SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 16TH JUNE, 1988, BY THE HON. PROF. G. SAITOTI, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE FISCAL YEAR 1988/89 (1ST JULY, 1988 TO 30TH JUNE, 1989)

Mr. Speaker, Sir,

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

1. INTRODUCTION

Mr. Speaker, since my last Budget, two major events have taken place on the Kenyan soil which symbolize the stability of our political institutions. First, we hosted the 4th All Africa Games; an event which underscored the confidence and trust which the Nations of Africa have in Kenya and, indeed, its leadership. Second and most important Kenya held both the Presidential and National Assembly Elections which ushered in the Sixth Parliament. The orderly and peaceful manner in which these elections were conducted is a tribute to His Excellency the President's commitment to the continued maintenance of democracy, peace and stability in Kenya as enshrined in our Constitution. It is, therefore, most befitting that I call upon all Honourable Members to join me in asking all Kenyans to emulate H.E. the President's footsteps in upholding the principles of our Constitution in order to sustain and enhance our political and social stability which is a pre-requisite for economic progress.

Mr. Speaker, the themes of the last four Budgets have centred around the subject of efficient utilization of resources in order to attain the objectives spelt out in both the Fifth Development Plan and the Sessional Paper No. 1 of 1986. Each year, we have endeavoured to formulate and implement policies aimed at achieving these objectives in order to sustain growth. Although considerable success has been recorded in this regard, there remain a number of fundamental problems which need to be addressed. Among them are two major structural imbalances which Kenya has been experiencing in the recent years. The first imbalance is a worsening balance of payment deficits occasioned by sharply deteriorating terms of trade, coupled with rising debt service payments. The second imbalance is the large budgetary deficits. Although the high coffee prices of 1986 considerably improved these imbalances, the downward trend in the prices of our major export commoditeis has resulted in the re-emergence of the status quo. This year's Budget will, therefore, attempt to lay the foundation necessary to restructure the economy in both the short and medium terms. Thus, it is within this context, that I have framed today's budget around the theme: "Economic Growth Through Financial Discipline and Efficiency".

As usual, I would like to, in rapid succession, begin by reviewing the international economic scene as a background to our own economic situation. I will then deal with some of Africa's economic problems and thereafter, review Kenya's economy in 1987, including a prognosis for the year 1988 and beyond. Finally, I shall address the budget out-turn for the current fiscal year, that of next fiscal year, and present specific measures relating to taxation and other changes for the fiscal year 1988/89.

2. THE WORLD ECONOMY

Mr. Speaker, the international economy is presently in its sixth year of cyclical expansion, following the severe worldwide recession in the first few years of this decade. This unusually long period of uninterrupted growth in global production and in international trade has coincided with a remarkable decline in international rates of inflation. Looking at this period from a long historical perspective, the combination of sustained growth and a sharp deceleration in inflation rates is quite unique. However, there have been severe trade imbalances between some of the major industrial countries, reflecting an unwillingness to co-ordinate their economic policies, particularly fiscal policies. This has led to sharp fluctuations in exchange rates. For instance, the dollar rose sharply for several years, only to decline almost as dramatically in the past year or two. Other key currencies have displayed similar instability.

Financial uncertainties have not been confined to exchange markets alone. In October last year, stock market prices in New York fell by about 25 per cent in a few days, causing panic in a number of financial markets in the U.S.A., Europe and elsewhere. The spectre of global depression similar to that of 1931 was suggested. Fortunately, the situation seems to have stabilized.

The trade imbalances in some key industrial countries (especially between U.S.A. and Japan) over the past several years, together with the financial instabilities in exchange and other markets have had two major adverse effects on the developing countries. First, increasing trade restrictions in various forms have led to a more protectionist climate, adversely affecting developing countries' exports to developed markets. Second, the resulting financial turmoil, coupled with uncertainties regarding the debt of developing countries, has led to a continuous slow-down in the transfer of new financial resources to developing countries. At the same time repayments by developing countries on their external debt have been mounting. An illustration of the awkward paradoxical situation that has developed is this: while in the five years up to 1982, there was a net transfer of financial resources to the developing countries of 140 billion dollars, that transfer has now been reversed, and in the five years since 1982 the developing countries have transferred financial resources to the developed world amounting to 80 billion dollars. The combined effect of these factors has crippled meaningful development in the developing world, particularly Sub-Saharan Africa.

Mr. Speaker, the growth record in Sub-Saharan Africa has been particularly poor over the past several years. This group of countries as a whole recorded persistent declines in per capita GDP (or incomes) since 1981. The cumulative decline in per capita incomes from 1981 to 1987 is close to 15 per cent. Last year, the growth in real output in the region, was less than 1 per cent, and in per capita terms there was a decline of 1½ per cent. Projections for 1988 and 1989 indicate the possibility of a very marginal increase in per capita incomes in Sub-Saharan Africa, although there are now convincing signs that the declining trend is being reversed.

Kenya with an average growth rate over the past three years of about 5 per cent and thus an average increase of 1 per cent in per capita incomes, has done comparatively well.

The slow growth in output and incomes -- and hence the decline in per capita incomes -- is, by far, the greatest problem facing the African continent today. In simple terms it means that we are collectively getting poorer instead of making a dent into the problem of poverty. Finally, Mr. Speaker, there are four main problems, relating to, and to some extent causing this stagnation, that I would like to touch on.

The first relates to the burden of external debt which Africa, together with many other developing countries, incurred during the first few years of the 1980's when oil prices shot up, the dollar value increased and interest rates in international markets doubled or trippled. This debt burden is being reinforced by the declining transfer of new financial resources to developing countries.

The second problem that I want to touch on is the instability, and in some cases the downward trend, in commodity prices. We have seen this in the past few years, when coffee prices shot up in 1986, only to decline to lower levels in 1987. This phenomen causes great problems in terms of stabilization policies. For how can a country absorb and harness the gains during a temporary export boom, without letting inflation loose, and then spread out the benefits in the following years? It requires a highly sophisticated policy apparatus to counteract these fluctuations. We have tried to learn from the latest experience and we have been partially successful -- mainly because the recent coffee boom was a moderate one in contrast to that in the late 1970's.

The third problem, which I have already touched upon, is the protectionist climate that has developed in the industrialized world over the past several years, and which harms exports from developing countries and thus limits these countries' ability to break out of stagnation and poverty.

The fourth problem which partly explains the slow growth in African economies is the frequent incidences of drought, and sometimes floods. Certain countries have been severely affected by climatic changes, particularly by droughts, in recent years. Fortunately, we in Kenya have been relatively spared compared to other countries in the region. Although there are certain ways in whcih one can reduce the adverse repercussions of droughts -- and I believe we were successful on this score when the severe drought hit us in 1984 -- droughts, nevertheless, cause great economic damage and human misery.

3. THE DOMESTIC ECONOMY

(a) ECONOMIC PERFORMANCE

Mr. Speaker, I would now like to turn to the domestic economy. Considering the fact that Hon. Members have already read their copies of this year's Economic Survey, which describes the performance of the economy during 1987 in detail, I will confine myself to a review of the highlights in that publication. Discounting 1984 as a year dominated by the drought, the last three years of the current Fifth Development Plan have recorded excellent economic performance in many years. If we ignore the coffee boom years of 1976 and 1977, we have to go back to the 1960's before we find a three year series where economic growth was as good as that recorded between 1985 and 1987. The average growth during this period has surpassed 5 per cent per annum which is slightly better than that targeted in the Plan. Even inflation, although far from being a matter for complacency, has over these same three years been, on average, below any three year period since the oil price crisis of 1973.

Mr. Speaker, 1987 recorded a paradoxically mixed performance of the economy. On the one hand, we recorded satisfactory growth while on the other, we experienced inadequate and erratic rainfall with declining tea and coffee prices in the world markets. Given these factors, one would have expected no growth at all. However, we achieved real growth of 4.8 per cent last year. Briefly, we managed that growth at the cost of our reserves. In a deliberate effort to sustain the positive signals which we had transmitted to the business community in 1986, we cut into our reserves to ensure industry would prosper. But this is not a strategy which can be repeated this year due to the reduced level of reserves.

The situation, of course, was slightly more complex than I have described it because there was a secondary problem, in part associated with the uncertain growth of the world economy. As world markets were not growing, we had to stimulate domestic demand to sustain growth, and it was here that the excess liquidity which I mentioned earlier in my last Budget Speech, played an important role. This approach was costly, as inflation, measured by the Consumer Price Index, rose from 5.7 per cent in 1986 to 7.1 per cent, which, although up, is still the second lowest inflation since 1973. Clearly, export oriented growth would have been preferable, but in default of that we can be satisfied that difficult external factors had so little depressing effect on the economy.

(i) Income and Employment

Mr. Speaker, in the light of the overview I have just presented, it is commendable that overall employment, including self-employment, grew by 5 per cent, well ahead of the rate of growth of new entrants to the labour force. The strategies in support of the small business sector are clearly bearing fruit since the wage employment portion merely kept pace with the new entrants, growing at about 3.5 per cent. And together with this increase in employment I am happy to report to this House that for the third year in succession, real income per head grew by more than one per cent. Unfortunately, movements on the terms of trade over which we have no control, have adversely affected the availability of goods and services. Nevertheless, we experienced real positive income distribution effects as the average money income per wage worker in the private sector grew by 11.0 per cent, giving a real growth of almost 4.0 per cent.

(ii) Savings and Investment

Mr. Speaker, turning now to an important measure of the confidence in our economy, I am happy to report that we have continued our recovery in real investment levels which started in 1986 following the long decline since 1978. Gross Fixed Capital Formation in real terms grew satisfactorily by 6.6 per cent in 1987. A deeper analysis shows that this figure conceals even more positive trends. Investments in agriculture, manufacturing, building and construction industries have all continued their excellent growth upon which I alluded to last year. Most important, all this expanded investment has been led by the private sector, and not by the public sector as was the case in the early 1980's. Although domestic savings have fallen from their record high level of 1986, they have not dropped back to their pre-coffee boom levels and we shall continue to apply real positive interest rates as an inducement to enhance their growth.

(iii) The Economic Sectors

Mr. Speaker, I would now like to discuss briefly the performance of the various sectors of the economy whose success can rightly be attributed to our restructuring efforts. Last year, agriculture grew by only 3.8 per cent due to poor weather and the inefficient delivery of inputs. Since the economy has diversified, this otherwise serious drag on growth was compensated for by a 5.7 per cent expansion in manufacturing and a 7.2 per cent growth in activities in trade, restaurants and hotels.

Since we had focussed our attention on agriculture by ensuring it was not short of foreign exchange and raised the Ministry's Development expenditures, the performance in this sector was rather disappointing. In this regard, maize production fell by 25 per cent from the record crop of 1986 -- that is not to say that the crop was bad but the yield was low. In spite of this low harvest, food security reserves have virtually stayed stable throughout the year.

To mar the picture, wheat production was down by 37 per cent and coffee production by 8 per cent. The only improvement related to tea prodcution, where a new record crop of 155.8 thousand tonnes was recorded compared to 143.3 thousand tonnes in 1986. There was also moderate expansion of meat related industries and horticulture.

