SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 12TH JUNE, 1986, BY THE HON. PROF. G. SAITOTI, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE FISCAL YEAR 1986/87 (1ST JULY, 1986 TO 30TH JUNE, 1987)

Mr. Speaker Sir,

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

INTRODUCTION

The Modern Budget occupies a distinguished place in the Government's Agenda for important activities. It is an occasion that affords the Minister for Finance an opportunity to inform the House about the Government's spending plans for the coming year. The annual Budget outlines the Government's spending priorities as well as the financing plans for such expenditures as may be approved by Parliament. The presentation of the Budget is, therefore, rightly regarded as the principal economic act of Government -- it signals the economic direction that the government intends to follow in the short run. But as Honourable Members are plainly aware, the economic well-being of the nation owes far more to the vitality and political foresight of its leadership and the stability of its institutions than to any single act of the Government, however, important. I would, therefore, like to take this opportunity to thank H.E. the President for his untiring efforts in not only ensuring that he attends this occasion, but also because of the importance he attaches to economic issues of this nation. By his personal example, and through the philosophy of Nyayo, he has taught us how to face and overcome the economic misfortunes of a world characterized by political and economic instability. The current economic recovery being experienced to-day in the country is a remarkable tribute to the foresight and courage of H.E. the President. I am sure I speak for all Honourable Members in stating that all of us should resolve collectively and individually to support his efforts.

Mr. Speaker, after 23 years since the attainment of independence, the main concern now rests on economic growth. This can only be achieved through sound management that stabilizes the economy over the short run and promotes vigorous growth over the long term. It is because of our belief in this basic economic philosophy that over the last three years, Kenya has undertaken stabilisation measures aimed at ensuring steady and less inflationary growth. In pursuant of this policy, Parliament recently debated and endorsed Sessional Paper No. 1 of 1986, which provided blueprint for renewed growth. This Budget is a first step in implementing that blueprint, and therefore, takes the same theme as the Sessional Paper -- "Economic Management for Renewed Growth".

Mr. Speaker, I shall first review events in the international economy that bear directly on our ability to achieve renewed growth and then describe Africa's economic situation. Following that, I will review Kenya's economy in 1985 and its prospects for 1986 and beyond. This will set the stage for a discussion of the policy framework, within which this Budget will strive to attain both short-term stabilization and renewed long-term growth. Finally, I will present budgetary outturns and announce specific tax measures for 1986/87.

2. THE WORLD ECONOMY

Mr. Speaker, the fortunes of every country are deeply affected by conditions in the world economy. The state of international markets profoundly influences our ability to stabilize Kenya's economy and to renew economic growth. It is for that reason, that it is important to review recent trends in the international economy.

In 1985, economic growth in the industrial countries remained at satisfactory levels. On average, the Gross Domestic Product of our major industrial trading partners advanced by about 2.5 percent in 1985, a fall from 1984 when these countries grew at close to 4 percent. However, the more modest growth of 1985 was also accompanied by a fall in the rate of inflation, which is running at about 3 percent a year. With inflation largely under control in the industrial world, there is some hope that income growth can be maintained or increased a bit in 1986, with a resulting boost in demand for the exports of developing countries.

However, the slowdown in GDP growth during 1985 caused a more-than-proportionate fall in the growth of world trade. The volume of world exports and imports expanded by 3 percent in 1985. But the value of this trade fell by 1 percent, because the dollar prices of commodities fell by 2.5 percent. Both agricultural and mineral exports declined in value, so that developing countries' export revenue also declined. For 1986, the dominant news in world trade will continue to be the recent decline in petroleum prices. Prices of crude have fallen from the pre-December level of about $28 a barrel to the current North Sea price of about $15. The losses are, of course, concentrated in a few exporting countries. It is estimated that the industrial countries alone could gain by $60 billion in reduced import costs. Non-oil developing countries like Kenya will also benefit, although the benefits are unlikely to be permanent.

Mr. Speaker, over the past fifteen years, the world economy has become a less stable environment in which to manage an economy like Kenya's. Exchange rates have been freed from their fixed rate moorings and now fluctuate quite widely over short intervals. The U.S. dollar, for example, rose by 34 percent against the SDR from the end of 1979 to the end of 1984, after which it fell by 16 percent in the last 17 months.

Industrial world has experienced high rates of inflation during the late seventies and early eighties. The rates of inflation have also varied widely. Wholesale prices, which never rose by more than 3 percent a year from 1955 to 1968, shot up by 7.5 percent a year on average from 1968 to 1984. Interest rates have responded with large swings in response to changes in inflation rates. They have also been at historically high levels in real terms, that is, net of the rate of inflation. The London Interbank Offer Rate for example, reached a peak of 16 percent on one-year Eurodollar loans in 1981, but has fallen to less than 8 percent today.

Commodity prices have always fluctuated widely and continue to do so, with the added burden that these prices have been turning steadily against the non-oil developing countries until very recently. Even the drop in oil prices, which can be so beneficial in promoting more rapid growth for all oil importers, presents new challenges to countries like Kenya. Now that market forces have taken over, petroleum prices may well become unstable. As many developing countries -- importers as well as exporters -- depend heavily on petroleum taxation, this new price flexibility will translate into additional instability in government revenues, making it more difficult to stabilize our economies.

The world economy is plagued by several severe imbalances in the budgets and foreign payments of a few industrial countries. As these governments struggle to restore balance, the smaller economies of the world can only watch and hope that international cooperation will prevail to make these adjustments smoothly, without too much fall-out for other countries. The realignment of exchange rates now taking place may also dampen protectionist pressures against the exports of developing countries.

The foreign debt of developing countries continued to grow last year, approaching $800 billion. For some countries, default is a distinct possibility. But despite the constant threat of excessive debt and the continuing drain of debt service, recent developments in the world economy give some hope to borrowing countries. Both debtors and creditors recognize that major defaults will harm everyone, and attempts are being made to ease repayment burdens. At the same time, the substantial decline in interest rates in recent months gives hope that refinancing can be accomplished on terms that debtors can afford.

In summary, the world economic climate has improved for developing countries like Kenya, particularly because of lower oil prices and reduced world inflation. However, the challenges of world price instability and of debt service will continue to require careful economic management as we seek to renew economic growth in Kenya and other developing countries.

3. AFRICAN ECONOMIES

Mr. Speaker, the economies of Sub-Saharan Africa, hit so hard in the past several years by falling terms of trade and then by severe drought, are also enjoying a spell of good economic news. Rains have been plentiful throughout Africa during the past year and agriculture is recovering. The F.A.O. estimates that in 1986 agricultural output will exceed pre-drought levels. In a recent study of Sub-Saharan countries, the World Bank estimates that the terms of trade will recover in 1986 to roughly the level of the late seventies though still 20 percent below the level of the early seventies.

However, the effects of past instability, of unfavourable world markets, and of the drought still linger on. In 1985, GDP for Sub-Saharan African countries scarcely grew at all and per capita income is no higher than the level achieved in 1960. Because domestic saving has fallen to only 6 percent of GDP and investment to only 14 percent, it will be difficult to renew economic growth for the region as a whole, though individual countries are well placed to do so.

Debt has grown to be a serious problem for Africa as well. It now takes 26 percent of export earnings just to service Africa's existing debt, compared to only 18 percent in 1980. Unless Africa can break out of this vicious circle of decline and indebtedness, the remarkable gains of the last 20 years in health, education and other social services will be put in jeopardy.

To renew growth in Africa will require a number of favourable conditions. First, we must pray that the rains continue to be good in the region and that nothing like the recent droughts repeat themselves soon. Second, we need a long extension of the favourable international economic climate that we have only just begun to enjoy. Third, African governments need to take bold steps to stabilize and restructure their economies, as, indeed, a number have already done.

