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**SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 15th JUNE, 1989, BY
THE HON. PROF. G. SAITOTI, VICE PRESIDENT AND MINISTER FOR FINANCE,
REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE FISCAL
YEAR 1989/90**

(1ST JULY, 1989 TO 30TH JUNE, 1990)

Mr Speaker, Sir,

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

1. INTRODUCTION

Mr Speaker, this Budget comes at a critical turning point in our approach to the management of the national economy. It is the fourth consecutive budget stressing long-term development and the need to spur economic growth through a restructuring of the economy along the lines of Sessional Paper No 1 of 1986 on "Economic Management for Renewed Growth".

Mr Speaker, for more than a quarter century Kenya's economic performance attests to the effectiveness of the Government's economic policies and to the stability of our political system. We have improved our administrative capability to respond to crises, and strengthened our willpower to confront and deal with emerging problems by using our own resources. Our ability to do so has been greatly augmented by the constant support and guidance of H.E. the President. I am sure Honorable Members will join me in paying our most sincere tribute to H.E. the President for his tireless enlightened leadership of this Nation.

Mr Speaker, the main challenge for us in formulating economic policies, is to create jobs for our rapidly increasing labour force. The most efficient method of achieving this goal is to stimulate economic growth. Although we have enjoyed satisfactory growth rates of production and incomes over the past several years, we must now consolidate these gains and accelerate the tempo of this growth. We must also ensure that these gains are equitably distributed throughout the Nation. It is for these reasons that I have chosen the theme of this year's Budget to be "ENHANCED GROWTH THROUGH EFFICIENCY"

Mr Speaker, I will begin, as usual, with a quick review of the international economic scene and developments in the Third World countries. This will form a background to a review of the domestic economy in 1988 and the outlook for the near future. That outlook is conditional upon the macroeconomic, sectoral, fiscal and monetary policies on which I will dwell at length. Thereafter, I shall discuss the budget outturn for the current fiscal year and outline the budget for next year. Finally, I shall present specific measures related to taxation and other changes for the fiscal year 1989/90.

2. THE INTERNATIONAL SCENE

Mr Speaker, the world economy is now in its seventh year of uninterrupted growth. This is the longest cyclical upswing in the postwar period and there are no signs that the expansion is about to end. In 1988, world production grew at an estimated 4 % compared with 3.2 % in 1987. The exceptionally long, uninterrupted upswing has been accompanied by a surprising degree of price stability. The rate of inflation in the industrial countries has been around 3 to 4 % in the past three years. This combination of an extended expansion in production and sustained price stability is quite unique in recent economic history.

The economic upswing in industrial countries has, through a buoyant demand, led to a rapid expansion of world trade. In volume terms, it has accelerated over the past several years to reach an estimated 9.2 % in 1988 -- the strongest performance in this decade and over 3 % above the average for the 1970's.

The favorable international economic climate over the past several years has been accompanied by continuing and very large imbalances in trade between some of the major industrial nations. The large deficit in the United States' trade and current account balances has remained, with mirror image surpluses in Japan and West Germany. These imbalances have created strains in international trade relations, leading to political pressures in several industrial countries to raise trade barriers. A new round of GATT negotiations started last year, but encountered great difficulties, particularly in the area of liberalizing trade in agricultural products. These negotiations have been rescued for the time being, but many thorny issues still remain. It is extremely important for us in the developing world that the GATT negotiations make substantial headway because an important part of these negotiations concerns us directly. From our own perspective, it is ultimately a question of whether the industrial countries are genuinely willing to let developing countries participate fully in international trade.

Mr Speaker, despite trade restrictions, the long and powerful upswing in economic activity in the industrial world has generated rising demand and output also in the developing world. The growth in production in developing countries was approaching 4 1/2 % in 1988 -- a significant acceleration over the preceding years and is well above the average for the decade as a whole. Commodity prices have also responded to the international upswing, with a record increase of over 18 % in the prices for non-oil commodities in 1988.

Turning from the global scene to the African economic situation, there is now some evidence that the African economies are also beginning to benefit from the favorable international economic climate. Output growth in Sub-Saharan Africa has been somewhat higher in the past three years than in the preceding decade, although per capita incomes have continued to fall. By comparison, Kenya has done particularly well over the past years, with growth rates around 5 % per year with resultant gains in per capita incomes.

However, the somewhat brighter situation on the Sub-Saharan African continent in the past few years can only be partially ascribed to the cyclical upswing in the industrial world. There are also other reasons for the somewhat improved economic conditions in Africa. For instance, an increase in agricultural production in the past three years is probably associated with improved weather conditions; there has been an absence of severe droughts and generally good rainfall has prevailed in most of the countries on the continent. Moreover, a number of countries have adopted economic policies which encourage production through more appropriate incentives. An additional boost to growth in the area has come from a significant increase over the past three years in concessional financial flows to Sub-Saharan Africa.

Mr Speaker, in a survey of the African economic scene, it is important to stress the fact that external debt remains a major obstacle to economic development. Although the absolute size of African debt is modest in comparison with that of Latin America, it is nevertheless a heavy burden for the individual African countries which are less developed. The recent increase in financial assistance to Africa will ease the pressures, but the problems are still grave, and in some countries seemingly insurmountable. Debt cancellations by bilateral donors is one partial solution. Financial restraint and discipline on the part of the countries in the region is another. Over the longer term, we might hope for renewed inflows of private capital from the industrial countries, something that would help our balances of payments as well as boost our industries.

In summary, therefore, the outlook for the world economy remains fairly bright, although we should not count on continued growth rates of the magnitude experienced in 1988. Inflationary pressures are beginning to emerge in some industrial countries, and interest rates are edging up to counteract these inflationary impulses.

Forecasts for the Sub-Saharan region show a continued but marginal improvement in terms of economic growth, but the rapid population increases in these countries are likely to leave per capita incomes more-or-less unchanged over the next few years.

3. THE DOMESTIC ECONOMY.

Mr Speaker, I would now like to turn to the domestic economy. First I want to draw the attention of the House to the fact that the Sixth Development Plan has been recently launched. That document underscores the continuity of our economic policy. In my analysis of recent economic trends, I will assume that Honorable Members have already read that Plan as well as their copies of this year's Economic Survey which describes the performance of the economy during 1988 in detail. In my speech I will confine myself to a review of the highlights of the Survey.

Since 1985, Kenya has recorded an average annual growth rate of 5.1 %; in 1988, output grew by 5.2 % and we have reasons to expect growth around 5.0 % in 1989. Thus the average real income per person over this period has increased by an average of 1.2 % annually. This means that our average living standard has improved each year over the last four years, in stark contrast to the average performance of the other Sub Saharan economies where real living standards have declined annually by about 1 %.

(i) The Economic Sectors

Mr. Speaker, an important question we must ask is how strong and robust is the growth we have seen over the past years. In an attempt to answer that question let me first point out that, over the four years since the drought of 1984, agricultural output has grown annually by 4.6 %, manufacturing production has risen by 5.5 % annually and the service sector has expanded by over 6.0 % each year on average. In effect the picture that emerges is one of a broadly based expansion with increasing diversity and sophistication. Furthermore, this expansion is likely to continue provided that international conditions do not change for the worse.

(ii) Investment Performance

A second important indicator of the sustainability of the current economic expansion is the size of national savings and the composition of our investments. The more we save and the more we invest to raise productive capacity, the better equipped we are to maintain a healthy growth rate of the economy. Savings as a proportion of GNP, the so-called savings ratio, increased by one percentage point to 18.3 % in 1988 over 1987 while the corresponding investment ratio rose to 26.7 %. However, if we are to realize the ambitious growth targets set out in the Sixth Development Plan, we need to continue to raise the investment ratio towards the 30 % mark.

I am particularly pleased to note that, after the relatively stable level of investment in the manufacturing industry in 1987, this rose by no less than 25 %, calculated at constant prices in 1988. Investment in the agricultural sector on the other hand slowed down somewhat. Thus satisfactory investment levels in productive sectors is a further sign that the present expansion has a solid foundation.

