SPEECH TO BE DELIVERED TO THE NATIONAL ASSEMBLY ON 23RD JUNE, 1983 BY THE HON. ARTHUR K. MAGUGU, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR FINANCIAL YEAR 1983/84. (1ST JULY, 1983 TO 30TH JUNE, 1984)

Mr. Speaker, Sir,

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

INTRODUCTION

Since my last budget message the country has experienced severe economic strains which have inevitably affected the pace of economic growth.

In particular, weaknesses on the balance of payments front, and the inevitable drop in Government revenues have combined to make economic management during the current financial year very challenging Our capacity to bear this burden has, however, been greatly strengthen by the constant support and advice of H.E. the President and I am sure all Hon. Members will join with me in paying tribute to H.E. the President for his continued enlightened guidance of this Nation.

Last year, Mr. Speaker, my budget message dwelt to a very large extent on the problems of financial management in the public sector. This year, I would like to turn the attention of the House to the natu of the Government's response to the continued adverse economic conditi In doing so, I shall highlight some of the elements of the adjustment process which have at various times been discussed in this House. Some of these will, therefore, be familiar to Hon. Members; but in outlinin the Government's short term economic policies, I hope I shall be able to demonstrate to Hon. Members the coherence and the logic of various policies in the light of the difficult economic circumstances we now face. This is necessary because the environment within which we are operating is so volatile that at times Government action may appear to be somewhat abrupt. But a review of the various fiscal and monetar measures undertaken shows that Government action has been consistent with the medium term objective of adjusting the economy towards a healthier external balance in the context of prudent fiscal management It is my hope that this House will come to the same conclusion after listening to my remarks this afternoon.

I. RECENT ECONOMIC PERFORMANCE

(i) The International Background

For a country such as ours which actively participates in international trade, global economic prospects are intimately related to our economic circumstances. As Hon. Members may have seen from the recently issued Economic Survey, imports of goods and services in 1982 amounted to 30 per cent of our Gross Domestic Product, while exports amounted to 25 per cent. Hence when international events affect adversely the terms on which we trade, the external demand for our products and our access to foreign markets, the growth of the domestic economy must suffer.

The virtual doubling of oil prices during 1979 and the policy reactions of the industrialized nations plunged the world into a severe international recession. Recovery from that recession has proved very difficult for the international economy as a whole.

From a global perspective, the immediate effect of the rise in oil prices was a sharp rise in the current account surpluses of the major oil exporting countries and a consequent increase in the deficits of industrial and oil importing developing nations. In effect, a very substantial transfer of income occurred from the oil importing countries to the oil exporting countries whose current account surpluses increased from $5 billion in 1978 to $115 billion in 1980. At the same time the average inflation rate in O.E.C.D. countries (Europe, the U.S.A. and Japan) rose from 8 per cent in 1978 to 12 per cent in 1980.

The growing fear of inflation in the industrialized nations led them to focus their policies sharply on anti-inflation measures such as higher interest rates and firm control of money supplies.

Whereas the average inflation rate in O.E.C.D. countries has begun to subside from 10.5 per cent in 1981 and to 7.5 per cent in 1982, production and employment in these countries has continued to stagnate. Indeed, production in these countries grew by only 1.3 per cent in 1981 and fell by 0.5 per cent in 1982. During 1982 industrial production alone fell by 4.0 per cent. At the same time unemployment rose from 7.0 per cent in 1981 to 8.5 per cent in 1982 with a further rise to 9.5 per cent expected in 1983. The adverse effects of anti inflation measures on production and employment in these countries prompted moves toward greater protectionist measures, thus contributing to the fall in the volume of world trade in 1982 of 2.0 per cent.

The impact of these events on many oil importing developing countries has been, to say the least, devastating; and as an oil importer Kenya's economy has been very seriously affected by these adverse international trends. Between 1978 and 1982, the price of petroleum rose by 163 per cent while the price of tea fell by 13 per cent and the price of coffee by 16 per cent. Overall, our terms of trade deteriorated by 30 per cent during that period.

The result of these adverse international trends, namely the fall in the terms of trade, the end of the coffee boom in 1977, and the sharp rise in oil prices in 1979 together with special food imports in 1980, was a very large deficit on the current account of our balance of payments. From a small surplus in 1977, the current account showed a deficit of over K£250 million in 1978, reached nearly K£330 million in 1980, but fell to K£280 million in 1982, largely because of slightly improved export earnings and a drop in total imports of 12.5 per cent.

