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REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1994/95

(1st July–30th June)

by

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Minister for Finance

REPUBLIC OF KENYA

Speech delivered to the National Assembly on 16th June, 1994, by the Hon. W. Musalia Mudavadi, Minister for Finance, Republic of Kenya, presenting the Budget for the Fiscal Year 1994/95 (1st July to 30th June).

Mr. Speaker, Sir,

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

1. INTRODUCTION

Mr. Speaker, the financial year 1993/94 which is just coming to a close was marked by extraordinary turbulence in the sphere of short-term economic management. A turbulence, I hasten to add, which has now passed. The economy has emerged from it not only unscathed, but refreshed and vigorous, proving yet again the resilience acquired through the structural adjustment process of the last several years.

Mr. Speaker, our national leaders and economic managers would not be able to steer the economy through the storm, unless they had firm commitment to the structural adjustment policies that were being implemented. When I presented the Budget to Parliament in June last year, the discount rate on Treasury bills exceeded 70 percent, the annualised three-month rate of inflation was above 100 percent, the external value of the Kenya Shilling had fallen sharply, and the country's foreign exchange reserves had been depleted to a critically low level. Yet through the year, we persisted with high volumes of Treasury bill sales in the weekly auctions, continued to decontrol prices, extended the foreign exchange retention scheme to all exporters and liberalised the exchange control regime further. There were Doubting Thomases among us who were afraid that these policies would push the economy over the brink into economic chaos. But today, all those doubters and critics will agree, I hope, that their fears have been proved unfounded. The rate of discount on Treasury bills has come down from dizzy heights to below

30 percent, the three-month annualised rate of inflation fell to 16 percent in December, the external value of the Kenya Shilling has stabilised, and the country's foreign exchange reserves have grown to a very healthy level in relation to our import requirements.

Mr. Speaker, our firm commitment to reform policies and the economic turn-around have been duly appreciated by all commentators, both at home and abroad. The embargo imposed on quick-disbursing external aid in November 1991 was lifted in the second half of 1993. A successful Consultative Group Meeting was held in Paris in November last year, in which the donors made substantial new aid commitments. We have also been able to reach understanding with our creditors on a schedule of repayment of our accumulated external debt service arrears.

Mr. Speaker, a crucial factor in all these has been the personal involvement and wise counsel of H.E. the President. I am sure that Honourable Members will join me in expressing our sincere thanks and appreciation for his continuing guidance and leadership of the Nation.

Mr. Mr. Speaker, as is customary, I shall first make some brief remarks on recent developments in the international economic scene, including the countries of Sub-Saharan Africa, before drawing your attention to developments in the domestic economy and our policy framework for the short and medium-term future.

2. WORLD ECONOMIC SCENE

Industrial Countries

Mr. Speaker, the world economy posted a mixed performance in 1993 with policy successes and failures spread unevenly among the rich industrialized nations. Among the OECD countries, USA, Canada and U.K. recorded GNP growth rates of between 2 and 3 percent. However, performance was poor in other major OECD member countries, including, in particular, Germany and Japan which experienced contraction of GNP of between 1 and 1.5 percent. The German economy suffered from relatively high interest rates and non-competitiveness of industry arising from high production costs in a situation of declining labour productivity. Economic growth in Japan, on the other hand, was affected by the appreciation of the Yen, and contraction in private expenditure resulting from balance sheet adjustments due to a steep fall in asset values. The overall growth rate for the OECD region was about 1.1 percent in 1993, while that for the G7 countries was slightly higher at 1.5 percent.

Mr. Speaker, the industrial countries' performance on the inflation front was very satisfactory in 1993. The average OECD inflation rate was 3.7 percent, with inflation in the G7 countries even lower at 2.6 percent. This trend of very low inflation has been continuing for sometime, leading many people to wonder whether the world economy may now realistically target a zero inflation rate. One reason for continuing low inflation rates was, of course, the sluggishness of economic recovery itself. Another contributory factor was the low price of crude oil.

Mr. Speaker, while the picture was mixed for economic growth and good for inflation, it was generally depressing for employment. For OECD countries as a whole, unemployment *rose* from 7.8 percent of the labour force in 1992 to 8.2 percent in 1993. Changes in technology, labour market rigidities and high unemployment benefits are regarded as the major reasons for the persistence of high unemployment. Public authorities in these countries are under pressure to devise effective policies for generating more employment. Reducing the number of hours of work per week, lowering real wages, cutting down on unemployment benefits, and raising labour productivity are among the measures being discussed. However, the only sure solution to the problem of unemployment in the long run, Mr. Speaker, is a sustained high rate of economic growth.

Mr. Speaker, one major event on the international economic scene in 1993 was the signing of the GATT agreement in December, after protracted negotiations spread over 7 years since the beginning of the Uruguay Round of trade talks. Strong protectionist tendencies in some large industrial countries, including the USA, Japan and the European Union had to be overcome before the final deadline of December 15, 1993. The process has been advanced further with the signing of the Marrakesh Declaration in March this year, paving the way for the setting up of the World Trade Organisation. While the agreement will still need to be ratified by the legislatures in the respective countries, there is widespread optimism that any remaining hurdles will be removed. Mr. Speaker, this was very good news for international trade and development. Various estimates have been made of how much additional growth for the global economy can be expected to result from the signing of the GATT deal. One recent estimate by OECD puts the additional world output at $ 275 billion per year by the year 2002. It is important to note, Mr. Speaker, that the alternative to an agreement would not be continuation of the *status quo*, but a *deterioration,* resulting from the intensification of protectionist wrangles and the replacement of multilateralism in trade by regional groupings.

Mr. Speaker, the short-term outlook for the industrialised world is a somewhat higher GNP growth of 2.1 percent in 1994, rising to 2.7 percent in 1995. The inflation rate is expected to remain low with the OECD average expected to be around 3.2 percent, and the average for the G7 countries around 2.4 percent. The 1994 growth performance is expected to improve for all countries, with the good performers of 1993 such as the USA, Canada and UK likely to achieve somewhat higher growth rates and the other important G7 countries such as Germany, Japan and France forecast to record positive growth during 1994, as compared to declines registered in 1993. The employment situation, however, is expected to take some more time to turn around. Specifically, it is anticipated that the unemployment rate will worsen from 8.2 percent of the labour force in 1993 to 8.5 percent in 1994.

Developing Countries

Mr. Speaker, following the general pattern of the last decade, the GNP growth rate for developing countries during 1993 continued to exceed that of the industrialised countries. The gap in growth performance was very substantial in 1993, with developing countries' growth rate averaging about 5.7 percent, which compares with 1.1 percent for industrial economies. As usual, the developing countries' performance varied across regions. China put up a spectacular growth performance of 13 percent. Other Asian economies recorded satisfactory growth of around 5.3 percent. Latin American countries achieved a more modest growth rate of about 3.5 percent, while the African economies managed to attain an average growth rate of only 1.4 percent. The worst performers were the economies in transition in Eastern Europe and the former Soviet Union where there was a sharp *decline* in GNP of about 10 percent.

Mr. Speaker, one reason for the faster growth in poor nations is the substantial policy reforms which most of them have introduced during the last few years. An important consequence of these reforms was a sharp increase in foreign private capital flows into the developing economies, some of which was a return flow of domestic savings that had deserted the countries under the earlier command economy regimes. Another factor is the rapid growth in trade among the various regions and sub-regions of the developing world.

Mr. Speaker, medium-term forecasts for developing countries as a whole indicate that the strong growth of over 5 percent will continue in both 1994 and 1995, rising to 6 percent in 1996. Growth rates are also expected to improve somewhat in Africa and in the transition economies of Eastern Europe and the former Soviet Union.

The African Scene

Mr. Speaker, the estimated low growth rate of 1.4 percent recorded in African economies in 1993 still compares favourably with 0.7 percent recorded in 1992. For the countries of Sub-Saharan Africa, the growth rate was somewhat higher at around 2 percent. The slow pace of recovery in African economies can be attributed to various factors, such as: (i) drought in North Africa, as well as in Eastern and Southern Africa; (ii) continuing civil and political conflicts, especially in Liberia, Somalia, South Sudan, Rwanda and Angola; and (iii) a further fall in the terms of trade for African countries. Mr. Speaker, the growth rate of population in Africa is estimated at around 3 percent per year. 1993 was, therefore, yet another year when per capita income and living standards of Africans deteriorated, marking a continuation of the trend that had set in from the early 80's.

The prospects for 1994 do not look very bright either. There are signs that the drought is going to end in most of in Africa, but normal rainfall patterns are not firmly established yet. Also, it will take continuing good rains for two to three seasons before the productive potential of land can be fully restored. Armed conflict is still continuing in some African countries; uncertainty and insecurity continue to inhibit the resumption of normal levels of production, trade, saving and investment. A major good news on the African continent is the long overdue political settlement and recent elections in South Africa. This will now pave the way for the economic re-integration of South Africa into the regional economy, boosting trade and investment in the entire region. Another positive factor is the expected recovery and growth in industrial countries. However, the completion of the Uruguay Round may have some adverse effects on *African* economies *in the short run*, through: (i) rise in food import costs due to reduced subsidies on European food; (ii) limitations on the further expansion of textile exports due to the delay in bringing the Multi-Fibre Agreement under GATT discipline and (iii) increased competition in the European markets because of the relative erosion of the privileges enjoyed by African countries under the LOME Convention.

Mr. Speaker, the current forecast of growth in African economies during 1994 is about 2.5 percent. For the medium term, opinions vary. Optimists expect the growth rate in Africa to rise gradually to 5 percent and above, while pessimists forecast the growth rate to stagnate around 2 percent for the rest of this decade. The former pin their faith on the expected benefits of economic and political reform measures implemented in course of the last few years, while the latter point to the possible continuation of economic mismanagement, corruption, and civil and political strife. Mr. Speaker, the absence of consensus on this issue is understandable, because sustained high growth of African economies will not be easy to achieve. It will call for inspired and selfless political leadership, continued social harmony, competent economic management and focussed international co-operation.

3. DOMESTIC ECONOMY

Mr. Speaker, I now turn to the domestic economy. The overall performance in 1993 was even worse than that of 1992, with a real GDP growth of only 0.1 percent. Indeed, 1993 was the fourth year in a row of decreasing growth in Kenya. Although in this respect the Kenyan economy appears to have replicated the performance of industrial economies, there were some specific factors working in the Kenyan situation which should be noted. These were: first, the continuing poor rainfall making three seasons in a row; second, the lingering effect on coffee output of the serious neglect of the crop by farmers following the price crash of 1989; third, the disruption to economic activities due to ethnic clashes that continued through 1993, although on a reduced scale; fourth, the continuing weakness of the confidence factor among investors and the business community in general; and finally, the progressive cuts applied to Government development expenditure in real terms for containing the Budget deficit.

Sectoral GDP

Mr. Speaker, the agricultural sector performed poorly in 1993 with an estimated 24 percent decline in the production of maize and a 12 percent decline in the output of coffee. The sharp fall in maize production was mainly a consequence of the failure of rains in major growing areas at critical times in the crop cycle. As regards coffee, although auction procedures and payment systems were improved, and international prices recovered significantly, especially for Kenyan coffee, farmers had to pay the price for neglecting the crop for about three years in the past. Coffee production should begin picking up again this year, and I see no reason, Mr. Speaker, why there should not be a period of sustained recovery and growth in this sector.

The outturn for tea was good, with a growth rate of output of over 12 percent achieved in 1993, despite the adverse rainfall conditions mentioned before. In the area of horticulture, while the production of fresh fruits declined marginally, that of fresh vegetables and flowers registered satisfactory growth. Among other crops, production of wheat fell sharply, while that of rice, beans, sisal and pyrethrum increased. Overall, GDP from the agricultural sector declined by 4.1 percent, due mainly to the large shortfalls in the production of maize, coffee and wheat.

Mr. Speaker, agriculture is the prime mover of the Kenyan economy, generating income and effective demand, supplying raw materials to agro-based industries and merchandise for our major exports. When agriculture is depressed, the other sectors of the economy also perform poorly. Thus, the manufacturing sector recorded only a low growth rate of 1.8 percent. Although this was an improvement over the performance in the previous year when the growth rate was 1.2 percent, it was much lower than the 6 percent growth recorded as recently as in 1989, and the long-term average growth potential of this sector. Apart from the contraction of the agricultural sector, other factors which affected manufacturing activities adversely were a fall in real investment in the sector during 1991 and 1992, and the high cost of both foreign exchange and domestic bank credit. A positive factor was strong growth in exports of non-traditional manufactured goods. Canned food, textiles, plastic products and furniture and fixtures are some of the industry groups which registered strong growth during 1993. Industries which recorded declines, on the other hand, were domestic consumer durables and non-durables like grain mill products, clothing, leather and footwear, and transport equipment.

Mr. Speaker, among the other major sectors, building and construction suffered the sharpest decline of 6.7 percent, as a result of reduced investment in both the public and the private sectors. Major service sectors like trade and transport recorded marginal growth rates of less than 1 percent. The finance sector, however, registered strong growth of 7.5 percent, due mainly to the steep rise in interest rates and expanded scale of activities in the financial system, including the capital market. Growth in GDP in the Government Services sector was only 2 percent, compared to 2.4 percent in 1992, due to deliberate compression of both recurrent and development expenditures in real terms.

Investment and Saving

Mr. Speaker, the most disappointing news on the performance of the economy in 1993 was the continuing fall in investment or gross fixed capital formation. In real terms, it *fell* by 16.4 percent in 1993, following declines of 5.8 percent in 1992 and 2.9 percent in 1991. It is the most disappointing news because fixed investment increases the capital stock, which is the basic determinant of the growth potential of an economy. Low investment today is bad news for growth in output and employment tomorrow.

Mr. Speaker, the falling trend of investment is a matter of serious policy concern and I shall return to this subject later in my comments on the policy framework. At this point, I wish only to note a few statistics in the area of investment and saving. As I have already mentioned, total gross investment fell in 1993 by 16.4 percent. In absolute terms, this represented a decline of K£ 117.8 million in constant 1982 prices. The *good news within this bad news* is that nearly 80 percent of this contraction occurred in investment by Government and the parastatals sectors.

Mr. Speaker, it is well known that we are trying to bring down the fiscal deficit through a reduction in Government expenditure. While the long run aim is to reduce recurrent expenditure through policies like civil service and parastatal reforms, it is an unfortunate fact that in the short run, the axe frequently falls on development expenditure, which later shows up in the statistics as reduced capital formation by Government. The parastatals are also under pressure to restore financial order and viability. Many investment projects by parastatals, which were to be financed by commercial loans from abroad under Government guarantee, have had to be shelved in the last few years.

Mr. Speaker, within the overall decline in investment of 16 percent in 1993, Government investment fell by 31 percent, parastatals investment by 26 percent, and investment by the private sector, excluding traditional dwellings, by a more moderate 3 percent. Even this 3 percent fall is disappointing, because we have done a lot over the recent past to improve the investment climate and are anxious to see the results in a strongly rising trend of private investment. The explanation probably lies in that ethereal factor called confidence. As I shall point out again later, we intend to press on with our reform programme of adding incentives for, and removing impediments to investment, while consolidating economic stability. At the same time, we shall wait for a vote of confidence from the investors - both domestic and foreign. I am confident, Mr. Speaker, that that vote of confidence will come in the very near future.

Turning next to saving, Mr. Speaker, I am happy to report that the ratio of domestic saving to income has gone up steadily over the last few years from 14.6 percent in 1989 to 16.2 percent in 1993. This rise shows clearly that the measures of fiscal and monetary reforms and liberalisation, which we have put in place over the last few years, are bearing fruit in boosting the saving propensities of our people. It has also to be remembered in this context that the period we are looking at was one of decelerating economic growth and high inflation, both of which are factors that normally depress savings.

Mr. Speaker, one final statistic to which I wish to draw your attention in this context is the percentage of domestic investment that has been financed by domestic saving. I am happy to report that this percentage has gone up sharply over the last few years from 59.3 percent in 1989 to 94.2 percent in 1992 and 100.8 percent in 1993. This sharp rise is a reflection of the squeeze on external resources that we have experienced in recent years, especially since 1991. That squeeze forced us to rely increasingly on our own resources for financing investment and growth. The very high 1992 and 1993 percentages were also due in part, to the accumulation of debt ~~serviee~~ arrears, and to the fact that total investment in real terms has gone down substantially over this period.

Balance of Payments

Mr. Speaker, the balance of payments in 1993 showed a very large overall *surplus* of K£ 1563 million (US$ 539 m). Even after removing from this figure the accumulation of external debt service arrears of K£ 279 million (US$ 96 m), there was a substantial surplus of K£1284 million (US 443 m) *on an accrual basis*. This compares with an accrual basis *deficit* of K£433 million incurred in 1992. The current account, *excluding* official grants, also showed significant improvement from a deficit of 4.7 percent of GDP realised in 1992 to a deficit of 1.5 percent in 1993. The main reasons for this favourable outcome were: (i) average volume decline of imports other than oil of about 9 percent, coming on top of sizeable declines in each of the three previous years; (ii) substantial return flows of flight capital estimated to have been around US$ 200 million, and (iii) the unfreezing of external aid funds in the second half of the year, resulting in disbursement of programme loans amounting to about US$ 250 million, most of which came in the fourth quarter of the year.