(iii) Export Performance and the Balance of Payments

A third indicator of the sustainability of our recent growth record is the degree to which we produce for sales abroad. For several years, we have stressed the need to re-orient more of our productive capacity towards export production. This has the obvious and beneficial effect -- apart from stimulating employment at home -- of raising our earnings of foreign exchange which enables us to import more freely the goods we need from abroad. An examination of our export performance over the past few years gives reason for some optimism. In the traditional areas of coffee we are holding our place and in tea, we are steadily increasing our share in world markets.

It is particularly encouraging to note that non-traditional exports, are becoming increasingly important. These exports have risen at an average annual rate of about 14 % in value terms over the past four years. In 1988, they grew by no less than 22 %. Horticultural exports, which are now the fifth largest foreign exchange earner, have risen at an average annual rate of close to 25 % over the past four years. Textiles and food products are other examples of rapidly expanding export commodities, while "exports" of tourist services continue to expand at about 20 % per annum.

Mr. Speaker, while it is too premature to make any bold statements about a major diversification of our exports, these achievements are rather encouraging and should this trend continue, our economic expansion would be placed on a more solid footing. This would stabilize and strengthen our balance of payments situation and allow us to raise the level of imports more rapidly, especially imports of capital and intermediate goods needed to raise industrial production.

In this connection it is worth noting that the growth of imports is essential to the growth of the economy. In 1986 their growth was financed by the coffee boom, in 1987 by running down foreign exchange reserves and in 1988 by foreign assistance in the form of programme loans and balance of payments support. In fact, external assistance during 1988 was large enough to allow us to rebuild the foreign exchange reserves by about one billion shillings.

(iv) Prices, Wages and Employment.

The final factors I wish to review in seeking to establish the sustainability of our growth relates to the key areas of employment and the standard of living as measured by real wages.

Mr. Speaker, after the fierce inflation of the first three years of this decade during which our lowest inflation was over 12 1/2 %, we have managed to keep prices under reasonable control; over the past 26 months inflation has crept up by less than 6.0 %. This is not a cause for complacency nor is it a cause for panic. Last year's inflation rate of 10.65 % was more an outcome of price creep than inflation but I am confident that with the improved management of the money supply, which I will discuss in detail later, and the sustained growth of the economy, we can expect a down turn.

Despite this inflation, real earnings per worker grew by almost 2 % in 1988, with a slight bias towards rural dwellers rather than those who live in urban centres. Furthermore, over the last four years employment in the modern sector has, on average, increased by 4.6 % annually which is ahead of the growth in population. Notwithstanding this achievement, we need to increase job opportunities at a substantially faster rate if we are to succeed in sustaining our development strategy.

4. ECONOMIC POLICIES

a. The Policy Framework

Mr Speaker, against this background of international and domestic events and prospects, I would now like to discuss the policy strategy for the coming fiscal year.

The over-riding goal of our economic policy must be to provide gainful employment and to raise the standard of living for all Kenyans. This is important not only because we want all citizens to have a chance to lead a dignified life, but also because improved economic and social conditions are a prerequisite for political stability and unity. In the Sessional Paper No 1 of 1986 a strategy to reach this goal was outlined, the Budgets over the past years have elaborated on the theme, and the Sixth Development Plan re-affirms the strategy.

The foundation for this policy is rapid economic growth through the efficient use of our resources. Our policies over the past several years have been focussed around this theme, and as I have already mentioned we have witnessed encouraging results in terms of improved growth rates. We now need to consolidate these gains because, only through continued widespread growth, will the benefits penetrate to all segments of society.

Moreover, to accelerate growth and ensure improved living standards for all, we need to become more efficient. One of the most important aspects of efficiency is that the talents of the citizens of the Nation are not wasted. This requires us to continue our emphasis on improved and appropriate education, while ensuring that the necessary information on technological choice and consequential rewards is widely available. In this way people will be induced to undertake careers which will best serve their personal and the collective well - being.

Mr Speaker, it is the Government's task to create an economic and social environment which promotes growth through higher efficiency. As we create this environment, it is the task of the private sector to generate the increases in activity and employment. However, it is important to stress that the right policy framework cannot be established over night. Instead, policy strategies serve as a compass, or as benchmarks for the piecemeal and daily decisions which together implement economic policy.

There are two major strands in our long-term strategy to improve efficiency and to raise production. The first is to change the system of incentives in order to expose the economy to more competition, both domestically and internationally. This will trim costs, remove waste and make our economy better adapted to modern economic conditions. The second is to shift more of the activities of production and distribution to the private sector, while finding ways to raise productivity of those resources that continue to be used in the public sector.

In the economic jargon of today, these measures, taken together, are called structural adjustment policies. They aim at changing the basic structure of the economy so as to utilize human and other resources more efficiently, to expand the growth potential of the economy, and to increase its resilience to future external shocks. And, let me repeat, the goal of all these policies is to raise the standard of living of the population. I want to stress the fact that structural adjustment policies are not new in Kenya. Nor are they something that the World Bank or the International Monetary Fund are forcing on us against our will. Instead, the World Bank and the IMF, as well as bilateral donors, are supporting our own policies by providing assistance on highly concessional terms.

Mr Speaker, let me add one more observation on the policy approach we have adopted. We believe it is important that economic policies should evolve gradually over time and with a maximum of political consensus. The credibility that results from such consistent policies is worth much more than flashy initiatives which may capture the imagination of international donors and other observers. International experience has shown us that erratic policies, with reversals of direction, have detrimental effects on economic growth. As I have already indicated, our pragmatic and consistent policies are now beginning to pay off in terms of income growth, in terms of export diversification, and in terms of international financial support.

Keeping in mind the theme of this Speech, I will now discuss various aspects of our policies to illustrate how I envisage a policy framework that stimulates efficiency in order to enhance economic growth.

b. Fiscal Management

Mr Speaker, in my Budget Speech last year, I talked about the role of public expenditures in relation to the economic activities of the private sector and, specifically, about the need to curtail the increase in public spending. I want to return to this topic because it remains a core problem in managing our economy. And in doing so, I want to draw the attention of the House to the speech given by His Excellency the President during the opening of Parliament in March this year, when he remarked that, and here I quote, "those charged with the responsibility of spending public funds must avoid committing the Government to expenditures that are in excess of available resources", unquote.

Discipline in public expenditures remains crucial to our efforts to increase efficiency in the economy. Government has therefore decided that the completion of ongoing projects is the first priority for each Ministry. Mr Speaker, there are a number of examples of new projects initiated without careful economic appraisal and with little thought of how to finance the recurrent costs of the new ventures. No new projects must be started without first ensuring that those under completion are fully financed. In the Sessional Paper No 1 of 1986, we decided to bring down the size of public expenditures as a share of total expenditures. Unfortunately, not much success has been recorded so far. I am determined to follow the guidelines set out in the Sessional Paper and I shall expect full cooperation from all decision makers in the public sector.

A **second** and related problem in the area of public finance which has become increasingly acute over the past decade is the rising share of public expenditures absorbed in salaries of employees in Government Ministries. In 1989/90, nearly 70 % of Ministries' recurrent expenses will go to salaries and allowances, leaving a dwindling share for essential operational and maintenance expenditures. This is likely to result in the underutilisation of staff and deterioration of Government assets.

We have to change this trend and raise the effectiveness with which the public sector delivers its services. One way to accomplish this goal is to be extremely cautious in our employment policies. This will require strict discipline and loyal cooperation from all managers, high and low, in the public sector. The public sector must not be seen as an employer of last resort. There is not such a thing as automatic entry into the civil service; all new applicants will have to be scrutinized carefully before employment contracts are signed. These, and a number of other measures have been discussed and decided by Government, and I sincerely hope that we will now be able to change the pattern of public expenditures in a more efficient direction.