(ii) <u>The Domestic Economy</u>

The year 1982 was a difficult one for the domestic economy. Hon. Members will find a careful economic and statistical analysis of the events of that year in the Economic Survey released last week, and I will not bore Members with repeating that analysis. However, allow me, Mr. Speaker, to highlight some of the achievements of the past grew by 6.2 per cent; our best achievement on this front since 1976. Our farmers especially are to be commended for producing 4.5 per cent more in 1982 than in the previous year, thus increasing our agricultural output more than the growth in population. Our work force also contributed to development by increasing labour productivit by 2.4 per cent. In the field of energy, conservation efforts succeeded in reducing consumption of petroleum products by 5.9 per cent while electricity generation increased by 2.9 per cent. In the social sphere, enrolment in primary schools rose by 5.1 per cent and in secondary schools by 6.8 per cent.

Hon. Members may wish to note that these and other achievements were realised despite the very severe pressures placed on our economy and on the Government budget by depressed international economic activity.

(iii) Outlook for 1984

There are pointers, however, that 1983 and 1984 may experience some revival of economic activity. The O.E.C.D. forecasts a return to real economic growth in 1983, with momentum for growth picking up in 1984. Fiscal and monetary policies pursued by these countries also look less restrictive, and coupled with continued stability in oil prices, business confidence may recover in many countries. Although such recovery by the industrial countries may lead to improvements in the demand for developing countries' exports, no general commodity boom can be expected in the near future. So although there might be some improvements in our terms of trade, it is unlikely that the improvements in the world economy will be felt in Kenya before 1984/85. There will be need, therefore, to sustain our adjustment efforts both on the domestic and international fronts.

II. THE POLICY RESPONSE

Hon. Members may recall that the need for substantial structural adjustment of the economy was identified by Government immediately after the oil prices first began to rise in late 1973. Sessional Paper No. 4 of 1975 addressed itself fully to this issue. Later on, the Fourth Development Plan further outlined the nature of the required adjustment while subsequent Sessional Papers Nos. 4 of 1980 and 1982 reported to Parliament progress so far achieved. More recently the Presidential Statement on Economic Policies issued in September 1982 outlined the means for implementing essential elements of the programme as quickly as possible. I commend all these papers to Honourable Members who may wish to review in greater detail the structural adjustment programme of Government.

(i) Measures for Adjustment on the External Front

The main thrust of Government policies affecting the balanc of payments has been to promote exports and to reduce the nation's dependence on imports. Both of these objectives imply a more effectiv mobilization of domestic resources and a more temperate reliance on external borrowing. Some of the policies adopted have had an early effect in mitigating external deficits; others will take longer to be effective because they depend on more fundamental structural changes and on the revival of external market opportunities Nothwithstanding this the Government has responded quickly to the grew by 6.2 per cent; our best achievement on this front since 1976. Our farmers especially are to be commended for producing 4.5 per cent more in 1982 than in the previous year, thus increasing our agricultural output more than the growth in population. Our work force also contributed to development by increasing labour productivit by 2.4 per cent. In the field of energy, conservation efforts succeeded in reducing consumption of petroleum products by 5.9 per cent while electricity generation increased by 2.9 per cent. In the social sphere, enrolment in primary schools rose by 5.1 per cent and in secondary schools by 6.8 per cent.

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The nation's exporters have also been accorded other preferences and incentives and as the international recovery begins, we expect them to participate fully in emerging opportunities in foreign markets. The export compensation scheme has been reinstated and increases in exports now qualify for total compensation of 25 per cent. Imports required by producers of exports will be given priority in the modified import licensing scheme which I will discuss in a moment. Credit for exporters will be given a higher priority by commercial banks. And, firms which are prepared to arrange facilities for manufacturing in bond for export should apply to the Government for this privilege.

As Hon. Members are aware, the Government has since independence provided substantial protection in various forms to producers serving the domestic market in order to stimulate domestic manufacturing and to reduce imports. In the future special protection for new industries will be provided primarily through the adjustment of tariffs, but this special protection will diminish over time and will not exceed eight years, which should be ample time for infant industries to mature and achieve competitive efficiency. As industry adjusts towards production for export, improvements in efficiency of domestic firms will be gradually induced through reduction of high tariffs complemented by increases in sales taxes. The Government feels that industrial efficiency must be improved so that firms with idle capacity can compete effectively and profitably in external markets rather than relying solely on the domestic market for sales. Clearly adjustments of this kind will take time to accomplish, and manufacturers co-operation is sought in implementing the new industrial reforms.

