

**SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 13th JUNE, 1991,
BY THE HON. PROF. G. SAITOTI, VICE PRESIDENT AND MINISTER FOR
FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE
FISCAL YEAR 1991/92**

(1ST JULY, 1991 TO 30TH JUNE, 1992)

Mr. Speaker, Sir,

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

1. INTRODUCTION

Mr. Speaker, this is the sixth budget since the adoption of our own structural adjustment programme under Sessional Paper No. 1 of 1986 on " Economic Management for Renewed Growth ". As Hon. Members are aware, this is not a programme which was conceived in haste only to be recanted later. The programme is well thought out and the policies enunciated in it have already been in place for a number of years. The success of these policies is reflected in the very admirable annual economic growth rate of more than 5 percent achieved over the last six years. Such a level of economic growth, and therefore of employment, is very much dependent on the peaceful atmosphere and on the pace of this restructuring.

Mr. Speaker, world economic history is replete with examples of nations, the economic disintegration of which has followed political turmoil. Kenya's record of political stability has been unsurpassed in Africa. The need to maintain this stability cannot be overemphasised. The philosophy of peace, love and unity that our beloved President has tirelessly cultivated, has led to economic development. I am sure I speak for all Hon. Members when I say that we should continue to uphold and strongly support His Excellency's efforts towards these noble goals.

In general, economic reforms are not expected to produce their full results immediately, especially following long periods of structural maladjustment. On average we have done better than others who have undertaken such programmes as can be shown by our enviable economic performance. Under these reforms we have managed our resources prudently and have, in consequence, experienced positive real economic growth and an improvement in the living standard of our people each year.

As I stated in my last Budget we are seeing the results of this structural transformation. Notwithstanding this we are now confronted with an inhospitable international environment. It is therefore important that we

continue with this strategy for efficient management of our resources. It is within this context that I have formulated the theme for the 1991/92 Budget, to be **"SUSTAINING ECONOMIC GROWTH UNDER ADVERSE CONDITIONS THROUGH THE EFFICIENT MOBILISATION OF RESOURCES."**

As has been traditional, I will begin by reviewing the international scene; the African regional position and our own performance in 1990 and then outline the prospects for this year and beyond. Thereafter, I shall highlight the budget out-turn for 1990/91 and the forecast for 1991/92 fiscal years. Finally I will introduce specific taxation measures and other changes.

2. THE GLOBAL CRISIS

Mr. Speaker, the world economy in 1990 suffered a crisis, unprecedented in recent times. The dominant event which caused the crisis was, of course, the Gulf War. Its consequences for the world at large were serious. First, the price of oil climbed briefly to an unprecedented \$40 a barrel before settling at around \$30 and finally dropping to \$20 per barrel. These prices cost importers dearly and diverted resources from investment and other uses. The loss to Kenya is estimated to be about K£ 117 million over the five months from August to December 1990, a loss equivalent to over 10 percent of our export earnings for the entire year. Second, travel and tourism were specially hard hit due to fears of terrorism. As Hon. Members are aware, Kenya depends heavily on tourism and hence suffered severely. Tourist arrivals were reduced by about 50 percent during the peak season of January to March 1991, compared to last year. This resulted in a further loss of over K£ 70 million. Unfortunately, this depression in tourism may not yet be over, as vacation plans made during the Gulf War could well affect tourist arrivals for a few months yet. Related to this, airline traffic was reduced so less cargo space was available for Kenya's exports, particularly horticulture.

Mr. Speaker, the second major event was the world-wide recession. The global rate of growth of income shrank from over 3 percent in 1989 to just over 2 percent in 1990 and the forecast is a further decline to 1 percent this year. The recession is severe in the US and the UK with little growth predicted for the former and a decline in Gross National Product predicted for the latter over this year. Although growth has also slowed down in Germany and Japan, these nations are still expected to register increases of 3.0 and 3.7 percent respectively, in 1991.

The expected decline in income will dampen world trade which is expected to slow down from 7 percent in 1989 to about 5 percent in 1991. The recession has allowed interest rates to fall. This year six month London

Inter Bank Offer Rate (LIBOR) - which acts as a sort of international benchmark - has fallen from 13.56% in January to 11.19% in June, a 17.5 percent decline over five months. However, inflation in the industrial economies has remained high despite the recession, and this has prevented central banks in these countries from lowering interest rates further. The world recession has also contributed to a decline in commodity prices. Two of these are of particular interest to us. Coffee prices were 18 percent lower in dollar terms in 1990 compared with 1989, while tea prices improved slightly.

Mr. Speaker, the Gulf War and the world recession can be seen as transitory events which deeply affected the world last year but they will soon fade in importance. The world also witnessed major changes in the structure of political and economic power that will profoundly affect the international environment for years to come. The most profound set of events has been the continuing saga of German reunification; the political and economic reforms in Eastern Europe; and the challenges to unity in the Soviet Union. The developing countries will be affected adversely by this dramatic transformation. Capital, including foreign aid and private investment, especially equity investment, is likely to be diverted to Eastern Europe, while the additional demands for finance are likely to keep world interest rates higher than they would otherwise have been, thus affecting all commercial borrowers.

The failure of the Uruguay Round on GATT (General Agreement on Tariffs and Trade) to conclude an agreement on global trade was a further disappointing event in 1990. It is regrettable to note that while many developing countries, including Kenya, are striving to end trade restrictions and to lower import duties, industrial countries have failed to reciprocate by opening their markets wider to both our manufactured and agricultural exports. A renewal of the GATT negotiations should therefore be high on the international economic agenda for the coming year.

Mr. Speaker, while the GATT struggles to keep the world trading system open, Europe marches towards its economic integration at the end of 1992, with uncertain consequences for the rest of the trading world. North America, in response to this and to the continuing challenge from Japan, seeks its own trading bloc. The US and Canada have already signed a free trade agreement and Mexico has broken out of its protective shell to propose a similar treaty with the US. Developing countries in particular, and others in the world, will continue to benefit most from an open trading system. If however, the world is dividing into blocs, this intensifies the challenge to countries like Kenya, which must become competitive enough to export around and through any trade barriers thrown up by regional

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groupings. Furthermore, it is most urgent that the countries of Africa strengthen the implementation of their own regional trading arrangements such as the Preferential Trade Agreement (PTA).

Mr. Speaker, turning to Sub-Saharan Africa the pace of economic activity slowed in 1990, reflecting the effects of the rise in oil prices and a drop in the prices of non-fuel primary commodities, particularly coffee, tea and cocoa which fell to their lowest levels since 1980. The GDP growth is projected to recover from 3 percent in 1990 to 4.75 percent in 1992. However little progress is expected to be made in alleviating poverty, and regrettably real per capita GDP should remain near the level of 20 years ago. The modest growth outlook for Africa also reflects the expected declines in the terms of trade and the slowdown in the growth of world trade in 1991. The continent's sluggish growth has been accompanied by an average inflation of between 15 to 20 percent. In 1991, inflation is projected to increase to 22 percent from 16 percent in 1990.

The scenario in the East African region is mixed. His Excellency, the President recently focused international attention on the human toll of misery resulting from the tragedies of war, drought and poverty in Somalia, Ethiopia and Sudan. These events have of course depressed potential for growth in the region. Beyond that, the strife in Somalia and Ethiopia has already had direct costs to us in Kenya, in terms of the inflow of refugees. The drought is of particular concern because it comes at a time when political turmoil make it especially difficult for some of the stricken countries to cope. But the drought is not confined to our northern neighbours alone. It has affected Mozambique and Malawi as well, while rain in East Africa has not been generous.

Mr. Speaker, another event of world-wide importance has been taking place in Africa. This is the gratifying progress being made in South Africa to end the crime of apartheid and bring the African population into the political life of the country. South Africa, once it becomes an open society, should play a major role in trade within the Continent and we can expect countries in Southern Africa to turn even more towards it as a customer for their exports and as a source of their imports.

These various challenges from the world trading system - the GATT negotiations, the European Community and North American trading blocs - all serve to re-emphasise the importance of structural adjustment and export competitiveness to Kenya.

Mr. Speaker, the final issue from the world economy is the old problem of debt. The debt of the developing countries remains high and

several are facing difficult repayment problems. Many innovative ideas are being examined and there is now a prospect that the official aid donors, to whom most African debt is owed, may provide some widespread debt relief. The two major debt relief components of official bilateral creditors' support are debt cancellation and debt rescheduling. Cancellations of Overseas Development Agency (ODA) loans are expected to reduce the stock of debt by 7 percent, while official bilateral debt rescheduling could be carried out with longer maturities and grace periods. In addition, there are other forms of indirect assistance which include increased bilateral disbursements of concessional assistance through the World Bank's Special Programme of Assistance (SPA). At present 21 African countries are undergoing adjustment, and thereby qualify for SPA support. Donors plan to provide about US\$ 8 billion through 1993 in co-financing or co-ordinated financing with IDA credits. And it is hoped that such relief will come in response to the efforts of the nations of Africa to restructure their economies so as to deal with debt and to establish export competitiveness.

3. THE DOMESTIC ECONOMY

Mr. Speaker, the many adverse events in the world at large that I have just described have lessened the funds available in the developed world to support developing countries. Although donors have continued to be generous we received less aid in 1990 than we had planned for. Moreover, collection of domestic revenue from major indirect taxes like Customs and Excise and the Value Added Tax on local manufactures fell considerably short of the original budget estimates, reflecting, in part, depressed levels of activity in some important sectors, relative slowdown in the growth of imports, and financial difficulties faced by many parastatals. Since we were unable to anticipate these shortfalls expenditure was not curtailed to the same extent. Furthermore, Hon. Members will recall that we recently passed in this House, a supplementary budget as a consequence of urgent increases in expenditure which have been found necessary in view of the problems in neighbouring countries.

This decrease in revenue and aid coupled with the increase in expenditure has caused our deficit to rise and has also meant that we have had to increase our domestic borrowing, thus depleting the investible funds available to the private sector and causing the interest rate to rise.

Mr. Speaker, the recently issued Economic Survey shows how these adverse movements have given rise to a reduction in private investment, a decline in domestic savings and an increased pressure on prices. The need for fiscal discipline to restore the stability of the economy will be the theme of most of this budget.