The overall balance surplus resulted in a substantial addition to foreign exchange reserves. Including foreign assets held by the commercial banks, reserves at the end of 1993 stood at US$ 867 million (K£ 2,118 m.), which was equivalent to nearly 7.5 months of merchandise imports, a level that has not been achieved in recent history.

Mr. Speaker, while the growth in the country's foreign exchange reserves is welcome, the contraction in import volumes, which is one of the reasons for that growth, is worrying. It is worrying since it marked a continuation of the trend of decline which set in 1990. Contrary to popular belief, lack of foreign exchange was not the explanation of low imports. Indeed, the availability of foreign exchange was better for most of last year compared to any other recent year. The real reason was that importers did not want to import due to factors such as : (i) high price of imports resulting from the massive depreciation of the Shilling during the first half of the year; (ii) high cost of bank credit required to finance imports due to sharp rise in interest rates, (iii) low demand for holding stocks of imported materials, due to the liberalisation of the import regime, and (iv) depressed levels of domestic investment and economic activity in general. The extraordinary rise in yield rates on Treasury bills and bonds may also have had the effect of attracting funds that would otherwise have been used to finance imports and productive investment. This, of course, is the familiar proposition that high interest rates depress investment and economic activity. Interest rates are coming down gradually, the exchange rate has stabilised, and there is widespread anticipation of economic recovery and growth. In view of these, I expect a strong recovery in demand for imports during the next couple of years.

Mr. Speaker, the performance of our exports was satisfactory, with the overall volume growth being 11 percent if petroleum products are included, and 17 percent if they are excluded. The quantity of tea exported grew by 16 percent and coffee by 8 percent. Although there was a decline in coffee production, stocks were run down in response to a significant improvement in the price of Kenya coffee by over 20 percent in dollar terms. Mr. Speaker, the best news here is that our exports of *non-traditional manufactured goods* grew in volume by a remarkable 38 percent. This growth compares very well with growth rates of between 10 and 20 percent recorded in recent years, and is particularly gratifying when viewed in the light of the recession that the Kenya economy has been passing through. I need hardly add, Mr. Speaker, that this strong growth of our non-traditional exports is an eloquent testimony that our export promotion measures are bearing fruit.

Mr. Speaker, I would like to draw your attention also to the significant volume growth in tourism in 1993 of about 6 percent. This is a welcome reversal of the trend of decline which started in 1991, when the sector suffered from the impact of the Gulf War. Among the factors that have affected Kenya's tourism adversely in recent years are: (i) the recession in industrial economies, especially in countries of Western Europe; (ii) adverse publicity in the international press on the security situation in Kenya, and (iii) some diversion of tourist traffic to newly emerging destinations in Europe and Africa. I am glad to note, Mr. Speaker, that indications so far in the current year suggest that the recovery experienced in 1993 will be sustained.

Money and Credit

Mr. Speaker, Honourable Members are aware that there was a very rapid growth in money supply during 1992, particularly during the last few months of that year. Indeed, while the growth during the whole of 1992 was 34.6 percent, the growth during the last four months of the year was at an annualised rate of 68.4 percent. A high rate of growth continued for the next four months to April 1993. However, a very tight monetary policy was instituted in March/April 1993 which has been continuing to date. The volume of Treasury bills offered at the weekly auctions was raised from around Ksh.1 billion to Ksh.5 billion, a move which resulted in a steep rise in the discount rate on Treasury bills. A few weak banks and financial institutions were put under statutory management or liquidated by the Central Bank. The overdraft facility at the Central Bank was closed, the interest rate for rediscounts at the Central Bank was linked to the latest discount rate on Treasury bills and the minimum required cash ratio of banks was raised in successive steps from 6 percent in March 1993 to 20 percent in March this year.

Mr. Speaker, as a result of these firm actions, the supply of broad money (M2) *fell* by K£ 235 million during the three months from April to July, 1993, neutralising most of the increase that had taken place earlier in the year. However, the stock of money began growing rapidly again during the following months, due almost exclusively to growth in the net foreign assets of the banking system. Mr. Speaker, as I have already mentioned, much of this build up of reserves of net foreign assets during the last part of 1993 was due to (i) low demand for imports, (ii) disbursement of external resources under the various structural adjustment programmes, and (iii) some return of flight capital due to the very high domestic interest rates. Another contributory factor was some further accumulation of debt-service arrears during 1993.

The growth rate in money supply for the year 1993 as a whole turned out to be 28.1 percent, not significantly lower than the growth rate of 34.6 percent recorded during 1992. However, there is a very significant difference between the two episodes of monetary expansion. The growth in 1992 was due primarily to expansion in bank credit and other *domestic* assets of the banking system. In contrast, the growth during 1993 can be ascribed entirely to the growth in foreign exchange reserves. Indeed, while the growth in money stock over the year was K£ 1,354 million, growth in net foreign assets was K£ 1,411 million. In 1993, there was actually a *decline* in total domestic credit of 1.1 percent. I am also happy to note that within this total, net credit to the Government *declined* by 10.0 percent, while credit to the private sector *increased* by 3.0 percent.

Mr. Speaker, the growth in money supply of over 28 percent during 1993 is worrying, for it will exert the usual upward pressure on prices, notwithstanding the fact that it resulted from accumulation of foreign reserves in the banking system. Monetary policy will therefore need to remain very tight. The level of foreign reserves will begin to come down if, as we expect, the demand for imports picks up during the coming year. Also, as the domestic interest cost in the Budget comes down following the recent decline in Treasury bill rates, it will be possible for credit to Government to shrink even more, which will relieve the pressure on money supply further.

Interest Rates

Mr. Speaker, the most representative short-term interest rate in Kenya is the discount rate on Treasury bills. This rate was 17.1 percent at the end of February 1993. It then began to rise from the third week of March, when the Central Bank increased the weekly sales of Treasury bills to Kenya Shillings 5 billion with a view to mopping up excess liquidity from the financial system. The discount rate rose dramatically to 70.4 percent at the end of July and then began its slow decline in response to increased demand for Treasury bills from both individuals and institutions. By the end of December, the rate had fallen back to 39.3 percent and continued to fall further, reaching 22.6 percent by end of February this year. Mr. Speaker, the rise and fall in the Treasury bill rate has been followed, after some time lag, by other major interest rates in the Kenyan financial system, such as the yield rates on bonds, the inter-bank rates, and the lending and deposit rates in commercial banks. Fortunately, the movements in these other rates were less pronounced, and therefore, did not lead to serious financial instability in the short run.

Price Decontrol

Mr. Speaker, a major plank of our policy of structural adjustment from its inception has been the removal of price controls. The progress in this regard has been more rapid at each stage than was considered possible at the time of setting the respective targets. As recently as in December 1992, there were 130 products still under statutory price control. All these controls have now been removed, including the highly sensitive ones on maize and maize flour. There only remain now general price controls on some categories of petroleum and pharmaceutical products. Members of this House will recall that last year I undertook to clear the remaining controls this fiscal year. Unfortunately, there still remain a couple of logistical problems before I can do this. Hence I shall most probably miss my June 30th deadline. Nevertheless, Mr. Speaker, I can assure Honourable Members that statutory controls on consumer prices, which were once ubiquitous in Kenya, will soon become a relic of the past. Prices will be determined in each case by the forces of supply and demand, so that changes in them may provide the correct signals to guide the decisions of producers and consumers. In the process, the allocation of resources in the economy will move towards a more optimal pattern. Government will, of course, still be able to exert influence on prices that may be considered important from the social welfare viewpoint, through the use of appropriate fiscal and monetary policy instruments.

Mr. Speaker, the Government is aware that a fully liberalised pricing regime may be abused by producers' cartels and monopolies, who may take advantage of the absence of competition and controls to fix prices at unfairly high levels. The Restrictive Trade Practices, Monopolies and Price Control Act has been put on the Statute book to guard against this possibility. The Act is being administered by the Monopolies and Prices Commission which has been restructured in terms of its manpower and other resource requirements for more effective discharge of its responsibilities.

Inflation

Mr. Speaker, the most distressing aspect of the turbulence in the economic sphere which we passed through in 1993 was the rapid escalation of prices. The rate of inflation in 1993 was 46.0 percent, compared to 27.3 percent in 1992. Mr. Speaker, an annual inflation rate of 46.0 percent is indeed excessively high, going by historical experience in Kenya. The major reasons for this sharp acceleration of inflation are, however, well-known. These were first, massive depreciation of the Kenya Shilling; second, rapid growth in money supply; third, fall in agricultural output and stagnation of overall domestic production; fourth, the continuing decline in imports and, finally, rise in unit wage cost of output.

Mr. Speaker, the measure of the annual rate of inflation just mentioned fails to reveal fluctuations in the severity of the inflation problem within the year. These fluctuations may be captured by computing the rate of inflation for shorter periods of time. One such short rate that we are monitoring is the rate of inflation measured over successive three-month periods and expressed as an annual rate, the so called *three-month annualised rate*. This rate, Mr. Speaker, stood at 70 percent in May 1993, rose to 101 percent in June and thereafter began to fall gradually, reaching 16 percent in December, 1993. Honourable Members will recall that during the presentation of the Budget last year, I had mentioned the Government's target of bringing down the three month annualised rate to under 10 percent by December 1993. We did not succeed in getting there, but Honourable Members will agree, I hope, that we were *almost there* when the inflation rate came down from 101 percent in June to 16 percent in December.

Mr. Speaker, the steady decline observed in the inflation rate during the period June to December 1993 did not continue in the new year. In fact, the three-month annualised rate turned up again in January and continued to rise for the next two months. The rapid growth in money supply during the last few months of 1993 was undoubtedly one reason for this resurgence of inflation, but the main reasons were the decontrol of maize meal prices in late December and a steep rise in school fees in January. There were also a rise in vegetable, milk and meat prices on account of the unusual dry spell experienced during the first few months of 1994.

I am glad to report, Mr. Speaker, that these forces which were responsible for this short-lived acceleration of inflation appear to have largely spent themselves. There has been significant deceleration of inflation during April and May with the 3-month annualised rate coming down to 18.8 percent at the end of May. Mr. Speaker, this quick turn-around in the rate of inflation encourages us to believe that we are gaining ground in our fight. Indeed, we are setting ourselves a new target of bringing the 3-month annualised rate down to one digit level by the end of this year.

External Debt and Re-organization of the Arrears

Mr. Speaker, I now turn to the issue of our external debt and the recent understanding reached with the donors in regard to clearance of the accumulated arrears. As at the end of 1993, Kenya's outstanding external debt stood at the equivalent of US$ 5,614 million. At the exchange rate prevailing at the time, this amounted to K£ 19,133 million. About 88 percent of this total debt was medium and long term debt to the public sector comprising of the Central and Local Government, the Central Bank and the Parastatals. The rest was private and short term debt.

Mr. Speaker, while the stock of our external debt has gone up rapidly in Kenya currency terms due to the depreciation of the Shilling, it has not changed much in terms of foreign currency. Thus, the total stock of debt in terms of US dollars was $ 5,697 million at the end of 1989, which was somewhat higher than the stock at the end of 1993. Moreover, the quality of the debt portfolio has improved remarkably in the recent past, because the average terms of new commitments have improved steadily since 1988. The average interest rate has dropped from 4.4 percent in 1988 to 0.7 percent in 1993, the maturity period has increased from 22 years to 39 years and the grace period has also increased from 6.8 years to 9.8 years over this period.

Mr. Speaker, although in the past Kenya has had a good record of servicing its debt on schedule, we started accumulating arrears following the complete freezing of quick disbursing aid flows in November, 1991. As at the end of 1991 the debt service arrears amounted to K£ 300 million or US$ 210 million. In 1992, the arrears continued to rise and by the end of that year stood at US$ 465 million. We also accumulated arrears of current payment obligations of US$ 90 million during 1992. In June 1993 the arrears reached a peak level of some US $ 720 million. To avoid erosion of Kenya's credit worthiness in the international financial markets, it was decided at that time to clear the arrears through multilateral re-organisation arrangements.

Mr. Speaker, as Hon. Members are aware, a meeting of Paris Club creditors was held in Paris in January, 1994 in which the creditors agreed to schedule our debt service payments over an 8 year period, including one year grace period and 7 years' repayment period starting in 1995. The repayment in 1995 will be 5 percent; this will rise gradually to 25 percent in the year 2001. In total we were able to refinance US$ 564 million with bilateral creditors through the Paris Club. In the consolidation of the arrears, the Kenya Government assumed responsibility for payment of all the arrears owed by the parastatals estimated at US$ 188 million. In turn, the Government will enter into on-lending agreements with the parastatals for repayment of these funds over an agreed period, at the prevailing market interest rates, together with a guarantee fee of 2 percent.

Mr. Speaker, as I have mentioned already, the arrears are a new phenomenon in the Kenyan situation and one which we deeply regret. It should be noted that the *scheduling* we have agreed with the donors is just that, namely scheduling; we have not asked for any debt write-off or specially concessional interest rates. We have also agreed to be current in respect of all debt service obligations falling due from the beginning of 1994. A special committee consisting of members of the Treasury and the Central Bank has been set up to ensure that no fresh arrears are accumulated. We have met obligations to date this year and commit ourselves to continuing to do so. It is also worth noting that our total external debt obligations, including the *arrears*, have not gone up since 1991.

POLICY FRAMEWORK

Mr. Speaker, I shall now turn to the policy framework. The Seventh Development Plan for the period 1994 to 1996 was published in December last year. In addition, the Government will shortly put out a Sessional Paper on "*Recovery and Sustainable Development to the year 2010*", which will provide another outline of Government policy designed to address the problems of economic recovery in the immediate future and sustainable development in the long run. In view of these, I shall be brief in my own Statement, and dwell mainly on policies which focus on the relatively short-term issues of economic management.

Mr. Speaker, my Budget message last year was drafted around the theme of *Economic Recovery through Fiscal and Monetary Discipline*. Looking back at the year that is coming to a close, I feel that we have been able to re-establish a large measure of discipline in fiscal and monetary management. However, there is a need for more to be done in this regard. Moreover, economic *recovery* as measured in terms of moderately high rates of growth of investment, output and employment is yet to begin after the prolonged downturn experienced since 1989. I have decided, therefore, to stick to the same theme for this Budget message, signifying that there is unfinished business here. Through the coming fiscal year, we shall strive to create a conducive environment for economic recovery through further tightening of discipline in economic management.

Fiscal Policy

Mr. Speaker, I shall begin with fiscal policy which naturally lies at the heart of a Budget message. The central objective of Government fiscal policy will remain the same as it has been during the last few years, namely that of bringing down the deficit as a proportion of GDP, with the aim of eliminating it entirely in the near future. This will be done by acting on both blades of the fiscal scissors, namely by raising revenue and by compressing expenditure. As has been stated before, the emphasis will be placed on the second of these, namely reducing Government expenditure.

Mr. Speaker, a high budget deficit, especially when it is financed through domestic borrowing, creates undesirable pressure on many things, i.e. on domestic prices, on interest rates, on balance of payments and on the exchange rate. At the micro level, the allocation of resources tend to be distorted and the confidence of the private sector eroded. Mr. Speaker, if all these evils emanate from a high budget deficit, who will not agree that it should be controlled and eliminated? It is also commonly accepted that economic resources are in general utilised more productively by the private sector. For this reason, when reducing the deficit, it is better to do it by reducing Government expenditure.

Mr. Speaker, our efforts to limit Government expenditure and deficit within targets set at the time of the Budget have been frustrated repeatedly in recent years. For the fiscal year 1992/93, for example, we had started with a deficit target of K£ 283.6 million in the Budget and ended with a deficit on commitment basis of K£ 1,442.8 million, which was more than five times the planned level. For the current year again, the deficit target announced in the Budget was K£ 456.8 million, whereas we are now looking at a revised estimate of around K£ 1,200 million. Mr. Speaker, escalation of the deficit of this order has tended to erode the credibility of the Government's fiscal targets.

I would like to take a couple of minutes to explain *why* the deficit exploded in 1992/93 and is threatening to have done so again during the current year. As I have mentioned before, the critical problem of economic management that we had to grapple with in the early part of 1993 was the excessive growth in money supply and rapid acceleration of inflation which could not be foreseen in June 1992 when the 1992/93 Budget was presented in this august House. Real interest rates had become deeply negative which discouraged savings, distorted resource allocation and aggravated the problem of capital flight. These, together with the continuing embargo on donor assistance, put excessive pressure on the exchange rate. To contend with a situation that had assumed crisis proportions, the Government has taken the short-term crisis management measures which have been noted already: namely, a very high volume of Treasury bill sales at very high discount rates and massive adjustment of the exchange rate.

