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Kenya Finance Bill 2018: VAT on Petroleum Products and Pesticides – Analysis and Impact on Food and Nutrition Security

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1 Abbreviations and special terms

BPS	Budget Policy Statement
CBK	Central Bank of Kenya
CS, NT	Cabinet Secretary, National Treasury
FNS	Food and Nutritional Security
FNSP	Food and Nutritional Security Policy
IPM	Integrated Pest Management
MDAs	Ministries, Departments and Agencies (mainly State Corporations)
MSMEs	Micro, Small and Medium Sized Enterprises
NT	National Treasury
PCP	Pest Control Products
PBB	Programme Based Budget

2 Background on the VAT Law in Kenya and the Application to Fuel Products

2.1 How did we get here?

Kenya introduced Value Added Tax (VAT) in 1990 to replace the 3% Sales Tax. Though the *standard rate* at introduction was set at 17%, there were a plethora of other VAT rates. Over the years these have been reduced gradually. The historical record shows that Kenya has constantly "tinkered" with the VAT rates as shown in Table 1 in a bid to achieve transient policy goals, for example curbing tax evasion and making local products competitive. Table 1 further illustrates *the multiplicity of VAT rates over the years. The VAT Act 2013 sought to simplify these multiple rates into just 2 rates – a standard rate and zero rating.*

Table 1

Financial Year	No. of Rates	VAT Rates (%)	Standard Rate (%)
1989/90 VAT Introduced	**15**	**0, 3, 5, 17, 18, 25, 30, 35, 45, 50, 75, 80, 100, 150, 210**	**17**
1990/91	9	0, 5, 18, 30, 45, 50, 80, 100, 150	18
1991/92	8	0, 5, 18, 25, 35, 50, 75, 100	18
1992/93	6	0, 3, 5, 18, 30, 50	18
1993/94	4	0, 5, 18, 40	18
1994/95	4	0, 5, 18, 30	18
1995/96	4	0, 6, 15, 25	15
1996/97	3	0, 8, 15	15
1997/98	3	0, 10, 17	17
1998/99	4	0, 10, 12, 16	16
1999/00	4	0, 10, 13, 15	15
2000/01 to 2002/03	4	0, 10, 16, 18	18
2003/04 to 2006/07	3	0, 10, 16	16
2007/08 to 2012/13	3	0, 12, 16	16
2013/14 to **2018/19**	**2**	**0, 16 ****	**16**
2018 Finance Bill **President's Memo**	**2** **3**	**0, 16,** on petroleum products defer for 2 years **0, 16, <u>8 on petroleum products, apply now</u>**	**16** **16**
** Upon enactment of VAT Act No.35 of 2013. Finance Bill 2018 proposes to defer 16% VAT in petroleum products for a further 2 years to 1 September 2018[1] President proposes a **concessionary VAT rate of 8% effective 20 September 2018.**			
Source: KNBS Surveys			

The VAT Act 2013 brought many previously ***<u>exempt</u>*** goods and services into the VAT tax regime at 16%, such as wood and charcoal. Some previously ***<u>zero-rated</u>*** goods and services became taxable at 16% such as milk and cream, maize, wheat flour, bread, infant formula and electricity to domestic consumers (DC) under a lifeline tariff (for monthly use under 200kwH). The impact on low income consumers, particularly in the informal sector, was significant.

[1] Petroleum products had been exempt from VAT since 1 September 2013 (when the Value Added Tax Act, 2013 became effective) for a transition period of 3 years, which was due to expire on 1 September 2016. On 9 June 2016, the National Assembly through the Finance Act 2016, approved a 2-year extension to the exempt status of petroleum products to 1 September 2018.

2.2 Initial considerations of VAT as a form of consumption tax

It's important to state at the outset what VAT is. **Value Added Tax (VAT) is a general consumption tax that's ultimately borne by the final consumer**. It is assessed on the value of goods produced and services rendered at each stage in the production, distribution, sale and final consumption stage, including on food and agricultural products and services.

VAT is an indirect tax on expenditure-which means it's not a tax levied directly on income or earnings like income tax and corporation taxes. Unlike VAT, taxes that vary with income are considered progressive.

VAT is almost always a regressive tax as the tax burden falls disproportionately on low income earners, and the poor and vulnerable members of society including the elderly and people living on social welfare transfers. **VAT therefore impacts heavily on all aspects of the lives and livelihoods of consumers, particularly low income consumers** living in urban and rural areas and the 83.45% of Kenyans who earn their livelihoods in the informal sector. Further, VAT on petroleum products, which permeates into the costs of all products, also impacts critically on all businesses – large and small.

2.3 How well does VAT suit an economy with a large informal sector?

Just how well does VAT suit the Kenyan economy? About **14.1 million Kenyans or 83.45% are employed in the informal sector**. **55.8% of the 138,190 enterprises in Kenya** report a turnover below the VAT registration threshold of KSh. 5 million. Hence a significant number of workers are *mostly employed by MSMEs in the informal sector*, and by few *formal sector enterprises* with turnover below the KSh.5mn VAT registration threshold.

These MSMEs and small enterprises are unable to claim VAT paid on inputs, materials and services that they purchase to enable them supply *vat-able* output. Accordingly, **input VAT paid by non-VAT registered MSMEs and small, formal sector enterprises is, for all practical purposes, a "final tax"** in the same way that sales tax that preceded VAT was ***a final tax*** – except that sales tax was levied at rates as low as 3%. Hence, the *cost of VAT boomerangs (or "telescopes*") through the supply and value chain of most products and services.

The implementation of VAT in economies like Kenya with a large informal sector, low levels of tax and VAT compliance and poor record-keeping tends to achieve just the opposite of what the typical VAT regime ought to achieve.

For small enterprises and MSMEs even a small rate of VAT including a concessionary VAT rate of 8% on petroleum products is transmitted, and reverberates through, the supply chain of virtually all products and services. It follows that VAT for most enterprises in Kenya – *irrespective of whether their supplies fall under exempt or zero-rated regime* – automatically translates into price increases that are higher than the standard or concessionary rate of VAT imposed as most or all of ***input VAT*** in the supply chain falls on them as ***a "final tax"***.

Only taxpayers registered for VAT and who meet the annual turnover threshold of KSh 5mn can claim ***input VAT*** (defined as VAT paid by *registered persons / entities* on purchases of vat-able goods and services used for business purposes towards supplying taxable supplies).

Other requirements for claiming input VAT beyond the annual turnover threshold for VAT registration are onerous or exceed the capacity and capabilities of most MSMES

and small enterprises in Kenya. These include requirements to acquire *Electronic Tax Register / Electronic Signature Device* (ETR/ESD) machines as input VAT can only be claimed on invoices issued with ETR/ESD devices. ETRs and ESD devices were introduced in 2005 to improve efficiency, address VAT evasion and the poor record keeping for business transactions across large and small enterprises.

A simple example to illustrate the impact of VAT on final consumers is set out in the tables below. These assume an enterprise that adds a ***modest 25% of internal value* addition** to what it buys. The business in turn sells its output at a selling price that adds a **modest profit margin of 20%** on its inputs and internal value added. The process is then repeated through 5 stages in a simple supply chain before reaching the final consumer.

Table 2

Standard VAT applied is fully recoverable and not factored into costings Purchases and Sales between VAT registered enterprises							
Inputs & Purchases				Outputs & Sales			
Stages in Supply Chain	**Cost Prices**	Input VAT	TOTAL	Internal Value Added	**Selling Prices + margin**	Output VAT	**Due from Customers**
		16%		25%		**16%**	
1	**80.00**	**12.80**	**92.80**	**20.00**	**100.00**	**16.00**	**116.00**
2	100.00	**16.00**	116.00	25.00	**125.00**	**20.00**	**145.00**
3	125.00	**20.00**	145.00	31.25	**156.25**	**25.00**	**181.25**
4	156.25	**25.00**	181.25	39.06	**195.31**	**31.25**	**226.56**
5	195.31	**31.25**	226.56	48.83	**244.14**	**39.06**	**283.20**

Table 3

Fully Recoverable Input VAT on Zero Rated Supplies NOT factored into costings. Purchases and Sales between VAT registered enterprises							
Inputs & Purchases				Outputs & Sales			
Stages in Supply Chain	**Cost Prices**	Input VAT	TOTAL	Internal Value Added	**Selling Prices + margin**	Output VAT	**Due from Customers**
		16%		25%		**0%**	
1	**80.00**	**12.80**	**92.80**	**20.00**	**100.00**	**0.00**	**100.00**
2	100.00	**16.00**	116.00	25.00	**125.00**	**0.00**	**125.00**
3	125.00	**20.00**	145.00	31.25	**156.25**	**0.00**	**156.25**
4	156.25	**25.00**	181.25	39.06	**195.31**	**0.00**	**195.31**
5	195.31	**31.25**	226.56	48.83	**244.14**	**0.00**	**244.14**

Table 4 shows a supply chain with *only one VAT registered* intermediate input supplier at the first stage charging VAT that then ripples through the 5 stages in the supply chain as *input VAT* from the first buyer to the final consumer price. It illustrates that **even one single stage where un-recoverable input VAT is factored into costings** can transmit dramatically *higher prices* in the food or supply chain.