Sectoral Performance

Mr. Speaker, the economy grew by 4.5 percent in 1990 compared with 5 percent in 1989, there are signs in the various sectors that 1991 will not be an easy year. Agriculture grew at 3.4 percent, compared with 3.9 percent last year. The manufacturing sector continued to grow satisfactorily but not as well as in 1989. Growth rates of 5.2 percent and 5.9 percent in 1990 and 1989 respectively are satisfactory but not good in view of the contraction in overall investment by 7 percent.

Employment in the modern private sector grew by 3.9 percent, while overall job creation, excluding small scale agriculture, went up by 5.1 percent, well above the rate of growth of new entrants to the labour force. Most of these new jobs were to be found in the small scale, informal sectors of the economy. It is therefore clear that policies favouring these sectors are bearing fruit. Tourism, despite the cutback in the last four months of the year, had a good year and the sector was our most significant foreign exchange earner, growing by some 9 percent in the number of tourists. The number visiting game parks went up even more spectacularly by 22 percent.

Savings and Investment

Mr. Speaker, since government borrowing from the banking system went up by 59 percent last year, it is not surprising that private investment has been adversely affected. In current value terms, stocks declined by 25 percent including a running down of coffee and maize stocks, while gross fixed capital formation decreased by almost 13 percent in real terms although it was 4.5 percent up in current value terms.

The overall decrease in investment, linked with the decline in foreign aid relative to the expected levels has meant that domestic savings to finance such investments, has declined by over 8 percent.

Balance of Payments

Mr. Speaker, a healthy overall balance in the balance of payments is a key aspect of economic stability that every country desires. To achieve this stability and sustain it, we in Kenya have been pursuing, over the last few years, a strategy of export promotion hand in hand with the structural adjustment policy of import liberalisation. However, non-oil exporting developing countries are handicapped by a chronic deterioration in their external terms of trade, arising from the relative stickiness of prices of primary products which form the bulk of their exports compared to prices of

manufactured goods and crude oil which make up most of their imports. In this respect, our own terms of trade fell from 103 in 1986 to 69 in 1990, a fall of 33 percent in the space of four years. This demonstrates the damaging effect of this relative stickiness over which the developing nations have no control.

Nevertheless during 1990, the value of our total exports rose by 19.1 percent, reflecting good growth in our earnings from tea and a recovery in exports of horticultural products. Imports, on the other hand, increased by only 13.5 percent which reflects, in part, the effect of restrictions on parastatal imports. In part, again, it reflects the squeeze on domestic credit, international inflation and exchange rate adjustments which made imports more costly and money scarcer. As a result of these developments, the current account deficit fell from 7.4 percent of GDP in 1989 to 5.5 percent in 1990. However, because of a significant reduction in Government programme borrowing and some fall in private long term capital inflow, the overall balance deteriorated considerably, from a surplus of K£ 81 million in 1989 to a deficit of K£ 169 million in 1990.

In consequence, the foreign reserves of the country fell at the end of 1990 to a level equivalent to 2.1 month's normal imports, compared to 2.6 months at the end of the previous year.

Money, Credit and Prices

Mr. Speaker, turning to money and credit, I would like to point out that the aim of the monetary policy in 1990 was to contain inflation by limiting the rate of growth of money supply. The expansion in money supply was 20 percent compared to 13 percent in 1989; however it was still much less than 33 percent recorded in 1986. The sharp increase in money supply arose from a substantial expansion of total domestic credit of 27 percent compared with the corresponding increase of 7 percent in 1989. The growth of credit largely reflected the increase in Government borrowing domestically to finance its budget deficit. This borrowing amounted to a 59 percent growth compared with a 3 percent drop in 1989. Credit to the private sector and other public institutions registered a 12 percent increase, the same as in 1989. The monetary growth led to an increase in average liquidity of commercial banks from 26 percent in 1989 to 30 percent in 1990, which was 10 percentage points higher than the minimum requirement of 20 percent. The excess liquidity was mopped up through the floating of additional Treasury Bonds and Treasury Bills. During the year interest rates were also adjusted to curtail the rapid rate of growth of domestic credit. In addition, real positive rates were maintained on average, in order to stimulate savings and the

efficient allocation of resources. A number of commercial banks introduced local Bearer Certificates of Deposit during the year as an alternative financial asset with attractive yields which savers could hold.

Mr. Speaker, to get perspective of the progress we have made in the area of money and prices, it is necessary to review, for contrast, what the position of the economy was in a period before we started our adjustment. Although inflation at the end of 1990 was 12.6 percent and therefore slightly higher than any time in the previous six years, it is noteworthy that it is lower than the rates recorded in most months between October, 1980 and April, 1984, a period of almost four years in which inflation averaged over 15 percent. It is also important to realise that we have managed to keep inflation under control to this extent despite the sharp rise in oil prices in the recent past.

External Debt

Mr. Speaker, regarding our external debt position, Kenya is the sixth most indebted nation in Sub-Saharan Africa and yet remains one of only four countries which has not had to reschedule its debt in the past eight years. Our total debt per capita now stands at US\$ 244 which is lower than 31 of the 44 countries in the rest of the region.

Mr. Speaker, our debt burden is a manifestation of persistent deficits, particularly budgetary deficits. Although we have managed to service our debts in the past without defaulting, this has been done at great cost and sacrifice. The high service payments on our domestic debt obligations are already exerting pressures on our ability to control annual recurrent costs, while external debt service payments are cutting into our export earnings thereby exerting further pressure on our ability to import essential intermediate goods and capital equipment. These difficulties have been compounded by large, past, imprudent borrowing by parastatals. Consequently the Government, as the final guarantor of parastatal debt, is increasingly being called upon to bail them out. Thus additional heavy debt service claims not only erode budgeted resources but further distort and divert them to meet the sudden, unbudgeted obligations. The Government has therefore tightened up on parastatal borrowing through a very close scrutiny to avoid such abrupt burdens.

In view of our policy to progressively reduce our budget and current account deficits and in view of already high external debt, we can afford to raise loans from abroad only on very soft terms. This can be done through strict discipline and close co-ordination in the public sector. We are determined to bring down our debt service ratio and therefore the Deb

Division of the Treasury will scrutinise each loan even more carefully before recommending it. In addition, the Treasury will guarantee loans for the parastatals only if the borrowing are on soft terms. Furthermore, we have set ourselves rigid annual ceilings on our non-concessional external borrowing with a view to controlling such debt.

During the past year, several donor countries have cancelled our external debts converting them to grants, these total some K£ 228 million and we are most grateful for these generous decisions. In consequence, our debt profile has improved somewhat. The debt service ratio has decreased from 32.1 percent in 1989 to 28.3 percent in 1990. The grant element has increased, the interest rates on new loans have declined, the grace period is longer and the maturity period is extended. I anticipate, the external debt service will decline further once our export policy is successful in accelerating the growth of our export earnings.

Tax Modernisation

Mr. Speaker, it is necessary to review the progress made in the course of our tax modernisation over the last five years, before discussing the Policy Framework, for this is a key factor to bringing the deficit under control. One of the major ways in which this can be achieved is by having an effective taxation strategy, and I would like to demonstrate how we have been building up our capacity in this area.

Mr. Speaker, under Income Tax in 1986 there were eight tax band each of which was K£ 1,800 wide. The maximum relief was Shs 1,800 to a family, while the maximum marginal tax rate was 65 percent. We have now five tax bands each K£ 2,300 wide, the maximum family relief is Shs 3,960 and the maximum rate is 45%. Similarly Corporation Tax has declined in this period from 45% to 37½%.

Under tariffs there have been equally spectacular changes. In 1986 all but imports under Schedule I and II were subject to quantitative restrictions, but now only 10 out of almost 5,800 items are under such restrictions. The movement from quantitative restrictions to the tariff regulation of imports has been accompanied by a decrease in the number of tariff bands from 25 to 11, while the maximum rate has declined from 170 to 70%. In the last three years the median tariff band, where the greatest number of items were to be found, has declined successively from 45% to 30% and is now 25%.

There has also been a progressive reduction of tariffs which has been counter-balanced by changes, firstly in Sales Tax and later in the Value

Added Tax. These have ensured that revenues have not been undermined and have maintained proper market signals to dampen demands which might otherwise have eroded our foreign exchange. Following the conversion of Sales Tax to a Value Added Tax in 1990, we have undertaken various measures to enhance the efficiency of this form of taxation. The number of VAT tax bands has decreased from 15 to 8 while the maximum rate has declined from 210% to 100%. Furthermore under both the Value Added Tax and tariffs, a large number of goods that were previously subject to specific rates now have ad valorem rates, thereby increasing the buoyancy of the tax measures. VAT has the further benefit of being applicable to a range of services. I have also looked at the Excise Duties and have expanded them to cover a number of new products, including some imports and have converted them to ad valorem rates.

In addition to changes in rates and coverage of taxation, revenue collecting departments have undergone transformation in terms of computerisation. Introduction of computers has facilitated improved administration through changes in procedures and legalisation in these departments. Routine tasks and tax revenue data are now computerised and have enabled the departments to carry out frequent analysis and operation with greater degree of efficiency.

Prognosis

Mr. Speaker, in the year under review, the rate of Gross Domestic Product (GDP) grew by 4.5 percent which was below the target of 5.1 percent. This could have turned out to be much worse in the face of the exceptional circumstances that prevailed, had our economy been less resilient. The balance of payments position turned out to be weak, basically reflecting a further worsening in our external terms of trade, the oil price shock, a contraction in inflows of private investment and a relative slowing down in the disbursement of programme finance from abroad. However, the areas of major deterioration were the higher budget deficit and the high rate of inflation. The former increased from last year's target of 3.5 percent to 5.3 percent, while the latter rose to 12.6 percent from the 1989 rate of 10.6 percent and our 1990 target of roughly 7 percent.

The tentative forecast for the growth of the economy this year is 4.0 percent and the latest balance of payments projections indicate that gross official reserves will improve slightly. The budget deficit will be reduced from 5.3 percent in 1990/91 to about 2.0 percent of GDP in 1991/92. The central economic aim is to bring sustainable stability to the economy which will require bringing inflation down and keeping it down. To attain this objective, the macroeconomic policies of the Government will

need to stabilise and sustain the healthy economic performance through stronger structural adjustment measures. Mr. Speaker, the realisation of these measures calls for prudent economic management, and the policies and measures which I will be introducing seek to achieve this goal.