Mr. Speaker, the rise in interest rates and depreciation of the Shilling naturally had the effect of blowing up Government's expenditure commitments in the 1992/93 Budget. The domestic interest bill went up from K£ 567 million estimated in June 1992, to K£ 1,266 million, that is a K£ 699 million excess. The foreign interest bill rose from the estimate of K£ 266 million to K£ 455 million due to the depreciation of the Shilling. The Ministry of Foreign Affairs and International Co-operation had to incur an excess expenditure of K£ 27 million, because many of its expenditure commitments are fixed in foreign currency terms. The Central Bank of Kenya made substantial losses in its operations during 1992/93. Government, as the only shareholder, had to meet K£ 150 million of these losses through allocation from the Budget. Finally, a decision was made to make a capital injection of K£ 100 million into the National Bank of Kenya, the financial position of which was also weakened seriously by bad loans. Mr. Speaker, these items of extra expenditure which are all related to the financial crisis of late 1992 and early 1993, add up to K£ 1,165 million, which compares with the K£ 1,159 million by which the 1992/93 deficit exceeded the initial target. There were other areas where actual expenditure exceeded the Budget estimates such as the increased allocation made to cover the expenses of the 1992 General Election, to maintain security in the face of the large influx of refugees from neighbouring countries and expenses of Kenya's participation in UN peace-keeping operations in Europe. These were accommodated within the initial deficit targets mainly by raising additional revenue through new measures and to a lesser extent, by cutting down other expenditure.

Turning to the current year, Mr. Speaker, the deficit is likely to exceed the Budget target by about K£ 740 million, whereas the revised estimate of the domestic interest payment exceeds the original Budget estimate by K£ 1,090 million.

Mr. Speaker, I took some time to explain the reasons for the overshooting of the deficit targets to underline the point that *it was not a result of lack of fiscal discipline either now or in the recent past*. Indeed, in regard to other elements of the Budget, the Government has been able to put its fiscal house in order. The performance of Revenue Departments is satisfactory and has been improving over time. The implementation of the Budget in all its aspects is being monitored continually, looking for early warnings about disquieting trends and the need for corrective policy action. A tight lid has been put on expenditure other than debt service payments. If anything, the lid will be tightened even further in the coming year. Mr. Speaker, beginning with this coming fiscal year 1994/95, the Treasury will issue monthly expenditure ceilings for the Recurrent Estimates of all Ministries two weeks before the beginning of each month. For the Development Estimates, such expenditure ceilings will be issued on a quarterly basis. The Ministries will be required to stay within these ceilings in issuing cheques and to the extent possible, also in incurring expenditure commitments. Computer linkage between the Central Bank and the Paymaster General's office in Treasury has been established with a view to monitoring the cash balances of Ministries on a daily basis. In every case when the cash balances of a Ministry fall below authorised limits, the Accounting Officer concerned will be required to furnish an explanation. Disciplinary action will be instituted against Accounting Officers whose explanation is found to be unsatisfactory, especially when there is a recurrence of such overdrawing for the second time within the same financial year.

Mr. Speaker, as I have already mentioned, the central objective of fiscal policy will be to reduce the Budget deficit. Our target is to eliminate the deficit completely by the next fiscal year 1995/96. The other objective is to reduce domestic borrowing for budgetary financing. Indeed, our policy aim is to make net *repayments* to the domestic economy starting from the coming fiscal year, so that more resources can be left at the disposal of the private sector households and entrepreneurs. I do believe that these targets are realistic, barring any pressures arising from the area of debt service or any emergency in the domestic or international situation calling for substantial additional expenditure.

Mr. Speaker, in the area of revenue, our aim in the medium term will be to maintain total revenue as a proportion of GDP at about 24 percent. The tax system will continue to be reviewed and adjusted to secure greater efficiency and equity in tax administration. The aim continues to be to reduce the rates of taxation, while maintaining the overall collection target through wider coverage and improvement in the collection machinery. Tariffs, in particular, will be reduced further with a view to making steady progress towards freer trade. Finally, the system of taxation will incorporate incentives for household and corporate savings, domestic and foreign investment and intra-regional trade.

On the side of expenditure, Mr. Speaker, the main objectives of Government policy will be to (i) increase the share of operations and maintenance (O&M) expenditure in the Recurrent Budget, as well as the share of development expenditure in total budgetary allocations;
(ii) continue the process of reviewing the project portfolio towards the goal of directing 75 percent of total expenditure to core Government functions. These functions are maintenance of law and order, administration of justice, provision of infrastructure and basic health and education services and preservation of the environment.

A major macro level objective is to reduce progressively Government expenditure as a proportion of GDP to around 26 percent. In the short-run, expenditure is expected to come down mainly through a fall in domestic debt service charges, which in turn will result from (i) the fall in interest rates on Treasury bills and other Government paper; (ii) debt management policies aimed at lengthening the maturity structure of domestic debt and (iii) a fall in the total stock of debt due to net *repayments* to the domestic economy. In the longer run, budgetary savings are to be realised from progress made in the areas of civil service reform and reform of the parastatals sector. I shall now turn briefly to these areas.

Civil Service Reform

Mr. Speaker, as Honourable Members are aware, a Civil Service Reform Programme and Action Plan has been adopted by Government. A Civil Service Reform Secretariat has been established in the Office of the President to implement the programme. The objective of the programme is a comprehensive reform and rationalisation of the Civil Service with a view to improving its productivity, and in the longer run, reducing the personnel cost of delivery of Government services. Under the programme, the size of the Civil Service is to be reduced by 16,000 positions every year for the three years 1994/95 to 1996/97, of which 10,000 are expected to be reduced through a scheme of voluntary retirement for members of job groups A to G, and 6,000 through non-replacement of retirees. The voluntary retirees are being paid lump-sum cash benefits or separation packages, and also pensions where applicable. A sum of K£ 48.0 million was spent for this purpose in the current 1993/94 Budget. A further sum of K£ 85.2 million has been allocated in the Budget for 1994/95. Since the inception of the programme, the target group has responded very well and projections indicate that the target levels of reduction of the civil service will be realised. Payment for the first group of retirees has already been effected and training of the retirees to enable them to undertake income generating activities is also on-going.

Mr. Speaker, although the retrenchment aspect of Civil Service Reform has received most publicity, there are other equally important aspects of the programme which should not be missed. One of these is the reform of civil service salaries. This will involve enhancement of salaries to improve morale and to attract and retain competent staff in the Service. There is provision also for monetization of non-cash benefits to reduce inequities between housed and non-housed staff and to increase transparency. A code of ethics will be developed for civil servants including increased financial accountability and clear rules governing conflict of interest. The programme will also include in the short-run a plan for intensified training of officers in the techniques of key policy analysis, which will be important in the current environment of accelerated structural changes in the economy.

Mr. Speaker, because of the above expenditures, I do not expect any *net* saving from the Civil Service Reform programme until at the end of 3 to 4 years from now when the programme has been well entrenched. The major benefit in the meanwhile will be a leaner and more productive Civil Service, endowed with strengthened analytical and policy making capability and more able to deliver flexible and responsive management.

Parastatal Reform

Mr. Speaker, Honourable Members are well aware of the adverse impact that inefficient operations of parastatals have had on fiscal stability in this country. It is estimated that direct and indirect subsidies provided to the parastatal sector from the Budget have reached a level of 5.5 percent of GDP. Moreover, the parastatal sector uses resources with below normal productivity, whereas to generate employment and raise income levels, we need to raise both the level of productivity of capital, and the level of investment. Increasing productivity in the parastatal sector, and expanding opportunities for private investors in areas so far monopolised by parastatals, are therefore important objectives of the programme of parastatal reform. Mr. Speaker, the privatisation of non-strategic parastatals has proceeded well so far. A total of 22 will be privatised by end of this month and 32 by end of September, 1994. This process will now be intensified. To ensure full transparency, all sales will be advertised and the outcome of the sales will be published. In regard to the strategic parastatals, various pieces of legislation will be tabled in the course of this fiscal year.

Firstly, the aim of the legislation will be to facilitate participation of the private sector in electrical power generation. Power generation will require an investment of approximately 1 billion US dollars by the year 2000, and the Government will need to supplement its resources by encouraging private sector participation. The proposed legislation will also facilitate separation and re-organization of assets in the power sector into three groups of generation, transmission and distribution functions, and enable a regulatory body to set tariffs at each step.

A second aim is to improve the efficiency of the postal and telecommunications systems. A Ministerial Order has already been issued separating the postal and telecommunications operations of the Kenya Post and Telecommunications Corporation (KPTC). Appropriate legislation to formally divide the KPTC into two entities will be tabled in Parliament in the course of this financial year. The Ministry of Transport and Communications has already approved a plan for divesting certain telecommunications functions. A programme for such divestiture is being drawn up by the KPTC.

A third aim is to improve transport services. To this end, various activities currently performed by Kenya Railways and the Kenya Ports Authority will be opened up for private sector participation:

Mr. Speaker, I am today tabling the State Corporation (Amendment) Bill, 1994 to make changes to the Corporate Governance System, as I had promised in my last Budget Speech. The Corporate Governance system aims at strengthening the autonomy of Boards and management of parastatals and will also help to enforce accountability for performance, or lack of it. These amendments will also pave the way for the recruitment, appointment and dismissal of Board Members and Chief Executives through a professionally managed process and develop appropriate tariff policies including automatic tariff review mechanisms.

The Government is also reviewing the role of Development Finance Institutions with a view to withdrawing exposure to lending. Their role, henceforth, will be to act as a facilitator for private sector investments.

Mr. Speaker, I have already noted before that when parastatals fail to meet debt service obligations in respect of *guaranteed* debt, the Government will pay on their behalf. However, the parastatals will, in such cases, be required to enter into explicit loan agreements with the Government, undertaking to repay these sums *with interest* over an agreed period. I am also today initiating the closure of the Exchange Risk Assumption Fund. Mr. Speaker, the exchange rate is now fully market determined and finance institutions and other corporations in the country should be sophisticated enough to take any perceived exchange risks fully into account in planning their external borrowing.

Monetary Policy

Mr. Speaker, I now turn to monetary policy. The principal goals of monetary policy everywhere are the maintenance of a stable price level and a stable exchange rate. These are sought to be achieved through the management of liquidity in the domestic economy and the maintenance of an appropriate balance between inflation and interest rates. Mr. Speaker, Honourable Members are aware that in the new liberalised financial system in Kenya, the Central Bank no longer fixes interest rates administratively as it used to, nor does it control liquidity by fixing credit ceilings for commercial banks. It seeks to control these indirectly through the use of traditional monetary policy instruments such as the cash ratio, discount rates and open market operations. In this new environment it is all the more necessary for the monetary authorities to maintain discipline in the financial system so that banks and non-bank institutions always respect the various statutory requirements and other prudential guidelines. Mr. Speaker, the Government will attach the highest priority to the task of re-establishing discipline in the financial system through continuous monitoring of performance criteria, imposition of stiff penalties for non-compliance and management take-over or liquidation of chronically ailing institutions.

Mr. Speaker, as I have already mentioned, money supply grew at the rate of 28.1 percent in 1993, much in excess of the target rate of 16.6 percent. This growth took place despite monetary stringency characterised by high cash ratios, large volumes of Treasury bill sales in weekly auctions, discontinuation of overdraft facilities at the Central Bank and very high rates charged on rediscounts of eligible securities. The main reason for the expansion was a rapid build up of foreign exchange in the Central Bank's coffers. The economy is expected to recover with the return of more normal rainfall, unfreezing of donor assistance and the measures put in place to encourage investment and exports. With economic recovery, demand for imports will also recover, and the pressure on money supply arising from the build up of foreign exchange reserves will ease. Meanwhile, the exchange rate will be managed flexibly through selective intervention by the Central Bank in the inter-bank market for foreign exchange.

Mr. Speaker, the overall stance of monetary policy will continue to be restrictive as long as inflationary pressures remain active in the economy. The cost of rediscounting at the Central Bank will be raised further to discourage access to this facility by the commercial banks. The commercial banks and their affiliated financial institutions will also be required to meet the statutory cash and liquidity ratios on a consolidated basis. Open market operations will be continued on a large scale to mop up excess liquidity from the financial system. The Central Bank will take various measures to increase the breadth of the market for Treasury bills and bonds, including development of secondary trading, publicity campaigns, and further reduction in the minimum value of bills that can be purchased. Debt management policies will aim at increasing the share of longer maturity paper in the total portfolio, thus siphoning off excess liquidity from the system for a longer period.

Financial Sector Reform

Mr. Speaker, the Government will take further measures towards improving the soundness of the financial system. The balance sheets and profit and loss accounts of institutions will be monitored by the Central Bank continuously with a view to detecting weaknesses sufficiently early, and taking preventive action to forestall a crisis. The character, performance record and qualifications of the directors will be assessed periodically to ensure that public money is safe under their management. Renewal of licences for existing institutions will not be automatic, but subject to certification from the Central Bank that the management of the institution meets all criteria established under the Banking Act. The financial year of every institution shall be the period of twelve months ending on 31st December of each year. The minimum capital requirement for mortgage finance companies will be enhanced in view of the escalation of construction costs. Further, the minimum assigned capital for institutions incorporated outside Kenya will also be raised to ensure consistency with capital requirements of local institutions. Mr. Speaker, I am today tabling a Bill seeking to amend various provisions of the Banking Act with these purposes in view.

Mr. Speaker, the reform of the financial sector will include divesting Government's share-holding in some major institutions like the National Bank of Kenya. Honourable Members are aware that the National Bank has regained its financial health, enabling it to give a dividend cheque this year to Government for the first time since its inception. Shares of the National Bank will soon be offered for sale to the public through the Stock Exchange. Mr. Speaker, an actuarial study of the financial position of the National Social Security Fund has been completed. I am happy to report that the Actuaries have concluded that the Fund is at present in a sound financial position. The NSSF is not re-investing maturing funds deposited in commercial banks but investing them in Treasury securities.

Mr. Speaker, as a further step in the process of liberalisation of the foreign exchange regime, non-bank financial institutions will now be allowed to trade in foreign exchange. The modalities for licensing other institutions to operate foreign exchange bureaux for purposes of buying and selling foreign currency only are also being worked out for implementation in the near future. These bureaux will cater to the needs of small users and receivers of foreign exchange and help in enhancing competition in the market as well as creating additional employment. These institutions will operate under the overall guidance and supervision of the Central Bank.

Development of the Capital Market

Mr. Speaker, it is impossible to over-emphasize the point that economic growth and development are critically dependent on high rates of saving and investment. A well-diversified and vibrant capital market is immensely beneficial in boosting saving and investment rates in the economy. Mr. Speaker, a substantial amount of groundwork has been laid in this regard since the establishment of the Capital Markets Authority. Among other things, the Authority has streamlined the procedure for issuing corporate securities to the public and enhanced efficiency and transparency in the trading of securities at the Nairobi Stock Exchange through the "Open Outcry" continuous auction system. The variety of securities traded as well as the total turnover has also improved over the last few years. However, the development of the capital market needs to be pushed further forward to mobilise saving; more efficiently for investors.

Mr. Speaker, the framework under which the Nairobi Stock Exchange operates, as presently constituted, is still unsatisfactory despite the improvements already implemented by the Capital Markets Authority. First, the Stock Exchange is incorporated as a private limited company by shares although it is not expected to distribute profit to its members. Secondly, the number of operating stock brokerage houses has hitherto remained static at six for more than 30 years. Thirdly, the stockbrokerage service is concentrated in Nairobi without adequate regional representation. It is unable therefore to provide a fair distribution of shares throughout the country.

Mr. Speaker, I now table amendments to the Capital Markets Authority Act in order to redress these structural weaknesses in the operating framework of the Exchange and to enhance the regulatory oversight of the Authority. These amendments will enable a fair and orderly progression appropriate for our present state of development. The amendments will also ensure the independence of the Stock Exchange and facilitate a workable, self-regulatory framework.

Following these amendments, Mr. Speaker, I expect to see immediately an increased number of licensed brokers in the market. The CMA will continue to ensure compliance with the established regulatory framework and impose penalties on any violations in order to maintain the integrity and confidence of the market.

I shall further review the possibility and extent of participation in the Stock Exchange of banks and other financial institutions, including foreign brokers.

Mr. Speaker, the objectives of the proposed changes are three fold: Firstly, it is designed to create an enabling environment for efficient, market based, financial intermediation. Secondly, it is to improve the legal and regulatory framework for a sound financial market. Finally, I want to ensure that any company wishing to raise capital will have easy access to the capital market and that all investors will have equal access to an efficiently functioning stock market. It is absolutely essential to our privatisation programme that as many Kenyans as possible have the opportunity to participate in the process.

Insurance

Mr. Speaker, an efficient insurance industry is another essential component of a healthy and growing financial system. With this in mind, I am today tabling an Amendment Bill to the Insurance Act with a view to enhancing the supervisory role of the Commissioner of Insurance on the entire insurance industry, while at the same time liberalising the investment environment for the companies and protecting the interests of policy holders. Under the provisions of the Amendment, the Commissioner will be empowered to carry out direct inspections on insurance and reinsurance companies and to monitor closely the operations of insurance brokers. The Bill will introduce measures to strengthen the financial base of insurers and re-insurers, and relate the volume of business to be handled by them to their paid-up capital. The minimum paid-up capital for insurers will be Kshs 50 million and for re-insurers Kshs 500 million. Existing companies will be allowed a transition period to raise their paid-up capital to these minimum levels, which will be two years for insurance companies and three years for re-insurance companies. The Commissioner will also be mandated to appoint managers to take over insolvent and illiquid companies.

