

PARLIAMENT  
OF KENYA

SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 4th JUNE,  
1992 BY THE HON. PROF. G. SAITOTI, VICE-PRESIDENT AND  
MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING  
THE BUDGET FOR THE FISCAL YEAR 1992/93

( 1ST JULY, 1992 TO 30TH JUNE, 1993 )

Mr. Speaker, Sir,

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

1. INTRODUCTION

Mr. Speaker, in the last few years, the economy has been buffeted by a series of shocks. These include the prolonged recession, the high interest rates of the developed industrial countries and the collapse of the international coffee agreement. The Gulf War, realignments in Europe, political upheavals in neighbouring countries and disturbances within Kenya together with insufficient and unevenly distributed rainfall have caused yet further deterioration. The structural adjustment policies already in place, have made the economy more resilient. These have enabled it to withstand these shocks while registering reasonable rates of economic growth. Such levels of economic growth, and therefore of employment, are dependent on a peaceful atmosphere and on the pace of restructuring.

Mr. Speaker, world economic history is replete with examples of nations, the economic disintegrations of which have followed political turmoil. Thus an important variable in the equation for accelerated growth in any economy is the prevalence of political stability in the country. His Excellency the President has on several occasions reminded us all of the need for political stability through national unity. In Kenya's present circumstances patriotism demands that we heed, through deeds, His Excellency's wise counsel.

Mr. Speaker, the 1992/93 Budget will be the seventh of continuous structural adjustment as articulated in our Sessional Paper No.1 of 1986 on "Economic Management for Renewed Growth". This has paid dividends in the form of higher annual rates of economic growth than would have been experienced had we continued our inward-looking industrialisation with excessive dependence on coffee and tea. The Government is committed to continue and to accelerate the pace of restructuring of the economy during the remainder of this, the last decade of the 20th Century.

Within the framework of structural reform export promotion has been, and will continue to be, a prominent feature of policy leading to rapid economic growth and employment. This will again feature as of very high priority in this Budget as well as in the future. It will ensure that our structural adjustment process is not jeopardised by the sudden curtailment of resource inflows from foreign sources, as has happened since last November following the Paris Meeting with donors.

Prospects for the coming year, and indeed the near term, are still shrouded in considerable uncertainty. It is our firm belief, Mr. Speaker, that in these times of difficulty and uncertainty, the right policy response on the economic front is to press ahead with even speedier implementation of further structural reforms in all sectors of the economy. It is within this context that I have formulated the 1992/93 Budget around the theme: **"ENHANCED ECONOMIC REFORM FOR RENEWED GROWTH"**. This will lay a firm foundation to attain, in the not too distant future, economic growth rates similar to those prevailing in the most successful South-East Asian countries.

Mr. Speaker, as is customary, I shall begin with a review of the world development and prospects, the Sub-Saharan African position, and our own current economic performance in 1991 and then outline prospects for this year and beyond. Thereafter, I will highlight the budget out-turn for 1991/92 and the forecast for the next fiscal year. Finally, I will present my taxation proposals.

## 2. THE GLOBAL SCENARIO

Mr. Speaker, 1991 saw a mere 0.9 percent growth in output in the world's seven major economies, the weakest growth in a decade. Industrial production in this group of seven countries actually fell. Furthermore, there was a sharp decline in the growth of world trade to only 3.3 percent, continuing the slow-down from nearly 9 percent in 1988 and 5.2 percent in 1990.

The United States economy was expected to recover in 1991, but despite low interest rates, the upturn faltered towards the end of the year. A significant rise in the ratio of debt to national income has made US firms and households more sensitive to higher interest rates and more cautious about spending. In addition, banks have been reluctant to increase their lending. Similar problems have been experienced in Japan where also growth has slowed significantly. In Germany, excessive expansion in domestic demand following reunification has led to a rise in inflation, resulting in higher interest rates. Germany is now experiencing a recession, which has induced recessionary trends in other European economies.

World economic growth is expected to begin picking up in 1992, although there is still considerable uncertainty about the timing of the recovery. In the OECD countries the real GNP in 1992 is projected to grow at 2.2 percent, more than double the 1991 rate, while the rate of growth of domestic demand should rise from 0.6 percent to 2.3 percent. There are two main factors that are expected to bring about the OECD recovery in 1992: Firstly, the possibility that inflation will come down further from the present, already low, average levels. Secondly, the likelihood that there will be further aggressive easing of monetary policy, especially in the US and Japan. The South-East Asian countries are again expected to outpace the rest of the world in economic growth, as their exports continue to surge upwards and structural reforms bear fruit. Their Gross Domestic Products are forecast to grow by 6.5 percent in 1992 and 6.7 percent in 1993.

Mr. Speaker, growth prospects in developing countries will depend on recovery in the industrial economies and in particular on resumption of stronger growth in world trade. It is important in this context that industrial countries open up their economies somewhat wider to exports from developing countries; many of which have embarked on the difficult and risky process of structural adjustment in order to reorient their economies towards exports. If, however, the European Community adopts protectionist 'Fortress Europe' policies after the integration of Europe in December 1992, prospects for growth in world trade will be damaged further. For developing countries, it is both a grave frustration and a serious brake on their development process to have market oriented economies and not to be able to export to world markets. A development process based on trade is much more stable than one based on debt. Therefore, successful GATT negotiations are of paramount importance to ensure freedom of trade and world prosperity.

Mr. Speaker, the main commodity price with a profound effect on the world economy is that of crude oil. In US dollar terms, its average spot price in 1990 increased by 28.2 percent but declined by 17 percent in 1991. Given the projected demand and supply for oil, this price is expected to remain low. Non-oil commodity prices are also likely to remain depressed. A major commodity, the international price of which has plummeted, is coffee. This has reversed the terms of trade of a number of coffee producing developing countries with adverse effect on their balance of payments. Coffee price recovery is no where in sight unless a new agreement on quotas is concluded by the International Coffee Organisation.

Mr. Speaker, last year the Gulf War and the resultant inhospitable international economic environment adversely affected very many economies, particularly, in the third world. Fortunately, the War was short-lived. However, another world event of great importance that will have a profound influence for years to come on

foreign aid and private investment to third world countries, is the opening up of the economies of Eastern Europe and the Commonwealth of Independent States (CIS), i.e. the former Soviet Union. Suddenly now the third world is confronted with competitors in its attempt to attract foreign resources from the developed world. It is very likely that the developed world, because of its proximity to the newly established economic groupings of Eastern Europe and CIS, and the expectation that their economic growth will benefit from the reforms that they have undertaken, will divert resource flows to those destinations at the expense of Sub-Saharan Africa.

One glaring example, reflecting this contrary adverse tendency, is the near deadlock in negotiations over how much money the European Community (EC) should pay to the African, Caribbean and Pacific (ACP) economies under the Stabex programme. This programme was set up to cushion the AGP against fluctuations in commodity prices on the world market. This threatened contraction has come at a time when the EC has promised hefty financial aid to the CIS, thus fuelling fears that Europe's Lome partners will be left out in the cold, now that the risk of a "Cold War" has receded. It was reassuring that at the recent Global Coalition for Africa meeting in Kampala, donors noted this concern and promised to maintain the growth of support to this continent.

Mr. Speaker, preliminary data suggest that the 1991 growth in non-oil exporting developing countries is likely to be lower than in 1990. Per capita income in Sub-Saharan African countries is estimated to have declined by 0.9 percent in 1991, compared to a growth of 0.8 percent in 1990. The fall in commodity prices and the prevalence of drought in Eastern and Southern Africa have further lowered the growth potential of the region. Added to these difficulties, the civil wars in a number of countries still rage and peace settlements are elusive. All these factors indicate that the growth prospects for the near term future in the region remain bleak. However, two important events give a glimmer of hope for enhanced trade opportunities in Sub-Saharan Africa. These are the dismantling of apartheid and the recent positive endorsement by the white population for a peaceful transition to majority rule in South Africa, as well as the commitment to encourage inter - African trade.

### 3. THE DOMESTIC ECONOMY

Mr. Speaker, in 1991, the low average rate of growth overseas depressed our growth. The strain on our economy was further compounded by the influx of refugees from Somalia, Ethiopia and Southern Sudan. However, the structural adjustments we have undertaken over the years have made our economy much more resilient to external shocks than was the case some ten years ago. Our economy is more diversified and efficient than before as can be

seen from the fact that exports of non-traditional manufactured goods have increased in volume terms at an average rate of more than 13 percent per year since 1988. The average standard of living as measured by per capita real incomes, has improved every year since 1984 with the exception of 1991, when it declined by 1.3 percent; but even in that poor year it grew by nearly five percent over 1990 when the impact of the terms of trade are taken into consideration.

Mr. Speaker, as Hon. Members will have seen from their copies of the 1992 Economic Survey, there were factors beyond our control which led to lower growth of the economy. These include the global recession, the fall in world market price of coffee in dollar terms, the decline in tourism and the impact of bad weather on the agricultural sector. In addition the curtailment of donor finance adversely affected us. I am convinced that stronger action on our own policies would have ameliorated that situation. In my budget speech last year, I reminded Hon. Members of the adverse effects of large budget deficits on economic growth. I also expressed my concern over the high 1990/91 deficit and stressed the need to control future deficits. Unfortunately, by the end of November 1991, the fiscal deficit was already 2.8 percent of the forecast GDP which when grossed to an annualised basis would have been a 6.7 percent deficit. To re-establish fiscal discipline, I undertook a series of strong measures and I anticipate that the 1991/92 deficit will be around 3.5 percent of GDP. While this is higher than my target announced last year of 2 percent, it is a major improvement over the 6.3 percent recorded in 1990/91 or the November annualised forecast.

Mr. Speaker, it is important to clarify the precise nature of the outcome of last year's Consultative Group Meeting. The multi-lateral donors suspended funding under quick disbursing programme aid pending the re-establishment of fiscal discipline. On the other hand bi-lateral donors, who mainly finance projects, made diverse decisions. Some cut their aid frames, others delayed commitments to further assistance, while yet others maintained their finance levels to ongoing projects. I must record my thanks to those who have steadfastly stood by us during these difficult times.

### **Sectoral Performance**

Mr. Speaker, the overall growth of GDP in Kenya in 1991 has turned out to be 2.2 percent which was much lower than my forecast last year of 4.0 percent or the actual growth rate of 4.3 percent the previous year. This was a result of a decrease of over one percent in the output of the agricultural sector, the first decrease in production since the drought of 1984. This was once again a result of uneven distribution of the long rains, with prolonged dry spells at critical stages of plant development. This resulted in total crop failure in some parts of the country. The

crops most adversely affected were maize, beans and potatoes. Coffee production continued to fall. Increase in tea production was lower than the level attained in recent years largely due to inadequate rains. Horticulture and sugar cane output, also, recorded significant decline. The slaughter of large numbers of livestock, following the drought, resulted in increased meat production. However, this actually reflected disinvestment in the industry, because of depleting future growth potential.