4. THE POLICY FRAMEWORK

Introduction

Mr. Speaker, turning to the substantial issue of the policy framework, I would like to reiterate that Kenya's economic growth rate, faster than 5 percent a year since 1985, puts us in the ranks of the more successful developing countries. For this achievement we are grateful to the leadership of His Excellency, the President, whose governance has maintained stability in the country and made possible the major economic reforms of the past six years. The implementation of the past structural adjustment policies has enabled Kenya to regain the path of economic growth.

Mr. Speaker, to protect this record, we must guard against two economic forces, both inside and outside Kenya, that are threatening to blow us off the course of growth travelled over the past six years. I mentioned first the possibility of foreign capital, including concessional aid, but especially equity investment, being diverted from countries like Kenya to those of Eastern Europe. Mr. Speaker, resources from overseas have played a crucial role in our development. Official assistance has financed about a third of our gross investment in the recent past. Without that assistance, the economy could not have expanded fast enough to keep up with population growth. However, it would be unwise to build a long term growth strategy that is dependent on this flow of external resources. Prudence dictates that we must mobilize our own resources to augment, and eventually replace, foreign assistance. We must raise the domestic saving rate from its recent level of 20 percent of GDP. And, more crucially, we must ensure that our workers, our land, and investments are used in the most productive ways possible.

Mr. Speaker, a second force working against our economic development is the issue of fiscal deficits - the tendency to spend more than we collect in revenues. The Budget has run deficits for many years, but in recent times these have been contained to manageable levels compared with Gross Domestic Product. The trouble is that there is a growing tendency to become accustomed to these deficits, despite our earnest attempts to reduce them. There is a further temptation to sanctify Budget deficits as "essential for development and employment creation." The contrary is true! Budget deficits do not promote either development or employment. Instead, they

threaten to wreck the programme of structural adjustment on which Kenya's economic growth and employment creation depend.

Fiscal Policy

Mr. Speaker, in view of the deteriorating external position and particularly the decline in donor support for structural reform, fiscal policy has assumed a central role as a tool for economic stabilisation. Taken in the broadest sense under fiscal policy I will cover the evils of uncontrolled deficits, the control of public expenditures and the enhancement of revenue.

Mr. Speaker, the underlying premise of Government's strategy is that the well-being of the wananchi ultimately depends on the sustained growth of income. Income growth, in turn, depends on continuing growth in the productivity of workers, capital and land. And employment creation can only be maintained in a growing, increasingly productive economy. To achieve this, first the private sector is to take the lead in investment, production, and employment creation. Properly guided, it is predominantly the private sector that has the incentives to use resources more productively, to make investments that yield higher growth and development, and to create more jobs at decent incomes on a sustainable basis. Private firms that cannot do these things will find themselves bankrupt and out of business. Governments, in contrast, are not compelled to produce efficiently in order to survive, and are, therefore, not as productive in their use of resources as the private sector. Second element of the strategy is that markets are far better able than government to guide the private sector to use resources productively. For markets to fulfil the role of monitors of development, the Government must assist them to work better by reducing its own controls over market behavior; by ensuring competition by helping to create new market institutions; by providing a reliable legal framework; and by making investments in infrastructure that the private sector cannot undertake.

To implement our development-and-employment strategy, we have undertaken a long-term structural adjustment programme which embodies these changes.

Mr. Speaker, let me emphasise that anything that jeopardises the implementation of the Government's structural adjustment programme threatens our basic strategy for generating higher incomes and creating new jobs. It is here that budget deficits enter the picture. Deficits cause imbalances in the economy. They can add to the demand for imports while taking resources away from exporters. Deficits can add more to the money supply than the economy needs for transactions and cash balances, causing

prices to rise. And greater inflation can force the Central Bank to depreciate the currency more rapidly. In short, budget deficits, especially high or rising ones, create economic instability. They undermine investor confidence and lead to unhealthy speculation.

Mr. Speaker, there is a further reason why deficits may undermine development and employment. When the Government borrows from the private sector, it diverts private savings into government consumption and investment. This switch of resources into government hands means a reduction in growth and hence a reduction in new job creation for the economy as a whole. Unless we reduce the deficit substantially, we run the risk of tipping the economy towards faster inflation and larger, unsustainable balance-of-payments deficits.

Today I will present a budget that sharply reduces the projected deficit from the levels seen in recent years. This will require determined efforts to curb the growth in Government expenditure and to raise more revenues. I view this concerted effort to reduce deficits as one of the cornerstones of Kenya's development strategy and of our approach to employment creation.

The control of the deficit is tackled from two sides: expenditure and revenue.

From the expenditure side, wide-ranging measures were taken last November. Expenditure cuts covered both recurrent and development outlays. The creation of unauthorised posts was clamped down upon, while upgrading in the civil service posts were disallowed, and vacancies, unfilled for more than six months, were frozen. Recently, an expenditure control and monitoring system has been established by the Budgetary Department of the Treasury to monitor non-wage, non-pension and non-interest commitments of the major ministries. During the next financial year, the focus will be on overall expenditure reduction in relation to GDP and a reallocation of funds towards operations and maintenance.

Mr. Speaker, in the areas of development spending, the tendency has been for ministries to embark on new projects before even completing ongoing ones, or providing for operating and maintenance expenses. In the coming year no new projects will be allowed unless they are donor financed. Priority will be given for the completion of ongoing projects and ensuring that the existing ones are operational. Considerable efforts are already under way to strengthen the budgeting and implementation of these outlays. The Government, in 1991/92, will assess and review the relative economic merits of the major projects for the Public Investment Programme. With the

assistance of IDA, reviews of public investments in energy, transportation, telecommunications and health will be carried out for 1992/93 through 1994/95. This consultation will give rise to briefs that will include a description of the projects, expected sources of funding and estimates of recurrent cost.

From the revenue side, structural reforms in taxation policy announced under the rubric of Tax Modernisation several years ago, will also continue to be implemented to broaden the tax base and to increase the elasticity of the tax system. For example, the target of revenue as a percentage of GDP, for 1991/92 is 23.7 percent. Revenue can and will be increased substantially through more effective collection and management systems. Through the Tax Modernisation Project, all the revenue departments are being strengthened by means of staff training, technical assistance, institution capacity building and computerisation. Revenues will also expand through the rationalisation of tax rates and by introducing tax changes.

Monetary Policy

Mr. Speaker, I shall now turn to monetary policy. The central aim of our monetary policy is to achieve rates of growth in money and credit together with a structure of interest rates which provide adequate support to production and investment, while avoiding the build up of inflationary pressures. In the past, we have attempted to control money and credit mainly through quantitative ceilings placed on credit extended by banks, including credit to Government, while interest rates have been fixed administratively, and changed from time to time. Achieving desired rates of growth in money and credit in this way has not been easy, especially because interest rates have generally been fixed at low levels, resulting in chronic excess demand for bank credit. The commercial banks have therefore tended to exceed the credit ceilings. To curtail this the Central Bank recently introduced stiff penalties for the offending banks. The targets in regard to bank credit to Government have also been difficult to achieve with precision because such credit is usually the residual financing of the budget deficit and is therefore determined by the balance of government expenditure in various ministries, the actual out-turn of revenue, the net inflow of external resources and net borrowing from the domestic non-bank sector.

Mr. Speaker, credit controls set by the Central Bank have been supplemented by the use of other credit management instruments such as a cash ratio, liquidity ratios and diversified interest rates. At the same time, new monetary instruments have been introduced to facilitate more effective monetary management and existing instruments have been put to more

active use. Thus, Treasury Bonds of maturities ranging from 1 to 5 years were introduced a couple of years ago to widen the range of instruments available to savers and more recently we have brought out the Bearer Bonds I promised last year which have wide appeal. Commercial banks have been permitted to issue Bearer Certificates of Deposit which tap deposits which otherwise would evade the banking system. Similarly the Central Bank has begun to issue Foreign Exchange Certificates which are designed to attract foreign exchange from outside the jurisdiction of Exchange Control.

Mr. Speaker, regulating the growth of the quantity of money as opposed to regulating the growth of credit, has proved even more difficult because it is affected also by movements in the country's net foreign assets arising from external trade and payments, and by movements in other assets and liabilities of the banking system on which the monetary authorities do not have direct and immediate control. It has therefore proved difficult to be on target in respect of the growth of money and credit, although it is fair to say that monetary expansion in Kenya has been, by and large, in reasonable balance with growth in economic activities over the past few years.

Mr. Speaker, what I want to stress today, is not this difficulty, but the point that this method of conducting monetary policy through quantitative ceilings and administratively fixed interest rates is inefficient and unfair. It is inefficient because it stifles competition among banks by requiring them to expand credit at the same maximum rate, irrespective of their relative efficiency in mobilising deposit resources and attracting prospective borrowers through the quality of financial services they offer to their clients. It is also inefficient because interest rates on loans are charged on the basis of a client's bargaining skill rather than his business ability or profitability. It is unfair to the depositors because the rates of interest they receive on their savings are kept low and not negotiated except for favoured customers. Also with uniform rates fixed administratively, the depositors cannot benefit from higher rates offered by banks competing for deposits, especially when the deposits are large.

Mr. Speaker, I hasten to add that in keeping with the policies of Sessional Paper No. 1 of 1986, over the last few years, we have been progressively moving away from this type of policy towards a system in which market forces determine the returns to depositors' saving and the cost of capital to investors. In this more liberalised system, banks and other financial institutions compete among themselves for deposits and advances. In the process, the financial system is more integrated and the efficiency of both mobilisation and allocation of resources will improve.

Last year, we took a very important step by removing the legal requirement that loan interest rates subject to ceilings be inclusive of all lending related fees and charges. Furthermore, greater flexibility in the determination of the yield on Treasury Bonds was allowed while complete liberalisation of the determination of Treasury Bill rates was effected in mid-November. These changes are important since they have facilitated effective interest rates to move closer to the market determined ones.

For the future, Mr. Speaker, our task is to consolidate the gains so far attained including moving towards a market determined structure for allocating investible funds. At the same time we will develop mechanisms to bring interest rates down. In the interim, we will ensure credit to target groups like small borrowers, farmers, etc. at lower rates.

