SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 11TH JUNE, 1987, BY THE HON. PROF. G. SAITOTI, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE FISCAL YEAR 1987/88 (1st. July, 1987 to 30th June, 1988).

Mr. Speaker Sir,

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

1. INTRODUCTION

Mr. Speaker, the themes of the last two Budgets reflected the particular problems and challenges we were facing then as a nation. The way in which we coped with the 1984 drought demonstrated to the world, and to ourselves, how fundamentally sound our economy is and how flexible our policies are. It also demonstrated the political, administrative capability, and the will power of Kenyans to respond to unprecedented crises and deal with these problems using our own resources.

Mr. Speaker, I am sure that all Kenyans have come to appreciate the fact that Economic Development can only be achieved in an atmosphere of political and social-stability. It is for this reason that I would like to call on all Honourable Members to join me in expressing our deep gratitude to H.E. the President for the distinguished manner in which he conducts the affairs of this country. Guided by his personal example and our political philosophy of Peace, Love and Unity, Kenya should be able to achieve the economic and social goals we have set for ourselves. I am sure I speak for all Honourable Members in stating that we should all resolve collectively and individually to support His Excellency's efforts.

The task that we have set for ourselves as spelled out in the Sessional Paper No. 1 of 1986, is to create a set of policies which will increase efficiency and thus accelerate growth, reduce unemployment, while maintaining financial stability at home vis-a-vis the rest of the world. Within this framework, there will be no letting up in our determination to control inflation. We shall continue the structural adjustment and stabilization policies we have followed consistently in the last few years. These policies provide the only way to achieve our objective of stabilizing the economy -- for to abandon them would be to risk renewed inflation and much higher unemployment. We need to establish a set of incentives that will stimulate the private sector to become an engine of economic growth. We need to remove all the unnecessary bureaucratic and other obstacles to economic growth, and we must ensure that the increase in incomes generated in this process is widely distributed among our citizens.

If these targets are going to be achieved, we need to establish and maintain close co-operation and mutual confidence between the Government, the business community in Kenya and abroad and the multilateral and bilateral institutions which assist us in our development efforts.

Mr. Speaker, the circumstances which led to Kenya's impressive economic performance in the first decade after independence have now run their course. The international economic environment during the last ten years has not been conducive to rapid economic and social progress. However, we must not blame others for our own shortcomings. Instead, we should use the example of those countries which have been successful even in adverse circumstances and focus our attention on matters at home, which we ourselves can change. It was in this spirit that the Sessional Paper No. 1 of 1986 was prepared, later debated and approved by this Parliament. As you may recall, the scope of this Paper concerns Kenya's development up to the end of this century. In this Year's Budget, I will continue to transform the principles set out in the Sessional Paper into concrete economic policy actions.

Mr. Speaker, last year, I spoke about renewing economic growth. That was and remains an important issue, in view of the fact that Kenya's average income per household has hardly grown since the first half of the 1980's. Today, however, we can look back on 1986 as a year of remarkable economic achievement. We had significant performance and registered the highest real growth rate of income per head in almost a decade. Inflation abated, and we enjoyed a substantial surplus in our transactions with the rest of the world. Behind this good achievement were some fortuitous, and temporary factors which we cannot count on in the years ahead. Nevertheless, I am confident that the growth momentum from last year can be maintained. We should now aim at utilizing effectively the strengths in the economy and shape our policies so that we can continue to enjoy rapid economic and social progress.

Mr. Speaker, in this connection I shall begin by reviewing the international economic scene as a background to our own economic situation. I shall deal with some of Africa's economic problems, in particular the serious and often damaging situation brought about by large external debt obligations. Thereafter, I will review Kenya's economy in 1986 and provide a prognosis for 1987 and beyond.

These introductory sections of my speech should set the stage for a discussion of the policy framework I have formulated for this year's Budget. Finally, I shall discuss the budget outturn for the fiscal year just ending, and present specific measures relating to taxation and other tariff matters for 1987/88.

THE WORLD ECONOMY

Mr. Speaker, events in the world economy often affect economic variables in developing countries like Kenya in a variety of ways and in 1986 this was especially true. The year was marked by large swings in key world prices especially in the price of petroleum products and in the exchange rates between major currencies.

The price of petroleum, the single most important price in world trade, fell by approximately 60 percent between November, 1985 and August, 1986. By early this year, oil prices had rebounded to around U.S. $18 per barrel which is still 40 percent below the 1985 level. It is our expectation that oil producing countries will continue to meet their increasing demand from expanded output and that oil prices may be maintained at this level, at least for several months.

Non-oil commodities continued the long historic decline which has characterised their performance since the beginning of this decade, falling by another 7 percent during the year. Overall non-oil commodity prices have fallen by 30 percent since 1980. A slight correction in these prices is expected during 1987. Despite this, the terms of trade for non-petroleum exporting developing countries is expected to fall further in 1987.

Partly, as a result of the decline in commodity prices, inflation generally abated throughout the world. Lower inflation in turn led to lower interest rates which fell by about 20 percent in the major industrial countries last year. These reductions could have eased debt service burden faced by many developing countries, but adverse exchange rate shifts have deepened the foreign debt crisis. As inflation rates increase, we can expect a rise in interest rates: this process has already begun in the United States.

Mr. Speaker, the international prices turmoil also extended to a sharp realignment of the major currencies which centred around the U.S. dollar, which had become substantially over valued from 1980 through 1985. The dollar fell by 30 percent on a trade-weighted basis from its peak in early 1985 until the end of February this year while the Japanese yen appreciated by the same amount; the German mark rose by approximately 10 percent. Industrial countries' exchange rates are expected to stabilise this year as trade flows begin to respond to the large shifts of the past two years.

The dramatic shifts in fuel prices and in exchange rates had offsetting effects on economic growth in the industrial countries. Consequently, gross national product in the industrial countries as a group grew by only 2.4 percent last year, compared to a 3 percent rise in 1985. The prognosis for 1987 is a continuation of growth rates averaging less than 2.5 percent.

Among the developing countries, oil exporting nations suffered losses in their terms of trade of close to 15 percent of their national income. Despite a 10 percent expansion of export volumes, the real gross domestic product of oil exporters fell last year and further declines may occur in 1987. On the other hand, non-oil exporters enjoyed the benefits of falling oil prices, but this was largely offset by other price changes. Partly because export volumes grew by a robust 8 percent, GDP growth in these countries accelerated from 4.6 percent in 1985 to 5.4 percent last year; and per capita incomes,therefore,rose by 3.6 percent, the best performance in many years. With the slowed economic expansion of their industrial country markets, non-oil developing countries are likely to experience slower growth of both exports and GD! in 1987, probably around 4 percent.

3. AFRICAN ECONOMIES

Mr. Speaker, economies of Sub-Saharan Africa, with the exception of oil exporting countries, benefitted from lower oil prices and expanded trade; growing by 4 percent last year, an improvement from 3% of 1985. On average, per capita incomes rose by almost one percent, the first such major improvement in nine years. African inflation abated somewhat and, at 9 percent last year was below the levels in Europe and Latin America. Sub-Saharan Africa's exports expanded by 8 percent, and despite a 12 percent decline in the terms of trade, there was a 3 percent rise in import volume, the first such gain since 1980. Unfortunately, the conditions that sustained such growth are unlikely to persist in 1987. Sub-Saharan economies are projected to expand at only 3 percent this year, with virtually no rise in per capita incomes.

The consequences of external debt continued to plague developing countries. In 1986, total external debt rose to 168 percent of total exports for all developing countries and 22 percent of exports were required to pay the interest and principal.. Africa's debt problems receive less attention than those of Latin America, probably because the dollar amounts are so much smaller: Sub-Saharan countries owed about 76 billion dollars at the end of 1986 which is only about 20 percent of Latin America's total. But repayments are becoming a serious drain on Africa's resources: last year, 30 percent of export earnings were used to service debts. In contrast to Latin America, where most debt is from Commerical banks, 60 percent of Africa's long-term debt is owed to national and international aid agencies. In the short-term, debt postponement or forgiveness by these donors provide the only way to alleviate this burden. However, the ultimate solution to Africa's debt burden lies in fundamental structural adjustment measures to accelerate economic development. It must, therefore, be pointed out that the debt load cannot be lightened much unless African countries are able to reduce their imports, especially of food and increase their exports. This in turn requires investments in higher productivity sectors, particularly agriculture and industry.

One encouraging observation to be made in this respect is that creditor countries have been easing the terms of debt re-scheduling for countries seeking relief through the Paris Club. While this is to be applauded, it must be emphasized that ways need to be developed to relieve debt burdens for those countries, like Kenya, which have avoided insolvency through sound economic management, sometimes at great social costs.

It is within this context of world economy that we can appraise Kenya's economic performance in 1986 and its prospects for 1987.