The **third** issue concerning fiscal management that I want to raise concerns our tax system. Mr Speaker, as Honorable Members are aware, I took some measures last year as an initial step in a reform of our tax system. This year I am continuing with the reform process. Here I merely want to outline the directions in which we are going and the reasons behind the reform. I am convinced that it is necessary to broaden the tax base by seeking revenues from more economic activities than at present. As a result, I hope that tax revenue will rise at least in step with the increase in national income; a more automatic response in tax revenues to increases in national income will also have the pleasant

effect of easing the burden on the Minister for Finance, since he will have to introduce fewer discretionary tax measures in coming years.

The tax reform will also entail an improvement in the tax administration in order to make the collection of taxes more effective. A stronger and more professional staff, together with improved computerization will help us achieve this part of the reform.

Mr Speaker, in order to achieve the aims of a broader tax base, a more equitable tax burden, and a higher so-called "tax elasticity", I intend to shift the emphasis towards indirect taxes, which means taxes on goods and services that we buy and trade. I therefore, intend to extend the present rather patchy system of indirect taxes into a unified Value Added Tax which will apply to practically all goods and services that are transacted in the economy.

The **fourth** area within the fiscal domain concerns the financing of various services which traditionally have been supplied by the Government. There is no doubt that the bulk of the services in, for instance health and education, will have to be provided by the state. In fact, this is one of the most important functions of a Government concerned with the well-being of its citizens. We have made great progress in raising the level of education of Kenyans since Independence, and the provision of health services has also improved dramatically over this period. However, in view of the rapid growth of our population, the demand for these services is rising at a pace which is increasingly difficult to satisfy with public means. In particular, expenditures on health and education are already putting considerable strains on the central Government's budget.

To alleviate some of these strains and to avoid raising taxes further, the Government wants to encourage wananchi to participate, in a modest way, in the financing of health and educational services which are now provided by the Government. We have taken some cautious steps in this direction, for instance in the field of higher education. Certain other measures have been announced recently by the Ministries concerned. With these changes, I am hopeful that, together, we shall be able to continue to improve our educational and health services. In these joint efforts, I want to stress again, that the Government Ministries involved will do their utmost to improve the efficiency in the delivery of services.

Finally, Mr Speaker, one of the key developments that I, as Minister of Finance, have to watch is the overall balance in the Government's transactions, that is, the budget deficit. We have had periods in the past with large budget deficits, usually because expenditure controls have not been effective. Those periods have been characterized by high inflation rates, large deficits in our transactions with the rest of the world, and declining foreign exchange reserves. In other words, large fiscal deficits lead to financial imbalances in the economy. In order to maintain stability in the economy, I want to make sure that the Government's own finances are run in a prudent way, and the main indicator of fiscal prudence is a low budget deficit.

In the fiscal year under review, on the basis of day to day monitoring, I expect the deficit to be around 4.5 % of the gross domestic product (GDP). This is slightly higher than what was planned a year ago, as expenditures have exceeded the budgeted levels. It is my intention to reduce the deficit to K& 381 million, or 4.2 % of GDP in the coming fiscal year, and further reductions in the ratio are planned for the following years. This will require a strict control of expenditures, confining them only to high priority activities. To the extent that we can identify development projects, entirely financed through concessional donor funds and thus not adding to domestic financing, nor to inflationary pressures at home, I may consider including some of them in the expenditure plans. This would raise the deficit slightly, but leave the financing picture unchanged.

Mr Speaker, in reducing the size of the budget deficit in relation to the size of the GDP, I intend to achieve three goals. Firstly, a smaller fiscal deficit will require less domestic finance for the Government's operations and thus release more financial resources for the private sector; this is in line with our philosophy of stimulating private economic activity. Secondly, a smaller deficit reduces inflationary pressures on the economy and stabilizes the economy as a whole. And finally international experience shows that a country which endeavours to broaden and liberalize its financial markets, which is the case in Kenya at present, is more likely to succeed in such a process if the Government reduces its claims on total resources and runs a prudent fiscal policy.

c. Financing the Budget Deficit: Public Debt Management

Mr Speaker, this year it is my intention to elaborate once again on the significant question of the proper financing of the Budget deficit. This is important because it is an additional and effective economic policy tool which we are developing.

The deficit in the Government's operations, is financed in part by loans from abroad, and I will return to that issue later in my speech. However, a large part of the budget deficit is financed by borrowing in domestic financial markets.

Depending on how and where the Government borrows its domestic funds, the effects on the economy may vary. Borrowing from the Central Bank and from commercial banks, which has been the traditional method of financing budget deficits, has the effect of creating more liquidity in the economy. This carries the risk that too much money will be created in relation to the goods and services available, and the result is unavoidably a rise in prices. I want to avoid that possibility. However, if the Government can adjust its borrowing operations by financing part of its deficit from the economy outside the banking system, we will get a much better control over the growth in liquidity and money supply.

d. Monetary Policy

Mr Speaker, money can be seen as the "lubricant" that makes the economy function more efficiently, it is the medium in most of our daily transactions. The more efficiently we manage our monetary affairs, the smoother our economic transactions will be performed, and the whole economy stands to gain from such a development. Monetary policy, executed by the Central Bank, has the key role in this area.

The Central Bank has two major domestic tasks in the economy. The first is to control the supply of liquidity and of money in the economy so as to ensure, on the one hand that there is enough money and credit to "lubricate" the economic system and, on the other, that there is not too much money in the system, since that will lead to inflationary pressures. The second task is to supervise the banking system, ensure that weak institutions are strengthened in time, and to set guidelines for what should be considered sound banking practices.

Hence monetary policy must provide the appropriate amount of credit and money to maintain financial stability in the economy. Following a period of rapid monetary growth, we managed to reduce the growth in money supply from over 32 % in 1986 to about 8 % in 1988. The sale of Treasury bonds, which commenced in 1987, was the most effective instrument for controlling liquidity. Although some critical voices have been raised over their sale, I want to stress that it is the national interest -- in this case the most successful preservation of financial stability -- that predominates in the formulation of economic policy.

Mr. Speaker, the Government's borrowing from outside the banking system in 1988 was large enough to permit some repayment of government debt to the banks. This, in turn, made it possible for the banks to shift more of their lending to the private sector. In fact, the commercial banks' lending to the non-government sector increased by about 17 % during 1988; even more telling is the fact that if lending to parastatals and other public bodies is excluded, credit growth to the private sector proper rose by no less than 19.6 % in 1988. That rate of expansion has moderated in recent months and, in my judgement, we now have the monetary situation under good control.

Although this shift in bank lending towards the private sector was desirable in many ways, there was a risk that credit and money supply might rise faster than was consistent with financial stability at a national level. Therefore, the Central Bank found it necessary to retain the quantitative ceilings on banks' lending to private customers.

Looking ahead, I believe it is consistent with financial stability to plan for an increase in total domestic credit of about 9 % in the course of the coming fiscal year. Given our forecast for the balance of payments, that would mean an increase in money supply of the order of 12 %. This means a less restrictive policy stance than in 1988 and the early part of 1989.

Within this overall target, our objective is to limit the share of bank lending to the Government, and thus to free as much of the financial resources as possible for the private sector. This is consistent with the general thrust of our development policy, namely to stimulate private economic activity and private initiative.

Mr Speaker, we are in a period of reassessing the techniques of monetary management. As the monetary system becomes more sophisticated, we need to develop new methods of influencing monetary conditions in the economy. Last year, we established the Monetary Policy Committee under the chairmanship of the Governor of the Central Bank and with high level participation from the Treasury, to oversee this process of improved monetary management.

In the past few years we have tried to activate several new methods of controlling money supply -- the use of cash deposits by the commercial banks with the Central Bank, the sale of Treasury bonds, and open market operations by the Central Bank. These techniques can be refined and become increasingly effective in influencing monetary conditions. An important part of monetary policy is the use of interest rates. We reviewed the interest rate structure a few months ago, partly in order to stimulate commercial banks to take on longer term, more development oriented loans. Looking ahead, we are determined to maintain interest rates positive in real terms. We will also continue to move towards a market-oriented interest rate structure.

