

News Release

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A paradigm shift?

The Economy

PricewaterhouseCoopers welcomed the 2009 budget's focus on spending at constituency level that will call for greater accountability and auditing of its implementation. There was a deliberate move towards fiscal devolution through the Constituency Development Fund (CDF) and devolution of funds to the constituency through line ministry conditional grants.

Kuria Muchiru, the incoming Country Senior Partner said "This is likely to have an effect of achieving equitable distribution of resources and efficiency in spending, albeit varied, by enhancing absorption rates at local levels. It remains to be seen how the structures at CDF level will be bolstered to manage the increased funding."

There was a great boost to the Infrastructure and ICT, a clear stimulus for spending. The minister intends to spend Kshs 140 billion for roads across the country, with Kshs 3 billion for the new railway. However there are implementation challenges around the capacity to absorb this allocation.

Kuria Muchiru said "While this allocation to infrastructure is very welcome and will propel the economy to the desired 5% GDP growth, the key challenge around the allocation will be the capacity to absorb this money within this sector in the given year."

Kuria Muchiru said, "The budget is consistent with the Vision 2030 pillar of achieving social equity. The political pillar needs to be addressed by the government for the economic pillar to hold. The budget is bold, different and shifts focus to outputs rather than inputs. This is crucial for the economy to grow. The challenge is to ensure that, for once the budget is executed fully".

Capital Markets

The Minister set out to harmonise regulatory framework and stabilise capital markets. The sector reforms in the 2009 budget followed the past pattern of focusing on financial services. It was expected that the Minister for Finance would take some action on this important sector given the recent turbulence caused by stock brokers and the need to restore investor confidence in the stock exchange.

The outgoing country leader, Charles Muchene pointed out that the changes proposed in the budget have borrowed significantly from current regulation in the banking industry and for this reason the significant impact is in Capital Markets, the Insurance Industry and Pension Schemes.

Charles Muchene said “This is a step in the right direction. However, it is yet to meet the expectation that ultimately there will be a single Financial Services Authority/Regulator.”

Charles Muchene said, “This is a more expansionary budget, no increase in taxes, putting the government’s hopes more on borrowing. But of course this does depend on a number of factors such as term structures, maturity profile for banks, among others. Given the current economic situation, banks have high liquidity and there is little demand from private sector so the issue of high interest rates may not necessarily arise.”

Tax

The bottom line is that the government needs to increase revenues by at least 10% in the coming fiscal year through revenue collection drive to be underpinned by reforms in the tax and customs administration by the KRA to fund this increase.

Some of the tax reforms include mobile phones made exempt as opposed to zero-rated that may not translate to price reductions, as well as taxable value changed to exclude any remitted duty and only take into account duty paid and not duty payable. One contradiction exists in the hybrid excise regime on wines and spirits likely to lead to an increase in costs against a reduction of excise duty on juices, water and carbonated drinks, cosmetic products and jewellery.

Steve Okello, Partner and Head of Tax said, “The Minister has been hamstrung by environmental issues largely outside his control and has acknowledged this. The tax measures mooted are part of the economic stimulus that is of a longer term nature and should not be expected to bear fruit in the next 12 months”

However, there are winners under the VAT regulations: VAT on services exported out of Kenya now clarified but more work needs to be done with the areas of VAT exemption on financial services now expanded regardless of supplier. There are several Incentives given to a number of sectors: dairy farming, agriculture, horticulture and forestry. In addition the Minister has extended the investment allowance incentive to non-manufacturers who invest at least Shs 200m in the construction and the fitting of a building. This is a welcome move that would be greatly appreciated by most businesses that intend to own or to rent out their properties.

Summary

The business environment proposals will provide incentives for more investments. However, external factors such as global economic downturn will weigh heavily on new or expanded investments locally.

The government's capacity to spend, equitable distribution of resources, implementation of austerity measures in government spending and ability of the coalition government to work cohesively will be important to the success of the budget execution.

Charles Muchene said, "How effective and sincere the government is, will be reflected by the levels of aggregate demand for goods and services within the year. Government has to bring in the private sector to enhance the absorption capacity of funds and continue its own reform agenda."

For more detailed analysis of the economy, direct taxation, customs and excise, VAT, Sector reforms and East African highlights, please visit www.pwc.com/ke.

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