Finally, we need greater infusions of foreign assistance on much more flexible terms. The World Bank estimates that, over the next five years, at least $2.5 billion of additional aid a year debt relief is required, all on soft terms. The international donor community recognizes this need and is trying to respond in a number of ways, including a proposed substantial replenishment of the International Development Association. The recent extraordinary session of the United Nations General Assembly on Africa's recovery discussed these and other measures to renew economic progress in Africa. But, despite this good-will, African countries will have to rely primarily on their own resources and sound economic management to achieve even moderate growth targets in the foreseeable future.

4. THE DOMESTIC ECONOMY

Mr. Speaker, having described the international economic climate, I now turn to the domestic economy, its performance in 1985 and its prospects for 1986 and beyond.

(a) Economic Performance

As the Hon. Members will have seen from their copies of the Economic Survey, 1985 was a year of moderate recovery from the severe drought of 1984, with outstanding results in employment creation. The economy established a good base from which to launch our drive for renewed economic growth. The quantity of maize production was 71 percent higher in the 1985/86 crop year, and other food crops -- wheat, beans and potatoes -- also rebounded strongly from the drought. But the quantity of marketed coffee declined by 18 percent due to the delayed impact of the drought. In the case of tea, the quantity marketed increased by 27 percent but world prices fell dramatically by 35 percent. The result was that agricultural value added expanded by 3.5 percent during 1985.

Agriculture's recovery made it possible for gross domestic product to rise by 4.1 percent in 1985, which is close to the trend of the past decade. Manufacturing value added grew by 4.5 percent, while construction expanded by just over one percent, the first increase in four years. It is gratifying to see that financial and other services continued to grow briskly, at 5.2 percent in 1985, while public utilities -- electricity and water -- expanded by 4.9 percent, and domestic trade enjoyed a strong surge of 8 percent over the previous year.

Government services continued to grow faster than GDP. However, under our blueprint for renewed economic growth, in the next few years the private sector will have to accelerate its expansion to surpass the continued growth of Government services.

(i) Income and Employment

The expansion of GDP in 1985 permitted a slight improvement in average income, which grew by just 0.2 percent per capita. But when we take into account the effects of falling terms of trade -- due substantially to declining tea prices -- average income fell by 4.5 percent. This just offset a similar rise in GDP per capita for 1984, adjusted for the terms of trade. Nineteen eighty-six should see this indicator rising once again, due to falling oil and rising coffee prices. Mr. Speaker, this dramatically illustrates the effect on Kenya of the instability in the world economy of which I spoke earlier.

One of the bright spots in Kenya's economy last year was the creation of new jobs: wage employment expanded by 4.9 percent. This improvement was shared by all parts of the country. Indeed, the rural areas of the country enjoyed above-average expansion of wage employment.

Averaged over the past two years in order to eliminate the effects of the 1984 drought, wage employment grew by 3.6 percent a year. Government is responsible for much of this growth: employment by Central Government, including teachers, expanded by 7.2 percent a year from 1983 to 1985. Some of this was due to the requirement of the 8-4-4 system for additional teachers. In the private sector, employment grew by only 3 percent a year. To achieve the long-term growth and employment targets of Sessional Paper No. 1, we need to increase the rate at which the private sector creates jobs, so that employment expansion in Government no longer dominates the picture.

The urban informal sector continued to demonstrate its ability to create jobs. Although statistics on the informal sector are inherently uncertain, urban informal jobs appear to have expanded by about 9 percent last year. On average since 1982, the urban informal sector has created additional jobs at the rate of over 7 percent a year. Continued rapid job creation in the informal sector is a crucial element in Government's strategy for renewed growth.

(ii) Saving and Investment

On saving and investments front, Kenyans saved only 13 percent of gross domestic product and invested 19 percent last year. Both levels were substantially below the performance of 1984 when, despite the drought, Kenyans saved 17 percent and invested 23 percent of GDP. Nineteen eighty-five performance was also well below the average for the past five years. Part of the decline was due to much lower investment in inventory, a factor that should reverse itself in a buoyant economy during 1986. In real terms, gross fixed capital formation grew by only 2.5 percent in 1985 and all the growth was due to public sector investment.

I anticipate a surge in both saving and investment by the private sector in 1986, as the economy recovers further and we begin to feel the effects of rising coffee prices and falling oil prices.

(iii) Money and Prices

Controlling the money supply to restrain inflation is a central component of economic management for renewed growth. In 1985, Government permitted the money supply to grow by only 6.1 percent. Since 1982, the money supply has increased by only 9 percent a year on average. In order to encourage private sector growth, Government has reduced its budgetary deficit and, therefore, its claim on domestic credit. In 1985, the public sector as a whole borrowed 31 percent of total domestic credit, and since the end of 1982 has borrowed only 20 percent of the available new credit.

Government's cautious monetary policy did help to restrain inflation during 1985. The average consumer price index rose by 10 percent from December 1984 to December 1985, comparable to the rate for the previous year. Taking all prices, as reflected in the price deflator for Gross Domestic Product, inflation during 1985 averaged 8.5 percent, an improvement over previous years.

(iv) Trade and Payment

Mr. Speaker, Kenya's balance of trade worsened in 1985, as the total cost of imports rose by 9.5 percent while export revenues improved by only 3.2 percent. Allowing for price increases, the quantity of imports actually fell by 7.5 percent, indicating that the recovery was not yet fully under way in 1985. If production and incomes are to grow substantially in the future, some real import growth is essential. The quantity of exports grew by 4.2 percent in 1985. It was a deterioration in the terms of trade, which fell by 16 percent, that caused the balance of trade to worsen.

Net inflows of long-term capital also fell in 1985, so that overall the balance of payments suffered a larger deficit than in 1984, by K£125 million. Nevertheless, Kenya's reserve position remained comfortable: with K£321 million in foreign reserves at the end of the year.

(b) Outlook for the Future

Mr. Speaker, as Hon. Members are aware, good news is hard to contain. Therefore, and as the public already knows, the outlook for the economy is particularly promising in 1986 and 1987. Coffee prices, which averaged Sh. 44/- per kilo last year, have been holding at Sh.70/- or above since January. It is estimated that the effects of a devastating drought in Brazil are likely to keep prices above average levels well into 1987. Moreover, the suspension of export quotas under the International Coffee Agreement will enable Kenya to export larger quantities than ever before. Consequently, we expect revenues from coffee exports to rise by almost 90 percent in 1986.

At the same time, declining world prices for crude oil will reduce our expenditures on petroleum imports. Even allowing for a rebound in the oil price, we expect to spend at least 25 percent less on petroleum imports in 1986 than last year. This, plus an anticipated strong improvement in our long-term capital account should permit Kenya to meet its external debt obligations without recourse to additional external borrowing, and still raise her international reserves by almost 20 percent this year.

We have been blessed with ample long rains again in 1986, the second good year in a row. This should enable farmers to produce good crops once more, extending agriculture's recovery from the drought and stimulating the rest of the economy.

Manufacturing output should also grow faster this year, stimulated by increased consumer demand, the need to replenish inventories, and export opportunities both within the PTA and overseas. The strong balance of payments position will permit us to import sufficient inputs to support growth in manufacturing and other sectors.

These favourable developments should enable Government to earn sufficient revenue to reduce its budget deficit substantially in 1986/87, to below 4 percent of gross domestic product. The decline in both oil prices and the budget deficit, along with continued restraint in monetary policy, will help to counteract the inflationary impact of higher coffee prices. Indeed, we already have excellent news to report on inflation: during the first four months of 1986, the consumer price index rose at an annual rate of only 2.6 percent -- one of the lowest rates experienced in recent years.

Mr. Speaker, we have not enjoyed such a favourable combination of economic events since the mid- 1970s. But we must recognize precisely the nature of this good fortune: it is temporary and not permanent. Coffee prices will probably fall some time next year. Oil prices could well rise within this year.

What we are experiencing currently, and probably in 1987, ar windfall resources that have afforded us a chance to work on our long-term structural problems. If we can manage these resources well, and if we are lucky with good weather and a strong world economy, we can avoid the cycle of a boom with inflation, followed by stabilization and recession.