Reducing restrictions on imports is another essential element of the structural adjustment programme. Industrial efficiency requires the freedom to import those raw materials and intermediate products essential for production which are not available in Kenya at competitive prices. The import licensing system, which had to be suspended for some time last year because of a severe shortage of foreign exchange, will therefore be implemented in a modified form early in the new financial year. The major modification is the division of former Schedule I into two parts Schedules IA and IB. Items on Schedule IA will be freely imported while items in Schedule IB will be subject to foreign exchange allocation to importers who may import what they choose from the Schedule. As foreign exchange reserves improve over time, items will be moved from Schedule IB to IA. These new Schedules are being printed and will be available shortly.

I should also bring to the attention of Hon. Members that the building of strategic reserves of food, as outlined in the Food Policy Paper is underway and should reduce future needs for special food imports. Moreover, the Government has reduced its other imports and will continue to monitor them carefully in order to make adequate foreign exchange available for private sector imports.

Hon. Members may have noted that interest rates have risen in recent years. Those who save earn more, those who borrow pay more. The increases in rates are intended to stimulate savings and to discourage the use of credit for marginal purposes, excessive imports and the accumulation of unneeded stocks. Hon. Members will agree that the effects of these changes are painful but unless there is a meaningful adjustment in the balance of payments, such tight monetary policies will remain in place.

These major policy initiatives represent the principal components of the Government's structural adjustment programme as it affects our external economic relations. Because some of these policies require more time and substantial international economic recovery to be fully effective, the effectiveness of the programme cannot be clearly evaluated at this time. I would point out, however, that over this period of international crisis, i.e. from 1978 to 1982, despite the fall in our volume of non-oil imports of 41 per cent, real Gross Domestic Product has grown at an average annual rate of 4.1 per cent. That is a remarkable achievement by any standard; and a firm indication that substantial structural adjustment has already been achieved.

(ii) <u>Measures for adjustment on the budgetary front</u>

Hon. Members will recall that during my budget message last year, I outlined the manner in which a large fiscal gap has emerged since 1976. Whereas revenues have performed well in the past, the demand for Government services have continued to outstrip the financing capacity of the Government. Because external revenues have been less easily available, the Government has been forced to rely increasingly on bank financing of the budget deficit with serious consequences on the availability of credit to the private sector.

The Government therefore embarked on a serious programme of fiscal adjustment beginning in 1979. From a level of 9.5 per cent of G.D.P. in 1980/81 the level of the budget deficit has been progressively reduced to 4.7 per cent in the current financial year, and it is expected that it will be further reduced in the next financial year. This significant fiscal adjustment has been achieved through curtailment of Government expenditures.

This adjustment, as Hon. Members will be aware, has been achieved with great difficulties. The productivity of many Government institutions has been affected, and the pace of development activity reduced. Yet, in spite of these difficulties, the Government feels that it is necessary to continue the tight fiscal policy because, as I have indicated, we have no alternative as a nation but to live within our means.

The task of fiscal management ahead of us therefore requires that the efficiency of resource utilisation in the public sector be improved. The Report of the Working Party on Government Expenditures which was recently adopted by this House highlights the need for such improved management in the public sector.

Mr. Speaker, Sir, I am glad to report that since June last year, there has been a significant improvement in the level of financial management in the public sector as a whole. In particular, I am heartened by the improvements in expenditure control in the last twelve months. Unlike in previous years, many Accounting Officers have responded positively to instructions from the Treasury on expenditure control, and it is my hope, Mr. Speaker, that this trend will be continued in the next financial year. Furthermore, timely implementation of the recommendations of the Report of the Working Party on Government Expenditures with regard to Government involvement in commercial activities, should reduce the call on limited Government revenues. Again, it is important to stress that in the light of continuing tight fiscal conditions, it is essential to adhere strictly to laid down plans and priorities in Government expenditure. In this regard, Treasury will continue to monitor closely implementation of Government programmes to ensure that financial prudence prevails at all times.

Looking ahead to 1983/84, it is clear that the tight expenditure posture of the last few years will have to be sustained. Consequently, there will be need to continue the close co-ordination of monetary and fiscal policies which has characterised our economic management in the last few years. The reduction in the level of Government deficit should mean greater availability of credit to the private sector. However, in view of the continuing weaknesses in the external sector as well as high domestic price pressures, it will be necessary in the coming year to pursue a cautious financial policy in order to match the level of required domestic financing of the budget to available credit resources. Only by adopting a cautious fiscal stance can we be sure that action for adjustment in the external sector has a chance of succeeding. As stated earlier, it is proposed that during the next financial year, the Government deficit will be further reduced. Because the scope for further taxation is limited, such a reduction will once again entail reduction of Government expenditures. But before I outline the financial programme for the coming fiscal year, allow me Mr. Speaker, to review briefly the financial out-turn for this year.