In the manufacturing activities, there was substantial decline in the production of milk and other dairy products and very little increase in output of grain mill products, reflecting the depression in corresponding sectors in agriculture. A high inflation rate depressed domestic demand for other consumer goods such as textiles, clothing and leather footwear. However, production of manufactured goods catering for the export market fared well. Provisional estimates show that there was 20 percent growth in the quantity of non-traditional manufactured exports.

Mr. Speaker weak performance was also recorded in other sectors of the economy. The level of activity in the building and construction sector was relatively depressed as reflected by the decline in the production and consumption of cement and by a fall in employment in that sector. A similar fall in transport and communications was recorded due to increases in freight charges following the Gulf crisis. Tourism fell for the year as a whole, despite some recovery in the second half of 1991. Poor performance in agriculture, manufacturing and some exports and imports resulted in lower growth in the trade, restaurant and hotel sector.

### Investment and Savings

Mr. Speaker, investment is central to the process of economic growth and the generation of employment. But a high rate of investment is not enough by itself; it is equally important to ensure that the capital equipment is fully and productively utilised. The same amount of capital will generate different amounts of output and employment depending on the type of enterprise, the technology and utilisation ratio. In Kenya, comparison over time shows that while the rate of investment has come down significantly compared with that of the late seventies, both output and employment per unit of capital employed have gone up. This is due partly to fuller utilisation of capital, and partly to changing composition of the country's output of goods and services towards more labour-intensive products and processes where we have comparative advantage.

Notwithstanding these results, there is little doubt that if income growth rates in the range of 5 to 6 percent a year are to be attained, saving and investment ratios have to be raised significantly from their current levels. Mr. Speaker, towards this end we have introduced many policies in the course of the

structural reform of the economy. To encourage savings, we have introduced the following measures. First, the interest rate was raised in successive steps and finally deregulated; second, various new financial instruments such as the bearer bonds, the certificates of deposit and the foreign exchange bearer certificates have been introduced; third, the network of commercial bank branches and other financial institutions have been expanded; fourth, the Unit Trust Act has been revised; and fifth, the stock exchange has been revitalised. In addition, the Government has embarked on an effort to raise its own saving through a reduction in the budget deficit.

Many policy measures, have also been introduced on the side of investment. These include simplification of investment licensing procedures, reform of the Foreign Investment Protection Act, reduction in corporate and individual income taxes, tariff reform, exchange rate adjustment and the whole range of other policies aimed at promoting export industries.

Mr. Speaker, an essential ingredient in any decision to invest in productive enterprises is the investor's confidence in the security of the capital assets and the future prosperity of the economy concerned. Such confidence builds up only slowly. It is, therefore, heartening to note that real private investment in 1982 prices, which fell from a 1988 level of K£446.7 million to K£400.6 million in 1990, recovered slightly to K£401.1 million in 1991. This indicates a restoration of confidence since the recovery was mainly in machinery and other equipment.

#### **Money, Credit and Prices**

Mr. Speaker, money supply including all bank deposits, grew by 20.0 percent in 1991 following a similar growth in 1990. This high growth in money supply was mainly due to a high growth in domestic credit, which increased by nearly 27 percent in 1990 and 19 percent in 1991. Within these totals, credit to Government rose sharply in 1990, while credit to the private sector increased faster in 1991. The high rate of growth of money supply has undoubtedly been one among several factors generating inflationary pressures in the economy.

The month-on-month rate of inflation as conventionally measured by the Nairobi Consumer Price Index, was 10.5 percent for December 1991 as per the old index and 14.7 percent on the basis of the revised index compared with month-on-month measures in December 1990 of 18.3 and 19.4 percent for the old and new indices respectively. The rates were much higher for certain months of 1991, mainly due to the sharp increase in pump prices of petroleum products in September 1990 which raised the overall level of the index causing month-on-month measures to remain high for 12 months. Other factors which contributed to higher inflation were the rapid expansion of money supply, the increase in the budget deficit and

the exchange rate adjustments made to protect the balance of payments from further deterioration and to encourage exports.

### Balance of Payments

Mr. Speaker, a sustainable balance of payments deficit is the envy of all developing countries. In order to control trade deficits and achieve self sustaining external sector balance in the long run, Kenya has adopted export promotion rather than the inward looking import restriction policies. This is a gigantic task particularly viewed in the light of more or less continuous deterioration in our external terms of trade. This unfortunate situation arises because our exports are predominantly primary products and imports mainly manufactured items and crude oil. Over the years, countries such as Kenya have been compelled to cover their external deficits by borrowing abroad. This has, in turn, led to a high burden of debt service and has tended to make net resource flow to developing countries negative in some recent years.

Mr. Speaker, the overall deficit in our balance of payments for 1991 fell, in SDR terms, from SDR 109 million in 1990 to 60 million in 1991. The merchandise trade deficit improved sharply from 15 percent of GDP in 1990 to 11 percent in 1991 as a consequence of over 26 percent growth in our export earnings and under 3 percent growth in imports. The growth in exports was led by exports of non-traditional manufactured goods which increased by nearly 40 percent in value. Strong growth was also registered in exports of processed fruits and vegetables. With respect to imports, there was a significant decline in the volume of manufactured goods and machinery and transport equipment.

Turning to the services account, there was a much slower growth in earnings. Net earnings actually declined in SDR terms. In particular, tourism suffered a small decline in volume, due mainly to the sharp fall in bookings during the Gulf crisis in the first quarter of the year. However, the sharp improvement in the merchandise account followed through to make the current account deficit considerably lower at 2.8 percent of GDP in 1991, compared with 5.5 percent the previous year.

Mr. Speaker, these developments in the balance of payments are entirely in line with our policy objectives relating to the external sector. There is no doubt that some of the improvements in 1991 were a result of the many adjustment policies that have been implemented. The sharp fall in the value of some major categories of imports, however, was also due partly to the relatively depressed state of the economy in 1991. The foreign exchange reserves position was quite tight for most of the year and this accounted for some lengthening of the queues for import licences towards the end of the year. This led to a compression of actual imports.

## Prognosis

Mr. Speaker, 1991 turned out to be a year of low real income growth, high budget deficit, high growth in money supply and high inflation. Prospects for the coming year are better for budget deficit and money supply growth. However, more concerted efforts will have to be applied in order to raise the growth of real incomes, which is currently forecast at 2.0 percent, and to control inflation. The recent long rains were not satisfactory. This, coupled with disturbances in some rich farming areas, disrupted farming activities during the early part of the long rainy season and is likely to result in another year of low agricultural growth. Given its pivotal role in the economy, poor performance in agriculture is likely to dampen economic activity in all other major sectors. Manufacturing industries are likely to be affected further by rainfall induced electricity rationing. Constraint on foreign exchange to finance imports have been experienced but should improve in the second half of this year.

## 4. THE POLICY FRAMEWORK

Mr. Speaker, in order for Kenya to join the league of successful developing countries elsewhere in the world, it is essential to reverse the downward slide in economic growth of the last few years and regain the path of high economic growth. This will entail pursuing the policy of export promotion vigorously because an export-oriented development strategy will expand employment and diversify output. Export promotion in turn will require a competitive market economy with a low and sustainable rate of inflation. We intend to control the rate of inflation through appropriate fiscal, monetary and other macro-economic policies which should enhance efficient resource allocation both between and within the public and private sectors.

Mr. Speaker, the framework for economic policies in various sectors of the economy is already in place. We are committed to pursue the same course, with vigour and without changing the direction. This is the underlying basis for the budget theme: "**ENHANCED ECONOMIC REFORM FOR RENEWED GROWTH**". I shall start with a discussion of fiscal policy, which is the cornerstone of any sound budget.

### Fiscal Policy

Mr. Speaker, the over-riding aim of our fiscal policy for 1992/93 and the medium term will be to control the budget deficit, mainly through a reduction in the rate of growth of Government expenditure. As Hon. Members are well aware, this is not a new policy. Indeed, it has remained at the top of our fiscal policy agenda since the publication of the Sessional Paper No. 1 of 1986.

However, this particular goal has also proved extremely difficult to attain. Let me hasten to add, Mr. Speaker, that this difficulty is not unique to Kenya. Other countries - among them many rich nations - have also, for one reason or another, found it extraordinarily difficult to achieve planned reductions in their fiscal deficits. However, that is no reason for us to feel complacent. We are convinced that low budget deficits are an essential element in a process of sustained growth with stability. Hence our response to past difficulties in containing the budget deficit must be to redouble our efforts towards achieving this goal.

The budget deficit, being the gap between expenditure and revenue, can be compressed by either reducing expenditure or raising revenue, or through a combination of these two strategies. It is my belief, Mr. Speaker, that the best option is to reduce the deficit through cutting Government expenditure. It is now widely accepted that economic resources are utilised more efficiently when they are left at the disposal of the private sector, rather than the Government. More efficient utilisation of available resources leads, of course, to higher economic growth, employment opportunities and welfare.

Another strategy for reducing the deficit is to raise revenue. This is not the best option since, the basic objection against high Government expenditure, viz., relatively inefficient utilisation of resources, remains valid, whether the expenditure is financed by taxes or by borrowing. If expenditure must be high, it is better ordinarily to finance it through taxes rather than through borrowing. However, it is preferable to reduce the expenditure. This is particularly true in Kenya where the ratio of total revenue to GDP is already high. For the year 1990/91, this ratio excluding grants was nearly 23 percent. Raising tax ratios beyond these levels, in a developing economy like Kenya, may begin to impinge adversely on incentives to work and invest and generate additional inflationary pressures on the economy. Such developments would retard the growth of economic activity in the private sector and consequently overall economic growth.

Nevertheless, following the Tax Modernisation Programme, I am proposing to increase revenue collection efficiency by restructuring the Inland Revenue Department by redistributing its activities between Customs and Excise and the VAT Departments. In order to ensure that taxes imposed are collected and regularly remitted, I propose to appoint the Customs and Excise Department, the collector of revenue from Airport Passenger Service Charge and the Investment Secretary in the Treasury to be the Receiver of Revenue, for the Loan Interest and Redemption Receipts.

Mr. Speaker, it is in the light of these considerations that the 1992/93 budget deficit will be reduced from the present 3.5 percent of GDP to 2 percent. The burden of this adjustment has

to fall entirely on Government expenditure, more specifically on recurrent and development votes of ministries. We have little control on CFS payments which have already been determined by past debt. The only way to control them is to control the growth of debt in the future.