The second task of monetary management, namely that of providing guidance and rules to the financial system, is equally important, especially in a young financial system such as ours. Over the past five years, the Government has worked to strengthen the financial system in order to protect the interests of depositors, to foster financial prudence and discipline, and most importantly to promote public confidence in the financial system. This requires a stronger supervisory role for the Central Bank. Hence the Banking Act has been reviewed to strengthen the Central Bank's supervisory role while consolidating past amendments. To this end, Mr. Speaker, I am today presenting to the House a Bill reflecting the proposed changes.

e. Making Financial Markets More Efficient

Mr. Speaker, turning now to the need to make financial markets more efficient, we want to channel more effectively our national savings to those sectors and activities where they make the maximum contribution to economic development. At present, there are various obstacles to a smooth functioning of financial markets. I want to remove those obstacles. This is a large undertaking and it will require time, energy and expertise. Financial markets and financial transactions are built largely on trust and the stability of expectations. This argues for a gradual, but steady, approach to financial reform. We must not expect wonders in a short time, but at the same time we must set our goals high and define our path clearly.

Mr Speaker, in my last year's Budget Speech, I announced the establishment of a Capital Market Development Advisory Council to set in motion the financial reform process. The Council, with the assistance of a Secretariat, has now prepared the legislative basis for a Capital Markets Authority, which will oversee the process of opening up financial markets, particularly securities markets. With this Budget, I am tabling the Bill to establish the Capital Markets Authority. Upon enactment it will guard against insider trading and stock market racketeering while providing for the creation of multiple stock exchanges. It will also enhance the Nation's investment environment through investor protection.

The Authority will have a strong representation from the private sector, as well as high level participation from the Government. It will be given certain regulatory and supervisory powers, particularly in the field of corporate finance. My intention is to stimulate a largely self-regulating financial system where those operating in the financial markets will take the primary responsibility for the development and deepening of these markets. An important task for the Authority

will be to establish the basic "rules of the game" so as to let the financial markets develop in a responsible manner and, of course, to oversee and guide the whole process of financial reform. I want to stress again that the evolution of financial markets is -and should be -- a gradual process.

f. External Resource Flows and External Debt.

Mr Speaker, one important theme in the Budget Rationalization Programme launched in 1986 was to persuade donors to shift emphasis from traditional project support, which is difficult to handle, to programme support. We then argued that broader forms of aid for a whole sector or general balance of payments assistance has a stronger development impact. Our efforts to modify the pattern of aid flows are now beginning to bear fruit. The volume of programme and balance of payments support has increased significantly.

Mr. Speaker, in addition, it is important for us to attract support on very soft terms, because we cannot afford to raise expensive, commercial loans abroad since our external debt is already very high. We are, at present, using about one third of our export earnings to service our foreign debt. We need to change this state of affairs and reduce the size of our external debt. This can only be done through concerted efforts and severe discipline, particularly in the public sector. As I indicated in my Budget Speech last year, we have put in place procedures which will vet all new loan proposals and judge them on the basis of their usefulness to the economy. As a policy, other than in exceptional circumstances, no new commercial loan contracts should be entered into. I intend to strengthen further the debt management function of the Ministry of Finance in order to make sure that we reduce our external debt obligations.

And here, Mr. Speaker, I am happy to inform the House that Kenya has continued to be current in servicing all its sovereign debt despite the fact that this has represented a significant cost to the economy. We are committed to the continuation of this policy. Notwithstanding what I have just said, Mr. Speaker, we still wish donors to consider the cancellation of debts or their conversion to grants. Indeed, as a result of H. E. the President's visit abroad early this year, the Federal Republic of Germany cancelled debt amounting to K sh 8.17 billion. We are indeed most grateful for this generosity and hope that other donors will follow this initiative.

g. Industrial and Trade Policy

Mr Speaker, as I have pointed out in my speeches over the last couple of years, Sessional Paper No 1 of 1986 has laid down the main directions of our industrial policy. Industry will have to become more efficient, for only in that way can it contribute to higher living standards, provide cheaper goods to the consumers, create more employment and raise exports. I intend, therefore, to continue supporting the policies espoused in that paper and developed further in my previous Budgets.

In addition to the financial reforms that I have already discussed, a restructuring of our industrial sector is the key to further economic progress. Although we are still, and for a long time to come will be, a predominantly agricultural economy, the industrial and service sectors must expand rapidly if we are to succeed in our efforts to raise living standards for all Kenyans. The service sector, and particularly the tourist industry, has showed encouraging growth for a number of years. However, there is a large scope for raising efficiency in manufacturing industry, and the industrial sector should be much more of a generator of employment than we have seen so far. This applies to large as well as small industrial enterprises. Industry and trade together must create jobs at a rate well in excess of the population growth of 3.7 % if we are to succeed in our development strategy.

It is important that we translate these general phrases into practical programmes and effective actions. I will discuss a number of actions designed to modernize Kenya's industry. Let me focus on two areas, first efficiency and competition, and then export promotion.

(i) Industrial efficiency and import competition.

Mr Speaker, during a decade or more after Independence, our industrial policy was one of stimulating indigenous entrepreneurs by providing high protection from international competition. The purpose was to nurture the so-called "infant industries" into a stable industrial base. That policy served us well in the beginning, but it has become increasingly clear that the protection we provided has led to inefficiencies.

The main reason for this is that we have retained an excessively high and inefficient level of protection through our quota system. The rationing of foreign exchange implied in such a system leads to uncertainties about deliveries of imported goods and therefore to inefficiencies in the production processes.

Our aim is to replace quantitative restrictions with an import system relying solely on tariff protection and an appropriate exchange rate for all but some designated products. This will create a policy environment where our human, capital, and other resources will be used in their most efficient manner. We are already well on the way towards that goal. The exchange rate is continuously adjusted in such a way as to make the import system increasingly competitive.

Mr. Speaker, we have now taken steps to speed up the license procedures and to make them transparent to importing manufacturers. Computerization of the import licensing system is helping us in this direction, as also is the prudent management of our foreign exchange reserves which sustain this programme.

In line with the message in the Sessional Paper No. 1 of 1986, we have taken a serious look at the publicly owned corporations. We have observed clear evidence of mismanagement, including failure to service debts. A tighter monitoring of the parastatal corporations is therefore necessary. Accordingly, the Auditor General (Corporations) is already working on this. Within the Treasury we have also streamlined our monitoring systems so as to ensure that parent Ministries obtain timely and relevant information on the performance of these

organisations. Further, the Government has undertaken restructuring of some of these organisations, for instance, the sheds of the Kenya Industrial Estates have been sold to private interests, the Kenya Meat Corporation is being restructured with a view to placing it in the hands of the producers and Kenya Commercial Bank has sold part of its shares to the public.

Moreover, market rates of interest will be charged to parastatals on direct government loans. This, of course, will not apply to concessional funds which are being on-lent from donor sources.

Mr. Speaker, during the past year we have conducted a thorough investigation of the Development Finance Institutions (DFIs) with a view to strengthening and reorganising them. The investigation has revealed a number of serious problems in the DFIs. Their capacity to lend fresh money has been eroded as they have become more like holding companies than providers of fresh risk capital. And some of their long-term investments are quite dubious, revealing imprudent management. Clearly the DFIs are no longer performing strictly the function for which they were designed. There is therefore a convincing case for re-evaluating, strengthening and reorganizing them.

(ii) Export promotion.

Mr. Speaker, a topic that I have returned to on many occasions over the years, has been export promotion. Export promotion is required for two reasons. Firstly, a more rapid growth in exports provides us with more foreign exchange which we can use for imports, including importantly such imports that are needed as inputs in our own production processes. A development along these lines will strengthen our underlying balance of payments and make us stronger in our dealings with the rest of the world. Secondly, we want to stimulate non-traditional exports so that we become less vulnerable to fluctuations in the prices of a few commodities in world markets; in other words, we will be able to withstand external shocks more easily, the wider the spectrum of exports we produce.

The key to success in this field lies in establishing a realistic exchange rate. For several years, we have pursued a flexible exchange rate policy designed to shift resources to exporting and import competing activities. In particular, this will ensure that the business of exporting is becoming increasingly profitable. As I have already indicated, we are beginning to see the results of this policy in actual export performance. But there are a number of additional measures which can and should be taken to support the exchange rate policy. I will now discuss some of these reinforcing policies.

