv. Maximize economic opportunities for all Kenyans and ensure that they continue to benefit from the fruits of higher economic growth through targeted programs to reduce inequality and poverty; and
- v. Encourage growth of business through improved governance and reduce the cost of doing business.

Medium Term Macro-Fiscal Framework and Structural Reforms

18. Mr. Speaker, the economic outlook for the medium term is bright, buoyed largely by consumer and investor confidence and continued strong growth in our trading partners' economies. Hon. Members may wish to refer to the 2007 Budget Strategy Paper for more details. We expect to achieve a growth rate of 6.5 – 7% in 2007, which should rise gradually to 10% by 2012 as a result of the interventions we are planning to put in place.

19. Mr. Speaker, to achieve this level of growth, we will: (i) continue to maintain low inflation and stable positive real interest rates to facilitate adequate expansion of credit to private sector to support increased economic activities; (ii) increase the level of public and private sector investments by at least 10 percentage points of GDP over the next five years; (iii) strengthen the financial sector by enhancing its efficiency and to help mobilize the required savings to finance the additional investments; (iv) deepen the on-going efforts to improve the investment climate through reduction in cost of doing business; (v) accelerate infrastructure development to crowd-in private investments; (vi) enhance efficiency in the financial sector; and (vii) increase the productivity of our labour and capital.

Fiscal Framework

20. Mr. Speaker, to implement our development programs based on a fiscal framework which focuses on: (i) maintaining a strong revenue effort underpinned by deepening tax administration reforms and modernization of our tax system; (ii) containing growth of total expenditures, while creating fiscal space through expenditure rationalization to shift resources from non-priority to priority areas, including expenditures on the flagship projects critical to achieving Vision 2030; and (iii) containing the growth of domestic debt to a sustainable level to encourage expansion of credit to private sector for faster development.

Deepening Structural Reforms for a Competitive Business Environment

21. Mr. Speaker, macro economic stability must also be accompanied by deep structural reforms in order to maximize growth. Therefore, to consolidate the recent gains in the public sector, the Government will implement structural reforms to further improve efficiency in the use of public resources and ensure effective service delivery. We will focus on priority areas of: (i) public expenditure and financial management; (ii) public sector restructuring and privatization; (iii) deepening financial intermediation; and (iv) private sector competitiveness. The implementation of these measures is expected to improve business environment, encourage private sector investment – both domestic and foreign and expand its capability to create more jobs and reduce poverty amongst our people.

Further Improving Governance for Achieving Vision 2030

22. Mr. Speaker, the Government fully recognizes that accelerating and deepening the reform agenda in the areas of governance and anti-corruption is critical for accelerating economic growth and sustained reduction in poverty. Therefore, the Government has developed a Governance Strategy for Building a Prosperous Kenya and an Action Plan, which sets out time-bound specific and prioritized anti-corruption interventions in the broad areas of: (i) prevention; (ii) investigation and recovery of corruptly acquired assets; (iii) strengthening the prosecutorial capacity; and (iv) improving governance in priority sectors. The implementation of these measures is expected to result in a measurable improvement in the fight against corruption in the short - and medium- term.

THE 2007/08 BUDGET STRATEGY FOR ACHIEVING VISION 2030

23. Mr. Speaker, the 2007/08 budget framework I am presenting to this August House is set against the background of the medium-term macro-fiscal framework I have just outlined. We envisage a continuation of the recent strong economic performance, with real GDP expected to increase by 6.5 – 7.0% in 2007/08, largely propelled by continued strong performance across all sectors. Inflation is expected to remain under control reflecting continued implementation of prudent fiscal and monetary policies and projected easing of food and oil prices. We also expect gross international reserves to increase to the equivalent of 3.9 months of our projected import cover.

24. Mr. Speaker, as in the previous year, the Government is committed to containing expenditures and re-orienting them towards growth and poverty-reducing programs in the areas of infrastructure, health, education and other priority projects, which are expected to lay the foundation for achieving Vision 2030. The Government further aims to maintain a stable and predictable level of domestic borrowing in order to sustain the relatively stable interest rates witnessed in 2006/07 and to further boost private sector economic activities.

Revenue Projections

25. Mr. Speaker, the 2007/08 budget targets revenue collection of about 21% of GDP. As noted earlier, this performance will be underpinned by the on-going reforms in tax administration. The streamlining of the exemptions regime in line with other East African Community Partner States is also expected to protect the revenue base. Total revenues, including appropriations-in-aid, are projected to increase by about 14 percent, bringing the total tax collection to about Ksh.428.8 billion.

26. Mr. Speaker, the revenue collection has been a major success under the Kibaki administration. Revenue has increased from Kshs.210 billion in 2002/03 to the current

level of Kshs 376 billion, against which the 2007/08 projections are made. I wish to thank the Kenyans for paying taxes, and our KRA for their dedication in revenue collection.

Expenditure Forecasts

27. Overall expenditures in 2007/08, excluding amortization payments and restructuring costs, will amount to Ksh.580.4 billion, about 28.2% of GDP, up from KShs.427.6 billion or 23.4 percent of GDP in 2006/07. In line with Government policy to shift resources from recurrent to capital expenditures and core-poverty programs, the share of recurrent expenditure is projected to decline sharply from the level of 2006/07, while domestically financed capital expenditures are planned to increase from KSh.54.7 billion to KSh.85.1 billion or from 3.0% of GDP to 4.1% of GDP. Expenditures are therefore forecast to be more development oriented, and with a special focus on improving the infrastructure in the key priorities sectors identified in Vision 2030, such as the road network, access to water, reliable and affordable energy, and efficient telecommunications system.

28. Mr. Speaker, the overall budget deficit (including grants) in 2007/08 will be KShs.109.8 billion, equivalent to 5.3% of GDP, largely reflecting the substantial increase in development expenditure. Net external financing amounting to KShs.39.8 billion or 1.9% of GDP, is expected to cover part of this budget deficit, leaving KShs.70 billion or 3.4% of GDP, to be financed through domestic borrowing (Kshs.34 billion) and net privatization receipts of about KShs.36 billion. The net domestic borrowing requirement of 1.6% of GDP in 2007/08 is well below that of the current financial year of 1.8% of GDP, and is consistent with the medium-term target of 1.5 percent of GDP.

29. Mr. Speaker, allow me to emphasize that the proposed domestic borrowing of Ksh.34 billion and the net privatization proceeds of Ksh.36 billion will all go toward financing our development budget which amounts to Kshs.85 billion. That is to say, the proceeds raised will not be used to fund recurrent expenditure.

Expenditure Reform Measures

30. Mr. Speaker, in the recent past, implementation of annual budgets has experienced some challenges, including implementation delays, weak links between actual spending and policy priority in some line ministries, expenditure leakages and low absorption of funds under the development votes, among others. As a result of these challenges, our potential for more rapid economic growth and employment is constrained.