Table 4

Standard VAT that is NOT recoverable by at least one enterprise is factored into **costings** on subsequent stages. Purchases and Sales *mainly* between **non-VAT** registered enterprises/informal sector firms (except for one used as an example)					
Inputs & Purchases			Outputs & Sales		
Stages in Supply Chain	**Cost Prices**	Input VAT	TOTAL	Internal Value Added	**Due from Customers**
		16%		25%	
1	**80.00**	**12.80**	**92.80**	**23.20**	**116.00**
2	116.00		116.00	29.00	**145.00**
3	145.00		145.00	36.25	**181.25**
4	181.25		181.25	45.31	**226.56**
5	226.56		226.56	56.64	**283.20**

Table 4 and 5 illustrate a *mix* of VAT registered and Non-VAT registered firms trading taxable intermediate inputs with each other in a simple, 5 stage supply chain before the final product reaches consumers. Table 4 shows that VAT ripples through to the final consumer price, even when the supply chain *has just one VAT registered firm* in the supply chain – in contrast to Table 5 – where the supply chain *has a mix of VAT registered and Non-VAT registered firms* trading intermediate inputs with each other.

Table 5

Standard VAT NOT recoverable by a few non-registered firms in a supply chain **that contains a few vat-registered enterprises.** Purchases and Sales take place between a **mix of** small enterprises /informal sector firms **not registered** for **VAT** with large *VAT Registered Firms*							
Inputs & Purchases				Outputs & Sales			
Stages in Supply Chain	**Cost Prices**	Input VAT	TOTAL	Internal Value Added	**Due from Customers**	Output VAT	**Due from Customers**
		16%		25%			
1	**80.00**	**12.80**	**92.80**	**23.20**	**116.00**		
2	116.00		**116.00**	**29.00**	**145.00**	**23.20**	**168.20**
3	168.20		168.20	42.05	**210.25**		
4	210.25	**33.64**	243.89	60.97	**271.22**		
5	271.22		**271.22**	**67.81**	**339.03**	**54.24**	**393.27**

Table 5 shows the **typical** supply chain that contains a mix of *VAT registered and Non-VAT registered* SMEs and small firms trading with each other where:

(a) *VAT registered* intermediate input *suppliers* sell to *Non-VAT registered buyers*
(b) *Non-VAT registered* intermediate input *suppliers* sell to *VAT registered buyers.*

It's clear that VAT can transmit significant prices increases in an economy like Kenya's as demonstrated in the examples above. For a simple 5 stage supply chain and a product sold at a reference price of KSh116.00 (base price of **KSh.100.00** and **VAT at 16%**) the final consumer can pay prices ranging from:

- **KSh. 244.14** on supplies *that are zero-rated*;
- **KSh. 283.20** on supplies at *the standard VAT rate*; to
- **KSh. 393.27** when VAT is applied to a supply chain with a mix of small un-registered firms interacting with VAT registered firms.

3 Introduction of VAT on Petroleum Products

VAT on petroleum products was introduced through the VAT Act No. 35 of 2013 effective from 2 September 2013. The Finance Bill 2013/14 deferred VAT on fuel for a 3 year *transition period* which was extended for a further 2 years by the Finance Bill 2016 to 1 September 2018.

The Finance Bill 2018 presented by the Cabinet Secretary, National Treasury (CS, NT) to the National Assembly did not propose any extension to the deferral. Accordingly, VAT on petroleum products became applicable automatically under operation of the VAT Act of 2013 from 2 September 2018 (upon expiry of the deferral extension of 2016 to 1 September 2018)

3.1 The purpose was simple – to raise revenue for Government.

Given the adverse impacts on household consumption and welfare the two key questions are whether, and to what extent, the initial enactment of the VAT Act 2013 that brought in most categories of goods and services under the *standard rate* of VAT including petroleum products (a) ***resulted in increased Government tax revenues*** from VAT or (b) ***impacted on consumers through increases in price levels.*** This report concentrates on the latter question, taking as given that Government's primary purpose of levying **VAT on petroleum products** as well as removing several items like agro-chemicals from zero-rating is to generate revenue to finance its operations.

The standoff between Parliament and the Executive on the 16% VAT on petroleum resulted in a concessionary 8% VAT rate on petrol. This re-introduces multiple rates into the VAT regime (0%, 16%, and 8%) that the 2013 reforms sought to eliminate. **It also perpetuates the annual tinkering with the VAT and tax code that introduces distortions into the market place** and denies investors the certainty of laws and regulations and tax rates that is necessary for a conducive business and investment environment. This does not bode well for the four core taxation principles of *equity, certainty, simplicity and efficiency* ([2]).

3.2 What the VAT law provides for petroleum products

Extract of VAT Act 2013 that introduced VAT on most products including *Petroleum Products*

5. Charge to tax
(1) A tax, to be known as **value added tax**, shall be charged in accordance with the provisions of this Act on—
(a) **a taxable supply** made by a **registered person in Kenya;**
(b) **the importation of taxable goods**; and
(c) **a supply of imported taxable services**.

(2) The rate of tax shall be—
(a) in the case of a zero-rated supply, **zero per cent**; or
(b) in any other case, **sixteen per cent of the taxable value of the taxable supply**, the value of imported taxable goods or the value of a supply of imported taxable services.

6. Cabinet Secretary may amend the rate of tax
(1) The Cabinet Secretary may, by order published in the Gazette, amend the rate of tax by increasing or decreasing any of the rates of tax by an amount not exceeding twenty-five per cent of the rate specified in section 5(2)(b).

[2] Adam Smith, The Wealth of Nations, 1776

3.3 Provisions of the VAT Act 2013 in relation to its goals and objectives

The VAT Act 2013 sought to simplify the VAT system with the primary objective of

- increasing revenues by broadening the VAT base and sealing revenue leakages
- rationalizing the VAT collection system
- modernizing and aligning the VAT regime to international best practice (under intense prodding by the IMF)
- improving the management of VAT refunds by removing and reducing exemptions

The VAT Act specifically sought to reduce the "multiplicity of rates" by setting only two VAT rates (refer Table 1) instead of several rates spanning *exempt*, *zero-rated, a standard rate* of 16%, a 12% *concessionary rate on electrical energy, and VAT remissions* on specified items.

The key provision of the VAT Act 2013 included *zero-rating certain* items (taxable supplies attracting 0% VAT rates); applying the standard VAT rate of 16% on most taxable supplies; scrapping of the 12% concessionary VAT rate for electrical energy which contributed to raising power bills to consumers by a minimum of 4% in June 2013. **The VAT Act 2013** aimed to reform the VAT regime by **slashing exemptions from 395** to **39 and reducing the** groups of goods and services that **exemptions apply to from** 22 to 18. It reduced **zero-rated supplies of goods and services** from **416 to 8**.

The Cabinet Secretary responsible for the National Treasury is empowered under the VAT Act 2013 **to increase or decrease the VAT rate by up to *25% of the standard rate,*** but only by order published in the Gazette, and with approval of the National Assembly.

Accordingly, the Cabinet Secretary for the National Treasury, in respect of *taxable supplies attracting VAT at the standard rate of 16%, concessionary rate of 8%*, and *0% rate* on *zero-rated supplies* can:

a) **reduce VAT on any taxable supplies** by 4% to **12%, 4% and (-4%** <u>*subsidy*</u>), respectively, OR
b) **increase VAT on any taxable supplies** by 4% to **20%, 12% and 4%,** respectively

Hence, the proposals in the Presidents Memorandum of 14 September 2018 of a <u>*concessionary*</u> VAT Rate of 8% on petroleum products which was approved by MPs, require amendments to Section 6(1) of the VAT Act 2013.