III. FINANCIAL OUT-TURN FOR 1982/83

From the perspective of the medium term objective of reducing the level of the Government deficit, there is no doubt that the achievements of FY 1982/83 are commendable. The 1982/83 financial programme envisaged a reduction of the size of the Government deficit from K£214.5 million (or 6.6 per cent of the G.D.P.) in FY 1981/82 to K£183.0 million (or 4.7 per cent of the G.D.P.). In the event, it is expected that the Government deficit will be K£188.7 million equivalent to 4.8 per cent of GDP. In addition, bank financing of the budget was originally targeted at K£ 51.25 million. The latest estimate indicates that a total of K£ 38 million of bank credit will be utilized to finance the 1982/83 Government deficit.

(i) Recurrent Revenue

In terms of the specific targets for recurrent revenue, it was estimated that ordinary revenue during 1982/83 financial year would amount to K£875.2 million, with Appropriations-in-Aid estimated at K£85.2 million, making a total of K£960.5 million. This recurrent revenue was to comprise of K£296 million from Customs and Excise; K£236 million from Income Tax; K£242 million from Sales Tax and K£101 million from other taxes. However, because of the severity and intensity of the domestic recession, there were significant revenue shortfalls in customs and excise and sales tax amounting to K£ 111 million as well as a minor shortfall in income tax amounting to K£ 13 million. Treasury foresaw this shortfall as early as November last year; and Hon. Members may recall that it became necessary to introduce new fiscal measures some time last December. In spite of this corrective action, it has still proved impossible to attain the revenue targets for the year as a whole notwithstanding the higher receipts from other taxes of K£19 million. Consequently, planned recurrent expenditures have had to be correspondingly adjusted.

(ii) Recurrent Expenditure

The 1982/83 printed estimates indicated gross recurrent expenditures of K£953 million, comprised of ministries gross expenditure of K£668 million, and Consolidated Fund Services of K£285 million. However, because of the poor revenue out-turn, it became necessary to adjust the level of recurrent expenditures of ministries to K£ 643 million. The provision for Consolidated Fund Services has, however, had to be adjusted upwards from K£285 million to K£296 million, largely on account of increases in the cost of domestic debt and costs inherent in the exchange and interest rate adjustments of last December.

(iii) Consolidated Fund Services

Mr. Speaker, Sir, I would like to draw the attention of Hon. Members to the fact that we have now entered into a different phase of development where repayments of both domestic and external debt will take an increasingly large share of available Government revenues. This means that Government revenues available for financing on-going activities will be limited and operating Ministries must plan their activities accordingly.

(iv) Development Revenue

The fiscal programme for 1982/83 envisaged that Kenya would avail itself of K£253.6 million from external sources in the form of grants and other concessionary loans. Partly as a result of the poor absorptive capacity of ministries as well as the curtailment of development expenditure necessitated by the tight fiscal policies, the out-turn for development revenues in 1982/83 was less than forecast. Out of an envisaged amount of K£253.6 million, only K£ 187 million in form of loans and grants was realised.

Let me put it on record Mr. Speaker, that Kenya greatly appreciates the development assistance received from the international community. In particular, I would like to thank those Governments who so quickly responded to H.E. the President's appeal for special balance of payments and project support last November. Notwithstanding such international assistance Kenyans must expect to continue contributing more to development efforts as indeed they have done in the past. In the meantime, budgetary measures will be intensified to ensure prompt utilisation of any donor finance currently available to the Government. To this end, I would once again urge operating Ministries to adhere strictly to disbursement procedures and to ensure that development projects that are financed are implemented on time.

(v) Development Expenditure

It was anticipated that Development Expenditure during 1982/83 financial year would amount to K£370 million, comprising of Appropriation in-Aid of K£86.60; Excess Votes from previous years of K£13.3 million; and net Development Expenditure of K£270 million. However, because of the poor revenue out-turn, development activity during 1982/83 has had to be severely constrained. Consequently, it is estimated that net Development Expenditure for 1982/83 will amount to K£170 million; compared to an actual net expenditure for 1981/82 of K£273 million. While development activity in 1982/83 has been somewhat higher than the Exchequer out-turn indicates, in real terms the outcome represents a very severe retrenchment in development activity, which, as I have already observed earlier on, has caused very acute difficulties to the private sector. That the country has withstood such a shock with resilience is largely due to the robustness of our national institutions in the public and private sectors and we once again pay special tribute to H.E. the President's wise leadership during these difficult economic times.