31. Mr. Speaker, in order to address these challenges and to institutionalize a framework for effective budget implementation, starting with 2007/08, Treasury will: (i) closely monitor the implementation of the development budgets of key line ministries; (ii)

coordinate the development of result-oriented budget performance benchmarks; and (iii) identify areas of public resource leakages and develop strategies for creating fiscal space to release resources for financing priority Vision 2030 projects. And to sustain high economic growth and further reduce poverty, the Government will accelerate reforms in public financial management in order to improve efficiency, enhance transparency and accountability under a coordinated strategy to revitalize Public Finance Management.

32. Mr. Speaker, to demonstrate our commitment to further deepen fiscal reforms, we have, began to entrench programme based performance budgeting starting in 2007/08. These measures are expected to ensure that budgetary allocations are based on programmes that are linked to clearly specified objectives and targets such as the Millennium Development Goals (MDGs) as well as the objectives of the Vision 2030.

Deepening the Financial Sector Reforms for Faster Economic Growth

33. Mr. Speaker, we fully recognize the important role played by the financial sector towards the realization of our development goals. We are also desirous in making Nairobi the financial services hub for the region. We will therefore continue with targeted reforms for the sector.

34. Mr. Speaker, as part of these reforms, Government will be tabling in the course of 2007/08 the SACCO bill to regulate all SACCOs that take deposits from members. In addition, we will fully make operational the Insurance Regulatory Authority, which is expected to strengthen the regulation of the insurance companies and enhance the level of governance in the sector. We will also review the Capital Market Authority Act to strengthen the CMA's supervisory capacity. On the banking sector, I will also be introducing in this House a modern Banking Bill that will benchmark banks' operations with international best practices.

35. Mr. Speaker, in order for Nairobi to become the regional hub for financial services, it is important to strengthen the banking and insurance sectors, so as to enhance the stability, efficiency and access of the overall financial sector. Toward this objective, I will be proposing later in my speech measures to increase the capital requirements for these two sectors over the next three years.

36. Mr. Speaker, I did earlier underscore the importance of containing inflation to low levels. In this regard, to strengthen the operational autonomy of the Central Bank of Kenya and enhance its capacity to effectively maintain a proper balance between the demand and the supply of money in the economy, I will be introducing significant amendments to the Central Bank Act.

Privatization and Public Private Partnership for Economic Efficiency

37. Mr. Speaker, to institutionalize transparency and accountability in the privatization process, we will make fully operational the Privatization Commission before end 2007. In addition, preparations for the sale of the Telkom Kenya shares to a strategic partner, has now been completed and Request for Proposals will be released to the prospective investors within the next few days. We will also float additional shares of KENGEN when we are satisfied that the market price reflects the fundamentals of the company and that the taxpayer will get fair return. In addition, Mr. Speaker, we intend to sell part of Government shares in Safaricom through an Initial Public Offer (IPO) on the Nairobi Stock Exchange. We will also sell part of the Government's and NSSF's shares in NBK.

38. We intend to attract more financial and management resources from the private sector, through privatization. In this regard, we are putting in place the necessary framework to allow active Government participation in the stock exchange to take advantage of favourable market conditions to offer shares in already listed companies without necessarily having to go through a second offer.

39. Mr. Speaker, to attract more financial and management resources to enhance our productive capacity, the Government is in the process of finalizing the policy, legal and institutional framework for the implementation of Public Private Partnerships. This framework is intended to allow private sector participation in the provision of key infrastructural services such as water, energy, road and other transport services and is critical for the financing of the flagship projects under Vision 2030. We will also create an institutional framework to assess the fiscal risks associated with these PPP projects.

40. Soon, the Government will be inviting private sector participation in the development and operation of free port facilities once the legal framework which is currently under preparation is approved by this House.

SECTORAL PRIORITIES FOR ACHIEVING VISION 2030

Expanding Quality Infrastructure for Sustained Development

41. Mr. Speaker, in the Vision 2030, the Government, in consultation with a wide cross-section of Kenyans, has identified six priority sectors as having the highest potential for economic growth. These sectors are: tourism, agriculture, manufacturing, wholesale and retail trade, business processing outsourcing and financial services. However, to exploit the growth potential from these sectors, it is necessary to improve the infrastructure in areas that best support these growth engines, in addition to implementing key reforms in the public sector.

42. Mr. Speaker, no country has achieved and sustained a high economic growth rate with poor infrastructure. We must, therefore, accelerate the expansion and rehabilitation of our infrastructure in order to enhance our efficiency and become globally competitive. The investments in infrastructure development are also critical to the achievement of MDGs. It is in this regard that we have allocated for infrastructure development a total of KSh.166.8 billion in 2007/08, up by 113% from KSh.78.3 billion in 2006/07. In addition to increased resource allocation, we will continue to focus on strengthening our capabilities to plan, implement and monitor all infrastructural programs countrywide.

Accelerating Expansion and Rehabilitation of Roads

43. Mr. Speaker, on road infrastructure development, we have made notable progress, especially in the rehabilitation and construction of key road networks during 2006/07. As I committed in last year's budget, I am happy to report that we have now completed: (i) 228 Km of periodic road maintenance; (ii) 287 Km of rehabilitated roads; (iii) 116 Km of completely new sections; (iv) 580 Km of routine road maintenance; and (v) about 572 Km of rural roads improvement under the Roads 2000 program.

44. Mr. Speaker, to lay the foundation for creating more jobs, we will accelerate the completion of the on-going road networks and speed up the rehabilitation and construction of new road networks in 2007/08, I have, accordingly, increased the budgetary allocation to roads from KShs.42.5 billion in 2006/07 to KShs.62.1 billion in 2007/08, an increase of 46%. To enhance our capacity to provide road networks and effectively supervise road projects, we will make operational the three roads authorities currently being debated by this house. We will also increase the participation of private sector players in road financing, construction and maintenance. The use of labour-intensive Road 2000 program will be expanded to continue generating employment opportunities to our youth.

45. Mr. Speaker, to hasten construction and completion of infrastructure projects in a timely manner we will roll-out the current framework for monitoring implementation of road projects to cover implementation of water, energy and other key infrastructural sectors. We expect this framework, which reviews quarterly implementation on the basis of agreed delivery benchmarks, will ensure timely completion of these projects.