Mr. Speaker, the proposed Amendment Bill also liberalises regulations relating to the investment of the assets of insurance companies, taking into account considerations of security, liquidity, yield and diversification. Control of the Kenya Reinsurance Corporation by the Commissioner will be enhanced through the introduction of registration. The 25 percent mandatory cess on direct insurance business, which the Kenya Reinsurance Corporation receives under the provisions of the Insurance Act, will be phased out over a period of four years. The Bill also proposes to tighten up claims settlement by insurance companies to ensure that companies meet their obligations to the policy holders without undue delay. The Government will study the modalities of setting up a Motor Vehicles Accidents Fund for the purpose of paying compensation on injuries and death to human beings arising out of road motor accidents.

Employment and Wages Policy

Mr. Speaker, the most visible benefit of sustained and high economic growth is rapidly expanding employment opportunities and rising living standards of the people. In Kenya, we have considerable ground to cover before reaching such a stage in our development. Between 16 and 20 percent of the urban labour force is estimated to be unemployed at present, and the living standard of the average Kenyan has been falling in recent years. For the first time in five years, there was a marginal rise of about 0.6 percent in per capita real income in 1993, *thanks to some improvement in the country's external terms of trade*. However, it was negligible compared to the 14 percent decline that occurred from 1988 to 1992.

Mr. Speaker, recent projections suggest that the Kenyan economy needs to create around 450,000 additional jobs per year to accommodate all the new entrants to the labour force. Most of these jobs will need to be created in small-scale agriculture and in rural and urban informal sectors, which together account for over 80 percent of total employment in the economy and over 90 percent of growth in employment from one year to another. The Government's role will be to create a conducive environment of regulations and other policies to maximise the potential for employment growth. All policies aimed at raising the rate of economic growth on a sustainable basis are indeed policies for generating higher employment. Our policy of fighting inflation is also conducive to employment generation since inflation erodes the workers' purchasing power and thus reduces effective demand and hence growth of output, investment and employment. Export promotion is also central to employment generation since our exports draw heavily upon labour intensive products of the agricultural and horticultural sectors.

Mr. Speaker, the small and micro-enterprises which make up the rural and urban non-agricultural informal sectors are expected to be the most dynamic sectors in creating additional employment. Within the overall policy framework, therefore, particular attention will be given to investment in rural infrastructure, simplification of licences and regulations impeding growth of small and micro enterprises, and provision of land and title deeds to these latter enterprises which will also assist them in obtaining adequate credit from established financial institutions.

Mr. Speaker, the framework of regulations governing various aspects of industrial relations in Kenya such as wage bargaining, redundancies, benefits and working hours has been generally successful in maintaining industrial harmony through orderly settlement of disputes. As part of this framework, a set of Guidelines for the determination of wage awards have been issued periodically to the Industrial Court with the objectives, among others, of promotion of employment, control of inflation and equitable distribution of income as between industries and sectors and as between rural and urban areas. In the new liberalised industrial environment, it is considered desirable, as indeed was promised by my colleague the Honourable Minister for Labour and Manpower Development in his May Day speech, to take a fresh look at these Guidelines to check that they do not hinder the working of market forces in the determination of employment and wages by factors such as profitability and growth potential of an industry, skill and productivity of workers, and basic human needs. Mr. Speaker, I have today issued an amended set of Guidelines to the Industrial Court, which seek to simplify the older Guidelines and allow greater room for the play of market forces in the determination of wages. As a parallel measure, I am also proposing amendments to the Trade Disputes Act and the Employment Act with a view to allowing greater freedom to firms in declaring redundancies, *subject to adequate severance allowances.*

External Sector Policies

Mr. Speaker, sustained and rapid growth of international trade has been the most important single factor behind the remarkable growth of the world economy since the end of the Second World War. Growth of international trade has been particularly critical for small open economies like those of the Asian tigers. Mr. Speaker, Kenya belongs to that same class of economies which are small and highly open to international trade. It is no exaggeration to state that a sustained high rate of expansion of international trade is the *sine qua non* of rapid growth and development in Kenya.

Mr. Speaker, in recognition of this, over the last few years, we have introduced wide-ranging policy reforms aimed at freeing up international trade -- removing laws, regulations and procedures that restricted imports and discouraged exports. Import licensing has been abolished, tariff rates have been rationalised and reduced progressively, the exchange rate has been made freely determined by market forces and all those who earn foreign exchange through trade in goods and services have been allowed to keep 100 percent of their earnings. Exchange controls on current account transactions had been removed earlier in February this year. More recently, in the last week of May, all remaining exchange controls on capital account transactions have also been abolished through an Exchange Control (Exemptions) Order under the Exchange Control Act. The only remaining restrictions are on investment by foreigners in shares and securities in Kenya. Even these will be removed in the near future once appropriate legal provisions governing these transactions are ready to be put in place. Mr. Speaker, these are very far-reaching reforms. I also wish to assure Honourable Members that we shall deepen and strengthen the reforms in the coming months and years.

Export Promotion

Mr. Speaker, I would like to add a few remarks on our export promotion efforts. I have just mentioned that we have liberalised imports and will soon remove all restrictions on capital payments also. In this new liberalised environment, we anticipate and indeed welcome strong growth in imports of goods and services, to support growing investment and income generation. However, we must also plan for an even higher and sustainable growth in export earnings, to be able to meet our growing import bills and to reduce progressively our dependence on foreign aid to cover deficits in our balance of payments. Mr. Speaker, I am happy to report that Government policies in the area of export promotion have been bearing fruit, as evidenced by the export data I have already referred to. This growth of exports has been very encouraging, as it was achieved during a period in which the economy has been otherwise very depressed.

Mr. Speaker, on the institutional side, the Export Promotion Council which was established by H.E. the President two years ago, is now registered under the Companies Act with the well-identified objective of assisting in overcoming bottlenecks affecting export performance and promoting an export culture as the way of ensuring stable long term growth. Among the new measures which are being incorporated into this Budget, a new pre-shipment inspection contract for imports has been finalised with three international companies which came into operation on 1st May, 1994. This will not only improve revenue collection, but will provide even better quality and value assurance to importers.

Mr. Speaker, we have recently abolished export licensing requirements for all agricultural products. In addition, I am abolishing all export duties today. Hon. Members will be aware that the Export Promotion Programmes Office (EPPO) administers the various programmes of remission of duty and VAT on imports for approved purposes, especially for the production of exports. I am pleased to announce that the staffing and resources of EPPO will be substantially increased and upgraded. In addition, the Government will contract out the duty/VAT reconciliation and export inspection work under the EPPO and MUB programmes. This will remove a major administrative bottleneck which is adversely affecting the cash flow position of many companies seeking cancellation of the bonds taken out as security for unpaid duties and VAT. This contract will be awarded to the pre-shipment inspection companies and will come into effect at the beginning of the next financial year.

Mr. Speaker, I am aware that a major constraint affecting the ability of our exporters, particularly our non-traditional exporters, to compete abroad has been the difficulty in obtaining short-term export finance on moderate terms. Hon. Members will be aware that such finance is usually required for one to six months both for importing materials so as to produce the export product and grant credit terms to customers abroad. While the experience of the Government in directly facilitating such pre-shipment and post-shipment credits in the past has not been altogether a happy one, it is clear that the provision of such credits by the private financial sector under the present regulatory framework, has been less than adequate to meet the demand. I have therefore provided some incentives in this Budget to encourage the growth of short term finance through the removal of Stamp Duty from promissory notes and bills of exchange.

Mr. Speaker, the availability of export finance also depends to a large extent on the availability of export insurance. At present, our export insurance services are constrained both by the restrictions placed on their ability to effect insurance denominated in foreign exchange and on the distribution of their assets, both as between Government and commercial securities on the one hand and as between Kenyan and foreign investments on the other. The relevant restrictions will also be relaxed in the amendments to the Insurance Act which I have already mentioned.

Mr. Speaker, I am also introducing regulations to make effective the zero rating of sales from domestic suppliers to MUB manufacturers to obviate the need for input VAT refunds and to encourage their use of domestically available materials.

Mr. Speaker, Hon. Members are aware that the Kenya Exporter Assistance Scheme has been in operation for over two years now. In that time, it has made a large number of small grants to assist exporting companies on a 50 percent reimbursement basis. I had informed this House last year that the scheme was achieving 14 dollars by way of export earnings for every dollar of grant. This figure has now gone up to 42 dollars for every one dollar granted. Mr. Speaker, agreement has now been reached on sufficient replenishment of funds for this scheme to continue for another 12 months. The other similar project in this area, namely, the Kenya Export Development Support (KEDS) project, also has a firm level support component and I am pleased to announce that this component is now fully operational. All serious exporters should approach the KEDS office to assess their eligibility and where possible to take advantage of these support funds available on a 50 percent reimbursable basis.

Promotion of Regional Trade

Mr. Speaker, another objective of Government policy in the external sector is to encourage the growth of regional trade. As Honourable Members are aware, Kenya is a founder member of the Preferential Trade Area (PTA) and is an active participant in various PTA fora and programmes. The objective of the organisation is to encourage the growth of regional trade through progressive reduction in tariffs, removal of non-tariff barriers and harmonisation of fiscal and monetary policies. Implementation of these plans is not equally advanced in all member states, but significant progress has been achieved to date.

Mr. Speaker, the most important new initiative taken in this area during the last year was the signing of the Treaty establishing the Common Market for Eastern and Southern Africa (COMESA) in November 1993. The Treaty, when it comes into full effect, will transform the PTA into a common market. Progressive co-operation under COMESA will entail action on the following basic elements: the development of free trade arrangements including the free movement of goods and services produced within the Common Market; the establishment of common external tariffs; closer harmonisation of macro-economic policies; and the eventual liberalisation of capital movement and immigration.

Mr. Speaker, COMESA offers new opportunities for sustained growth and development for this region. With an estimated population of 270 million people and a GDP of US$ 120 billion, it promises a wider, harmonised and more competitive market, necessary to support new and expanded production and distribution of goods and services. The resultant benefits will be greater industrial productivity and competitiveness, increased agricultural production and food security, and cheaper and reliable transport and communication infrastructure.

Mr. Speaker, Hon. Members are aware of the Agreement on East African Co-operation which was signed by the three Heads of State in Arusha, late last year. In this context, I take particular pleasure in noting the very high level of co-operation shown by all parties towards the re-establishment of the East African Community. It is our wish that the reborn Community will set the pace within COMESA for the liberalisation of cross-border trade and investment. I may also remind Hon. Members that for the first time for many years, the Budget Statements for all our three States are being presented to their respective Parliaments on the same day.

Promotion of Investment

Mr. Speaker, our hope is that all these policies of export promotion and promotion of regional economic co-operation will attract substantial amounts of investment in the export sector; in that sense these are also policies for promotion of investment. But we are waiting for a strong revival of investment, both domestic and foreign, not just in the export sector, but in all other sectors of the economy - agriculture, industry, tourism, infrastructure, power, finance and social services. Direct foreign investment is particularly important for maintaining a healthy capital account in the balance of payments, while not increasing the external debt burden of the country. Mr. Speaker, there is an urgent need to reduce our dependency on donor aid, which in any case has been shrinking over the recent past with recession in industrial countries and the emergence of new claimants to the available funds.

The Government is keenly aware of the crucial role of investment in driving the process of growth and development. This was demonstrated through the International Conference on Investment in Kenya which was held last month, thanks to the personal initiative and encouragement of His Excellency the President. As Hon. Members will recall, the Conference was very well attended by local and foreign investors, and was welcomed as the beginning of a process of comprehensive and critical dialogue between the Government and the private sector.

Mr. Speaker, there was general agreement among the participants in the Conference that far reaching policy changes have taken place within the last year to make investment propositions in Kenya much more attractive than before. While we were encouraged by this assessment, we are aware that more can be done to improve the environment for investments. A number of policy changes have already been announced since the end of the Conference, a very important one being the virtual abolition of exchange controls on inward and outward investments. This has made some provisions of the Foreign Investment Protection Act (FIPA) redundant, and I am today, presenting amendments to those provisions. I wish to assure Honourable Members that we shall press ahead with consolidation and introduction of further reforms, many of which I have already mentioned today. At the risk of some repetition, may I indicate the major areas of policy reform for investment promotion that we shall concentrate on. These are:

- Maintenance of macroeconomic stability;
- Steady progress towards free multi-lateral trade, through further reduction in tariff rates and removal of licensing requirements;
- Complete removal of exchange controls;
- Reallocation of Government expenditure towards improvement of infrastructure, including roads, telecommunications, and strengthening of basic education and health services;
- Additional fiscal incentives for saving and investment;
- Expansion of regional co-operation through COMESA and other initiatives, to make Nairobi the hub of a large regional market; and,

Maintenance of the rule of law and good governance, where the fundamental freedoms of speech, press and assembly are respected and protected for everybody.

Mr. Speaker, as I mentioned before, we realise that the single most important factor affecting investment decisions is *confidence* - mainly confidence in long-term economic and political stability of the country in which investors are planning to stake their fortunes. Policies must be conducive and widely appreciated to be so; and they should be implemented in a just and transparent manner. Investors must also have confidence that there is sufficiently strong commitment and national consensus on the policy framework, so that even if there is change in Government through a democratic process, the main direction of policy will not be reversed. Mr. Speaker, the basis for such confidence *does exist* in Kenya today. Perhaps the investor community needs some more time to be convinced. They want to 'wait and see'. We shall also be waiting. The famous economist Keynes said that venturing into long-term productive investment is more a matter of *animal spirit* than one of cold profit-and-loss calculations. We shall wait for that animal spirit in our investors to wake up and enthuse them into action, while taking positive policy actions all the time to encourage that enthusiasm.

Agricultural Policies

Mr. Speaker, all through the foreseeable future, the agricultural sector will continue to drive the other sectors in the Kenyan economy and thus have an overwhelming impact on the overall rate of growth. This is so, as I have noted before, because of its crucial role in generating income and effective demand, in supplying inputs to agro-based industries and in producing cash crops which account for over 50 percent of our foreign exchange earnings from exports. Sessional Paper No.2 of 1994 on *National Food Policy* published recently, has dwelt in detail on Government policy in the agricultural sector. I shall, therefore, touch only briefly on the main elements of that policy here, particularly on those that have budgetary implications.

Mr. Speaker, with the on-going liberalisation and other structural reforms, the role of Government in the economy has been changing fundamentally. The field of agriculture is no exception. In the new setting, Government's role will be limited mainly to policy formulation, provision of infrastructural facilities, and research and extension services. Mr. Speaker, it has been estimated that agricultural output in Kenya has the potentiality of growing at a sustained rate of 3 to 4 percent per year in the long term. This growth will have to come mainly from progressively higher output per unit area through the use of more and better quality agricultural inputs. Our policy in agriculture will continue to provide strong incentives to farmers to go for such intensification of agriculture. The major elements of this policy are:

First, duty and VAT-free importation of most critical agricultural inputs such as fertilisers, farm machinery, livestock drugs and other supplies;

Second, increased budgetary allocation for the development and maintenance of infrastructure such as rural roads, rural and urban market centres, milk collection points and cooling facilities;

Third, increased budgetary allocation for agricultural research and extension services;

Fourth, a guaranteed floor producer price for major crops like maize, wheat, rice and sugarcane, based on international prices; and,

Lastly, improved provision of agricultural credit through the establishment of an Agricultural Development Bank, which will have the mandate to accept deposits from the public and will lend to farmers and selected agro-industrial enterprises, while operating on commercial principles.

Mr. Speaker, incidental to the changing role of Government in the agricultural sector, the role of a number of parastatal bodies in this field will need to be reviewed and changed as necessary. The National Cereals and Produce Board, for instance, will be entrusted mainly with the responsibility of maintaining a strategic food reserve and will therefore require less staff and storage capacity. In addition, necessary action is being taken to privatise and commercialise sugar and tea factories and to improve the coffee and dairy industries. Policies will be put in place for the development of a market oriented oil seeds industry.

Industrial Policy

Mr. Speaker, my reference to industrial policy will be brief. Most of the important elements that go into making up our policy towards industrial development have already been mentioned. These are policies relating to promotion of exports and investment, extension of regional economic co-operation, improvement of infrastructure, reform of labour legislation, decontrol of prices, removal of exchange control, reduction of import tariffs, and last but not the least, maintenance of economic and political stability. All these should help in bringing about strong recovery and growth of the industrial sector. A Task Force has been reviewing the laws relating to bankruptcy, liquidation and recovery of debts, with a view to fostering a more disciplined environment for the private sector and allowing more rapid reorganisation of companies. Appropriate modifying legislation will be framed on the basis of the recommendations of this Task Force. Mr. Speaker, numerous licences, high fees and cumbersome administrative procedures are known to inhibit growth of industry and trade and creation of jobs. In the near future we shall substantially reduce the number of national and local fees and licences required for new start-ups and minimise restrictions on retail and wholesale trade under the Trade Licensing Act.

Mr. Speaker, with liberalisation of trade, reduction of tariffs and removal of price controls, local enterprises will face stiffer competition both from within and from the external sector. This will force the industries to become more cost - and quality - conscious, and to look for appropriate technology in production. In the process, the allocation of resources in the economy will become more efficient. Mr. Speaker, the provisions of the Restrictive Trade Practices, Monopolies and Price Control Act will be enforced strictly and impartially to ensure that competition is not thwarted through concentration of market power and undue vertical integration.