3.4 Changes to VAT on fuel under the VAT Act 2013

Fuel type	New Rate	Old Rate
Petrol	16%	Exempt
Diesel	16%	Exempt
Kerosene	16%	Exempt
Aviation spirit	16%	Exempt

The main effect of removing petroleum products from ***vat-exempt*** to a ***standard or concessionary* VAT** rate is to increase prices of petrol as well as virtually all products and services which embody transport and power costs **by a minimum of the VAT rate**. Only a small number of large, VAT-registered enterprises can claim the benefit from the recoverability of input vat.

The tables below illustrate the effect of Vat at the standard rate, zero rate and on exempt supplies (continuing with the data from the simple example above).

Table 6: Supplies at *standard rate*: Input VAT recoverable (Seller and *Input Supplies* VAT registered)

Supply chain step	**Cost Prices**	Input VAT	Due to Suppliers	Value Added	**Selling Prices**	Output VAT	**Due from Customers**
Input VAT		**16%**				**16%**	
1	**80.00**	**12.80**	**92.80**	**20.00**	**100.00**	**16.00**	**116.00**

Table 7: *Zero-rated* Supplies: Input VAT recoverable (Seller and *Input Supplies* VAT registered)

Supply chain step	**Cost Prices**	Input VAT	Due to Suppliers	Value Added	**Selling Prices**	Output VAT	**Due from Customers**
Input VAT		**16%**				**0%**	
1	**80.00**	**12.80**	**92.80**	**20.00**	**100.00**	**0.00**	**100.00**

Table 8: *Exempt* Supplies: Input VAT NOT recoverable (even if Seller, *Input Supplies* VAT registered)

Supply chain step	**Cost Prices**	Input VAT	Due to Suppliers	Value Added	**Due from Customers**
Input VAT		**16%**			
1	**80.00**	**12.80**	**92.80**	**23.20**	**116.00**

3.5 Changes to excise duty on kerosene under Finance Bill 2018

Fuel type	Increase from 1 July 2018	New Rate	Old Rate
Illuminating Kerosene per 1,000 litres (*Tariff Line (2710.19.22)*)	**43.03%**	KSh 10,305	KSh 7, 205

"The introduction of tax on illuminating kerosene is an attempt by the government to fight the adulteration of petrol and diesel using kerosene due to the differential in the excise duty rates. **This is however expected to significantly increase the cost of kerosene which is the main fuel used for cooking and lighting by a majority of Kenyans. Combined with the proposed imposition of VAT on petroleum products**, the cost of kerosene is likely to fall out of the reach of a majority of Kenyans" – *KPMG Finance Bill 2018 Analysis (June 2018)*

Changes to the Excise Duty Act increasing excise duty on illuminating kerosene with effect from 1 July 2018 further aggravate the cost and livelihoods burden on low-income citizens.

While the stated intention of increasing excise duty on kerosene is to "fight adulteration" of petrol and diesel, the consequences of the increase will be to **significantly increase the cost of kerosene** which is the main fuel used ***for cooking and lighting by a majority of Kenyans***.

4 Impact of 16% VAT on Petroleum Products on Food and Nutritional Security (FNS)

4.1 Impact on FNS – Small-scale producers

The impact of *8% VAT on petroleum products* on small-scale producers is likely to be felt most through the increased transport costs and power costs, which in turn raise the costs of most inputs. Kerosene, petrol, diesel and electricity prices have increased by an average of 20.6% in August 2018 compared to a year earlier. Prices to consumers compared to **pre-budget levels** in the months of June 2018, July 2018, August 2018 rose by **2.2% 3.5% and 5.1%,** respectively, compared to May 2018. The impact on the average *consumer household* wallet in Kenya at an income level of KSh 54,000 annually is depicted in Table 9. Price increases will most likely be taken from, or absorbed by, necessities and the food budget as low income earners have no discretionary spending.

Table 9

Average Consumer Wallet per KNBS in Post Budget Prices changes on food and fuel after VAT	**Basis Weights**	**Changes Over Last Year**	**Post 2018 Budget June 18**
Food and Non-Alcoholic Beverages	**36.04%**	**40.23%**	**41.16%**
Transport	8.66%	**9.67%**	9.89%
Water, Electricity, Gas and other Fuels	3.30%	**3.68%**	3.77%
Communication	3.82%	**4.26%**	4.36%
ALL Others	48.18%	**42.15%**	40.82%
	100.00%	**100.00%**	100.00%

4.2 Impact on FNS – Large-scale producers

Due to their sheer size and scale of operations, large scale agricultural enterprises, their suppliers and other producers are likely to experience the full increase in prices closely following the overall inflation levels. Hence the **sharp increases in transport and power costs after the 2018 budget statement is consistent with the retail price changes that are higher by on average 5% compared to pre-budget levels**.

Increases in transport and power costs arising from imposition of VAT on fuel in turn raises the costs of all other inputs used in production, distribution and sales. This is consistent with what the ***"telescoping"*** effect of VAT which ripples through the production, distribution and supply chain of most products, raising costs at each stage of the value chain.

Large enterprises can offset the *input VAT against their output VAT, and only bear a net VAT burden on the value added or generated in the enterprise.*

The stylized "VAT model" appears to be ineffective or broken down in Kenya. While Kenya has **19.6 million voter/citizens** (IEBC) and **138,000 formal enterprises** (KNBS Survey, 2015) KRA reports only **8.1mn registered PIN numbers and less than 1.6mn active taxpayers** with a target of 4.8 million by 2018 (KRA, 2015 figures). Hence most "large producers and enterprise" regardless of VAT registration status either have low levels of tax and VAT compliance, deliberately keep poor or scanty tax records or choose to stay semi-formal to effectively avoid scrutiny by the taxman.

The result is that many large enterprises and producers in Kenya including those in the agricultural and food production sector are in the same VAT position as small enterprises and MSMEs – with the VAT burden on their inputs and purchases borne by their business **as**

a "final tax". They are forced to pass on the 8% VAT on petroleum products to final consumers.

4.3 Cost of food

The VAT on petroleum products, ahead of being implemented at 8%, had negative repercussions on household food consumption baskets *through speculative, advance price increases* on common staples and essentials including maize, potato, vegetables (*sukuma wiki*) milk and bread (see Table 10 for selected items). These massive prices increases are evident in the KNBS price changes in August 2018 before the VAT on petroleum products was signed late in September 2018.

	May-18	Jun-18	Jul-18	Aug-18	Sep-18
Overall Inflation Month-on Month	**3.95%**	**4.28%**	**4.35%**	**4.04%**	**5.7%**

Source: CBK, KNBS

4.3.1 Price changes on consumer basket (August 2018 vs 1 year ago)

Table 10

Price Changes in Essential Consumption Basket Aug 2018 vs Aug 2017 (Latest Month Over Same Month Last Year)			
	Aug 2017 in KSh.	Aug 2018 in KSh.	+/- over Aug 2018
Potatoes (Irish) 1 Kg	**57.13**	**73.62**	**28.9%**
Processed Fresh Milk 500 Ml	**60.17**	**60.81**	**1.1%**
Kale - Sukuma Wiki 1 Kg	**42.19**	**45.30**	**7.4%**
Maize Flour - Sifted 1 Kg	**61.71**	**45.32**	**-26.6%**
Kerosene 1 litre	**64.41**	**85.90**	**33.4%**
Petrol 1 litre	**96.98**	**114.58**	**18.1%**
Diesel 1 litre	**86.84**	**103.69**	**19.4%**
Electricity 200 kwH Units	**3,944.26**	**4,392.82**	**11.4%**
Simple average (excluding maize seasonal price variation due to favourable rains)			17.1%

The Kenyan consumer wallet has been hit hard by the significant price increases in critical items in the consumption basket. Consumers are shouldering higher transport costs caused by significant increases in prices of kerosene, petrol and diesel of **33.4%, 18.1% and 19.4%,** respectively, in August 2018 compared to the same month in the previous year. For example, bus tickets for a journey from Bungoma to Nairobi have risen from KSh. 1,000 to KSh. 1,400 after the VAT increase on fuel.

KNBS monthly consumer prices and inflation statistics for September 2018 show a similar pattern for most food and fuel items as shown in Figure 1 (KNBS National Average Retail Prices of Selected Commodities. August, September 2018).