(iv) Money and Prices

Mr. Speaker, I have indicated that domestic demand was boosted by the liquidity of the economy and I would now like to deal with this in greater detail. As a result of the mini-coffee boom, money supply grew by 32.5 per cent in 1986 -- an extremely high expansion. There was, therefore, an urgent need to bring it more under control, particularly as there was no reason to expect the fortuitous foreign exchange windfall last year. Although we reduced the rate of growth of money supply to 11.2 per cent last year, this has not fully managed to control inflationary pressures.

The conventional measure of inflation which I mentioned earlier, Mr. Speaker, is the consumer Price Index and it was showing a rise of 7.1 per cent over the year, with the lower income group benefitting slightly, in relative terms as the index for that group rose by only 5.1 per cent.

(v) Trade and Payments

Mr. Speaker, let me finally, turn to our international transactions. I have already mentioned the expansion of tea production and contraction of coffee production, together with the decline in the world prices of both of these commoditeis. This had an adverse effect on our balance of payments. While the quantity of coffee exported fell by 21 per cent, the price fell even further by 36.6 per cent. Gains from increased tea exports were wiped out by an 18.2 per cent fall in price. Overall the quantity index for our exports declined by 3.5 per cent.

On the other side of the account, we had expanded imports by 5 per cent in real terms in order to get the indsutry moving. The value of imported industrial supplies rose by 15 per cent, fuel by 18.4 per cent and machinery and equipment by 25.6 per cent. From these figures, it is clear that the industrial sector has been given extensive support, and hence the need for requiring it to be efficient.

(b) PROGNOSIS

Mr. Speaker, as I have noted it is encouraging, that the turmoil in international financial markets over the past nine months appears to have had little effect on economic activity at a global level. As Honourable Members will have noticed from their copies of the economic survey, based on estimates at the end of 1987, world economic growth was estimated at 2.35 per cent. More recent data shows that the forecast growth of output in industrial countries is close to 3 per cent this year, about the same as in 1987, and the volume of world trade is projected to grow by about 5.5 per cent, an acceleration from last year. Forecasts for 1989 based on the assumption that oil prices in real terms do not rise from present levels, show a marginal decline in global growth rates, with the increase in world trade projected at about 4.5 per cent.

Therefore, Mr. Speaker, our prognosis for the Kenya economy is one of cautious optimism. Domestically, the weather has been good and fertilizer is rapidly available. These factors suggest that the economy should be able to sustain its growth around the 5 per cent mark this year.

4. POLICY FRAMEWORK

Mr. Speaker, against this background of international and domestic events and prospects, I would now like to discuss policy strategy for the coming fiscal year. As I have stated on a number of occasions, Sessional Paper No. 1 of 1986 outlines a policy agenda for the period up to the year 2000. This is the third Budget based on that Sessional Paper. I see each year's Budget as an instalment in the long-term strategy outlined in that document, as well as dealing with short-term issues and emergencies to stabilize the economy. Therefore, this and the previous two Budgets should be seen as a consistent effort to increase efficiency in domestic markets, an improvement in the functioning of financial markets and the opening up of the economy to international competition -- in short, an improvement on the efficient utilization of our scarce resources.

Mr. Speaker, we have this year come to the end of the Fifth Development Plan. As we are preparing a new Development Plan, I find it, again, important to stress the continuity in our policy direction. Many of the things we said we would achieve in the current Plan have been realized, but not all. I would, therefore, like to see the "unfinished business" of this Plan become an integral part of the new Plan.

The major "unfinished business", and one of the key questions in shaping Kenya's economic future is that of moving from an inward-looking industrial policy, which has proved to be an impediment to economic growth, to an export-oriented, dynamic industrial policy [2]which can attract new risk capital and which can employ a large part of our rapidly growing labour force.

Bearing in mind the consistency of the Government's economic policies, as well as the need to focus on the immediate problems at hand, I believe that a two-pronged approach is called for in this Budget as reflected in the theme: "financial discipline" in order to keep the economy on a stable course on the one hand, and "increased efficiency" on the other hand in order to sustain economic growth and ensure that incomes per capita continue to rise. I will announce a number of policy initiatives in both these areas in the hope that the two sides of the budget will complement and support each other.

I will first deal with the fiscal, financial and monetary aspects of economic policy. Later on, I will discuss in some detail the longer-term issues that I have just touched upon.

(a) Fiscal Policy

Mr. Speaker, taken in its broadest sense, fiscal policy represents the extent of Government's involvement in the economy. Given the need to optimize resource allocation, the extent of Government involvement should be based on what Government can do better than the private sector. The public sector should then confine itself to those areas where its role is crucial, and leave the rest to the private sector. The Government should ideally provide an economic environment which encourages individuals and enterprises in the private sector to utilize their capacities to the fullest.

At a more practical level, there is, however, the question of the selection and composition of public expenditure. We have tried to articulate a philosophy in this field in the Budget Rationalization Programme, where we have stated, first, that priority in our investment projects will be given to those projects promising the highest returns, and second, that we will reduce the share of recurrent expenditures (of which salaries are the major component) in total budget expenditures. This process has begun, but substantial work remains to be done. For example, the share of recurrent expenditures continues to increase, and in particular, the salary bill has proved very difficult to contain. Salaries now take about two-thirds of total recurrent expenditures which means that resources for other expenditures, recurrent as well as capital,will have to be compressed to the point where the efficiency of public sector is seriously impaired. It is, therefore, essential that employment in Ministries and public agencies are scrutinized and that the volume of employment in the public sector is reviewed over time.

The Budget Rationalization Programme should also guide us in containing the total level of Government expenditures, which has risen too rapidly over the past few years. In fact, the share of Ministries expenditures in GDP has been rising and is now well above the target level of about 23 per cent set out in the Sessional Paper No. 1 of 1986. This trend of rapidly increasing public expenditure has two undesirable effects. First, it pre-empts real and financial resources from the private sector, contrary to our long-term goals; second, it causes the budget deficit to widen, and this destabilizes the economy.

Mr. Speaker, this second effect is of great importance, and I would, therefore, like to deal further with the question of the Budget deficit. After the deficit had been contained in the early eighties, there was a sudden increase in the deficit in 1986/87 due to some unavoidable Government expenditures. In the year just ending, the deficit will be brought down to just around 5 per cent of GDP. However, I still consider this deficit to be too large.

It is too large for two reasons. First, it is difficult to finance such a deficit in a non-inflationary manner. Second, a deficit of this size demands so much financing from the banking system and from the economy as a whole, that funds are diverted from other uses, such as productive investment in the private sector. I, therefore, want to reduce it further in the two coming fiscal years. For 1988/89 the Budget will aim at a deficit of 4.0 per cent of GDP. If we are to succeed in bringing down the budgetary deficit, it will not be sufficient to tighten controls on expenditure. It will also be necessary to raise revenue and introduce participation charges in several areas.

Mr. Speaker, the issue of cost sharing, or participation charges, has been discussed extensively over the past few years. Since then, I believe we have now established a broad political concensus about the necessity of finding new sources of finance for some of the services provided by the Government. It is, therefore, necessary that operating Ministries should identify areas where participation charges can be introduced.

(b) Financing the budget deficit -- Debt management

Mr. Speaker, the financial stability of a country is not only influenced by level of the budgetary deficit, but also by the manner in which it is financed. It is, therefore, important that debt management policy is developed into a more active tool of our overall economic development policy.

It was in recognition of this fact that, last year, we embarked on a process to broaden and diversity the financing of Budget deficits. The new and active debt management policy means that the Government offers a variety of debt instruments -- in addition to the conventional Treasury bills -- to banking institutions as well as to the public. A major aim in the past year has been to try and absorb liquidity from the non-bank public (by offering government bonds on attractive terms), and thus reduce part of the large excess liquidity which was created during the 1986 coffee boom.

The debt operations, particularly the Treasury Bond issue in March, have been successful in terms of Government's policy aims, i.e. to reduce the growth in money supply. While the Budget deficit in 1986/87 added some 20 per cent to the stock of money in the economy, that contribution in the fiscal year just ending is estimated to be less than 5 per cent. Moreover, recent bond issues have opened up new markets, outside the financial system: private companies, co-operatives and individuals have invested in Government bonds. I regard that as an important step forward because it broadens and deepens the market for government debt instruments and is thus likely to facilitate future debt operations. As we continue with regular bond issues, and as the borrowing requirements diminish with the lower budget deficit that I envisage, a more normal situation will emerge in the financial system, and more funds will become available for lending to the private sector.

(c) Monetary Policy

Mr. Speaker, the development of Government debt policies has gone hand in hand with an activation of monetary policy. The task has been a difficult one: to reduce the large excess liquidity that was created in 1986 and early 1987.

First and as a precautionary step, the Treasury and the Central Bank introduced, in late 1986, cash ratios for the commercial banks in order to limit the risk of a secondary credit expansion, based on the high liquidty in the banking system. Second, in late 1987, quantitative limits on the banks' private sector credit were imposed, as we predicted a tendency for this credit to accelerate and endanger financial stability. Third, as a step to reduce the excess liquidity, Government debt operations were activated.

As a result of these measures, we have now managed to reduce the annual growth rate of money supply from a peak of nearly 30 per cent about two years ago to some 8 per cent at present. Although we have not yet restored a normal relationship between the money supply and real economic activity, we are well on the way to doing so. I intend to continue using monetary policy actively as a supplement to fiscal policy. My intention is to allow a growth in total domestic credit (to both the government and the private sectors) of the order of 6 per cent over the next year. In this respect and on present assumptions for the balance of payments, (which influences domestic monetary conditions) this means that we are forecasting money supply over the coming fiscal year to rise by 6.8 per cent.

In order to achieve the 6 per cent target for total domestic credit and, at the same time, to smooth operations in the financial system, the foregoing policy instruments will be reinforced, and modified as necessary.

In addition and, in order to smooth out fluctuations in banks' liquidity and to operate monetary policy in a more effective and market-oriented manner, the Central Bank has activated its open market operations. That means that banks and other financial institutions can use Treasury bills and bonds to obtain cash on short-term, and also that the Central Bank, by altering the interest rates on its re-discounting and lending operations, can influence the cost of credit in the market in a flexible manner. We intend to pursue these policies in active collaboration with the financial community.

Mr. Speaker, a fundamental underpinning of all our monetary arrangements is the maintenance of a competitive exchange rate. The flexible exchange rate policy we have chosen has been highly successful over the past several years. We have managed to gradually make exports more competitive in international markets and raise the price of imports. The management of the exchange rate has had the effect of making the shilling a "hard currency" in the East African region -- a clear sign of success of our monetary policy. This flexible exchange rate policy will be maintained.

(d) <u>Efficiency and stability of the financial system</u>

Mr. Speaker, the primary role of the financial system is to absorb savings from various parts of the economy and to redirect these savings -- as loans and credits -- to those who can use the money in the most efficient manner. Therefore, as the financial system becomes more flexible and effective, the national savings can be directed to those activities that contribute the most to economic growth.

Mr. Speaker, I have already described the trends in public debt and monetary policy. One purpose of these policy initiatives is to stimulate new financial markets, thus improving the "financial intermediation" process -- a process of channelling savings into productive investments.