Mr. Speaker, I have already noted the vital role that small scale enterprises are expected to play in the generation of employment. Their role will be equally vital in promoting growth and structural transformation of the industrial sector. The Government will continue its efforts to remove the constraints to the growth of small and medium scale industries, as have been detailed in Sessional Paper No.2 of 1992 on '*Small Enterprises and Jua Kali Development in Kenya*'. I may note that our policy aim will be to achieve an appropriate balance between larger and smaller establishments, both developing in a symbiotic relationship based on their respective comparative advantage. In particular, the small firms may grow as suppliers and sub-contractors to the larger firms, which will facilitate their integration with larger market and trading networks. We shall encourage the formation of associations of small units in particular industries to enable them to interact better among themselves and with the larger establishments.

Policy on Environment

Mr. Speaker, over the last three decades since Independence, Kenya's population has grown three-fold, and there has been rapid growth in urbanisation, industrial development and growth of tourism. These forces have threatened the preservation of Kenya's unique natural environment. Mr. Speaker, for economic growth to be sustainable over the long run, it is essential to ensure that the environment is conserved, so that higher production today is not achieved at the cost of diminished future productivity of national resources. In recognition of this fact, a comprehensive National Environment Action Plan (NEAP) has been prepared. The central objective of NEAP is to facilitate the optimal use of the national land base, forestry and water resources, while conserving bio-diversity and maintaining ecological balance. NEAP will draw upon many serious and elaborate studies such as those on forestry and water, where master plans are already in existence.

Mr. Speaker, under the NEAP, assessment and monitoring of the environmental impact will be made an essential component of all private and public sector investment programmes. Very wide participation will be sought for the assessment and monitoring exercises, involving local communities, district committees, business, industries and NGO's. Appropriate incentives will be provided to encourage sustainable use of natural resources; at the same time, penalties will be devised to minimise over-exploitation and pollution.

Mr. Speaker, appropriate land-use decisions are crucial for preservation of the environment and for sustainable development. With a view to encouraging land transfers so that land use may move towards the optimal pattern, I shall be announcing reductions in the stamp duty rates on land transfers.

Urban Development and Local Government Financing

Mr. Speaker, the growth in our urban centres has been very rapid in the past few years. This growth has been fastest in towns with populations of 50,000 and above. The demand for facilities and services is thus greatest in relatively bigger towns; hence, the need to develop new policies to facilitate the provision of public infrastructure and services in such towns.

Mr. Speaker, financing of urban development is a major plank of rural urban strategy. With the planned upgrading of a number of towns, Ministries, Local Authorities and the District Development Committees (DDCs) will need a greater share of the national resources to enable them finance infrastructures and the facilities required to support new economic activities in manufacturing and commerce, as well as to provide services to the urban residents. On the other hand, Government capital investment for urban development has not kept pace with population growth. Indeed, capital expenditure in city, municipal, town and urban councils in has been declining in recent years. The challenge during this year and after, is to reverse this trend.

Mr. Speaker, with this in mind, we are today publishing new schedules of Local Authority Service Charges these were last revised in 1988. To increase the revenues available to local authorities, the service charge rates on businesses will be increased by 50%. The service charge on employees will remain approximately one percent of basic monthly income, but the brackets will be widened such that no tax will be charged on incomes of less than Kshs 1,500 per month, but the top bracket will increase from Ksh 6,000 and above which Ksh 100 per month is currently charged to Ksh 19,000 and above which Ksh 200 will be charged. The revised rates will enable the Local Authorities to raise their revenue significantly. At the same time, my colleague the Hon. Minister of Local Government is instructing all local authorities to review licence fees applicable to small traders and businessmen with a view to reducing them. Special attention will be paid to licences which are of nuisance value to individuals and businesses, such as licences for use of bicycles, hiring dust bins, use of donkeys and roasting of meat. In particular, licence requirement for use of bicycles will be abolished immediately, thus saving the *wananchi* who pedal to work and in general some financial costs and a lot of harassment.

Mr. Speaker, at the same time as finding sources of additional revenue, it will be necessary to tighten the administration of Local Authorities' finances, so that more resources can be directed to development expenditures.

Housing

Mr. Speaker, the Government recognises the important role played by the housing sector in providing shelter and in creation of employment. The Government will continue supporting the activities of this sector with the prime objective of providing decent housing for all, whether privately or publicly owned. Specific policies to be adopted in this regard will include strengthening property rights, mobilising building societies and financial institutions, encouraging service-tenancy and owner-occupancy, relaxing building codes and bye-laws and promoting the activities of women groups and the youth in providing cheap building materials.

Mr. Speaker, a study on building societies has been commissioned already to identify specific provisions of the Building Societies Act and the Banking Act which need amendment in the interest of more rapid and equitable growth of this sector. The issue of providing further incentives to investment in financial instruments such as the housing development bonds with a view to strengthening the flow of funds to this sector will also be examined.

Social Dimensions of Adjustment

Mr. Speaker, I shall end my remarks on the policy framework by referring briefly to the issue of Social Dimensions of Adjustment. There is widespread concern that the on-going structural adjustment process will, in the short run, increase hardship for the poor and disadvantaged classes of society. It is feared, for example, that there will be loss of jobs due to civil service and parastatal reforms, a rise in prices due to removal of subsidies and price controls, and closure of local businesses under pressure of competition from foreign enterprises due to removal or reduction in protection. Mr. Speaker, while all this is true to some extent, several points which are relevant in this context are usually overlooked and therefore the fears exaggerated. Firstly, there will be provision for safety nets in the case of redundancy through civil service and parastatal reform, consisting of cash benefits and facilities for training to acquire other skills. Secondly, some of the price increase and growth in exports resulting from liberalisation of prices and exchange controls benefit the farmers - including small scale farmers who are among the poorer sections of the community. Thirdly, the entire structural adjustment process is aimed at attaining a higher trajectory of growth in output and employment, which in the long-run is the only way of reducing poverty on a sustainable basis. Fourthly, as I have indicated before, Government expenditure will be progressively redirected towards 'core' functions including programmes like basic education and health services which will benefit an increasing number of the poor. Finally, we shall adopt intervention measures targeted specifically for the poor and the disadvantaged. Currently, we are distributing relief food among five million people who have been stricken by the drought of the last couple of years. This, of course, is a short term emergency which will pass when satisfactory harvests are realised following normal rainfall.

Mr. Speaker, the National Household Welfare Monitoring and Evaluation Survey was launched at the end of 1992 with a view to identifying target groups for intervention on a long term basis. A substantial body of information on the extent of poverty and the characteristics of the poor in Kenya has already been collected through this survey. The work will continue and will provide a solid basis for the direction of poverty related intervention measures from the Government. As Honourable Members may have already seen in their copies of this year's Economic Survey, the highest prevalence of absolute poverty in rural areas in Kenya in 1992 was among subsistence farmers, as opposed to informal or formal sector wage earners. When classified on the basis of education, the highest prevalence was among those with no education. Also, the larger the family size, the greater was the prevalence of poverty. Mr. Speaker, these findings clearly indicate that the overall thrusts of policy are in fact on target in terms of reduction of absolute poverty. Before concluding, I wish to draw Honourable Members's attention to one small, but significant finding of the survey. This is that the prevalence of absolute poverty in rural Kenya has fallen from 47.9 percent in 1981/82 to 46.4 percent in 1992. Mr. Speaker, this finding indicates that the structural adjustment process, which started in earnest from around 1986, has not resulted in pushing more people below the poverty line. The reduction in the prevalence of poverty would surely have been greater if our agriculture and the economy as a whole had not performed so poorly since 1990. Indeed, I am confident, Mr. Speaker, that we shall be able to achieve a much more rapid reduction in poverty as the growth rate of the economy picks up.

Prognosis

Mr. Speaker, as I said in the beginning, the turbulence which the Kenyan economy experienced last year is now behind us. The containment of domestic debt service costs in the budget will enable us to increase development expenditure, including expenditure on improvement of infrastructure and other core functions of Government. With the resumption of quick disbursing donor aid and scheduling of debt arrears, our credit rating in international financial circles has improved. The long rains this season have been adequate and widespread, although they started late and thus inflicted some damage on major crops like tea and maize. We have initiated co-operation and dialogue between the private sector and Government at various levels, as was stressed during the recent Investment Conference. Finally, as I have just described, we shall put in place a policy framework that will provide strong incentive to exports, investment and growth. Mr. Speaker, in view of all these, I expect GDP growth rate during the calendar year 1994 of around 3 percent, rising to approximately 5 percent during 1995. Much of the growth in 1994 will come from recovery of agriculture, which had contracted by 3 to 4 percent in each of the two previous years. The 1995 growth will be more evenly distributed between sectors, with a strong growth in manufacturing, thanks to the expected recovery of investment starting in 1994 and becoming stronger in 1995.

Mr. Speaker, the *average* inflation rate is likely to be in the lower twenties for the calendar year 1994, given the high month-on-month inflation rates that we have observed already during the first few months of the year. The tendency of rapid growth in our foreign exchange reserves is continuing, which is creating upward pressure on prices through its effect on money supply. Adjustment in wages and salaries and in other prices to past inflation will also make it difficult to bring down the inflation rate quickly. However, within the above constraints, our policies will remain firmly geared to the challenge of reducing the 3 month annualised inflation rate below 10 percent by the end of the year.

Mr. Speaker, for the financial year 1994/95, I expect a real GDP growth rate of about 4 percent and a rate of growth in the GDP deflator of about 17 percent. The forecast fiscal outturn for 1994/95 that I shall now present is based on these assumptions. Before going into 1994/95, however, I shall present the expected outturn for the current year, 1993/94.

Financial Outturn: 1993/94

Mr. Speaker, I now turn to the probable financial outturn for the current financial year.

I shall begin with revenue.

Recurrent Revenue

In the original Budget estimates for the current year, total Ordinary Revenue, excluding export compensation, was estimated at K£ 4,374.2 million. This would be made up of a collection of K£ 1,254.0 million from Customs and Excise, K£ 1,243.8 million from Income Tax, K£ 1,418.3 million from VAT and K£ 458.1 million from other Taxes, Dividends and Income. This last figure included an estimated K£ 200 million of dividend to be received from the Central Bank.

On top of the Ordinary Revenue of K£ 4,374.2 million, another K£ 149.1 million was expected to be collected as Appropriations-in-Aid, including K£ 54 million from the UN, being reimbursement of the expenses of our participation in peace-keeping operations in Europe. Export compensation payments which were abolished from the beginning of September 1993 were still estimated to amount to K£ 30.3 million because of some time lag in processing the payments. The ordinary revenue, A-in-A and export compensation were altogether to make up a total Recurrent Revenue of K£ 4,553.6 million.

Mr. Speaker, compared to this original estimate I now expect to collect a total of K£ 5,052.2 million as Recurrent Revenue. I am, therefore, expecting an *excess revenue collection* of K£ 498.6 million. This will include additional Appropriations-in-Aid of K£ 9.6 million and excess export compensation payments of K£12.1 million. But most of the excess will arise out of additional collection of Ordinary Revenue which is expected to exceed the budget estimate by K£ 476.9 million. Mr. Speaker, I have already mentioned that the growth of the economy during 1993 was a dismal 0.1 percent. Economic activities have continued to be depressed through the first part of 1994 also. While the somewhat higher than anticipated rate of inflation has undoubtedly helped in raising revenue collection, it required considerable effort and innovativeness on the part of the Revenue Commissioners and some new revenue measures in the course of the year to boost the revenue outturn to this extent.

Of the excess ordinary revenue collection of K£ 476.9 million, 80 percent is expected to be realised through over performance in the collection of Income Tax. Mr. Speaker, this extraordinary performance was the combined effect of several developments, namely, (i) the re-introduction of the PIN, (ii) the offer of amnesty, (iii) intensified collection of corporation tax from parastatals who had assumed an exempt status until now, (iv) tax collected on very substantial interest income earned by holders of Treasury bills and (v) effect of the new instalment system in payment of corporation taxes. The collections from Customs and Excise and VAT are also expected to exceed the original estimates, mainly because of a 25 percent surcharge levied on import duties in September of 1993. On the other hand, the collection from Other Taxes, Dividends and Income is expected to fall short of the original estimate by K£ 68.1 million. This however is due entirely to the fact that the Central Bank was unable to pay any dividend to the Government on the basis of its operations during 1992/93. Despite this loss of expected dividend of K£ 200 million, the shortfall was limited to K£ 68.1 million, mainly through collection of dividends and arrears of debt service payments from other parastatals.

Mr. Speaker, I now expect to collect K£ 1,341.3 million from Customs & Excise, K£ 1,625.0 million from Income Tax, K£ 1,494.8 million from VAT and K£ 390.0 million from Other Taxes, Dividends and Income, making up a total Ordinary Revenue collection of K£ 4,851.1 million.

Recurrent Expenditure

Consolidated Fund Services (CFS)

Mr. Speaker, as I have already mentioned more than once, there was a sharp increase in interest payments on domestic borrowing during the current year. Our latest revised estimate on this item is K£ 1,975.0 million, compared to the original Budget estimate of K£ 884.2 million. This excessive rise in domestic interest payments has dominated the entire outturn of the Budget during the 1993/94. It tended to blow-up the Budget deficit far beyond acceptable limits and forced us to both look for additional revenue through new and innovative measures and maximum possible savings in other expenditure. Fortunately, we are likely to realise a saving of about K£ 60 million in external interest payments, mainly due to the appreciation of the Kenya Shilling that has taken place since October of last year.

Net Issues

As regards net issues in the recurrent Budget, Honourable Members will recall that a total additional expenditure of K£ 212.5 million was approved recently under the Supplementary Appropriation Bill to meet additional expenditures in our Missions abroad due to devaluation, operating expenditures for maintaining security, purchase of drugs for hospitals and dispensaries, maintenance of roads, and holding of by-elections. However, because of the overwhelming need to keep the deficit within reasonable limits, while approving these additional expenditures, we reduced expenditure in other areas by K£ 249.1 million, thus securing a *net* reduction in recurrent expenditure of K£ 36.6 million compared to the Budget estimates. The final outcome is likely to be an even higher reduction because of very tight controls that were maintained on Exchequer issues. I am now expecting that the total recurrent expenditure, including Appropriations-in-Aid, but excluding CFS, will amount to K£ 2,667.5 million, compared to the original estimate of K£ 2,765.3 million.

In addition, I shall have to finance Excess Votes and Under Issues relating to previous years amounting to K£ 46.69 million.

Mr. Speaker, I therefore expect this year's gross recurrent expenditure, together with Excess Votes and Under Issues, to be K£ K£ 7,709.6 million, compared to an expected total recurrent revenue of K£5,052.2 million. There will therefore be no surplus in the recurrent account to finance development expenditures.

Development Expenditure

Mr. Speaker, during the Supplementary Estimate for this fiscal year, development expenditure authorisations were raised by K£ 228.1 million for financing the drought expenditures, communication equipment for police, down payment for the Mombasa Airport Rehabilitation project, expenditures for settlement of pending bills on construction projects, dredging operations at Kilindini harbour, payment to Kenya Railways, and payment of Government obligations on the rehabilitation of Kenya Meat Commission. The full details of these additional expenditures have been given in the Supplementary Estimates discussed in this House. However, the Treasury was able to identify savings from other areas in the Development Estimates to the extent of K£ 110.6 million, resulting in a net Supplementary of K£ 117.5 million.

Appropriations-in-Aid in the development vote, which represent direct payments made by donor agencies on development projects, also increased by K£ 147.9 million over the levels in the Printed Estimates. Major projects accounting for this increase include the Mombasa Airport Rehabilitation project, Protected Areas and Wildlife Service project, Athi River Export Processing Zone project, Sewerage projects under Ministry of Local Government and road projects under the Ministry of Public Works and Housing.

Despite the above increases, I expect a *net* saving of K£ 28.5 million in issues in the Development Estimates, as a result of limiting Exchequer to availability of Development Revenue. There will, however, be an increase in *total* development expenditure of K£ 137.1 million, due mainly to expenditure for rehabilitation of the Moi International Airport in Mombasa which is being financed through loans under Appropriations-in-Aid.

Payment for Parastatals

In addition to the foregoing, Mr. Speaker, we have had to pay a sum of K£ 126.3 million on a *net* basis on behalf of parastatals which have been unable to meet their external debt service obligations on time. This, Mr. Speaker, illustrates how the financial weaknesses of parastatals impinge on the Budget and crowd out other productive expenditure. The Nairobi City Council is not excluded from this category.

Programme Grants

Finally, Mr. Speaker, there will be a shortfall in External Programme Grants of K£ 54.5 million, because the negotiations with all bilateral donors could not be completed within this financial year.

Deficit

As a result of these developments, I am now expecting a deficit of about K£ 1,200 million, compared to our original estimate of K£ 456.3 million. This estimated deficit will amount to 6.2 percent of GDP, compared to a deficit of 10.0 percent of GDP on a commitment basis realised in 1992/93. While a high deficit of 6.2 percent is depressing news, Honourable Members will recall that the extent of the likely overshooting of deficit compared to the Budget estimate is about K£ 740 million, while the escalation of domestic interest alone is over K£ 1,090 million.