Mr. Speaker, within the compressed total expenditure, it has been necessary to make appropriate reallocations in line with our policy of budget rationalisation. In the area of recurrent expenditure, budget rationalisation aims at reducing expenditure on wages and salaries and using the funds saved for raising allocations for non-wage operating and maintenance expenditure. This improves utilisation of productive resources (schools, health centres, vehicles, equipment, and manpower) which are already in place in Government, thus raising the average productivity or efficiency of resource use. Thus the Expenditure Estimates, already tabled, show a moderate growth in proposed operating and maintenance expenditure in some key ministries.

Mr. Speaker, we have adopted the same objective of raising efficiency of resource utilisation in the area of development expenditure. This calls for higher allocation of development funds to projects which are of high priority and/or at a fairly advanced stage of implementation. It has, therefore, been necessary to reallocate some resources from other projects which are of lower priority and at an early phase of implementation, including new ones which are at a planning stage. In this connection, a revised Public Investment Programme was published last month. This incorporates the new priorities of the Government in respect of development expenditure.

Mr. Speaker, in order for budget rationalisation to take full effect it is essential to reduce the rate of growth of expenditure on wages and salaries in recurrent expenditure. The reduction in the growth rate of expenditure under these headings can only come about through slowing the growth of employment in the civil service and, in the long run, reducing new projects which will require operating and maintenance. Average rates of remuneration cannot be reduced - indeed they need to be raised periodically to protect real earnings from erosion through inflation. Mr. Speaker, we have already been implementing this policy through not filling vacancies created by retirement and freezing of recruitment in certain job groups. However, much stronger measures involving actual retrenchment will be required if we are to effect significant restructuring of recurrent expenditure and raise productivity in the civil service. Retrenchment is a difficult undertaking and for it to be successful we require significant resources. Among other things, we shall seek donor support for the setting up of adequate safety nets for those who may be affected by this programme.

Mr. Speaker, I want to make it quite clear that the allocations made to ministries in the Estimates already tabled, need to be regarded as absolute ceilings on expenditure. Any expenditure in the course of the year outside those Estimates can be provided for only through reallocation of funds which are already in the votes. In other words, there can be no additional expenditure in the course of the coming fiscal year on top of the ceilings that are already given.

At the same time, accounting officers in the various ministries must always ensure that any cheques written are covered by adequate credit balances in their cash books. They must seek written approval from the Treasury to overdraw their cash books. Accounting Officers who flout these directives will face very strict disciplinary action. Using the powers conferred by the Exchequer and Audit Act I will only authorize the issue of funds for the first six months of this fiscal year and, furthermore, will require all accounting officers to declare all pending bills in December this year before any further issues are authorised.

### Monetary Policy

Mr. Speaker, I now turn to policy objectives in the monetary and financial sectors. The structural adjustment to-date has been most advanced in this sector of our economy. Indeed, it is fair to claim that very little remains to be done in this sector in the way of structural adjustment.

Mr. Speaker, until recently, the financial sector in Kenya was highly segmented and interest rates distorted. Within the banking sector, commercial banks and non-bank financial institutions were working under different sets of rules and regulations. These gave rise to non-market based credit allocation. The Central Bank used to fix all types of interest rates in the country through administrative fiat. At the same time uniform quantitative ceilings were set for commercial banks within which to limit the total loans they could extend to their clients in each period. Penalties were imposed on banks which exceeded these limits. Consequently, interest rates neither attracted savings nor allocated funds efficiently.

To overcome these difficulties a number of phased measures were undertaken. The Central Bank Act was amended in both 1985 and 1989 to enhance the CBK's ability to inspect and audit financial institutions. The 1989 Act also laid down capital adequacy and exposure limits and established a Deposit Protection Fund. The Act, in addition, facilitated restructuring of weak financial institutions by 1990. To make interest rates effective, the band between the maximum lending and minimum deposit rates was widened and the ceiling on lending rate for commercial banks was brought in line with that for the non-bank financial institutions. This harmonisation of interest rate structure across institutions

allows banks greater flexibility in varying interest rates according to loan maturity. In April, 1990 CBK permitted banks to charge fees for lending. This effectively meant the charges for borrowing were made fully flexible. Finally, interest rates were liberalized in July, 1991. This deregulation of interest rates was a very important structural reform. The change-over from administratively fixed rates to free market rates was achieved without any destabilizing movements in rates or market activity - a fact that speaks volumes for the quality of economic management in Kenya. Indeed, although the change was revolutionary, it was brought about through a gradual evolutionary process.

Mr. Speaker, another important change that has taken place during last year is the introduction of open market operations, which aim at controlling the volume of bank credit indirectly by regulating the cash base of the commercial banks. However, its use is not widespread among developing countries because in such countries the market for Government securities is not well developed. The policy has been successfully used in Kenya for nearly a year now which is a sign that our financial system has already acquired a certain level of sophistication. Once the use of this technique is firmly established as part of the day to day monetary management by the Central Bank, it will be possible to do away with the quantitative credit ceilings. As the market gets more used to this sort of trade, it will be possible to extend the scope of open market operations beyond Treasury Bills to include longer term securities, which will give the Central Bank a handle to work on the term structure of interest rates.

Mr. Speaker, many factors have a bearing on inflation. There is no doubt that any growth in money and credit in excess of the growth in real output produces an upward pressure on prices. Indeed, the recent rising trend in the rate of inflation has coincided with a rising trend in the growth of money supply.

One important reason for the recent rise in the rate of growth of money supply has been the high budgetary deficit and high Government borrowing from the domestic banking system. It is with this in mind that I am bringing this year's deficit ratio to 3.5 percent of GDP and plan next fiscal year's deficit at 2 percent.

Mr. Speaker, the budget deficit impacts the general price level in various ways. Any deficit between recurrent revenues and recurrent expenditures means that the Government is drawing on the nation's savings for recurrent requirements. In so far as this means resources are diverted from investment, this lowers the goods and services available to the wananchi in the long run. Furthermore, domestic borrowing by the Government puts pressure on the price of loanable funds which raises the cost of borrowing - and therefore the cost of production - to all other segments of the economy. Naturally salaries and other costs paid to domestic business put purchasing power into the hands of local consumers.

Where these are not matched by tax measures, there is a direct inflationary impact since matching goods and services do not appear in the short run, if at all.

Mr. Speaker, many steps have been taken in the recent past to ensure that banks and other financial institutions respect sound principles of financial management so that the depositors' money remains safe. All deposit taking institutions are required to maintain statutory minimum liquidity ratios. These aim at ensuring financial prudence in the management of the asset portfolios of those institutions. At the same time, they give the Central Bank a convenient base for exercising monetary control. The monitoring of these ratios will be strengthened during the coming year, to make sure that all banks abide by these regulations at all times. The Central Bank has recently reactivated its discount window to enable those banks which may face temporary shortages of cash to discount Government securities. However, suitably high discount rates will be charged to make sure that banks exercise caution and discipline in the management of cash and use this facility only as a last resort.

Recent revisions of the Banking Act have strengthened the supervisory role and responsibilities of the Central Bank, and have provided for many new restrictions against imprudent banking practices. The Bank Supervision Department conducted a large number of bank inspections last year with a view to monitoring the financial status of individual institutions. The Central Bank will take steps to restructure those which are considered to be in financial distress. In appropriate cases, it may intervene in the management of the institutions, or take more drastic measures if they are called for in its judgement.

Mr. Speaker, the Consolidated Bank of Kenya which was set up by amalgamating a number of weak financial institutions is now well established and has already begun operations as an ordinary commercial bank. To-date, it has been able to recover more than Shs 300 million of the bad debts which were owed to the various institutions which were brought together under it. The Deposit Protection Fund has been augmented substantially to provide adequate security for depositors' money and thus help maintain confidence in the country's financial system which serves a highly productive role of financial intermediation between savers and investors.

Mr. Speaker, before concluding my remarks on the monetary and financial sector developments and future policies, I shall refer briefly to the Capital Markets Authority. In the course of the first two years of its life, the Authority has contributed a great deal to the development of an active market for company shares. A trading floor was set up in the Nairobi Stock Exchange to increase transparency, boost market activity and enhance investor confidence. The activities in the Exchange are receiving extensive

media coverage, enlightening public opinion on the central role of a stock exchange in channelling resources for the development of the nation's commerce and industry. The Capital Markets Authority is also expected to play a crucial role in the process of divestiture of parastatals. Arrangements are being made to sell Government's shareholding in a number of parastatal companies which are already listed with the Nairobi Stock Exchange. A couple of other companies are waiting to be sold through public flotation of shares. Steps will also be taken to develop a second tier market with less stringent disclosure requirements.

### **External Sector Policies**

Mr. Speaker, the central objective of our policies in the external sector is to achieve and sustain long-term viability of our balance of payments. The fiscal and monetary policies that I have been commenting upon will all have significant impact on this objective. In a highly open economy like Kenya, the domestic and the external sectors are closely inter-linked. A strong and vibrant domestic economy supports, and in turn is supported by, a growing and prosperous external sector.

Mr. Speaker, we are seeking to achieve external viability through three interrelated strategies - strong growth and diversification of exports, encouragement of foreign equity investment, and stemming the outflow as well as securing the return of flight capital. I shall comment in brief on the policies that are in place which have a direct impact on these objectives.

### **Export Promotion**

Mr. Speaker, we have adopted the following major policy initiatives which have a direct impact on export incentives: Export Compensation, Manufacturing-Under-Bond (MUB), Export Processing Zones (EPZs) and exemption from duty and VAT on imports for exports. All these policies are well entrenched. Over 300 companies are exporting under the export compensation scheme and its scope is being continuously reviewed and expanded. 60 projects have to-date been approved by the Investment Promotion Centre under the MUB scheme. 17 of these are already operational and construction work is at various stages of completion for 38 others. To encourage exports further the administrative fee of 2 percent levied by the CBK on goods imported under no foreign exchange by MUBs, will be abolished forthwith. Under the EPZs scheme, the first private EPZ near Nairobi is now fully occupied. A second private EPZ which is already fully booked, has been licensed to be set up at Ruaraka, while approval in principle has been given for a third private EPZ to be set up in Nakuru. Work has already commenced on the Government EPZ at Athi River. Preliminary engineering work has also started in the Mombasa EPZ. The duty/VAT exemption scheme has to-date been used by nearly 40 exporters, who have imported about Shs

500 million worth of inputs, to be used in exports worth about Shs 1 billion.

Mr. Speaker, besides the above, there are other policies which have somewhat indirect, but even more important bearing on the growth of exports and encouragement of capital inflows. In the 1970s we had a tariff and rate of exchange structure which favoured imports and import replacement industries. This anti-export bias has since been replaced. The relevant policies here are the constant monitoring and adjustment of the exchange rate, progressive liberalisation of imports and reduction and rationalisation of tariff rates with a view to reducing both nominal and effective protection. These policies which are already in place are progressively being applied to correct this anti-export bias.