The very fact that a wider variety of debt instruments -- Treasury Bonds with different maturities -- are offered to the public will mean that new market activities can develop. We have also encouraged the financial system to start secondary trading in Government bills and bonds; that means that individual holders of such papers should be able to sell them before they mature, if the holder needs cash immediately. This will make these securities even more attractive to buy. There are a number of other financial markets that we will need to develop in order to increase the efficiency of the financial system. Here, I have in mind the market for housing finance, the market for risk capital to the private company sector, i.e. the stock market, etc. these are all issues I discussed in my last year's Budget when I promised to set up a "Capital Markets Development Authority".

Mr. Speaker, in view of the substantial legal work that needs to be undertaken before a bill establishing the Capital Markets Development Authority can be laid before this House, I have decided to establish, as an initial step, a Capital Market Advisory Council. The proposed Council will draw its members from the private financial and manufacturing sector, as well as from the Government and the Central Bank. The council will have a secretariat which will prepare papers on the key issues which need to be resolved. It will also draw up the necessary legislation for the establishment of the Authority. I consider the Council to be a useful meeting place for those in the public and private sector concerned with the development of our financial system.

(e) Strengthening the Banking System

Mr. Speaker, an important aspect of the efficiency and stability of a financial system is the rules and guidelines concerning its solvency. As we all know, there were some problems in this area during 1986. We want to avoid a recurrence of that episode. To that effect, we have started the process of strengthening the system to protect it from disruptions. It is for this reason that the Deposit Protection Fund was established to ensure that depositors do not lose money if and when a bank has to close, and the capital requirements for banks and financial institutions were increased in order to provide a safer basis to their operations. However, the Deposit Protection Fund needs strengthening, and a number of other measures will be considered to improve the stability and solvency of the system. Over the longer term, I envisage a gradual consolidation of the financial system into fewer and stronger institutions. This process of strengthening the banking industry has already started. The Central Bank is currently engaged in a major effort to improve its supervisory capacity and to review the regulatory framework so as to provide a more stable foundation for the banking industry.

In order to supplement the administrative efforts being made by the Central Bank, I have in the Finance Bill published today, proposed amendments to the Banking Act. Briefly, these amendments are intended to firstly, enhance penalties including further emphasis on custodial sentence chargeable under the Act; secondly, allow more transparent disclosure of information relating to the balance sheets of the banking institutions to the public; and thirdly, increase the membership of Deposit Protection Fund Board to include representatives of banks and financial institutions.

(f) External debt and balance of payments policies

Mr. Speaker, during the periods of large balance of payments deficits in the past, we have borrowed funds abroad to supplement our own foreign exchange reserves. We have done that in order to avoid a painful contraction of imports, something that would have had negative effects on economic growth, as importers would not have been able to supplement their stocks of spare parts and raw materials.

However, Kenya's external debt now standing at approximately one-third of all our export earnings, has reached a level where we have to take some strong measures to contain any further growth in foreign borrowing on commercial terms. Such loans are much too expensive for a developing country. A number of other African countries have gone further on this path, and have been forced to renegotiate their loans in the so-called Paris Club. The Kenya Government would want to avoid this "solution" and instead correct the situation on its own.

The crux of the matter is that we cannot afford commercial borrowing abroad other than in the most extraordinary circumstances. We will have to focus almost exclusively on concessinary loans, i.e, money which is extended at very low interest rates and with long repayment periods. To the extent possible we should also try and raise the volume of money which is extended as grants.

Mr. Speaker, it is of utmost importance that we must try to reduce the debt service ratio over the next few years. That will require a more co-ordinated effort within the Government than we have had so far. I have, therefore, decided to establish a firm central control of all new loan proposals (both concessional and commercial) in the Treasury through the establishment of a Debt Management Division which will be charged with the task of analysing and monitoring external (as well as internal) debts.

(g) Industrial Policy

Mr. Speaker, I would now like to turn to some important issues concerning the efficiency and hence the future of our industry. The efficiency aspect of my theme emphasizes the need to promote growth in the economy through a more efficient use of our resources. I believe that Kenya can accelerate its growth further through appropriate improvement of our economic policy framework.

Mr. Speaker, looking back over our history, we started with a very deliberate policy of stimulating indigenous industries by protecting them from international competition. We did that in order to build up industrial, technical and administrative competence which we lacked at Independence. This strategy served us well for a decade or more, but towards the end of the 1970's it was becoming clear that the gains from this policy of so-called import substitution was coming to an end. Since then, growth in industrial output has been low, exports of industrial goods in relative terms have declined and various indicators tell us that efficiency in this sector has deteriorated significantly.

The truth of the matter is that we must now make some difficult decisions, because our choices are limited. I am convinced that if we have the courage to make these decisions, the Kenyan economy can continue to expand, and even to accelerate from the growth recorded in the past few years. We must now embark on a more active industrial policy which will, first and foremost, create more jobs for the rapidly growing labour force. Secondly, ensure that goods are produced more efficiently and in greater volumes, therefore at lower prices to the consumers. The combined result of these two objectives should be an improvement in the standard of living of all Kenyans.

Before going into specific policy matters, two general points are worth noting. First, that the policies I am proposing form one further step in a consistent policy for long-term economic growth.

The origin of these policies is Sessional Paper No. 1 of 1986. Indeed, the Fourth Development Plan (1977-83), also suggested that we need to increase competition in the industrial sector and rid it of some of the rigidities that impede its efficiency.

My second general observation is that industrial transformation involves changes -- changes for firms as well as for individuals. We have for too long tried to avoid changes in our industrial structure, and that is now beginning to hurt us. It is, therefore, necessary that we must reverse this position. The proposed changes might force the inefficient industries to restructure their operations. Those manufacturers who are likely to be affected will need to pull up their socks and improve efficiency. What is important is that the society as a whole stands to benefit from the transformation. And the ultimate purpose of transforming industry is, of course,to make us all better off: to produce goods more cheaply to enable us to export more and thus earn more foreign exchange which can, in turn, be used to buy more imports; to create more and meaningful jobs, etc.

I will now discuss the specific policy areas where I intend to effect these changes.

(i) <u>Import restructuring</u>

Mr. Speaker, the restructuring of our import policy is an ongoing process. The policies that have over-protected many of our industries are gradually being changed. there are three components in this import strategy. First, the flexible exchange rate policy we have pursued over the past several years will be continued. This form of "protection" is probably the most efficient one of all, as it entails no discrimination between industries. Second, the tariff system can be seen as a complement to the exchange rate as a protective device. Overall, there will be little change this year in the average rate of protection provided through tariffs. I will also propose a number of detailed measures to simplify the tariff structure.

The combined effect of the exchange rate and tariff policies is to raise the overall effective protection for domestic industries. This allows us to de-emphasize protection via quantitative restriction. Thus, the third element in this year's import policy is a simplification and liberalization of the import licensing system through a move towards more efficient and transparent import schedules.

On the question of tariffs, you will recall that over the past several years, we have substantially reduced tariffs on imported inputs. This year, I shall be reducing the number of tariff categories so that similar goods bear similar tariffs. This change will simplify the handling through customs and minimize the risk of faulty classification of imported goods. I shall also effect changes intended to counteract both over-invoicing for capital repatriation and under-invoicing for duty evasion.

Mr. Speaker, with the added protection provided by the exchange rate movement, and possibly also through a small increase in the average effective tariff protection, we are in a position to modify and liberalize the import licensing policy. The purpose here is to ensure rapid and easy access to foreign exchange licences for a variety of goods -- essential items for domestic production as well as raw materials -- which are important for efficiency in our production process.

Accordingly, I have today published a revised booklet on Import Licensing Schedules containing a complete list of traded products classified into three schedules, with the third schedule being subdivided into three categories. Importers applying to bring in goods under Schedule I, which are primarily raw materials and intermediate goods, will receive foreign exchange allocations expeditiously. Import licences under Schedule II include medicines, fertilizers and other high priority goods requiring Ministerial approval. After such approval, processing should again be expedited. Items on Schedule III A will need slightly more careful scrutiny to avoid over-invoicing. However, if genuine, such import applications will also be freely approved and local protection will depend on appropriately high tariffs. For items under Schedule III B, which are of somewhat lower priority, we will ensure that tariffs will be appropriate to restrain import demand and to provide adequate protection. Low priority and sensitive items are covered under Schedule III C.

It is my expectation that these three approaches to import rationalization -- the continued flexible use of the exchange rate, the rationalization of the tariff structure, and the simplification of the imports licensing policy -- will help provide a more competitive environment for Kenya's industry, and thus help improve the efficiency with which we use our foreign resources.

(ii) Export promotion and investment incentives

Mr. Speaker, to achieve a stronger position in our transactions with the rest of the world, we need to stimulate exports. The experience of those developing countries which have been successful in reducing poverty and raising social and economic welfare tells us that an export-oriented growth is an important key to success.

We are already actively using one important policy instrument to stimulate exports: the movement of the exchange rate over the past several years has provided substantial additional stimulus to exporters. One of the basic reasons behind the exchange rate policy is,in fact, to move resources -- labour and capital -- into exporting activities and thus raise export production. We have seen effects in some areas.

However, processed exports from Kenya industries have not expanded as we had hoped. It is, therefore, necessary to design a strategy to promote industrial exports, both in order to raise the total value we earn from exporting, and at the same time to diversify the commodity pattern of our exports.

Mr. Speaker, Honourable Members will recall that in addition to the Export Compensation Scheme the Government decided some time ago to establish manufacturing under bond. I am happy to inform the House that there has been some progress in this area. Applications for this Scheme will be dealt with expeditiously and I am sure that entrepreneurs will find the arrangement most attractive. To make production under this Scheme efficient, we will assure producers taking advantage of it that import applications for raw materials will be dealt with within five days. I hope that many new industries will be started under this Scheme, taking advantage of Kenya's location, low cost of production, and political stability.

Since export growth is so essential to our strategy, we are currently exploring the possibility of establishing Export Processing Zones. I believe that this scheme should be a further component in our export promotion policy, and we are prepared to start discussions with any consortium interested in developing such a facility with us.

Mr. Speaker, my last remarks on industrial policy relate to price control and foreign investment.

(iii) <u>Price Control</u>

Mr. Speaker, the issue of price control has been the subject of heated debate in recent weeks. Strong views have been expressed by those affected by decontrolled prices, and the newspapers are making big headlines about it.

Some of the criticism may well be valid. For instance, a sudden jump in prices a few days after price controls were lifted in some items does not show a responsible attitude on the part of the business community. They should be careful, in their pricing policies, to build up trust vis-a-vis the Government and the consumers. Moreover, it is important to stabilize prices of certain necessities, especially basic foodstuffs, and to give producers and consumers well-advertised prices on which they can depend. This should be seen as a policy to protect lower income groups and to which the Government is committed.

However, the policy that we outlined in Sessional Paper No. 1 of 1986 of gradually lifting price controls on non-essential needs to be viewed within a broader economic context than the perspective of separate interest groups. Excessively strict controls do not serve the basic purpose of providing low-cost goods to consumers, because they reduce the incentive to produce such goods and ultimately lead to scarcities instead. There are innumerable examples from other countries which show that harsh price controls, even on basic commodities, dry up the supply of price-controlled goods and stimulate a flourishing black market, where prices are far higher than warranted from the point of view of producer costs. In this situation, price controls, merely suppress the symptoms of inflation, while allowing disguised -- and therefore, not measurable -- inflation to continue. We do not want this kind of situation to arise here.