The main challenge facing the Central Bank in the forthcoming financial year will be the introduction of open market operations, which will gradually replace credit guidelines as the basic instrument for controlling the growth of money supply. The groundwork has already been laid for the introduction of such operations and the Central Bank is acquiring a stock of Treasury Bills which are necessary for commencement of this procedure. But success will depend on the reduction of the budget deficit to a level that will enable the Bank to utilise these Bills as instruments for pushing down the level of interest rate. This will be supplemented by the control of the Government's deficit and domestic borrowing which will dampen inflation thereby reducing the need for high nominal interest rates to maintain positive real returns on savings.

Mr. Speaker, with a view to encouraging savings further and improving the efficiency of allocation of resources, steps will be taken to develop short-term markets for inter-bank funds, commercial papers and bank deposits, as well as a secondary market for Treasury securities. The Central Bank will monitor the competition between financial intermediaries to ensure that there is no exploitation and that the benefits of this, more flexible monetary policy are passed on to the public. At the same time, non-bank financial institutions will be required to adhere to their prescribed liquidity and capital-to-assets ratios. The financial health of such institutions will be closely monitored to identify sick ones and decisions will be taken in regard to their restructuring, consolidation or liquidation as appropriate.

Mr. Speaker, in keeping with the increasingly sophisticated nature of the economy, the Banking Act was amended a couple of years ago to provide, among other things, for a much tighter regulatory framework, for institutions to strengthen their capital base, and for enhanced prudential

supervision to protect the interest of depositors. Furthermore, the supervisory role of the Central Bank was strengthened while its powers of intervention in insolvent institutions have been put to use through the establishment of the Consolidated Bank of Kenya. Other improvements include the Deposit Protection Fund to protect the small depositors. In order to provide the needed professional training for the staff of the rapidly expanding industry, the College of Banking and Finance has been established.

Financial Markets

Mr. Speaker, the Government established the Capital Markets Authority (CMA) at the beginning of 1990, to organise the stock exchange on a more formalised basis in accordance with practices in other countries, and to stimulate the development of long-term debt and equity markets. Steps have already been taken to increase the technical expertise of the CMA staff necessary for its adequate functioning.

Mr. Speaker, to foster the development of long-term capital markets and to facilitate access to the organised markets by companies currently obtaining financing from informal sources, the establishment of a second-tier stock exchange with less stringent disclosure and auditing requirements will be developed during this year. The purchase of securities listed in the second tier will be restricted to institutional investors so as to protect private, less sophisticated investors. Also the price of public issue of domestic corporate securities will be studied further to seek possible modifications which will stimulate companies to issue shares and encourage trade in them. The CMA will take steps to encourage the development of full-scale securities firms that can engage in transactions in a broad range of fee-earning financial assets. Finally, the CMA will develop clear requirements for licensing securities firms.

Growth of Exports

Mr. Speaker, I would like to highlight the single most revealing indicator of Kenya's success in structural adjustment -the growth of its exports, especially non-traditional ones. The Government intends to improve Kenya's competitiveness in world markets. In the face of declining foreign assistance, we cannot be satisfied until exports provide adequate foreign exchange to finance imports and permit the economy to grow at 5 to 6 percent a year. Once Kenya can do this, we will begin to accumulate the capital and other resources needed to achieve all our social and economic development goals. Up to now we have done reasonably well in producing for export. From 1985 to 1990, the volume of our non-oil exports grew by almost

6 percent a year on average while the quantity index of manufactured exports grew by an average 17 percent a year. This export performance is encouraging and is the result of policies we have implemented over the past several years.

At the core of our export strategy is the flexible management of shilling exchange rates. Since the end of 1985 the Central Bank has adjusted exchange rates gradually but steadily, to improve the competitiveness of our exports. Exporters can continue to have confidence that their ability to sell profitably in foreign markets will be enhanced, and never compromised, by exchange rate management in Kenya.

To boost exports further, and to shield exporters from the costs of import duties on intermediate goods, the Government last year, improved the operations of the export compensation facility by speeding up payments to exporters through commercial banks. Mr. Speaker, also last year, in a major innovation, Government introduced an alternative plan for exporters, the Duty Exemption Programme. Under this new facility, export firms can receive exemption from duties on imported inputs. I am glad to report that this facility is in operation today. In the coming year we will strengthen the administration of duty exemption so that more exporters can obtain them with greater certainty and with little delay.

Another important step was taken last year towards an export-oriented economy by introducing Export Processing Zones (EPZ). We have made considerable progress within the year. This House enacted the Bill containing the legal and administrative framework for implementation of the Zones and the regulations relating to customs, exchange control and the operations of the EPZ Authority have been gazetted. Land for EPZ has already been acquired in Athi River and Mombasa. We have also successfully acquired funds from the World Bank for the Athi River Zone and we are evaluating tenders to bring it to fruition by mid-1992. As far as the Mombasa Zone is concerned, the ADB has provided funds for the site design work. In April this year, we had hosted a seminar on 'Strategies for the Development of EPZ'. Its objective was to examine critically issues to make our EPZ programme more effective. At present, applications have been approved or are in process for three factories in a privately established zone. Furthermore, we recently appointed the Chief Executive of the Export Processing Zone Authority, whose task it will be to let it be known to investors all over the world that Kenya is a hospitable and profitable country for export industries. The EPZ will also be an important link in the chain of policies adopted by the Government to generate more jobs for a growing labour force.

Mr. Speaker, last year the regulations governing imports under Manufacturing under Bond (MUB) were liberalised including, the introduction of transfer of imported materials from one manufacturer to another. Today there are eleven firms operating under this scheme. In this Budget we are further easing the restrictions. These include customs inspection at the factory premises, as well as rapid release of goods from the harbour or the airports.

Mr. Speaker, import policy is also an integral part of our drive for exports. When we permitted firms to become established behind high protective barriers, it almost guaranteed that these firms would never become exporters and contribute to Kenya's development. What is more damaging is the negative impact that protected firms have had on potential export industries: Why should anyone undertake the risks and hard work to earn profits in export markets, if instead the Government is willing to let them earn high profits in the protected domestic market? Where protected domestic markets exist, it is those markets that attract investors, not the overseas markets where competition is stiff. Furthermore, exporters cannot afford to buy the expensive products of protected industries, and are therefore forced to import so as to compete internationally. Until all our industries come closer to producing at competitive world prices, we cannot expect to develop links between exporters and local input industries. Kenya will only go part-way towards becoming a modern industrial economy unless it develops these links. With this in view our import policies have been aimed at increasing productivity for the domestic market and encouraging the expansion of non-traditional exports.

The Budgets since 1986 have promised and gradually introduced import policies that meet the objectives of an export-oriented economy. Today, as in the past, I will announce several more measures in this direction.

Mr. Speaker, import policy has two features. First, over the years we have worked towards liberalising import controls. The first steps, taken in the middle-1980s, were to put import controls under a set of transparent and reliable rules and procedures. This has largely been accomplished. The next steps have been gradually to move imports from more to less restrictive categories of licensing. Last year we moved a large number of items from the most restrictive Schedule III C to Schedule III B, under which licences are granted liberally. In this Budget, I have shifted a further, significant number of items from Schedule III C to III B, which virtually cleans out the more restrictive category and removes quantitative restrictions.

raise the profitability of the operation. New managements will be sought where necessary. Managements will be given autonomy to make decisions affecting their firm's performance, but will be held accountable for that performance.

Strategic parastatals are sometimes asked to perform tasks that meet national goals but which are not necessarily profit oriented. When such requirements lead to losses, Government will have to subsidise the operation of these firms. Under the restructuring programme, all such subsidies will be identified and reflected explicitly in the Budget. In addition, one parastatal will not be permitted to subsidise another, and all parastatals will be expected to pay their obligations to other firms promptly. The level of subsidy will be related to the tasks performed at Government's request, and will be agreed annually between the Government and the parastatal.

To repeat and emphasise, Mr. Speaker, our aim in restructuring the parastatal sector is to make all in it more productive, so they contribute more to Kenya's development. To the extent possible, we will use market competition as the regulator of productivity. When parastatals become private firms, they will not retain monopoly privileges, but will be exposed to competition from domestic firms or imports under the reformed tariff and liberalised import system. Many strategic firms, too, can operate in competitive markets. Where there are now restrictions on private competition against parastatals, these will be removed. Where strategic regulatory parastatals also have commercial functions, these will be removed and taken over by new bodies which will be sold to the private sector. As part of Government's structural adjustment programme, parastatal restructuring will eventually lead to a greater sustainable rate of job creation, and should even generate new jobs in the near term. The Government, while restructuring, will require during the transition period, assistance for retraining, relocation and advanced retirement benefits for the affected workforce. We will seek donor financial support to assist our efforts at privatisation by financing such as an adjustment fund.

Agriculture

Mr. Speaker, turning to agriculture I would like to underscore the fact that all the sectors of the economy must grow rapidly to face the challenges of the 1990's, but agriculture must grow even faster since it is expected to play a leading role in development.

Kenya's agricultural growth strategies have been generally compatible with improved food security, employment creation and foreign

exchange generation. The cornerstone of these strategies has been smallholder-led growth centered on the production of high value cash crops, most notably coffee, tea and horticulture. The strategy has directly enhanced food security in three important ways. First, at the level of farm production it has led to an increased net value of output, thereby generating additional incomes for small farmers. Second, by increasing the incomes of farm families, their ability to acquire food in the market has improved giving rise to food security in households whose food crops have failed or which live in situations where their land holdings are so small that they cannot grow sufficient food to meet their full needs. Third, at the national level, export crop production has increased the availability of foreign exchange.

Mr. Speaker, if the agricultural sector and especially the smallholder sector, is to continue to play its rightful role in development, we must continue to provide an appropriate set of price signals. However, proper prices by themselves do not achieve their full impact on agricultural production unless other complementary inputs and services are also in place. Among the most important aspects of pricing is prompt payment.

Mr. Speaker, the need to enhance timely payment is now well recognised and measures to ensure this for various crops including coffee, wheat, maize, milk and cotton have already been taken. For example, last year, Government approved an improved coffee payments system designed to speed up payments for the smallholder. Under the Small-scale Coffee Improvement Programme, coffee farmers will receive part of their payment on delivery to the primary coffee societies and the balance after the coffee has been sold by the Coffee Board. Another example of timely payment is that for the past two years, most farmers and buying agents have been paid by National Cereals and Produce Board (NCPB) within 2 months of delivery compared with up to 9 months previously experienced. Yet another improvement is in the cotton sector. The Government has streamlined the marketing and the payment system by allowing the co-operative unions to buy directly from the farmers in competition with the Cotton Board. The farmers have responded by increasing cotton production. Between 1989/90 and 1990/91, the lint bale production in metric tonnes has increased by more than 50 percent.