Figure 1: National Average Retail Prices of Selected Commodities

Commodity Name	Units of Measure	Average Price September 2017	Average Price August 2018	Average Price September 2018	% Change on last month	% Change on same month last year
Potatoes (Irish)	1 Kg	53.13	73.62	77.60	5.4	46.0
Kale-Sukuma Wiki	1 Kg	41.48	55.59	57.03	2.6	37.5
Beef - With Bones	1 Kg	420.11	442.95	443.21	0.1	5.5
Sugar	1 Kg	142.42	147.33	152.29	3.4	6.9
Carrots	1 Kg	67.55	61.19	59.35	-3.0	-12.1
Cabbages	1 Kg	46.58	42.58	43.53	2.2	-6.5
Beans	1 Kg	115.59	106.94	107.20	0.2	-7.3
Wheat Flour	2 Kg	135.16	119.04	120.83	1.5	-10.6
Maize Grain - Loose	1 Kg	57.84	42.39	40.55	-4.3	-29.9
Maize Flour - Loose	1 Kg	59.27	45.00	43.59	-3.1	-26.5
Tomatoes	1 Kg	103.45	72.88	70.55	-3.2	-31.8
Charcoal	4 Kg	81.86	137.71	141.24	2.6	72.5
Electricity	50 Kwh	581.79	1,063.72	1,064.21	0.0	82.9
House rent	1 Room	4,177.08	4,403.40	4,406.45	0.1	5.5
Electricity	200 Kwh	3,665.54	4,392.82	4,394.80	0.0	19.9
Kerosene	1 litre	65.34	85.90	109.25	27.2	67.2
Matatu Fares	250 Km	396.86	416.75	449.77	7.9	13.3
Petrol	1 litre	99.20	114.58	117.54	2.6	18.5
Country Bus Fares	350 Km	982.99	1,098.38	1,171.93	6.7	19.2
Diesel	1 litre	87.84	103.69	108.97	5.1	24.1

- In urban areas, increased transport costs are absorbed into the cost of food due to the distance that produce has to travel from rural farms to urban markets. The average 'food miles' (sourcing distances) for Nairobi's food supply ranges between 15km and 175km (according to a study published by the East Africa Institute, Aga Khan University).

- Compared to price levels in the previous 12 months, *essential "wananchi" consumption items cost as much as **7.4% more for kale** (sukuma wiki), **11.4% for electricity** under the domestic consumer lifeline tariff for the poor (first 200kwH), and as much as **28.9% more for potatoes.*** The decline in maize prices is mainly due to seasonal causes related to the favorable rains in the previous year – as well as the 7-month program of subsided maize in 2017 – and will reverse at the first sight of the next drought episode.

- With food and beverages (non-alcoholic) in the standard KNBS *consumer basket* (see extract above) comprising a weight of 36.04% this translates into ***less kerosene** available for cooking and lighting (due to a 33% price increase in August 2018, 67% compared to same month last year**),*** and as much as 2-3 meals fewer in a week with potato prices (up 28.9% *in August 2018, 37.5% compared to the same month last year)* and kale (sukuma wiki) (up 31.8% *in August 2018, 46.1% compared to the same month last year).*

  These will devastate household **food and nutrition security** and increase vulnerability to ill-health – further straining household health and food budgets.

The 8% VAT on petroleum products is likely to result in further significant **increases at the consumer market** with probably **worsening effects** on household access to food, availability of food and diversity of the household food intake and nutritional status.

The pattern of prices responding, more or less immediately, to the imposition of VAT on more goods and services or higher VAT was evident upon enactment of the original VAT Act 2013. **By September 2013, the typical consumer basket had experienced a 10.9% price increase on essential household items and significant spikes in common food items (see Table 11).**

The expansion of VAT and its application at the standard rate to a wider and broader range of goods and services in 2013 led to increases in petroleum products notwithstanding the 3-year deferral proposed in the Finance Bill until 2016. This pattern is clearly demonstrated in September 2013. The suppliers of petroleum products also require other inputs and supplies that attract VAT and which form part of their cost base beyond the liquid fuels themselves. Accordingly, imposition of VAT on a greater number of goods and services in 2013 (though **deferred on petroleum products)** ***still caused 5% increment in petroleum product prices, on average.***

Table 11

Price Changes in Essential Consumption Basket – Historical changes when VAT Act 2013 was enacted (Sept 2013 vs Sept 2012)			
	Sept 2012 in KSh.	Sept 2013 in KSh.	+/- Sept 2013 Sept 2012
Potatoes (Irish) 1 Kg	**50.08**	**49.49**	**-1.2%**
Processed Fresh Milk 500 Ml	**41.98**	**57.43**	**36.8%**
Kale - Sukuma Wiki 1 Kg	**31.22**	**45.31**	**45.1%**
Maize Flour - Sifted 1 Kg	**115.07**	**110.12**	**-4.3%**
Kerosene 1 litre	**79.41**	**86.39**	**8.8%**
Petrol 1 litre	**110.81**	**114.27**	**3.1%**
Diesel 1 litre	**103.90**	**106.47**	**2.5%**
Electricity 50kwH Units	**629.00**	**603.70**	**-4.0%**
Simple averages			**10.9%**

5 Learning from the Past: Effects of VAT Act 2013 on Pricing

Upon announcement of the VAT Act 2013 in the 2013/14 Budget Statement and enactment, there was an immediate and significant increase in prices for milk, kale, kerosene, petrol and diesel, between July and September 2013 ***which has not subsided to pre-VAT 2013 levels to date.***

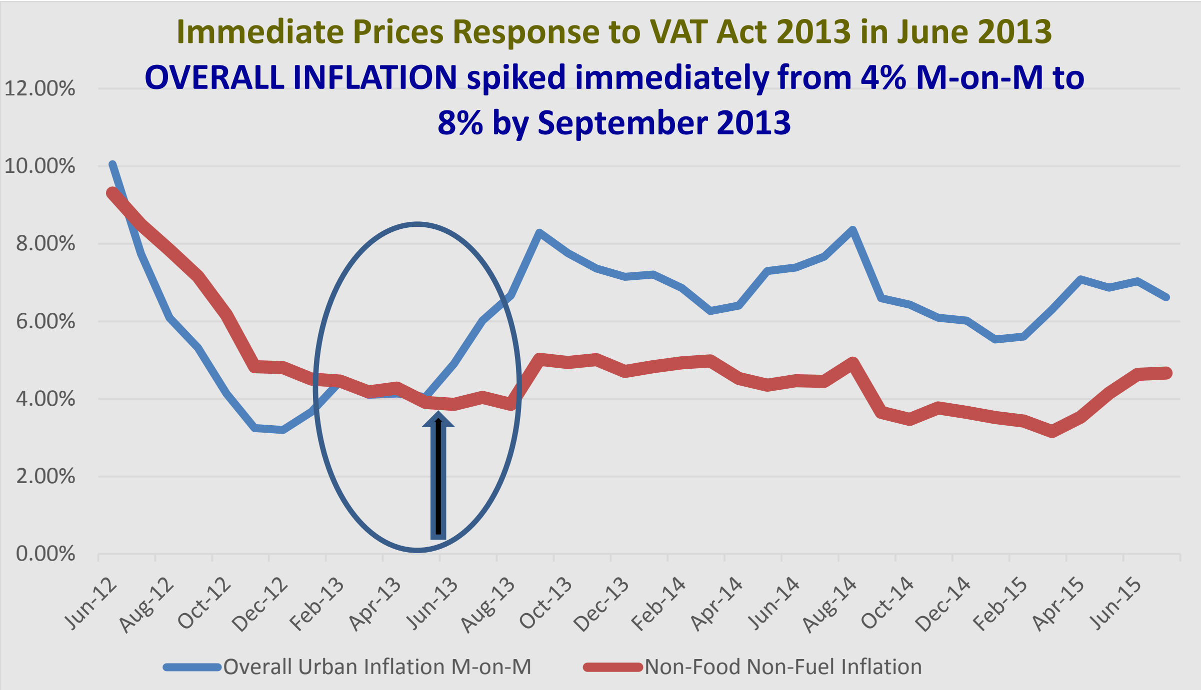
5.1 Impact of VAT 2013 on overall inflation month on month (urban)

- **a significant and immediate increase in overall inflation** levels with month on month prices nearly **doubling** by September 2013 from levels of 4% to 8%. **The general level of prices remained** at elevated levels post-**VAT Act 2013** over the following years and has persisted to the present time (see Figure 2).