The manufacturing under bond policy which I announced two years ago and reported on its progress last year, continues to move forward efficiently under the One Stop Office administered by the Investment Promotion Center. The bureaucratic bottlenecks that previously hampered investment decisions, particularly by foreign companies, are being removed. There has been a significant increase in the interest of foreigners to establish business in Kenya, mostly in partnership with Kenyan businessmen, and the range of activities is quite wide, including textiles, packaging, tourism etc. The total amounts involved, as measured in potential foreign exchange earnings or employment opportunities are still modest.

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but it is clear that the investment climate is changing as a result of our efforts to simplify the procedures.

Another step in the same direction will be the establishment of Export Processing Zones. The Government has acquired land in the Nairobi and Mombasa areas for the establishment of two zones. We have held positive discussions with the World Bank and the USAID to finance steps towards the establishment of the EPZs. Consultants are being contracted and an Authority is being established to ensure that this becomes an effective operation. Further incentives relating to production in the EPZs are being worked out and I intend to act swiftly on this matter.

I am confident that all these actions taken together will help boost and diversify our exports over the years to come and thereby put our balance of payments on a sounder footing. Furthermore, and in a broader perspective, a constructive integration of the Kenyan economy into the world economy, both through trade and financial transactions, is likely to bring economic as well as technical, managerial and cultural rewards of various kinds and thus to strengthen the foundation of our society.

h. Agriculture

Mr. Speaker, I now wish to turn to the agricultural sector. Agriculture must continue with its vital role of providing food security, foreign exchange, jobs and economic growth. For it to do so we must manage our scarce high quality land resources efficiently, provide appropriate and timely credit and inputs, and also ensure the efficient dissemination of research results. Further, we will continue to review prices regularly and the payments system which has been streamlined will be maintained so as to encourage the farmers.

Mr. Speaker, I am happy to inform this House that the reforms announced last year with respect to the National Cereals and Produce Board and the Kenya Meat Commission are proceeding satisfactorily. The restructuring reforms will now be widened to embrace the sugar companies, the Agricultural Finance Corporation and the Cotton Board, not to mention the Kenya Cooperatives Creameries. Besides this eclectic approach to those institutions which participate in the handling of agricultural output and farmers assistance, I have provided financial support as necessary to the Ministries of Agriculture and of Livestock Development so that extension services will be delivered efficiently.

The key element for expanding agricultural output is the provision of the appropriate inputs and amongst these probably the most wide spread and vital is fertiliser. In acknowledging this the Government has prepared a fertiliser policy paper which provides a framework for the long term development of marketing and pricing arrangements. The paper also addresses the handling of donor-financed fertiliser providing guidelines and an efficient allocation system associated with a more liberal and broader distribution system.

To complement the Government's efforts in the agriculture sector, the recently established Ministry of Reclamation and Development of Arid, Semi Arid and Wasteland will play a key role in activating the real economic potential of the arid and semi-arid lands. In the near future, Mr. Speaker, the Government will

launch a strategy which will convert these areas from being viewed purely as recipients of welfare into areas that will provide employment, surplus food and significant growth. This strategy, while covering the traditional concerns such as water and soil erosion, will also address potential crops along with wildlife management and rehabilitation associated with the Nation's fuel requirements, amongst other things. I would strongly encourage all those donors, who have taken an active interest in the welfare of those districts to support the forthcoming strategy.

1. Rural-Urban Balance

Mr. Speaker, the recently launched Sixth Development Plan underscores the requirements of a successful rural-urban balance strategy. In this context we envisage that almost 600 thousand small scale enterprise jobs and a further one million jobs in agriculture need to be created over the next five years. The key to achieving these ambitious goals is the development of small, prosperous towns interacting with their hinterlands.

Last year the Government established the Jua Kali and the District Development Funds to finance jua kali sheds and Rural Trade and Production Centres respectively. This year I have provided adequate resources to these Funds so that they can continue to play their role effectively. In this connection 26 sheds have since been constructed in various Districts and I am happy to report that the plans for the first eight group of RTPCs have been finalised and their implementation is under way.

This year, the Government will undertake the provision of basic services in the sheds while expanding their coverage. This is only a part of our broader Small Scale Enterprise Programme which will be launched in the course of the year to cover all the multifaceted requirements of this most crucial sector.

I wish to appeal to the Hon. Members to take a keen interest in and support for the implementation of the District Focus strategy for rural development as articulated in the recently published District Development Plans. The support for those projects which essentially underlie any stable prosperous private sector investment is vital. Only in this way will trained youth and the surplus earnings be retained in the rural areas to realise their full potential. The distributional impact of the developments outlined under our rural-urban policies will make a major contribution to the Nation's welfare.

2. FINANCIAL OUT-TURN 1988/89

(a) Recurrent Revenue

Mr. Speaker, I would now like to turn to this year's Budget out-turn. This fiscal year's recurrent revenue was estimated at K£ 1744.6 million plus appropriations-in-Aid of K£ 76.2 million making a total of K£ 1820.8 million. This revenue was to comprise of K£ 405.4 million from Customs & Excise; K£ 516.1 million from Income Tax; K£ 563.2 million from Sales Tax and the balance of K£ 99.9 million from export duty, other minor taxes, charges, dividends and fees. Mr. Speaker, revised estimates show that I may realise a total recurrent revenue of the K£ 1792.2 million, i.e. K£ 47.6 million above my last year's forecast.

There will be increases in Income Tax and Sales Tax which will exceed their targets by approximately K£ 19 million and K£ 26 million respectively; while Customs & Excise will exceed the original target by K£ 1.5 million. This improved performance is due to marginally higher rates of real economic growth and inflation and significantly higher value of imports than were anticipated at the time of framing the Budget Estimate.

Therefore I expect to raise K£ 407 million from Customs & Excise; K£ 535 million from Income Tax; K£ 589 million from Sales Tax and K£ 261.2 million from other taxes and revenue.

(b) Recurrent Expenditure

This year's Printed Estimate of Recurrent Expenditure was K£ 1159.6 million, excluding Appropriations-in-Aid and an accounting adjustment of K£ 258.5 million, being the write-off of loan principal and interest to NCPB. Consolidated Fund Services were to take another K£ 740.7 million, making a total recurrent expenditure: K£ 1900.3 million.

As the House will recall, there were a number of reasons which forced the Government to seek Parliamentary approval for Supplementary Appropriations amounting to K£ 79.9 million. The principal among these were the need to recruit more teachers for the 8-4-4 system and expenses due to increased enrolment in our universities, increased costs associated with maintenance of security along our borders and implementation of the Ominde Committee Recommendations on salary increase for Police and Prison Services staff. I had also to finance excess Votes and Under Issues of K£ 56.4 million. I therefore, expect this year's recurrent expenditure to be 2036.6 million, compared to an expected total revenue of K£ 1792.2 million. I will therefore, have no surplus in the Recurrent Account to transfer to the Development Exchequer.

(c) Development Expenditure

This year's Printed Development Estimates projected gross expenditure of K£ 702.5 million, including Appropriations-in-Aid of K£ 397.1 million. Earlier this year the House approved gross Development Supplementary Estimates of some K£ 87.0 million. As I have already indicated this increase was necessitated by the need to expand university intake, while enhancing our territorial security and making additional provision for roads, other transport and waterworks. Therefore K£ 392.4 million will be issued for Development Expenditure.

On the basis of the preliminary estimates, I expect the overall Budget deficit this fiscal year to be around 4.5 % of GDP. As I had indicated I am determined to reduce this deficit during the coming fiscal year. I now turn to the forecast out-turn for 1989/90.