Having said this, I want to stress three aspects of price decontrol. First, the timing and the pace of price decontrol; we should move ahead with caution to minimize possible disruptions. Second, I want to stress the responsibility of those benefitting from decontrolled prices; if they take undue advantage of their position they can do great harm to the whole process. Third, even those prices which have been removed from price control will continue to be monitored carefully. In this respect, I have today published the "Restricted Trade Practices, Monopolies and Price Control Bill" which will be debated by this House. the passage of this Bill by Parliament will outlaw collusion by manufacturers to increase prices while providing Government with the necessary powers to dismantle practices which restrain the competitive forces in our economy, thus paving the way for indigenization.

(iv) <u>Attracting Foreign Investment</u>

Mr. Speaker, as Hon. Members are aware, foreign investment in Kenya is protected by our Constitution and more specifically by the Foreign Investment Protection Act. This Act has not been reviewed over a number of years. As we compete with other developing countries for outside investment, there is need to review the Act in order to maintain our competitiveness. In this regard, I propose to amend some sections of the Act which are no longer compatible with increased foreign investment.

First, the Act guarantees the repatriation of foreign capital invested in an approved enterprise where "capital" is defined as "a fixed amount representing the equity of the holder........expressed in Kenya currency". This definition does not take into account the movements of other currencies vis-a-vis the Kenya shilling. It is, therefore, proposed to amend the Act to provide that foreign investors can repatriate not only the value of the original equity investment denominated in the currency in which the investment was initially made; but also the value of any profits which were reinvested in the firm valued in the currency of the original investment at the time of reinvestment. The proposed amendment cannot, for obvious reasons, be backdated. It will, therefore, apply only to future foreign investments or reinvestment.

Second, if an investor sells his business at a price above the original shilling value, the difference between the sale price and the original value in shillings is considered a capital gain. The remittance of this gain is blocked for five years, during which time it is invested in Government securities at a low rate of interest. Although this practice is not contained in the Act specifically, and notwithstanding the fact there are very good reasons for its existence, it nevertheless deprives the genuine investor of his income because he is paid less than the market rate of interest on his blocked funds. I propose to change this practice and allow blocked funds to be invested at the prevailing market rates of Government securities at the time of investment.

(g) <u>Rural-Urban Balance</u>

Mr. Speaker, a major focus on our development strategy has been, and continues to be, its spatial dimensions -- what we have come to call "Rural-Urban Balance". Included in this, are District Focus for Rural Development and Jua Kali Development Programme.

In support of this strategy, the government has established the District Development Fund to finance such programmes as Nyayo Sheds for Jua Kali artisans and the Rural Trade and Production Centres. In order that the infrastructure set up by the Government can be fully utilized, entrepreneurs need the necessary finances but unfortunately they face two major constraints: First, in view of the low level of returns from these investments, the capital employed takes a long time to repay itself. Therefore, short-term loans availed by branches of commercial banks are not appropriate. Second, majority of these small entrepreneurs are generally not aware of the availability of these existing long-term loans.

Those who are aware, are forced to borrow from institutions, with exception of K.I.E., whose facilities are designated in foreign currencies with the associated exchange risks and unfortunately this has led to some bankruptcies.

In the course of the next financial year I shall explore the possibility of passing foreign funds, without exchange risk, through a diversity of financial institutions to enable this segment of the business community access to long-term funding. I know that the Government will incur a cost in bearing the exchange risk but there are under-utilised lines of credit which, if mobilised, would provide a number of economy-wide benefits ranging from increasing employment to relieving the balance of payments. I am convinced that we would be well recompensated for whatever costs we have to incur.

(h) Agriculture

Mr. Speaker, agriculture remains the mainstay of our economy and, therefore, this review would be incomplete without making any reference to it. The majority of Kenyans of working age are engaged in agriculture. Agriculture earns the bulk of our foreign exchange and most important, agriculture has enabled us to be self-sufficient in our basic food requirements.

With this record and achievement in agriculture it is essential that we maintain our success. There is, therefore, no need for major policy changes in this sector, but rather an enhancement of those factors which lead to further growth. Agriculture is the biggest private sector activity in our economy and what is required is to keep our farmers properly serviced, making inputs readily available to them and providing them with positive results from research so as to increase their productivity. One further essential requirement is to enable them to market their produce at prices which give reasonable returns. With these factors in mind, I have allocated more funds to both the Ministries of Agriculture and Livestock Development.

The other major support to the agricultural sector I mentioned earlier is marketing. The Government has looked at the various marketing problems faced by farmers and has embarked on a series of measures aimed at ameliorating these problems. The problems have centred around delayed payments, restricted access to alternative markets and sluggishness to reflect market opportunities. Besides undermining farmers' efficiency, inefficient and sometimes inappropriate marketing has presented a major burden to the taxpayer. Nowhere was this more so than with the operations of the National Cereals and Produce Board. Here I am happy to report that, with assistance from E.E.C., the Government has embarked on a programme of reform which will not only be less costly to the Government but will also benefit the farmers by increasing their marketing options.

The reform under way consists of management re-organization, streamlining the network of NCPB buying, financial restructuring of NCPB and a gradual development of other marketing outlets. With effect from July 1st this year, KGGCU, co-operatives and small maize traders will be allowed to buy directly from the farmers up to 20 per cent of the marketed maize. As these alternative channels are developed, more and more can be allowed to go through these channels and NCPB will revert to its more basic role of holder of strategic reserves and buyer of last resort. Farmers will continue to be able to sell to the NCPB since we are establishing a special crop revolving fund.

Mr. Speaker, Treasury will continue to support policy changes in Agriculture and Livestock Ministries. In this respect we will assist the ongoing reforms aimed at speeding up coffee payments, and an auction system in cotton with early payments to farmers, somewhat along the lines of the system enjoyed by our tea farmers. Further support will entail the development of the marketing and processing for the meat industry, not by pouring more taxpayers money into K.M.C. and Uplands, but by encouraging commercial approaches in running such ventures. I would like to assure the House that this will be done with the full cognizance of the need to develop indigenous ownership, although initially foreign investment may be necessary and indeed, welcome.

Finally, Mr. Speaker, one of the most improtant ways in which the Government has boosted agricultural output is the regular review of producer prices to reflect the economic value of the agricultural commodities. The other is to ensure that agricultural inputs are available to the farmers timely and in sufficient quantities. These policies will be continued and improved upon.

5. FINANCIAL OUT-TURN 1987/88

(a) Recurrent Revenue

Mr. Speaker, I would now like to turn to this year's Budget out-turn. This fiscal year's recurrent revenue was estimated at K£1,542.0 million plus Appropriations-in-Aid of K£48.8 million making a total of K£1,590.8 million. This revenue was to comprise of K£356.0 million from Customs & Excise; K£447.0 million from Income Tax; K£477.9 million from Sales Tax and the balance of K£261.1 million from export duty, other minor taxes, charges, dividends and fees. Mr. Speaker, revised estimates show that I may realize a total revenue of some K£1,527.7 million, i.e. K£14.3 million below my last year's forecast.

There will be marginal increases in both Income Tax and Sales Tax which will exceed their targets by approximately K£10 million and K£15 million respectively; while Customs & Excise will exceed the original target by K£2 million. There will, however, be a large shortfall in other taxes and revenue mainly as a result of reduced dividends received from parastatals, reduced export duty on coffee whose prices have fallen and a shortfall in other minor taxes and fees.

Therefore, I expect to raise K£358 million from Customs & Excise; K£457 million from Income Tax; K£493 million from Sales Tax and K£219.7 million from other taxes and revenue.

(b) Recurrent Expenditure

This year's Printed Estimates of Recurrent Expenditure were estimated at K£1,009.4 million excluding Appropriations-in-Aid. Consolidated Fund Services were to take another K£624.2 million making a total Recurrent Expenditure of K£1,633.6 million. As the House will recall, there were five important items which forced the Government to seek Parliamentary approval for Supplementary Appropriation amounting to K£92.6 million early this calendar year. These were, firstly, the need to triple the intake into our national universities late last year and the increased enrolment in our primary schools; secondly, the carry-over related to the hosting of the 4th All Africa Games in Nairobi; thirdly, the costs related to the holding of the Presidential and National Assembly Elections which ushered in the Sixth Parliament; fourthly, the increased cost associated with maintenance of security along our borders; and lastly, the need to accommodate expenditures of new Ministries created recently with the view to improving delivery of Government services to wananchi. I had also to finance Excess Votes and Under Issues of K£81.8 million. I, therefore, expect this year's Recurrent Expenditure to be K£1,808.0 million, compared to a total revenue of K£1,527.7 million. I will, therefore, have no surplus in the Recurrent Account to transfer to the Development Exchequer.

(c) Development Expenditure

This year's Printed Development Estimates projected gross expenditure of K£613.6 million including Appropriations-in-Aid of K£288.6 million. Early this year, the House approved gross Development Supplementary Estimates of some K£10.2 million. As I have already indicated, this increase was necessitated by the need to increase university intake while enhancing our territorial security. Therefore, some K£299.9 million will be issued from the Development Exchequer.

On the basis of preliminary estimates, I expect the overall budget deficit this fiscal year to be K£328.6 million. As I had indicated, I am determined to reduce this deficit next fiscal year. I now turn to forecast out-turn for 1988/89.

6. FORECAST OUT-TURN 1988/89

(a) Expenditure

Mr. Speaker, as Hon. Members have already seen from their copies of Printed Estimates, the Gross Recurrent Expenditure of Ministries is estimated at K£1,494.3 million, with Appropriations-in-Aid of K£76.2 million and a net expenditure of K£1,418.1 million. Those estimates include an amount of K£258.5 million representing the write-off of loan and interest owed to Government by the National Cereals and Produce Board. Since these transactions do not involve cash, this amount should be excluded from the estimates. Thus the Gross Recurrent Expenditure of Ministries in 1988/89 will be of the order of K£1,235.8 million, Appropriations-in-Aid of K£76.2 million and net expenditures of K£1,159.6 million.

If this year's special expenditures on defence equipment, Registration, General Elections and All Africa Games, which will not be repeated next year are excluded, there will be an increase of more than 8.5 per cent in next year's Recurrent Expenditures. I am also happy to inform the Hon. Members that local Appropriations-in-Aid to finance such expenditures will go up from around K£48.8 million in 1987/88 to K£63.6 million in 1988/89.

The increase in recurrent expenditures next year is necessary to meet the costs of salaries and allowances for civil servants and teachers and the requirements of the new Ministries. In addition, provision has been made for the cost related to our 25th Independence Anniversary celebrations as well as ten years of Nyayo era. Consolidated Fund Services will take another K£740.7 million. Therefore, total Recurrent Expenditure, excluding the write-off of NCPB debts, will be K£1,976.5 million.