Mr. Speaker, having narrated our recent economic performance and our economic prospects for 1986/87, in the context of this year's Budget Theme, I now move to the policy framework underlying the Budget.

POLICY FRAMEWORK

Mr. Speaker, the theme of my 1984/85 Budget was "More efficient use of domestic resources." In 1985/86 the theme was "Mobilization of domestic resources for renewed growth." Both budgets introduced policies that made substantial progress towards these goals. But, as we have seen the dominant economic realities of those years, were, first, severe drought; then a satisfactory recovery, and, today temporary windfalls. The crucial task today is to turn these windfalls into the beginnings of sustainable, renewed economic growth. Mr. Speaker, the themes and the tasks of the previous two Budgets remain valid, and are incorporated into the theme of the 1986/87 Budget, "Economic management for renewed growth".

(a) Long-Term Policies

Mr. Speaker, this is the first Budget after the approval of Sessional Paper No. 1 of 1986 by this House. The basic thrust of the Sessional Paper is that economic growth must once again become the fulcrum for all our economic policies. Only by renewed growth, at rates approaching 6 percent a year by the 1990s, can we generate the resources we need to feed, clothe, house and educate our people. Only rapid growth can provide time for Kenya's families to decide on fewer children, and only rapid growth can provide jobs for those children.

More rapid growth is essential to create sufficient employment for another 7 million workers by the end of the century. However, adequate job creation is also the only way to ensure that most of the population benefits from rapid growth.

Underlying both economic growth and job creation is the need for increased productivity. Kenyans save enough, but we do not invest our savings productively enough to generate rapid growth. More productive use of our land, capital, and other resources will generate more growth, more jobs, and higher incomes. The burden for increasing productivity lies with everyone: farmers, private firms, parastatals, individual workers, and Government itself. Let me start with Government.

Over the past several years, Government has concentrated on reducing its expenditures and reducing its deficits. In order not to curtail any investments or services, we tended to spread fewer resources across the same number of activities. Inevitably, productivity suffered. Development projects have taken longer to complete. Once completed, many lacked funds to operate at full capacity, or to operate at all. In addition, the growing numbers of civil servants have had to work with fewer resources.

To correct this situation, Government has adopted a programme of budget rationalization with the aim of managing its own resources in order to contribute more effectively to renewed economic growth. The first goal of Budget rationalization is to concentrate development resources on fewer projects, but to ensure that these are completed in less time and thus begin contributing to development much sooner. For this budget, we have enforced a rule that very few new projects could be started until existing ones have been completed. In the future, we will undertake fewer new projects than in the past. Our second goal is to ensure that the projects we do undertake are the very best we have, that they are highly productive, contributing directly to economic growth or delivering public services at the lowest possible cost.

The third goal of budget rationalization is to ensure that development projects, once completed, have adequate resources to function at full capacity; and to be certain that existing facilities also work up to their capacity. It makes little sense to invest in new projects while existing facilities lie idle. Hence we will direct more revenues towards recurrent expenditures for a time, until we have utilized fully the capacity we already have.

If we achieve these three goals of budget rationalization -- fewer projects, better projects, and more adequate recurrent financing -- then Government will have improved the productivity of its own expenditures, showing the way to renewed growth. Future budgets will move increasingly in these directions as, ministry by ministry, programmes of budget rationalization are worked out.

As part of Government's efforts to make all its expenditures more productive, we have taken important steps within the past year to bring parastatal finances under closer control. All investments by parastatals that are financed in any way by Government or by borrowing under Government guarantee must now be approved within the context of the annual and forward budgets. Even if parastatals are able to finance investments out of their own resources, the projects must be consistent with the stated priorities of the parent ministries before they are authorized. As announced in last year's Budget, we have begun to bring parastatal debt under control by instituting a computerized debt monitoring system and by the introduction last year of a standard parastatal loan agreement. Also as promised last year, the Office of the Auditor-General for Parastatals has been established and the Auditor has already begun his work. Progress has been made in drafting the Government Corporations Bill, which will formalize and extend the new financial and managerial controls over parastatals. The Bill will be published and laid before this House in the coming financial year.

Even though we will improve the effectiveness of Government expenditure, it will be necessary for Government to raise more <u>revenues</u> than in recent years. Revenues have fallen as a percentage of Gross Domestic Product from 24 percent during the early 1980s to 20 percent in 1985/86. The Sessional Paper states a policy of returning gradually to the higher level. As I will announce later, this Budget takes a first step in that direction. In addition, Treasury has begun a major exercise to review taxation policy and administration with a view to increasing revenue. As a result, I expect that in future, the ratio of Government revenues to Gross Domestic Product will steadily increase.

The main objectives of a higher revenue base are, first, to fund the growing demand for Government services, especially in health, education and other basic needs; second, to do this while increasing the share of expenditures going to immediately productive activities such as agriculture and rural infrastructure; and, third, to accomplish all this while reducing Government's deficit as a share of Gross Domestic Product.

Government has already committed itself to gradually decrease the deficit as a share of GDP. The target is to have a maximum deficit of 2.5 percent of GDP, compared to the projected 3.5 percent in 1986/87. A lower deficit will have a number of benefits: Government will be reducing its need for domestic credit, thereby reducing inflationary pressures. The private sector will have a correspondingly larger share of domestic credit, consistent with its expanding role in income and job creation. Government will be contributing to increased domestic saving, helping to mobilize this crucial resource. And, finally, a lower deficit will mean less external borrowing and a reduced debt service burden.

Mr. Speaker, I mentioned earlier that employment creation through economic growth is the central aim of Sessional Paper No. 1 of 1986. Today, almost 80 percent of all jobs are in agriculture and in non-farm occupations in the rural areas. Unless these kinds of employment grow rapidly, we cannot avoid a major unemployment crisis before the end of the century. In this connection, Government's long-standing commitment to rural-urban balance becomes a crucial part of our strategy for economic growth and employment creation. Beginning with this Budget, we will be moving a larger share of Government resources towards the rural economy.

In future budgets, rural infrastructure will have a high priority. But it will be infrastructure focused on the expansion of rural centres and small towns that serve farm communities. The majority of non-farm jobs will emerge in such centres and small towns. District Development Committees will be encouraged to emphasize small-scale infrastructure -- such as urban water supplies, rural electrification systems, and basic site-and service schemes -- that will boost private economic activities of all kinds in the rural areas.

As stated in Sessional Paper No. 1 of 1986, Government will also be seeking innovative ways to channel finance into rural activities. One promising scheme, soon to be implemented, will supply low-cost loans to commercial banks for on-lending to agro-based industries, including some quite small-scale activities. Concessionary interest rates will help the banks to cover the higher costs of small-scale lending to a whole set of customers who, until now, have never been able to borrow from commercial banks. We hope that this programme will become a model for aid donors to channel funds into small scale, rural activities, consistent both with District Focus and with rural-urban balance.

Earlier, Mr. Speaker, I pointed out the rapid growth of employment in the urban informal sector. Well over half of all non-farm workers are engaged in the informal sector, consisting of most self-employed persons and very small firms in manufacturing, trade and other services. The rapid growth of this sector in both urban and rural areas is essential to our strategy of renewed growth because informal activities must create more than half of the new non-farm jobs between now and the year 2000. The informal sector is important to Kenyan's well-being in other ways as well.

Jua kali workshops produce many essential manufactured products at prices that lower-income families can afford; and informal sector traders reach consumers who would otherwise have to expend much energy and valuable time to obtain basic necessities. We will take two immediate steps to promote informal sector growth along the lines suggested in Sessional Paper No. 1, with further measures to be developed during the course of the coming year.

First, Treasury, in consultation with the Kenya Commercial Bank, will develop a credit programme designed to reach very small-scale workshops, manufacturers, traders and others. We expect a pilot scheme to begin very soon. Kenya Commercial Bank will be making loans to informal sector firms using its own resources, but backed by aid funds that will provide a guarantee against default and will cover extra administrative costs. This approach will, we hope get around the problem that banks require collateral that very small firms cannot offer. If this scheme proves successful, we intend to channel more funds through similar programmes.