IV. PROSPECTS FOR FY 1983/84

(i) Balance of Payments and Revenue Prospects

Hon. Members are aware that the Government depends to a very large extent on revenues derived from taxation of imports. To the extent that balance of payments prospects are more promising revenue prospects are likely to be brighter. Prospects for imports and related revenues during 1983/84 are expected to be considerably better than in this year largely on account of two main factors, namely the continued inflow of balance of payments support arising from the Special Donor Conference of November last year and the prospects for continued programme support from the World Bank and the International Monetary Fund. Taken together, these favourable events during FY 1983/84 should permit a steadier and larger flow of imports. Revenues derived from imports should therefore perform moderately in the next financial year. The effects of such improvements in the balance of payments will, however, take some time to spread into the economy. We can, therefore, expect that revenues based on domestic taxation will continue to be less buoyant in the next financial year. But as I have indicated, if the Government is successful in managing the size of the deficit, we should expect a higher volume of domestic credit to flow to the private sector instead of going to finance Government operations. Mr. Speaker, it is my hope that a steadier inflow of revenue to Government will in future enable the Government to exercise more effective control over its expenditures and thus ensure a steadier pace of economic activity

(ii) Outlook for Expenditure:

While it is expected that revenue prospects will improve somewhat in the next financial year, demands on those revenues will grow even more rapidly. Inevitably, there will be pressures to recover the momentum of Government spending of earlier years; but financial management demands that we do not deviate from the set path of fiscal adjustment. All in all, revenue prospects for 1983/84 indicate that recurrent expenditure for 1983/84 will be less in real terms compared to the provision of the year now about to end. It is important, therefore, that the Treasury directives to Ministries on expenditure control which were issued in March are sustained in the next financial year.

With regard to development expenditure, the situation is equally less promising; for as I have indicated earlier on, the demands on Government revenue from both recurrent expenditure and payment of public debt leave development expenditure as a residual. It is, therefore, expected that in real terms, development expenditure next year will be less than this year. This calls for an imaginative approach in development programming. While every effort will be made to ensure that all on-going projects are completed, it is inevitable that some projects may lag behind. In order not to waste national resources, it is essential that proper priorities are observed by all operating ministries. Cost overruns in project implementation must be avoided through close monitoring of progress and better forward planning. To this end, the Treasury will maintain close consultation with Ministries in the coming financial year so that any adjustments which may become necessary in the course of the year are made within the budgetary framework in a consistent manner.

Having made these observations, I now turn to the forecast of expenditures and revenue for the coming financial year.

V. PROJECTED OUT-TURN 1983/84

(i) Expenditure 1983/84

Hon. Members may have seen from their copies of the Printed Estimates that the Gross Recurrent Expenditure of Ministries is estimated at K£647.45 million, comprising of net expenditure of K£572.54 million and Appripriations-in-Aid of K£74.91 million.

In addition to this, there are carryovers of Excess Votes from prior years of K£32.14 million. Thus estimated issues from the Recurrent Exchequer are expected to be K£604.68 million.

Hon. Members will note that expenditure on Consolidated Fund Services will go up from K£296.70 million this year to K£343.90 million next year. This rapid rise in the burden of debt reflects the maturing of past debt and higher servicing costs.

Development Estimates for 1983/84 indicate that K£266.46 million of public funds will be devoted to development activities compared to K£248.38 million in the current financial year. How this amount will be spent is clearly spelt out in the Printed Estimates and I do not want to bore members with any further details. In addition, there will be carry-over of excess votes from prior years of K£13.35 million. Suffice it to say that I intend to finance a total expenditure of K£1303.30 million. The rest of my Speech will outline how I intend to do this.