- VAT Act 2013 enactment immediately ***reversed a gradual reduction in overall CPI in the preceding 12 months from July 2012 to June 2013*****.** The downward trend in the general level of prices abruptly ceased and reversed, with prices rising significantly upon enactment of VAT Act 2013 which extended the standard 16% VAT rate to most goods and services (see Figure 2).

- **Non-food, non-fuel inflation (month on month) rose from 4% to 5% between June 2013 to September 2013 – the comparatively small increase** suggests that a significant portion of Kenya's price levels are determined by food and fuel prices. The ultimate deferral of VAT on petroleum products clearly cushioned the consumer basket from price increases in fuel components.

Figure 2



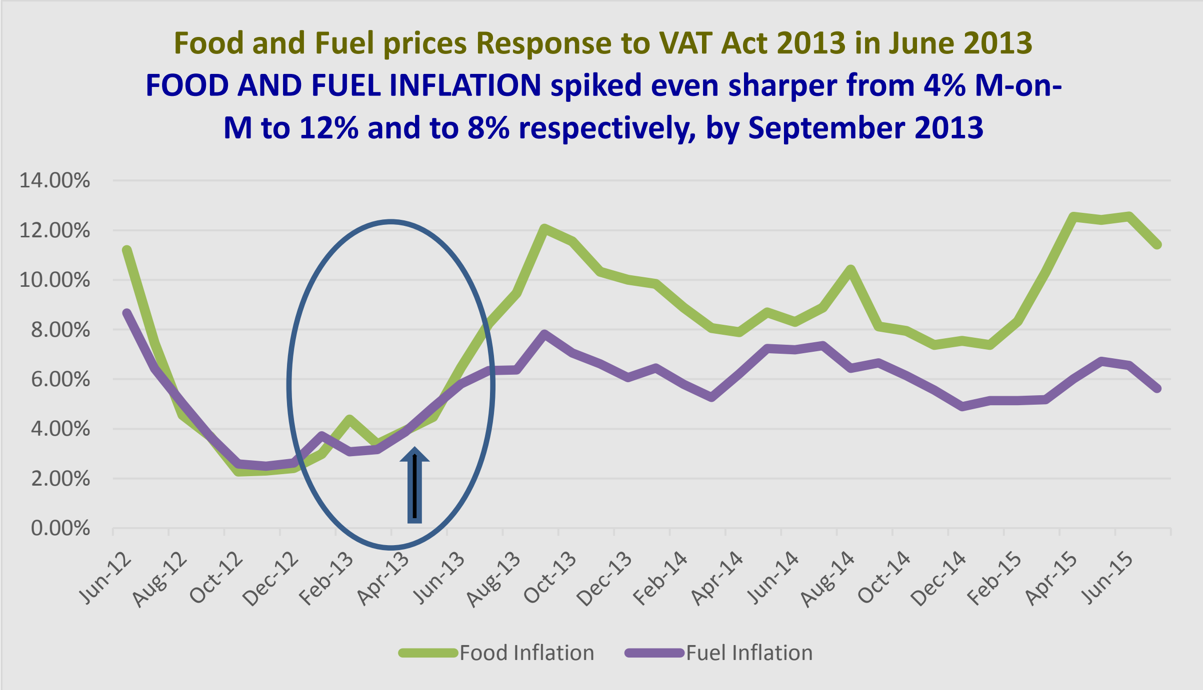
5.2 Impact of VAT on prices measured by monthly consumer price indices (CPI)

Figure 3 illustrates the impact of VAT 2013 **on food inflation month on month (urban) was a dramatic and immediate increase in *food inflation*** with food prices month on month **trebling**, by September 2013 from levels of 4% to 12%. **Food prices remained at *significantly high and elevated levels*** post enactment of VAT Act 2013 over the next 2 years, never going below 8% month on month increases since then.

- Even with the deferral of VAT on petroleum products, the VAT Act 2013 had a ***devastating result on household purchasing power***, with price increases shrinking household food budgets and reducing the capacity of households to afford food and meet their nutritional needs.

- **Imposition of VAT also immediately reversed the gradual reduction in food CPI in the preceding 12 months from July 2012 to June 2013.** The downward trend in the general level of prices abruptly ceased and reversed, with price levels rising significantly after enactment of VAT Act 2013 which extended VAT to most goods and services.

Figure 3

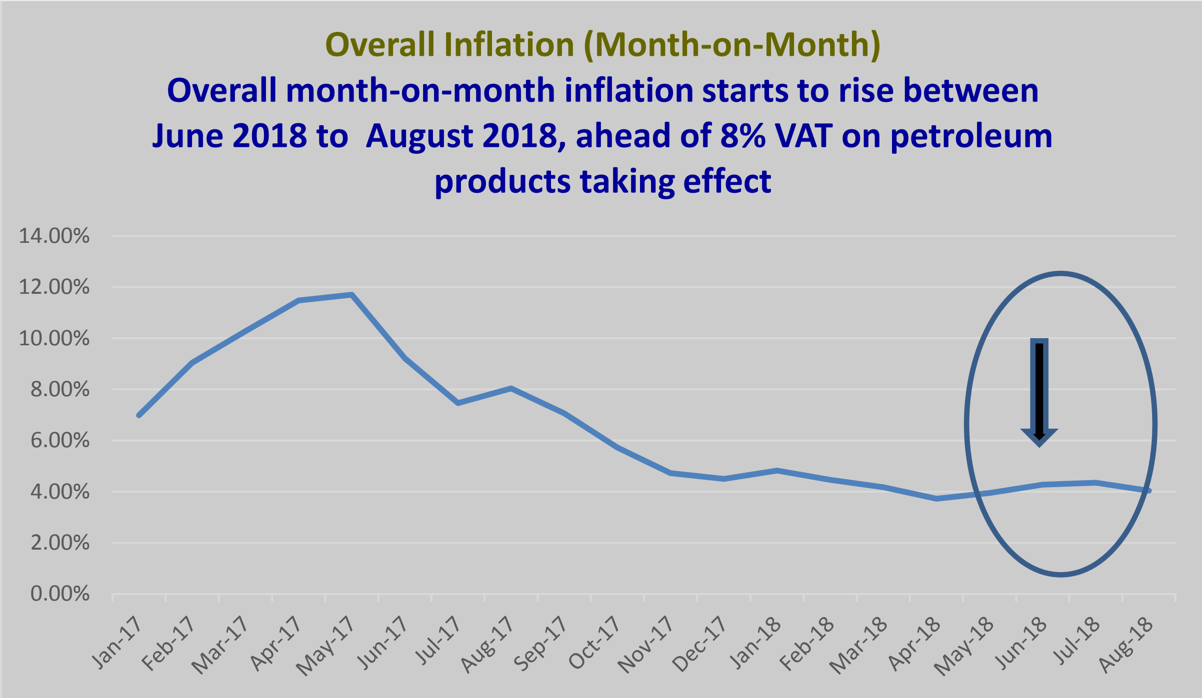


5.3 Impact of 16% VAT 2018 on overall inflation month on month (urban):

Despite the initial uncertainty over the 16% VAT on petroleum products, the general level of prices measured by month on month inflation between June 2018 and August 2018 ***shows a clear upward rise*** (see Figure 4).

The 8% VAT on petroleum products will likely result in the same significant increase in overall prices, as well as more severe increases on food and fuel prices. This would mirror the same pattern of price increases that occurred during the original enactment of the VAT Act 2013 in September 2013. *Clearly prices were adjusted ahead of new VAT rates taking effect on petroleum products from 1 September 2018.*

Figure 4



Mth/ Year	Jan -17	Feb-17	Mar-17	Apr-17	May-17	Jun-17	Jul-17	Aug-17	Sep-17	Oct-17	Nov-17	Dec-17	Jan-18	Feb-18	Mar-18	Apr-18	May-18	Jun-18	Jul-18	Aug-18
Rate	6.99%	9.04%	10.28%	11.48%	11.70%	9.21%	7.47%	8.04%	7.06%	5.72%	4.73%	4.50%	4.83%	4.46%	4.18%	3.73%	3.95%	4.28%	4.35%	4.04%

6 Introduction of VAT on Agricultural Pest Control Products (Pesticides)

VAT on *Agricultural Pest Control Products* (“*Agro-Chemicals and Pesticides*”) together with VAT on *inputs and raw materials produced locally or imported and supplied to manufacturers of Agricultural Pest Control Products***,** was introduced through the **VAT Act No. 35 of 2013** effective from 2 September 2013. However, these items were *zero-rated* as shown in the extracts from the laws (below)

VAT Act No. 35 of 2013
SECOND SCHEDULE -
ZERO-RATING
PART A – ZERO RATED SUPPLIES

Where the following supplies, excluding hotel accommodation, restaurant or entertainment services where applicable, take place in the course of a registered person’s business, **they shall be zero-rated in accordance with the provisions of section 7 [***VAT Act 2013***] —**

16. All inputs and raw materials whether produced locally or imported, supplied to manufacturers of agricultural pest control products upon recommendation by the Cabinet Secretary for the time being responsible for agriculture.