Development Estimates for 1988/89 call for a gross expenditure of K£702.5 million including Appropriations-in-Aid of K£397.1 million. This represents an increase of 12 per cent over this year's Revised Estimates. This increase is accounted for by the need to increase the absorption in the Budget of grant and loan financed projects partly because of the unavailability of local resources and mainly because of the need to have increased external resources inflow to support our balance of payments.

Apart from the foregoing expenditures, I have also to finance an additional K£96.2 million as Under Issues relating to previous years.

Mr. Speaker, I will not analyse further the details of either recurrent or development expenditure at this stage. I shall hold the matter until we come to debate the spending allocations of Ministries in the Committee of Supply.

It suffices to note that I have to finance a total expenditure of some K£2,775.2 million. The rest of my Speech will outline how I propose to do this.

(b) External Revenue

Mr. Speaker, Kenya is committed to maintenance of cordial international relations. I have also indicated that Government is committed to Budget Rationalization programme aimed at improving efficiency in public expenditures through optimal utilisation of existing capacity and giving priority to completion of on-going projects with high returns. Within this criteria, and in the light of the sound economic policies which Kenya has been pursuing, foreign donors have pledged to assist us with an amount equivalent to K£676.1 million next fiscal year. Of these external in-flows 50.5 per cent will be in the form of grants and 49.5 per cent in the form of project and programme loans. This is indeed a very large amount and I would ask Hon. Members to join me in expressing our gratitude to those foreign Governments, bilateral and multilateral institutions who have consistently continued to assist Kenya. Thus, I expect to finance nearly 24.4 per cent of my total expenditure from external sources. As usual, the main burden of financing Government expenditure will be borne by Kenyans and I now turn to how I intend to raise the balance of K£2,099.1 million.

(c) Domestic Borrowing

Mr. Speaker, I have already indicated my intention to reduce the growth in money supply. I have also indicated that, to achieve this reduction in money supply, I need to borrow money from non-bank sources. Given this position, I propose to raise some K£284.2 million from local borrowing. This money will be raised by way of long-term stocks, Treasury Bonds, and Treasury Bills.

(d) Internal Revenue

Mr. Speaker, when I outlined the economic outlook for 1988/89, I indicated that the economy is projected to grow by approximately 5 per cent this year. On the basis of this projection, I estimate that ordinary revenue, at present rates of taxation, will provide some K£1,694.3 million. Appropriations-in-Aid will provide another K£70.3 million.

Thus, I will raise a total of K£1,764.6 million from this source. I have, therefore, a gap of K£50.3 million to finance from additional taxation. The rest of my Speech will outline the areas of extra revenue.

7. TAXATION PROPOSALS

Mr. Speaker, I have appraised the House on the international economic environment, the problems facing Sub-Saharan Africa, the state of our economy and the policies we propose to pursue to sustain growth. In particular, I have emphasized the need to restructure our financial, fiscal and industrial policies in order to reduce the imbalances inherent in the economy. I have also indicated that I have a financing gap of K£50.3 million. I now turn to my taxation proposals, and as usual, I would ask Mr. Speaker, that the rest of my Speech be regarded as Notice of a Motion to be moved before the Committee of Ways and Means.

(a) Customs Tariff

The Finance Bill published today contains substantial amendments to the Customs and Excise Act. It contains amendments to the Act aimed at correcting typographical errors and omissions. It also contains amendments to the Schedule of excise duties intended to align the schedules with the requirements of Customs Co-operation Council Numbers. In addition, it has been considered necessary to reclassify fresh flowers and raw skins in order to assist exporters of fresh flowers and tanneries who import raw hides and skins.

Mr. Speaker, I would now like to turn to those amendments which have significant structural and revenue implications. As I indicated earlier, there is need to restructure our industry towards efficiency so that it becomes competitive on the export markets. It is mainly with this in mind that the following changes have been made in the Customs Tariff.

First, some offences under the Act carry very lenient penalties. As a result, these offences have recently been on the increase. In order to discourage those who may be tempted to continue committing these offences, I propose to increase the current penalties as a deterrent measure.

Second, as the House is aware, we have authorized manufacturing in bond under section 40 of the Act which empowers Commissioner to allow assembly in bond provided that such assembly does not substantially change the essential character of the goods. The Act does not, therefore, contain specific provisions governing this important instrument of our export promotion. Given the fact that most of the prospective manufacturers in bond will require to source some of their raw materials domestically, it is essential that the law be amended not only to provide for this, but also to enable proper control, supervision and regulation of these operations. I am therefore proposing to amend the Act to ease administration of this kind of manufacturing.

Third, there are far too many different tariff categories. This complex and sophisticated system arose from historical developments as Government addressed problems and concerns of particular industries and sectors of the economy. Such a diversified tariff system treats products entering the economy in 25 different ways, creating 25 alternative incentive patters which benefit certain products, firms and industries, while penalising others. There is no method of establishing with certainty whether those activities being favoured by this differentiated structure are the best for the economy. However, to some extent,exactly the oppsite occurs because "sometimes it is the most inefficient firms and industries which need and obtain the greatest benefits from a differentiated tariff system." A tariff structure which is more uniform (with a narrower range and fewer categories) provides a similar Effective Protection Rate to all firms and industries; it is more efficient in its impact on the economy; fairer to all concerned; and easier to administer with integrity, than wide-ranging tariffs, with 25 different categories. I therefore, propose to reduce the number of tariff categories from the current 25 to 17 by abolishing eight rates: 55%, 65%, 75%, 90%, 95%, 110%, 125%, and 170%. Mr. Speaker, this is perhaps the most fundamental reform in the history of our tariff structure and its impact on the industry will be far reaching.

Fourth, Mr. Speaker, it has been Government policy to move towards a more uniform tariffs structure and substantial progress towards this goal has been made in the last few years. However, there still continues to be anomalies in the current tariffs where similar goods though made of different materials, continue to bear different tariffs. In order to remove this inconsistency, I have attempted to ensure that similar goods bear the same rate of duty. For example, bathtubs and sinks of either plastic, stone or ceramic will now be dutiable at the same rate.

Fifth, I have already indicated that I intend to restructure our import system such that items on Schedules 1, 2 and 3A shall be liberally licensed for importation. I have also indicated that we are experiencing severe balance of payments problems. Given this situation, it is only logical that demand for those items which will be licenced liberally be restrained by way of increased tariffs. Accordingly, I propose to raise duty on some of these items like magnesite, live horses and cloth-washing machines by between 5% and 15%. Similarly, and in order to provide appropriate protection to domestic industry, I have increased duty on biscuits, calf leather, locks and keys by between 5% and 10%.

Sixth, keeping the public informed is an important aspect of our overall development policy. It is for this reason that the Voice of Kenya and more recently the Ministry of Political Affairs & National Guidance, have been charged with the responsibility of informing and guiding Kenyans on matters relevant to political, economic and social development of this nation. While these institutions are doing an excellent job, their output reaches the public mainly through the radio, one of the largest means of information dissemination to the public. It is, therefore, essential that this important means of communication should be made readily available to the public. In order to enhance availability of radios to the public while simultaneously reducing incentive to evade tax, I propose to reduce duty on these items by approximately 10%. For similar reasons, duty on T.Vs. will be reduced accordingly. In spite of this reduction, I expect some revenue increase as importers will now be less inclined to cheat.

Seventh, it is common knowledge that specific duties do not keep up with the rate of inflation. In spite of this fact, some of our specific duties have not been adjusted for many years --

with the result that they are much too low compared to other ad valorem duties. In addition, I have also discovered that this state of affairs has been used for over-invoicing for capital flight and under-invoicing for tax evasion. In order to correct this situation, I propose to increase specific duty on unassembled monochrome T.Vs. from sh. 50 to sh. 350 and impose ad valorem rates of 135% on all spirits.

Eighth, graphite lead for manufacture of pencils is currently dutiable at 25%. Recently, there have been complaints that local manufacturers of pencils are threatened by cheap imported pencils. In order to ease the situation, I propose to reduce duty on this raw material from 25% to 20%.

Ninth, yarns. During the early years of our industrialization suspended duty was imposed in order to protect infant yarn manufacturers without recourse to Parliament. In spite of the fact that majority of these industries have now grown up, suspended duty continues to be in our statutes. I propose to abolish this duty by combining it with the normal duty such that yarns will from now on bear one rate of duty. In combining these rates into one, I have ensured that duty on yarn which is a raw material for manufacture of textiles bear a lower rate of duty than that of yarn for retail sale.

Tenth, leather. The shoe industry has constantly complained to me that duty on imported finished leather shoes and similar leather products is too low and is, therefore discouraging local leather industry. I am aware shoe manufacturers know best where that shoe pinches, and consequently, I intend to correct this situation. I therefore propose to, firstly, lower duty on raw hides and skins from (10-35) per cent to 15 per cent; secondly, raise duty on leather products from 45% to 50%; and thirdly, raise duty on shoes and leather shoe uppers from 55% and 75% to 60% and 80% respectively.

Eleventh, steel. Mr. Speaker, steel industry is basic to the whole process of industrialization, and hence economic development. Indeed, it is virtually impossible to find any industry which does not, in one way or the other, use steel or steel products in its manufacturing process. Because of the importance of steel in manufacturing and the economy in general, it is essential that steel industry itself be rationalized cautiously. It is because of this reason, and its complicated nature, that the government has decided to commission a study on how best to rationalize the steel industry. Pending the outcome of the study, I have today attempted to rationalize duty on its raw materials and the final products, such that duty on billets will be reduced from 20% to 10% while that of wire rods will be reduced from 25% to 20%.

Twelfth, films. Recently, a number of foreign film producing companies have shown interest in shooting new films in Kenya, mainly due to the beautiful sceneries available in our country. Alhtough they eventually take the films out of the country after shooting, they have been unable to bring the unexposed films into the country duty-free because, once exposed, the Act considers the film as having been entered for home use. Therefore, by practice, films are deemed ineligible for temporary importation. In order to promote Kenyan sceneries abroad, and therefore tourism, I propose to amend the law to allow such film shooting companies to bring into Kenya unexposed films duty-free provided that they have been licensed by the Ministry of Information and Broadcasting to shoot the films.

Thirteenth, buses. Mr. Speaker, prior to the introduction of matatus on our roads, buses used to be the biggest means of public transportation. However, they have recently been surpassed by matatus in terms of passengers carried. This means that the number of matatus coming into use is growing faster than that of buses but unfortunately, this has been accompanied by road carnage. In spite of this growth, public transportation continues to be a major problem, particularly in our major towns. In case of our capital city, the Government has, through H.E. the President's initiative, introduced Nyayo buses to alleviate this problem.

Notwithstanding these Government's efforts, the problem has continued to worsen. I am informed that one of the main reasons why the number of buses on our roads is not keeping pace with the growth of the travelling public is that the cost of buses is prohibitive. The high cost of buses is not due to duty alone, it is mainly attributable to the appreciation of our trading partners' currencies. Nevertheless, and in order to give further support to H.E. the President's efforts in improving public transportation, I propose to lower duty on big buses from (35-45) per cent to (20-35) per cent.