6. FORECAST OUT-TURN 1989/90

(a) Expenditure

Mr. Speaker, as Hon. Members have already seen from their copies of the 1989/90 Printed Estimates, the Gross Recurrent Expenditure of Ministries is estimated at K£ 1495.0 million, with Appropriations-in-Aid of K£ 184.6 million, giving a net expenditure of K£ 1310.4 million. This will represent an increase of more than 5.7 % over the 1988/89 approved recurrent expenditures, excluding the NCPB write-off. I am also happy to inform the Hon. Members that local Appropriations-in-Aid to finance such expenditures will go up from around K£ 71.5 million this year to K£ 114.6 million next year. Consolidated Fund Services will take another K£ 977.8 million. Therefore, total Gross Recurrent Expenditure will amount to K£ 2472.8 million in 1989/90.

Development Estimates for 1989/90 call for a gross expenditure of K£ 848.8 million, including Appropriations-in-Aid of K£ 479.4 million. In addition, I am seeking the House's approval to finance another K£ 73.3 million worth of development projects through highly concessional additional external resources in the form of Appropriations-in-Aid. When this additional development expenditure is taken into account the total will amount to K£ 922.1 million, making an increase of 14.4 % in the Development Estimates in 89/90 compared to the revised estimates of the current year. This is accounted for by the need to increase the absorption of external grant and soft loan financed projects in the Budget, partly as a result of the scarcity of local resources and the need to increase external resource inflow to support our balance of payments.

Apart from the foregoing expenditure, I have also to finance an additional K£ 70.1 million as Excess Votes and Under Issues relating to previous years.

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

It suffices to note that I have to finance a total expenditure of some K£ 3465.0 million. The rest of my speech will outline how I propose to do this.

(b) External Revenue

Mr. Speaker, Kenya is committed to the maintenance of cordial international relations. I have also indicated that the Government is committed to the Budget Rationalisation Programme to improve the efficiency in public expenditures through optimal utilisation of existing capacity and giving priority to completion of ongoing projects. Within these criteria and in the light of the sound economic policies which Kenya has been pursuing, foreign donors have pledged to assist us with an amount equivalent to K£ 971.1 million next fiscal year. Of these external inflows, about 40 % will be in the form of grants and 60 % in the form of project and programme loans. Mr. Speaker, these are indeed very large amounts and I would ask Hon. Members to join me in expressing our gratitude to the

foreign governments as well as bilateral and multilateral institutions who have consistently continued to assist Kenya. Thus, I expect to finance over 28 % of my total expenditure from external sources. As usual the main burden of financing government expenditures will fall on Kenyans and I now turn to how I intend to raise the balance of K£ 2,493.9 million.

(c) **Domestic Borrowing**

Mr. Speaker I have already indicated my intention to reduce the growth in money supply. I have also indicated that, to achieve this reduction in money supply, I need to borrow more from non bank sources. Given this position I propose to raise some K£ 328.0 million from local borrowing. This money will be raised by way of long term stocks, Treasury Bonds, and Treasury Bills and will mainly come from non-bank sources.

(d) **Internal Revenue**

Mr. Speaker, when I outlined the economic outlook for 1989/90 I indicated that the economy is projected to grow by approximately 5.1 % next fiscal year. On the basis of this projection, I estimate that ordinary revenue, at present rates of taxation, will provide some K£ 1,982.9 million. Appropriations-in-Aid will provide another K£ 125.0 million.

Thus, I will raise a total of K£ 2,107.9 from this source. I have therefore, a gap of K£ 58.0 million to finance from additional taxation. The rest of my Speech will outline the areas of extra revenue.

7. **TAXATION PROPOSALS**

Mr. Speaker, I have already highlighted to this august House the prevailing international economic climate, the marginal improvement in output growth in Sub - Saharan Africa, the continued encouraging performance of the Kenyan economy and the policy framework proposed to enhance growth through improved efficiency. In particular, I have stressed the need for structural adjustment with a view to stimulating private initiative, efficient use of government resources and economic development. I have also indicated that I have to finance a gap of K£ 58.0 million. I now turn to the 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**

Mr. Speaker, the Finance Bill published today contains a number of amendments to the Customs and Excise Act. I have divided these into two categories - those with no revenue implications and those that do. Some of the amendments are aimed at correcting errors and omissions while others are aimed at rectifying a few anomalies. As is the practice, I would like to deal initially with those amendments which have no direct revenue implications.

First, a major change reflected in the Bill relates to the reclassification of traded goods and commodities to a new Harmonised System. This

Second, I would like to draw the attention of this House to my last year's proposals regarding the restructuring of our import system, under which I announced three Schedules with the third Schedule being further subdivided into three categories. I am pleased to inform this House that this action has proved successful and that import licence requests under Schedules I, II and IIIA have been processed expeditiously and industry has been able to obtain its requirements readily. However, bearing in mind the need to conserve foreign exchange and give protection to local industries, I have significantly increased tariffs on a range of new items designated IIIB and intend to work with my colleagues in the Ministries of Commerce and of Industry to see that quantitative restrictions will no longer be used on those items. The increased tariff protection of some local industries should be enough to ensure that they are fully viable if operated efficiently. I have also raised duty for revenue purposes on a number of other luxury and locally produced items which will continue to be subject to quantitative restrictions.

Mr. Speaker, in reviewing the tariffs I have borne in mind the need a) to protect local industry while stimulating its efficiency; b) to manage our foreign exchange reserves prudently; c) to increase revenue; and d) to be conscious of the cost of living implications resulting from such tariff changes.

Third, while eliminating the 5 tariff duty categories, I have, in general, lowered the import duty rates on raw materials and intermediate goods by an average of 5 % while raising the duty on refined and final products by between 5 and 35 %. In the process I have rationalised the rates to ensure that imports in crude and raw form bear lower duties than those on semi-finished items and the latter in turn bear duties lower than those on finished products.

Fourth, as Hon. Members will recall our beloved President is on the forefront of the efforts to stimulate the electrification of our rural areas. Rural electrification is absolutely essential for our policy of rural-urban balance, a policy that will ensure job creation and secure the development of the hinterland through the growth of dynamic small towns and market centres. These will provide farmers with production inputs and profitable outlets for the produce of their farms and pastures. This policy also encourages the growth of small scale industries.

Unfortunately, progress in the area of rural electrification is scattered and slow often because of the high cost of transformers. In order to tackle this problem, I propose to abolish the duty and sales tax on transformers, cables and other equipment for power generation and distribution which are imported by Kenya Power and Lighting Co.Ltd. In addition, I would like to ease the burden of the majority of the rural population who use oil lamps and lanterns to light their homes. For them Mr. Speaker, I propose to reduce the duty on glass chimneys for lamps and lanterns from 45 to 40 %. Further, since electric energy to produce engine power is unavailable in most rural areas, an alternative energy device is the windmill. This is energy saving since wind is free. Consequently, I have lowered the import duty on windmills from 35 to 20 %, in order to encourage their usage.

Fifth, the robust health of both the people of this country and their livestock is essential to enhance the productivity of our Nation. In support of this I propose to remove duty on active ingredients used for the preparation of drugs, including veterinary drugs, fungicides and pesticides. In addition, so as to lower the high cost of dentures to our senior citizens who are so often dependent on the

expanded version of the existing Customs Cooperative Council Nomenclature (CCCN), which classified traded goods and commodities in an internationally accepted pattern. Kenya agreed some years ago to make this change so as to follow the rest of the world. The Harmonised System allows for a uniform classification of goods in international trade. This provides a standardisation of trade documentation which results in the details required for customs and statistical purposes by governments and trade interests, as well as providing accurate and comparable data for the purposes of international trade negotiations. The new system groups product-items more logically and allows for more refined policy analysis.

Second, under the existing law an importer who fraudulently fails to pay duty is liable to prosecution which may result in a fine or a jail term. However, the Act is unclear as to what happens to the unpaid duty. This is a major omission. Currently, under the Sales Tax Act, a person with an offence of this nature not only pays a fine or serves a jail sentence, but has also a liability to pay the sales tax. Similarly, I would like to align the Customs and Excise Act to the Sales Tax Act in this respect and I have, therefore, proposed an amendment under Section 158 A of the Act that provides that the duties and penalties will not be waived by reason of conviction.