Ensuring Reliability in Energy Supply

46. Mr. Speaker, reliable supply of electricity is critical to our growth efforts and in particular to the manufacturing sector. Building on the success of current rural electrification programme, the Government will further expand this Program in 2007/08 in order to make power accessible to all Kenyans. To this end, an additional 460 market centres, 110 secondary schools, 38 health centres and 17 water projects, will by May 2008

be connected with electric power. In large towns, which are far away from the national grid, the Government will provide diesel-fired isolated mini grids. And to enhance capacity of power generation and distribution to sustain the on-going economic expansion, I have allocated KShs.8 billion in the budget for 2007/08 which should avert any shortage of power supply that could impact negatively on our manufacturing sector. I also expect the recently enacted Energy Law to open up participation in electricity generation to private investors and reduce the direct fiscal burden.

47. Mr. Speaker, as a result of increased economic activities, demand for petroleum products has increased significantly. The pipeline throughput volume now stands at 3.6 billion litres, a level we cannot sustain. The Government will fast-track the installation of booster pump stations to double the capacity of the pipeline. And in order to serve the growing petroleum demand in Uganda and the Great lakes regions, we are, in partnership with the Uganda Government, fast-tracking the extension of the oil pipeline from Eldoret to Kampala. When completed by end of 2008, this pipeline will lower the tariff for transporting petroleum fuels, and reduce, among others, the road maintenance costs, accidents and environmental pollutions. The government has also undertaken to modernise the oil refinery, and I am including in this budget part of our contribution.

Promoting Science, Technology and Innovation for Higher Productivity

48. Mr. Speaker, the Government recognizes the important role science, technology and innovation plays in promoting efficiency, productivity and competitiveness, which are fundamental for economic transformation. The Ministry of Science and Technology, working together with the private sector players, will implement a comprehensive science and technology strategy to promote efficiency and productivity in the key priority areas of: (i) agriculture development; (ii) expansion of infrastructure; (iii) healthcare and education delivery; (iv) security and crime management; (v) public administration; and (v) industrial production.

49. Mr. Speaker, to demonstrate our commitment to this important area, I have allocated KShs.200 million as start up capital in 2007/08 for the establishment of an Endowment Fund for innovation and research. Mr. Speaker, I wish, therefore, to appeal to all private sector players to contribute towards this Fund whose access by our talented scientists and researchers is expected to strengthen our capacity to use knowledge and technology in supporting a productivity and knowledge driven economy.

Further Deepening Efficiency and Productivity through ICT Development

50. Mr. Speaker, as I noted earlier, the Business Processing Outsourcing (BPO) sector is one of the priority sectors in the Vision 2030. This Government intends to make our country a preferred investment destination for ICT related activities that will create

more wealth and employment opportunities. To achieve this goal, the Government will develop and support an efficient ICT infrastructure that provides easy access to international and national network; establish legislative and regulatory framework for ICT development; and promote and ensure quality ICT education to provide a pool of world class professionals to meet the needs of local and global markets.

51. Mr. Speaker, starting in 2007/08, the Government will facilitate the completion of the ongoing ICT infrastructure expansion in order to improve broadband connections. This will be achieved through investment in an undersea fibre optic cable and the development of a National Fibre Optic Network. Accordingly, I have allocated KShs.1.0 billion towards The East African Marine System (TEAMS) project, whose completion by mid next year is expected to provide cheaper and faster internet connection with the rest of the world. This project is also expected to reduce significantly the cost of making both local and international telephone calls. Mr. Speaker, as earlier indicated, plans are underway to restructure fully and privatize Telkom Kenya before the end of 2007/08 in order to improve its operational efficiency and reduce further the cost of telephony in our economy.

Human Capital Development Sector

52. Mr. Speaker, although the Government has improved access to education and healthcare services, much more needs to be done to ensure Kenyans enjoy good health and are appropriately skilled for our envisaged transformation to a globally competitive economy. In this regard, and in addition to measures we have already initiated, the Government will go a step further in 2007/08 to deepen reforms aimed at improving efficiency, effectiveness and access to education and health services countrywide.

Further Improving Quality and Access to Education for Achieving Vision 2030

53. Mr. Speaker, the new world of globalization demands that we develop a world class pool of brilliant and talented scholars, doctors, scientist, engineers, ICT experts, accountants, economists and other professional if we are to compete and succeed on the new world stage. This pool of talent will come from all corners of Kenya; from rural and urban areas, and from rich and poor Kenyans who will be nurtured by the fair and equitable education system we are systematically putting in place. In recognition of the important role played by quality education towards economic growth and expansion of employment opportunities, I have increased budgetary allocation to the education sector by 11% from KSh.108.3 billion in 2006/07 to KSh.119.5 billion in 2007/08.

54. Mr. Speaker, the Government will ensure efficiency in the use of funds, improve quality and access to primary, secondary and university education and re-orient our educational system to make it more relevant to the needs of the economy. In this regard,

and to demonstrate our commitment to enhance access to quality education, I have allocated KSh.8.1 billion for free primary education to cater for recurrent and capital expenses and another KSh.7.3 billion for teachers' salary adjustment as the final phase of the agreement between the Government and the Kenyan National Union of Teachers (KNUT). This amount now brings to KSh.28.5 billion paid by this Government to teachers since 2003.

55. Mr. Speaker, we are going a step further to allocate KSh.1.5 billion to recruit an additional 7,000 teachers countrywide to replace those we have lost through attrition. In addition, I have allocated another KSh.1.0 billion to recruit an additional 4,000 new teachers, bringing the total number of teachers to be employed in 2007/08 to 11,000 and we will continue recruiting more in the medium term to increase the teacher-pupil ratio to internationally accepted standards. I expect the additional teachers will go along way in improving quality of teaching in our school systems.

56. Mr. Speaker, to further improve the transition rate in our schooling system and reduce the households' burden of financing secondary school education, the Government will, with effect from January 2008, remove as a first step all tuition fees for secondary schools countrywide. I have, therefore, allocated KSh.2.9 billion to cater for these tuition expenses. And to ensure poor and orphaned but bright students do not miss attending school, because of other non-tuition related expenses, we are allocating KSh.800 million in 2007/08 towards bursary funds to assist them to cater for such expenses.

This level of funding, together with the on-going reforms in the educational sector aimed at ensuring efficiency, is expected to release additional resources to rehabilitate and develop village polytechnics and vocational training centres. The savings generated through expenditure rationalization are also expected to support free tuition for secondary education and enhance bursary funding for university education in the medium term.

Deepening Reforms to Improve Healthcare Delivery to all Kenyans

57. Mr. Speaker, the Government has implemented various reforms in the health sector, which are aimed at improving quality and access to healthcare services. As a result of these reforms, over 1,000 additional dispensaries have been built countrywide, budgetary allocation for drugs increased by 72% and over 4,080 additional health personnel have been deployed to rural and needy areas to scale up health services. In addition, the Government has improved referral services by increasing the number of ambulances and has also implemented financial management reforms to improve efficiency and service delivery countrywide.