THE DOMESTIC ECONOMY

a) Economic Performance

Mr. Speaker, last year, three events in the world economy propelled Kenya's economy to its best performance in many years. Brazil's drought helped to raise the average Kenya coffee price by 22 percent, while the suspension of quotas enabled Kenya to expand its quantum of exports by 21%. Simultaneously, the fall in petroleum prices enabled Kenya to spend 45 percent less on oil imports in 1986, compared to 1985. These two factors alone contributed an additional 5 percent to our national income in 1986. Good weather was the third factor for an excellent year. The result was the greatest expansion of Kenya's gross domestic product since 1978, a growth rate of 5.7 percent.

(i) Income and Employment

The substantial growth in GDP enabled a corresponding growth on the average incomes of Kenyans. Per capita income grew by 2 percent. And when the benefits of a 12 percent improvement of our international terms of trade is taken into account, the adjusted GDP rose by almost 10 percent and the average per capita income of Kenyans increased by almost 6 percent. However, this welcome jump in incomes only compensates for the previous years of little growth or decline. To make a substantial difference in the welfare of Kenyans, we have to extend last year's achievements into the future for many years ahead.

Mr. Speaker, last year wage employment expanded by 4 percent, and on average wages were higher, increasing by 3 percent more than consumer prices. Since 1980, wage employment has been growing at 3.3 percent a year. But when informal or micro-enterprise sector workers are included, jobs have expanded by over 4 percent a year since 1980, sufficient to accommodate the new entrants to the labour force. Mr. Speaker, this emphasizes both the importance of the micro-enterprises sector in our development plans and the need to create jobs faster with rising productivity in larger scale formal sector enterprises.

(ii) Savings and Investment

Mr. Speaker, Investors' confidence rebounded with the economy. In 1986, real gross fixed investment rose over 13 percent, following a similar rise in 1985. Over 80 percent of the increase in investment was due to private sector efforts. When increase in stocks is included, Kenya invested 25% of gross domestic product which is above average for countries with similar incomes. Even more impressive was our savings effort last year: domestic savings by households, firms and government was equivalent to 23% of GDP, a quantum jump over the savings rates in recent years. Revised estimates show that over the past four years, through stabilization, drought and now recovery, Kenya has been investing at an average rate of 22 percent of its gross domestic product, and financing 85 percent of that investment through domestic savings. Although we could do more, we are already saving and investing enough to generate growth rates of 5 to 6 percent over the long run; however, we have not grown that fast in the last decade, primarily because our investments have not been productive enough. At several points in today's speech I will outline policies intended both to increase investment and to improve its productivity.

(iii) Agriculture, Manufacturing, Construction and Services:

Agriculture, the main engine of our economy, grew by almost 5 percent last year, mainly as a result of good weather which helped farmers to harvest an exceptionally good maize crop, and high coffee prices. The farmers enjoyed an improvement in their terms of trade, as the prices they received for their produce increased 5 percent faster than the prices they paid for inputs and consumer goods. Manufacturing value added expanded by almost 6 percent in 1986, while almost 4 percent more jobs were created in this sector. Construction continued to recover from its depressed condition, growing by 3.7 percent and adding 11 percent to its work force. Value added in energy production, stimulated by lower oil prices, rose by 7.5 percent last year. Spurred by general prosperity and a good tourist year, trade, restaurant and hotel services enjoyed the fastest growth of over 8 percent. In fact the number of visitors grew by almost 14 percent, despite the adverse publicity which at times evoked the Aids Scare.

(iv) Money and Prices

Mr.Speaker, Government's fiscal performance in the year under review reflects both the surge in our economy and the impact of our development policies. Based on our most recent data, revenues will have increased by 22 percent over 1985/86 in current prices. Ordinary revenue thus equals 24 percent of GDP -- which is the long-term target suggested in the Sessional Paper. Primarily as a consequence of certain unavoidable expenditures which I will explain later, expenditures for 1986/87, as currently projected, are more than 30% higher than those of 1985/86. The resultant deficit is projected to be around 5 percent of GDP. Deficits of this magnitude do exert inflationary pressures on the economy and divert valuable resources from the private sector whose investment is critical for sustainable growth. I am, however, convinced that we can still reduce the deficit down to a sustainable level.

The money supply expanded by a third last year far in excess of the 15 percent rise in nominal gross domestic product. Two factors contributed to this phenomenon. Half of this expansion was caused by the need to finance Government's deficit through the banking system. Net credit to the private sector expanded by 17 percent -- thus helping to fuel the recovery of private investment -- and contributed almost a third of the increment to the money supply. However, most of the balance of the money supply growth resulted from the increase in foreign reserves, which in turn are due largely to the favourable shifts in coffee and petroleum prices.

Despite the economy's expansion and the large growth in the money supply, inflation fell to about 5 percent in 1986, the lowest rate by far in the past 13 years. But even without the drop in oil prices, the underlying rate of inflation would still have been around 8 percent, a substantial improvement over previous years. Results for the first four months of 1987 suggest that consumer prices have risen close to 3 percent since December, which would yield an inflation rate just over 10 percent for the entire year. A crucial task for fiscal and monetary policy is, therefore, to prevent the one-third increase in the money supply of 1986 causing a rapid rise in inflation in 1987.

(v) Trade and Payments

Mr. Speaker, coffee was not the only good news on the export front. The value of fresh horticultural exports was 34 percent higher in 1986 than 1985. Non-traditional exports including manufactured goods, grew by almost 30 percent in volume, while beverage and tobacco exports grew by 47 percent. But such growth should be viewed within the context of previous poor years, which has since 1984 been under 5 percent a year. We hope, however, that the 1986 recovery represents the future trends.

Imports also grew at rates unprecedented in the recent past. The most encouraging indicator of the true buoyancy of the economy is private sector imports, which expanded by over 10 percent last year; with inputs to industry growing by around 25 percent. But this robust recovery needs to be put in the context of the poor performance in 1985. Taking the two years together, the quantity of industrial input imports grew by just under 8 percent a year.

When performance of the services sector is included, the current account deficit fell from K£77 million in 1985 to K£33 million last year. Capital movements, both long-term and short-term, rose from the depressed levels of 1985 when an overall outflow of K£22 million was recorded to an inflow of K£111 million in 1986. The net effect was a rise in the overall balance from a deficit of K£94 million in 1985 to a surplus of K£73 million last year. Our foreign exchange reserves stood at an equivalent of K£343 million at the end of 1986.

(b) Outlook for the Future

Mr. Speaker, I have already appraised the House on the performance of the economy last year. We should now pause to reflect what the immediate future holds for us. Kenya's economic prospects for 1987 are promising despite some negative factors. First, coffee prices are already below the levels of 1985. Second, petroleum prices are likely to be higher this year but will probably stabilize at around $18 a barrel. Third, any rebound in the prices of other primary commodities, particularly tea, will not be dramatic. Fourth, last year's rapid money growth means that monetary and fiscal policy cannot be expansionary this year, especially given the latest acceleration of inflation that I remarked on earlier.

At the same time, there are signs that we can sustain a growth rate of over 5 percent this year. Last year's surge in investment has created new capacity that should soon produce more goods and services. The 27 percent expansion of investment over the last two years, much of it private, leaves me hopeful that investors will provide a new stimulus to long-term growth. Farmers have shown tremendous resilience and energy since the drought of 1984. These factors coupled with reasonable rains so far this year, should turn in another year of satisfactory growth. Manufacturing shows signs of rejuvenation, while services such as trade and finance are expanding faster than GDP. Finally, and crucially, recent projections suggest that non-traditional exports can compensate for the decline in coffee revenues. We should, therefore, be able to continue making foreign exchange available for imports at rates high enough to sustain another 5 to 6 percent expansion of our economy without running into financing difficulties.

In short, careful macro-economic management and an endorsement of the private sector's confidence can be combined to produce a robust but responsible expansion of the economy over the next twelve to eighteen months.

POLICY FRAMEWORK

Mr. Speaker, the economic conditions just described set the stage for the formulation of the policy framework for the 1987/88 Budget whose theme is "Sustaining economic growth with financial stability". The first priority is to ensure a continuation of the healthy growth we experienced last year. Equally important is the focus on financial stability, that is, sound management of the budget, the money supply and the balance of payments. In Kenya's present circumstances, there is no conflict between the short-term goal of financial stability and the long-term goal of economic growth: growth can neither be attained nor sustained without fiscal and monetary stability. By judicious short-term measures inflation will be curtailed, investment will be attracted and funded, while our debts will be maintained at manageable levels.

(a) Fiscal Policies

Mr. Speaker, as I have consistently emphasized in the past, we should always aim at a sustainable budgetary deficit for two reasons: First, a lower deficit protects balance of payments. Second, it reduces inflationary pressure in the economy. Government's fiscal performance this year reflects both the surge in our economy and the impact of our development policies. Although this year's deficit was projected at 3.5 percent of GDP, the final outturn is now estimated at around 5 percent of GDP. This unfortunate development was occasioned by three factors which were beyond our control.