Fourteenth, section 51 of the Act spells out the rates of warehouse rent to be charged on goods stored with Customs Department. Currently, the rent at Kilindini port is Sh.15 per bill of lading ton per day and Sh. 10 per bill of lading ton per week or part thereof in other areas. Recently, there has been an increase in volume of goods stored in customs warehouses outside Kilindini and particularly at the Inland Container Depot at Embakasi thereby causing congestion leading to pilferage and evasion of taxes. In order to discourage importers from using Government warehouses for inordinate storage of their goods, I propose to raise rent chargeable on these other warehouses as follows:-

(i) Inland Container Depot at Embakasi from Sh. 10 per bill of lading ton per week to Sh. 15 per bill of lading ton per day.

(ii) All other places from Sh. 10 per week to Sh. 10 per day.

(iii) The minimum charge which is currently Sh. 5 will be increased fourfold to Sh. 20.

Finally, Mr. Speaker, bicycles. As. Hon. Members are aware, bicycles used to be a major means of short distance transportation for individuals in both urban and rural areas. However, in recent years, this important mode of transport has become increasingly unaffordable by those who genuinely require it because of the exorbitant price of bicycles. I have reflected on this, and although bicycles are expensive partly because of the low level of imports, it is equally true that duty on bicycles is high.

Therefore, in order to make this basic item available to wananchi at a reasonable price, I propose to drastically reduce the rate of duty on bicycles from 80% to 40%. It is my earnest hope that bicycle dealers will reduce their prices proportinately.

Mr. Speaker, taken together, the measures I have announced today on customs tariff will provide the Exchequer with a marginal additional revenue of K£1.65 million - but will have a far reaching effect on our industrial growth.

(b) Excise Tariff

Mr. Speaker, I would like to turn to excise tariff where I have only two minor amendments to make. As I indicated earlier, the rate of domestic inflation this year is currently estimated at 9.3%. Given this rate of inflation, it is only logical that prices of luxurious items like cigarettes and tobacco be adjusted accordingly. However, it is not my intention to penalise smokers by anything higher than the rate of inflation. Therefore, I propose to raise the levels at which the current rate of excise duty on these products apply by an overall weighted average of approximately 9.1 per cent. I also propose to raise the current rates of excise duty nominally by approximately 6.2 per cent. These two measures will have the effect of raising the price of some popular brands of cigarettes such as Ten Cent, Rooster, Nyota, Score and Crown Bird by 50 cents per packet; while that of elegant brands such as Embassy and Sportsman will go up by Sh. 1 per packet.

This measure, which takes effect from mid-night tonight, will provide the Exchequer with an additional K£9.9 million in revenue.

(c) Local Manufactures (Export Compensation Act.

Mr. Speaker, the House will recall that, two years ago, I reduced the number of items eligible for export compensation from about 2,000 to 700. In effecting this reduction, I took account of the need to increase domestic value added on our exports; the need to avoid a situation where one may import a product and re-export it to earn compensation; and the need to make the eligible list small and workable. I also requested those exporters whose products were deleted from the eligible list to apply for reinstatement giving all the necessary details for consideration by an Inter-Ministerial Committee of Treasury, Planning and National Development, Commerce and Industry. Although some of the applications have been considered and acceptable products reinstated over the intervening period by way of Legal Notice, there is still a large number of items which qualify for eligibility and have not been gazetted. While the exercise of scrutinizing these applications continue, I propose to add some 43 items which have been recommended to me for the eligible list. Accordingly, the Finance Bill published today contains these additional items. I estimate that this measure will cost the Exchequer some K£315,000 in lost revenue.

(d) Sales Tax

Mr. Speaker, I now turn to sales tax. First, there are certain cases the Department has been unable to collect some tax due to insolvency, death, bankruptcy, closure or departure from Kenya of the manufacturing firms/owners. A substantial amount of this uncollected tax is in the form of "Return to Drawer" cheques which remain in the Department's books as arrears because there is no provision in the Act to write off such bad debts as is the case with Income Tax Act. I am, therefore proposing to amend the Act to provide that such uncollectable tax may be written off subject to default schedule being vetted by the Controller and Auditor-General and approved by the Minister.

Second, from the way in which the Act is worded, sales tax liability is determined by reference to Tariff Numbers. Therefore, local manufacture should be seen as a process involving conversion of raw materials of a different tariff from that of the finished product. However, our tariff structure is such that, this is not always the case. In cases where the imported CKD kits fall under the same tariff as the final product after assembly such as motor cycles, bicycles, electric smoothing irons, etc., manufacturers have argued that tax should only be paid once on the CKD kits. This is obviously unacceptable because tax should be levied at the point of sale taking into account the direct costs of assembling, overheads and profit. In order to close this loophole, and without altering the rate of import duty on CKD kits, I propose to amend the tariff structure to provide for separate tariff numbers for these items.

Third, last year, I amended the Act to curtail tax avoidance through sales by manufacturers to related businesses at artificially low prices. This amendment empowered the commissioner to register both the purchaser and the seller where he is satisfied that the goods are being sold at an inappropriate price. This amendment has not had the intended result for two reasons:

(a) The basic charging section of the Act was inadvertently not amended to provide that the purchaser shall be deemed to be a registered manufacturer and the goods sold by him to be the goods manufactured by him.

(b) The registration of the purchaser is not automatic but subject to the discretion of the Commissioner. If the Commissioner does not find out about the inappropriate prices on which tax is being paid, then there is no liability on the purchaser for any additional tax.

Because of these deficiencies, I propose to amend the Act to deem the purchaser to be a registered manufacturer and the sale of such goods by him to be deemed as sale of goods manufactured by him. In addition, the Act shall be amended to define related businesses so that, those who are using this loophole to evade tax can consider themselves liable to additional tax and, therefore, register themselves without waiting for the Commissioner to discover them.

Fourth, as I indicated a few minutes ago, very high rates of tax sometimes serve as an inducement to tax evasion. In the case of sales tax, a very high rate of tax discourages the small producer from registering for sales tax and, because of the large price differential between taxed and untaxed goods, demand for high taxed goods may shift from large scale registered manufacturers to small scale unregistered manufacturers with substantial loss of revenue. In order to avoid this situation, and while measures are under way to broaden sales tax base and improve tax compliance, I propose to reduce rate of tax on bakers wares and sugar products from 35 per cent to 25 per cent.

Fifth, margarine. Mr. Speaker, this product is a direct substitute for butter which is currently taxed at the general rate of 17 per cent. It is only fair that the two items should be given equal tax treatment. I, therefore, propose to impose tax on margarine at the general rate. Similarly, advertising materials and commercial catalogues made of paper are exempt from tax while those made of plastics, base metal, etc., are taxable at the general rate.

I, therefore, propose to impose tax on paper advertising material and commercial catalogues. I am sure Hon. Members will agree with me that, had there been tax on this item, the Exchequer would have received its fair share of the cost of the recently completed elections which saw thousands of campaign posters scattered across the nation.

Sixth, motor cars. Last year, I made a substantial reduction on tax payable on passenger cars. As I emphasized at that time, the high cost of passenger cars is attributable more to the appreciation of the currencies of our major trading partners rather than to taxation. This continues to be the position. However, the Government is aware of the high price of passenger cars and I am, therefore, effecting further tax reduction this year. Accordingly, with effect from midnight, the rate of tax on passenger cars with an engine capacity not exceeding 1200 c.c. will be reduced from 30% to 25%; exceeding 1200 c.c. but not exceeding 1500 c.c. from 40% to 30%; exceeding 1500 c.c. but not exceeding 1750 c.c. from 55% to 45%; exceeding 1750 c.c. but not exceeding 2000 c.c. from 75% to 60%; exceeding 2000 c.c. but not exceeding 2250 c.c. from 195% to 155%; and exceeding 2250c.c. from 340% to 270%.

Seventh, soda. The price of this beverage was increased last June. Since then, the price of sugar has been increased with the view to compensating sugarcane growers for increased costs of production. As a result of this, soda manufacturers have applied to me for a price increase. I have considered their application and their allowable increase falls far short of the rate of inflation. I have, therefore, decided to slightly raise the rate of tax on soda by approximately 3% of the existing rate. As a result of these two factors, the price of soda will go up by 20 cents per bottle with effect from midnight to-night.

Eighth, beer. As I have already stated, it is Government policy to ensure that the prices of luxurious items like beer, rise in line with the rate of domestic inflation and particularly where tax on those items can be used to close the budgetary deficit. Considering the large budgetary deficit I have already alluded to, it is only fair that this deficit be reduced slightly by increased taxation on alcohol. I have pointed out in my previous budgets that although our beer ranks among the best in the world, its price is also among the lowest. I am, therefore, proposing to increase the rate of sales tax on beer by Sh. 1/20 per litre. In addition, Kenya Breweries has applied for a price increase of 40 cents per half litre bottle mainly because of higher maintenance costs occasioned by appreciating foreign currencies and the need to expand their manufacturing capacities at Nakuru, Nyeri and Mombasa to meet domestic and export demand. I have analysed their request and concluded that it is justifiable. Those two factors will have the effect of raising the price of beer by Sh. 1/00 per half litre bottle with pro-rata increases in other sizes with effect from midnight to-night.

Ninth, petrol. Mr. Speaker, those who are still with me will have noticed that I have so far been very generous to motorists. Not only have I reduced duty on buses for public transportation, but I have also effected substantial reduction in sales tax on passenger cars. In order to recoup some of the revenue lost by these measures, I propose to increase the rate of tax on petrol.

Therefore, effective from midnight to-night, the price of premium will go up by 30 cents per litre, regular by 20 cents per litre and diesel by 10 cents per litre. Considering the duty reduction I have already effected on big buses, there would be no reason for commuter bus operators to increase fares as a result of this minor increase in diesel. Further, and in order not to adversely affect the cost of basic consumer items, I have not increased the prices of kerosene and industrial diesel. This will enhance forest conservation while maintaining the energy costs of industrial diesel based manufacturing at existing levels.

Tenth, tax refunds. Mr. Speaker, sections 25(b) and (c) of the Act provide that the Commissioner shall refund tax paid on raw materials used to manufacture goods which are subsequently sold. The Department, therefore, uses this provision to refund tax paid on raw materials used to manufacture both taxable and non-taxable goods. In the processing of these refunds, it has become clear that there are numerous manufacturers of non-taxable goods who simply use the Department as a refunding institution of taxes paid on their raw materials. In view of the fact that these manufacturers of non-taxable goods do not pay tax, it is often difficult for the Department to verify whether the raw materials on which refunds are being sought have actually been used as an input into manufacturing or for some other purpose. Our conjecture is that we may be losing substantial revenue through these refunds. In view of this suspicion, I propose to abolish refunds on raw materials used to manufacture tax exempt goods.

Finally, pencils. Mr. Speaker, pencils are a basic educational material which is locally manufactured and mainly used by school children. In view of the importance Government attaches to education, I propose to abolish sales tax on pencils.

Mr. Speaker, taken together, the various measures I have announced on sales tax will provide the Exchequer with an additional K£24.1 million.

(e) Income Tax

Mr. Speaker, I would now like to turn to income tax where I shall be making fundamental changes aimed at improving investment.

(i) Leasehire Transactions

Under normal leasing arrangements, the lessor or owner receives a payment for the use of his asset or property and the lessee or user of the asset pays for such use.

For tax purposes, the lessor pays tax on what he receives from user and user deducts these payments in computing taxable profits.