58. Mr. Speaker, to facilitate completion of the on-going reforms in the health sector, I have allocated KShs.34.4 billion in 2007/08. Efficient use of these funds is expected to enhance quality of health care and access in line with Vision 2030. The Government will also continue to shift focus from curative to preventive care, help to expand immunization coverage, improve reproductive health needs and allocate additional resources to facilitate an effective multi-sectoral response to epidemics such as HIV/AIDS and malaria.

59. Mr. Speaker, the Government is aware of the low absorption of budgetary resources attributed to bureaucracy in financial and other logistical management systems within the Health Sector. The Government therefore, intends to streamline and enhance community participation and ownership in the management of health resources at the local level, through a review of the legal and administrative framework.

60. Mr. Speaker, the Government will also strengthen KEMSA's procurement capacity. The specific reforms will include; improving supply chain management of public health resources, establishing capacity within MOH to monitor KEMSA's procurement function, and strengthening the supervision of medical supplies to rural health facilities.

Promoting Agricultural Productivity and Rural Development for Poverty Reduction

61. Mr. Speaker, agriculture is key to the realization of a hunger free society, one of the MDGs. In this context and also being one of the growth engines for the Vision 2030, the Government will continue to implement a wide range of structural reforms aimed at improving efficiency and productivity in the sector. These reforms will be targeted towards encouraging value-addition in agro-processing and making agriculture the catalyst for our economic transformation and prosperity. To achieve this broad objective, we will in the medium term:

- i. Transform key agricultural institutions into complementary and high performing entities that facilitate private sector agricultural productivity and output expansion;
- ii. Facilitate access to input services for farmers and pastoralists in Kenya to achieve world class benchmarks in productivity, including access to affordable fertilizer.
- iii. Further develop irrigable areas of arid and semi-arid lands (ASAL) for both crops and intensified livestock; and
- iv. Improve market access for small holder farmers by facilitating the establishment of aggregators, processing, packaging and branding of our agricultural export product;

62. Mr. Speaker, as an initial step towards the transformation of our agriculture, I have increased budgetary allocation to the sector by 20% from KSh.24.9 billion in 2006/07 to KSh.29.8 billion. These resources will be deployed to:

- i. Expand disease free zones and control of vectors to improve quality of livestock;
- ii. Roll out, in consultation with local farmers, a more practical and cost effective extension service methodology; and
- iii. Spearhead biotechnology research to increase food productivity and self reliance.

63. Mr. Speaker, in addition to increased resources to the sector, the Government will deepen reforms under: (i) the co-operative sector to improve governance and encourage its growth to support farmers; and (ii) the National Cereals and Produce Board and Strategic Grain Reserve to improve their management so that they can play more effectively their strategic role of guided intervention in food crisis situations. In addition, post landing losses suffered by fishermen will be reduced by promoting of storage and processing. Surveillance effort against illegal fishing and conservation of fisheries resources will be enhanced as well.

64. Mr. Speaker, over the last four years, this Government has paid most of the arrears owed to farmers arising from past governance challenges. This year, we are going a step further to relieve the pyrethrum farmers of their long suffering by allocating an additional KShs.664 million to clear the remaining arrears. We are also allocating Shs.641 million towards payment of debts owed by Coffee Board of Kenya to farmers. In both instances however, we will follow up on the culprits occasioning the loss of funds as per the law.

Empowering the Internally Displaced through Settlement

65. Mr. Speaker, as we have done in the past, we will, in the coming fiscal year, once again deal with the problem of squatters and internally displaced persons. In this regard, I have allocated KShs.1.3 billion to acquire land for settling some of our fellow Kenyans who are internally displaced. I am confident that with the allocation of these parcels of land, those affected will improve their living standard, increase food safety and be able to share in the growth of our country.

66. Mr. Speaker, the largest beneficiaries of this first term of the Kibaki administration are the farmers though increased production, higher quality produce, and sustained high prices. We are committed to improve further on this in the years to come.

Economic Services Sector Strategy

Manufacturing and Trade

67. Mr. Speaker, arising from various reforms we have implemented and supported by the hard work and resilience of private sector players, growth in the manufacturing sector accelerated from zero percent in 2002 to 6.9% in 2006. The on-going efforts of deepening regional integration under both the East African Community (EAC) and COMESA have also contributed to boosting the demand for Kenya's manufactured products in those markets. Continued expansion in the COMESA as well as the forthcoming Economic Partnership Agreements (EPAs) means that Kenya will have to continually enhance the efficiency of its manufacturing sector in order to remain competitive.

68. Mr. Speaker, to accelerate and diversify the recent growth momentum of the sector, we must effectively facilitate our industry players to overcome remaining challenges. These include: (i) continued high cost of doing business; (ii) low productivity and slow adoption of new technologies; and (iii) inadequate start up capital for small and medium enterprises. On its part, the Government will: (i) maintain a stable macroeconomic environment; (ii) deepen reforms to enhance private sector competitiveness by reducing cost of doing business; and (iii) continue to provide the one-stop investment shop to encourage domestic and foreign investments and attract modern technology in our country. In the coming financial year, we will also be studying the feasibility of establishing special economic clusters such as agro-industries zones to help stimulate the manufacturing sector in line with initiatives under Vision 2030.

69. Mr. Speaker, counterfeits and trade in contraband products poses a threat to the future of manufacturing and the trade sector in our country. To safeguard the sector against unfair competition from cheap and low quality counterfeit substitute goods, the Government will in 2007/08 introduce stringent administrative and legislative measures against trading in counterfeit and substandard goods. In this regard, I will be introducing shortly before this August House a Counterfeit Bill to stomp out dumping of counterfeit and substandard goods to safeguard our industrial and revenue base.

Promoting Growth of SMEs and Facilitating their Formalization

70. Mr. Speaker, encouraging growth of Small and Medium Enterprises remains top on Government priority as a vehicle for economic empowerment of our people. To this end, we will accelerate the on-going reforms aimed at reducing cost of doing business and formalize activities of the sector through introduction of wholesales and retail hubs countrywide in line with Vision 2030. The Government will also build platforms for enterprise start-ups and incubation that will create the pool of new and innovative SMEs.

In addition, Mr. Speaker, I have allocated an additional KShs.400 million for the ongoing construction of a hawkers market in Nairobi, whose completion is expected to provide a secured and decent business environment to over 10,000 small traders.

Empowering Our Youth

71. Mr. Speaker, in recognition of the role that our youth can play in our economic development and to create job opportunities for them, last year I allocated Ksh.1 billion to the Youth Enterprise Fund. As H.E The President indicated during the inaugural launch of the Fund, we are going a step further to enhance this Fund by allocating an additional KShs.250 million. This amount now brings the total money allocated to the Fund to KShs.1.25 billion. More funding will be allocated as the demand increases, and lessons from the initial grants are factored in the funds operation.