Mr. Speaker, a further important factor to encourage farm production has been the cost and the availability of agricultural inputs. The Government, with the assistance of the World Bank under the second Agriculture Sector Adjustment Operation (ASAO II) will address the issue by liberalising the distribution of the inputs. A complementary service which is of equal importance for increased production is the extension of the processing capacity. Nowhere is this more important than in tea production.

their funding is under negotiation and planning and implementation should start during the coming year.

As Hon. Members will recall, at the initiative of H.E. the President, we established the Rural Enterprise Fund in order to provide loans to small-scale rural enterprises. It now stands at Shs 280 million. In the Estimates for the financial year 1991/92, another Shs 120 million are shown as additions to the Fund. I hope to add a further Shs 600 million which will bring the Fund to Shs 1 billion. This will be distributed in the various Districts. In taking this, and other measures to support the rural-urban balance, the Government is providing the strongest endorsement to its commitment to address the problems of unemployment. Mr. Speaker, it is the small and medium-scale industries which are the backbone of small towns, they will create jobs more cheaply and address the requirements for prosperous development in the rural areas.

Mr. Speaker, there is a wide range of other development programmes each contributing to the goals of rural-urban balance. Urban local authorities are receiving assistance to upgrade and expand their infrastructure and increase their management capacities, while investment continues in rural roads and electrification, in water supplies and other support for productive activities. This diversity of development requires careful co-ordination if it is to be effective. In particular, I would urge DDCs to work closely with all local authorities in their District. The interlinkage between rural areas and urban settlements means that they must be developed together, that Local Authority Development Plans must be integrated into the District Plan and that resources should be shared for the benefit of all.

Mr. Speaker, important though infrastructure is, there are other aspects to the strategy. I have referred elsewhere to initiatives to encourage small scale enterprises the development of which is a fundamental goal of rural-urban balance. In my last year's Budget I suggested that we needed to gain a greater understanding of the "webs of economic interchange" so as to identify ways of strengthening opportunities for employment generation. Work on this concept has been undertaken and will be pursued vigorously in the coming months. In addition, so as to accelerate rural-urban balance, will double the import duty exemption on industrial machinery to a maximum value of Shs 40 million from its present Shs 20 million level, for small-scale industries being located in rural areas.

Finally, in view of the scarcity of investible funds the Government will explore ways to assist the private sector to gain access to external resources for investment. In this respect the Government recent

established a facility called the Exchequer and Audit (Exchange Risk Assumption Fund), to absorb exchange risk arising from hard currency loans to small borrowers. The purpose is to provide finance required to meet the exchange risk relating to obligations contracted by IDB, ICDC and DFCK. This measure has attracted substantial resources from the European Investment Bank which will be on-lent to small and medium-sized projects, for the assumption of exchange risk. Indications are that this will provide a precedent for more external loans to finance investment.

Mr. Speaker, as I have mentioned, we now have some initial results from 1989 Census. Overall these show that the urban population now amounts to nearly 18 percent of our total, thus urban growth is still well above the national average but that there are some indications that it may have slowed down somewhat recently. Furthermore, although the largest towns continue to dominate, the most vigorous growth is taking place in small towns of under 10,000 people. This early evidence demonstrates the correctness of the rural-urban balance strategy in reinforcing an existing and desired trend. However a detailed analysis of the Census data must be completed before the full picture emerges. Once the analysis has been assimilated it will be used by the Ministry of Planning and National Development, together with other relevant evidence, to assess the degree to which the rural-urban balance strategy is reaching its goals and to suggest modifications to increase its effectiveness.

5. FINANCIAL OUT-TURN 1990/91

Recurrent Revenue

Mr. Speaker, I now turn to this year's Budget Out-turn. In the original budget for 1990/91 ordinary revenue was estimated at K£ 2,310.0 million net of export compensation payments. Another K£ 118 million were expected to be available from Appropriations-in-Aid, making a total available recurrent revenue of K£ 2,428.0 million. The ordinary revenues were to comprise of K£ 811.1 million from VAT, K£ 691 million from Income Tax, K£ 507.8 million from Customs and Excise and K£ 300.1 million from all other taxes, dividends and fees. Mr. Speaker, the revised estimates for 1990/91 show that I may realise a total recurrent revenue of K£ 2,388.3 million.

The actual collections under ordinary revenues were somewhat lower than anticipated. This shortfall was mainly a result of the Gulf Crisis in the latter part of 1990 when I even took some extra measures to contain the shortfall. There was also the continued depression in coffee prices. All these developments, I have shown, had the effect of slowing down the tempo of growth of taxable activity. Thus, there is an anticipated

shortfall of K£ 65.8 million in Customs and Excise revenue and K£ 43.1 million in VAT collections. However, collections under Income Tax are expected to exceed the printed estimates by K£ 19 million, and collections of other taxes and revenue by K£ 44.1 million.

Mr. Speaker, I therefore, now expect to raise K£ 768.0 million from VAT; K£ 710.0 million from Income Tax, K£ 992.0 million from Customs and Excise, and K£ 344.2 million from other taxes in 1990/91.

Recurrent Expenditure

This year's Printed Estimates of Recurrent Expenditure were K£ 1,443.5 million, excluding Appropriations-in-Aid. Consolidated Fund Services were to take another K£ 1,283.9 million.

In the course of the year, a number of Ministries had to incur unavoidable and high priority, additional expenditures amounting to about K£ 51.1 million. These have pertained to national security, additional expenditures on teachers salaries and the expansion of the university system. This House will recall that the Government sought its approval for Recurrent Supplementary Appropriations of this amount. In addition, I had to finance Excess Votes and Under Issues amounting to K£ 39.7 million. Expenditures under Consolidated Fund Services are also likely to be above target by about K£ 40.1 million mainly on account of the Government honouring the debt service obligations of some State Corporations and increases in interest rates.

Mr. Speaker, I therefore expect this year's gross recurrent expenditures, together with Excess Votes and Under Issues to be K£ 3,085.6 million compared with an expected total recurrent revenue of K£ 2,388.3 million. Thus, I had no surplus in the recurrent account to finance development expenditures.

Development Expenditure

Honourable Members will recall that this year's Printed Development Estimates were for K£ 970.6 million, which include Appropriations-in-Aid of K£ 528.7 million. Earlier this year, the House approved Supplementary Estimates of some K£ 35.9 million, to cater for additional expenditures on a number of high priority, on-going projects. As in the case of recurrent expenditure, these additional requirements would have been much larger but for the austerity measures introduced in October last year. In addition, I had to finance Excess Votes and Under Issues under the development vote to the tune of K£ 25.5 million.

Mr. Speaker, K£ 65 million of this year's revenue was used to diminish the Government overdraft at the end of the previous financial year and was therefore not available to finance 1990/91 expenditures. Taking all these factors into account, I expect the budget deficit during this fiscal year to be around 5.3 percent of GDP. I will now turn to the forecast out-turn for the coming financial year, 1991/92.

6. FORECAST OUT-TURN FOR 1991/92

Expenditure

Mr. Speaker, as the Hon. Members have already seen from their copies of the 1991/92 Printed Estimates, laid before the House, gross recurrent expenditure of Ministries will be K£ 1,686.9 million, including Appropriations-in-Aid of K£ 97.9 million. The projected expenditure on Consolidated Fund Services will amount to K£ 1,649.9 million. Therefore, the total gross recurrent expenditures will amount to K£ 3,336.8 million. Since a major component of this cost is related to education, I wish to point out that, this demonstrates the high priority that the Government continues to attach to the development of education with the aim of generating knowledge and skills necessary to support the country's development effort, realising that education is the best route to individual, social and economic advancement. In 1990/91 financial year, the education budget claimed more than 36 percent of total Government recurrent expenditure. This level of expenditure on education is fiscally unsustainable in the long run. The Government therefore appreciates the important contribution and great sacrifice made by parents, local communities, Harambee efforts and non-governmental organisations, towards the provision of educational facilities at the primary and secondary level and wishes to sustain and enhance this partnership and to extend it to the University level. In consequence university students will be called upon to meet a greater proportion of their costs; but it remains Government's firm policy that no qualified Kenyan will be denied university education because of his or her inability to pay.

Development Estimates for 1991/92 will call for an expenditure of K£ 1,090.3 million, which includes Appropriations-in-Aid of K£ 593.5 million. This represents an increase of 9.6 percent over the revised estimate for 1990/91.

Mr. Speaker, expenditures on projects financed by concessionary loans will increase by 11 percent in 1991/92 compared to this year's Approved Estimates and those financed by grants will increase by 25 percent. This feature reflects the confidence that the international donor community have placed in Kenya, particularly in the political and economic

stability which we have continued to enjoy under the distinguished leadership of our beloved President. It also reflects further progress on budget rationalization in that we are able to finance more projects from concessionary loans and grants, as opposed to costly internal borrowing.

In addition, I will have to finance Excess Votes and Under Issues of K£ 89.5 million in 1991/92 arising out of expenditures in previous years.

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

I will thus have to finance a total gross expenditure of some K£ 4,516.6 million in 1991/92. The rest of my speech will outline how I propose to do this.

External Revenue

Mr. Speaker, as I already mentioned, the international donor community are fully backing our efforts for the rapid development of the nation, by committing substantial assistance in the form of concessionary loans and grants. This continuing support and our cordial relations with the donors, both multi-lateral and bilateral, are undoubtedly due to, among others, the sound economic policies we have been implementing both at home and in the external economic sphere. Thus, in 1991/92, we expect total assistance of K£ 1,077.1 million. Of this, nearly 47 percent or K£ 510. million will be in the form of project and programme grants and 53 percent or K£ 566.8 million in the form of project and programme loans. Thus I will be able to finance 23.8 percent of the total expenditure from external resources.

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

I shall now turn to how I intend to raise the balance of K£ 3,439.5 million.

Domestic Borrowing

Mr. Speaker, as I said earlier the Government is committed to reduce its claims on the domestic credit market to a minimum, so that more resources can be made available to the private sector. I expect total domestic borrowing in 1991/92 to be restricted to about K£ 646.4 million, of which a major portion, namely K£ 503.9 million, will come from renewal of maturing debt. Again, consistent with our policy of promoting the private sector, this money will come mainly from non-bank sources by means of Treasury Bonds and Treasury Bills.