However, as far back as 1970s, there were certain devices invented by taxpayers to frustrate this symmetry of treatment.

Under these arrangements, a payment of capital for the acquisition of an asset was disguised as a payment of hire. In consequence, the payment became deductible in computing taxable profits.

Section 12 was, therefore, introduced to counter these devices which were known as collusive hiring. The section worked by neutralising the tax advantage gained by taking the capital value of the asset when the asset passed into the hands of the lessee.

Of late, this section has been abused. Contracts are being devised under which the asset will never change ownership, thus avoiding the recapture envisaged under section 12.

I propose to change the law so that any payment which purports to be a payment for hiring, renting or leasing of any asset will not be deductible unless the taxpayer proves that it is income in the hands of the person to whom it is paid.

(ii) Investment Deduction

Last year, I re-introduced investment deductions for factories put up within the Municipalities of Nairobi and Mombasa. The rate of deduction was set at 10% within those two municipalities but at 60% outside.

I have since received complaints that a 10% rate is too low due to the negative effects of inflation. Taking into account the Government's commitment to promote industrial development in both urban and rural areas, I have decided to increase the Investment Deduction rate from 10% to 25% for Nairobi and Mombasa; and from 60% to 75% in other areas.

Mr. Speaker, I have spoken at length elsewhere about the introduction of Manufacturing Under Bond Programme. In order to strengthen this programme further, I propose to introduce additional special Investment Deduction to be known as Investment Deduction Bonded Manufacture under the Income Tax Act.

The Investment Deduction Bonded Manufacture will be at the rate of 75% of cost of new machinery and buildings within the municipalities of Nairobi and Mombasa and at the rate of 25% of cost elsewhere in Kenya.

The effect of Investment Deduction Bonded Manufacture as an initial investment deduction is to allow manufacturers under the programme to get a 100% investment deduction on new machinery, equipment and industrial buildings no matter where the premises are situated.

As a safeguard to Revenue, if the licensed manufacturer ceases to manufacture for export under the programme within three years, then the additional advantage received will be clawed back and assessed on him.

(iii) Taxation of Professional Income of Married Women

Traditionally, the income of married men and women has been added together for income tax purposes. Since 1980, however, the wife's employment income has been taxed separately but at the same rate as that of the husband. This special treatment of the arms length employment income of the wife has encouraged many married women to seek paid employment and I have been encouraged to seek further measures that would promote more participation of women in self employment as opposed to purely paid employment.

I am pleased to announce that in recognition of the expanding contribution of women to national development, I propose to extend to self-employment professional income the same treatment as is accorded to wife's employment income for the purposes of assessment to tax. This means the income earned by a professional woman, in exercise of her professional skills, will not be aggregated with that of her husband as the practice is today.

Mr. Speaker, by introducing a special treatment on wife's professional income, we have given higher impetus to women professionalism in the country. We are also pointing out explicitly that our professionals are equal, irrespective of their sex. The eligible professions are enumerated in the Finance Bill published today.

(iv) Increase in Employee Benefit Value

Mr. Speaker, benefits provided by an employer to his employees are subject to personal income tax according to the Income Tax Act. The law provides that each benefit facility or advantage must be valued in monetary terms and the total values added to the employee salary for taxation.

These benefits were moderately increased last year as a result of my concern at the Commissioner's low valuation. However, their levels are still too low.

Therefore, there will have to be a further revaluation this year. Indeed I am of the opinion that such revaluation must become a periodical event in order to at least keep up with the rate of domestic inflation. This will ensure that those employees who enjoy these benefits in lieu of straight salary increases will have their taxation maintained at par with that of the rest.

(v) Retirement Benefit Rules

Mr. Speaker, in order that a Pension Fund or Provident Fund may be registered with the Commissioner of Income Tax, and in order that such a Fund may enjoy the tax exempt status which it automatically does on registration, such a Fund is required to pass simple rules which quarantee certain principal objectives.

Included in these objectives are the maximum amounts that may be contributed by both the Employers and their Employees in any any given year. In the case of a Provident Fund, the rules also provide for the maximum amounts that may be payable to an employee in respect of his Employer's contribution. The maximum amount that may be commuted is critical in the case of a pension fund and clear limits are set out in the rules too.

I have been asked to examine these amounts with a view to increasing them, the reason being that the last review was made in 1980.

I have given this matter careful thought and have accepted that increased wage and salary levels since eight years ago do justify a re-assessment of the figures. Consequently, I have signed a Gazette Notice increasing the amounts generally by about 50%. The actual details are contained in the Gazette Notice.

(vi) Foreign Exchange Losses and Gains

Mr. Speaker, in a world of fluctuating currency values or exchange rates, any country that remains oblivious to the realities of gains and losses arising from such currency stands to lose investments as a result of losses imposed on investors by the fluctuations. When a currency appreciates, any investor who holds a loan or suppliers credit denominated in that currency stands to lose. As the Hon. Members are aware, the Kenya shilling has fluctuated at varying degrees relative to other currencies. In some cases, there have been substantial gains, as well be noticed with currencies of some neighbouring countries. In other cases the shilling has lost substantially.

Perhaps the most significant measures that I wish to propose under the Income Tax Act concerns foreign exchange losses and gains. Hitherto, the practice has been that only exchange gains and losses relating to trading transactions were taken into account in computing gains and profits of a business. In particular, an exchange loss on repayment of a foreign currency loan was ignored.

I propose to abolish this distinction. Effective year of income 1989, all foreign exchange gains and losses whatever their character and howsoever arising will be taken into account in computing business profits so long as they are incidental to the conduct of that business.

The Finance Bill contains a new provision to provide a comprehensive set of rules to deal with foreign exchange gains and losses. Firstly, the new law affects exchange gains and losses realised on or after 1st January, 1989. Secondly, the law affects all exchange gains and losses realised whether in respect of a foreign liability or a foreign asset.

One important effect of this new provision is that business will be able to deduct a foreign exchange loss realised upon repayment of a foreign currency loan except that in the case of pre-1989 foreign assets and liabilities only the exchange rate movement after 30th December, 1988 will be taken into account.

Mr. Speaker, the deductibility of foreign exchange losses automatically increases the incentive for a foreign controlled subsidiary to increase debt relative to equity thus reducing the corporate tax liability of the Kenyan subsidiary.

To counter this possible manipulation, foreign exchange losses will be disallowed to the extent that the debt equity ratio exceeds 3 - to - 1. Excess losses will be carried forward to be deducted from future foreign exchange gains.

Rules have also been formulated to disallow interest on external loans to foreign subsidiaries to the extent that the debt- equity ratio exceeds 3 - to 1 except when the loan was taken prior to the budget date.

All foreign exchange gains will be taxable without restriction. Mr. Speaker, in view of the timing of these measures, I expect no revenue loss next fiscal year. However, I project substantial losses thereafter.

(f) Air Passenger Service Charge

Mr. Speaker, passengers departing on international flights have been paying ten dollars to the department of Aerodromes for the services rendered to them. This charge is levied under the Air Passenger Tax Act. I am informed that, because of the word "tax" in the title of the Act, some passengers belonging to certain organizations have objected to paying these charges presumably because they are ordinarily tax exempt.

I would like to emphasize that this is a service charge for the services rendered by our airports to departing passengers, and not a tax. In an effort to clarify this point home, and considering that the costs of these services have gone up since the charge was last revised in 1985, I propose to introduce three amendments to the Act: First, the name of the Act will be changed from "Air Passenger Tax Act" to "Air Passenger Service Charge Act". Second, the rate of the service charge will be doubled for passengers departing on international flights from ten dollars to twenty dollars per passenger. Finally, a service charge of Sh. 50 per passenger will be levied on all domestic flights originating from Jomo Kenyatta International Airport, Moi International Airport, Wilson Airport, Malindi Airport and Kisumu Airport. These changes which will take effect from midnight tonight, will provide the Exchequer with an additional K£5.72 million in revenue.

(g) Second Hand Motor Vehicles Purchase Tax

Mr. Speaker, Second Hand Motor Vehicles Purchase Tax has not been adjusted over the last three years. During this period, the number of used cars changing hands have increased mainly as a result of the growth of economy which I alluded to earlier. As a result of this increased transfer, the cost of registration has gone up considerably. It is only fair that the Exchequer be compensated and be seen to share equitably in this growing motor trade. I, therefore, propose to increase the rates of Second Hand Motor Vehicles Purchase Tax by approximately (19 - 25) per cent.

From this minor change, the Exchequer will realize an additional K£350,000 in revenue.

(h) Hotel Accommodation Tax Act

Mr. Speaker, the current rates of Hotel Accommodation Tax Act stand at a reasonable level to give the Exchequer the estimated revenue from this source. However, in spite of the fact that tourism is growing at good rate, the amount of tax collected from this tax is not rising proportionately. This is mainly because some hoteliers have made deliberate efforts to evade this tax. In order to discourage this tax evasion, I am increasing the various penalties payable under the Act. I also propose to amend the Hotel and Restaurants Act to provide that, where a hotelier deliberately swindles Government of its legally entitled revenue in the form of Hotel Accommodation Tax, then his licence shall be cancelled.

(i) Traffic Act

Mr. Speaker, traffic charges were last increased in 1985. During the last three years, the costs of various services rendered by Government to the motoring public have increased considerably in line with the increased number of vehicles. In view of these increased costs, it is only fair that motorists pay a little more to supplement Government efforts in this important sector of our economy. Consequently, I propose to effect the following measures on traffic charges.

First, I have already increased the rate of Second Hand Motor Vehicle Purchase Tax, i.e. tax on used cars changing ownership. However, the registration fee of a new car is Sh. 200. I am sure Hon. Members would agree with me that it is inequitable to tax a person who is buying an old car at a higher rate than the buyer of a new car. In order to put them on equal footing, registration fees for new cars will be equated to the new Second Hand Motor Vehicle Purchase Tax rates. Therefore, new vehicles registration fees will be graduated such that, the higher the engine rating of the vehicle, the higher the registration fee.

Second, I propose to effect an increase ranging from 7 per cent to 27 per cent on road licence fees covering all classes of vehicles. These increases will maintain the current graduated structure where, the higher the engine rating of a vehicle, the higher the fee.

Finally, the cost of full driving licence will now be raised from Sh.200 to Sh. 250 while annual renewals will rise from Sh. 100 to Sh. 150.

It is estimated that these changes will provide the Exchequer with an additional K£4.0 million in revenue.

(j) Entertainment Tax Act

Mr. Speaker, Entertainment Tax is payable by those who attend cinemas. The rates of this tax have remained stagnant since 1981 when they were last amended. I am, therefore, proposing a moderate increase in these rates. I am also widening the coverage of this tax to include discotheques and nightclubs where customers are entertained by way of music.

These measures will provide an additional K£350,000 in revenue from this source.

(k) Trade Licensing Act/Imports, Exports and Essential Supplies Act.