Empower Our Women

72. Mr. Speaker, in the same spirit, and in recognition of the immense role played by our women in developing our economy, the Government will establish a KShs.2.0 billion Women Enterprise Development Fund, with an initial injection of KShs.1.0 billion in 2007/08. I wish, therefore, to encourage corporate entities to assist the Government in this noble initiative aimed at empowering women and youth by contributing towards the two Funds established by the Government.

Further Deepening Tourism Sector Growth

73. Mr. Speaker, reflecting the international confidence accorded to Kenya as a premier tourist destination, the number of tourists has risen from about 1 million in 2002 to 1.6 million last year. And as anticipated in the ERS, we expect to hit the 2 million mark this year and the Vision 2030 anticipates this number to increase to at least 3 million visitors by 2012. As a result of more visitors, the hotel occupancy rate has also increased sharply. Tourism earnings have risen almost three fold from KShs.22 billion in 2002 to KShs.56.2 billion in 2006. The strong performance in the tourism sector continues to have a positive knock on effect on the growth of the air transport sector, hotel industry, and other related sectors of the economy. We, therefore, welcome the recent entry of Virgin Atlantic into our market.

74. Mr. Speaker, to further consolidate the gains and accelerate the sector's growth, more effort will be directed towards expanding and diversifying tourism and providing the infrastructure and ancillary services to boost the sector into becoming one of the top 10

long haul destinations, offering a high-end, diverse, and distinctive visitor experience. To this end, the Government will pay particular attention to improving tourist circuit roads. In this regard and in addition to increased resources to infrastructures sector, I have allocated KShs.300 million specifically for improving conditions of roads in national parks and game reserves. More resources will also be channelled towards improving the quality and breadth of Kenya's product offering, revamping the business visitor offering, and marketing of Kenyan brands abroad.

75. Mr. Speaker, over the medium-term the Vision 2030 envisages aggressively facilitating the development of the underdeveloped coast segment by increasing bed capacity, up scaling premium safari parks, high value niche products such as eco and lake tourism, and the business tourism. Resort cities are also contemplated in Mombasa, Turkana, and Isiolo which should serve to broaden the participation by all Kenyans in generating income and helping to make Vision 2030 a reality. These will be facilitated by the private sector, as is currently the case with tourism in the country.

Enhancing Public Safety Law and Order

76. Mr. Speaker, protection of all Kenyans and the security of their property remains top on our priority agenda. Building on the recent reforms to enhance the capacity of our police force to deal with crimes, we will, from 2007/08, focus our attention on modernizing the security systems to cope with new crime related challenges. Resources will be channelled towards modern equipment to assist the force in crime investigations, surveillance and intelligence gathering. In addition, we will continue to provide more housing to the force, recruit additional police officers to deal with any emerging crimes and provide more police equipment and vehicles to ensure security of all Kenyans.

Creating a Competitive Environment for Business Growth and Expansion

77. Mr. Speaker, to attract investment and to remain competitive in the global economy, Kenya must have an efficient and predictable regulatory business environment. This is an area where we still have important challenges ahead of us. But it is also an area where the government's sustained efforts are beginning to bear fruit. The comprehensive review of all business licenses in Kenya which started in 2005 is now coming to an end with specific actions designed to reduce the licensing burden on businesses.

78. Mr. Speaker, for the first time ever we have a comprehensive overview of the number of business licenses in Kenya – they total 1,325. Out of these licenses the government has already eliminated 110 and simplified 8. Today, I propose to eliminate another 205, and to simplify another 371. As announced in last year's Budget Speech, we

are also putting in place mechanisms to ensure the quality of new regulations and licenses.

79. Mr. Speaker, a good business environment requires a sustained and systematic government effort. Building on the positive results of the Business Licensing Reform, the government is working on a Regulatory Reform Strategy. The Strategy will provide a blue print for future efforts to streamline and improve the broader regulatory business environment, and it will build regulatory reform capacities within government agencies and within other key stakeholders. One key aim of the strategy will be to cut government “red tape” in priority areas by 25% over the next three years.

FINANCIAL OUTTURN FOR 2006/07

Revenues

80. Mr. Speaker, turning to the budget outturn for 2006/07, Hon. Members will recall that the total revenues (including LATF) were originally estimated at KSh.375.9 billion comprising KSh.336.8 billion in ordinary revenue and KSh.38.9 billion in appropriations-in-aid. I am pleased to report that, despite some challenges faced in collection of excise taxes on petroleum, total revenues are on target and are now estimated at KSh.376.1 billion thanks to additional enforcement steps taken by KRA. Of this total, KSh.338.5 billion is ordinary revenue and KSh.37.6 billion is appropriations-in aid.

Expenditures

81. Mr. Speaker, turning now to expenditures, the 2006/07 Printed Estimates indicated Recurrent Expenditure including those financed through Appropriations-in-Aid of KShs.283.4 billion. The Consolidated Fund Services took another KShs.129.1 billion while Development Expenditures took a total of KShs.137.6 billion.

82. Mr. Speaker, Owing to unforeseen commitments, we recently requested Parliament to authorize additional expenditures under the Supplementary Appropriation Bill amounting to KShs.26.9 billion. This increased total expenditures to KShs.577.0 billion comprising of KShs.293.9 billion for discretionary recurrent expenditures, KShs.142.4 billion for development expenditures and KShs.140.7 billion for non-discretionary expenditures (Consolidated Fund Services)

83. Mr. Speaker, the Consolidated Fund Services for the 2006/07 financial year consist of KShs.36.4 billion for domestic interest; KShs.5.7 billion for foreign interest; KShs.23.3 billion for pensions, gratuities and other nondiscretionary expenditures. In addition,

KShs.57.2 billion and KShs.16.7 billion were provided to finance domestic and external redemptions, respectively.

FINANCIAL PROJECTIONS FOR 2007/08

84. Mr. Speaker let me now turn to the 2007/08 budget.

Revenue Forecast

85. Mr. Speaker, the total revenue target for fiscal year 2007/08 is KSh.428.9 billion (20.8% of GDP) comprising of KSh.389.2 billion of ordinary revenue and KSh.39.6 billion of appropriations-in-aid. The targeted revenue is predicated on the on-going reforms in tax modernization, customs administration and simplification of taxation for small enterprises.

Expenditure Forecast

Recurrent Expenditure

86. Mr. Speaker, as Hon. Members have noted from their copies of the Printed Estimates gross recurrent expenditures for 2007/08 are estimated at KSh.491.9 billion. This includes KSh.38.2 billion to be financed through appropriations-in-aid, and payments for the Consolidated Fund Services, amounting to KSh.154.2 billion. The discretionary recurrent expenditure amounts to KSh.337.8 billion.