Third, the Commissioner of Customs and Excise, when in doubt about the value of goods claimed by the importer for the purpose of customs declaration, has constantly resorted under Section 127 of the Act, to appraising the values of such imported goods through extensive use of "Clean Report of Findings" of the government appointed inspection firms. The Commissioner usually takes this step when an importer is suspected of under-valuing such goods to avoid paying more import duty. However, when an importer disputes the appraised value these "Clean Reports" have no force of law. Therefore, to ensure that these "Reports" are admissible as evidence in a court of law, I have proposed amendments in Section 2 (3) of the Act.

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

First, as stated in my Budget Speech last year, the Government is committed to a tariff structure which is more uniform with fewer categories of rates, which provides a similar effective rate of protection to all firms and industries, which is more efficient in its impact on the economy and which is easier to administer with integrity than a structure with wide ranging rates. Towards this objective, last year, I reduced the number of tariff categories from 25 to 17. This year, I have reduced the duty categories further from 17 to 12 and in the process I have eliminated import duty rates of 15 %, 35 %, 45 %, 70 % and 120 %. Mr. Speaker, this is a major reform whose impact on trade and industry, I am certain, will be far reaching.

fruits of their past labour, it is proposed to abolish the duty on plasters used in dentistry which currently stand at 35 %. I hope this measure will provide a welcome smile to our senior citizens.

Sixth, as part of the rationalisation of the duty structure for vehicles, I have lowered duties for minibuses, small pickups, lorries and trucks, from 35 to 30 % and from a range of 45 to 120 % to a range of 40 to 100 %. The assistance provided will definitely give relief to the farming industry, tourism and commercial and industrial sectors.

Seventh, bicycles. As Honourable Members are aware, for a large number of people in the rural areas, the only readily available means of transport is that faithful bicycle. It is used to deliver farm produce to the market, as a carrier for transporting people and to run the family errands. However, in recent years, this important mode of transportation has become increasingly unaffordable by those who genuinely require it, notwithstanding the relief provided in last year's Budget. I am therefore proposing to lower the duty on unassembled cycles and bicycle parts from 45 to 20 %, which is more than a 55 % reduction. This is a major concession and I hope that it will reduce their costs and stimulate the growth of bicycle assembly.

Eighth, it has been brought to my notice that importers have been bringing in almost fully assembled items and claiming them as unassembled so as to take advantage of the tax benefit which I have provided to completely knocked down kits brought in for assembly here. I have closed this gap by grouping partially assembled items with those that are fully assembled. In this way the protection to local industry and consequent employment will go to those contributing most to the economy.

Finally, it has come to my attention that there is a likelihood of a fair amount of transfer pricing through over invoicing of imported second hand machinery thereby circumventing Exchange Control Regulations. In order to discourage this undesirable practice, I propose to impose a 20 % duty surcharge on all imports of second hand or used machinery including motor vehicles.

Taken together, the measures I have announced today on Customs tariffs will provide the Exchequer with an additional K£ 10 million in revenue.

(b) **Excise Tariff**

Mr. Speaker, as the Hon. Members will recall in April this year, I pre-empted the action of hoarders who stockpile cigarettes, tobacco and beer in anticipation of increases in excise duty and sales tax. By raising such taxes ahead of the Budget I prevented loss of potential revenue to the Exchequer. I do not therefore wish to tax this sector more than once this year. The pre-emptive operation afforded me the opportunity to raise the excise and the sales tax on these commodities. I expect those measures to raise K£ 31 million extra revenue from those sources.

(c) Sales Tax / VAT

Mr. Speaker, I now turn to the Sales Tax. As is the practice, I would like to deal first with those amendments which have no direct revenue implications. Currently, Mr. Speaker, when registered manufacturers export taxable goods manufactured by them, the sales tax on these goods get remitted so that export price becomes that much lower and competitive. Traders and contract manufacturers on the other hand do not enjoy this remission of sales tax paid and are deterred from exporting. This is because their export price includes sales tax and therefore becomes non-competitive. The outcome is that Kenya's manufactured goods cannot find an export market even though there is a potential through the traders and contract manufacturers, who are able to identify the market. The amendment in the published Finance Bill provides that such exporters be allowed to export goods free of sales tax, provided they produce evidence of firm export orders of irrevocable Letters of Credit or evidence of advance payment, as well as an irrevocable bank bond covering the sales tax liability. On receipt of proof from the Central Bank, of the foreign exchange received in an approved manner, the bond will be released and the waiver of sales tax on exports will become operative. The waiver of the tax will be valid for 90 days only within which time, the exporter has to account for the export proceeds otherwise the tax becomes due and payable.

Second, Mr. Speaker the subject of indirect taxation, and in particular the Sales Tax as a source of revenue, has become very important. This tax has been operating for 16 years and on the whole, it has been a reliable source of revenue. However, as our economy has become more sophisticated the many disadvantages of the tax have become more marked. I have, therefore, over the past few months, been considering a number of alternative reforms and I am now convinced that a fairly simple or basic Value Added Tax system (VAT for short) will give the flexibility necessary.

Mr. Speaker, VAT is a tax on consumer expenditure collected on business transactions and imports. It differs from the Sales Tax in that it is not limited to manufactured goods but can be imposed on any type of goods or services. The way it operates allows the person registered for VAT to operate in practical terms with tax free goods and materials, because the tax is ultimately passed on to the consumers. This is because while, for each month, he has to declare and pay the tax due on his sales, he can at the same time claim back the tax he has paid on his purchases. There is another feature I consider of great importance and that is the encouragement given to exporters. The VAT in the first instance will be limited to manufacturers currently registrable under the Sales Tax

As a new measure, the VAT will also include the taxation of business services such as those rendered by accountants, lawyers, estate agents, business consultants, etc., which will be levied at 17%. It would allow for taxation of services as well as goods and assist the registered business by permitting it to deduct taxes paid on inputs before paying taxes due. Thus a trader would have a tax free inventory while the Revenue Department would collect tax at every stage in the production process. The VAT will become operative from 1st January 1990. To give effect to this measure the VAT Bill is being tabled in Parliament today and I wish it to be one of the first bills to be deliberated upon after the Finance Bill.

Third, exercise books. Mr. Speaker, I am sure that all the Hon. Members are aware of the dedicated efforts of His Excellency the President towards the expansion of Education in the country and his concern for its cost. It is a fact that the cost of educating our children in schools has gone up rapidly in the last few years. One of the items commonly used in schools is exercise books. I therefore propose to provide some relief to parents of school-going children, by removing the sales tax on paper from which exercise books are manufactured and I hope that this measure will keep the prices of such books down.

Fourth, industrial fan blowers. Mr. Speaker, there is an anomaly in that domestic room fans carry a sales tax of 17 % while industrial fan blowers have the unpardonable rate of 100 %. In order to remove this injustice I propose to lower the rate for the industrial fans to the level of 17 %.

Fifth, passenger cars. Over a long period of time, it has been the Government's intention to lower the cost of passenger cars and in the last few Budgets, tax reductions of these cars have been effected. In the present Budget, I have proposed lowering of sales tax as well. In reforming the taxation of these vehicles, Mr. Speaker, I have borne two objectives in mind; first the availability of affordable passenger cars and second the higher effective rate of protection for domestic assemblers and parts manufacturers. While keeping a lower uniform rate of duty on unassembled cars as compared to assembled ones, I have lowered the sales tax rates of cars with varying cylinder capacity so that the combined duty and sales tax on assembled vehicles will lie between 80 and 91 % of the old level, while the reduction for unassembled cars will be even larger, to between 79 and 88 % of the previous combined rates. The Finance Bill being tabled provides the proposed schedule of tax rates by category of cylinder capacity for both assembled and unassembled cars. Mr. Speaker, the proposed reduction is a major concession and I would like to see the prices of these cars lowered. The revenue forgone by the proposed changes is estimated to be about K£ 3.5 million.