First, the bumper harvest of 1986 required the National Cereals and Produce Board to purchase and store record amounts of grain. Stocks of maize reached 12 million bags, the highest level in our history, enough to feed the nation for a year in the worst of droughts. This is a major achievement, for which our energetic farmers are to be commended. It is, and remains, Government policy to pay farmers promptly for their output. To do this in the face of a record harvest required Treasury to provide a total of K£120 million to NCPB, which is K£90 million over our original estimates.

Second, we also incurred extraordinary expenditures in education. The development of Kenya rests on the creation of a literate and skilled work force, and our policies, from primary through University levels, reflect this. Last year, it was decided that, in fairness to those students whose entrance to university has been delayed, the three universities should double their intake next year and eliminate the three-year backlog of deferred admissions. This, together with the implementation of the 8-4-4 system, necessitated an increase in expenditure.

The third extraordinary outlay was a consequence of Kenya's commitment to the nations of Africa to host the Fourth All Africa Games. Mr. Speaker, it is a source of national pride that we are able to do so. However, the construction of facilities for the games necessitated substantial additional outlays.

Without these demands on the Treasury, the deficit would have been only 3.5 percent of GDP, precisely the target level I set last year. This demonstrates the soundness of our fiscal policy. Nevertheless, there is need to put our fiscal policy back on track immediately. If we delay, we will be forced to take much more drastic actions later, and that would hamper economic growth. I, therefore, intend to reduce the budgetary deficit from its current estimated level of 5 percent of GDP this fiscal year to a more sustainable level of 4 percent in 1987/88.

To achieve this deficit level, the government has been forced to make significant cuts in previously planned expenditures. Total expenditures in the 1987/88 Budget will remain virtually unchanged in real terms from the estimated outturn for this year. Since this is a Budget devoted to stabilization and growth, Government has to ensure that its limited expenditures are channelled to the most productive investments and most efficient services. The key to this reorganization of public expenditures is budget rationalization. Budget rationalization is a long and complex process in which Ministries are being asked to approach their budgets and expenditures in a new way. Lower priority projects will be postponed or dropped so that funds can be concentrated on the early completion of high productivity investments including rehabilitation. In addition, we will ensure that sufficient funds to cover the necessary recurrent expenditures are allocated to operate and maintain existing facilities and newly completed projects.

Mr. Speaker, expenditures which I have just discussed, are only one aspect of the budget equation. The other most important aspect is revenue generation. Efforts will, therefore, continue to be made to restructure our taxation system, to improve its administration and collection, and also to make revenue more responsive to increases in incomes. For the time being I would like to turn to financing of the deficit, monetary policy and development of financial markets.

(b) <u>Financing the Deficit - Public Debt Management</u>

Mr. Speaker, we have learned during the past few years that the various ways of deficit financing have important consequences for the financial stability of the economy. It is, therefore, important that debt management policy is developed into a more active tool of our overall economic development policy.

It was in recognition of this fact that, last year, we introduced two new government debt instruments, namely, Treasury bonds with maturities of 2 and 5 years respectively. The intention was to attract medium to long-term funds from outside the banking system, i.e. from non-inflationary sources, and so contain the growth in money supply.

Due to various circumstances, including the financial uncertainties experienced by a few financial institutions in the middle of the year and the repercussions of this on market confidence, we were not successful in directing our borrowing operations towards the non-bank sector. Instead we were forced to rely heavily on borrowing from the Central Bank and from commercial banks.

Now, fortunately, confidence in the financial markets has been restored and I have decided to resume the sale of Treasury bonds. These bonds will be offered at regular intervals, with maturities of six months, one year, two years, and five years. This should attract investors with differing liquidity needs. The interest rate, or effective yield, on the bonds will be determined through an auction system to ensure that the return on the bonds is competitive.

(c) Monetary Policy

Mr. Speaker, this now leads me to the interest rate structure: during the last five years, interest rates in Kenya have been higher than the rate of inflation. In other words we have had positive real interest rates over this period. This has been and remains a deliberate policy. Positive real rates encourage the flow of savings into the banking system, and they screen out the use of these savings in unproductive investments.

Maximum lending rates and minimum saving rates have been kept unchanged, in nominal terms, over the past year. In real terms, this has meant that some interest rates, particularly the maximum lending rate of 19 percent for non-bank financial institutions (NBFI) has been very high indeed. That remains true today, even though the forecast rate of inflation is somewhat higher than last year. Although I am aware of the reasons behind the differential in rates pertaining to banks and financial institutions, I still consider 19% to be on the higher side. I have, therefore, decided to lower the lending rate of NBFIs from 19 to 18 percent with effect from today. The other interest rates remain unchanged. This move can also be seen as one step in gradual process of aligning the interest rate structure of NBFI with that of commercial banks -- an alignment that we shall be working on in the future. The cash ratio of 6 percent introduced last year will be maintained and reviewed if the need arises.

Taking into account the fiscal and monetary policies I have discussed, as well as the projected balance of payments, the growth in money supply over fiscal year 1987/88 will be considerably curtailed. Looking at the projected balance of payments position, there are no major external inflows expected. Therefore, total domestic credit will be expected to grow at about the same pace as the money supply.

(d) Financial Market Development

Mr. Speaker, Kenya has a well developed financial system with a large variety and number of banks and financial institutions. However, as the system has developed and various regulatory decisions made to attain different policy objectives, we have neither stopped to take a comprehensive look at the viability and efficiency of the system as a whole, nor have we examined its internal dynamics and its interaction with the rest of the economy. There is, therefore, an urgent need to make the financial system more responsive to the economy's needs and thus to create more efficient mechanisms for transforming national savings into productive investment.

Last year, I made public a joint study of the financial sector by the Central Bank of Kenya and the International Finance Corporation. In line with the theme of this Budget, I have appointed a coordinating committee, involving primarily the Treasury, the Ministry of Planning and National development and the Central Bank, to prepare an implementation programme of reforms required in the money and capital markets. The committee has already started consulting with representatives from the private sector where the expertise on many of these questions can be found.

The committee will submit its report and recommendations to me soon and I expect that a Capital Market Development Authority, to oversee the process of financial market reform, will be established in the course of the coming fiscal year.

(e) Management of the Balance of Payments

Mr. Speaker, I would now like to turn to payment with regard to the rest of the world. The substantial surplus in the balance of payments in 1986 allowed us to raise imports much more rapidly than in earlier years, to accumulate reserves, and to make a large repayment on our debt to the International Monetary Fund. We cannot count on being as fortunate in the year ahead. Taking into account the substantial debt repayments that we are scheduled to make over the next four years, there is a need to work on the balance of payments to keep reserves at acceptable levels and make us less vulnerable to short-term international fluctuations.

Although we could improve our short run balance of payments by tighter control of imports, this clearly would conflict with the aim of faster growth. Therefore, we opt for economic policies which expand exports, while in the short to medium term using inexpensive balance of payments support from bilateral and multilateral sources. This will allow a healthy growth in imports, thus enabling us to attain our output, income and employment targets. Since these sources of funds are inexpensive, using them will only raise our external debt burden marginally. In addition to these measures, we will continue to manage the exchange rate actively and flexibly, for it is the single most powerful and efficient instrument both to promote exports and to protect domestic industry.

Another element in a forward-looking and growth-oriented strategy is the gradual liberalization of the import regime. Although a rapid dismantling of import protection is not feasible, our aim is to simplify and gradually lower import barriers, so that our industry, through access to cheaper inputs and exposure to increased competition, will have incentives to become more efficient, thereby providing cheaper goods to domestic consumers while enabling those with export potential to take advantage of it.

(f) Sectoral Policies

Mr. Speaker, I have already dealt with our fiscal, monetary and balance of payments policies. Although these policies overwhelmingly guide the overall growth of the economy, I shall today go out of tradition and briefly attempt to articulate our policies on the ground, that is, on the major sectors of our economy where actual economic activities do take place. As the Sessional Paper has indicated, economic growth is the core of our development policy in order to create sufficient jobs; improve income distribution; and satisfy our basic needs. Rapid economic growth and equitable income distribution will be generated by increased productivity in agriculture; a strategy of rural- urban balance; and a dynamic and re-structured manufacturing sector. I shall deal with each of these sectors in turn.

(i) Agriculture

Agricultural growth is central to our long-term strategy. At present it produces almost 30 percent of gross domestic product, employing over half the labour force, and supplying over three-quarters of Kenya's export earnings while enabling the nation to effectively feed itself. The prosperity of our rural areas, and hence the equity of income distribution in Kenya, also depends on a productive agriculture as do the prosperity of the traditional and the emerging urban centres.

The major long-term investment programme for agriculture include the expansion of tea and coffee production for export; wider adoption of improved practices in growing food crops; intensified research on new maize varieties and improved dairy production. Last year, Kenya signed a credit agreement with the International Development Association which provides K£60 million over two years to support such initiatives. Treasury has accordingly raised the budget ceiling to accommodate these funds as a recognition of agriculture's priority in our economy.

Government has actively used price policy to encourage farm production particularly by raising productivity. Prices for grains, milk and other foods have been set at levels that are attractive to farmers. Last year, we relaxed controls over fertilizer prices outside the main centres to encourage traders to make fertilizer available to small-scale farmers. This year fertilizer prices have been reduced in the main centres as well.