Development Expenditure

87. Mr. Speaker, gross development expenditures for 2007/08 are estimated at KSh.201.7 billion. Out of this amount, KSh.52.2 billion will be financed through Appropriations-in-Aid, which consists of direct project financing amounting to KSh.21.2 billion in loans, KSh.27.9 billion in grants and KSh.3.0 billion in local Appropriations-in-Aid. Consequently, I expect to finance net development expenditures amounting to KSh.149.4 billion from the Exchequer, comprising of KSh.15.2 billion in grants, KSh.17.3 billion in loans and a net of KSh.116.9 billion from Government of Kenya own resources.

88. Mr. Speaker, the proposed composition of expenditure is consistent with the government's objective of gradually increasing the share of development expenditure. Indeed, with the proposed sharp increase in capital spending in 2007/08, the share of recurrent expenditure will have declined from 83.6% of total expenditures in 2002/03 to

70.3% in 2007/08-conversly the share of development expenditure will have risen by about 10 percentage points.

External Grants

89. Mr. Speaker, on external grants, I have received commitments amounting to KSh.36.5 billion, and KSh.45.3 billion in loans to finance projects. Details of the donors and projects financed are included in the Development Estimates.

Deficit

90. Mr. Speaker, the overall fiscal deficit, after grants, will amount to Ksh.109.8 billion mainly on account of higher development expenditure. After taking into account expected net foreign financing of projects, amounting to Ksh.39.8 billion, the deficit to be financed domestically will amount to KShs.70 billion. I plan to finance this deficit through net privatization receipts amounting to Ksh.36.1 billion, and domestic borrowing Ksh.34 billion. Mr. Speaker, this means that the fiscal framework for 2007/08 is fully financed and there are no financing gaps.

TAXATION PROPOSALS

Overview of the Proposed Tax Policy Measures

91. Mr. Speaker, the rest of my speech outlines various tax policy and administrative measures I intend to propose through the Finance Bill, and other regulation to be tabled in this house. I therefore, request that the reminder of my speech be regarded as a notice of a motion to be moved before the committee of ways and means. As was the case last year, these measures are grouped on the basis of their intended objectives. Overall, Mr. Speaker, the measures I am proposing are targeted at:

- i. Promoting Business Competitiveness and Making Imports Affordable
- ii. Deepening the EAC Regional Integration
- iii. Promoting Equity and Enhancing Access to Medical Care and Higher Education
- iv. Promoting Agricultural Development and Environmental Conservation
- v. Promoting Housing Development
- vi. Encouraging Development of the Capital Market;
- vii. Deepening Reforms for Retirement Benefits; and
- viii. Ensuring Safety on our Roads

Promoting Business Competitiveness and Making Imports Affordable

92. Mr. speaker, the Government remains fully committed to creating an enabling environment for private sector growth and development. The following measures I am proposing are, therefore, aimed at facilitating the growth of business and expanding employment opportunities, while making domestic and imported goods affordable to Kenyans.

93. Mr. Speaker, battery recycling plants in our country have been experiencing shortages in the supply of used batteries, a key input in their manufacturing process. These shortages, which have been occasioned by increasing exports of used batteries, have consequently forced some industry players to scale-down their operations, resulting in job losses. To discourage exportation of used batteries and to protect jobs in the battery recycling plants, I propose to impose an export duty of 20% or KShs.10 per kilo on used lead acid batteries.

94. Mr. Speaker, the imposition of the Sugar Development Levy on industrial sugar has continued to limit the growth and expansion of industries that use such sugar as their raw material for manufacturing goods. In order to reduce cost of importation and encourage expansion of these industries, I propose to remove the Sugar Development Levy on all imported sugar for industrial use.

95. Mr. Speaker, partly to reduce cost of doing business and to encourage expansion of economic activities, I propose to remove the Public Service Vehicle Licence (PSV) for passenger carrying vehicles for commercial purposes. In addition I propose to remove classes 'B' and 'C' licences for goods carrying vehicles. Henceforth, there will be no more TLB licence required for non-passenger commercial vehicles.

96. Mr. Speaker, laying the foundation for achieving Vision 2030 will require adopting new technologies and deployment of cost-saving measures in order to be globally competitive. It is, therefore, imperative that the leasing sector be encouraged in order to provide avenues for businesses to acquire financing of new technologies. I propose, in this regard, to amend the Eighth Schedule to the VAT Act to zero rate leasing of some equipment.

97. Mr. Speaker, the withholding VAT system has brought administrative challenges both to the taxpayers and KRA. I will be reviewing this system soon in order to bring our VAT system in line with best practice. In the meantime, I propose to give the Commissioner the powers to exempt some taxable supplies, including lease financing from the withholding system requirements as well as to deregister any person from being a withholding VAT Agent.

98. Mr. Speaker, during last year's budget, I proposed amendments to the Insurance Act to provide for cash and carry in respect of fire and motor vehicle insurance cover. In view of the positive impact of this measure on the industry and in order to further streamline the industry, I propose to extend cash and carry to all classes of business.

99. Mr. Speaker, while on the VAT subject, I wish to acknowledge complaints I continue to receive from the business community regarding the persistent delays in the refund of VAT and its impact on their business operations.

100. This is despite the fact that last year I enhanced funds for VAT refunds to Kshs 900 million, per month. Being a government that listens to its citizens the KRA will adopt a fast track system for VAT refunds. The new system will allow automatic refunding of the first two claims within a quarter without audit. The third claim, however will trigger an audit of the entire period. To ensure effective cooperation of this system and to ensure it is not abused, KRA will monitor closely the new system for further improvement as VAT refund audit indicates lower risks.

101. Mr. Speaker, last year, in consultation with my counterparts from Uganda and Tanzania, we agreed to reduce import duty on several goods to encourage growth of our industries. To further consolidate the growth of our manufacturing sector and expand opportunities for Kenyans to find jobs, we have agreed to:

- i. Reduce import duty rate from 25% to 10% on felt material that are used for the manufacture of oil and air filters for motor vehicles.
- ii. Remove import duty rates on textile fabrics and felt that are needed in the manufacturing process of paper. Further, import duties on millstones and grindstones for milling, grinding or pulping are removed.

102. Mr. Speaker, our importers have continued to incur higher import costs arising from the Import Declaration Fee (IDF). In order to reduce the cost of importation and make such imported goods affordable to Kenyans, I propose to reduce the IDF from 2.75% to 2.25% for all goods imported from outside the EAC countries, while no IDF will be charged on goods imported from EAC Partner States.