Second, Treasury will soon establish new tendering procedures that favour informal sector firms in bidding for all Government contracts. These preferential guidelines will apply to Central Government purchases as well as those of the District Development Committees.

Mr. Speaker, as Honourable Members are aware, Agriculture is the heart of Government's strategy to create employment, through growth. Agriculture must pump sufficient income into the system to stimulate growth in other sectors, create the bulk of all jobs, and invigorate the rural economy. In view of the fact that good land is limited, Kenya's large and small-scale farmers must increase their productivity in producing grains, dairy products and other foods, sufficiently to continue feeding our rapidly growing population from essentially the same land area.

The Sessional Paper endorses a long list of measures to ensure that agriculture is truly the engine of Kenya's growth. These range from aggressive efforts to grow and sell more coffee and tea; to intensified research and extension that will help to double the yields of food and dairy crops. These programmes will be worked out in detail during the coming year. One measure which falls within the responsibility of the Ministry of Finance has already been taken: The ceilings on expenditure by the Ministry of Agriculture & Livestock Development have been raised, partly with the help of a new agricultural facility by a major donor. Development expenditures on Agriculture & Livestock Development will be K£19.7 million -- or 29 percent -- above the original ceilings, consistent with the strategy in the Sessional Paper of shifting expenditures towards more directly productive activities of Government in order to renew economic growth.

Within the Budget of the Ministry of Agriculture and Livestock Development, there will be increased emphasis on crop research and on improved extension services for dairy and other livestock production. Payment systems for the major crops will be reviewed and plans will be made to speed up payments to farmers. The increased ceiling, also, contains £5 million to construct grain storage facilities for the National Cereals and Produce Board, increasing storage capacity for cereals and thus improving food security.

As agriculture stimulates growing incomes and employment, we will have the opportunity to reinvigorate industry. I have emphasized the importance of increased productivity in renewing economic growth. Nowhere is this need greater than in manufacturing. Part of the blame for poor productivity rests with economic policies that over-protected our industries during the 1970s. It is easy to overlook the high costs of protection. After all protection leads to investment, to growth, and to jobs. That is high cost to consumers and to other firms, whose costs rise in turn; many of our protected industries add little value; they employ relatively few workers for the enormous investments made in them; few of these firms are capable of exporting; and yet, despite this, many of them are profitable.

In the past three years, we have substantially reduced tariffs on imported inputs. Most of these goods have been shifted to priority import schedules and are now liberally licensed. This has lowered the cost of manufacturing. What now remains is to reduce duties on imports that compete with our own products and to licence these competing imports more regularly than is now the case. These next steps will introduce greater competition and encourage cost reduction by local industry. After two years of substantial changes in import policies, this year the budget contains no major adjustments in tariffs or licensing policy. This year of stock-taking will give manufacturers a chance to respond to the improved import "regime" by increasing their productivity and their competitiveness.

(b) Short-Term Policies

Mr. Speaker, I now turn to the short-term policies which will be implemented during the course of 1986/87 financial year. I have already emphasized the crucial importance of short-term economic management to take advantage of the windfall gains from coffee and oil. The Government has worked out a short-term strategy to save these windfalls for use when prices turn against us once more. By not spending our windfall incomes right away we will stabilize the economy, keeping it close to a gradually rising trend of economic growth.

There are several ways that the Government will save windfall benefits on behalf of the entire economy and thus stabilize the incomes of all Kenyans. First, we shall reduce the budgetary deficit from its current level, close to 4.5 percent of gross domestic product, to below 4 percent based on current price and revenue projections. And if the windfall benefits are larger than we have projected, we will use the extra gains, not to increase expenditures, but to reduce the deficit further.

Second, we shall accumulate foreign reserves. While in the past, additional export revenue was used to increase imports, especially of luxury goods, this time we will permit only gradual increases of imports in line with normal growth trends. The accumulated reserves will be managed prudently to enable the country maintain stable growth in the future.

Third, Government will continue its prudent monetary policy in order to insulate the economy from the inflationary effects of high coffee revenues. In 1986/87, the money supply will be allowed to grow by 13.4 percent over this financial year. One way of off-setting the money supply injection arising from the balance-of-payments surplus is to sell medium-term and long-term Government securities. Therefore, the public as well as banks will be offered, on a voluntary basis, the opportunity to invest excess liquidity in such securities, to be called Treasury Certificates. In this regard, I propose to issue two Treasury Certificates, one with a maturity of two years and the other with a maturity of five years. The second Certificate is primarily designed for insurance companies and other institutions in the long-term capital market, while the first is intended for a broader spectrum of investors -- banks, financial institutions and individuals.

While on monetary policy, it will be recalled that, in 1984, the Central Bank in collaboration with the International Finance Corporation, undertook a study on Kenya's Money and Capital Markets. The Report and Recommendations of this study have now been considered by Government and plans are under way to make the report available to the business community with the view to exchanging ideas on how best the recommendations can be implemented. Since purchase of these new Government borrowing instruments is voluntary, I am proposing to sell them without a pre-announced interest rate in order to let the market indicate how high a return it expects from these securities. However, the Treasury has planned an upper ceiling on interest rates for these borrowing instruments in order to ensure that they are not unduly expensive. With these measures, it should be possible to maintain inflation well below the levels of recent years, especially in light of the very low price increases recorded so far this year.

Mr. Speaker, the coffee and oil windfalls will pump additional growth into the economy during the next year or two. By saving a large part of the windfalls -- and thus stabilizing the economy -- in the ways just described, Government will be restraining that growth somewhat. But the wisdom of this course will be borne out in later years, when coffee prices fall and oil prices recover. Then, against the tendency for a recession, Government will be in a position to boost the economy by spending some of the accumulated reserves and permitting somewhat larger increases in domestic credit. The net result will be a smooth acceleration of growth towards our target rate of 6 percent a year, instead of a boom next year followed by a recession a year or two later.

Mr. Speaker, price controls are one element of our incentive structure that need revision. Experience has proved that excessively strict controls do not serve the basic purpose of providing low-cost goods to consumers, because they reduce the incentive to produce such goods and ultimately lead to scarcities instead. Yet there remains a role for price controls in Kenya, if only to avoid large fluctuations in prices of essential commodities. Three important changes in our price control regime will be implemented with this Budget.

First, a Bill will soon be tabled in this House to establish a Monopolies and Prices Commission within the Ministry of Finance. The new department will continue to administer price controls, but will extend its surveillance to practices that restrain competitive forces in our economy. As we become proficient in halting such practices, competitive forces will emerge as the most effective controller of prices in many industries.

Second, certain non-essential items will be removed from price control. We will continue to review the list of controlled items and take further action as it becomes appropriate.

Third, the Determination of Costs Order, which is the basis for recommending adjustments in controlled price has already been amended and will soon be made operational, after the publication of a Legal Notice. The formula for calculating costs will be expanded to include items that are legitimate costs of doing business, but have been excluded until now.

Finally, Mr. Speaker, we as a nation need to improve Kenya's investment climate and attract both domestic and foreign investment on terms that contribute to renewed growth and employment creation. Three steps will be taken during the coming financial year. First, the Investment Promotion and Advisory Centre has been directed to make recommendations on ways to simplify and streamline the procedures that investors must go through before they implement their projects. Second, foreign investors will now have greater access to loans from domestic banks. They will be permitted to borrow upto the amounts needed to pay any duties on imported capital equipment; and they will be permitted to borrow locally amounts proportionate to the share of equity owned by Kenyan citizens. The Government and, indeed all Kenyans, will expect foreign investors to re-invest substantial portion of their profits for future growth of Kenya. Third, an interministerial committee under the chairmanship of the Ministry of Finance will soon begin a thorough review of the Foreign Investment Protection Act to bring it up-to-date in an era of fluctuating exchange rates and rapid international inflation.