Taxes on farm output have been kept to a minimum. As a result, since 1982 the prices farmers receive for their products have grown faster than the prices farmers pay for their inputs. These incentives to farming will be continued. In addition, the Government has embarked on an exercise intended to restructure the organizational and operational nature of the National Cereals and Produce Board with the view to improving its marketing; ensuring that farmers are paid promptly; and reducing its recourse to the Exchequer.

(ii) Rural - Urban Balance

Mr. Speaker, Kenya needs more dynamic small towns to complement the growth of agriculture. Agricultural development depends on active market centres that provide farmers with production inputs and profitable outlets for the produce of their farms and pastures. Increasing agricultural productivity stimulates the growth of such centres. In turn, these emerging towns provide numerous employment opportunities for our growing labour force. This relationship between agriculture and market centres lies at the heart of the rural-urban strategy articulated in the Sessional Paper.

In order to stimulate the growth of market centres the government has introduced the Rural Trade and Production Centre Programme. The central objective of this programme is to concentrate scarce resources for urban infrastructure in selected small towns so as to support a growing agricultural sector and bring into bearing the capacity of their hinterlands. If this is achieved, it will stimulate the emergence of productive employment generating activities. The Rural Trade and Production Centres (R.T.P.C.), are small towns that process and market output from farms in the area; offer services and supply inputs to farmers; and create jobs for part-time farmers and full-time rural workers.

In support of this objective, the Government is establishing a new fund that will finance essential packages of investments in designated Rural Trade and Production Centres. This fund, entitled the "District Development Fund" will be operational with effect from 1st July, this year. Managed by the Ministry of Planning and National Development, the DDF will work within District Focus to channel funds from interested aid donors into roads, water and power supplies and other infrastructure that supports the growth of private small industry and services. The DDF is designed to respond rapidly and flexibly to initiatives from the District Development Committees, and can finance both development and recurrent expenditures. The DDF will concentrate on centres where the potential for rapid growth has become a major force in stimulating rural private activity and thus promote rural-urban balance.

(iii) Industrial Policy

Mr. Speaker, as all Honourable Members are aware, His Excellency the President has taken the lead in supporting the expansion of jua kali industries and the micro-enterprises of the informal sector in general. These very small-scale enterprises provide inexpensive goods to consumers through efficient local marketing channels; create large numbers of jobs with very little capital; rely primarily on family savings to cover their capital requirements; require very little foreign exchange; usually utilise appropriate technologies and often provide their own skill training; and are an important source of future entrepreneurs.

To promote the expansion of jua kali enterprises we have to find ways of reaching these firms without compromising the independent, entrepreneurial spirit that makes them effective. The District Development Fund can become a powerful instrument to promote small firms in the rural centres by creating crucial pieces of infrastructure. In support of the efforts by His Excellency the President, I propose in next year's budget to incorporate within the District Development Fund concept, finance for the construction of Nyayo sheds to accommodate jua kali artisans and workshops located in appropriate rural centres.

Turning now to medium and large-scale manufacturing industries, it must be emphasized that rapid growth of these industries is necessary to expand and diversify Kenya's export base; create jobs at high and rising productivity; and attract and generate indigenous Kenyan managers and entrepreneurs. From Independence until 1980, value added in manufacturing grew by 9 percent a year. But for the following five years, manufacturing expanded by less than 4 percent annually. In 1986 there was a revival, as manufacturing value added rose by about 6 percent. Our aim is to sustain and increase that growth over the next several years.

Given that most of our industries depend on imported plant and raw materials, it is important that ways be found to make them more competitive in the export market. In this connection, we have lowered duties on raw materials, and proposed the introduction of manufcturing in bond.

I am pleased to be able to inform the Hon. Members that we have already implemented manufacture under bond. Now that the mechanism for starting such plants has been established we look forward to being able to take full advantage of this policy to attract new and diverse investments.

To speed up the approval of new investments in manufacturing, I have gazetted an interministerial, one-stop office within the Investment Promotion Centre to assist those seeking investment approvals. Through this office, Government will provide responses to prospective investors within three months of any request for any necessary permissions, registrations, licences or other approvals. The IPC will also prepare an investment policy document, providing detailed information on all policies and procedures affecting investors, which will be widely distributed, within Kenya and abroad.

Mr. Speaker, Kenya has always welcomed foreign investors, whose capital, technology, management, and world-wide marketing skills can add enormously to our own productive capacity and especially our ability to export. Three further measures will be undertaken in order to encourage further foreign investment into the country.

Firstly, as promised in the last Budget, the Central Bank is now permitting foreign investors to borrow from local banks to cover the costs of import duties on capital equipment. This should eliminate the need for overseas investors to find additional foreign currency to pay these duties.

Secondly, Kenya has decided to join the Multilateral Investment Guarantee Agency, and the Attorney-General's Chambers is currently drafting the necessary legal instruments. This will further reduce the risks undertaken by a foreigner wishing to invest in Kenya.

Finally, His Excellency the President, in his Jamhuri Day Speech in 1986, announced that the Government would consider revisions to the Foreign Investment Protection Act. I hope to lay before this House a set of proposed amendments which will go far towards removing those anomalies and barriers that have caused foreign investors to suffer unintended penalties by investing in Kenya.

Through re-structuring and policy changes, Government has demonstrated its willingness and readiness to create a favourable investment climate. However, these measures and reforms have costs, which are borne directly or indirectly by consumers, farmers, and the Government. These costs can be justified and the Government can sustain these policies, but only if manufacturers respond with greater investment in industry, providing more employment, raising productivity, lowering prices for consumers, and expanding exports of manufactures. Once manufacturers begin to achieve these goals, Kenya's second stage of export based industrialization will be underway.

Mr. Speaker, although I have dealt at length on the need to develop an export oriented growth strategy, I still consider the domestic market equally important. Hence there is, therefore, a need to improve further on our domestic trade policy to which I shall now turn.

6. RESTRICTIVE TRADE PRACTICES AND MONOPOLIES

Mr. Speaker, Hon. Members will recall from last year's Budget Speech, that I promised to effect three changes in our price control system: the removal of certain non-essential items from price control; the revision of the Determination of Costs Order to include items that are legitimate costs of doing business; and finally, the publication of a Restrictive Trade Practices, Monopolies and Price Control Bill which will not only regulate price control administration but most importantly extend surveillance to practices that restrain the competitive forces in our economy. I am glad to report to the House that some eleven items were removed from price control and the Determination of Costs Order was revised and gazetted late last year as promised.

The Restrictive Trade Practices, Monopolies and Price Control Bill which I intend to lay before the House during this Session marks the most important step in restructuring our trade policy. As Hon. Members are aware, it is Government policy to reduce its intervention in the economy via parastatals. As we progress in the implementation of this policy, it will be necessary to put more reliance on policy instruments to influence farm management and industrial decisions, on product choice, investment and employment. However, as private sector activities and community efforts increase in scope and magnitude, opportunities for abuses, favouritism and exploitation also increase. It is ~~common knowledge that~~ various kinds of groupings with dominant power in different sectors of the economy operate tightly knit enclaves with the purpose of freezing out others including new, emerging businessmen, who may thus be driven into failure or confined to fringes of commerce despite a high degree of efficiency and willingness to work hard.

At present Government has few if any legal tools to combat these restrictive practices, hence the preparation of this important Bill. By equipping ourselves with appropriate legislation and enforcement machinery to combat such practices, we will make a major step forward towards acceleration of indigenisation of commerce and industry; promotion of efficiency; and lowering of consumer prices which will eventually increase exports by virtue of enhanced competition. This will simultaneously promote economic development and greater equity in the distribution of income.

7. BANKING SYSTEM

Mr. Speaker, the Honourable Members will recall that H.E. the President appointed a Special Investment Committee following the instability which the banking system experienced last year. The Committee was to look into the problems facing the industry and put it back on sound footing. The committee began its work last August and although it has not completed its report, its appointment has greatly helped in restoring public confidence and stability in the banking industry. The public was greatly encouraged by H.E. the President's assurance that the situation would be kept under control and that the Committee would safeguard the depositors' funds. The halting of the withdrawal of parastatal deposits from financial institutions and the establishment of the Deposit Protection Fund also helped in the restoration of confidence in the industry. The payment of creditors, including all the small depositors, within a few months of the establishment of the Committee was another major factor in restoring stability in the banking industry. Mr. Speaker, I would like to call upon all Honourable Members to join me in paying tribute to H.E. the President for the speed with which he ensured that public confidence was restored; small depositors were paid; and one of the indigenous banking conglomerate has reopened its doors to the public.

In order to strengthen further the legal machinery necessary to maintain a sound banking system, the Finance Bill I have published today contains a number of further amendments to the Banking Act. These amendments are intended to improve on the control, supervision and regulation of banks and financial institutions licensed under the Act. Among the proposed amendments are the following:

First, some hire-purchase companies have been known to be taking deposits like banks and financial institutions under the pretext that they are financing their clients, while in fact they are simply trading like the former institutions. Since the public is not fully aware of which institutions are licensed as financial institutions, innocent Wananchi stand to lose money deposited with these hire-purchase companies which are styled "XY Finance Limited". In order to remove this deception, I propose to restrict the use of the word "finance" and its derivatives only to financial institutions licensed under the Banking Act.