Encouraging Regional Integration

103. Mr. Speaker, as a demonstration of our commitment to the EAC regional integration in accordance with the East African Community Protocol, I propose to:

- i. Treat all citizens of the East African Community Partner States who invest in the Nairobi Stock Exchange and earn dividend income as residents and will pay withholding tax at the rate of 5% just like Kenyans.
- ii. I am also proposing to amend the Capital Markets Act to increase the percentage of IPOs reserved for Kenyans from 25% to 40% and treat citizens of other East African Partner States as local investors.

Promoting Equity and Enhancing Access to Medical Care and Education

104. Mr. Speaker, I received various representations from Kenyans proposing a reduction in personal income tax. However, given the various projects we intend to finance, and the targeted intervention by government to reduce poverty, it will not be desirable to address this issue in this budget. We consider rationalization of the tax brackets as a priority policy and I have accordingly instructed my officers to conduct comprehensive simulations and propose possible options for consideration in the next fiscal year. In the meantime, our analysis shows that the interventions I have proposed in this budget will go along way in increasing the disposable incomes of majority of Kenyans, especially in the lower income brackets. These interventions which are intended to reduce the financial burden on Kenyans, include among others, funding for: tuition fee in secondary schools; increased medical supplies to health facilities; support for orphaned children; settlement of landless; construction of hawkers' market; accelerated and expansion of rehabilitation of road network; and reforms in the telephony sector to reduce cost of making calls, among others.

105. Mr. Speaker, to make medical care affordable and accessible to Kenyans, I propose to exempt from import duty medical equipment imported by licensed hospitals. I urge all managers of medical facilities, especially those under the private sector, to review downwards their charges accordingly.

106. Mr. Speaker, establishment of Private Universities has continued to play a vital role in enhancing knowledge and skills development amongst the youth of this country. In order to encourage expansion of these institutions, I propose to zero rate taxable goods, and taxable services supplied by a registered person for use in the construction or expansion of Private Universities, excluding student hostels and staff housing.

107. Mr. Speaker, to further promote equity in our excise tax systems and to enhance tax administration, I propose to introduce the following simplification:-

- i. Re-categorize the existing cigarette bands to be based purely on cigarette characteristics comprising of length, package and whether the cigarette is

filter or non-filter. This measure is intended to harmonize excise regime for domestically produced and imported cigarettes and to enhance our tax administration. This will also effectively deal with any trade in counterfeit and contraband cigarettes. I also propose to increase excise tax on cigarettes falling in categories “B”, “C” and “D” by KShs.1.70 per pack, KShs.4.20 per pack and KShs.6.20 per pack, respectively. I expect this modest contribution by smokers will assist the Government in financing healthcare provision and other development priorities.

- ii. Convert the current complex taxation of spirits at KShs.120 per proof litre or 65% to its equivalent of KShs.200.40 per litre or 65% in line with the internationally accepted World Customs Organization (WCO) Nomenclature, which provides “litre” as the unit of measure. I propose to adjust upward the excise tax on portable spirits from KShs.200.40 per litre or 65% to KShs.280.00 per litre or 65%, whichever is higher; and that of wine, from KShs.54.00 per litre or 65% to KShs.85.00 or 65%, whichever is higher.
- iii. In addition to the above, I propose to:-
 - a. Increase the excise tax on malt beer by KShs.2.00 per litre, from KShs.48.00 per litre to KShs.50.00 per litre. This modest increase will make a token contribution towards financing tuition fee in secondary schools
 - b. Introduce a specific excise tax at KShs.6.00 per litre on bottled mineral water, besides the current ad valorem excise tax of 10%;

Mr. Speaker, These excise measures are effective from Midnight, today.

Promoting Agriculture Development and Environmental Conservation

108. Mr. Speaker, in order to reduce losses to our milk farmers and encourage growth of our dairy sub-sector, I propose to zero-rate milk powder for VAT purposes to encourage processing of excess milk into powder. This measure is expected to make powder milk affordable to all Kenyans.

109. Mr. Speaker, I also propose to zero-rate pyrethrum extract in order to encourage the manufacture of insecticides using local pyrethrum extract and also bring it in line with all other imported raw materials for insecticides which are currently zero-rated.

110. Mr. Speaker, last year I reviewed the export duty on local hides and skins upwards to 20% or KShs.10 per kilo in order to encourage local value-addition and ensure availability of raw materials for the local tanneries and to create employment. In order to give further impetus to value addition in this important sector, I am proposing to increase the export duty on raw hides and skins to 40% or Kshs.20 per kilo.

111. Mr. Speaker, environmental conservation is a central pillar of sustainable development. Partly to protect our environment from further degradation, I propose to impose an excise duty of 120% on plastic bags. I further propose to impose a ban on very thin plastic bags. These measures are expected to encourage industry players to devise environmentally friendlier bags for shoppers.

Promotion of Housing Development

112. Mr. Speaker, the current housing and shelter is still inadequate to meet the demand of Kenyans. Last year I exempted interest earned on deposits for home ownership savings plan of up to Kenya Shillings three million. To further encourage development of housing and provision of affordable shelter to Kenyans. I propose to:

- i. Give industrial building allowance to persons constructing residential buildings for rental purposes to the Low Income Earners.
- ii. Zero-rate taxable goods and taxable services supplied to specific projects for the constructions of a minimum of 20 units of houses situated in planned development schemes for the benefit of low income earners.

113. Mr. Speaker, in order to encourage more people to own houses, I propose to amend the Retirement Benefits Act to provide for assignment of pension benefits as security for accessing housing loans subject to the development of appropriate Regulations to ensure the spirit of pension benefits is not eroded and also to ensure that not all the pension benefits amount is used for security for the housing loan.

114. Mr. Speaker, to encourage further expansion of commercial buildings in line with increased economic activities, I propose to remove non-residential buildings from the VAT exempt category and allow input tax deduction on commercial property development. I also propose to impose VAT on rental of non-residential buildings. This measure will not affect rental of buildings for residential purposes which remain exempt. In addition small scale landlords will be left out of the tax since the law will only apply to those landlords who earn in excess of Kshs.5 million per annum in rent.

Strengthening the Financial Sector

115. Mr. Speaker, our banking sector is currently characterised by many small unviable institutions incapable of investing in modern technology and critical mass of competency required to provide modern and efficient banking services to Kenyans. This has led to dominance of local banking sector by foreign owned institutions. In order to encourage the merging of small local banks so as to enable them to expand and compete with foreign owned banks, in terms of resources, technology and services, I propose to raise the minimum capital for bank from the current KShs.250 million to KShs.1 billion over a period of three years. This will prepare our banking industry players to consolidate their services and ensure efficiency in order to take advantage of the emerging regional opportunities.