17. Agricultural pest control products.

The **Tax Laws (Amendment) Bill, 2018** (assented to on 18 July 2018) moved ***Agricultural Pest Control Products*** from *zero-rating* (Para. 16 and 17, SECOND SCHEDULE, Part A) to *exempt supplies* (para. 104, FIRST SCHEDULE, PART I – Section A) as shown below

Tax Laws (Amendment) Bill, 2018
FIRST SCHEDULE
EXEMPT SUPPLIES
SECTION A, PART I – GOODS

Insert the following new paragraphs immediately **after paragraph 93-**

104. Agricultural pest control products.

The effect of moving *Agricultural Pest Control Products* from ***zero-rating*** to ***exempt*** is equivalent to **increasing their cost by 16% VAT incurred on all inputs and purchases in their supply and value chain**. Accordingly, suppliers, traders and members of the *Agro-Chemical Association of Kenya (AAK)* adjusted prices to farmers immediately from **18 July 2018 by applying the 16% standard rate of VAT on all agro-chemicals and pesticides.**

The zero-rating under the SECOND SCHEDULE of *"All inputs and raw materials, whether produced locally or imported, supplied to manufacturers of agricultural pest control products…"* ***appears to have been retained***. Inputs and raw materials to suppliers of *agro-chemicals and pesticides* were not changed by the *Tax Laws (Amendment) Bill 2018* (Assent: 18 July 2018).

6.1 The purpose has effectively become a pure revenue raising measure

The stated purpose of moving *Agro-Chemicals and Pesticides* from *zero-rating to exempt* is **"to limit zero-rating to exports".** In plain language, the purpose is to raise revenues for Government. [Source: *Memorandum of Objects and Reasons.* The *Tax Laws (Amendment) Bill, 2018]*

6.2 Consequences of designating agro-chemicals and pesticides as VAT exempt

The consequences of designating *agro-chemicals and pesticides* as VAT exempt was an **immediate and massive increase in their costs by more than the notional standard rate of VAT of 16%**.

Taken together with the proposed ***VAT on petroleum products of 8%,*** *and increases in the excise duty on illuminating kerosene under the Excise Duty Act* from KSh7,205 to KSh10,305 from 1 July 2018, the ***effective increase in the cost of agro-chemicals and pesticides to farmers will rise by as much as 40% to 50%.***

The prohibitive cost of agro-chemicals and pesticides creates an opportunity for Kenya to strive towards a more sustainable way of farming. The focus should be on the promotion of **Integrated Pest Management (IPM)** techniques, agro-ecology and bioscides in pursuit of achieving lasting food and nutrition security.

The Members of the Agro-Chemical Association of Kenya (AAK) estimated that the changes in VAT upon operation of the *Tax (Amendment) Laws Act 2018* **would increase agro-chemicals and pesticides prices by 50%.**

This is powerful evidence from the agro-chemical industry of the finding in this report that VAT on essential production inputs, specifically VAT on petroleum products and agro-chemicals and pesticides, is transmitted (“telescopes” or “ripples”) through the supply chain of most products as **a “final tax”** that ultimately increases prices by **40% to 50%, or 3 to 4 times the VAT rate imposed.**

6.3 Using taxation as a mechanism towards sustainable farming

The harmful effects of pesticides usage on human health and the environment gives us reasons to question the continued use of potentially harmful and carcinogenic chemical inputs in Kenya’s agricultural sector. In the current VAT regime – where agro-chemicals and pesticides costs are out of reach of the majority of farmers in Kenya – a staggered taxation scheme could be adopted to promote sustainable farming practices.

The policy approach would be to reduce tax (and therefore production cost to farmers and consumer costs of food) for the pesticides that pose a low risk towards health and the environment –while raising them on a graduated scale for those that cause more harm to health and the environment. The result would be that the least harmful products become comparatively less expensive and thus more attractive for use by farmers. Harmful products would be replaced with less harmful alternatives – a positive substitution effect.

The box below provides a brief summary of best practices in selected countries in the design of **graduated, differentiated taxes on pesticides** based on assessments of usage, and harm to human health and the environment.

Staggered Taxation Schemes on Pesticides: A Case Study from Denmark.

Denmark successfully implemented a **staggered taxation scheme** that resulted in a 40% decrease in use of pesticides harmful to the environment. France also introduced a similar system. Germany has proposed a comparable system a couple of years ago which is on hold.

Denmark introduced *an ad valorem* pesticide tax in 1996 (modified in 2013). Its key feature is a **differentiated VAT or tax** based on an assessment of the level of harm caused by pesticides with the broad objective of **discouraging use of bad PCPs while encouraging use of less harmful substitutes and organic farming**. Hence higher taxes are levied on pesticides with substances considered more harmful and toxic to human health and the environment. The graduated pesticide tax was set initially at 35% for insecticides and 25% for herbicides, fungicides, and growth regulators.

In 2013, Denmark refined the pesticide tax by introducing a differentiated pesticide tax scheme for ***individual pesticides based on an assessment of pesticide use and risk indicators***. For each pesticide an *environmental load indicator* was to be assessed based on a combination of indicators comprising of: *(1) environmental toxicity load; (2) environmental fate and behaviour load; and (3) human health load.* The differentiated pesticide tax scheme also ushered in higher tax rates of 40% on insecticides (up from 35%); and 30% on herbicides and fungicides (up from 25%).

Denmark also mandated specific uses for the differentiated pesticide tax. While the State Treasury would collect the tax, the proceeds were **earmarked for agricultural and environmental (re-mediation) purposes.**

France similarly in 2009 replaced its ***pesticides volume tax*** (*General Tax on Polluting Activities* or “TGAP”) with a ***graduated, diffuse agricultural pollution fee*** based on the *quantities of active substances in the pesticides products and toxicity levels*. Pesticides based on minerals attracted the lowest taxes (€ 0.9/kg) while environmentally dangerous pesticides attracted higher tax rates (€ 2,0/kg). Pesticides considered *mutagenic, carcinogenic, or hazardous* would draw the highest taxes (€ 5.10/kg).

Like Denmark, France also earmarked or mandated specific uses for the proceeds from the pesticide fees. Half the revenues were earmarked for cleaning up pesticide contamination in regional waters by water utility and waste-treatment-plant operators. The balance of the proceeds from the pesticide taxes would be invested in remedial measures.

Kenya should consider adopting graduated, differentiated taxes on pesticides based on assessments of use, and harm to human health and the environment. The objective would be to discourage use of "bad" agrochemicals and pest control products (PCPs) while encouraging use of less harmful substitutes and organic farming.

The proceeds from implementing *graduated/differentiated taxes* on *pesticides* should similarly be earmarked for specific uses to encourage "green", sustainable and organic farming practices; and to pay for remedial measures like cleaning up the agricultural pollution and harmful impacts on human health and environment caused by PCPs.

Kenya can earmark (or assign) proceeds from pesticide taxes to specific purposes in the same way as the *railway tax* that Kenya collected from fuel sales was *earmarked* to help pay for the SGR railway. More recently the 2018 Budget Statement earmarked proceeds from the *excise tax on mobile money transfers* to pay for investments in universal healthcare.

7 Implications and Effects of VAT on Pesticides on FNS

The recent changes in VAT pose the following threats to food and nutrition security:

- **Increased prices** of agro-chemicals and pesticides, **in absence of sustainable farming alternatives,** will increase the cost of production that will be transmitted through the supply and value chain. The subsequent increases in prices reduce affordability and access to inputs that are currently being used by farmers for food production.