(ii) External Revenue

As Hon. Members are aware, Kenya enjoys very cordial relations with many foreign countries, and as in the past, we shall continue to welcome the assistance these countries give to us in cur development efforts. Similarly we shall continue to rely on multilateral development finance institutions, particularly the World Bank Group, to help us in achieving our development objectives. In doing so, we shall ensure that the machinery for project implementation is adequately established and properly organised in order to make the best use of such external assistance. I am aware that we continue to experience difficulties in certain areas of collaboration with some donors, but I can assure our international friends that all efforts are being made to solve these difficulties. Indeed, during this financial year some innovations have taken place, particularly in payment arrangements. The system of direct payment for certain contracts has been tried by several donors, and experience proves that such practice reduces delays in project implementation. Although such direct payment relieves the pressure on the Exchequer, it is essential that proper arrangements are made for ensuring accountability of funds as well as the responsibility for project design and selection. Such initiative must always lie with Kenyans, and I hope that our foreign friends will understand this need for controlling the nature and pace of our development activities.

(iii) External Borrowing

Hon. Members will be aware that pressures for external borrowing have been mounting within the private and public sectors. Of late Treasury has been innundated with all sorts of offers of so-called cheap money from unauthenticated sources. But as Hon. Members know, our laws define very clearly the limits of prudent borrowing as well as the manner in which such foreign borrowing can be contracted. In all instances of foreign borrowing by the Government, Parliament must be informed through appropriate Sessional Papers of the purpose, source, and terms and conditions of such borrowing. Moreover, all such borrowing must be channelled through the Treasury and integrated into the budgetary process.

In the meantime, Treasury has formulated a detailed external borrowing plan for the Central Government as well as parastatals and local authorities which contains the policy guidelines and control procedures which should govern external borrowing in the medium term.

For the moment, Mr. Speaker, we must continue to watch closely the level of external borrowing because the cost of servicing such debt is rising very rapidly. Indeed, the debt service ratio has risen from 12.2% in 1980 to 21.5% in 1982 and it is estimated that this figure will increase further to approximately 24.4% in this calendar year. Clearly, such a trend cannot be allowed to continue and we must look to the domestic economy to sustain our development activities.

However, as I have already indicated, we shall continue to rely on our traditional sources of external finance and I estimate that in the next financial year we shall draw some K£250.78 million from external sources in the form of commercial and concessionary loans and grants frc both bilateral and multilateral sources. Thus I expect to finance 19 per cent of the total expenditure of K£1303.30 million from external sources. The main burden of financing Government expenditure will, therefore, once again, fall on Kenyans and I now turn to how I intend to raise the balance of K£1052.52 million from local sources.

(iv) Domestic Borrowing

I have already indicated that Government reliance on deficit financing is being curtailed not only in order to limit the inflationary consequences of an expansionary monetary policy but also in order to limit the costs of such debt as such expenditure obviously have direct bearing on revenues available for normal Government activities. It is imperative, therefore, that Bank financing of the deficit be kept to the minimum in the next financial year. It is proposed that the bulk of the domestic financing of the deficit will come from non-bank sources. In particular it will be necessary to arrange for placement of approximately K£50 million of Government stocks with parastatals and approximately K£92 million in Treasury Bills with banks and non-bank financial institutions. In order to achieve these targets it will be necessary for parastatals to assign priority to payment of outstanding debt to Government and purchase of Treasury Bills and stocks from their normal working surpluses.

(v) Internal Revenue 1983/84

I estimate that in the coming financial year, ordinary revenue, including local Appropriations-in-Aid, should provide some K£888.10 million at current rates of taxation. Government stock and Treasury Bill issues should provide another K£142 million from the bank and non-bank sectors, making a total of K£1030.10 million. I have already indicated that I shall draw K£250.78 million from external sources. I, therefore, have a gap of K£22.42 million to finance, and the rest of my Speech will outline how I intend to close this gap.

VI. TAXATION PROPOSALS

Mr. Speaker, Sir, I have appraised the House of the economic policies which we have pursued and which we intend to pursue in light of the prevailing adverse economic situation. I have also indicated that I have a financing gap of K£22.42 million. Again, as I have said earlier on, this deficit cannot be wholly financed from the banking system. I am therefore forced to institute some measures to raise additional revenue. As usual, I would ask that the rest of my Speech be regarded as being Notice of a Motion to be moved before the Committee of Ways and Means.

(i) CUSTOMS AND EXCISE

Before dealing with specific tax proposals, I wish to briefly dispose of a few amendments to existing taxation laws aimed at closing tax loopholes. The 1983 Finance Bill also contains several amendments to Customs and Excise Act aimed at reinforcing the restructuring measures in the industrial sector. I would like to deal with some of these amendments which have no direct revenue implications.