Internal Revenue

Mr. Speaker, the economy is already fast recovering from the effects of the Gulf Crisis and I anticipate that it will grow at about 4.4 percent in 1991/92. On this basis, I estimate that ordinary revenue, at present levels of taxation, will provide some K£ 2,672.1 million, net of export compensation payments. Appropriations-in-Aid will provide another K£ 82.0 million.

Thus, I will raise a total of K£ 3,400.5 million from these sources. I have therefore, a gap of K£ 39 million to be financed through additional tax measures. The rest of my speech, will outline as to how I intend to close this gap.

7. TAXATION PROPOSALS

Mr. Speaker, I have already appraised the House on the world economic outlook, on the Sub-Saharan economies in 1990, and have indicated the potential growth of our economy. I have developed the policy framework to first stabilise and then raise this growth. I have also indicated to this august House that I have a financing a gap of K£ 39 million. I now turn to my taxation proposals. As usual, I would ask, Mr. Speaker, Sir, that the rest of my Speech be regarded as Notice of a Motion to be moved before the Committee of Ways and Means.

Customs Tariff

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

First, to promote exports we have established EPZs and MUBs. However, there is a difference in their legal treatment. The EPZ law provides that goods can be sold into the Customs Area subject to the normal import procedures and payments. However in MUBs there is no such provision and this has created problems since in the course of the manufacturing process wastes and rejects are produced. Also at times MUB contracts with overseas buyers may get cancelled. There is therefore the need to make a provision for the disposal of these items otherwise a lot of storage space will be required and money will be tied up in stocks of such goods. Therefore I propose to amend the law to permit sale of such goods in the domestic market on payment of import duty, excise duty and the VAT to those with import licences for such goods. However in such cases the applications will have to be made to the Commissioner for recommendation to the Minister.

Second, I propose an amendment to the customs procedures in order to allow the use of books, records and audit reconciliations, to provide MUBs with a treatment similar to duty exemption for exports.

Third, Section 141 of Customs and Excise Act deals with the duty exemption of exported goods, entered for reexport, transshipment, transit or for use as stores for aircrafts or vessels. With the recent introduction of duty exemption of imports for exports scheme, I propose an amendment to this Section to allow exemption for inputs into the manufactured goods for exports, on submission of the proof that the finished goods have been duly exported.

Fourth, currently a person who imports a dutiable and VATable item and under-declares it, is charged a penalty of 2 percent per month on unpaid duty, whereas under the VAT this penalty is 3 percent per month. To correct this anomaly I propose to amend the law and to charge a uniform penalty of 3 percent on all unpaid taxes after under-declaration.

Fifth, under the existing law the maximum fine that can be charged for contravening Customs and Excise Regulations is fixed at Shs 20,000, whereas the maximum penalty under MUB and Duty Exemption Regulations is Shs 200,000. In order to align the Customs and Excise Regulations penalty with that in the MUB and Duty Exemption Regulations I propose an amendment to Section 234 of the Act.

Sixth, an open competitive environment is required to establish Kenya as an attractive location for filming. The film industry is a potential export for Kenya, and it further boosts our exports through tourism by introducing Kenya to filmgoers all over the world. At present, costly and cumbersome procedures prevail concerning filming in this country. They

range from delays in obtaining filming licence, work permits and visitor's passes, to payment of customs duties and VAT or bond security on all production equipment and heavy fees for locations. To facilitate filming in Kenya I am proposing a number of measures. A film maker will be permitted to make a list of all the equipment required for filming so that it will be included on the licence. Also all the equipment for filming will be allowed to be brought under temporary importation procedures without the need of paying a bond security, on payment of a non-refundable fee of 1 percent on the value of equipment, and neither will such equipment require Letters of Release. Furthermore, special passes for foreigners coming to participate in film production will be issued on arrival at a fee of Shs 1,500 per visitor. In addition, a lot of flexibility will be allowed regarding the clearance for the movement of animals between locations and dates of movement and the release of film rushes will be expedited. To facilitate film making here a "one stop facility" will be established. Lastly, film makers' applications to access local funds for financing part of the cost of filming in Kenya, will be considered on their own merits and will be confined to funds in the queue for repatriation by the Central Bank.

Mr. Speaker, turning to changes that have direct revenue implications, I would like to emphasise that there is a need to reorient our economy towards efficient utilisation of resources, through continuing the process of import liberalisation and export promotion. It is with this in mind that changes in customs tariffs are proposed.

First, to continue the rationalisation of the import duty rate structure started in the 1989/90 Budget, I propose to reduce the current number of duty rates from 15 to 11. In the process I have deleted the rates of 100%, 80%, 75%, 60%, 55% and 45%, while adding new rates of 2 and 70%. As a result the highest duty rate will be lowered from 100% to 70%. I expect this rationalisation will reduce smuggling and other tax evasion activities, while compliance will improve since fewer rates will decrease misclassification problems.

Second, in last year's Budget, as part of the import liberalisation policy that has aimed at lowering the cost of manufacturing and raising the competitiveness of local goods, I reduced the average duty rate on imported raw-materials, intermediate goods and spare parts in Schedules I, II, IIIA and IIIB by 5 percentage points. Continuing with this policy, in this Budget I am proposing a further 5 percentage point duty reduction on all similar imports.

Third, a number of companies and organisations have enjoyed import duty remission for a long time. Some of these remissions are redundant, while others are discriminatory. A number of remissions are also

misused. To raise additional revenue and minimise the discretionary nature of import duty exemptions, all long term exemptions excluding those provided for by treaties and specific international agreements, will be revoked. Blanket exemptions enjoyed by particular companies and organisations will also be discontinued and made subject to a case-by-case examination, with effect from mid-night tonight.

Fourth, fresh horticultural produce is the rising non-traditional export, earning substantial foreign exchange and providing expanding job opportunities. Much of this produce must be shipped by air. Yet air cargo space is a serious limiting factor for its expansion. At present tariffs and value added tax are levied on 50 percent of the air freight charges on imported cargoes and I propose to remove this with effect from midnight tonight. This measure will encourage more imports by air which will provide more space for exports.

Furthermore Mr. Speaker, the price of jet fuel is a major impediment to the development of the horticultural sector. The fact that fuel costs are a high proportion of total air freight costs also compounds the problem. Therefore, I propose to reduce the price of jet fuel for air cargo from US\$ 1.75 to US\$ 1.45 from midnight tonight. This reduction will assist the nation to maintain its regional advantage in horticultural exports.

Fifth, for several years fees such as late applications, overtime and bonded warehouse fees, as well as, licences for transit goods and Customs agents charged under the Customs and Excise Act have remained static. To correct for inflation over the years and take account of the rising cost of administration, I propose to raise the annual charges and, for the first time, to introduce triennial charges with small discounts.

Sixth, the tourism industry is an important earner of foreign exchange. To encourage further expansion of this industry and to earn more foreign exchange, I am introducing a programme of duty exempt importation of equipment for constructing new tourist hotels where these are financed with external funds.

Finally, last year I removed duty on capital machinery for small scale industries located in rural areas where the cost of such machinery did not exceed Shs 20 million. The higher prices of imported machinery and equipment as a result of the appreciation of foreign currencies have eroded this value considerably. In order to maintain the level of incentive in rural terms and to further encourage the rural-urban strategy, I propose to double the value limit once more from Shs 20 million to Shs 40 million.

Mr. Speaker, the measures I have announced in the customs tariffs will cost the Exchequer some K£ 15.00 million in foregone revenue.

Value Added Tax (VAT)

Mr. Speaker, two years ago I had replaced the Sales Tax by the Value Added Tax. This was done because VAT has many advantages over the Sales Tax. The VAT is not limited to manufactured goods and is imposed on services as well. At the same time while the tax is due on a person's sales, he is also eligible to claim back the tax on his purchases. Furthermore, it encourages exports by allowing the exporters to deduct the tax paid on inputs. However, the implementation of the VAT has highlighted some anomalies, errors, omissions and difficulties which need to be corrected to streamline its procedures and regulations. Also the importance of this tax in terms of revenue potential is growing and is certain to become the dominant tax of the 1990s. As is customary, I will deal first with those amendments which have no direct revenue implications.

First, under the Customs and Excise Act, the Minister can vary the rate of import duty provided the variation does not exceed 25 percent. This is a flexible instrument which enables the Minister to raise revenues when required by exceptional circumstances. However, no such provision exists in the case of the VAT and this is a major omission. I therefore propose an amendment to the VAT Act to provide for a variation of up to 25 percent.

Second, VAT on petroleum is collected by the Commissioner of Customs but the claims for input tax which the oil marketers pay on various items used for processing petroleum are lodged with the Commissioner of VAT. However the VAT Commissioner is unable to offset the tax against VAT since he does not collect this tax and has therefore been delegating his obligation to the Commissioner of Customs. This provision is not covered under the VAT Act. I have therefore proposed an amendment of the law to provide for the delegation of all operations.

Third, in the last Budget the VAT law was amended to require any local person who hires an external professional to withhold the VAT and remit it to the VAT Commissioner. Apparently, there is no guarantee that the tax will be withheld. Therefore, to ensure that the tax will in fact be withheld, I am strengthening it by introducing an additional safeguard. This will require any person seeking Central Bank approval for remittance of funds representing payments for taxable imported services overseas, to

produce a proof from the VAT Commissioner certifying that the correct amount of tax has already been paid.

Fourth, a number of manufacturers have failed to register their activities for VAT purposes on the grounds that they are not manufacturing but assembling, repacking, bottling, etc. In order to seal this loophole and to broaden the base, it is proposed to amend the law to include mixing, repacking, grinding, etc. as manufacturing and therefore liable for taxation.

Fifth, last year I zero rated the exports of taxable goods. My aim in this exercise was to zero rate all exported goods and not necessarily only those that were taxable, in order that all exports could receive a refund of their input taxes. However there was an omission in that the law zero rated only the taxable goods which were exported, thus making it impossible to refund input tax paid on non-taxable goods. Consequently, exporters of cut flowers, who pay VAT on packaging materials and on forwarding services cannot claim refund of input tax. I therefore, propose an amendment to the Act to embrace all exported goods, including exports of non-taxable goods.

