ICPAK PRESS STATEMENT ON THE BUDGET STATEMENT 2017-2018

Friday 31st March 2017

The Institute of Certified Public Accountants of Kenya (ICPAK) applauds the Cabinet Secretary, National Treasury on presentation of the Budget Statement for the Financial Year 2017-18. This indeed is a historic budget of Ksh. 2.6 Trillion!

Macro-Economic Environment

This year's budget is framed against a backdrop of stable macro-economic environment anchored on a projected economic growth rate of more than 5.9% in 2017 against the 6.0% growth rate realized in 2016. The projected growth s is expected to be fueled by recovery of the tourism sector, strong private sector investment, completion of key public projects in road, rail and energy generation.

Nevertheless, ICPAK is of the considered opinion that more mitigation measures should be put in place to deal with both external and internal economic shocks. Most notably, effects of Brexit at global level and protectionist policies by advanced economies are yet to be felt here in Kenya. The continued drought in many parts of the country and uncertainties associated with the run-up to 2017 elections may also impact on overall projected growth.

It's imperative to note that economic growth has been noted to slow down in three out of five past election years. In fact, with elections, uncertainties among investors may lead to reduction in inflow of forex. Some investors may hedge exposure to the shilling by converting their shillings to the increasing strong dollar thus exerting pressure to the shilling.

ICPAK commends the Government for the improved business environment. The increase in Foreign Direct Investment (FDI) from US$ 0.514 Billion in 2013 to US$ 2.3 Billion in 2016 is a testament of the greater efforts put in by the government, private sector and all stakeholders. We need to maintain this trend!

Containing inflation

We applaud the government for making importation of white maize to be on a tax-free basis for a period of four months. Expansion of the tax bands implies that disposable income for lower households below the bands increases.

However, ICPAK believes more needs to be done to cushion these low-income households against the brunt of increase in prices of other basic commodities; and general improve the food security of the nation.

Private Sector Credit

The Institute is concerned with the continued deceleration of private sector credit from 13.5% in April 2016 to 4.7% by October 2016. This is a worrying trend given the role the sector plays in job creation and offering entrepreneurial opportunities, enabling technology transfer, building essential human capital and physical infrastructure and generating public revenue for governments.

There's need for the government to consider the factors causing this scenario with an aim of reducing their adverse effects on the sector.

Focus on completion of projects and diversification of the economy

We recognize the need for infrastructural development as a key plank to our country's transformative agenda. Indeed, investment in rail, road and air transport is vital in unlocking the economy's potential.

We further laud the Government for developing guidelines on how implementation of capital projects.

However, ICPAK is concerned with:

- Will this remedy the persistent delay in completion of some capital projects such as the SGR?
- Does this mean that the expected benefits of these projects will not be felt any time soon?
- Is there more focus on infrastructure development at the expense of manufacturing and industrialization?

As such, we are of the considered opinion that there's need to diversify to manufacturing and industrialization sectors. Indeed, manufacturing, is one of the largest sectors, contributing approximately 10.5% to GDP in 2015. This will play a major a major role in creating jobs and increasing revenue generation.

Public Expenditure

To improve the implementation and absorption capacity of projects and curb non-priority expenditures, the CS indicated that he has issued guidelines on how capital projects should be planned, appraised and evaluated before funds are finally committed in the Budget.

The Government committed to continue rationalizing public expenditure and keep Government spending under control in the FY 2017/18. To manage the wage bill, new recruitments will remain frozen except for limited technical staff, security personnel, teachers and health workers. These actions will release funds for priority social sectors and critical infrastructure. Despite the measures, wage bill is but a component of the bigger challenge of public finance management failures in Kenya. Inherent to its root causes is the lack of the necessary policy framework, failure to rationalize other recurrent expenditures, misappropriation of funds and resources, mismatch in professional custodianship and misplaced priorities among others.