Firstly, section 46 of the Act provides for the sale of warehoused goods by public auction in the event they are not re-warehoused or cannot be further warehoused. The effect of this provision in certain cases is to relieve the owner of the goods of any obligation to pay duties liable on the goods. This provision also subjects the Commissioner to lengthy and costly procedures in recovering revenue. I, therefore, propose to amend this procedure to make it mandatory for the owners of goods to pay duty on the first warehouse account thus making the disposal of goods the responsibility of the owners of such goods.

Secondly, the law also provides that where the conditions of any bond have not been complied with, the Commissioner may institute legal proceedings to enforce the bond. As Hon.Members may be aware such civil cases take a long time before adjudication. I, therefore, propose to amend the relevant section of the Act to give the Commissioner powers to execute the bond directly.

Thirdly, under existing legislation on excise duties an excise licensee who fails to pay duty when it is due and payable is subject to a distress levy. Such distress warrant, however, is limited to land or buildings only. These limitations are obviously detrimental to revenue collection. It is therefore proposed to amend the law to make such distress warrants to apply to other properties as well.

Fourthly, Hon. Members are aware of the high rate of road accidents particularly at night. The accidents are particularly common on roads without reflective studs which are currently dutiable at the rate of 60 per cent. In order to make it cheaper for Government and Local Authorities to provide more of these road signs to protect the public from danger, I propose to remove duty on road and traffic signs.

Mr. Speaker, Sir, I would now like to turn to those amendments which have significant revenue implications. Earlier on in my Speech, I outlined the measures the Government has undertaken in promoting exports of locally-manufactured goods.

In pursuit of this objective, I propose to lower most import duties which are currently above 30 per cent by an average of 14.7 per cent of the existing rate. The main effect of this measure will be to grant duty relief to manufacturers who export their products. The measure will afford a significant incentive to such industries as steel, where duty on imported scrap will be abolished; and food processing as well as plastic industries where duties on raw materials will be reduced to 20 per cent.

This measure, which takes effect from midnight, tonight, will cost the Exchequer some K£30 million in foregone revenue.

(ii) SALES TAX

Mr. Speaker, I would now like to turn to Sales Tax. As usual I would first like to deal with those amendments which have no direct revenue implications.

At present the Sales Tax Act allows a manufacturer to register after carrying on business for one year. But since the Commissioner is unlikely to know that a new manufacturer will produce goods worth more than KSh.200,000/-, there is a loss of revenue involved in this lag in registration of manufacturers. I therefore propose to amend the law to provide that where a new manufacturer expects to produce goods in such quantities as would make him eligible to pay tax, then he should register himself prior to commencement of production.

Secondly, the law also imposes a penalty of 2 per cent per month on tax which remains unpaid after due date. However, under present legislation only tax that is due can be recovered by distraint. I propose to amend the law to provide that penalty payments, like tax, shall be recoverable by distraint.

Currently, manufacturers aggrieved by decisions of the Commissioner can appeal to the Tribunal within ninety days. This period is too long and has been used by some unscrupulous manufacturers to delay tax payment. I therefore propose to reduce it to thirty days through appropriate amendment to the law.

Mr. Speaker, I would now like to turn to those amendments to the Sales Tax Act which have direct revenue implications. As I have already indicated, the Government is committed to promotion of exports while reducing excessive protection of local industries. It is in this light that the proposed reduction in import duties should be seen. As Hon.Members may know, at present manufactured goods which are exported are not subject to Sales Tax. So that the duty relief on raw materials does not go entirely to manufacturing for the domestic market, it is proposed that concomitant with the lowering of custom duties for every item on which duty has been reduced, there will be a corresponding increase in sales tax. Furthermore, in order to ensure that there is a net increase in overall revenue as a result of the restructuring exercise I propose to raise the general rate of sales tax from 15 per cent to 17 per cent.

Mr. Speaker, I do not intend to increase the rate of sales tax on beer this year. However, in view of the increased manufacturing costs, the Kenya Breweries has requested a price increase of 30 cents per half litre bottle. The Government after careful examination has accepted this request and the price of beers will, therefore, go up by 30 cents per half litre with effect from midnight, tonight.

Considered together, I estimate that these measures, which come into effect from midnight, tonight, will provide the Exchequer with an additional K£52 million in revenue.