Second, the Act will be amended to provide that all banks and financial institutions will be required to be registered as public companies under the Companies Act and that no single shareholder shall own more than 25% of the shares. Other than the fact that they will be required to provide more information to the Registrar of Companies, this provision will increase public accountability in the management of these institutions.

Finally, powers of the licensing authority will be enhanced to serve as a deterrent to misbehaviour by directors of banking companies. In particular, the licensing authority will be empowered to endorse or vary conditions on a current licence including its revocation if it is considered necessary.

8. BUILDING SOCIETIES

Mr. Speaker, last year, I promised the House that a study on Building Societies will be undertaken with the view to harmonising their operations with those of other deposit taking institutions. The study has not been completed. However, on the basis of the progress and recommendations so far made in this regard, I have today published the Building Societies (Amendment) Bill, 1987, which contains provisions intended to strengthen their capital base, improve their supervision and protect public deposits. Briefly, it is proposed that the following conditions should govern Building Societies:

(a) Advances made by societies will be required to be secured on land for residential purposes;

(b) Treasury will be the licensing authority for these societies. Prior to licensing, Treasury will have to be satisfied about the financial conditions of the society, its earning prospects and the character of its management;

(c) The Central Bank will become the supervising authority as is the case with banks and financial institutions;

(d) The minimum capital required to start a building society will be raised from sh. 100,000 to sh. 5 million; and

(e) As in the case of banks and financial institutions, the appointment of auditors by Building Societies will be subject to the Central Bank's approval.

When these and other provisions contained in the Bill are enacted, it will be easier to keep tract of what is happening in this important sector of our financial system. More important, it will enable the monetary authorities to supervise and guide the operations of these institutions.

Mr. Speaker, the policy framework which I have just outlined will guide the economic management of this nation in the years ahead. Consequently, next year's budget has been formulated within this framework in mind, I will now turn to the financing of Government Expenditures.

FINANCIAL OUT -TURN 1986/87

(a) Recurrent Revenue

This year's ordinary recurrent revenue was estimated at K£1,382.8 million plus Appropriations-in-Aid of K£38.4 million making a total of K£1,421.2 million. This recurrent revenue was to comprise of K£298.5 million from Customs and Excise; K£370.0 million from Income Tax; K£437.1 million from Sales Tax and the balance of K£277.2 million from other minor taxes, dividends, charges and fees. Mr. Speaker, I am glad to inform the House that the revised total revenue is now estimated at K£1,415.5 million -- K£32.7 million or 2.4% above my last year's projections.

While there will be substantial shortfall in Sales Tax, this will be more than compensated by the over-collection of Income Tax and import duty. This shortfall was principally because of the remission granted to oil companies in order to compensate them for the risen crude oil prices I alluded to earlier, while increased income tax and customs duty is attributable to the buoyant growth of the economy last year, and the liberal import policy pursued over recent months. I now expect to raise K£331.4 million from Customs and Excise; K£395.0 million from Income Tax; K£416.0 million from Sales Tax; while other various taxes are expected to raise K£273.1 million.

(b) Recurrent Expenditure

This year's Printed Estimates of Recurrent Expenditure were estimated at K£929.7 million excluding Appropriations-in-Aid. Consolidated Fund Services were expected to take another K£497.1 million making a total Recurrent Expenditure of K£1,426.8 million. As the House will recall, there were four items which forced Government to seek Parliamentary approval for Supplementary Appropriation of K£88.8 million early this calender year. These were the need to pay farmers for the good maize crop I have already alluded to; the need to enhance security within the country; the increased costs of teachers to cope with the enhanced primary school enrolment; and the additional cost related to double intake in our national universities. I had also to finance Excess Votes and Under Issues on prior years amounting to K£55.34 million. I, therefore, expect this year's net Recurrent Expenditure to be K£1,509.6 million. However, issues from the Recurrent Exchequer are now estimated at K£1,504.6 million compared to the total revenue of K£1,415.5 million.

I shall, therefore, have no surplus in the Recurrent Exchequer Account to transfer to the Development Exchequer.

(c) Development Expenditure

This year's Printed Development Estimates projected gross expenditure of K£488.9 million including Appropriations-in-Aid of K£196.3 million. Recently, the House approved gross Development Supplementary Estimates of K£48.8 million making a total gross Development Expenditure of K£537.7 million. As I have already indicated, this additional expenditure was occasioned by the need to revitalize Kenya Meat Commission; construction of facilities for the All Africa Games and the doubling of the university intake. However, it is estimated that only K£305.2 million will be issued from the Development Exchequer.

The overall deficit will, therefore, be K£289.3 million which is approximately 5 percent of GDP. I expect to reduce this deficit next fiscal year and it is to this that I now turn.

FORECAST OUT-TURN 1987/88

(a) Expenditure 1987/88

Mr. Speaker, as Hon. Members have already seen from their copies of Printed Estimates already laid before the House, gross Recurrent Expenditure of Ministries is estimated at K£1,791.2 million, composed of net expenditure of K£1,633.7 million and Appropriations-in-Aid of K£157.5 million. This estimated Recurrent Expenditure represents an increase of 19 percent over the revised estimated issues for this fiscal year.

This increase is accounted for by: first, the final instalment in salary increases for civil servants recommended by the Ramtu Commission; second, the increased interest and debt repayment charges; third, the increased university intake; and fourth costs related to voter registration and the hosting of the All Africa Games.

Development Estimates for 1987/88 call for an expenditure of K£613.6 million including Appropriations-in-Aid of K£288.6 million. This represents an increase of 14.1 percent over this year's Revised Estimates. This increase is accounted for by the high budgetary allocations to Ministries of Agriculture, Livestock, Transport and Communications and Health. These high allocations reflect Government's commitment to boost agricultural and livestock production; and improve rural access roads and health facilities.

Mr. Speaker, I do not intend to analyse further the details of either recurrent or development expenditure at this stage. We shall debate the spending allocations in the Committee of Supply and I shall hold the matter over till then.

It is sufficient at this stage to merely note that I have to finance total expenditure of some K£2,404.8 million. The rest of my Speech will be concerned with how I intend to do this.

(b) External Revenue

Mr. Speaker, H.E. the President has continuously emphasized that Kenya has no quarrel with any country and we are strong believers in cordial international relations. As a result of the friendly relations existing between us and the rest of the world, various governments and international financial institutions have continued to assist Kenya at times of need. Next year will be no different and I would like this House to join me in expressing our gratitude to the international donor community for its favourable response to our requests.

As I have already indicated, external resources will be negotiated within the overall Budget Rationalisation Programme. The objectives are to achieve substantial improvements in the composition of Government expenditures, improved utilisation of existing capacity and the rapid completion of on-going high priority projects. Using this criteria, I expect to draw some K£539.5 million from external sources. Of this amount, 44.7% will be in the form of grants and 55.3% in the form of project and programme loans. Thus, I expect to finance 22.4% of my total expenditure from external sources. As customary, the main burden of financing Government expenditure will be borne by Kenyans and I now turn to how I propose to raise the balance of K£1,865.3 million.

(c) Domestic Borrowing

As I have already indicated, last year's growth in money supply was on the higher side. I have also indicated that in an effort to improve Government debt management policy, I propose to introduce new government securities intended to attract funds from non-inflationary sources. Using this criteria, I propose to raise K£274.5 million from local borrowing. Out of this, some K£50 million will be raised through long-term stock and the balance through Treasury Bonds and Treasury Bills.

(d) Internal Revenue

In spite of increased crude oil prices and fallen coffee prices, I project that the economy will grow by 5 percent this year. On the basis of this projection I estimate that, ordinary revenue, at current rates of taxation, will provide some K£1,506.8 million. Appropriations-in-Aid will provide another K£48.8 million making a total of K£1,555.6 million. I have, therefore, a gap of K£35.2 million to finance from additional taxation. The rest of my Speech will outline how I intend to do this.

. TAXATION PROPOSALS

Mr. Speaker, I have already briefed the House on the international economic situation, the debt crisis facing Sub-Saharan Africa, the state of our economy and the policies we intend to pursue to maintain sustained growth. I have also indicated that I have a financing gap of K£35.2 million. I now turn to my taxation proposals, and 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.

(a) Customs Tariff

The Finance Bill published today contains substantial amendments to the Customs and Excise Act. Before drawing the attention of the House to the most important of these changes, let me first deal with a few technical and procedural matters. The Bill contains amendments to the Customs and Excise Act intended to rectify typographical errors and omissions. It also contains amendments to streamline and harmonise tariff and statistical codes in accordance with the recommendations of the Customs Co-operation Council. Most important,it has been deemed necessary to classify fertilizers by their types so as to enable the Ministry of Agriculture keep track of the availability of various types of this essential agricultural input.