Sixth, at present, some registered taxable persons such as professionals have sought to minimise VAT by lowering the taxable value of the services they render. They have deducted costs like travelling, accommodation, etc. on the grounds that they are reimbursed. Some confusion has arisen in calculating the taxable value. These claims are impossible to verify and control. In order to remove the basis of controversy I have proposed to amend Section 9 of the VAT Act to exclude direct disbursement from the taxable value.

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

First, there are several tax anomalies and their effect is to raise the local cost of production compared with the cost of directly imported goods. The anomaly is most glaring in the case of finished goods which are exempt from VAT, and yet the local or imported inputs are taxable. While the direct importer is not affected by the tax the local manufacturer bears an added cost since input tax on raw material cannot be offset against output tax. An additional problem relates to where the final product is zero rated or taxed at a lower rate than the raw material. The result is that the output tax will be less than the input tax and the manufacturer will need to be refunded. In order to solve these problems I propose a uniform rate of 18% tax on both the output and the input of a large number of items. This measure will not only increase revenue substantially, due to reduction of evasion, but also make local products more competitive and therefore export worthy.

Second, at present we have 15 VAT rates, and if the Guinness Book of Records recorded VAT rates we would certainly be in it! Such a large number of rates tempts tax evasion through mis-classification and also makes tax administration both complex and cumbersome. I therefore propose to reduce this number to 8. In the process I will eliminate the rates of 150, 80, 70, 55, 45, 40, 30 and 1%, while introducing a new rate of 75%. The highest VAT rate will now be lowered from 150% to 100%.

Third, currently the telecommunications tax is 15% and is collected by the Department of Inland Revenue. However the refund for input tax is only available under the VAT. In order to facilitate input tax and also to raise additional revenue from this growing service, I propose to convert the telecommunication tax of 15% into the VAT at the standard rate of 18%.

Fourth, last year I had raised the electricity rate under the VAT from 1 cent per unit to 1%. In order to encourage energy saving and to raise more revenue from this expanding sector, I propose to tax electricity at 5%. However to protect the users of electricity in the rural areas and the urban poor, no tax will be charged on the first 200 units.

Fifth, to benefit the farming sector and rural and urban poor, I propose a reduction in the VAT on diesel and kerosene. On kerosene the reduction will be 35 cents per litre and on diesel it will be 15 cents per litre. To encourage better distribution of kerosene in the countryside, 10 cents of the cut in VAT on kerosene will be awarded to the oil distributors.

Sixth, currently hotels, entertainment services and video rental services are taxed under different Acts by the Inland Revenue Department. These and restaurant services which represent the largest, untaxed luxury consumption item, are generally consumed by high income groups and therefore should be taxed. There is a need to expand the VAT base in order to gain additional revenue and these services represent appropriate areas of taxation. Hotel and certain restaurant services are already taxable under the Hotel Accommodation Tax. As of the 1st of January 1992, this tax will be discontinued, and all hotel and restaurant services will be covered by the VAT. This will not only increase the tax base, but it will also remove distortion caused by double taxation of hotels. At present many hotels pay VAT on inputs, including large management contracts and Hotel Accommodation Tax on output. Under VAT input tax will be offset. Putting the taxation of hotels under the VAT will also remove the burden of taxation off the many small rural hotels. Collecting tax from these small businesses was very cost-inefficient.

In addition, entertainment services are already currently subject to the Entertainment Tax. It is proposed to harmonise this tax with the VAT and retain it to cover situations not covered by the VAT. Furthermore, the existing Video Tax will be dropped in favour of the VAT.

Seventh, the minimum turnover level for compulsory registration under the VAT has remained at Shs 200,000 per year, the same level as under the Sales Tax, and has not been adjusted for inflation for many years. To correct this and to encourage efficient tax administration, I am raising the minimum turnover level to Shs 250,000. However, to ensure that small hotels and restaurants which are frequented by ordinary wananchi do not come under the VAT net, the turnover level for them will be established at Shs 300,000. In addition, hotels and restaurants which are registered under the VAT will be required to display their VAT registration certificates at a prominent place in their premises for the benefit of their patrons.

Eighth, in the last Budget I lowered the VAT rate on passenger vehicles with varying cylinder capacity. This year in order to rationalise both the import duty and VAT rates, I have proposed a few amendments. There is no change in the taxation of assembled cars with a capacity of 1500cc and less, but for cars of over 1500cc I have proposed to reduce the combined tax burden, on average by 17 percent. I have also proposed to lower the combined tax on minibuses of over 1800cc on average, by 18 percent, since these are basically used by tourists and will therefore further promote the development of tourism. There is a problem of enforcement of very high tax rates on imported cars and frequent exemptions make it difficult for domestic manufacturers to compete. The proposed individual rates are as follows:

Assembled Cars

Capacity	Current (%)			Proposed (%)		
	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>
1500cc & less -	50	28	77	50	18	77
Over 1500cc to 1800cc -	50	30	95	50	25	87
Over 1800cc to 2000cc -	50	45	118	50	35	102
Over 2000cc to 2250cc -	50	100	200	50	75	162
Over 2500cc -	50	150	275	50	100	200

Assembled Mini Buses

Capacity	Current(%)			Proposed (%)		
	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>	<u>DUTY</u>	<u>VAT</u>	<u>COMBINED</u>
1500cc & less -	40	35	89	40	35	89
Over 1500cc to 1800cc -	50	35	103	50	35	103
Over 1800cc to 2000cc -	80	50	170	70	50	155
Over 2000cc to 2250cc -	100	50	200	70	50	155
Over 2250cc -	100	80	260	70	75	198

Ninth, I would like to refer to the zero rated goods. When goods are zero rated, they bear no VAT charge. Some goods which are exempted should be zero rated in order to make them eligible for a tax offset. For example, at present tubers, potato seeds and cuttings for planting are exempted but should be eligible for tax offset. For such goods I propose that they be zero rated. This measure will assist our farmers who with great care and perseverance produce inputs like seeds, tubers and cuttings for our horticultural industry.

Tenth, under the VAT a registered taxpayer normally can deduct the VAT paid on inputs from the VAT paid on his outputs where the inputs are used in the course of producing and supplying taxable outputs. Where these inputs are used for personal consumption purposes input deductions are not allowed. To ease the administration of this procedure, input deductions are disallowed for certain goods and services. I am proposing to expand the list of goods and services where input deductions will no longer be allowed to include restaurant, hotel and entertainment services, and alcoholic beverages and spare parts, bodies, fuel and lubricants for passenger motor vehicles. In addition to reduce the abuse of the input deduction provision, no input deduction will be allowed more than six months after the date on which the input VAT was paid.

Finally, problems have been encountered in the collection of VAT on goods such as furniture, electrical and other household appliances. Such goods may be smuggled and therefore cannot be taxed. Goods like furniture, which are manufactured in the informal sector and untaxed and sold by central city retail trading companies, also avoid the payment of VAT. In order to collect revenues I am categorising these goods as "Designated Goods", and I am proposing to reduce their VAT rates to either 25% or 18%. This will expand the tax base, reduce tax evasion in these sectors and increase the revenue yield.

Mr. Speaker, the VAT measures I have announced upto this point, today will raise an additional revenue of K£ 52.00 million.

Excise Duty

Mr. Speaker, I would now like to turn to excise duty where I am proposing some fundamental changes. To offset the revenue loss from lowering of import duty rates, to allow rationalisation of VAT rates and to increase controls on high tax rate goods, I have extended the excise duties not only to an additional range of domestic goods, but also to imported goods as well. I am also proposing to make most excisable goods subject to VAT as well as excise duties, with corresponding offsetting adjustments in the excise duty rates. This removes distortions where manufacturers cannot deduct the VAT on their inputs. Furthermore, I have converted a number of rates from a specific to an ad valorem basis.

First, currently the combined effective tax rates are highest on low cost beers and lowest on high cost ones. For instance, the rate on Tusker/White Cap is 150%, while that on Guinness is 75%. Under this practice substantial revenue from high income buyers who consume high cost beers is foregone. Furthermore the high cost beers have the higher alcohol and import contents. In order to remove this inequity I propose to change the basis on which beers are taxed. The proposed combined tax rate embraces the import duty, which is lowered from 100% to 70%, the VAT of 18% and the excise duty which is converted from specific to ad valorem rates which will be 100% on beer and 75% on stout. In addition, import protection for domestic beer will be increased. Mr. Speaker, the effect of proposed combined taxes on retail price will be an increase of Sh 1/20cts per bottle in the case of Allsops Pilsner and the dumpy bottles of Export, White Cap and Tusker.

In addition, I have also placed Chibuku, Nyuki, International and other non-malt beers subject to excise of 25%. These beers were previously taxable under VAT at 25%, and will now be subject to 18%. Their combined rate will be 47½%. This measure will give equal tax treatment to all types of beer and will also close the tax gap between malt and non-malt beers.

Second, I have proposed the extension of excise on wines champagnes and sodas. The excise duties on these items will be 40%, while import duty and VAT will be 70% and 18% respectively. At the same time spirits will carry both the specific as well as ad valorem rates. For wines spirits and sodas there will be a modest increase in tax. To continue to encourage the development of the domestic wine industry, the VAT on wine produced from locally grown fruits will be 5%, while VAT on imported wine will be 18%.

Third, cigarettes and tobacco products will now be subject to VAT as well as excise duties. The excise duties have been adjusted, however, to leave the combined tax rates at about the same levels as before. Matches will now also be subject to VAT at 5%. This will allow manufacturers to offset their input taxes.

Mr. Speaker, these measures will take effect from midnight tonight and will provide the Exchequer an additional revenue of K£ 15.00 million.

Income Tax

Mr. Speaker, I would now like to turn to income tax where I am proposing changes aimed at attracting investment and inducing exports. As usual I will deal first with amendments which have no revenue implications.

First, the introduction of the instalment tax in the last Budget was the first step towards moving to the modernised income tax system. A major feature of this system will be self assessment which requires the taxpayer to estimate his taxable income, calculate his tax obligation and send a return of the estimated income together with the payment for the tax due, to the Income Tax Department. I am proposing that this system of final self assessed returns be introduced for financial years starting in 1992. Consequently, from 1993 onwards provisional returns will no longer be required three months after end of the financial year. Instead a final return with a self assessment of taxes will have to be submitted four months after the end of the financial year.