Mr. Speaker, diversification of exports in our case will essentially mean growth of non-traditional exports, mostly exports of manufactured goods. Most of the market for our manufactured goods used to be in the Eastern and Southern Africa region. Although markets for Kenyan manufactured goods are being developed in Europe, the Middle East and other industrially advanced regions of the world, - and this process is expected to intensify with the growth of the EPZs - inter African trade will continue to account for a large share of our total exports of manufactured goods. The progressive strengthening of trade links with PTA countries will be seen to be an important export promotion policy in this context. Closer to home, significant progress is being made in reactivating the economic co-operation among the three economies of the East African region.

#### Foreign Equity Capital

Mr. Speaker, attracting foreign equity capital into the country is another high priority objective of Government. If developing economies like ours are to attain a stage of high and sustained growth of per capita real income, capital formation has to be on a scale which usually cannot be supported by domestic savings alone in the early stages. They need to be supplemented by foreign savings. It is highly desirable that the foreign saving comes in the form of equity capital, rather than in the form of loans. Equity capital brings with it management skill, technical know-how, and risk-bearing. If we are careful in negotiating the terms of foreign equity participation, the country can make large gains in terms of employment, technology transfer and development of entrepreneurial skills among local investors.

Mr. Speaker, most enterprises set up with foreign equity participation will aim at producing for the export market. The entire range of our export promotion policies will therefore also help in attracting foreign equity capital. So will all other policies aimed at encouraging investment at home - such as the

removal of price controls, freeing of interest rates, import liberalisation, reform of exchange control regulations, and simplification of investment licensing procedures. Earlier reforms of the Foreign Investment Protection Act were measures that were aimed particularly at the foreign investor. Here, as elsewhere, we shall refine and widen the scope of our existing policies and strengthen their implementation. Mr. Speaker, in furtherance of our policy of making the Investment Promotion Centre a one-stop office for investment licensing, today I am publishing an amendment to the Investment Promotion Centre Act which will enable it to issue a general authority which will radically reduce the number of licences which a new investor will have to obtain at the time of start-up. Furthermore, this amendment will rationalise the new firm's registration requirements.

### Return and Retention of Flight Capital

Mr. Speaker, no country can develop unless and until the nationals of the country invest in their own development. Indeed, foreign investors will start investing in Kenya on a large scale only when they see Kenyans doing so. Mr. Speaker, the structural adjustment measures in their totality are geared to this basic objective of making Kenyans invest more in their own country. In fact, the structural adjustment measures will attract some flight capital back into the country. This is already happening on a limited scale. Mr. Speaker, I am referring to the no-foreign exchange imports level which has gone up substantially in the course of the past two years.

Mr. Speaker, we have already taken a major step towards freeing transactions in foreign exchange through the introduction of the convertible foreign exchange bearer certificate of deposit. Net sales of foreign exchange bearer certificates by the Central Bank so far has been substantial. Judging by the results of weekly auctions in these certificates, the instrument has already become popular. It will gain further popularity as more such trading centres are opened in future.

A concomitant reform was the abolition of the currency declaration form for all arriving passengers - both visitors and returning residents. Anybody who had earned or otherwise come into possession of foreign exchange outside the ambit of exchange control regulations, can now freely bring their money into the country and invest in building up our wealth and prosperity. All our structural adjustment measures are aimed at creating the right environment for such investment and the necessary confidence for the investors in this country's future.

I wish to assure Hon. Members that Government policy is set firmly on the course of liberalisation in the area of exchange control, as in all other areas of the economy. Further measures in

this area are currently under Government consideration and will be announced in due course. Here, as elsewhere, our policy approach is to enhance the economic reforms that are already in place for renewing the momentum of growth.

### External and Domestic Debt

Mr. Speaker, external and domestic debt creation is determined by the levels of budget and the balance of payments deficits. Deficits and debt are two sides of the same coin. The higher the deficit the bigger the debt.

External borrowing is a supplement to our domestic saving. If we did not borrow from overseas we would rapidly deplete our foreign exchange reserves. To reduce the external debt we should stimulate export earnings. Our external borrowing has fluctuated over the years but in recent years, the trend shows that it has declined vis-a-vis domestic borrowing. The debt service ratio has also fluctuated and despite a marginal decline in recent years, has stayed at a high level. Kenya has always serviced its external debt because it is our policy not to reschedule it and this has been an enormous burden on the economy.

In recent years even parastatal debt service has become a burden on the Exchequer. A number of parastatals have persistently defaulted on their foreign debt obligations and since the Central Government has guaranteed most of these loans, it has been compelled to bail them out by honouring their obligations. Consequently the Government has had to incur substantial unbudgeted expenditure, which not only increase the budget deficit, but also has had the effect of postponing other essential capital expenditures. Such defaults or late payments by parastatals have also turned out to be costly. The World Bank has for sometime now introduced a facility whereby 0.25% on interest is waived as a reward for timely servicing of all loans owed to it by a member country. Kenya has failed to take advantage of this relief facility because of defaults by parastatals and has lost Shs 12 million worth of potential saving per annum.

Mr. Speaker, as far as domestic debt is concerned, there has been a significant growth of the outstanding stock. Between June 1986 and December 1991, it increased by 43.7 percent. As a percentage of the total budget, domestic debt servicing outpaced external debt servicing from 1988/89. In the current year as well, domestic borrowing to finance the budget deficit has been predominant because of the lack of donor finance from overseas. The domestic borrowing, however, is largely from the non-bank sector. Within the non-bank sector, borrowing through the one-year Treasury bonds is preponderant. This shift to non-bank borrowing is very welcome because it is non-inflationary. Financing of the deficit through bank borrowing in the current year is low and financing through the Central Bank is even lower, being actually negative

over the ten months to the end of April 1992. Mr. Speaker, this implies that our mode of financing the deficit is non-inflationary and quite contrary to financing through excessive printing of money.

The strategy adopted by the Government in the short run is to improve the management of existing stock of debt with a view to reducing the debt burden by way of minimising its maintenance costs. The Debt Management Division of the Treasury has computerised Government and parastatal debt and is in the process of computerising Government domestic debt as well. With correct debt data, the Division will be able to carry out analysis so as to determine borrowing ceilings to avoid debt overhang and recommend currency composition and average terms of new commitments. Finally, to highlight public debt issues for discussion and public dissemination, the Division will be required regularly to prepare and publish an annual report.

### Parastatal Reform

Mr. Speaker, Kenya had many state-owned enterprises - presently over 395 commercially-oriented and regulatory parastatals. The Government is a majority owner in over half of these enterprises. During 1986-90, the parastatal sector accounted for about 11 percent of GDP, nearly 16 percent of gross fixed capital formation and provided employment to over 120,000 people. In 1991 the sector was responsible for a substantial net outflow from the Central Government. In 1990/91 the Government serviced parastatal debt to the tune of Shs 1.1 billion and in the current financial year Shs 636 million. This sector represents a substantial actual and contingent liability, chiefly as a drain on the Government budget through high spending, low revenue contributions, and intermittent defaults on payments due to creditors. It also operates as a major constraint on economic growth. Firstly, the sector is characterised by widespread inefficiency in the use of scarce resources, with levels of productivity and rates of return on capital and equity contributed out of taxpayers funds, considerably lower than those in the private sector. Secondly, the growth of the more efficient private sector is stunted by the domination of parastatals and the conflicts of interest involved in government regulatory bodies that compete with private enterprises in the provision of commercial goods and services. Lastly, inadequate controls result in widespread misuse of and in waste of national resources consumed by rent-seeking activity related to their operations. This House will recall that in my last year's budget speech I stated that the Government was committed to the reform of grossly inefficient parastatals. I would now like to report to the House that considerable work has been undertaken in this regard.

To encourage and accelerate this reform, H.E. the President last year appointed the Parastatal Reform Policy

Committee (PRPC), with a mandate to liquidate and divest non-strategic parastatals. An Executive Secretariat and Technical Unit headed by an Executive Director has been established under PRPC. By December, 1991, 22 companies were wound up, divested either through the exercise of pre-emption rights or sold through an open tender system to the highest bidders. 13 companies were processed for sale through the same method in March, 1992. Arrangements are under way to sell Government's shareholding in three companies already listed in the Nairobi Stock Exchange. Work has been finalised on two additional companies and their sale through public flotation in the Stock Exchange will be executed in the near future. New Board and management teams have been established for two companies as part of their restructuring. In addition, the PRPC has directed the ESTU to process 12 more companies.

Mr. Speaker, in addition, to the above the Development Finance Institutions (DFIs) are being restructured so as to provide venture capital for new businesses which have non-bankable risks. Their incomes will come more from capital gains from the sale of successful companies which they have started than from dividends and interest as at present. In the course of this restructuring the revenues from the sale of their existing portfolios will be deposited on interest until it is used to further the efficiency of this sector. To support its efforts, the Government recently agreed with IDA on modalities for privatisation. Agreement has been reached on the list of non-strategic, non-viable companies that will be liquidated or put into receivership and on the list of non-strategic, viable or potentially viable companies that will be privatised including the methods and time-table for their privatisation. The proceeds from the sale of direct equity holdings of the Government will be placed in a special account at the Central Bank of Kenya and accounted as a receipt to the budget and used to reduce the Pay Master General's (PMG) overdraft.

### Agricultural Reform

Mr. Speaker, in the agricultural sector, improving productivity per hectare is of paramount importance, particularly when land is limited and population growth is rapid. The urgency of the task has been dramatically underscored by a 13 percent shortfall in maize production in the current crop year, which occurred after an equally steep fall in the preceding year. Structural adjustment in this area has entailed increasing the availability of essential inputs, especially fertiliser, strengthening producer incentives and improving efficiency in the public sector.

Mr. Speaker, for some time the Government has been concerned about inadequate fertiliser use by Kenya's farmers, smallholders in particular. Over the last ten years, fertiliser consumption has grown by approximately 6.5 percent annually. However, given the projected high rates of growth in the demand for

food, the need to increase agricultural inputs, and the diminishing availability of high and medium potential lands, intensified farming will require a higher growth of fertiliser usage. The Government objective is to increase fertiliser use by all farmers but most importantly by smallholders. The strategy to achieve this goal is to increase its availability throughout the country by ensuring an efficient marketing system for it. This has been achieved partially by the decontrol of fertiliser prices.

Availability of agricultural credit to farmers to obtain necessary inputs for increased production, strengthens producer incentives. In addition, farmers' ability to adopt new technologies is constrained by the limited financial resources at their disposal. At present, the involvement of Government in such credit has been through the financing of Agricultural Finance Corporation (AFC), the support for the Co-operative Bank of Kenya (Co-operative Bank) and a number of other credit schemes and projects administered by these two institutions. Commercial banks and non-bank financial institutions also provide credit to the farming community. However, the current credit system has two major problems. One is the inability of the credit system to reach small farmers. For instance, approximately 19 percent of the commercial bank agricultural credit and 20 percent of the AFC and Co-operative Bank portfolios went to farms below 50 hectares. The other is the existence of a large number of arrears by borrowers. This has adversely affected the financial viability and the liquidity of both AFC and Co-operative Bank. In order to improve the availability of credit a major restructuring of AFC will be carried out.