Mr. Speaker, this policy framework will guide Kenya's economic and financial policies in the years to come. It is within this framework that the 1986/87 Budget has been formulated. And it is to this Budget that I now turn.

FINANCIAL OUT-TURN 1985/86

(i) Recurrent Revenue

This year's ordinary recurrent revenue was estimated at K£1,105.4 million plus Appropriations-in-Aid of K£48.1 million making a total of K£1,153.5 million. This recurrent revenue was to comprise of K£270.2 million from Customs and Excise; K£350.0 million from Sales Tax; K£290.0 million from Income Tax and the balance of K£195.1 million from other minor taxes, dividends, charges and fees. Mr. Speaker, I am glad to inform the House that the revised total revenue will now be K£1,139.5 million -- K£34.1 million or 3% above my last year's estimate.

There will, however, be a substantial shortfall in sales tax, but this will be more than over-compensated for by the over-collection of income tax and export duty. This shortfall is mainly due to the sales tax remission granted last year to oil companies because of the appreciation of the U.S. dollar, while the excess export duty is attributable to the high coffee prices which have prevailed since December, 1985. I now expect to raise K£267.6 million from Customs & Excise; K£290.0 million from Sales Tax; K£355.0 million from Income Tax while other minor taxes are expected to raise K£226.9 million.

(ii) Recurrent Expenditure

Turning now to recurrent expenditure, it will be observed that this year's Printed Estimates of Recurrent Expenditure were estimated at K£803.0 million excluding Appropriations-in-Aid. The Consolidated Fund Services were to take another K£345.2 million making a total Recurrent Expenditure of K£1,148.2 million. As the House will recall, there were three issues which necessitated increased Government expenditure, namely, the need to pay farmers on time in light of the good harvest realized last year following the drought of 1984; increased civil service emoluments following the acceptance of the Ramtu Salaries Review Commission Report; and the introduction of 8:4:4 system of education. To meet these expenditures this House approved Supplementary Estimates amounting to K£23.4 million. I had also to finance Excess Votes and Under Issues on prior years amounting to K£30.6 million. Furthermore, Consolidated Fund Services took an additional K£68.6 million for increased debt amortization and interest payments. I, therefore, expect this year's net Recurrent Expenditure to be K£1,270.8 million. However, issues from Recurrent Exchequer are now estimated at K£1,265.9 million compared to the total revenue of K£1,139.5 million. I shall, therefore, have no surplus in the Recurrent Exchequer Account to transfer to the Development Exchequer.

(iii) Development Expenditure

The 1985/86 Printed Development Estimates projected gross expenditure of K£388.8 million including Appropriations-in-Aid of K£101.4 million. Recently, the House approved Development Supplementary Estimates of K£7.9 million. I expect additional Appropriations-in-Aid of K£13.1 million as detailed in the Development Supplementary Estimates, making a total gross Development Expenditure of K£409.8 million. This additional expenditure was occasioned by the need to increase Rural Development Fund and increased expenditure on roads under construction.

However, it is estimated that only K£273.6 million will be issued from the Development Exchequer, (including prior years excess votes and under issues amounting to K£11.5 million).

The overall deficit will, therefore, be K£237.9 million. I expect to reduce this deficit in 1986/87; and it is to this topic that I now turn.

FORECAST OUT-TURN 1986/87

(i) Expenditure 1986/87

Mr. Speaker, as Hon. Members will have seen from their copies of Printed Estimates already laid before the House, gross Recurrent Expenditure of Ministries is estimated at K£1,459.2 million, composed of net expenditure of K£1,420.8 million and Appropriations-in-Aid of K£38.4 million. This estimated Recurrent Expenditure represents an increase of 15.3% over the revised estimated issues for this financial year.

This increase is accounted for by: first, the proposed salary increases for civil servants and teachers as a result of the need to implement recommendations of the Ramtu Commission Report in phases; second, the need to provide increased teachers to cope with the new system of education; and third, increased interest and debt amortization charges.

Development Estimates for 1986/87 call for an expenditure of K£488.9 million including Appropriations-in-Aid of K£196.3 million. This represents an increase of 19% over this year's Revised Estimates. This increase is accounted for by the high budgetary allocations to Ministries of Agriculture & Livestock Development and Energy & Regional Development. The former for the development of the forests tea belt, cotton rehabilitation and provision of adequate extension services and the latter for the development of Turkwell hydroelectric project.

Mr. Speaker, I do not intend to analyse further the details of either recurrent or development expenditures for now. Hon. Members will discuss this in detail when they debate the Appropriations Bill. Suffice it to say I intend to finance a total expenditure of K£1,948.1 million. The rest of my Speech will outline how I intend to do this.

(ii) External Revenue

Mr. Speaker, we in Kenya realise that we cannot develop without the rest of the world. It is for this reason that Kenya under the wise guidance of H.E. the President maintains cordial relations with international community. Every two years, Kenya Government holds consultation meetings with all major donors to review our development projects and development assistance requirements. The last meeting was held in April this year in Paris. In that Meeting, we explained Kenya's economic policies to the donor community and I am glad to report, Mr. Speaker, that the donor community understands and agrees with the policies Kenya is pursuing for the betterment of its people.

As a result of this, both foreign governments and donor agencies have responded favourably to our requests for increased assistance and I would like Hon. Members to join me in expressing gratitude to the international donor community for their positive response to our requests.

Mr. Speaker, I have already indicated that, in our efforts to rationalize the budget, we shall give priority to those projects which promise high returns. Using this criterion, I expect to draw K£354.8 million from external sources. Of this amount, 45% will be in the form of grants and 55% in the form of concessionary project and programme loans. Thus I expect to finance 18% of my total expenditure from external sources. As usual, the main burden of financing Government expenditure will, therefore, rest on Kenyans and I now turn to how I propose to raise the balance of K£1,593.3 million.

(iii) Domestic Borrowing

As I have already indicated, money supply is expected to grow by 13.4% in 1986/87. I have also indicated that, while a major share of this growth will go to the private sector, Government will rely on the Treasury Certificates I have described earlier to raise funds from the domestic market -- mainly from non-bank institutions and individuals. Using this criterion, I propose to raise K£169.5 million from local borrowing. Out of this, some K£50 million will be raised through long-term stocks while the balance will be raised by way of Treasury Certificates and Treasury Bills. An additional K£1.0 million will be raised through sales of Tax Reserve Certificates. Therefore, I propose to raise K£170.5 million by borrowing domestically.

(iv) Internal Revenue

As I have already indicated, the economy is projected to grow by 5% this year. On the basis of this projection, I estimate that, ordinary revenue, at current rates of taxation will provide some K£1,343 million. Appropriations-in-Aid will provide another K£40.0 million making a total of K£1,383.0 million. I have already indicated that I shall draw some K£39.8 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 appraised the House on the world economic situation, the debt crisis facing Sub-Saharan Africa, the state of our economy and its short-term prospects plus the policies we propose to pursue in light of the prevailing situation. I have also indicated that I have a financing gap of K£39.8 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

Over the last three years, Government has reduced substantially tariffs on inputs used by the manufacturing sector. Export compensation has been increased and flexible exchange rate has been maintained. These measures are considered adequate to promote our exports. I do not, therefore, propose further changes this year. As I have already indicated, we should consolidate and take stock of the incentives so far accorded to the manufacturing industry. However, I propose to make changes in the Customs and Excise Act mainly aimed at streamlining tax collection.

First, section 16(2) of the Act provides, inter alia, that where goods imported in transit, or for transhipment, or are as stores for an aircraft or vessel are not prohibited or restricted, then they shall be re-exported within such time and subject to such conditions as the Commissioner may prescribe. The period of re-exportation of such goods has been prescribed under Regulation 96(3) of the Customs and Excise Regulations by the Minister by virtue of section 234 of the Act. The Commissioner's authority does not, therefore, conform to the Minister's prescribed period under Regulation 96(3). I am, therefore, proposing to amend the Act to conform with the Regulations. For similar reasons, it is proposed to amend section 61(2) accordingly.