Mr. Speaker, fees charged under the Trade Licensing Act have not been adjusted over the past three years. During this period,traders have experienced booming business whose rate of growth has surpassed that of GDP which I have already indicated. It is only fair that the exchequer receives its fair share of this fast growing sector of our economy. Therefore, I propose to increase trade licence fees by approximately 50 per cent. In addition, there are several professions trading across the country who are not currently required to hold a trading licence. These professions include land and quantity surveyors, estate agents, doctors, engineers, lawyers, etc. My attention has been drawn to the fact that these consultancy services are more lucrative than any retail shop business. I agree with this observation that there is no reason why these professions should not pay for trading licences like anybody else. Therefore, a legal notice has been published today declaring these occupations as trading occupations and, therefore, subject to licensing.

The KRA will be building upon improvements in tax administration that have been introduced under the Tax Modernisation Programme. One major innovation that commenced last year was the preshipment inspection programme to ensure the proper classification and valuation of imports for customs purposes. Reviews of the performance of this PSI programme reveal that it has been very effective. It is estimated that, directly and indirectly, it helped raise customs revenues on non-oil imports by more than 20%. This means that the increased revenue collections were more than double the cost of the PSI programme. I expect that the implementation of this programme will become more rigorous over the coming year as full reconciliation of the PSI documents is undertaken with the Customs documents. Mr Speaker, I will be announcing the implementation of further important initiatives to tighten tax collections in the next year.

Mr Speaker, as is conventional, I would now ask that the remainder of my Speech be regarded as Notice of a Motion to be moved before the Committee of Ways and Means.

I. Customs Duties

Following tradition, Mr Speaker, I will first present proposals that affect Customs procedures and other technical matters, and then I will turn to proposals with direct revenue consequences.

First, the maximum fines and penalties as well as the fees for licensing warehouses, customs clearing agents and other related activities under the Customs and Excise Act have not been reviewed for some five years. To bring these in line with current price levels, I am proposing that all fines, penalties and fees at least be doubled. I also propose to clarify that the late payment penalty of 3% per month is chargeable from the initial entry date and not merely from the date when Customs demands payment. Second, I am proposing to introduce penalties where the agents or masters of vessels or aircraft fail to properly account for goods reported for delivery or actually delivered at a port of entry.

Third, Mr Speaker, it has come to my attention that the approval and clearance procedures for imports for use by missions and agencies with diplomatic standing, aid agencies, and aid-funded organisations and their high officials has become somewhat confused and subject to abuse. I have instructed officers of the Ministry of Finance to work in co-ordination with the Ministry of Foreign Affairs and International Co-operation to ensure that only imports for the use of missions and agencies that have been Gazetted under the Privileges and Immunities Act will have their duty free imports approved by the Ministry of Foreign Affairs and International Co-operation. The Ministry of Finance will also be introducing stricter internal controls to remove import abuses in connection with aid-funded and donated goods.

Fourth, duty-free shops have not been operating under satisfactory customs control. I am therefore proposing to introduce the concept of a duty-free shop explicitly into the Customs and Excise Act such that the operations of these shops will be under controls similar to those of all bonded warehouses. Fifth, I propose to introduce amendments to Part A of the Third Schedule of the Customs and Excise Act to rationalise the items dealing with exemptions for the imports of the aid-funded projects and the personnel entering the country to assist in their implementation. These amendments also clarify the distinctions between persons changing residence to Kenya for the first time and residents returning to Kenya after a spell outside of the

6. TAXATION PROPOSALS

Mr Speaker, before I present my detailed taxation proposals, I wish to review some of the broad principles that underpin these measures. As members of this House are aware, the tax system has been undergoing a systematic process of modernisation, aimed at creating a fairer, more effective, and economically more efficient system. The taxation capacity has been significantly raised in recent years. Prior to 1993/94, ordinary revenue collections had never exceeded 24% of Gross Domestic Product. In 1993/94, ordinary revenues reached 27.9% of GDP. This financial year I expect ordinary revenues to exceed last years level. This remarkable achievement has been attained by a combination of lowering and rationalising tax rate structures and expanding the taxation bases. A key component of expanding the tax bases has been the strengthening of tax administration which is the foundation of good tax policy. This strategy will be taken a few major steps further with my proposals in this Budget. I am determined to spread the burden of taxation further on to those who evaded carrying their fair share in the past.

Mr Speaker, as I promised this House in my Budget Speech last year, I have brought legislation to the House to enact the Kenya Revenue Authority. This legislation will become effective on 1st July this year. The Kenya Revenue Authority will provide the vehicle for professional and equitable administration of the taxes. It will aim not only to collect taxes more effectively and efficiently, but also to provide better service to the taxpayer to make complying with the tax laws simpler and cheaper. The KRA will be responsible for collection of income taxes, VAT, customs and excise duties and a number of other levies and charges including those under the Traffic and Transport Licensing Acts. As specified in the KRA Act, the Authority will receive a base level of funding of 1.5% of the revenues estimated in this Budget. This amounts to K£95.4 million for 1995/96 which will be available to the Authority in equal instalments effective from 1st July. An initial provision has already been made for funding of the KRA. The funds available for recurrent expenditures on tax administration will increase to more than double those in the past. With these additional resources available to the KRA, I will be expecting increased revenue yields in excess of K£200 million from more effective tax collection. These additional revenues are built into the estimates of the increased revenues required from each type of tax that I will announce shortly.

On the side of tax policy, the Department of Fiscal and Monetary Affairs will also be strengthened in the coming year. This will include bringing the terms of employment of the officers working in the Tax Policy Unit in line with those in the KRA in order to motivate and retain these staff.

Mr Speaker, it is no secret that amongst our tax officers we have had a minority who have been willing to collude with taxpayers to defraud the Treasury and place a heavier tax burden on their fellow citizens who pay their tax honestly. Let me assure all Kenyans that such corrupt activities will not be tolerated under the KRA. The personnel policies of the KRA will be fair, but swift and sure in relieving corrupt revenue officers of their positions. At the same time, the KRA will be expected to collect taxes in a fair and firm manner. Whether a taxpayer is a private sector company or a parastatal, the company and its senior officers will be dealt with n the same fashion to ensure full compliance with the tax laws of Kenya.

country.

Sixth, persons changing residence to Kenya for the first time have to date generally been treated the same as returning residents who have been outside of Kenya for at least two years in respect of the allowable duty-free importation of personal and household effects. Both groups have been required to have used the goods for a minimum of 360 days prior to importation. I propose to introduce clearer distinctions in Part B of the Third Schedule for these two groups. In particular, the first-time arrivals changing residence to Kenya will be required to have used their household effects for only 90 days prior to arrival in Kenya.

Seventh, Mr Speaker, in my Speech last year I announced that the reconciliation and export inspection work under the EPPO duty/VAT exemption programme for imported inputs into the production of exports and under the Manufacturing Under Bond programme for exports would be contracted out in order to improve the administrative controls and service to exporters. The contract has been finalised and work under this contract will commence in July. As with the PSI programme, I expect to get a significant pay-back from reduced revenue leakage as full accounting will be required of all duty exempt imports. Any exempt imports not used for exports or other permitted uses are subject to duty. As part of the implementation of this contract, a thorough review of all EPPO procedures will be undertaken so that more efficient and flexible procedures can be introduced as well as extensions of the programme to a wider spectrum of exporters.

Eighth, Mr Speaker, as the customs controls on imports improved during this past year with the implementation of the new PSI programme, the indefatigable smuggler went to work to seek alternative ways of evading payment of duties and taxes. As a result, the incidence of transit and export fraud rose this year. Customs has moved to implement tighter controls. I expect that these controls will be even more effective under the new Revenue Authority. In addition, I am announcing a number of new measures to stamp out these fraudulent activities. I am determined to bring this situation under control rapidly and firmly. I am pleased to announce that as part of the growing co-operation within the region, the Governments of Kenya and Uganda have come to agreement to develop co-operative procedures to control transit and export frauds involving our two countries.

This agreement includes, first, the exchange of customs information between Uganda and Kenya. Uganda will be aware of the goods entered into Kenya for shipment to or through Uganda. Kenya will receive confirmation that goods have actually been received in Uganda. And a similar process will exist for goods shipped to or through Kenya from Uganda. The second component is that Kenya will receive copies of the Ugandan preshipment inspection documents for imports destined for Uganda. Clearly, any shipments arriving in Kenya in transit to Uganda that do not have the required preshipment inspection documents will be subject to detailed examination and strict controls. In addition, the transit control system will be underpinned by a strengthened bonding system. With immediate effect, only bank bonds will be permitted for transit goods, and in some cases the Commissioner may call for cash bonds. I expect banks to exercise due diligence in issuing transit bonds. Where transit shipment documents are in good order on low risk goods such as industrial machinery and raw materials, however, the Commissioner will not demand full coverage of the duties and taxes at risk.

Mr Speaker, these measures will help expose the fraudulent importer without hindering the flow of trade. I want to express my thanks to the Minister for Finance in Uganda for his co-operation. I look forward to growing co-operation in trade, customs and other taxation matters with neighbouring countries.

Ninth, the Customs Department has had problems with importers who demand release of goods prior to payment of duties. I am proposing to make it clear that prior release procedures are restricted to only gold bullion, currency, coins and perishable goods. Tenth, proper red and green channel self-declaration systems are being constructed at Moi and Jomo Kenyatta Airports for opening during the course of this year. I am amending the Customs regulations to give the proper legal basis to the red-and-green channel system.

Eleventh, the World Customs Organisation has agreed that effective 1st January 1996 some significant changes are required in the tariff classifications under the Harmonised System that is used by all member countries. These technical changes will have little or no effect on the tariff rate structures for import duties, excise duties and VAT. Accordingly, to effect these classification changes, I intend to bring to Parliament later this year a technical Bill that will amend the tariff classifications in line with the duty and tax rates approved in the Finance Bill.

Mr Speaker, I now turn to my major Customs proposals that have direct revenue consequences. First, to move the rationalisation of the import tariff one more step towards the goal of reaching a four-rate system (including duty free), I propose lowering by five percentage points the rates in the 45%, 30% and 20% bands. This will reduce the number of rate bands from seven to six. The new import duty rate bands will be: free, 5%, 10%, 15%, 25% and 40%.

Second, to lower the duty burden on capital equipment, I am proposing to lower the duty rates on all capital equipment in the 15% band to 10%. In addition, the tariff rates on food preparation machinery and computer equipment currently in the 20% band will also be reduced to 10%. And to encourage the private sector to participate more actively in electricity generation and supply, I propose to lower the import duty rates on electrical generators and convertors, and large transformers to 5%.

Third, to assist domestic industry, I propose to lower the duty rates on a range of primary raw materials by a further five percentage points to the 5% or 10% band. These include primary forms of rubber, aluminium, lead, tin, zinc, raw hides and skins, and hot-rolled steel coil. Fourth, to further rationalise the tariff schedule, I propose to lower the tariff rates on a range of commodities that are generally exported or not imported where they fall in the high-rate brackets reserved for protection of domestic industry.

Mr Speaker, the general tariff rate changes I have just announced will not only rationalise the rate structure, but they will also promote the efficiency and competitiveness of the economy. With the lowering of import duty rates on capital equipment and raw materials, Kenyan manufacturers will become more cost competitive in world markets.

Fifth, Mr Speaker, to help selected domestic producers I am proposing some further duty rate changes. To assist the local assemblers of lorries and buses, I am proposing to lower the tariffs on the completely knocked down kits for these vehicles by five percentage points. To