Mr. Speaker, a major determinant of future farm production remains the ability to guarantee sufficiently remunerative prices to farmers. In the absence of input subsidies, producer prices must be sufficiently high to enable farmers to afford the major inputs and machinery. Adequate producer prices coupled with prompt payments will motivate farmers to expand the area under cultivation. Accordingly, the Government has always announced producer prices well in advance of the planting season every year. In order to improve marketing efficiency, the Government has also liberalised the crop marketing system, especially in the case of maize. The Government recently allowed traders to move 88 bags of maize without a licence and total removal of the movement controls will be implemented in due course.

Mr. Speaker, there have been many advantages in having a single official producer price throughout Kenya for a full crop year. However, its main disadvantage is that it encourages inefficient spatial distribution of production as well as high transport and marketing costs. In realisation of this, I have gradually decontrolled prices of some of the non-strategic commodities such as meat, milk, margarine, tea and rice.

Mr. Speaker, today I will be introducing a variable tax to support certain areas of agricultural output. Kenya has to import food grains whenever there is drought in the country and has, in recent years moved to a policy of import parity for imported food commodities. It is common practice for governments in most countries to attempt to remove the downside price risk from major agricultural crops by providing a minimum price guarantee to the farmer, by adopting a variable duty. Where domestic supply cannot meet domestic demand and imports are required, the domestic market can be liberalised and a minimum floor price maintained by allowing in imports, while ensuring that import duties are such that imports cannot undercut the domestic producer. To prevent imports entering at a price lower than the floor price, the import duty is used to raise the price of imports to the floor price when the world price is low enough to result in imports otherwise being able to undercut local producers. Import parity normally includes world prices plus freight, insurance and duty. Mr. Speaker, this year I propose to introduce a variable duty on wheat, maize, rice, milk powder and sugar imports. The essence of a variable duty is to protect farmers and maintain floor prices for selected agricultural commodities.

Mr. Speaker, regarding livestock development, Kenya has a dairy system which is mainly based on smallholders and is highly developed. Its development was spearheaded through subsidised inputs and services. However, policy changes are essential to meet future consumption demand of the rising population, to be self-sustaining and to generate foreign exchange through export of surpluses. These policies are aimed at improving productivity and encouraging competition in processing and marketing. To achieve these aims, Kenya Dairy Board will be reorganised to co-ordinate and supervise the dairy sector. Restrictions on investments and competition in the dairy industry have been removed except for those relating to hygiene, while the producer and consumer prices of milk have been decontrolled.

#### **Rural-Urban Balance and Small Scale Enterprises**

Mr. Speaker, I now turn to rural-urban balance and the encouragement of small scale enterprise. Kenya is one of the least urbanised countries in the world - 108th out of 145 as per 1987 World Bank study. Thus it remains a priority of the Government's overall development strategy to distribute urban infrastructure to areas where infrastructure would be most needed. Limited resources dictate that the Rural-Urban Balance Strategy is aimed at identifying rural areas where infrastructure would be most effective. Therefore, to-date, eight Rural Trade and Production Centres (RTPCs) have been developed at a cost of Shs 165 million. The money has been spent on roads, bridges, market and storage facilities, water and electricity.

Early indications are that RTPCs have been well received and utilised. A number of potential sites have been identified so that when development funds are available these will be developed. The Government intends to seek further donor funding for this valuable initiative.

The basic tenets of the strategy stress the interaction between the agricultural, manufacturing and service sectors. It also emphasises that the inter-dependency between the rural and urban settlements is essential to create vibrant regional economies. It seeks to promote economic growth throughout the country. There is evidence that the number of settlements reporting a population of over 10,000 has increased and very vigorous growth is taking place in the smallest urban centres with populations of under 10,000 people. Thus, widespread urbanisation is taking place, but in a desirable, dispersed manner. This early evidence demonstrates the correctness and success of our rural-urban balance strategy.

Mr. Speaker, the development of a prosperous and growing small-scale enterprise sector has always been a cornerstone of our Rural-Urban Balance strategy. The Government has long been committed to the need to create employment opportunities for our rapidly growing work force. It has recognised the vital role of small enterprises, the informal sector and the "jua kali" artisans. This commitment was articulated in a Sessional Paper on 'Small Enterprise and Jua Kali Development in Kenya' which was tabled and debated recently in this House. This document lays down Government's policy framework for promoting small enterprise development and also reaffirms its role as a facilitator whose prime function is the creation of a positive enabling environment within which such businesses may flourish.

The Sessional Paper outlines a wide range of policies and strategies aimed at removing or alleviating the constraints which inhibit the development of the small enterprise sector. These include the review of licensing arrangements and rigid building codes and the issuing of new guidelines by the CBK on lending to this sector, to name only a few. As an important step in this process, I am publishing a replacement to the Trade Licencing Act which will also reduce the licencing requirement for small entrepreneurs seeking to set up businesses. Thus similar benefits to those which the Investment Promotion Centre will bestow on large investors will be made available to those who have previously suffered major frustrations in this area.

Mr. Speaker, small scale enterprises are the only part of the economy likely to increase jobs significantly. Experience in Kenya, like other developing countries, suggests that a major difficulty within the small enterprise sector is not so much encouraging the creation of new enterprises but rather assisting existing ones to grow. It is evident that the risks and

uncertainties facing very small enterprises greatly constrain their growth. Their inability to obtain such necessary inputs as loans for working capital and to find adequate, affordable work-places or supplies of raw materials add to their difficulties. To overcome these constraints requires a partnership between the public and private sectors. The private sector needs to be more active and receptive in making use of available opportunities for promoting its own interests. For its part, the Government will redouble its efforts to create a positive enabling environment through the provision of infrastructure, a sympathetic regulatory climate and economic policies that encourage investment.

## 5. FINANCIAL OUT-TURN 1991/92

### Recurrent Revenue

Mr. Speaker, I now turn to this year's Budget Out-turn. In the original budget for 1991/92, ordinary revenue was estimated at Kf2,711.1 million net of export compensation payments. Another Kf82 million were expected to be available from Appropriations-in-Aid, making up total available recurrent revenue of Kf2,793.1 million. The ordinary revenue was to comprise of Kf960.3 million from VAT, Kf791.8 million from Income Tax, Kf625.7 million from Customs and Excise, and Kf333.3 million from all other taxes, dividends and fees. Mr. Speaker, the revised estimates for 1991/92 show that I may realise a total recurrent revenue of Kf2,800.2 million, which is Kf7.1 million higher than the original estimates.

The actual total collection under ordinary revenue is likely to be marginally lower by Kf17.7 million, while total collection under A-in-A is expected to be higher by Kf24.8 million. Within the total of ordinary revenue, there has been considerable difference in the performance of different taxes. Mr. Speaker, I mentioned before that the overall growth in economic activity in 1991 was way below our original expectations, and that the value of imports recorded only marginal growth. This depressed the collection of import duty, while the suspension of VAT on restaurants reduced expected revenues by some Kf10 million. To offset part of the anticipated shortfall in these revenue categories, I took a number of vigorous new measures around the middle of the financial year. The situation was assisted by significant improvements in the efficiency of income tax collection, and sizeable payment of dividend by the Central Bank associated with the higher interest payments under CFS.

Mr. Speaker, I now expect to raise Kf928.9 million from VAT, Kf835.0 million from Income Tax, Kf581.3 million from Customs and Excise, and Kf348.2 million from other sources in 1991/92.

### Recurrent Expenditure

Mr. Speaker, as shown in the Financial Statement, this year's total recurrent expenditure is expected to increase by K£105.7 million from the Printed Estimates level of K£1,686.9 million. However, a part of this increase will be offset by an additional K£20.6 million collected by the Ministries as Appropriations-in-Aid, leaving a net increase in expenditures of K£85.1 million. This increase was required to meet additional expenditures on account of teachers' salaries and allowances, high priority expenditures on internal security and other increases, recently approved by this House in the Supplementary Appropriation Bill.

As far as Consolidated Fund Service payments are concerned, I anticipate an increase of K£304.9 million over the levels we had planned in the beginning of the year. Of this increase, K£84.5 million is accounted for by interest payments on external and domestic loans, due to exchange and interest rate changes as well as the take over of the debt service obligations of some State Corporations which were experiencing liquidity problems.

In addition, net Excess Votes and Under Issues of previous years had to be financed amounting to K£35.7 million.

Mr. Speaker, I, therefore, expect the global figure of this year's gross recurrent expenditures to be K£3,783.2 million, compared with an expected total recurrent revenue of K£2,880.2 million. Thus there was no surplus in the recurrent account to finance development expenditure.

### Development Expenditure

Mr. Speaker, arising out of the need to control total expenditure and the budget deficit, we have maintained tight limits on development expenditures this year. Consequently I expect the Gross Development Expenditure to be around K£1,069.7 million, which is about K£20.6 million less than what was originally planned. This reduction came about mainly as a result of the austerity measures introduced to reduce the overall expenditure and the re-phasing of some of the slow-moving projects.

In addition, I had to finance net Excess Votes and Under Issues under the development vote of about K£27.9 million.

As a result of these developments, I expect that this year's budget deficit will be around 3.5% of the GDP, which is substantially lower than the revised figure of 6.3% for 1990/91.

## 6. FORECAST OUT-TURN 1992/93

### Expenditure

Mr. Speaker, as the Hon. Members must have already seen from their copies of 1992/93 Printed Estimates, the gross recurrent expenditures of Ministries will be Kf1,867.7 million, including Appropriations-in-Aid of Kf108.0 million. The projected expenditures on Consolidated Fund Services payments are Kf2,345.7 million, of which a major part, namely Kf936.6 million is accounted for by internal loan redemption involving the roll over of existing internal loans, becoming due for repayment in 1992/93. Thus the total gross recurrent expenditures will amount to Kf4,213.4 million.

Mr. Speaker, a major part of the recurrent expenditure is accounted for by salaries and allowances of civil servants and teachers, including the payment of the second phase of salary increases awarded by the Mbithi Committee. As the Hon. Members will notice, funds have also been earmarked in the budget for the conduct of elections, when the Government seeks a fresh mandate from the people.

In addition to the gross recurrent expenditure of Kf4,213.4 million, I shall have to finance net Excess Votes and Under Issues relating to previous years of Kf69.3 million.

The total development expenditure in 1992/93 is estimated at Kf1,190.3 million, which includes Appropriations-in-Aid of Kf609.5 million. This represents an increase in Development Estimates of Kf120.6 million or 11% over the revised estimates for this year.