Mr. Speaker, I would now like to turn to those amendments which have revenue implications.

First, subsections 12(1)(a) to (g) of the Act contains a list of goods which are deemed to be under and subject to customs control. As provided under subsection 12(2)(b), such goods must not be interfered with by any unauthorized person. Interfering with the listed goods include converting of transit goods to home use without authority and consequently without payment of duties. It also includes diversion of warehoused goods for home use instead of transporting them to the bonded warehouse nominated and declared as a warehouse for the storage of such goods. Where a person is found guilty of such misdemeanor; the goods, if found, are seized and forfeited by virtue of subsection 12(4). However, this subsection does not provide for a specific penalty which may be imposed against the culprit.

Mr. Speaker, offences of this nature are detrimental not only to revenue but also to our industrial development and would appear to be on the increase. In order to discourage this kind of smuggling, I am proposing to amend the law to provide that, over and above the forfeiture of the goods, the culprit will be liable to imprisonment for a term of three years or to a fine of one hundred thousand shillings or to both such fine and imprisonment.

Second, the Department has had disputes with the Kenya Ports Authority and the owners/agents of imported goods arising from delays occasioned by the Department and thereby causing liability to demurrage or storage charges which are collected by Kenya Ports Authority. Delays on the part of the Department may be caused by:

(a) Entries being referred to Senior Officers for classification and duty rates.

(b) Samples being referred to laboratories for identification.

(c) Full examination of containers.

(d) Inadvertent misplacement of entries.

Where delays in clearing and delivering goods out of port area is due to Customs, an appropriate endorsement is made on the reverse of the Port Release Orders and the Customs Import Entries by the proper Customs Officer. This endorsement is meant to relieve the owner from penalty for delays attributable to the Department. However,where Kenya Ports Authority rejects these endorsements, the owners have turned to Customs for refund. In order to protect revenue, I propose to amend section 26 to provide that no such refunds shall be effected by the Department.

Third subsection 46(1) provides for an initial period of warehousing of warehoused goods as one year. It also provides a re-warehousing entitlement once only unless the Minister otherwise directs. It is not clear whether the period of re-warehousing is one year. Since the period of re-warehousing has not been specified, there is an ambiguity over the length of period of re-warehousing. It is, therefore, proposed to remove this ambiguity by providing that the period of re-warehousing shall be one year or such longer period as the Minister may direct.

Fourth, section 123 of the Act provides that "if any practice of the Customs relating to the classification or enumeration of goods for the purposes of liability to duty is altered with the result that less duty is thereafter charged on goods of the same class or description, no person shall become entitled to a refund of any duty paid before the alteration took effect". On the other hand, section 146(1)(b) empowers the Commissioner to grant a refund of any duty which has been paid in error. Section 123 may thus be used to bar affected importers from claiming and being granted refund of duty. However, such action may well be disputed in court by virtue of section 146(1)(b). In order to clarify the circumstances under which section 123 will apply, and therefore protect revenue, I propose to reword the law to provide that section 123 will only apply where the practice of Customs has been approved by the Commissioner or where it arises as a result of a ruling by the Customs Co-operation Council.

Fifth, I have already emphasized the importance of industrial development to our economic growth and indicated some of the incentives we are according this sector to boost its growth. As an additional incentive, I propose to reduce the rate of duty on industrial capital machinery by five percentage points. Since the rates of duty on capital machinery vary between (20 - 45)%, the overall average reduction will be (11 - 25)% of the current rate. I hope that industrialists will take advantage of this reduction in duty to expand domestic manufacturing.

Sixth, last year, I removed duty on capital machinery for small-scale industries located in the rural areas where the cost of such machinery does not exceed Sh. 5 million. During the implementation of this exemption, and because of the appreciation of foreign currencies, it has become clear that the ceiling of Sh. 5 million is far too low for these small-scale industries. I have, therefore, doubled this ceiling from Sh.5 million to Sh. 10 million.

Seventh, when duty reductions were effected over a wide range of raw materials during (1983 - 85) the textile sector was not affected. This sector was skipped because there was an on-going study to evaluate its competitiveness. Although I am informed that the sector is fairly competitive domestically because of the large number of industries involved, I propose to reduce duty on some of their imported yarn by 5 percentage points in order to make these industries more competitive internationally.

Eighth, early this year, the Government decontrolled the price of meat across the nation on the grounds that there is adequate competition in livestock production and marketing. This fact has been borne out by the fact that there has been very little increase in the price of meat after the decontrol. As the population grows and encroaches on marginal lands, there will be increased demand for zero grazing on small holdings. Hence the increasing demand for manufactured animal feed. In order to boost animal production, I propose to remove duty on premixes and oil cake used as raw materials for the production of animal feed. As a result of this measure, I expect manufacturers of animal feed to pass on the benefit to the consumers by way of reduced prices.

Ninth, pencil lead is currently dutiable at the rate of 80%. I have received complaints from local manufacturers of office and school pencils to the effect that this rate of duty is too high for a raw material. I have considered their case and I am now reducing the rate of duty from 80% to 25%.

Tenth, one of the items produced locally in large quantities is ceramic wares. In spite of the low domestic prices, some individuals with a high taste for imported goods continue to pester the Government to authorize importation of ceramic wares. In order to discourage such luxurious importation, I propose to raise duty on ceramic tiles, tableware, and other ceramic articles of adornment by (28 - 100)%.

Eleventh, currently, returning residents are allowed to import one passenger duty-free car provided that the person has owned and used the car outside Kenya for at least 12 months. In view of the very high cost of big passenger cars, some people have abused this privilege by asking Kenyan students overseas to buy these cars, keep them for one year and bring them to Kenya duty-free under the pretext that they are theirs. Thus, although there are numerous large passenger cars on our roads, there is hardly any tax paid on them. In order to ensure that the Exchequer gets a fair share of the price of these cars, I propose to amend the law to provide that, returning residents will only be allowed to bring back duty-free passenger cars whose capacity does not exceed 2000 c.c. Where the engine capacity exceeds 2000 c.c., the returning resident will be required to pay duty on the difference between the assessed value of the car and Sh.40,000/=. If the assessed value of the car is Sh.40,000/= or less, no duty shall be payable.

Twelfth, last year, I removed duty on agricultural sprayers in order to boost agricultural production. I am now informed that this measure was not as effective as it was intended because most agricultural sprayers are manufactured locally and their raw materials are dutiable. Therefore, in order to attain my original objective, I propose to remove duty on raw materials used for the manufacture of sprayers. It is my hope that manufacturers of this important agricultural tool will now pass on the benefit of this duty removal to farmers by way of reduced prices.

Thirteenth, for some time now, pharmaceutical manufacturers have been enjoying duty-free imports of raw materials for the manufacture of drugs. I have received complaints that some of the companies enjoying this privilege are not drug manufacturers anymore and that some of the items in the eligible list are not raw materials. In order to protect revenue, I have today published a fresh list of the eligible manufacturers and the raw materials.

Finally, Customs Agents Licence fee. These are the fees paid by clearing and forwarding companies for their annual licence. These licence fees were last increased some three years ago and may be this is the major reason for the increased number of applications being received by the Department annually. In order to maximize revenue collection, I propose to double the fees from Sh.5,000/- to Sh.10,000/- for renewal of a licence and from Sh.2,500/- to Sh.5,000/- for late applications.

Mr. Speaker, the measures I have announced in customs tariff will cost the Exchequer some K£2.58 million in lost revenue.

(b) Excise Tariff

Mr. Speaker, I would now like to turn to excise tariff where I have only one change to make on cigarettes and tobacco. I have annually emphasized the need to maintain revenue from these luxurious items in line with the rate of domestic inflation. I have also indicated that the rate of inflation last year was very low. In consideration of these two factors, I propose to raise the levels at which current rates of excise apply by an overall weighted average of 10.8%. This will have the effect of increasing the price of some popular brands of cigarettes such as Ten Cent and Score by 50 cents per packet; Rooster by 55 cents per packet; and the more elite brands of Sportsman, Embassy and State Express by Sh. 1.00 per packet.

This measure on excise tariff will take effect from midnight tonight and will provide the Exchequer with an additional K£6.60 million in revenue.

(c) Local Manufactures (Export Compensation) Act

Mr. Speaker, subsection (1)(b) of the Act provides that no compensatory payment shall be made in respect of the exportation of any eligible goods before foreign currency due in respect of such exportation has been received in Kenya by an authorized dealer. This provision, therefore, precludes exporters under the Preferential Trade Area Agreement or any other bilateral agreement between the Government of Kenya and any other government from qualifying for compensatory payment in respect of eligible goods on the grounds that foreign currency due is not receivable by an authorized dealer. It is for this reason that we have been unable to pay export compensation to exporters of eligible goods to Uganda under the settlement of assets and liabilities of former East African Community where Kenyan goods exported to that country are paid for in Kenya Shillings. This does not appear equitable and I am, therefore, amending the Act to provide that where eligible goods are exported under a bilateral agreement between the Government of Kenya and any other government, then compensatory payment may be effected irrespective of whether foreign exchange has been received by an authorized dealer.