FORECAST OUTTURN: 1994/95

Expenditure

Mr. Speaker, as I have mentioned before, we firmly believe that a tight fiscal stance is an essential requirement for economic stability and sustained growth. We have therefore set ourselves a target of a very low budget deficit for this coming fiscal year, despite the fact that our efforts in bringing down the deficit have been frustrated repeatedly in the recent past. Honourable Members may, in this context, wish to recall the wise saying that "our true greatness lies not in never falling, but in getting up again every time we fall."

Besides targeting for a low Budget deficit, we have also set a target of no *net* domestic borrowing to finance expenditures during 1994/95. This will ensure that Government budgetary operations create no inflationary pressure on prices and also that more resources in the economy are left at the disposal of the private sector for use in productive investments. The implication of all this, of course, is that there can be only modest increases in recurrent and development expenditures of Ministries in real terms.

Mr. Speaker, turning to the details of the expenditure proposals in today's budget, the first important area that I would like to highlight briefly relates to the provisions made for special programmes to mitigate the adverse effects of economic adjustment measures. Honourable Members will recall that H.E. The President has expressed his concern repeatedly on the social consequences of economic adjustment and on the need for the Government to take special measures to protect the poorer sections of our society.

Therefore the 1994/95 expenditure proposals include an allocation of K£ 155.80 million for Social Aspects of Adjustment distributed amongst a number of Ministries. A major portion of this allocation will cover the costs of free distribution of food to the affected population. Other programmes will include bursaries to poor parents to pay school fees in secondary schools, increased supply of drugs and other materials for health services in rural areas, site and service improvements for housing the urban poor, rural industries and employment generation programmes for the development of Jua Kali enterprises.

As far as food security is concerned, particularly for the vulnerable sections of our population, the budget proposals I am presenting to-day also include an allocation of K£ 72.9 million for free distribution of food assistance to the drought affected population and to refugees sheltered in Kenya. This is in addition to the allocation of K£ 17.3 million for food assistance to primary and pre-primary schools in arid and semi-arid areas. The Government will also continue to implement the Drought Relief Programme for which the 1994/95 expenditure proposals have earmarked an amount of K£ 33.0 million. Mr. Speaker, thus, taken together there is a total allocation of K£ 279 million in my expenditure proposals to implement special programmes for ensuring food security and addressing the social dimensions of adjustment.

Mr. Speaker, I shall next refer briefly to the provisions for salaries and allowances in my proposals. Government is aware of the need to compensate civil servants at least partly for past increases in the price level. The expenditure proposals I am presenting to-day include provisions for a general 6% increase across the board for all civil servants and teachers; in addition, funds have been earmarked for a differential salary increase of 10% for Job Groups K to T and an enhancement of the benefits package particularly for medical benefits for all civil servants. Full details of these improvements will be announced shortly by the Directorate of Personnel Management, so that they can become effective from 1st July, 1994. These changes are very much a part of the Civil Service Reform Programme currently being implemented by the Government for enhancing the productivity of the civil service.

Mr. Speaker, as Honourable Members are aware, the voluntary retirement programme covering Job Groups A to G, is proceeding well and as I stated before, I expect to spend nearly K£ 48 million during 1993/94, as terminal benefits paid to about 6,000 employees retiring from the civil service. The 1994/95 Budget proposals include an amount of K£ 85.2 million for continuing this programme.

Mr. Speaker, the expenditure proposals presented to-day also contain substantial allocations for rebuilding our physical infrastructure, particularly the road network - including the upgrading and improvement of rural access roads which will enhance the quicker marketing of our agricultural and livestock produce. A special allocation of K£ 75 million, to be financed out of the newly introduced levy on petroleum products, has been earmarked for this purpose. There is also a separate provision of K£ 12.5 million for rehabilitation of coffee and tea roads and K£ 10.0 million for access roads.

Mr. Speaker, Honourable Members are aware that the fiscal control measures we have been implementing in the past have had the undesirable effect of accumulation of pending bills in a number of Ministries. This is an embarrassment to the Government and needs to be controlled at the commitment stage. However, in order to address this problem, my expenditure proposals today include an allocation of K£ 50 million for payment of pending bills. The Treasury will allocate this money to the Ministries concerned during the year, after verifying the legality of pending bills. The Treasury will also ensure that such bills are paid in a strictly chronological order. The quarterly expenditure and commitment ceiling system which will be implemented from the next financial year will also ensure that pending bills are first paid from the existing allocations, before the Ministries enter into new commitments.

Mr. Speaker, Hon. Members will have adequate opportunity to discuss the various projects under the different votes; I am therefore not going into too many details at this stage. However, as in the past, I would like to highlight some of the major donor-financed projects which are included in the Development Estimates proposals.

Mr. Speaker, the single largest allocation in the Development Estimates for 1994/95 is for the Mombasa Airport Rehabilitation project which has been started this year. An allocation of K£ 70 million has been made for this project. I am sure when completed this investment will boost our tourism earnings substantially. Another major allocation is the provision of about K£ 92 million in the Development Estimates for preservation of wildlife and the management of protected areas.

Mr. Speaker, the Development Estimates have also allocated large sums for investments in the education sector, including an allocation of K£ 40.0 million for the Sixth Education project. Allocations have also been made for other major projects like the Smallholders Coffee Improvement Programme (SCIP II), the Kirandich Water Supply project, the Nairobi Water Supply Project, the Coast Water Supply Project and agricultural research programmes at KARI.

As Honourable Members will have seen from their copies of the 1994/95 Printed Estimates, the gross recurrent expenditures of Ministries will be K£ 3,233.0 million, financed partly by Appropriations-in-Aid of K£ 277.6 million. The projected total expenditure on Consolidated Fund Service payments are K£3,622.4 million, of which K£ 1,623.2 million is accounted for by internal and external loan redemption. Foreign interest payments are expected to be around K£ 526.5 million and domestic interest payments will be of the order of K£ 1,331.2. I shall also have to provide for Excess Votes and Under Issues relating to earlier years amounting to K£ 127.5 million. Thus the total gross recurrent expenditures will amount to K£ 6,982.9 million in 1994/95.

Development Estimates are about K£ 2,031.1 million, which includes an Appropriations-in-Aid of K£ 1,081.8 million. In addition, I will have to finance Excess Votes and Under Issues of K£ 111.1 million in 1994/95 pertaining to previous years.

Thus a total gross expenditure of K£ 9,125.1 million will have to be financed during 1994/95. K£ 238.6 million of these, being excess votes and under issues relating to previous years, will represent accounting adjustments and not call for fresh resources. Thus, I shall have to finance a total of K£ 8,886.5 million. I shall now briefly go into how I propose to finance these expenditures.

External Revenue

Mr. Speaker, the international donor community, including the multi-lateral aid organisations, have fully endorsed our development plans and programmes. They are also providing substantial resources in the form of grants and concessional loans to finance the development projects in the budget that I was describing a moment ago. Mr. Speaker, as always, we are thankful to friendly Governments and international aid organisations for their highly valuable support in our development efforts. Thus, for the financial year 1994/95, I expect external grants amounting to K£ 844.9 million and concessional loans totalling K£ 1,185.9 million. Of this latter, K£ 456.4 million will consist of a general budget support loan, the remainder being loans tied to various high priority projects.

Mr. Speaker, I would wish to digress a little at this point and draw Honourable Members' attention to the problem of donor funds being tied to specific projects. It has meant that we have to go short on operating and maintenance funding to existing facilities in order to attain our deficit target. The result has been that infrastructure has deteriorated while new, similar infrastructure, is being installed. This is not good economics. Development in the true sense of the word, comes from the operation of existing facilities: hospitals need drugs, nurses and X-ray film, cattle dips need acaricides, and schools need textbooks and chalk. Many water projects are in a poor state for lack of maintenance of pumps, irrigation ditches, etc. We, therefore, would wish donors to be supportive in the efficient operation of the high priority facilities which have already been constructed. Potholes on main highways discourage new investors much more than new roads in other areas attract them.

Mr. Speaker, because of our concern to keep the Budget deficit within tight limits, we are unable to absorb all the available donor funds that are tied to particular projects. Indeed, in the Expenditure Estimates tabled today, we have been able to absorb less than 50 percent of such funds. Even *grant* funds tied to specific projects cannot be fully absorbed. Some of them may call for matching allocations on the part of the Government. Facilities built with the use of donor grants will call for operations and maintenance expenditure in future which the donors are unwilling to fund. Further, since grant funds often generate domestic counterpart shillings, they may not always be an unmixed blessing.

Mr. Speaker, to return to the present context, the levels of donor funding for the Budget for 1994/95 which I have mentioned indicate that these will account for nearly 23 percent of the projected expenditure. I shall now turn to how I intend to raise the balance of K£ 6,855.7 million.

Domestic Borrowing

Mr. Speaker, I have already mentioned our policy aim of having no new *net* borrowing from the domestic economy during 1994/95. Our plan, therefore, is to have a *gross* borrowing of K£ 537.3 million from domestic sources, which will be *less* than the total domestic loan redemption projected at K£ 609.4 million. On balance, therefore, we shall *repay* K£ 72.1 million to the domestic economy.

Even this gross borrowing of K£ 537.3 million will be made in a non-inflationary manner. Thus, all these loans will be collected from the non-bank sector.

Internal Revenue

Mr. Speaker, I have already mentioned that we are now expecting the economy to register a growth rate of around 3 percent in real terms during 1994. Much of this growth is expected to come from a recovery of agriculture, which recorded a very depressed level in 1993 after an actual *decline* in GDP growth for three consecutive years. The long rains this year started late, but the amount and distribution of rainfall have since been reasonably satisfactory. I am assuming also that the short rains later in the year will be normal. Given these, I expect a somewhat higher growth of about 4.8 percent during 1995, as the recovery is consolidated and the industrial and services sectors pick up the growth momentum. Thus, for the financial year 1994/95, I expect a GDP growth rate of about 3.9 percent. The rate of inflation as measured by the GDP deflator is expected to be around 17 percent for the financial year.

As Honourable Members are well aware, another crucial determinant of internal revenue is the value of our imports. I have already noted that we are expecting imports to grow strongly during 1994 and more so, during 1995, following a fairly long period of contraction since 1989.

Mr. Speaker, on the basis of these assumptions and forecasts, I expect to collect ordinary revenue of K£ 5,732.6 million during 1994/95. This figure takes into account the loss of revenue resulting from the removal of the 25 percent surcharge on import duties that was levied in September last year on a temporary basis. In addition, I plan to collect K£ 100 million in arrears payment from various public enterprises during the coming financial year. Appropriations-in-Aid will provide another K£ 273.9 million.

Thus, I shall raise a total of K£ 8,674:6 million from all these sources, leaving a residual gap of K£ 211.9 million to be financed through additional tax measures. The rest of my Speech will deal with how I intend to do this.

Taxation Proposals

Mr. Speaker, Sir, before I begin to detail the specifics of the measures that I shall propose to close the revenue gap, I should like to reiterate the principles of taxation that I intend to follow. The modernisation of the taxation system has been aimed at creating a more effective, fairer, and more economically efficient system. The revenue raising capacity of Kenya has indeed become effective. I am pleased to announce that this fiscal year we expect to exceed the target set out in the Sessional Paper No.1 of 1986 of revenues reaching 24% of Gross Domestic Product -- ordinary revenues look set to exceed 25% of GDP, the highest collection rate in Kenya's history. The tax system has been getting fairer by broadening the base and bringing more Kenyans into the tax net who have the capacity to pay, while lowering the burden on those who have been bearing too heavy a load. The tax system has been promoting a more efficient economy. It has lowered rates, reducing them on savings and investment, and restructured the tax system to support an export-led economy.

While good tax policy and legislation is critical, ultimately it is the strength of the tax administration that provides the foundation of a modern tax system. Last year I announced that the budgetary provisions of the revenue departments would be raised to ensure that they had sufficient operating funds to collect taxes effectively and assist Kenyans in complying with the tax laws. The revenue collection performance this past year testifies to the success of that policy. My gratitude goes to the Revenue Commissioners for their sterling efforts over the past year. This policy of providing funding of the recurrent budgets of up to one percent of the collections of the revenue will be continued.

Mr Speaker, this year I intend to go further in building the foundations of the tax system. Ultimately, the efficiency and effectiveness of the tax system depends on the competence and integrity of the tax officers. For the Kenyan economy to remain competitive in the decades to come, it will require a modern tax system administered by a professional and well-motivated cadre of tax officers. To achieve this will require radical changes to the corporate structure of the revenue departments. I am, therefore, proposing to convert the revenue departments into a Tax Authority. The proposed Kenya Tax Authority would report and work closely with the Fiscal and Monetary Affairs Department in the Ministry of Finance, and would have the capacity to employ motivated professionals with the required skills in management, accounting, information systems, collections and the other skills needed to administer the taxes fairly and efficiently. Mr Speaker, I am determined to build the tax system that Kenyans deserve. I shall be bringing legislation before this House in the course of the next year to enable the Kenya Tax Authority to become operational by July 1995. In addition, I also recognise that at the same time the Fiscal and Monetary Affairs Department will need to be strengthened and build up its capacity to manage the increasingly complex fiscal, monetary and other economic situations facing Kenya.

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

I. Customs Duties

As has been the tradition, Mr Speaker, I shall first present the major proposed measures that concern Customs procedures and other technical matters, and then turn to the proposals that have direct revenue consequences.

First, the Customs administration is regularly faced with the problem of disposing of seized or abandoned goods. These goods may be perishable or storable. I am proposing amendments to clarify the rights and procedures for Customs in auctioning or otherwise disposing of such goods.

Second, errors can arise in assessing duties through miscalculations or misclassifications. Where such errors are to the benefit of the importer, Customs has the powers to refund import duties, but not excise duties. A provision is proposed to allow excise duties collected in error to be refunded.

Third, where goods, such as motor vehicles, are imported subject to some exemption, if the conditions for that exemption no longer apply, such as the exempt person selling the motor vehicle, then duty becomes payable. If the goods have been loan financed, then the payment of duty takes precedence over the payment of any loan arrears. An amendment to the Customs and Excise Act is proposed to clarify the precedence of the payment of taxes.

Fourth, the Commissioner of Customs and Excise has powers to appoint agents to assist in the collection of tax arrears. He does not, however, have the ability to impose penalties on appointed agents who fail to comply with their appointment without reasonable grounds. Amendments to the Act are proposed that lay out the procedures and obligations in the appointment of collection agents, and also specify the penalties for unreasonable non-compliance by an agent.

Fifth, to value imported vehicles properly, Customs regularly seeks the assistance of the motor vehicle dealers or agents. Currently, however, Customs has no powers to deal with misinformation or unreasonable lack of co-operation. Given the importance of this information to the charging of duties on motor vehicles, proposals are put forward to obligate such dealers and agents to assist Customs with information so that the appropriate duties can be charged.

Sixth, aircraft, vehicles and vessels have to be licensed to carry goods under Customs control as is the case with transit goods. A fine is imposed where unlicensed transport is used. The maximum fine that can be imposed is no longer a deterrent. I, therefore, propose to raise it from ten thousand to Ksh 100 thousand.

Mr Speaker, I now turn to my major Customs proposals that have direct revenue consequences. These proposals contain two themes. I shall be continuing the introduction of measures to move the Kenyan economy towards a more competitive, efficient and export-oriented structure. At the same time, I am acutely aware of the contribution that some of the traditional import-competing industries have been making to the Kenyan economy. I shall also be introducing measures to assist these sectors.

First, the temporary 25% increase in all customs duty rates that had to be introduced in September last year to cover the unexpectedly high domestic interest charges arising from the fight against inflation, will be revoked with immediate effect.

Second, the rationalisation of the customs tariff that has accompanied the economic liberalisation process since 1988 will be taken a few steps further. The 40% and 50% tariff bands will be combined into one 45% tariff band. All items in the 25% band will be lowered to 20%, and a new a 5% rate band is introduced for selected primary commodities such as primary forms of iron and steel including steel billets. These changes lower the top import duty rate to 45%, and reduce the number of bands (including duty free) from 8 to 7.

With these first two measures alone, Mr Speaker, I am lowering the duty rates on a wide range of raw materials by over one-third. I expected this lowering of raw material costs to give

Kenyan industry a significant boost. I also expect such lower costs to be reflected in lower prices.

Mr Speaker, as I mentioned earlier, Kenya is a member of the Preferential Trade Agreement (PTA) involving most Eastern and Southern African countries. Over recent years, import duty rates have been systematically lowered between member states and now stand at 40% or less of the regular import duty rates and by the year 2000, import duty rates will be removed completely between member states. Within the next year, the Common Market of Eastern and Southern Africa or COMESA will be established. As part of this process, the member states will be seeking to establish a Common External Tariff. Proposals are being studied for target tariff structures involving some three positive tariff rates with a maximum rate of 30%. Mr Speaker, it is important for all Kenyans to realise that we are not alone in liberalising our markets and generally lowering and rationalising import tariffs. In fact, I expect Kenya to take a lead role in the establishment of COMESA.

Third, to lower the costs of capital equipment, the duty rate on all capital equipment and parts in the old 20% tariff band will be lowered to 15%. This will lower the costs of items ranging from metal and wood working equipment to integrated circuits, and testing and measuring equipment. In addition, the duty rates will be reduced on passenger lifts for buildings, and on all large transformers. This latter duty cut will help lower the costs of electricity supply and support rural electrification programmes.