Mr. Speaker, the development budget I am proposing for 1992/93 is significant in many ways. Perhaps the most important item of expenditure that is included in it is the provision of Kf122.6 million for the distribution of maize by NCPB at subsidized prices. This is indeed a reflection of our commitment to ensure the adequate availability of basic food to the wananchi, at affordable prices, despite the current shortfall in domestic production.

Mr. Speaker, the development budget for 1992/93 also reflects the Government's concern for the welfare of refugees from neighbouring countries who have come to Kenya seeking our help. The Government has already started distribution of food to refugees in collaboration with the World Food Programme, and the budget includes a provision of Kf27.5 million for this activity during 1992/93.

Mr. Speaker, I do not want to go into other details of the Development Budget for 1992/93 at this stage, as the Hon.

Members will have adequate opportunity to discuss the various projects in the Committee of Supply. I would, however, like to highlight some of the major donor-financed projects included in the budget, merely to illustrate the main thrust of our development efforts. These include the K£31 million earmarked for further expenditure during 1992/93 on the Nairobi Water Supply Project; K£18.8 million earmarked for completing the construction of the export Processing Zone at Athi River; K£13 million for the Coast Water Supply Project; K£15 million for the Geothermal Energy Project; K£15 million for Wildlife Preservation; K£10.8 million for Forestry Development; and K£12 million for the Smallholder Coffee Improvement Project to name a few.

In addition to the Gross Development Expenditure of K£1,190.3 million, I will have to finance net Excess Votes and Under Issues of K£83.1 million in 1992/93, pertaining to previous years.

Thus a total gross expenditure of K£5,556.1 million will have to be financed during 1992/93. I shall now outline how I propose to finance this total expenditure.

#### External Revenue

Mr. Speaker, the international donor community has continued its support for projects to further our efforts for the rapid development of the nation, by committing assistance in the form of concessionary loans and grants. We anticipate that the suspension on quick disbursing programme aid from the multilateral donors which was imposed in November last year, pending the restoration of fiscal discipline, will be rescinded following the analysis of this year's successful fiscal outturn. Thus in 1992/93 we expect a total external assistance of K£1,165.7 million. Of this, over 44 percent or K£513.4 million will be in the form of project and programme grants and the remainder in the form of project and programme loans. Thus I will be able to finance 21 percent of the total expenditure from external resources.

Mr. Speaker, the financial support that we will be receiving from the international donor community is indeed substantial. I would, therefore, request the Hon. Members to join me in expressing our gratitude to the foreign governments and bi-lateral and multi-lateral institutions that have provided and promised financial support of this magnitude to our developmental efforts.

I shall now turn to how I intend to raise the balance of K£4,390.4 million.

### Domestic Borrowing

Mr. Speaker, I have stressed before our objective of bringing down the level of borrowing from domestic sources for financing the budget deficit, so that more resources can be left at the disposal of the private sector. The gross borrowing from domestic sources planned for 1992/93 is K£1,195.3 million, which is about the same as the expected gross borrowing of K£1,184.2 million for this year. It is significant that K£1,089.0 million of this gross borrowing will be directed towards recycling maturing debt, leaving a net borrowing of only K£106.3 million, compared with an estimated net borrowing of K£451.4 million during the current financial year.

Again, consistent with our policy of reducing the inflationary impact of the budget deficit, we propose to raise most of these domestic loans from non-bank sources.

### Internal Revenue

Mr. Speaker, the economy has performed poorly in 1991. For reasons already stated, I do not expect significant recovery to begin before the end of this calendar year. Our current forecast is a real growth rate of 3.1 percent during the financial year 1992/93, compared to a forecast level of 2.1 percent for 1991/92. The implicit GDP deflator is expected to be somewhat lower in 1992/93 at 11.2 percent compared with 13.7 percent for 1991/92. On this basis, I expect to collect, at present rates of taxation, a total ordinary revenue of K£2,990.8 million, net of export compensation payments. Appropriations-in-Aid will provide another K£88.3 million.

Thus, I shall raise a total of K£5,440.1 million from all these sources. I have, therefore, a gap of K£116.0 million to be financed through additional tax measures. The rest of my speech will deal with how I intend to do this.

## 7. TAXATION PROPOSALS

Mr. Speaker, I have already appraised the House on the global economy, on the Sub-Saharan economies and on our domestic economy. I have formulated a policy framework to encourage the expansion of output and employment through export promotion. I have also indicated that I have a financing gap of K£ 116.0 million. I now turn to my taxation proposals. As is customary, I would ask, Mr. Speaker Sir, that the rest of my Speech be regarded as a Notice of a Motion to be moved before the Committee of Ways and Means.

Mr. Speaker, raising tax revenue is one of those necessary evils with which Finance Ministers world over have to contend with. No one enjoys paying taxes. Nevertheless, governments require revenues to meet recurrent and development expenditures incurred in the course of provision of goods and services for their people. The best a finance minister can aim to do is to collect tax revenues in a fair and efficient manner. In the case of Kenya, over the past three years, the Government has implemented the Tax Modernisation Programme. The Programme involves the systematic reform of tax rate structures, improvement in tax administration and enforcement, as well as computerisation of revenue collecting departments.

Mr. Speaker, in the customs and excise area, significant rationalisation of duties have been achieved while mechanisms to support exports have been introduced. Over the years, average import duties have been lowered and number of rates compressed. The Sales Tax was replaced by the Value Added Tax on goods and services with a number of tax rates reduced and maximum rates lowered during the same period, to ensure compliance and efficient revenue collection. As far as income tax is concerned, both individual and company tax rates are lowered to encourage greater savings, investment and work effort, while instalment and self-assessment tax systems are introduced to ensure more accurate and prompt payment of taxes. Mr. Speaker, the results of these changes are note worthy, because despite significant cuts in tax rates over the years, tax revenue collections have increased. Accordingly, the revenue measures that I will propose will follow this successful pattern. I shall also highlight some of the progress made under the Tax Modernisation Programme as I deal with each of the major taxes.

### Customs Tariff

Mr. Speaker, the Finance Bill published today contains several amendments to the Customs and Excise Act. These are classified according to those that have no direct revenue implications and those that have. Some of the amendments correct errors and omissions, while others remove anomalies. I will deal initially with changes which have no direct revenue implications.

First, a major amendment proposed in the Bill relates to Section 2 of the Act. Presently, a container is valued together with its contents whether that container has repeated use or not. Following a change in the treatment of containers with repeated use by the Customs Cooperation Council, it is now necessary to change this. I therefore, propose an amendment to ensure that a container will be valued separately from the goods in it.

Second, Section 51 of the present law permits the Commissioner to license the establishment of a customs bonded warehouse only in a building. However, with the introduction of bonded factories licensed premises are bonded warehouses which

include open areas inside the factories' perimeters. The amendment proposed will allow the Commissioner to licence buildings and open areas within the factory premises as bonded warehouses.

Third, there is some confusion under existing law regarding the correct valuation of exports. When an exporter sells his goods, he sells the foreign exchange received to his bank and the value of exports is based on the bank buying rate for the foreign exchange. Disputes have arisen regarding the correct value for exports. Therefore Section 127 is amended to allow the value of exports to be based on the current buying rate of foreign exchange for sight drafts, as notified by the Central Bank, when an entry is presented and accepted by Customs. The current buying rate is defined as the rate prevailing at the close of the last working day of the previous week.

Fourth, following the liquidation of a number of companies which manufactured excisable goods, the Commissioner has found it impossible to collect duties in arrears, as the existing law does not provide for a write-off of uncollectible duties. I therefore propose an amendment to Section 158A to allow write-offs, where it would be impossible or too costly to collect such arrears. This amendment will be similar to provisions which already exist under the Value Added Tax and the Income Tax Acts.

Fifth, many bonded factories produce garments which need to be washed and ironed before they are exported. Similarly vehicle assemblers need to move bus and lorry chassis out of factories to fit on bodies. Every time this is done, a bank bond is required. This arrangement has proved to be cumbersome and expensive. I therefore, propose amendments to Section 42 to enable a business to execute a single bond to cover all such cases.

Sixth, in our endeavour to promote exports we have allowed manufacturers to assemble goods in transit. But the increased instability and wars in neighbouring countries is causing prolonged delays in goods destined for those countries. Under existing law the Commissioner has powers to grant an extension up to six months. This is not enough to allow assembly and shipment of goods. Therefore, amendment to Section 12 is proposed to allow the Commissioner to deal with all transit cases up to a period of six months, with a further extension of an additional three months.

Mr. Speaker, I would now like to deal with those changes which have important structural and revenue effects, which will come into effect from mid-night tonight. Our enhanced reform efforts aim at the continuation of the rationalisation of tariffs which began in 1989/90. These aimed at encouraging trade liberalisation and economic competitiveness as well as raising additional revenue.

First, I would like once again to draw the attention of the House to our policy which replaced quantitative restrictions by tariffs and which has gradually lowered high duty rates. In keeping with this policy, I am proposing a further lowering of the existing top duty rate of 70% to 60% and all 60% rates to 50%. This will lower the cost of raw materials and make exports competitive.

Second, in order to reduce the number of tariff bands from 11 to 9 and to raise revenue, the present duty rate of 2% will be increased to 10%, while a number of duty free items will become dutiable at 10%. The effects of these measures will be to reduce average tariffs and narrow their dispersion. This will lower the excessively high rates of protection which have discouraged efficiency.

Third, I am continuing the policy I introduced last year which limited the amount of duty remission which could be granted. Previous remissions have denied the Exchequer substantial revenues while not all such remissions had important beneficial social impacts. To raise additional revenue and limit the scope of remissions, I have introduced a minimum duty of 10% on all imports subject to a level of duty remission with a few carefully specified exceptions, such as imports for charitable organisations and aid funded imports. A detailed list of exceptions are to be found under the Third Schedule of the Customs and Excise Act. Remissions not covered under the new provision will either be revoked by mid-night tonight or by 30th September, 1992.

Fourth, in 1986, I first introduced an import duty exemption on industrial machinery upto a maximum value of Shs 5 million for small-scale industries located in rural areas. Over the years, I have raised the value of machinery and equipment to take into account the rise in prices of such items and the appreciation of foreign currencies. To continue to provide the level of incentive in real terms, I propose to raise the value limit from Shs 40 million to Shs 50 million.

Finally, Mr. Speaker, Kenya has relied on import parity for setting the domestic prices for producers of food commodities like wheat and maize. Import parity includes the world price plus duty, freight and insurance. As part of the rationalisation of the agricultural marketing and pricing policies, I propose a system of variable duty rates on the imports of maize, wheat, rice, sugar and milk powder. This will be effective from mid-night tonight. It will be imposed only when import prices are lower than the domestic ones. No import duty will be charged when import prices rise above domestic prices. This duty will protect the domestic producers from prices falling in the local market when import prices fall below the minimum prices guaranteed to Kenyan farmers. It will also enable imports to come in when domestic prices are unreasonably high, thus protecting the consumer.