- **Reduced agricultural output that** will lead to *increased food and nutrition insecurity and increased dependency on food imports.*

- **Increased imports of agro-chemicals and pesticides arising from distortions in the VAT regime** (PCPs being ***exempt*** while inputs and raw materials to suppliers of PCPs are zero-rated). Higher imports harms domestic manufacturers and suppliers, potentially leading to **loss of incomes and livelihoods across the domestic value-chain players.**

- **Increased imports of agro-chemicals and pesticides** which carry the additional risk of **increased supply of counterfeit pesticides** in the market, as well as dumping of sub-standard products harmful to consumers and the environment. Exposure to sub-standard pesticides may compromise food safety and health of consumers.

- **One of the most important impacts is the *increased cost of food* which reduces affordability and access to food by low income households and consumers who comprise the majority of Kenyans. This will impair food and nutrition security of the nation as a whole.**

8 Combined Impact of VAT on FNS (petroleum products and pesticides)

8.1 VAT on fuel is a tax on everything

VAT on Fuel is a Tax on everything. **The 8% VAT on petroleum products is effectively a tax on everything** due to the central role that fuel holds in the transportation, production, distribution and selling of virtually all producers and services. Petroleum products are also essential in heating, lighting (through kerosene) and cooking for the low income segment of the population – which is the majority of Kenyans.

The VAT on petroleum products will therefore increase:

- **transport costs** already up by 6.2% (August 2018) and 23.6% compared to the same period the previous year

- **electricity costs** on the *Lifeline Tariff* for direct consumers on the first 200kwH of monthly usage. These are already up by 1.6% (August 2018 vs pre budget levels) and 11.4% (in August 2018 compared to previous year's levels)

- **consumer goods for the low income** segment of the population which are expected to increase in prices by at least the level of ***fuel inflation*** of **1.6% to 11.4% monthly.**

- **costs of cooking and lighting for the low income segment and the poor** will rise by at least the amount of VAT on kerosene. A large percentage of Kenyans cook with Kerosene (per KNBS Household Surveys) and use kerosene for lighting.

8.2 VAT on fuel increases the costs of producing food

VAT on fuel increases the costs of producing food by farmers as well as raising production costs on all producers as measured by the *Producer Price Index* (PPI) including the costs of processing agricultural produce and food with direct bottom line effects on producers and the lives and livelihoods of ordinary Kenyans.

The overall impact on FNS is therefore:

- **Reduced availability of food** through the channels of higher power and transport costs, high food miles, higher input costs.

- **Reduced access through reduced food affordability** based on invariant household earnings that compromise households and consumers' **ability to buy.**

- **Reduced utilization and intake of nutritionally diverse food** caused by increased household substitution of less nutritious food and (at times) less palatable "survival" food options.

The impact of 8*% VAT on petroleum products in terms of the* availability, access and affordability of food; as well as on the utilization of food (nutritional intake) **is certain to be adverse, measured by the real increases in costs of essential items in the consumption basket**. The channel of transmitting these price impacts (on citizens and consumers) is through increases in the costs of transport, electricity and power. Electricity consumers further suffer fuel cost adjustments as well as VAT on other inputs by power producers.

The increase in overall food and fuel inflation from the initial 8% VAT may eventually be as high as 2 to 3 times the rate of VAT applied through the transmission of Vat as a **"final tax"** on most producers in the supply chain.

The Kenyan experience in extending VAT to most products in 2013 (even with the exclusion of petroleum products from VAT for a transition period of 3 years) still led to a **trebling of food inflation from 4.48% in May 2013 to 12.07%** by September 2013. Within three months' **fuel inflation doubled from 4.86% in May 2013 to 7.82% by September 2013** after enactment of the VAT Act 2013.

Kenyan consumers should brace for further and correspondingly high increases in the *non-food and non-fuel components* of the consumer baskets, though on a more limited scale compared to the experience in 2013. This impact is estimated to be as high as **3% to 5% by September 2018**.

The sum total effect is reduced access and availability of food by poor and low income segments of the population especially the urban consumers' dependent on the market economy for meeting their food needs. Their food intake based on the weights of food in the consumer basket (per KNBS) may decline by as much as 16%-20% compared to the previous year and to price levels in June 2018 immediately after the Budget Statement (see Table 12).

Table 12

Average Price Change in prices of essential items on consumer Basket		**11.628%**	**14.2%**
Consumer wallet (Selected portions that will be impacted most by 8% VAT on petroleum products	**KNBS Consumer weights**	**Change over Last Year**	**Change Post Budget June 2018**
Food and Non-Alcoholic Beverages	**36.04%**	**40.23%**	**41.16%**
Transport	**8.66%**	**9.67%**	**9.89%**
Water, Electricity, Gas and other Fuels	**3.30%**	**3.68%**	**3.77%**
Communication	**3.82%**	**4.26%**	**4.36%**
ALL OTHERS	**48.18%**	**42.15%**	**40.82%**
Total	**100.00%**	**100.00%**	**100.00%**
Estimated Reduction in Household consumption		**-6.03%**	**-7.36%**

Note: Housing, Water, Electricity, Gas and other Fuels per KNBS have a weight of 18.3%. Analysis above assumes Housing takes up 15%., hence water, electricity, gas and other fuels take up 3.30%

The impact of VAT on petroleum products comes into sharp focus in the changes in the **citizens' consumption basket**. This is based on the *average monthly wage earnings* of Kenyans (at the average consumer Income) of **KSh. 54,0000** (KNBS, 2016). Food price increases likely to be borne by reduced food spend since: (1) low income and average consumers have little or no discretionary income, and (2) The category of "*all others*" includes housing which is also a "*must spend*".

9 Proposed Options and Recommendations

9.1 Options to the VAT on petroleum products are limited but include the following:

- **Zero-rate VAT on petroleum products**
  This will effectively remove the application of VAT on petroleum products while allowing suppliers and VAT registered entities to claim input VAT on their purchases**.**

  This is the bold policy action required to reverse the adverse effects of *VAT-on-fuel-as-a-tax-on-everything* that has been clearly documented in this report. This report has demonstrated that the sky-high price increases triggered in June 2013 –and arising from the extension of VAT to most products - have persisted and remain embedded in the economy to-date.

  This policy option recognizes the special importance of petroleum products (and more generally transportation and power) in the supply chain of most products and services as an input, raw material and source of heat, power and lighting; and as fuel for transport as well as source of heat for domestic cooking purposes. Zero-rating petroleum products would partially help to minimize the effects of higher transport and power costs that are transmitted or ripple through to all products and services produced in the economy.

  This option is also consistent with the VAT reform path started in 2013 of simplifying and reducing the number of VAT rates to 2 rates - a *standard rate* and *zero-rating* of selected inputs and supplies critical to cushioning the poor and vulnerable.

- **Reduce or lower the *standard rate* of VAT on *all products* to 12%, 8% or 4%**
  This will effectively reduce the *costs of all products including lowering the costs of food* as well as prices of non-fuel and tradeable goods supplies. This option is consistent with the VAT reform path started in 2013 of collapsing and reducing the multiplicity and number of VAT rates to a *standard rate* and *zero-rating* on selected supplies that cushion the poor and vulnerable. It will help to lower prices and increase the purchasing power of consumers and households. Crucially, it helps millions of Kenyans to increase their ability to fulfil their food and nutritional needs.

  The policy option of lowering the standard rate of VAT to 12%, 8% and even as low as 4% on all products can be implemented in tandem with eliminating exemptions and zero-rating on most supplies within 2 years. It also helps to minimize market distortions by standardizing VAT to one single rate or two basic rate(s) applicable to all taxable supplies.

  This can be the best outcome that balances the Governments need for revenues from VAT with an efficient market that minimize price distortions and anti-competitive practices generated by exploiting any multiplicity of VAT rates and exemptions.

- **Know and understand consumer trends in Kenya in order to identify and make staple foods, essential commodities and water VAT zero-rated. The aim should be to create an environment that encourages low-income Kenyans to rise out of poverty and therefore working towards national realization of the Human Right to Food (Article 43, Constitution of Kenya 2010).**

9.2 Options and recommendations for VAT on agro-chemicals and pesticides

- **Introduce a staggered taxation system for pesticides.** Kenya should introduce graduated, differentiated taxes on pesticides based on volume of use, and toxicity or harm to human health and the environment with the aim of encouraging use of less harmful agrochemicals and *pest control products (PCPs),* hastening substitution with and adoption of "green" and organic fertilizers and farming practices which collectively offer a more sustainable agriculture and food production.