116. Mr. Speaker, we have in the past witnessed the collapse of a number of insurance companies largely attributed to inadequate legislative and regulatory framework and subsequently a weak financial base. In order to improve the financial strength of insurance companies, I propose to increase paid up capital for: (i). long-term insurance business from Kshs.50m to Ksh.150m; (ii). general insurance business from Ksh.100 million to Ksh.300m; and (iii). Composite insurance business from Ksh. 150 million to Ksh.450 million. The insurance companies will be required to comply with this new paid up capital requirement in two years.

Deepening Capital Market Development

117. Mr. Speaker, the Government is conscious of the need to protect the integrity of the stock exchange and to protect the small investors from unscrupulous market players. Therefore, in order to empower the Capital Markets Authority to effectively regulate the Capital Markets, I propose amendments to the Capital Markets Act to give the Authority power to levy financial penalties among other penalties depending on the nature and magnitude of offences. The penalties have also been enhanced to make them more deterrent.

118. Mr. Speaker, as I alluded to in my last year's Budget Speech, there is need for further reforms to deepen the money and capital markets. However, this can only happen if legal impediments caused by the Internal Loans Act are addressed. The said Act does not recognize dematerialized/paperless securities, thus keeping the government bond market behind technological developments. In this regard, I propose to make necessary amendments to the Internal Loans Act. This will go along way to facilitate implementation of a primary dealership system in the Capital Markets.

Deepening Reforms for Retirement Benefits

119. Mr. Speaker, in recognition of the invaluable contribution our senior citizens have given in the development of this country, I propose to exempt the monthly pension granted to these important persons from tax.

120. Mr. Speaker, in order to expand coverage by NSSF, I propose to amend the NSSF Act to allow individuals to contribute voluntarily to NSSF as is the case with NHIF. I further propose an amendment to the NSSF Act to provide that the monthly 5 per cent of total wages of casual workers paid to NSSF by employers be declared as surplus benefits whenever an actuarial valuation of the Fund is carried out and used to augment the benefits of voluntary individual accounts. This will now allow casuals and the self employed to voluntarily join and benefit from the NSSF.

121. Mr. Speaker, due to delays that have been witnessed in the past in relation to payment of benefits of a deceased person to survivors, I propose to amend the Retirement Benefits Act to provide that benefits arising by reason of death of a scheme member do not form part of a deceased person's estate and shall be paid by the trustees in accordance with the scheme rules.

122. Mr. Speaker, I propose amendments to the Retirement Benefits Act to provide for establishment of a Trust Fund within the Retirement Benefits Authority for receiving pension funds together with the accrued investment earnings of the pension benefits of scheme members that cannot be traced when the schemes are wound-up. This will safeguard the benefits of the scheme members that are eroded over time by liquidation costs since the liquidators are unable to discharge their duty until the amounts are completely depleted or the member turns up.

Ensuring Safety on Roads

123. Mr. Speaker, recent road accidents are partly caused by continued importation of used motor vehicle spare parts. In order to discourage importation of such spare parts and to enhance safety of Kenyans on our roads, I propose to impose a 20% excise duty rate on all imported used motor vehicle spares.

124. Mr. Speaker, in the 2006/07 budget I removed the requirement for road license for all motor vehicles. To further ensure safety and security of our motor vehicles, I propose to change the law to require that Vehicle Registration book(s) and Number Plates of all vehicles that have been written-off be returned to the Registrar of Motor Vehicles for proper keeping of records.

Mr. Speaker, I have highlighted only a few of the changes. The details are contained in the Finance Bill.

CONCLUSION

125. Mr. Speaker, while making my concluding remarks, allow me to commend all those Kenyans; (i) individuals and corporate entities; (ii) young Kenyan and senior citizens; (iii) business people and working class; as well as (iv) scientists and NGO players who participated in this year's budget. Mr. Speaker, for the first time in our history, the preparation of this budget benefited immensely from a very constructive interaction with Kenyan people some of whom wrote directly to us while others sent us proposals through our e-mail address at the treasury budget2007@treasury.go.ke.

126. Mr. Speaker, among many more contributions I received, allow me to cite one outstanding representation. This particular one was unique both in terms of its content and the writer – a 13-year old young Trevor Kibet Langat of Brook House School. In his submission for consideration in the 2007/08 budget, Trevor writes:

"I have been watching the economy grow from 0.3% to 6%. But sometimes I ask myself why Kenya can't be like Singapore or South Africa. I went for Young People Conference in South Africa in February and I was amazed by the infrastructure. Is Kenya ever going to build such roads? Kenya definitely has the potential to become a world class economy. I watch CNBC (Cable Network Business Channel). When I am of age, I will create a business Channel that will engage politicians to talk about business and economic activities of the people of Kenya. I think it is time that we have professional political leaders. We could make Kenya not only a huge economic country but also make Kenya a business centre. Kenya will one time be a huge economy and I will support the Government, but I will not just simply talk of how bad or good the Government is, I will take action and build Kenya even in the smallest way possible. I think it is time for me to take action and it is also time for all Kenyans to take actions. I have taken risk to write to you. I believe the biggest risk is not to take risk"

127. Mr. Speaker, Trevor is calling on all of us to take actions and join hands to build our country. The time is now for each one of us to take actions towards making our country prosperous. The budget I have presented to day for 2007/08, is therefore intended to consolidate and accelerate our recent achievements and to broaden opportunities for all Kenyans to participate in building a brighter future that Trevor and other Kenyans yearn for. This young Kenyan is challenging us all to have a positive outlook to life, love ourselves and our motherland and most importantly focus on economic development agenda. He is calling us to join hands to build our country.

128. Mr. Speaker, the success we have achieved on the economic front over the past four and half years can be directly attributed to our working together, in close partnership and collaboration with Kenyans of all walks of life. On the part of Government, this partnership has meant listening very closely to the people's wishes and then delivering on agreed policies and programs. The result is that Kenya has been ushered onto a new economic platform which facilitates the process of transforming it to a middle income country in the next 15 – 20 years or so, as envisaged in Vision 2030, but within a framework of good governance and the rule of law, respect of human and property rights, private sector development and prudent economic management.

129. Mr. Speaker, the budget I have presented to day for 2007/08, is intended to consolidate and accelerate our recent achievements and to broaden opportunities for all Kenyans to participate in building a more prosperous nation and to bring a better quality of life for all Kenyans. In pursuit of this noble goal, we as a people must unite and rally around a single Vision, that is, Vision 2030 which will engender high productivity and growth with a sense of social responsibility and equity. Let us all rededicate ourselves and work hard towards achieving this Vision.

130. Mr. Speaker, I therefore wish to urge my fellow Kenyans, not to allow themselves to be distracted from this successful partnership that has worked so well. With determination from all of us, and with God's help, we shall succeed beyond our wildest dreams, working together on the path to prosperity!

Mr. Speaker, I beg to move