(iii) INCOME TAX

Mr. Speaker, I would now like to turn to Income Tax in which I have very few amendments to make. Firstly, under existing law a penalty of 15 per cent on tax due and payable is imposed if tax is not paid on the due date. This section is a strong deterrent against late payment. It works well in all direct assessment cases but it is not explicit in law whether this section applies to withholding taxes. In particular, it is doubtful whether the relevant section can be legally applied to cases of P.A.Y.E. deductions made late. I, therefore, propose to amend the law to explicitly provide that penalty shall be payable on P.A.Y.E. deductions paid to the Commissioner after due date.

As an additional tax relief and in order to promote savings, I propose to exempt from tax interest earned on individual savings accounts held with registered banks or financial institutions licensed under the Banking Act provided the amount of such interest does not exceed Sh.7,500/- in any one year.

(iv) HOTEL ACCOMMODATION TAX

Under the Hotel Accommodation Tax Act, I propose to make an amendment to give the Controller of Inland Revenue powers of distraint in order to curb the large number of cases of arrears in this area.

(v) BANKING ACT

Mr. Speaker, judging by the increasing number of licence applications which my Ministry receives from prospective operators it would seem that the financial sector is still lucrative. I, therefore, propose to increase licence fees on banks and financial institutions by 50 per cent. This measure will provide the Exchequer with additional K£250,000 in revenue.

(vi) AIR PASSENGER TAX

Mr. Speaker, following the completion of the two international airports at Nairobi and Mombasa some four years ago, air passenger tax was doubled from Sh.40/- to Sh.80/- in 1979. In view of the increased costs of maintaining these airports, it is only logical that those who use them should pay a little more. I am, therefore, raising, with effect from midnight, tonight, air passenger tax from Sh.80/- to Sh.100/-. This should provide an additional K£240,000 to the Exchequer.

(vii) PRICES OF BOOKS

Last year, I requested all publishers of educational books to indicate on the cover of their books the recommended prices so that Wananchi are not exploited by unscrupulous booksellers. I regret to report that publishers did not heed my request. In order to rectify this situation, I have decided that, with effect from 15th July, 1983, no publishers, importers or booksellers shall expose for sale any educational book for used in secondary or primary schools without approval of such price from the Price Controller. This condition applies to both locally-published and imported books. I have, therefore, directed the Price Controller to embark on the exercise of compiling an up-to-date list of book prices with a view to reviewing them to reflect their true costs and adjusting them as necessary.

In the case of new publications, the Government will make the final decision on prices to be printed on the books before they can be exposed for sale.

VII. CONCLUSION

Taken as a whole, the new taxation measures I have announce today will bring a net addition to revenue of K£22.5 million, thus finally closing the budgetary gap.

Closing this gap has been difficult this year. Government programmes have had to be adjusted to reflect changing revenue prospects and emerging priorities. The budgetary process has therefore been flexible in the last financial year. Indeed, after the Financial Statement for 1982/83 was approved by this House last year, it became necessary to readjust, with the approval of Cabinet, the estimates of expenditures by Ministries some time in March this year. This was necessary in order to keep the level of expenditure in the coming year to what we can afford as a country. Because of the continued tightness on the budgetary front, it became necessary early this June after the 1983/84 estimates had been provisionally finalized, to readjust, once again with the authority of Cabinet, the estimates for spending by Ministries in the coming financial year. This readjustment affected such Votes as the Ministries of Agriculture Health, Livestock, Transport and Communications, Works and Housing and the Office of the Vice-President and Ministry of Home Affairs.

This process of readjustment and fine tuning called for close and prolonged consultations between Treasury and all operating Ministries whose expenditure ceilings had been affected. This process lasted upto June 15th, thus leaving the Treasury with only four to five days to finalize, print and submit the 1983/84 Annual Estimates to the House. This, Mr. Speaker, explains the background to the request for the leave of the House to present this year's Annual Estimates two days after the period stipulated in the Standing Orders. This outcome, Mr. Speaker, reflects the difficult circumstances within which our financial affairs have had to be managed during the past year; and I am grateful to Hon.Members for being understanding in this matter.

In conclusion, Mr. Speaker, I have to-day outlined measures which seek to consolidate the gains achieved under our programmes of financial stabilization and structural adjustment of the economy. For these measures to continue bearing fruit, we shall require the co-operation of industry and Government as a whole.

To sustain the momentum of growth under these circumstances will require extra efforts and sacrifices by all. And to make the burden of leadership in these circumstances lighter will require our total loyalty to H.E. the President. I'm sure Hon.Members will join me in once again reaffirming our unswerving loyalty to the President in the true spirit of our Nyayo Philosopy of Peace, Love and Unity.

Mr. Speaker, I beg to move.