Fourth, Mr Speaker, I have received many complaints of the dumping of cheap imports into the Kenyan economy. While some of these concerns arise from genuine cases of dumping, others are caused by smuggling and undervaluation of imports. I intend to tackle both problems using four new measures.

Firstly, at the beginning of May, I introduced a new Preshipment Inspection (or PSI) Programme, as promised in my last Budget Speech. This new programme has two critical features. The PSI-determined values will form the minimum values for customs purposes, and all PSI documents will be matched against all customs entry documents to ensure full compliance with this programme by all parties. Mr Speaker, I am committed to the vigorous implementation of this programme to ensure that fair and accurate duties are paid on imports.

Secondly, all alternative specific duty rates are being doubled. These fixed minimum duties serve to discourage undervaluation of imports as well as to raise additional revenues.

Thirdly, the variable duty rate structure is being amended to protect the local farmer against subsidised imports, particularly wheat imports. Under the new variable duty rate structure, where the landed cost of the imported commodity falls below a gazetted domestic reference price, duty will be charged to make up this difference. The domestic reference prices have been set so as not to cause any significant consumer price increases, especially for maize imports.

Fourthly, selective dumping duties will be imposed on subsidised imports where these are adversely affecting local manufacturers. Two such dumped products that have been identified are PVA emulsion and tea sacks being imported from South Africa which are subject to subsidies. To make these dumping duties effective, no remission for dumping duties will be provided under the EPPO or MUB programmes. Mr Speaker, I am willing to add to this list of imports subject to dumping duties in the future. Dumping arises from either explicit export subsidies in the country of origin or exporters selling at below the fair market values in their own countries. Industries should contact the Treasury if they find themselves to be the victim of dumping. They should supply evidence to the Treasury of the nature and source of the dumped imports as well as substantiation that their industry is being damaged by the dumped imports.

Fifthly, Mr Speaker, as I stated earlier, specific measures are being introduced to assist certain import-competing domestic industries. I shall mention a number of such measures: To help the cloth, clothing and carpet sector, the duty rate on yarns and threads is lowered to 30%. The duty rate on zinc is lowered to 10% to assist makers of galvanised steel products and dry cell batteries. New alternative specific duties are being introduced on used and retread tyre imports to protect the tyre industry. To assist motor vehicle spare part manufacturers, the import duty will be raised to 30% for brake linings and pads, ignition wiring sets, safety belts, radiators, suspension shock absorbers, silencers and exhaust systems. The resin industry is growing in Kenya. To sustain their development the duty rate on most resins is raised to 30%.

For the liquor trade, the import duties on bulk brandies and whiskeys have been lowered to 30%. Furthermore, To lower the costs of aluminium products, the duty rate on primary forms of aluminium have been dropped to 10%. To assist the manufacturers of lead-acid batteries, the import duty rate on all primary forms of lead will be lowered to 15%, and the duty rate on all types of lead-acid batteries is harmonised at 45%. The duty rate on primary forms of tin is lowered to 10%, and all forms of chrome and tin-plated flat rolled iron or steel are lowered to 15% to assist the users of tin cans.

Mr Speaker, this assistance will help the development of these Kenyan industries, but I also expect these industries to share their benefits with the people of Kenya. For example, I expect to see lower prices on galvanised steel sheets in the market place very shortly.

Sixth, as I mentioned in discussing agricultural sector policy, wherever possible major and identifiable inputs into the agricultural sector are made duty free and zero rated under the VAT. Today I shall extend the list of such items. Greenhouses will be made duty free to assist the rapidly growing horticultural sector. I should also point out that by making greenhouses duty free, local manufacturers of greenhouses can also apply to EPPO to import raw materials duty free under the Essential Goods Production Support Programme introduced in last year's Budget. Other items made duty free and zero rated include nematocides and acaricides; tractors (including pedestrian controlled tractors); day-old chicks and hatching eggs; and high density polyethylene plastic sheeting for lining dams subject to Treasury approval and supported by a recommendation by the Ministry of Agriculture, Livestock Development and Marketing. To assist the producers of fish meal for animal feed, the duty on imported sun-dried fish and fish waste will be lowered to 10%.

Other measures to lower the costs of agricultural production include lowering the tariff rate on hand tools such as spades and agricultural forks to 30%. To lower the costs of agricultural machinery, the 20% extra duty introduced in 1989 on used machinery and vehicles for foreign exchange control purposes, will now be limited to motor vehicles, excluding tractors.

Seventh, traditionally the health care sector has been favoured with low duty rates to minimise cost. Today I am pleased to introduce proposals to further that tradition. Operating tables and specialised mechanical fittings will be made duty free, as will cleaning and disinfecting solutions for contact lens. Dentists, but not hairdressers, will now be permitted to import dentist's chairs duty and VAT free once every three years. To lower the cost of X-rays, X-ray films will be imported duty and VAT free.

Eighth, Mr Speaker, the motor vehicle assemblers of Kenya have been undergoing a particularly difficult adjustment to the more open trade conditions, while consumers have been benefitting from the increased availability of motor vehicles. I am proposing, in general, to continue the protection provided to this sector to allow them more time to adjust to the new market situation. Assembled cars, motor cycles, small buses, and small lorries (those not exceeding 5 tonnes) will be dutiable at 45%, while the CKDs for these vehicles will be dutiable at only 15%. Large buses carrying more than 25 passengers will have a lower duty rate at 30%. To lower the costs of transport lorries, and to discourage transport companies from registering their vehicles in neighbouring countries, lorries over 5 tonnes but less than 20 tonnes will have a duty of 30%, while the duty rate on lorries over 20 tonnes will be dropped to 20%. The CKDs for large lorries will also have a lower duty rate of 10%.

Mr Speaker, for too long we have been neglecting the transport vehicle of the common man -- the bicycle. To lower the costs of bicycles, the duty on assembled bicycles will be lowered to 30%, and unassembled bicycles to 15%. This should allow for a significant price reduction in bicycles.

To assist the tourist industry and to rationalise the import protection for vehicle assemblers, the import category for minibuses for 10 to 14 passengers will be removed from the tariff schedule along with the excise duty on these buses. All minibuses with a carrying capacity in the range of 10 to 24 passengers will henceforth be treated as one import category.

Ninth, Mr Speaker, detailed studies of trade patterns have revealed that there are a large number of commodities in the tariff schedule that have unnecessarily high duty rates. Either the domestic industry requires no protection from imports or, in fact, the domestic industry is a major export sector. At the same time, the high import duty rates are often inducing significant smuggling activity. Where such products have duty rates in the top band these will be reduced to 30%. Such items include live animals, many basic agricultural products, stone and stoneware, art works, cigarettes and cigars, cosmetics and selected sports equipment. These changes will help lower consumer prices and reduce smuggling without any significant revenue loss.

Tenth, consistent with the overall export promotion policy, all export duties will be revoked. Generally, the sectors that have been protected by these duties such as the textile and leather sectors are now strong enough to survive without these export duties.

Eleventh, I am proposing to expand the Essential Goods Production Support Programme under EPPO to include domestic suppliers of stores to Kenya Airways and other designated airlines. Such stores can already be purchased duty free by the airlines. With this measure local producers will be able to get their raw materials duty and VAT free in order to win supply contracts on an equal footing with imported duty-free supplies of such stores.

Twelfth, Mr Speaker, the EPPO duty/VAT exemption programme has grown rapidly over the past year. To deal with this increased work load and to improve the administration of the EPPO, the reconciliation and export inspection work will be contracted out to one of the trade surveyor (PSI) companies as mentioned in the earlier part of my Speech. This will improve the protection of revenues as well as the service to the exporters. Once the administrative capacity of EPPO is sufficiently strengthened, consideration will be given to expanding the scope of EPPO to include exporters/traders to encourage their activities in developing export markets for Kenyan manufacturers.

Thirteenth, the purpose of an EPZ enterprise is to produce for exports. Unfortunately, a few EPZ enterprises have been continuing to sell too high a share of their products into the local market. To curb such excessive sales by EPZ enterprises into the domestic market, I am proposing to introduce a provision that will allow imposition of a 2.5% surcharge on the sales of such companies into the domestic market.

Fourteenth, Mr Speaker, under the Customs and Excise Act, there are a number of programmes to assist investors with lower duty rates on capital equipment. I am proposing to rationalise and simplify these programmes. Under the general programme allowing remission on capital equipment used in investments aimed at net foreign exchange earnings or savings, with the liberalisation of the foreign exchange controls, the provision requiring foreign sourced financing will be dropped. The programme will also now be open to assist all types of investment whether they are undertaking a new investment project, or an expansion, replacement or rehabilitation project as long as the value of the capital equipment subject to remission exceeds Ksh 10 million. In addition, the special provision for foreign-financed tourist hotels will be discontinued, but hotels will be able to qualify for remissions on capital equipment under the general programme I have just described, where the hotel investments expect to generate net foreign exchange earnings. A Legal Notice is published today that provides details of how investors should apply for these benefits.

It is also proposed that the rural small-scale industry programme be simplified by allowing all types of investments (new, expansion or replacement projects) outside of Nairobi and Mombasa to qualify for duty reduction on capital equipment imports of up to Ksh 50 million. This is a one-time remission and the business requesting it has to have a turnover of less than Ksh 100 million in the accounting period prior to the request to qualify as small scale.

Fifteenth, Mr Speaker, a number of special groups get special duty free privileges under the Customs and Excise Act. Today, I propose to provide the Prisons Service with the same privileges as the Kenya Armed Services. In addition, I am proposing to allow Kenyan sportsmen and women who have won awards in international or national sporting events to apply to bring them back to Kenya duty free -- a just reward and recognition from the Kenyan people for their efforts!

Finally, I am proposing to introduce a number of clarifications and controls for duty free imports. First, a number of groups get special privileges in importing duty-free motor vehicles: parliamentarians, university lecturers and returning diplomats. I propose to harmonise the types of vehicle that they can import duty free to include passenger cars, minibuses of 13 passengers or less, and pick-ups of two tonnes or less. In addition, where an owner of a duty free motor vehicle dies, the vehicle will be able to be passed onto the beneficiary of the deceased's will without duty being charged.

Second, there has been a growing amount of abuse of the duty-free donation provisions of the law by some non-governmental organisations. I am proposing, therefore, to disallow exemptions on office equipment and supplies (excluding computers). In addition, to obtain an exemption, it will be necessary to show that the donated goods will be for charitable, medical, religious or educational purposes.

Third, to improve the control over the disposition of goods purchased by contractors for the implementation of aid funded projects, for all new projects a security bond will be required to be posted that will be cancelled once the disposition of the goods acquired by the project can be accounted for.

Mr Speaker, the duty rate changes that I have I have announced above will become effective from midnight tonight. The Customs will raise for the Exchequer an additional K£126.4 million in revenues.

II. Value Added Tax (VAT)

Mr Speaker, the Value Added Tax was introduced in 1990 as a replacement for the old Sales Tax on imports and domestically manufactured goods. The VAT was introduced so that the taxation of consumption could be expanded on to a broader base. Increasing the tax on consumption allows reductions in the tax on investments. In addition, the VAT offered structures such as zero-rating to ensure that exports could be made without any tax content raising their cost and thereby making them uncompetitive. The base has been systematically expanded each year, and the revenue yield from VAT has increased in each successive year. In fact, VAT Department collections this year are expected to exceed budget targets by one-third. On top of this, Kenyan exports, particularly non-traditional exports as I discussed earlier, have grown at very satisfying rates. Mr. Speaker, there is still one discordant note, however, in the record of the VAT, namely, the unacceptably high number of VAT dodgers. Greater efforts are expected from the VAT Department to bring the offenders to book. Today, I shall announce further base expansions to once more enhance the role of the VAT in revenue collections, but I shall also be bringing forward measures to curb VAT evasion.

First, I am proposing to increase the range of goods taxable through to the retail level -- the so called "designated goods". It is proposed that effective from the 1st September, 1994 the schedule of designated goods will be expanded to include carpets, cosmetics, photographic and optical equipment, motor vehicles and motor cycles (but not bicycles), office equipment, watches and clocks, and all alcoholic beverages. In addition, there will be more complete coverage of the designated goods that were introduced last year in the areas of construction materials and equipment (but excluding hand tools), electrical appliances and fixtures, furniture, and motor vehicle parts.

Second, Mr Speaker, as more goods are made taxable at the retail level tighter controls will be necessary to ensure full compliance. To reduce the evasion of VAT at the retail level and to simplify the application of VAT, retailers and other registered businesses dealing primarily with the general public will be required to quote all prices as VAT inclusive. In addition, traders will be required to issue VAT receipts immediately when goods have been paid for and removed from a store. Currently, the supplier has two weeks to issue the invoice. This immediate issue of VAT invoices will assist the VAT officers in ensuring VAT has, in fact, been paid. Goods sold without payment of tax may be seized by a VAT officer and forfeited by the owner.

Third, to further expand the VAT base, I am proposing to make the following services subject to VAT, effective from the 1st of September, 1994: photographic services, balloon safaris, and car park services (but excluding car park facilities supplied by a local authority or by an employer to his employees on the employer's premises.)

Fourth, to improve compliance with the VAT, and given that all goods subject to the luxury good rate will become designated goods, the luxury good VAT rate will be lowered from 40% to 30%.

Fifth, to further rationalise the VAT rate structure, a few goods will have their tax rate categories changed. Wooden railway sleepers, printing machinery, metal sawing machines, and refined salt will be moved from the exempt to 5% category of goods. Macadam and tarred macadam, cinematographic film, metal road traffic signs and certain wire, rods and tubes will become taxable at the standard rate of 18%. These changes bring the tax rates on these goods in line with those on similar goods.

Sixth, with motor vehicles taxable through to the retail level, some special provisions have been introduced to accommodate this change. First, an individual will only be required to register for VAT as a designated dealer if he sells four or more vehicles in a year. This will clarify that sales of personal use vehicles will not require registration even where the value exceeds the turnover limit for a year. Second, in order to prevent double taxation of previously owned motor vehicles sales of motor vehicles by a registered person will be exempted (a) where the seller was not permitted to take an input VAT deduction when purchasing the motor vehicle, and (b) where the motor vehicle being sold was purchased tax-paid from an unregistered person (such as a private individual) or from a business that was not permitted to take an input VAT deduction upon purchasing the motor vehicle.

Seventh, to assist the insurance sector, the services of loss adjustors and insurance assessors involved in the Marine Cargo Loss Prevention Scheme will be exempted from VAT.

Eighth, to assist the farm and horticultural sectors, it is proposed that all vegetable seeds be zero rated.

Ninth, with the decontrol of all agricultural produce prices, the provisions to zero rate specific types of packaging for such produce are removed. The provision to zero rate packaging for seeds and seedlings, however, remains.

Tenth, to take into account the inflation of the past year, the minimum turnover levels for compulsory registration under VAT are raised by Ksh 300,000 per annum to Ksh 900,000 for manufacturing and Ksh 1,500,000 for other traders and suppliers of services. In the cases of traders in pre-recorded music and timber saw millers, however, the minimum turnover levels are removed in order to protect the formal sector businesses from unfair competition from informal sector businesses.

Eleventh, I am proposing to discontinue input tax deduction on returnable containers by the suppliers of beverages and liquid petroleum gases given that no VAT is ever charged on the use of the container. This will equalise the treatment of containers between vendors who supply goods in returnable containers and those that sell the container along with the goods.

Twelfth, when a business is required to register for VAT, it is proposed to expand the coverage of input VAT allowed to be taken as a deduction to include the VAT paid on capital assets acquired and construction costs incurred, within the last year prior to registration, or such longer period as the Commissioner may deem reasonable (except in the case of motor vehicles), but in any case no longer than two years prior to the date of registration.

Thirteenth, the time allowed for making payment of any tax collected to the VAT Department will be reduced from one month to 27 days from the end of the month in which VAT was due and payable. This will make for more efficient accounting of monthly tax collections. This change will become effective for tax payments due in July 1994.

Fourteenth, Mr Speaker, it has come to my attention that too many VAT payers are making payment with bad cheques. To reduce the administrative costs and lost revenues of returned cheques, henceforth only bank guaranteed cheques for amounts in excess of Ksh 20 thousand will be accepted by the VAT Department.

Mr Speaker, the measures that I have announced today in the Value Added Tax will raise for the Exchequer an additional K£28.3 million in revenues.

III. Excise duties

Mr Speaker, the excise duty has been playing an important revenue raising role since it was expanded to include imports as well as domestically produced goods in 1991. It took on the role of capturing the high tax rate element for a number of luxury goods such as tobacco products and alcoholic beverages where the VAT was not the appropriate tax for such a role. The measures that I shall propose today will build upon this effective revenue raising role for the excise duty.

First, I am proposing to restructure the indirect taxes on a number of major petroleum products so that the excise duty will start to take over as the major tax vehicle. Already under the VAT, no input deductions are permitted for motor vehicle fuels and oils. I am therefore transferring all the tax under the VAT to the excise duty for premium and regular gasolene, aviation gasolene and automotive diesel. This switch will not change the combined tax on these products. In the case of industrial diesel and residual fuel oils, the VAT will be reduced to two shillings per litre, but the import duty will be raised by corresponding amounts. This will bring the effective VAT rate more in line with the standard 18% rate of tax. In the case of liquid petroleum gas, the VAT is decreased to three shillings per kilogram, and the import duty is increased by a corresponding amount plus one shilling in order to bring the effective tax rate more in line with other fuels. Finally, Mr Speaker, in the case of illuminating kerosene, in order to reduce the price of this basic fuel of the wananchi, I propose to remove all indirect taxes from kerosene.