The measures relating to import duties proposed will provide the Exchequer with an additional Kf 95.3 million in revenue.

### Excise Duties

Mr. Speaker, I would now like to turn to excise duty. As Hon. Members will recall, in my last year's Budget I converted the excise on beer from a specific to an ad valorem rate. In spite of this increase in excise, the demand for beer has far outstripped supply. This demand exceeds the industry's capacity to produce. Given the expected high beer consumption in the forthcoming General Election, it is only fair that the Exchequer should benefit from this profligacy. Therefore, from mid-night tonight, the price of beer will go up by 50 cents per half litre bottle and 30 cents for smaller bottle.

Second, to offset the drop in import duty rate on alcoholic beverages from 70% to 60%, I propose to raise the excise duty by 5 percentage points from 50% to 55%.

Finally, Mr. Speaker, the soft drink industry has made representations to the Government complaining that their sales have dropped since increases in excise duty last year. To address the resultant contraction in the market and safeguard employment, I propose to lower the excise by 5 percentage points from 40% to 35%.

These measures will take effect from mid-night tonight and will provide the Exchequer with an extra revenue of Kf 3.0 million.

### Value Added Tax (VAT)

Mr. Speaker, VAT was introduced three years ago to replace the Sales Tax. Its importance is growing and has influenced many sectors of the economy. Its revenue potential has also been enhanced. Its implementation has brought to light a few anomalies and difficulties. Every year I have attempted to further rationalise this tax. Today I propose to continue with this rationalisation exercise in order to remove anomalies, ensure compliance and raise revenue collections. I will deal first with those changes which have no direct revenue implications.

First, as the law stands, there is no penalty for a person who submits his VAT return late or fails to submit it altogether. The Commissioner can only prosecute the person and such process of prosecution can take a long time. In order to discourage this practice, I propose to introduce a penalty of Shs 5,000 on such defaulters.

Second, the VAT Act requires the payment of tax to be made on the last day of the month. However, problems arise when the

last day of the month falls on a public holiday, a Saturday or a Sunday. Where this delay occurs, the Commissioner has charged interest for late payments which is unfair. To remove this inequity I propose to amend the VAT law to provide for payment of tax on the last working day of the month.

Third, in my last year's Budget, the VAT Act was amended to restrict the deduction of the input tax within six months. This provision requires further clarification and therefore I propose an amendment to Section 11 of the Act.

Fourth, the present law requires that a newly registered trader who has stock in trade and is now liable to tax, must claim the input tax within 14 days. It is our experience that newly registered traders are not conversant with the legal requirements and therefore 14 days is too short a period for such persons. In other cases the law provides traders 30 days within which to comply with other requirements. In addition, this provision discriminates against newly registered persons rendering taxable services like photocopying and also have tax paid stocks. For both these reasons, I propose an amendment to Section 12 to include persons rendering taxable services to claim input tax and to extend the period for claims to 30 days.

Fifth, Hon. Members will recall that two years ago I introduced partial registration to remove double payment of VAT. It has come to my notice that a number of traders have started using partial registration to avoid tax. This is particularly so in the case where a trader retailing shirts made by other manufacturers also manufactures shirts and sells them as well. It has proved difficult to verify whether the goods sold are manufactured or only retailed. To close this loophole, I propose amendments to the Sixth Schedule.

Sixth, during the introduction of VAT on hotels and restaurant services in January 1992, many non-taxable and non-registered establishments including kiosks, took advantage of this to raise their prices under the guise of VAT. Unfortunately, the clients were unable to verify the validity of VAT charged by these enterprises, for services rendered. To eliminate dishonest practices, I propose changes in the law which require enterprises to compulsorily display publicly, in a conspicuous place, the VAT certificate of registration and other identification notices required by the VAT Commissioner. Failure to do so will be an offence and liable to a penalty of Shs 100,000 or imprisonment of one year or both. Members of the public should report violations of this registration requirement to the Commissioner of VAT, who will take immediate punitive measures against the defaulters.

Seventh, under Section 33, a taxable person who is aggrieved by the VAT Commissioner's decision may appeal to the Tribunal. However, the Commissioner has reported cases of persons

filing appeals on flimsy grounds in order to delay payment of tax. To discourage this practice I propose an amendment in Section 33 which will require the appellant to deposit fifty percent of the tax so assessed, before the appeal is registered.

Finally, certain errors and omissions are corrected and proposed for incorporation in the present Finance Bill.

Mr. Speaker, I would now like to turn to those VAT proposals which have direct revenue implications.

First, in order to rationalise the VAT structure further, remove mis-classification and ease administration, I propose to reduce the current number of VAT rates from 8 to 6, by deleting the current rates of 100%, 35% and 25% and by introducing a new rate of 30%. The highest VAT rate will be lowered from 100% to 75%. The remaining rates that will prevail will now be 50%, 30%, a standard rate of 18% and the lowest rates of 5% and 0%.

Second, as in the case of Customs and Excise Act, I propose to limit the number of remissions of VAT. This measure will raise additional revenue. Hence I propose to discontinue VAT remissions and exemptions will be limited to the same categories as announced earlier, under the remissions of Customs duties.

Third, the minimum turnover level for compulsory registration under VAT was raised to Shs 250,000 last year. This level has been found to be inadequate when viewed in terms of the recent high inflation. To correct for this and to encourage efficient tax administration, I am raising the minimum turnover level to Shs 300,000.

Fourth, to ensure that wananchi who frequent small restaurants and bars are not caught in the VAT net, I propose a turnover of Shs 600,000 for small hotels, bars and wayside restaurants.

In contrast with the 18% VAT on hotels, I propose to impose a rate of only 5% on restaurants and bars, effective 1st February, 1993.

Fifth, in order to lower the cost of packaging materials for seeds and seedlings and the shade netting for horticultural use, I propose that these be zero rated. This measure will lower prices and therefore encourage our farmers to use certified seeds and increase our exports. In addition I have also zero rated ordinary bread and food preparations for infant foods.

Sixth, currently under VAT there still remain a number of exempt items such as raw materials, capital goods and agricultural inputs. In order to widen the revenue base and to allow these items

to claim input tax, I propose a VAT rate of 5% on all currently exempt goods with the exception of agricultural items.

Seventh, I propose to lower the VAT rates on a wide range of goods from 25% and 35% to a standard rate of 18%. These will include food items like ginger bread, biscuits, pastries, jams, marmalades and electrical goods like food grinders, TVs, refrigerators, and industrial inputs such as lifting, handling and unloading machinery. Mr. Speaker, this measure will minimise administrative and compliance costs, avoid mis-classification and reduce distortions in consumer choices. With the lowering of the tax rate, it is expected that the retail prices of these goods and services will also be lowered.

Eighth, in the process of rationalising the VAT rate structure, I have lowered rates of very many items in order to improve compliance, reduce smuggling and decrease requests for exemptions. In effect I propose to lower VAT rates of 35% and 50% to 30% while those of 75% and 100% will come down to 50% and 75% respectively.

Ninth, in my last year's Budget I lowered the VAT on passenger vehicles with differing cylinder capacity. In carrying out this exercise, I took into account the high prices of vehicles because of foreign currency appreciation and the need to increase compliance. This year I propose to continue with this exercise. Accordingly I propose, with the exception of cars below 1500cc, to lower the combined tax burden on all cars on average by 15 percent. Similarly, I propose to lower the combined tax burden on all minibuses with varying cylinder capacity by about 20 percent. This move should be very welcome by the tourist industry. The proposed individual rates are as follows:

**Assembled Cars**

Capacity	Current (%)			Proposed (%)	
	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>	<u>VAT</u>	<u>COMBINED</u>
1500 cc & less	50	18	77	18	77
1501 cc - 1800 cc	50	25	87	18	77
1801 cc - 2000 cc	50	35	102	30	95
2001 cc - 2250 cc	50	75	162	50	125
2251 cc & above	50	100	200	75	162

### Assembled Minibuses

Capacity	Current (%)			Proposed (%)		
	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>
1500 cc & less	40	35	89	40	30	82
1501 cc - 1800 cc	50	35	103	50	30	95
1801 cc - 2000 cc	50	50	125	50	30	95
2001 cc - 2250 cc	70	50	155	60	30	108
2251 cc & above	70	75	198	60	50	140

The VAT measures announced today except where otherwise specified will come into effect at midnight tonight. These will raise an additional revenue of K£ 46.4 million.

### Income Tax

Mr. Speaker, I now turn to income tax where I am proposing some changes in order to enhance growth of output and investment. I will deal initially with reforms which have no revenue implications.

First, co-operative societies can pay their members dividends or bonuses. Dividends are subject to withholding tax, but bonuses are not. Hence, some co-operatives have been paying bonuses instead of dividends to avoid tax. To close this loophole, I am proposing to amend the Income Tax Act such that bonuses paid by co-operative societies will be deemed to be dividends and hence be subject to withholding tax.

Second, an insurance commission paid to an insurance agent is liable to tax whether received by an individual or by a corporate entity. The Commissioner of Income Tax has, however, established that many insurance agents, including corporate ones, do not report the insurance commission accurately. To close this loophole, I propose an amendment to Section 35, to make withholding tax on all insurance commissions mandatory.

Third, last year I amended Section 52 to cater for self-assessment. This Section requires a person to submit a tax return, together with self-assessment of his tax, by the end of the fourth month after the end of the accounting year. However, the amendment did not adequately cover employed persons who also have business income. Therefore, the proposed amendment is made more clear to avoid possible disputes.

Fourth, currently a taxpayer who has income from other sources besides employment is required to file a provisional return. This requirement will not be necessary when self-assessment becomes effective. For this reason I propose a change in Section 53

to remove the need for a provisional return when a self-assessment return is filed.

Fifth, last year I amended the law requiring a taxpayer who objects to an assessment to submit a return and his accounts, within sixty days of filing an objection otherwise his objection will be treated as not valid. While this provision has helped curb the normal objections, it does not deal with cases of late objection. To cater for this, I propose an amendment to Section 84 which gives the taxpayer longer time to file an objection, sixty rather than thirty days, but now the objection is valid only if accompanied by a tax return and other supporting documents.

Sixth, currently interest on unpaid tax is charged at one and a half percent per month. This rate is lower than the cost of borrowing in the market. Accordingly, I am raising the interest charge on unpaid taxes to two per cent per month.

Finally, the Tax Modernisation Programme requires that the tax administration in Kenya be made more efficient. To meet this goal, in this Budget, I am introducing a new Thirteenth Schedule in the Income Tax Act, containing transactions for which Personal Identification Number (PIN) will be required starting on 1st January, 1993. This Schedule shows that transactions ranging from applications for foreign exchange allocations and import licensing to registration of motor vehicles will be carried out with PIN. Applications will have to be made to the Department of Income Tax for a Personal Identification Number.