- **Earmark the proceeds of differentiated taxes on pesticides for specific use** to encourage "green", organic and sustainable farming practices; and to pay for remedial measures to combat agricultural pollution and harmful impacts on health and the environment caused by PCPs.

- **Lower agro-chemicals and pesticides prices to farmers by removing the current market distortion of multiple rates** applicable on *"inputs and raw materials* supplied to manufacturers of agricultural pest control products" **which remain *zero-rated*** (*Second Schedule*, Part A) whilst agricultural pest control products are **exempt** (*First Schedule Section A, Part* 1). The best policy would be to zero-rate agro-chemicals and pesticides as well as all inputs and raw materials used in their production.

- Implement investment and policy options that create a ***conducive policy and financial environment*** *for* ***alternative, sustainable methods*** *of agriculture in Kenya.*

  Examples of these policies could include: *Investments in small scale irrigation infrastructure* to prevent soil and water run-off and reduce smallholder farmers' reliance on rain-fed agriculture; *investments and policies that encourage organic farming practices* and production and use of *soil, crop and climate specific fertilizers*; *concessionary interest rates* for agricultural loans; implementing a more effective *agricultural credit guarantee scheme*; introducing directed credit allocations (or quotas) to the agricultural sector similar to the minimum sectoral lending to agriculture that Kenya had in the 1980s; and land reforms to limit the continuing land fragmentation that may reduce smallholder land parcels below viable economic sizes.

10 Appendix: Extracts from the VAT Laws and Schedules

VALUE ADDED TAX ACT NO. 35 OF 2013 [REV. 2016]
FIRST SCHEDULE
PART I – GOODS
EXEMPT SUPPLIES
SECTION A

The supply or importation of the following goods shall be EXEMPT SUPPLIES

90. Inputs for the manufacture of pesticides upon recommendation by the Cabinet Secretary for the time being responsible for matters relating to agriculture.

[Act No. 15 of 2017, s.9]

SECTION B - EXEMPT GOODS ON TRANSITION

(1) The following goods *shall be exempt supplies for a period of three years* from the commencement of this Act unless the exempt status of the supplies is earlier revoked—

2709.00.00 Petroleum oils and oils obtained from bituminous minerals, crude.
2710.12.10 Motor spirit (gasoline) regular.
2710.12.20 Motor spirit (gasoline), premium
2710.12.30 Aviation spirit
2710.12.40 Spirit type jet fuel.
2710.12.50 Special boiling point spirit and white spirit.
2710.12.90 Other light oils and preparations.
2710.19.10 Partly refined (including topped crudes).
2710.19.21 Kerosene type jet fuel.
2710.19.22 Illuminating kerosene (IK)
2710.19.29 Other medium petroleum oils and preparations.
2710.19.31 Gas oil (automotive, light, amber, for high speed engines).
2710.19.39 Other gas oils.
2711.21.00 Natural gas in gaseous state
2711.29.00 Other natural gas in gaseous state.

((2) Notwithstanding paragraph (1), the exemption shall be extended by a further two years from 1st September, 2016.

[Act No. 38 of 2016, s. 30 (c)(ii).]

11 Extract: Value Added Tax Act No. 35 of 2013

Date of assent: 14th August, 2013
Date of commencement: 2nd September, 2013

Key sections on standard rate, zero-rate and powers to amend the rates

5. Charge to tax
(1) A tax, to be known as **value added tax**, shall be charged in accordance with the provisions of this Act on**—**
(a) **a taxable supply** made by a **registered person in Kenya;**
(b) **the importation of taxable goods**; and
(c) **a supply of imported taxable services**.

(2) The **rate of tax shall be**—
(a) in the case of a **zero-rated supply, zero per cent**; or
(b) in any other case, **sixteen per cent of the taxable value of the taxable supply**, the value of imported taxable goods or the value of a supply of imported taxable services.

6. Cabinet Secretary may amend the rate of tax
(1) The Cabinet Secretary **may**, by order published in the Gazette, amend the rate of tax by increasing or decreasing **any of the rates of tax** by an amount **not exceeding twenty-five per cent of the rate specified in** section 5(2)(b).

(2) **Every order made under subsection (1) shall be laid before the National Assembly** without unreasonable delay, **and shall cease to have effect if a resolution of the National Assembly disapproving the order is passed within twenty days** of the day on which the National Assembly next sits after the order is laid, but without prejudice to anything previously done thereunder.

7. Zero rating
(1) Where a registered person supplies goods or services and **the supply is zero-rated, no tax shall be charged on the supply,** but it shall, in all other respects, be treated as a taxable supply.

(2) A supply or importation of goods or services shall be **zero-rated** under this section if the goods or services are of the **description for the time being specified in the Second Schedule.**

12 National Average Retail Prices of Selected Commodities (KNBS)

Commodity	Units	Avg Price Aug 2017	Avg Price Sept. 2017	Avg Price July 2018	Avg Price Aug 2018	Avg Price Sept. 2018	Monthly Change		Annual Change year	
							Aug 2018	Sept. 2018	Aug 2018	Sept. 2018
Electricity	50 Kwh		581.79		1,063.72	1,064.20		0.0%		82.9%
Charcoal	**4 Kg**		**81.86**		**137.71**	**141.24**		**2.6%**		**72.5%**
Kerosene	**1 litre**	**64.41**	**65.34**	**86.69**	**85.90**	**109.25**	**-0.9%**	**27.2%**	**33.4%**	**67.2%**
Potatoes(Irish)	**1 Kg**	**57.13**	**53.13**	**60.12**	**73.62**	**77.60**	**22.5%**	**5.4%**	**28.9%**	**46.1%**
Kale-Sukuma Wiki	**1 Kg**	**42.19**	**41.48**	**57.58**	**55.59**	**57.03**	**-3.5%**	**2.6%**	**31.8%**	**37.5%**
Diesel	**1 litre**	**86.84**	**87.84**	**104.21**	**103.69**	**108.97**	**-0.5%**	**5.1%**	**19.4%**	**24.1%**
Electricity	**200 Kwh**	**3,944.26**	**3,665.54**	**4,122.26**	**4,392.82**	**4,394.80**	**6.6%**	**0.0%**	**11.4%**	**19.9%**
Country Bus Fares	**350 Km**		**982.99**		**1,098.38**	**1,171.93**		**6.7%**		**19.2%**
Petrol	**1 litre**	**96.98**	**99.20**	**113.07**	**114.58**	**117.54**	**1.3%**	**2.6%**	**18.1%**	**18.5%**
Matatu Fares	**250 Km**		**396.86**		**416.75**	**449.77**		**7.9%**		**13.3%**
Sugar	**1 Kg**	**145.10**	**142.42**	**137.11**	**147.33**	**152.29**	**7.5%**	**3.4%**	**1.5%**	**6.9%**
Beef-With Bones	**1 Kg**	**406.04**	**420.11**	**438.71**	**442.95**	**443.21**	**1.0%**	**0.1%**	**9.1%**	**5.5%**
House rent	1 Room	4,108.70	4,177.08	4,344.58	4,403.40	4,406.45	1.4%	0.1%	7.2%	5.5%
Cabbages	**1 Kg**	**53.54**	**46.58**	**40.53**	**42.58**	**43.53**	**5.1%**	**2.2%**	**-20.5%**	**-6.5%**
Beans	1 Kg	114.79	115.59	107.66	106.94	107.20	-0.7%	0.2%	-6.8%	-7.3%
Wheat Flour	1 Kg		135.16		119.04	120.83		1.5%		-10.6%
Carrots	1 Kg	99.16	67.55	63.04	61.19	59.35	-2.9%	-3.0%	-38.3%	-12.1%
Maize Flour-Loose	**1 Kg**	**61.71**	**59.27**	**57.27**	**45.00**	**43.59**	**-21.4%**	**-3.1%**	**-27.1%**	**-26.5%**
Maize Grain-Loose	**1 Kg**	**58.95**	**57.84**	**51.47**	**42.39**	**40.55**	**-17.6%**	**-4.3%**	**-28.1%**	**-29.9%**
Tomatoes	**1 Kg**	**98.72**	**103.45**	**95.60**	**72.88**	**70.55**	**-23.8%**	**-3.2%**	**-26.2%**	**-31.8%**
Milk Fresh Packed	500ml	60.17	60.17							

Source: KNBS. August, September 2018. Table 3: *National Average Retail Prices of Selected Commodities*
Gaps in prices are due to missing gaps in KNBS Monthly price sheets

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