Second, section 46(2) of the Act requires duties to be paid immediately in respect of goods which will not have been re-warehoused once. However, the law does not prescribe how goods which have not been re-warehoused shall be dealt with. The Department, therefore, keeps on sending the importer demand notes for duty on these goods. Where the importer does not respond within a reasonable time, the Department auctions the goods and pays the importer excess proceeds. This situation has occasioned some importers to deliberately fail to re-warehouse the goods so that Customs and Excise Department may undertake the selling of the goods for him after which he would simply apply for the excess proceeds. This is tantamount to turning the Department into a trading organization with no profits to be made.

Mr. Speaker, Hon. Members will agree with me that selling of goods and giving the owners of these goods excess proceeds is not one of the roles of Customs & Excise Department. In order to discourage importers from according the Department this role, I propose to amend the Act to provide the following -

(a) that where the owner fails to remit duty. within one month or within such period not exceeding three months, as the Commissioner may allow, the goods shall be auctioned.

(b) that all the proceeds realised from such aution excluding Warehouse Keeper's storage charges, shall be Government revenue.

Third, the value of goods imported into Kenya has been defined by section 127 as read with the Seventh Schedule to the Act. However, the Act does not clearly define the value of goods exported from Kenya. The Act simply talks of f.o.b. value. I have received representations from tea exporters to the effect that, for the purposes of export duty, the Department charges duty on duty on the grounds that f.o.b. value on tea must include tax because the tea cannot be free-on-board without export duty being included. Mr. Speaker, I do not think it was Government's intention to charge duty on duty on tea exports. In order to remove this anomaly, I propose to define explicitly f.o.b. value. I also propose to define value for export duty purposes to exclude the duty element.

Fourth, I have already pointed out that coffee export prices have been fairly buoyant since December last year. In spite of this, the Exchequer has not received proportionate revenue from export duty on coffee over the same period. One of the major reasons for this delay in revenue receipts is the fact that the Act does not specify the time within which export duty on coffee should be remitted to the Treasury by the Coffee Board of Kenya. In order to reduce this time lag, I propose to amend the Act to provide that duty shall be paid within fourteen days from the time it was due and collected. The tax rates, however, remain unchanged.

Fifth, the Kenya Post Office Regulations made under the Kenya Posts & Telecommunications Corporation Act prohibit the transmission and delivery of firearms by post. Similarly, it is an offence under section 50 of the said Act to transmit or post articles described as prohibited by Post Office Regulations. Consequently, where firearm or any prohibited article is transmitted by post, the Customs & Excise Department seizes it and hands it over to the Police. In order to make it easier for offenders to be prosecuted under the Customs & Excise Act, I propose to amend the Act to prohibit posting of firearms and ammunition of all types and other articles having the appearance of lethal weapons.

Sixth, on Customs Tariff, I would like to make a few changes on the rates of duty on certain items. First, and as the House is aware, agriculture is the mainstay of our economy. It is, therefore, essential that its productivity be boosted now that normal rains have resumed. In order to assist in this regard, I propose to remove duty on agricultural sprayers and agricultural pesticides imported in bulk. In addition, and in order to boost rural development, duty will be removed on solar modules used to generate energy for irrigation and rural households. It is hoped that the public will take advantage of solar energy to reduce depletion of our forests.

Some of these bonded warehouses are manned by as many as 2 Customs Officers, 2 Examining Officers and full-time Preventive Officers. It is, therefore, clear that the Government is incurring very high cost in controlling these bonded warehouses, not to mention the cost of delayed revenue to the Exchequer. Under these circumstances,it is only logical to require the owners of these bonded warehouses to meet the full cost of their supervision. However, since the cost of control depends on the size and number of entries of each warehouse, it will take time to work out specific cost of each warehouse. Pending the completion of this exercise, I propose to increase licence fees for bonded wareshouses from Sh.5,000/= to Sh.40,000/= per annum with effect from 1st January, 1987.

Finally, duty on capital goods. In his address to the nation on the occasion of this year's Madaraka Day, H.E. the President indicated that a set of incentives will be given to industrialists who establish small-scale labour intensive industries in areas outside the major urban centres. This set of incentives will be by way of customs duty and other tax concessions. H.E. the President further emphasized the need for Government policies and programmes to be implemented speedily. In furtherance of these objectives, I propose to grant duty concessions on industrial machinery, upto a maximum c. & f. value of Sh.1.0 million intended for small-scale industries being located strictly in the rural areas.

Mr. Speaker, this is a major tax concession and those who will enjoy it must fulfil the policy objectives for which it is intended. It must be clearly understood that the main objective is to create new industrial growth centres across the country in order to reduce the influx of job-seekers into the major urban centres where provision of basic services is already constrained by over-congestion.

In order to ensure that these policy objectives are met, I am proposing that this duty concession be graduated into three levels as follows -

(a) No duty concession will be granted for industries being located within the municipalities of Nairobi and Mombasa.

(b) A 50% duty remission will be granted for those industries being established within 20 km. of the boundaries of Nairobi or Mombasa and for industries located in, and within, a 10 km. radius of towns which had more than 20,000 persons enumerated in the 1979 census.

(c) Industries locating themselves any where else in the Republic will enjoy 100% duty remission.

Mr. Speaker, a Legal Notice will be published giving the foregoing remissions. Those investors who would like to take advantage of this concession will, however, be required to apply to the Treasury for each specific case. In order to ensure that this concession is not abused by those who are intending to invest in the major urban centres, the Government will work out a surveillance machinery which will include the respective District Development Committees.

Mr. Speaker, the measures I have announced on customs tariff will provide an additional K£1 million in revenue.

(b) Excise Tariff

Mr. Speaker, I would like to make two minor changes in excise tariff. First, excise duty on spirits is payable before the spirtis are compounded into the popular drinks of gin, whisky, vodka, etc. However, duty on other excisable goods like cigarettes, beer, and sugar is payable 21 days after the end of the month in which sales are made. I have received complaints from spirit manufacturers to the effect that the current law discrimanates against them. I agree with them. I am, therefore, amending the Act to put spirits on equal footing with other excisable goods.

Second, cigarettes and tobacco. As I indicated last year, revenue from these luxurious commodities should be kept in line with the domestic rate of inlation. I have also indicated that the rate of inflation is declining. With this in mind, I propose to raise the levels at which current rates of excise apply by an overall weighted average of 11 percent. In addition, and in order to increase Government's share of the income accruing to B.A.T. as a result of the former measure, I propose to increase the rates of excise duty on cigarettes and tobacco by an average of 3.2 percent. These measures will have the effect of increasing the price of some popular brands of cigarettes such as Nyota, Rooster and Ten Cent by 50 cents per packet, Sportsman and Embassy by Sh.1/= per packet, and the expensive brands of Rex and State Express by Sh.2/= and Sh.1/50 respectively. Out of the increased income arising from these measures, the manufacturer and traders will receive 31 percent while the balance of 69 percent will go to the Exchequer.

These measures on excise tariff which take effect from midnight will provide the Exchequer with an additional K£7 million in revenue.

(c) Sales Tax

Mr. Speaker, I now turn to sales tax. First, unlike the Customs and Excise Act, the Sales Tax Act has no provisions enabling the Commissioner to seize taxable goods being sold without payment of tax. Indeed, the Commissioner does not even have powers to seize such goods as exhibits to be used as evidence when prosecuting a manufacturer who does not comply with the law. In the absence of such powers, compliance with the law depends on the goodwill of the manufacturer. There have been situations where Sales Tax Inspectors have found wholesalers in possession of taxable goods but with no evidence that tax has been paid. In order to enable Sales Tax Department to deal with wholesalers who connive with manufacturers to evade tax, I propose to give the Commissioner powers to seize taxable goods on which he has reasonable cause to believe that tax has not been paid. This provision will only be used for direct purchases from the manufacturer and not purchases from retailers. With these powers, I am confident that the Department will be able to enforce compliance with the law by enabling it to countercheck the manufacturer's records with those of their wholesalers; comparing the tax paid with the value of the physical goods; and by being able to seize taxable goods sold without payment of tax.