Second, under Section 5 of the Income Tax Act, benefits provided by the employer to employees are taxable. Over the years the Commissioner has published a schedule of values of these benefits which the employer is required to include in estimating PAYE deductions. But in many cases, the cost of providing these benefits is more than the published value. I propose to amend the law so that the employer will be required to include in PAYE the actual cost where this exceeds the published value.

Third, when the Income Tax Department issues an assessment, the law allows the taxpayer to object within 30 days and requires the taxpayer to produce his books and records. Since there is no limit within which the objection has to be dealt with and since during that time the disputed tax remains unpaid, some taxpayers use this procedure to delay payments of tax, by delaying submitting books and records. In order to discourage this, it is proposed to give 60 days after the date of objection within which to prepare accounts and submit them. Failure to submit this

in the stipulated time will imply that the assessment of the Department holds and the tax payable. This measure will speed up tax payment.

Fourth, many professional advisers like accounting firms who assist taxpayers to complete and file their tax returns have either through negligence or wilful collusion assisted their clients to file erroneous tax returns. I have instructed the Income Tax Commissioner to take strong measures against such professionally assisted tax evasion. To strengthen his position in dealing with this problem, I am proposing to introduce stiff new penalties.

Fifth, improved administrative procedures supported by computerisation form part of our tax modernisation system. An important tool in modern tax administration is the use of personal identification numbers, where each taxpaying individual or organisation is provided with a unique identification number that is used in all tax dealings with all the tax departments. To start with the Income Tax Department, I am proposing necessary legislation to issue and require taxpayers to use such personal identification numbers.

Sixth, a number of organisations including parastatals who collect taxes whether PAYE or withholding taxes, etc. have formed a habit of keeping and using this money as it is cheaper for them than paying financial penalties. This practice does not only deprive the Exchequer of its funds but it is also illegal. In order to force such bodies to make timely remittances I am proposing an amendment to the law. Non-remittance of collected tax will be a serious offence under law which will hold the senior management of corporate bodies personally responsible for the payment of a fine of up to Shs 200,000 or an imprisonment of 2 years or both.

Mr. Speaker, I would now like to propose changes in income tax that would affect individual tax payers and existing investors.

First, the income tax measures proposed are aimed at maintaining the basic structure while giving a partial adjustment for inflation. To achieve this, the income tax brackets will be expanded by K 200 and the single relief will be raised and its coverage expanded to include married women. The latter will give a higher tax relief to the two income family, as well as remove the requirement to distinguish between single and married women. Consequently all married women can now make use of their husbands' names. All single individuals and married women will now receive a tax relief of Shs 1,320/-. Married males will continue to receive the family relief which is double this amount.

Compared to the current income tax brackets, the new brackets are expanded by about 10 percent and are as follows:

CURRENT	RATE	NEW	RATE
	Shs		Shs
First K£ 2,100 -	2;	First K£ 2,300 -	2
Next K£ 2,100 -	3;	Next K£ 2,300 -	3
Next K£ 2,100 -	5;	Next K£ 2,300 -	5
Next K£ 2,100 -	7;	Next K£ 2,300 -	7
Over K£ 8,400 -	9;	Over K£ 9,200 -	9

Furthermore, I have not changed single relief for sometime and to take account of inflation, the following change is indicated for single relief:

		PRESENT	PROPOSED
		RATE	RATE
		Shs	Shs
Family Relief	-	2,640/-	2,640/-
Single Relief (all single)	-	1,056/-	1,320/-

Second, turning to corporation tax, my main concern is to encourage profitable firms to go on investing in Kenya's future. The best way to do this is to increase still further the post-tax return on successful investment projects and enterprises. For that I am cutting the main rate of corporation tax on profits earned from 40 percent to 37½ percent for the year of income 1992.

Third, at present investment deductions for manufacturing machinery are allowed only if the machinery is new and is installed in a building not previously used for manufacturing. This has effectively limited the investment deduction to new factories. Manufacturers wanting to expand their capacity or replace and upgrade old equipment do not qualify for investment deduction and are forced to build new factories every time they need extension. Many investors have complained that this denies them the economies of scale. In order to encourage more investment and employment, I am proposing to amend the law to allow more flexible investment deductions. The base for deductions will be expanded. This will include investment deductions on new or old machinery installed in the existing factory, or part of the existing factory or in new extensions.

Mr. Speaker, in addition, I want to increase the certainty of investors in making investment plans. Therefore I am proposing that investors can apply to the Income Tax Commissioner for an "advanced

ruling", to establish whether planned investments will qualify for the deduction.

Furthermore, on investment deductions, to improve incentives to enterprises in the Export Processing Zones, a flexible, optional 100% deduction will be awarded which will enable them to replace or expand their capital investment in the zones.

Fourth, the new wear and tear allowances have not been amended for a number of years outside the Zones. I am therefore proposing a new wear and tear class with a rate of 30% for computer and office equipment. This measure will encourage new investment in high quality jobs and recognise the increasingly important role that computers are playing in all aspects of business in Kenya.

Mr Speaker, turning to pensions, last year I announced the introduction of tax deductions for contributions by employers and employees to pension and provident funds. I also indicated that I intended over the course of a number of years to phase in the deductible amounts and to introduce a number of other improvements in the taxation of pension savings. As promised, I shall introduce the next steps in the reform of the taxation of pension savings.

First, the tax deductible contribution limits will be raised to Shs 10,560 for contributions in respect of an employee effective in 1992. This limit on tax deductions will apply to contributions to both pension and provident funds. The contribution limits to provident funds will also be raised to be the same as that for pension funds, namely, Shs 90,000 a year.

Second, I am introducing an important new distinction in categorising pension funds for the purpose of controlling the tax deductible contributions made to them. In future, funds will either be categorised as defined contribution or defined benefit pension funds. Defined contribution pension funds are all those that operate like a savings plan, namely, the employee and employer make contributions to the fund each year and the funds accumulate over time in the name of the employee. Upon retirement a lump sum or pension is paid to the employee out of the accumulated balance. All provident funds are defined contribution funds as are many pension funds. The other type of pension fund are the defined benefit pension funds where the pension an employee receives is based on a predefined formula. The pension benefits are commonly earned as a fixed percentage of the final earnings of the employee for each year of service with the employer. The tax deduction limits for employer contributions will be treated differently for these two types of fund. In the case, of defined

contribution funds, they will be calculated on an employee-by-employee basis, while for defined benefit plans, the tax deductible contributions made by the employer will be calculated on a group basis for the employees who are members of such a fund.

Third, as was announced by the Income Tax Commissioner in January of this year, certain transitional measures are being introduced to deal with the switch-over of the taxation of pension savings from the previous system of non-deductible contributions to the deductible contributions. In the case of provident funds, I am also extending the deadline for informing the Income Tax Commissioner about the funds accumulated in the names of fund members from the 30th of June to the 31st of December of this year.

Finally, Mr. Speaker, I am announcing a major innovation in the area of pensions, namely, the introduction of "individual retirement funds". These will be registered funds in the name of individual Kenyans set up with banks and insurance companies. I want to reduce the reliance of employees on their employers in establishing pension funds. Initially, these individual retirement funds will only be allowed to receive funds from another pension fund when an employee leaves his current employer. Eventually, I plan to make these individual retirement funds open to contributions by self-employed and other individuals who do not have sufficient access to employer-based pension savings. Not only will these funds allow an employee to continue to build up his pension savings tax free after he leaves his current employer by transferring his pension savings into an individual retirement fund, but they will also supply the employee with a flexible mechanism for receiving pension income. Currently, a retiree only has a choice between receiving his pension savings as a lump sum or receiving a pension or retirement annuity. The individual retirement fund will allow the gradual withdrawal of funds during retirement while the remaining balance can still accumulate tax free earning current market interest rates.

Mr Speaker, these measures will serve to expand the access of Kenyans to pension savings. They will not only improve the welfare of individual Kenyans in their retirement years, but they will also serve to improve the capital markets by increasing the availability of financial savings in Kenya for capital investment. I will continue to study mechanisms to improve the operation and taxation of the capital markets. To this end, over the coming year, I and my officials will be holding consultations with the pension and insurance sectors to review their taxation and mechanisms for improving their operations.

Mr. Speaker, I will now discuss taxation of trusts. As you will recall last year I announced that the taxation of dividends would be limited to the withholding tax collected on the payment of dividends. I want to introduce a number of small measures to clarify the implications of this change for the tax treatment of dividends in a number of situations. The most important change is in the taxation of trust income. To prevent dividends received by a trust being over-taxed, I am amending the taxation of trusts to recognise that qualifying dividends and qualifying interest will bear no further tax other than their respective withholding taxes.

Mr. Speaker, I will forego some K£ 13.00 million from various measures proposed under this tax.

Miscellaneous Taxes/ Fees

Mr. Speaker, a number of miscellaneous taxes and fees are proposed. These include the entertainment tax under the Entertainment Tax Act which will impose a tax of 18% at ad valorem rate instead of a current specific rate. Another measure will be the increase of licence fees by 10 percent on banks, non-bank financial institutions, insurance companies and building societies. I will also levy a penalty of 50 percent for late payment of licence fees. Yet another measure concerns the long term life insurance funds. Currently subsection 5 of Section 46 of the Insurance Act does not allow dividend payment to shareholders out of a statutory fund exceeding 10 percent of the surplus. This limit is low and discourages investment in life insurance business. In order to encourage investment I have proposed to remove this subsection. Furthermore, licences under the Tourist Act have not been revised since 1970. I have created three categories and the proposed licence fees are Shs 4,000, Shs 3,000 and Shs 1,000.

Mr. Speaker, I expect to raise K£ 0.20 million from these few measures.

8. CONCLUSION

In conclusion, Mr. Speaker, this Budget has augmented and further strengthened our structural adjustment policies. The creation of a broadly based tax system in the Budget is aimed at allowing markets to function with a minimum of distortion. In particular, I have advocated sustaining economic growth through efficient mobilisation of resources. To achieve this I have prescribed lowering the budget deficit, controlling inflation and transforming the domestic economy from a highly protected

import substituting one to a competitive export oriented one. I am confident that these measures should all encourage growth and employment.

Mr. Speaker, this Budget has stressed that the continuity of peace and stability is of paramount importance to the health of the economy. It is therefore a great encouragement that we can always count on His Excellency the President's counsel and guidance in furthering this goal.

Mr. Speaker, I beg to move.