Public Sector Wage Bill

Beginning July 2017, the CS indicated that salaries and allowances of all public servants will be harmonized as per the guidelines provided by the SRC following the job evaluation exercise which resulted in an upward review of salaries for teachers and doctors and other public officers. We trust that

SRC provides a comprehensive and effective wage policy that will govern the review and setting of public sector salaries and remuneration. This is important for sustainable growth and development. One of the most glaring phenomenon on public wage system is that the sheer disparity of wages in the public service which is largely eschewed towards the middle and top managers. We need interventions to bridge the gap to entrench fairness and achieve desired level of commitment to public service by all civil servants. The pay structure must be commensurate with the costs of living index. This will help the government deal with ethical related concerns with public procurement, where it has been demonstrated that we lose about one third of the budget.

Budget implementation

Delay in release of funds by the National Treasury to entities has had a negative effect on absorption especially on development projects. Though entities continue to increase the absorption of both recurrent and development funds as compared to the previous years, there is need for MDAs to focus on fast-tracking the completion of key ongoing projects and ensure that new projects are considered in against the context of constrained exchequer support. Ministries improve the utilization of approved allocations especially of borrowed funds with a view to minimize the associated opportunity in form of delayed benefits to Kenyans, fiscal risks as well as contingent liabilities. Moreover, Ministries, Departments and Agencies should enhance the disclosure of Appropriations in Aid in the IFMIS.

The Institute strongly encourages government to manage the exchequer releases to ensure that there is adequate funds to drive growth in budget absorption rates.

Devolution

We applaud the National Treasury on the continued support to County Governments. As the second county governments come on board, it will be important that accountability systems are enhanced. We urge that the proposed policy and legislative framework to support county enhancement of own-source revenue thereby strengthening their ability to offer better services to the public, be finalized soonest preferably before the inauguration of the second county governments.

Revenue Raising Measures

We note that the total revenue projection for FY 2017/2018 amounts to Ksh. 1,704.5 Billion. The projections are supported by ongoing reforms in tax policy and automation through interagency collaboration. Income tax is therefore expected to be the primary driver of revenue growth for FY 2017/2018. The budget statement read by the CS National Treasury indicated the government's intention to introduce a 50% uniform tax rate all betting, lottery, gaming and competition. While we appreciate, the government's intention to utilize this tax to discourage consumption while raising additional revenue, we note that this rate imposes a substantial increase on the tax liability to this sector. We therefore strongly advise government to widely consult the industry players to prevent adverse effects occasioned by the variation in the tax rate.

We further note that the budget statement increases the excise duty rate on high value sprits from Ksh175 to Ksh. 200 per liter. The statement further introduces an inflationary adjusted tax rate on all excisable goods, to increase the contribution of excise to overall revenue collection. We note that the implementation of this policy will overall increase the cost of excisable goods which inevitably could affect consumption of this goods. Due to the vast portfolio of excisable goods, it is important for government to consider the overall implication of the increase in the cost of excisable goods on the various sectors affected.

We also note that Income Tax will be the primary driver of revenue growth in 2017/2018. The budget statement indicates that government is prioritizing the review of the Income Tax act. This implies that the attainment of the revenue targets hinges on how efficient the reforms around income tax are implemented. We however note that any delays in the enactment of the law could trigger an increase in borrowing to finance the deficit. It is there imperative that parliament fast tracks the enactment of the new income tax act in order to facilitate generation of direct taxes.

Deficit Financing

The Institute notes that the overall cumulative debt of the country currently stands at Ksh. 2.9 Trillion. We further note that the debt Service to revenue ratio, which measures how much of our revenue is servicing our debt, is projected at 34.7%, against a recommended threshold of 30%. This implies that there is a substantial amount of our revenue being applied to pay off our debts. We also note that the debt Interest and redemption in 2017/2018 stands at Ksh 621.8 B, increasing from 466.5 B in 2016/2017.The increase has been occasioned by maturing loans such as the Standard Chartered Syndicated Loan.

We also note that CFS Expenditure accounts for up to 41% of the total projected revenue, indicating that only 59% of the total revenue will be available for other government budgetary activities. This points to a widening funding gap which would be filled through borrowing.

FCPA Julius Mwatu
National Vice Chairman, ICPAK

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