Mr Speaker, before I present the specific Income Tax measures being proposed in this Bill, I should like to review the progress that has been made in reforming the income tax under the Tax Modernisation Programme. For both companies and individuals, the tax rates have been significantly reduced. Since 1988, the top individual tax rate has been brought down from 65% to 45%, while the tax brackets and tax reliefs have been increased to protect the low income individuals. For those high income individuals receiving a large share of their income as employee benefits, I have systematically taken measures over the years to ensure that they pay their fair share of tax on this income. Company tax rates have also decreased significantly from 45% to their current level of 37.5%. These rate reductions along with liberalised investment deductions and reductions in the double taxation of dividends have been aimed at increasing investment and employment for Kenyans. At the same time, I have taken a number of major steps to ensure that businesses pay their taxes accurately and on time. The instalment tax is being phased in since 1990 and the self-assessment system will start as of April 1994. I have also introduced more uniform and stricter penalties for late payment of taxes and underpayment. The administration of the tax is being supported by a growing network of computers to ensure more rapid and accurate processing of tax information.

Mr Speaker, the measures I am proposing will build upon the reforms of the income tax already taken. These adjust somewhat for inflation and provide further relief for corporation tax. There is a pressing need to lower the tax burden of the individual tax payer at all levels, especially in the middle income groups who have experienced the highest tax burden over time.

First, I propose to increase the single and family relief by 10%. This translates into single relief, which includes married women, going up from Shs 1,320 in 1992 to Shs 1,452 in 1993, while family relief for married men, increases from Shs 2,640 to Shs 2,904 over the same period. This measure will remove about 50,000 low income taxpayers from the Income Tax roll altogether.

Second, the middle income employees, since the 1980s have been paying almost twice the tax in inflation adjusted terms, than they did in the 1970s. Therefore, I propose to widen the income brackets by about 15 percent, from K£ 2,300 to K£ 2,640 in 1993. In addition, a new 20% tax rate bracket will be introduced, primarily to benefit middle income earners many of whom are civil servants.

Third, I propose the lowering of the top marginal individual tax rate. This is consistent with the policy of reducing the disincentives of the tax system to greater work effort and will encourage higher investment by the private sector. I, therefore, propose to reduce the top individual tax rate from 45% to 40%.

Thus the brackets and the marginal tax rates will be as follows:

<u>Taxable Income Brackets</u>		<u>Marginal Tax Rate</u>
<u>1992</u>	<u>(K£)</u>	<u>(%)</u>
	0 - 2,300	10
	2,301 - 4,600	15
	4,601 - 6,900	25
	6,901 - 9,200	35
	9,201 and above	45
<u>1993</u>	<u>(K£)</u>	<u>(%)</u>
	0 - 2,640	10
	2,641 - 5,280	15
	5,281 - 7,920	20
	7,921 - 10,560	25
	10,561 - 13,200	35
	13,201 and above	40

With the lowering of the top rate of tax to 40%, I want to make it clear to all high income earners that I expect a correspondingly more accurate declaration of income. It has come to my attention, for example, that many companies have started the practice of paying the credit card bills of their employees. Where such expenditures are not for business purposes, these amounts must be reported as employee benefits for tax purposes. I have instructed the Commissioner of Income Tax to strengthen his efforts to detect any income tax evasion through under-reporting of the value of employee benefits and allowances.

Fourth, in order to give Kenya a competitive edge over its neighbours I propose to further rationalise the company tax by lowering it from 37.5% to 35% for all resident companies including insurance companies currently at 40% and mines currently at 45%.

Fifth, since 1991, the 15% withholding tax on dividends has been a final tax. This was the first step in moving towards removing the double taxation of equity income earned in the corporate sector, thereby reducing the biases against equity financing of investments. To move another step towards the elimination of double taxation, I propose to reduce the withholding tax rate on resident and non-resident qualifying dividends to 10% in 1993. The only exception will be that dividends distributed by cooperative societies will not be treated as qualifying dividends since the cooperatives get a deduction for distributed dividends. For these the withholding tax will remain unchanged at a final tax of 15%.

Sixth, with the lowering of the tax on dividends to a final tax rate of 10% to reduce the double taxation of equity income, Mr. Speaker, I have to be sure that companies did, in fact, pay tax on their profits before dividends are distributed. Accordingly, I propose that all companies maintain a dividend tax account that will be credited whenever a company pays tax or receives dividends from another company, but debited whenever it distributes dividends in the same ratio as tax is to after-tax profits, namely 35% to 65%. If and when the dividend tax account becomes negative through dividend distributions being in a higher proportion than taxes paid, a special compensating tax will have to be paid at the company tax rate. This mechanism will not only guarantee the proper tax is paid on company profits, but it will also ensure that where companies use investment deductions that these are effective. When a company gets a generous investment deduction, the purpose is to increase the cash available to the company to undertake increased investment and production. The incentive is not to support increased dividend payments. The compensating tax will encourage the effective use of investment incentives.

Finally, with the recent Government action to decontrol the price of milk and deregulate its marketing, I propose to

strengthen these incentives to the dairy industry by abolishing Presumptive Income Tax (PIT) on milk. This measure will encourage dairy farmers.

Mr Speaker in my speech last year I announced that I would be reviewing the taxation and other matters relating to the insurance sector. The following are specific measures that I am introducing this year.

First, the insurance sector has been placed at a disadvantage in competing for pension business with other financial institutions in that it has to pay the premium tax on pension and other annuity contracts. To remove this adverse bias, I propose to eliminate the premium on annuity contract premiums.

Second, in the normal course of business, insurance companies cede a share of insurance contracts to other insurance companies abroad. While this is appropriate for major risks, insurance companies have been ceding outside of Kenya large portions of business that can be handled within the country. This practice raises concerns about loss of tax revenues, avoidance of foreign exchange controls, and the regulation of insurance to protect the policy holders. To discourage the unnecessary ceding of insurance policies to reinsurers outside of Kenya, I am introducing a two per cent premium tax on reinsurance premiums paid to reinsurance companies outside of Kenya other than for aviation, marine and industrial fire insurance and any other category of insurance where it will be of benefit to Kenya.

Third, it has come to my attention that life insurance companies are not paying their fair share of tax. Mr Speaker, this concern with underpayment of tax is not peculiar to Kenya. Ministers of Finance world wide have been wrestling with this problem. The problem arises out of the complex accounting rules used to measure income in the insurance industry which can be readily manipulated to minimise the taxes owed the Exchequer. Life insurance is taxed in such a way that the insurance company pays tax on the combined income earned by the policy holder and the profits earned by the company in undertaking insurance business. I propose to introduce an alternative minimum income tax that will ensure that life insurance companies pay tax at least on their own profits. In addition, I am clarifying in law that in the case of the calculation of taxable income of a life insurance business expenses incurred in conducting exempt businesses, are not deductible from life insurance income.

Mr Speaker, over the past two years I have introduced a number of major changes to the pensions system in the process of phasing in tax-deductible pension contributions. This year I shall continue that tradition. My proposals include the following items.

First, it is recognised that there is a growing need to set up a body to regulate pension standards in Kenya to ensure that the pension funds are invested prudently, and that the pensions promised by employers meet minimum standards and are, in fact, paid to retired Kenyans. I propose to start working towards this goal by undertaking the necessary studies and training that will allow the drafting and implementation of pension law in Kenya. Mr Speaker, the issue of protecting the pension rights of Kenyans is too serious to suffer long delays. Accordingly, I propose to introduce some basic rights into the Income Tax Retirement Benefit Rules. These will include mandatory eligibility for membership by employees in a pension plan after two years of service as well as full vesting of pension benefits within five years of pensionable service. All new plans will have to comply with these rules and existing plans will have to be in compliance by 1998.

Second, Mr Speaker as I announced last year, the tax deductible limits will be raised annually as part of the phased switch-over to a system in which pension contributions will be fully deductible, but pensions will be fully taxable. The annual deductible limits will be raised from Ksh 10,560 to Ksh 12,000.

Third, under the new system, pensions are taxable unless they fall below the tax exempt limits. These limits apply to pensions paid from registered funds. To ensure that pensions received by civil servants, members of the armed forces and parliamentarians amongst others, are also covered by these exemptions, an appropriate amendment is proposed to the Income Tax Act.

Fourth, Mr Speaker last year I introduced an accounting system to ensure that all tax deductible contributions made by or on behalf of an employee to pension or provident funds fall within the tax deductible limits. The limits for allowable contributions to pension and provident fund contributions, however, remained on an independent basis that required an employee to be a member of either a provident fund or a pension fund, but not both. I am now introducing a parallel accounting system that will allow contributions to both pension and provident funds as long as they remain within the overall contribution limits.

Finally, Mr Speaker, I am announcing a major innovation in tax-assisted pension savings. Starting in 1994, individuals, employees and self-employed persons, who are not members of registered pension or provident funds in a year will be eligible to make contributions to registered individual retirement funds. Employers will also be able to contribute on behalf of qualifying employees. Contributions will be tax deductible and subject to an annual limit of 20% of pensionable income or Shs 24,000, whichever is less. All withdrawals made from these funds will be subject to tax given that all contributions are deductible. Mr Speaker, this measure will expand significantly the opportunity of all Kenyans to

save for their retirement. This will enhance the fairness of the tax-assistance enjoyed by Kenyans for their pension savings.

Mr. Speaker, from the measures introduced under income tax, I will forego some Kf 30.8 million.

#### **Miscellaneous Taxes/Charges**

Mr. Speaker, a number of miscellaneous taxes and fees such as vehicle registration and licence fees have not been reviewed for a number of years. I therefore propose to increase them in order to take account of inflation and will be effective from mid-night tonight.

Finally, the Insurance Advisory Board will be granted greater independence to advise the Minister, on matters pertaining to the insurance industry. Furthermore, in order to protect life insurance policy holders, life insurance companies will be limited to distribute up to 30 percent of the surplus of the statutory fund backing such policies. This measure will come into effect on 1st July, 1992.

Mr. Speaker, I expect to raise Kf 2.1 million from these few measures which come into effect on 1st July, 1992.

#### **8. CONCLUSION**

Mr. Speaker, in conclusion I wish to recall the tough economic environment in which I have framed this Budget. 1991 was a difficult year and the 1992 forecast shows no signs of an upturn. This is aggravated by the decline in donor support. Despite this, I have outlined measures to continue to pursue our long term structural adjustment policies. In particular, I have formulated policies to sustain the fiscal discipline which has proved to be so effective over the last seven months. This strategy has been supported with concrete actions and plans in the parastatal sector and improvements in the investment and export environments. Mr. Speaker, I firmly believe that this Budget has marked the route for economic recovery.

Mr. Speaker, I beg to move.