Second, and unlike both the Customs & Excise Act and Income Tax Act, the Act does not give the Commissioner powers to compound offences even where a manufacturer agrees that he has committed an offence. In order to speed up tax collection while meting out appropriate penalties to offenders, I propose to give the Sales Tax Commissioner powers to compound offences.

Third, I have already alluded to the importance the Government attaches to the health of our population. It is for these reasons that insecticides are exempt from sales tax. However, mosquito coils are taxable. Hon. Members will agree with me that, mosquito coils are essential for the prevention of malaria. I, therefore, propose to remove tax on mosquito coils in order to put them at par with other insecticides.

Fourth, fencing nails. The House will recall that, last year, I removed tax on roofing nails in order to assist construction of classrooms for the 8-4-4 system of education. However, fencing nails remained taxable. In order to give some boost to agriculture, I propose to exempt fencing nails from tax.

Fifth, Mr. Speaker, I have already indicated that education is taking a very large share of Government expenditure. It is also equally true to say that it is taking a large share of the parents' incomes. It is with them in mind that I propose to abolish sales tax on two of the basic requirements in schools, namely exercise books and writing ink which are subject to tax at the general rate of 17%.

Sixth, photographs. I am sure Hon. Members will agree with me that printing and developing photographs is a form of manufacture. We also know that some of the popular studios have turnovers exceeding not only the Sh.200,000 required to qualify for sales tax registration, but also higher than that of small industries which pay tax. I, therefore, propose to make photographs taxable. However, in orderto ensure that tourists and returning residents are not inconvenienced by Customs over photographs of sentimental nature, no tax will be charged on imported photographs.

Seventh, cassettes. Currently, gramaphone music records are not taxed while pre-recorded cassettes with the same music are taxed at the rate of 35%. However, there is widespread illegal recording popularly known as piracy in the music industry and which makes it difficult to collect tax on pre-recorded cassettes. Thus, although there are numerous recorded cassettes on sale in the market, revenue from this industry is minimal. To reverse this position, I propose to raise tax on all types of cassettes, blank or recorded to 100%.

Eighth, yarns. Mr. Speaker, the only yarn liable to tax is that which is packed in retail packs of up to 125 grammes. Manufacturers have resorted to making retail packs of 126 grammes and above in order to avoid payment of tax. This is obviously a cunning way of beating the law. In order to close this loophole, I propose to make all sizes of yarn taxable.

Ninth, textile industrial machinery. Those who were Members of this Hon. House five years ago will recall that sales tax was removed on capital machinery in order to reduce costs of investment in manufacturing. Inadvertently, textile industrial machines were left taxable. To put those who want to invest in textiles on equal footing with other manufacturers, sales tax on textile industrial plant and machinery will be abolished.

Tenth, fruit juices. For some time now manufacturers of fruit juices such as Tree Top, Pineapple Juice, etc. have complained to the Government that the rate of tax of 35% on these juices is very high considering that these are not only price controlled but collection of fruits across the country is a very expensive operation to these manufacturers. This situation has forced them to rely on imported fruit concentrates to maintain their production. I have considered their representations, and particularly the need to encourage them to use domestically produced fruits as their raw materials and I am, therefore, reducing the rate of sales tax from 35 percent to the general rate of 17%. As a result of this tax reduction, the price of a bottle of Tree Top will be reduced by 60 cents, with pro-rata reductions in the prices of other fruit juices.

Eleventh, petrol, I have already mentioned that the price of crude oil has considerably dropped from the levels prevailing last December. In order to ensure that windfall gains accruing from this reduction in crude oil prices do not go to boost the profits of oil companies, Government has taken three actions: first, the sales tax remission of 49% granted to oil companies last year to compensate them for the appreciation of the U.S. dollar was reduced by half on 15th February, 1986. Second, by 31st March, 1986, the entire remission was revoked.

Finally, on 1st April, 1986, consumer prices were reduced and additional sales tax imposed by way of The Sales Tax (Amendment) Bill, 1986, which was tabled in this House but not debated. Government has continued to monitor these prices, and, although the situation continues to be very fluid, there has been a slight reduction since the Sales Tax (Amendment) Bill, 1986, and its Provisional Collection of Duties and Taxes Order were published. In light of this reduction in crude oil prices, I propose to increase sales tax on petroleum products as folllows:-

(a) Firstly, white oil products like premium, regular and illuminating kerosene will attract an additional sales tax of 15 cents per litre.

(b) Secondly, black oils like industrial diesel and fuel oil which are currently tax exempt will now attract tax at the rate of 75 cents and 38 cents per litre respectively.

(c) Thirdly, bitumen will now be taxed at the rate of Sh.500/= per metric tonne.

(d) Finally, in view of the high cost associated with transportation, storage and marketing of LPG, I propose to adjust tax on it.

In spite of these increases in sales tax on petrol, there will be no change in consumer prices. It will be noticed that I did not increase tax on diesel. This was deliberate. The increased tax which would have gone to diesel will now be passed to the consumer. Accordingly, retail pump price of diesel will be reduced by 15 cents per litre with effect from midnight. Mr. Speaker, let me hasten to add that should the price of crude oil rise beyond the current level, the public should expect to pay more for petrol.

Mr. Speaker, my last measure on sales tax will be on beer. Those who are still with me must be wondering how I propose to close the gap I mentioned at the beginning with the several concessions I have so far given. In view of the improved economic conditions, beer consumption has increased considerably. I expect consumption to increase even further in 1986/87. In light of this, and the need to ensure that Exchequer maintains a fair share of this increased revenue to Kenya Breweries Limited, I propose to raise the rate of sales tax on beer by 90 cents per litre. No price increase will be given to the company. This measure will have the effect of raising the price of the half-litre bottle of Tusker, White Cap and Pilsner by 45 cents with pro rata increases in other sizes.

Taken together, the changes in Sales Tax I have announced this afternoon will provide the Exchequer with an additional K£24.75 million. They will take effect from midnight tonight.

(d) Income Tax

Mr. Speaker, I shall now turn to Income Tax where I have four changes to make.

First, resolution of tax in dispute. Many tax systems require that an annual return of income issued to the taxpayer be returned to the Department within the stipulated period of time to enable timely assessments and payment of annual tax. Default in making such returns on time continues to be distressingly common forcing the Income Tax Department to issue numerous estimated assessments which in turn require such assessments to be resolved through the appelate system. What is worse is that the law as presently worded requires those assessments and tax so disputed to remain in abeyance until such appeal is determined at all possible stages./

Mr. Speaker, it is my determination to discourage these tax manipulations. From now on tax will be stood over until the first determination of that assessment by the Local Committee. After this stage, the taxpayer must pay all tax assessed even if he wishes to appeal to the High Court or the Court of Appeal. If he wins his appeal, the overpayment will be refunded to him quickly and expeditiously.

Second, investment deduction. Last year, I accepted a proposal put to me that Investment Deduction which is given to industries setting up new factories outside Nairobi and Mombasa be increased by raising the deduction from 20% to 50%. The purpose of the measure was to encourage rural industrialisation even more vigorously. I hoped then and still do that investors will take advantage of this amendment.

One unfortunate effect of the measure, however, is that it results in a bias towards investors who choose assets with short lives as opposed to those assets with long lives. Obviously, I cannot allow such a bias to subsist. Investors must be encouraged to choose the most efficient investments and not the least efficient in the interest of our economy. This means I am afraid, that I must remove the double deduction given both as an investment deduction and regular capital allowance on the same assets. From now on, Investment Deduction of 50% will count towards the determination of the written down value of those assets that quality for normal wear and tear and, therefore no asset can be depreciated over 100% of its cost.