(d) Export Duty

Mr. Speaker, I would now like to turn to Export Duty where I have two changes to make. First, rates of export duty on coffee and tea have not been changed for a number of years. During this period, farmers have complained to Government that the prices of agricultural inputs have risen considerably and we have, therefore, been taxing their costs in production of tea and coffee. I have considered their case and, in order to give them some respite, I propose to raise the export duty threshhold,i.e., the level at which tax starts to apply from K£1,000 per ton to K£1,200 per ton. Therefore, where the price of coffee or tea does not exceed K£1,200 per ton, then no export duty will be charged. This measure will give the producers of these two commodities some K£5.17 million in additional income which would have otherwise gone to the Exchequer. I hope this additonal income wil be judiciously used by these farmers to improve the welfare of their families whose sweat is the major factor of production of these crops.

Second, there are a number of raw materials which are produced or are available locally yet they are not available to our domestic users. These materials are exported by our local producers only to be re-imported by domestic users. These materials include wattle extract principally used in the tanning industry, and iron and aluminium scrap used in the manufacture of reinforcement steel and window frames.

In order to discourage the exportation of these materials, I propose to impose an export duty of 5 percent on these items. This measure will provide an additional K£2.37 million in revenue.

Taken together, these measures on export duty will cost the Exchequer some K£2.80 million.

(e) Sales Tax

Mr. Speaker, I now turn to Sales Tax. First, Regulation 11 of the Sales Tax Regulations gives tax remission on goods distributed free as advertising material. Some manufacturers have used this provision to avoid payment of tax where advertising companies have placed orders for manufacture of goods printed with advertising messages. Though the printers are actually paid, they have refused to pay tax on the grounds that the material is free of tax by virtue of this regulation. In order to protect revenue and seal the loophole, I propose to amend the regulation to require the manufacturer to seek authority in writing, prior to manufacturing any advertising material which is non- taxable.

Second, section 17(2) of the Act provides that taxable goods imported by land from Uganda or Tanzania should be produced by the importer to the nearest Customs Office to the point of entry and any importer who fails to do so shall be liable to imprisonment of upto five years and a fine of Sh.50,000/-. This provision was intended to prohibit smuggling of goods within the former East African Community. However, it is common knowledge that a lot of goods are smuggled by land from our other neighbours. In order to remove this discrimination and further deter smuggling, I propose to amend the law to include all goods imported by land and double the level of penalty to Sh.100,000/-.

Third, taxation of passenger cars. Last year, the Government undertook to review the taxation of small passenger cars with the view to making them affordable by the middle income families. I am glad to report that Treasury has now examined sympathetically this important issue and, although the major cause of passenger car price escalation is the appreciation of the currencies of our major trading partners, I propose to reduce the rate of tax on all passenger cars by between (15 - 25) percent. Therefore, with effect from midnight tonight, the rate of sales tax on passenger cars with an engine capacity not exceeding 1200 c.c. will be reduced from 40% to 30%; exceeding 1200 c.c. but not exceeding 1500 c.c. from 50% to 40%; exceeding 1500 c.c. but not exceeding 1750 c.c. from 65% to 55%; exceeding 1750 c.c. but not exceeding 2000 c.c. from 100% to 85%; exceeding 2000 c.c. but not exceeding 2250 c.c. from 230% to 195%; and exceeding 2250 c.c. from 400% to 340%.

Mr. Speaker, this is a major tax reduction. And while on this subject, I would like to inform motor vehicle assemblers that the public is becoming increasingly concerned about the high prices of locally assembled vehicles. Although I appreciate there are limited economies of scale due to the small number of vehicles assembled, I would nevertheless exhort them to improve their efficiency with the view to benefitting the consumer and the country at large.

Fourth, jewels. Mr. Speaker, jewels and other precious metals are normally used in this country as a vehicle to circumvent foreign exchange control regulations to take money out of the country. It is for this reason that it is very difficult to tell the difference between the miner, the manufacturer, the wholesaler and the retailer of jewels. Consequently, and although it is well known that dealing with jewels is a very lucrative trade, it has proved difficult for the Commissioner of Sales Tax to register any manufacturer of jewels as a taxpayer. Every time that he tries to register a jeweller as a manufacturer, the jeweller argues that he is a retailer and in any case he does not sell more than Sh.200,000 worth of jewels per annum. This is obviously a cunning way of avoiding tax. In order to close this loophole, I am amending the law to redesignate jewels as goods on which tax will be paid by dealers at all levels -- mining, manufacturing wholesaling and retailing. Therefore, effective from midnight, all dealers in jewels will be required to register with the Sales Tax Department as taxpayers.

Fifth, petrol: Mr. Speaker, those who have been following me closely will have noted that I have given away substantial revenue on passenger cars. In order to compensate the Exchequer for the revenue lost, I propose to raise tax on premium and regular gasolines by 40 cents and 30 cents per litre respectively. Since most public transportation is diesel propelled, this increase should not affect bus fares. Neither should it affect agriculture and manufacturing industries.

Sixth, beer. In spite of the fact that our beer is one of the best in the world, its price is still very low compared to beer prices worldwide. I am also told that, following the closure of off-licences late last year, bar owners are making substantial profits. In view of these factors, it is only fair that the Exchequer should maintain its share of the soaring profits in this industry. Consequently, I propose to raise the current rate of sales tax on beer by 80 cents per litre. In addition, Kenya Breweries have applied to me for a price increase of 20 cents per bottle occasioned by increased costs of plant maintenance and a planned price increase to barley growers. I have carefully evaluated their request and it is justified. As a result of these two factors, the price of beer will go up by 60 cents per half litre bottle with pro-rata increases in other sizes with effect from midnight tonight.

Seventh, soda. The price of this beverage has not been increased over the last one year in spite of the fact that the price of sugar was raised early this year. As a result of increased sugar prices, soda manufacturers have applied to me for a price increase. I am awarding the requested price increase and, considering the benefits which I shall give to taxpayers later, I have decided to increase rate of tax on soda by (16 - 20)% of the current rate. In view of these two factors, the price of soda will go up by 20 cents per bottle with effect from midnight tonight.

Finally, baby food. I have received complaints from working mothers to the effect that the cost of baby food has been rising considerably in recent years due to the sales tax of 17% imposed on food mix for the manufacture of infant milk. In order to ease their burden, and in cognizance of H.E. the President's unequivocal love for children, I propose to remove tax on this product to ensure that these mothers bring up healthy children.

Taken together, the measures I have announced today on sales tax will bring an additional K£23.90 million in revenue.

(f) Income Tax

Mr. Speaker, I would now like to turn to income tax where I am proposing major changes.

First, personal taxation. Some people have been heard to comment that Kenya is one of the most highly taxed countries. Whether this is true or not I would not like to say. I do know, however, that people who make this claim refer to our individual top tax rate which is 65%. Unfortunately, no credit is given for the spread of the tax brackets and the frequency with which these are reviewed. It is pertinent to point out here that, such an exercise was carried out only two years ago when I reduced the personal taxation by widening tax brackets by K£300.

However, there is now a world-wide concensus on the economic desirability of tax reform and reduction, and in particular the reduction of income tax. Lower rates of tax provide personal incentives and stimulate enterprise, which in turn is the only way to better economic performance. And it is only by improving our economic performance that we will be able to afford to spend; only by improving our economic performance will we be able to create jobs on the scale that we all want. I, therefore, propose to lower the top tax rate by a full 15% from 65% to 50%. I believe this measure will now classify Kenya in the category of normally taxed countries.

Mr. Speaker, it is my hope that by lowering the top tax rate, individuals in the top tax brackets will no longer spend their energies seeking legal ways to avoid taxes, or worse still, illegal ways to evade paying taxes. Those energies previously devoted to devising and operating tax schemes should now be diverted to economically productive activities. The lower tax rate should encourage work effort and more investment thus creating the right climate for greater economic growth which will benefit all of us including Revenue itself.

Second, I have good news for the small taxpayers. I have decided that in view of the rising cost of living, time has now come to raise the point at which an individual taxpayer starts to pay tax. These points will be raised by at least $33\frac{1}{3}$% throughout as follows -

(i) Single individuals from Sh.720 to Sh. 960 per year.

(ii) Married individuals from Sh.1,800 to Sh.2,400 per year.

(iii) Single person supporting a child from Sh.820 to Sh. 1,200 per year.

In other words, an individual who is single will pay no tax unless he earns Sh. 800 per month or more and a married man will pay no tax unless he earns Sh. 2,000 per month or more. For the single parent supporting a child, no tax will be due unless he earns Sh. 1,000 p.m.

The most remarkable feature of this measure is that it will release a total of 140,000 low income earners from taxation altogether. This is, indeed, a major gesture which should considerably improve the standard of living of this important section of our society.