Sixth, Buses. Bus transport is the most frequently used means of public transport in this country and over the years, the demand for this mode of transport has grown rapidly. Mr. Speaker, I would specifically like to draw the attention of Hon. Members, to the efforts of His Excellency the President in providing the Nyayo Buses on our roads because of his concern for the welfare of commuting passengers. In support of these efforts last year, I lowered the duty on buses of over 14 passengers from a range of 35 to 45 % to one of 20 to 35 %. Nevertheless, this area continues to be overstrained. In order to make bus transport more available, I propose this year to abolish altogether the sales tax currently standing at 17 % on assembled buses of over 25 passengers. This measure will cost the Exchequer K£ 1.5 million in forgone revenue.

Finally, sodas. Mr. Speaker, I have proposed a number of Sales Tax measures which will provide tax benefits to a number of items. I now propose a tax measure on sodas that will provide some revenue to the Exchequer by increasing the Sales Tax rate by 10 cents per bottle. I have also agreed to allow the industry to charge 5 cents additional per bottle and therefore, from mid-night tonight, the price of sodas will be increased by no more than 15 cents per bottle. This change in sales tax will provide the Exchequer with an additional K£ 5.0 million.

Mr. Speaker, all in all the various measures I have announced on Sales Tax / VAT will provide the Exchequer with an additional K£ 9.0 million.

(d) Local Manufactures (Export Compensation) Act

Mr. Speaker, I would now like to turn to export compensation. I have today published a positive list with several additions which include a number of agro - based processed items in which local value added is extremely high. This will benefit rural urban balance and more importantly, the farmers. This positive list is in the Harmonised System format so it will show members of the public a wide range of potential industries which can profit from this incentive.

(e) Income Tax

Mr. Speaker, I now turn to Income Tax where I have some fundamental proposals to make.

First, as Hon. Members are aware, income tax is paid by only a small proportion of the population. Many are not registered under this tax, especially those in the farming sector. Furthermore, many of those who do pay through PAYE deductions have other undeclared incomes from farming activities. It is now my intention to widen the income tax net so as to get some recompense from those who have benefitted most over the years from government services: the farmers and the traders in agricultural goods. To this end, I have proposed a new measure which will be introduced as a presumptive income tax on selected agricultural produce sales. This tax will be paid by the large number of farmers who have hitherto not been paying the tax. The presumptive tax of 5 % which will take effect on 1st July 1989, will be levied on the value of gross sales of agricultural produce ranging from maize, wheat, rice and barley to tea, coffee and fresh milk. The Finance Bill published today provides the full list of taxable agricultural produce. Since the tax will also affect a number of farmers who have already been paying tax through export duties on coffee and tea, the export tax has been abolished on these two crops with effect from midnight to-night.

Second, there is now a worldwide consensus on the economic desirability of tax reform and tax reduction and in particular the reduction of income tax. Lower rates of tax sharpen up incentives and stimulate enterprise which in turn is the only route to better economic performance. In keeping with this dictum and focusing firstly on the personal income tax, I propose to lower the top tax rate from 50 to 45 %.

Further, in order to enhance equity in our society and provide relief for all income groups, I propose to increase tax relief across the board, increasing the single, special-single and married allowances by 10 %. In addition, I propose to widen the income tax brackets by 5 %. Mr. Speaker, the important feature of these measures is that they will provide relief to all tax payers in the form of a reduced liability so as to offset the effects of inflation while at the same time removing 60,000 tax payers from the income tax net altogether.

Mr. Speaker, with such generous reductions in income tax, there should be no justification for employees to continue avoiding the tax by receiving

benefits which are not fully taxed. Accordingly, I propose to reduce the taxable allowances of employee benefits by 25 %.

Finally, Mr. Speaker, for some time now, my attention has been drawn to what some people consider to be the most sought after fringe benefit in employment by individuals. This is the artificially low interest rate loan benefits provided in some financial institutions, companies and even some parastatals. A loan of one or two million shillings at 3 % rate of interest confers a very large benefit indeed to an employee who would not otherwise be able to borrow anything approaching that amount at less than 15 % in today's money market. Therefore, to correct this position the Bill contains an amendment which clearly makes artificially low interest loans a chargeable benefit of employment. A prescribed rate of interest of 6 % which is well below the market rate, from the year of income commencing on 1st January 1990, is adopted to determine the level of benefit. Anyone obtaining a rate lower than that will be deemed to receive a benefit and therefore liable to tax. The prescribed interest rate will rise over the years until such time that it is equal to the market rate.

Focusing on the corporate tax, a number of countries which compete for investment with us have lower rates. In order to maintain our competitiveness I am proposing to lower the corporate tax rate from 45 to 42.5 %.

Also, as I promised in last year's Budget, I propose to increase the investment allowances in Nairobi and Mombasa from 25 to 35 % and from 75 to 85 % in the case of other municipalities and rural areas.

I expect that these generous incentives will encourage new investment.

Finally, Hon. Members will recall that in the last Budget I had allowed the foreign exchange losses to be a tax deductible expense by a Kenyan enterprise for the year of income 1989. I should, however, have made it clear that there would be no deduction for exchange losses with respect to assets or liabilities purportedly established between a Kenyan branch of a foreign head office or other offices of a non-resident person. I have, therefore, proposed an amendment in the Finance Bill under Section 18(4) to make this position free from doubt.

Mr. Speaker, I will raise some K£ 5 million from the various income tax measures proposed.

(f) Miscellaneous Taxes / Fees

Mr. Speaker, along with the foregoing taxation measures, I have also reviewed miscellaneous taxes affecting Liquor Licences, Hotel and Restaurant Licences, Transport Licences etc. It was noted that many rates had not been revised for four or more years. Given the level of inflation, the proposed tax measure would not be burdensome at all. For example, the Stock Trader's, Auctioneer's and Broker's Licences would be raised by 50 %, while Liquor, Transport, Petroleum and Hotel and Restaurant licences would be doubled. In the case of Hotel Accommodation Tax, bed or bed and breakfast rate would go up from 17.5 to 18 % whereas full board or half board rate would go up from 12.5 to 15 %.

Mr. Speaker, I intend to raise K£ 2.5 million from these changes in miscellaneous taxes, fees and licences.

(g) Export Taxes

As noted earlier, Mr. Speaker, as a result of the proposal to withhold payment of a portion of earnings by coffee and tea farmers, the export tax on coffee and tea is being abolished to avoid double taxation. However, on a number of vital raw materials which are needed for further processing in the country, export duty of 10 % is imposed to discourage their exportation. The Finance Bill, Mr. Speaker, has proposed a tax on the exports of raw cashew nuts, aluminium, brass and copper scrap, raw cotton and waste paper from mid-night tonight.

Mr. Speaker, export duties will provide an additional K£ 0.5 million in revenue.

8. CONCLUSION

In conclusion, Mr. Speaker, this budget is the first since the launching of the Sixth National Development Plan and it is the fourth to continue with the policies laid down in Sessional Paper No. 1 of 1986. In this speech, I have stressed the need for the Government and the private sector to continue to improve on the utilisation of scarce resources through structural adjustment policies, so as to enhance growth through efficiency.

I have reaffirmed the Government's commitment to continue its policy of controlling the budget deficit and to diversify the mode in which it is financed. Through tariff rationalisation and the variety of taxes, I have outlined how I will affect relative prices so as to stimulate the agricultural and industrial sectors, particularly to increase and diversify exports. I have further indicated how through the Jua Kali and the District Development Funds, as well as through generous investment deductions, I hope to encourage small scale industry and stimulate industrial growth in rural areas.

Mr. Speaker, the measures I have outlined today will, I believe, consolidate the gains achieved under our policy of structural adjustment. These have yielded satisfactory growth so far. Indeed they will also encourage more efficient and export oriented production and challenge the highly protected and inefficient sectors of the economy. Mr. Speaker, our economy is being gradually transformed to face a new international trading and financial environment. To sustain our momentum and to prosper in responding to new challenges, Mr. Speaker, we count on the leadership and wise counsel of H.E. the President who has demonstrated so often his commitment to serve this Nation. We should emulate his example by committing ourselves to work together in the spirit of the NYAYO philosophy of peace, love and unity.

Mr. Speaker, I beg to move.

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Mr. Speaker, I beg to move.