Mr Speaker, recently this House passed into law the Road Maintenance Levy Act which provides for special levies on automotive fuels to fund road maintenance activities. This Act has now received Presidential assent, so I am announcing the commencement of collection of these levies. With effect from midnight tonight, Customs will start to collect levies simultaneously with collecting other taxes and duties on petroleum products. The initial Road Maintenance Levy on premium and regular petrol will be at the rate of one and a half shillings per litre, and on automotive diesel at the rate of one shilling per litre. Based on these levies, a budget for 1994/95 of one and a half billion shillings has been established for the Road Maintenance Fund. As the operation of this Fund proves to be successful, the funding level will be raised over time. Mr Speaker, all Kenyans are looking forward to a smoother ride on our roads in the future!

With the various tax changes on oil products that I have just announced, corresponding changes in retail prices will also be brought into effect. In conjunction with the Minister for Energy, I am announcing the following price changes. Unfortunately, Mr. Speaker, the full amount of the Road Maintenance Levy will have to be added to the retail prices for petrol and diesel. At the same time, however, provision is being made for increased margins to the petrol station operators and for higher pipeline fees without any retail price increases. The Nairobi price of premium petrol will rise to 29.14 shillings per litre, and that for regular petrol, to 28.67 shillings per litre. The Nairobi price for automotive diesel will increase 23.81 shillings per litre. These price changes will be effective from mid-night to-night. Mr Speaker, it is important to note that these petrol and diesel prices, after taking inflation into account, are still lower than at most times over the last five years. With the removal of taxes from illuminating kerosene, the price will drop to 16.31 shillings per litre.

Second, I am proposing to announce the removal of the five percentage increase in excise duties introduced in February 1994 on beer and stout.

Third, I am pleased to announce that the excise duty on soft drinks will be lowered from 25% to 20%. This should lower the price of soft drinks to the wananchi.

Fourth, I propose to raise the specific excise duties on matches from Ksh 12.50 to Ksh 25.00 per 5,000 matches in light of the significant inflation over the past few years.

Mr Speaker, the amendments to the excise duties I have announced will raise a net additional K£15.7 million in ordinary revenues.

IV. Income tax

Mr Speaker, under the Tax Modernisation Programme the income tax has undergone fundamental changes over the last few years. Significant amendments have been introduced to make the administration more efficient and effective, for example, the introduction of the self-assessment system, the instalment tax, and the personal identification number. All these are backed by a growing use of computer systems in the Income Tax Department. At the same time, the income tax has been gradually restructured by lowering the tax rates, reducing the double taxation on company income paid out as dividends, while bringing into tax, benefits paid out to high income earners. These measures are aimed at more effective revenue collections and a more efficient economy. I will build on these traditions with the measures I am proposing today.

First, to offset the high levels of inflation experienced in recent years, and to reduce the burden of income tax on the low income earner, I am proposing to increase the tax reliefs by 50%. The family relief will increase from Ksh 3,636 to Ksh 5,460, while the single relief will increase from Ksh 2,424 to Ksh 3,636. This means that the minimum monthly taxable income is now Ksh 4,550 for married men, and Ksh 3,030 for all other individuals. Mr Speaker, these increases in the reliefs will result in some 230,000 fewer employees coming under the coverage of the PAYE.

Second, to mitigate the effects of inflation induced "bracket creep", the income tax brackets will be widened by 30% from K£3,000 to K£3,900.

Third, I am proposing to lower the top marginal tax rate from 40% to 35% to reflect the improved tax compliance under PAYE and the greater coverage of employee benefits, particularly amongst high-income employees. The new tax brackets and rates will be effective from 1st January 1995:

Annual income:	Tax rate in Ksh per K£:
First K£3,900	2
Next K£3,900 up to K£7,800	3
Next K£3,900 up to K£11,700	4
Next K£3,900 up to K£15,600	5
Over K£15,600	7

Mr Speaker, last July, the Income Tax Commissioner announced a PAYE amnesty on back taxes for all employers that committed themselves to start accurately reporting the income of their employees. I am pleased to announce that the majority of the large employers took advantage of this amnesty. PAYE revenues rose significantly thereafter and have remained over 20% above target this year. I want to thank those employers who have co-operated and complied with the law. The tax breaks I have been able to announce today are made possible by this improved compliance and are a just reward. For those employers who did not take advantage of the amnesty and are still not complying to the letter of the law, I am instructing the Commissioner to direct his PAYE audit efforts vigorously in their direction. Those who do not comply with the law are effectively getting unfair subsidies at the expense of those companies that do comply. Every effort will be made to remove this unfair, underserved, and unintended competitive advantage.

Fourth, Mr Speaker, all Kenyans have been painfully aware of the effects of drought over the past few years. Drought relief efforts have also put a strain on an already stretched Budget. While the drought now appears to be thankfully behind us, food shortages continue and the costs of the relief measures are still very real. As announced by the Government earlier this year, a temporary Drought Levy would have to be imposed to help offset the costs of the drought relief programme. This levy will be composed of an additional 2.5% charged on company income earned in accounting periods ending between 1st July, 1994 and 30th June, 1995, and a further 2.5% charged on the income of individuals in excess of K£19,500 earned in 1995. Since this temporary Drought Levy is only for one year, it will not damage the longer term investment incentives of businesses which currently have a tax rate of 35%.

Fifth, to improve the fairness of the tax system and encourage more work effort, all self-employment income of wives will be taxed on the separate tax schedule for wife's employment income with effect from 1995.

Sixth, I am proposing to continue the phase-in of tax deductible contributions to registered pension funds as well as the strengthening of the rules to protect the pension of Kenyans. In light of the recent high inflation levels, the limits for both contribution and deductions will be raised by 100%. The combined limit for contributions to registered pension and provident funds will be raised from Ksh 90,000 to Ksh 180,000 per year. The limit on deductions for contributions to registered funds will be raised from Ksh 18,000 to Ksh 36,000 per year. This limit will also apply to deductible contributions to Registered Individual Retirement Funds. In addition, the maximum amount that can be withdrawn from a registered pension fund as a lump sum upon retirement will be increased from Ksh 360,000 to Ksh 540,000.

Mr Speaker, to continue the progress that has been made in improving the standard of pensions and protecting the rights of pensioners, I am proposing to require formal audits of all registered funds at least once every three years. Where the pension fund offers a defined-benefit plan, a certified actuary will be required to conduct an actuarial evaluation. Reports will have to be sent to the Commissioners of both Income Tax and Insurance, as well as be made available to the members of the fund for scrutiny. Where the audits identify surplus funds in registered pension or provident fund, special rules are being introduced to prevent further build-up of such surpluses, and to ensure that such surpluses are appropriately allocated to the fund members over time. I am also introducing amendments that clarify the treatment of those provident funds that were segregated at the time of the introduction of deductible contribution in 1991, and also to remove any confusion over the tax treatment of contributions to unregistered as opposed to registered pension and provident funds.

Seventh, the Income Tax Act has been silent on the tax treatment of benefit payments from the National Social Security Fund. I am proposing that they receive similar treatment to lump sum withdrawals from registered pension funds. Benefit payments, therefore, will be tax exempt on the first Ksh 360,000 plus 50% of the excess of the amount above Ksh 360,000. This brings NSSF benefits in line with other pension withdrawals and recognises that the one-half of the contributions made by the employer receive a tax deduction. The provisions covering the application of withholding tax to pension payments and withdrawals in excess of the exempt amounts are also extended to cover any NSSF benefit payment in excess of the tax exempt limits that I have just announced.

Eighth, Mr Speaker, with the growing sophistication of the capital markets and the increased volume of debt instruments being issued and traded, the tax treatment of discounts on bonds and other debt instruments needs to be clarified in the law. I am therefore proposing to expand the definition of interest income and also to introduce a definition of "original issue discount." In addition, withholding tax provisions on residents and non-residents earning interest income by way of discounts will be added to the Income Tax Act. These withholding tax provisions will become effective as of 1st October, 1994 and all existing exemptions on withholding on interest income earned on Treasury Bonds or Bills will be revoked.

Ninth, Mr Speaker, some of the highest income earners are individual contractors. Unfortunately, their tax-paying track record is not equally impressive. To deal with this evasion problem, I am proposing to introduce a new 10% withholding tax on gross payments made on work done under contract by an individual not doing business under a registered business name where the gross payments exceed Ksh 24,000 per month. This measure will become effective on 1st October 1994. It has also come to my attention that some resident individual contractors are being hired under aid-funded contracts that purport to award an exemption from income tax. While such contractors are not subject to PAYE, unless there is a specific exemption provided under the Income Tax Act such exemptions have no validity. Where resident individuals are contracted directly by international aid agencies, I am providing the option for such agencies to report the PIN number and amount of the contract payment instead of withholding tax directly. Mr Speaker, I am taking this opportunity to appeal to the aid and diplomatic community to help the Government in enforcing its tax laws and to improve the transparency and accountability of the tax system.

Tenth, the Personal Identification Number or PIN system became operational in September 1993. PINs are currently required on tax documents and forms, and for third party motor vehicle insurance. The PIN has been assisting in identifying a growing number of persons doing business outside the tax net. It is also key to the ongoing computerisation of the tax systems. Today, I am announcing two further expansions of the use of the PIN that will become effective on 1st September 1994: First, the Registrar of Motor Vehicles will require the PIN of the owner for the registration of motor vehicles. Second, a company, partnership or other legally constituted body of persons contracting with a self-employed individual not doing business under a registered business name will be required to record the PIN of the contractor.

Eleventh, the subsidised element of employer-provided low interest rate loans is a taxable benefit. I am proposing clarifications such that where subsidised loans extend beyond the date of employment termination, the recognition of the taxable benefit will continue. In addition, the benefit will also be recognised where directors receive such loans, including where the loan is made out of a non-registered fund established by the employer.

Twelfth, where employers have been providing educational benefits for employees, no deduction has been allowed to the employer. Such benefits, therefore, have been subject to double taxation. I am proposing amendments to remove this double taxation problem on educational benefits.

Thirteenth, where a life insurance company is also involved in general insurance business and has to recognise its income as its book profits, currently in such situations all loss carry forwards are disallowed. In order to equalise treatment with a company only doing general insurance business, I propose that they will be allowed carry-forward losses from their non-life business against the income from their non-life business effective January 1, 1994.

Fourteenth, the requirement introduced in 1992 for the use of actuarial principles in establishing reserves (including discounting ultimate costs) in the calculation of income of general insurance business will be expanded to also include reserves for claims still unpaid or unreported at the year end.

Fifteenth, to extend the integration mechanisms to avoid the double taxation of company income, I am introducing proposals that prevent double taxation of company income where dividends are received as trading income by financial institutions. Such dividend income will become tax exempt to the financial institutions when received as trading income, but the expenses relating to earning such dividend income will no longer be deductible (other than the interest payments made to depositors, dividends or bonuses paid by co-operative societies, and dividends paid by building societies.) This measure will encourage the insurance companies, in particular, to undertake long-term equity investments.

Sixteenth, Mr Speaker, to further encourage investment, as I discussed earlier, I am proposing to make significant expansions in the types of investment qualifying for wear - and - tear deductions as well as investment deductions. (1) The meaning of construction of an industrial building is broadened to include renovations and rehabilitation other than routine maintenance and repair. (2) The types of building qualifying as an industrial building are expanded to include structures and civil works on the premises related to the industrial activity, including roads, parking areas, railway lines, water, industrial effluent and sewerage works, communication and electrical supply structures, and security walls and fencing. (3) The expenditures under this expanded definition of an industrial building will also qualify for the investment deduction for manufacturing activities. (4) The definition of machinery qualifying for the investment deduction is also expanded to include machinery and equipment used in activities indirectly related to the manufacturing activity, including equipment for electricity generation, transformation and distribution; for the clean up and disposal of effluents and reducing environmental damage; and for water supply and disposal.

Mr Speaker, the inclusion of expenditures on infrastructure, and on electricity and water supply equipment under the investment deduction will clearly benefit investments outside established urban areas. Taking this into account along with the general expansion of the investment deduction base and the lack of effectiveness in the past of the regional differentiation of the investment deduction rate, I am proposing that the investment deduction rate be made a uniform 60% across all regions in Kenya. New investments by manufacturers for export operating in Customs bonded facilities will still retain the 100% investment deduction rate.

Seveteenth, the ten-year tax holiday available to new EPZ enterprises provides an all too attractive opportunity for a related resident company to set up transfer pricing arrangements to evade income tax. To help control tax evasion behaviour through transfer pricing, I propose to introduce special rules where manufacturing or other services are being provided by a related resident company to an EPZ enterprise.

The measures that I have announced in the income tax will raise for the Exchequer a net additional K£30.6 million in revenues.

V. Stamp duties

Mr Speaker, the stamp duties are long over-due for review. Today, I am making a number of proposals to improve the collection of stamp duties and reduce or even eliminate them where they have been excessively hindering or distorting economic activity.

First, I propose to introduce a number of amendments to clarify the procedures for land valuation when it is being transferred, and to strengthen the powers to enforce collections of stamp duties.

Second, stamp duty rates have not been amended since 1985. Accordingly, I am proposing to raise the duties on 19 types of transactions, particularly where specific duties are involved and their values have been seriously eroded by inflation.

Third, since the stamp duty rates for land transfers were doubled in 1985, serious problems have arisen. Land subject to transfer has been grossly undervalued, or the transfer of ownership is not registered. Therefore, I am proposing to lower the stamp duties on urban land transfers from 6% to 4%, and that on rural land transfers from 4% to 2%. Mr Speaker, I expect no loss of revenues from stamp duties on land transfers -- with lower rates and tighter enforcement, more transfers at more realistic values should be registered and subjected to stamp duty.

Fourth, to assist the development of export finance facilities by the commercial banks, I am proposing to abolish the stamp duties on bills of exchange and promissory notes. This will allow the use of commercial paper as security in providing short-term finance for exporters and other traders.

These amendments to the stamp duties will raise a net additional K£5 million in ordinary revenues.

VI. Miscellaneous fees and taxes

Mr Speaker, I am proposing changes to a number of miscellaneous licence fees and taxes. First, to assist the flow of international trade with our neighbouring countries, the fees for authorisation permits for foreign private and commercial vehicles entering Kenya have been rationalised, lowered and simplified. Second, to take into account the high level of inflation in recent years, licence fees have been increased for banks, building societies, insurance companies, and auctioneers. In addition, Trade Licences and Tourist Enterprise Fees have been increased. Third, to assist the stability of the insurance sector, an exemption on the tax on foreign reinsurance premiums will be given effective January 1, 1995. This will cover catastrophe excess of loss contracts relating to marine, aviation and industrial fire risks.

Mr Speaker, I expect to raise an additional K£6 million from these miscellaneous measures.

CONCLUSION

Mr. Speaker, in ending this year's Budget Speech, I wish to recall that I have described the framework of policies that currently characterise the Kenyan economy. At the core of that framework is liberalisation through the removal of a wide variety of controls and regulations. I am confident that this liberalisation will liberate and stimulate the energies of private enterprise, as has happened in other parts of the world. Mr. Speaker, the two over-riding policy objectives in the short run are: (i) controlling inflation and (ii) eliminating domestic borrowing. These two are highly inter-related; if we succeed in some measure in realising one, the achievement of the other, will to that extent, become easier. It is, therefore, significant that, as I have already mentioned, despite a temporary resurgence over the first few months of this year, the three-month annualised rate of inflation was back down to 18.8 percent by the end of May. Indeed, prices of many items actually fell compared with April.

Mr. Speaker, this year I am attaching a *Statistical Annex* to the distributed Budget Speech which shows the movements various rates, ratios and percentages in several tables and charts. This innovation will help both Hon. Members and the public to have a visual impression of the turbulence which we went through last year. The inflation chart clearly shows the temporary resurgence that I have talked about. I am confident, Mr. Speaker, that with the policies I have outlined and with reasonable rainfall, we shall be able to curb this monster called inflation by the end of this year; getting the budget deficit and consequent domestic borrowing under control will then become an easier task.

Mr. Speaker, when I presented my Budget last year, the economy was grappling with many intractable problems. Today, in contrast, the economy is poised for strong recovery and sustained growth. There is an air of expectation and renewed confidence all around. Let me assure Honourable Members that the policies which have brought this turn-around will be continued and strengthened. In my Budget today, I have lowered taxes and duty rates and introduced measures to support exporters and investors. I have introduced wide ranging measures to reform and restore discipline to State Corporations and financial institutions. Hence, let me conclude by once again urging the investor, both here and abroad, to take advantage of these changes and reforms and to profit by getting in early.

In closing, Mr. Speaker, I call on all, here in this August House to work together to establish the environment in which business can thrive, then our families can grow up in the knowledge that we, in our time, laid a secure foundation for a sustainable and prosperous future.

Mr. Speaker, I beg to move.