Third, a further measure to take care of the low income groups will be bracket widening. I propose to widen the brackets by 10% throughout. A similar measure was carried out in my budget speech of 1985. Everyone has consequently paid less tax in 1986 and 1987 and now everyone will pay even less tax from 1988 onwards.

Fourth, as these measures will result in very considerable loss of Revenue, I am duty bound to find means by which I can recoup some of it back. I find this in the under-valuation of employer benefit schemes which are now proliferating in this country. Given that these benefits are typically provided to top executives, the under-valuation of benefits provides a very generous tax relief to these high income earners. It is estimated that for each high income earner, the tax relief could be costing the Treasury anything between £2,000 and £5,000 which is both costl and highly inequitable.

I am aware of the fact that the Commissioner of Income Tax uses a system of fixed benefit rates which he publishes from time to time to tax employee benefits. I also know that there was a general increase of valuation last year. However, these increases were minimal, half-hearted and far from the true value that should be placed on them.

Fifth, provident fund executive schemes. Any tax agency worth its salt must be on the lookout at all times for any tax schemes devised by taxpayers to minimise tax by unfair means. The Income Tax Department has identified avoidance schemes in the form of short-term provident funds whose principal aim is not to provide a lump sum payment to junior employees on retirement, but to provide tax free remuneration, on the side, to the highly paid company executives.

These provident fund tax avoidance schemes have considerabl expanded in the last three years. They all seek to exploit the difference between the 45% company rate of tax and the 65% top individual rate of tax.

With the introduction of a much lower individual top tax rate of 50%, these schemes should lose their attraction but, just in case they do not, I propose to amend the law to provide that the employee will be taxed on the employer's contribution to such a fund, unless the provident fund is first registered with the Commissioner of Income Tax.

Sixth, withholding tax on interest. Professional bodies in Kenya have advised me constantly that I should opt for more and more forms of withholding taxes. Apart from improving tax compliance, withholding taxes also accelerate Government cash flow. They have the advantage of collecting tax when money is available so that it is a less painful form of tax payment.

I have accepted this good advice, and this year, I propose to add to withholding taxes currently in operation in Kenya, a withholding tax on interest, paid by banks, financial institutions and building societies.

The income tax law will be widened to require banks, financial institutions and building societies to withhold tax at the rate of 10% upon payment of any interest, to any person, resident in Kenya.

It should, however, be noted that there will be two applicable withholding tax rates on interest -- a resident rate of 10 percent and a non-resident rate of 12.5 percent and the banking system have a duty to distinguish them. I would like to emphasize that banks, financial institutions and building societies will be required to remit all withholding tax deducted from their customers to the Commissioner for Income Tax at the end of every month. No further details will be called for as far as withholding tax on interest is concerned. I must emphasize here that, under no circumstances should these institutions use these funds for trading. The funds constitute Government revenue which will be due and payable, and should be strictly treated as such.

Mr. Speaker, interest income paid to banks, financial institutions, and building societies, engaged in the business of borrowing and lending money will not be subject to the withholding tax, so that, for them they will return their business income at the end of the year in the usual manner.

As usual with all forms of withholding taxes, banks, financial institutions and building societies will be required to give a certificate to the person whose interest has been subject to the tax indicating the gross and the amount withheld.

Interest income which is exempt from tax will not be subject to withholding tax. Persons holding accounts which are tax exempt will have to obtain certificates to this effect from the Commissioner of Income Tax to authorize the bank, financial institution or building society concerned not to withhold tax. The decision to introduce withholding tax on interest has necessitated a re-appraisal of the tax exemption status of Housing Development Bonds interest. The decision reached was that there was no longer a justifiable reason for its full exemption and that interest on Housing Development Bonds should also be subject to withholding tax at 10%. Unlike the other forms of interest, however, Housing Development Bonds interest which qualified for tax exemption previously will now bear this as the final tax. This means that after the withholding tax at 10%, that interest will not be subject to further tax on the gross amounts.

The new tax comes into effect from midnight tonight.

Seventh, investment deductions. For many years now, Kenya industrialists have complained that it is unfair to give investment deductions to encourage the building of factories only outside the municipalities of Nairobi and Mombasa. The argument has been that any investment anywhere in Kenya is good investment for Kenya's development and none should not be discouraged.

The strategy was developed a decade ago when it became obvious hat manufacturing industries set up in Nairobi and Mombasa were training the resources of those two municipalities sometimes to a breaking oint. In any case it remains Government policy to encourage district ocussed development for many other economic reasons.

However, I have some sympathy with the argument that rather han abolish investment deduction from the two main municipalities ltogether, we should give recognition to all investment regardless f where it is located and discriminate in favour of those industries hat are set up in the other municipalities and towns.

The Finance Bill, therefore, contains a clause to re-introduce nvestment deductions within the municipalities of Nairobi and Mombasa. he deduction will, however, be at the rate of 10% of new investment hile the rate outside the two municipalities will be increased rom 50% to 60%.

Finally, provisional tax payment. For some time now, I have een considering whether time has not come when businesses should be ade to pay taxes within the year of incme. After all individual axpayers pay their taxes by PAYE throughout the year so why not usinesses?

However, I wish to give this matter further thought but I would ke it known that time must come when Kenyan businesses will have to ay tax by instalments as it is done in many other parts of the world oday.

In the meantime, I propose to amend Section 95 of the Income ax Act to require a larger measure of accuracy in the provisional eturn.. Businesses have tended to pay only 80% of the true liability ecause of the permitted error margin of 20% in the provisional stimate.

I propose to amend the law to require a minimum of 90% accuracy llowing only 10% margin of error in the provisional estimate.

Mr. Speaker, the foregoing measures on income tax are obviously nerous and, considered together, they will provide me with an dditional revenue of K£7.00 million.

(g) Insurance

Mr. Speaker, I am informed that in spite of the phenomenal owth taking place in the insurance industry, the Exchequer is t getting its fair share of this growth.

Currently, the only direct share that the Exchequer gets from e industry is the Sh.4/- stamp duty charged on each insurance policy sued. Honourable Members would agree with me that this is a very all sum compared to other direct charges imposed under various ts on goods and services. In order to be more equitable, I have day published the Insurance (Amendment) Bill which introduces a x on insurance premiums to be known as "premium tax" and which ll be charged at the rate of one percent of the gross direct emium written by all insurers registered or authorised to undertake siness in Kenya. The tax shall be payable monthly to the Permanent cretary to the Treasury by banker's draft submitted through the mmissioner for Insurance.

This measure will provide the Exchequer with an additional 1.50 million in revenue.

(h) Miscellaneous Taxes/Fees

Mr. Speaker, along with the foregoing taxation measures, I have also reviewed miscellaneous taxes affecting betting, lotteries, gaming and hotel accommodation. Accordingly, tax on a bet placed with a bookmaker will be raised from 10% to 12.5% with that on the turnover of the bookmaker rising from 2.5% to 3.5%. Similarly, casinos will be subjected to licence fees ranging from Sh.50,000/- to Sh.150,000/- depending on the number of tables, while licence fee for national or public lotteries will be raised from Sh.10,000/- to Sh.20,000/-. Finally, the rates of hotel accommodation tax will be raised from 15% to 17.5% for bed and breakfast while that of full board will be raised from 10% to 12.5%.

These measures will give an additional K£1.58 million to the Exchequer.

2. CONCLUSION

Mr. Speaker, the main thrust of today's budget has been to address the fundamental issues relating to the Nation's economic well-being. In this context, not only have I highlighted the past economic events but have laid a firm base on which to construct a stable and prosperous future. I have reaffirmed Government's commitment that the resources that are to be utilised will be carefully managed to attain that desirable goal. More importantly, I have described the economic recovery and how the government intends to sustain it in the face of adverse international economic environment.

I have also outlined how, through tariffs and taxes, I will affect the relative prices so as to stimulate agriculture and exports of manufactured goods; and how, through the District Development Fund and other allied, spatial support measures, I hope to create an environment in which small industry can thrive.

I do not intend to repeat again the description of the major ways in which I have outlined this programme. But in this Budget, I have outlined new taxation measures which will raise an additional K£35.2 million, thus closing the gap. Since I have already informed the House of the existing obligations, I cannot decrease on the expenditure side; nor, in view of the policy to stimulate private activity, can I institute further revenue measures. I am, therefore, reluctantly forced to accept a budgetary deficit of 3.9 percent in 1987/88. The steps taken in today's Budget are steps towards a long journey to economic and solid prosperity. They have certainly been made possible through the efforts which have been undertaken in the past with the support of this August House.

In conclusion, Mr. Speaker, I have today outlined measures which seek to consolidate the gains achieved under our programmes of Stabilization and Structural adjustment of the economy. For these measures to continue bearing fruit, we shall require the co-operation of farmers, industry and Government as a whole. To sustain the momentum of growth under these circumstances will require extra efforts and commitment by all. And to make the burden of leadership in these circumstances lighter will require our total loyalty to His Excellency the President. I am sure Hon. Members will join me in once again re-affirming our unswerving loyalty to His Excellency, the President in the true spirit of our philosophy of NYAYO.

Mr. Speaker, I beg to move.