Third, interest deductions. Currently, interest charges on funds raised to buy debt or equity investments to earn dividends, interest, capital gains or annuity income can be deducted without limit. Given that many classes of interest as well as capital gains are exempt from tax, this unlimited deduction can result in net subsidy at considerable cost to tax revenues.

I propose to restrict interest charges under Section 15(3)(a) to the amount of investment income being interest and dividend included in the taxable incomes. I shall, however, allow any excess interest charges to be carried forward to the extent that this limit is not met in future years.

Finally, Housing Development Bonds. For some years now, I have supported the idea of Tax Free Housing Development Bonds in the hope that this measure will serve to promote private housing. Any taxpayer, including companies and trusts were permitted to earn interest upto Sh.60,000/- per year tax free provided that investment was made in Housing Development Bonds. A recent study carried out to find out how effective this tax incentive has been in promoting housing development has produced discouraging results. It has, for example, shown that individuals are investing in these bonds in various names in order to avade tax. Indeed, the study suggests that the measure is highly tax regressive.

To reduce the tax cost and some tax abuse associated with the Bonds, I have decided that the Tax Free Housing Bonds will be restricted to individuals only. This means that companies and trusts will not be permitted to invest in the Bond. In order togive time for any investors affected, this prohibition takes effect from 1st January, 1987.

Taken together, these measures on income tax will provide the Exchequer with an additional K£5 million in revenue.

(e) Export Compensation

Mr. Speaker, I would now like to turn to export compensation where I propose to make significant changes. Currently, the Act lists items which are subject to sales tax but not eligible for compensatory payment, and those exempt from sales tax but eligible. All other items which are subject to sales tax are, by implication, eligible for compensatory payment provided they meet other criteria spelt out in the Act. Therefore, for a manufacturer to know whether his products are eligible for export compensation, he would have to examine both the Sales Tax Act and the Local Manufacturers (Export Compensation) Act. This procedure is cumbersome, and exporters have complained to me about lack of an explicit list of items which are eligible for compensatory payments.

In order to fulfil this important need, I have today published a positive list of all items which will henceforth be eligible for export compensation. In drawing up this list, I have taken into account the need to increase domestic value added on our exports; the need to avoid a loophole where one may import a product and re-export it to earn compensation; and the need to make the list small and workable.

Taking into account the foregoing considerations, I have managed to reduce the number of items which are currently eligible from about 2,000 to approximately 700. A large number of items which were eligible have now been struck out of the list and a few others added to the list. Exporters of those items which have been removed from the list will not be paid compensation for exports leaving the country after midnight tonight. However, they shall be paid compensation for previous exports. Those who strongly feel that, on the basis of the criteria which I have just outlined, their products should be eligible for compensatory payment, will be given a hearing. To facilitate this, I have provided Form E.C.I. which will be used for such applications. I have also directed the Commissioner for Customs & Excise to make available to the apllicants detailed criteria for qualification. Such applications will be considered by an Interministerial Committee of Treasury, Ministry of Planning & National Development and Ministry of Commerce & Industry.

Mr. Speaker, there have been cases where some unscrupulous exporters have claimed export compensation on goods which never left the country. In other words, there have been fraudulent cases perpetrated by those involved in documentation and payment of export compensation. In such cases, the law provides that the culprit shall not only refund the compensatory payment made to him but will also be liable to a fine of up to Sh.50,000. In order to discourage such misguided individuals, I am amending the law to provide that, where one is convicted of such an offence, he will pay back to the Commissioner twice the amount paid to him and a fine of up to Sh.100,000.

Since export compensation claims are paid to commercial banks who in turn credit their customers with these receipts, commercial banks and exporters will be held jointly responsible for any fraudulent claims certified by and paid to them. Therefore, it will be both the banks and exporters who will be liable to refund to the Commissioner twice the amounts paid to them. It is, therefore, hoped that banks will now exercise greater care in certifying these claims so as to eliminate these fraudulent activities.

Finally, on export compensation, the Act makes exports with less than 30 percent domestic value added ineligible. However, some exporters continue to claim compensation on ineligible goods by inflating their costs in order to qualify. This practice is equally fraudulent and should be curbed. Accordingly, I am amending the Compensation Claim Form to provide that the exporter must certify that domestic value added is not less than 30 percent. Where an exporter fraudulently certifies so in his claim, he will be subject to the penalties prescribed in the Act.

The reduction on items currently eligible for export compensation will save the Exchequer some K£2 million in revenue.

(f) Hotel Accommodation Tax

Mr. Speaker Sir, despite the measures we have taken in the past few years, some hotel keepers continue to employ tax avoidance tactics. They do this principally by either not issuing receipts or by falsefying the records they keep. The records submitted for the assessment of tax are deliberately understated by omitting part of the receipts. As a result hotels with 30 to 60 rooms have been shown to pay as little as Sh.400 per month.

They have been able to do this because under the existing law the Controller of Inland Revenue cannot estimate the tax once the hotel keeper has submitted his records. Mr. Speaker Sir, there are some hotel keepers who claim to be receiving less revenue than the rent they pay for the premises. To close this loophole, I propose to amend the Hotel Accommodation Act in order to give the Controller of Inland Revenue powers to estimate the tax where he has reasonable cause to believe that the records submitted to him are not true and correct. Where the records are found to be incorrect, the Controller will estimate the tax to the best of his judgement and the hotel keeper will still be liable to other penalties for his failure to submit correct returns. This tightening measure will provide an additional K£500,000 in revenue.

(g) Miscellaneous Licence Fees

Mr. Speaker Sir, the licence fees paid by brokers, under The Brokers Act were last increased in 1981. During this period, the cost of processing such licences has risen in line with the increased costs of paper, printing and labour wages. In order to avoid processing of such licences being subsidized, I propose to increase the licence fees from Sh.200/= and Sh.600 to Sh.400/= and Sh.1,200/= respectively. For similar reasons, I propose to increase licence fees paid under the Methylated Spirits Act from Sh.200/= and Sh.20/= to Sh.400/= and Sh.50/= respectively, while doubling those payable under the Auctioneers Act.

These minor increases in fees will provide an additional K£50,000 in revenue.

(h) Building Societies

Mr. Speaker, last year, I proposed minimal licence fees for building societies and these were imposed following the enactment of the Building Societies (Amendment) Act, 1985. However, I continue to be concerned about the low level of capitalisation of some of these Building Societies, notwithstanding the fact that they have managed to pay their licence fees for this year. I am also convinced that the Act requires to be harmonised in order to fit these societies into the financial system. In this connection, a study will be undertaken to harmonise their operations with those of other deposit-taking institutions, remove ambiguities which seem to be affecting them, and ensure effective supervision of their activities. This study will be undertaken soon and appropriate recommendations will be made to Government for consideration.

However, pending the outcome of the study, there is one amendment I would like to make to-day. The Act requires Building Societies to send their Annual Accounts and their Notice of Annual General Meeting to each of their members. Previously, there was no such requirement. I have received complaints from these Societies that this requirement is making them incur very high costs in printing and postage where there are thousands of members. In either case, this cost is unwarranted because majority of the members do not attend A.G.M. nor understand accounts. I agree with these objections and, to alleviate the problem, I propose to amend the Act to provide that these Societies should publish their Notices of A.G.M. and audited Annual Accounts in the newspapers as is the case for banks and financial institutions.

(i) Hide and Skin Trade Act

Mr. Speaker, the Hide and Skin Trade Act imposes export cess on hides and skins depending on the extent to which they have been processed. The higher the level of processing, the less the rate of cess. The intention behind imposition of export cess was to discourage their exportation and therefore provide adequate raw hides and skins to local tanneries.
Unfortunately, the farmers have turned out to be the losers in this arrangement. In view of this disincentive to export raw hides, local tanneries have taken advantage of the situation by either refusing to buy or offering unbelievably low prices to the farmers for their hides and skins because the later cannot export due to the high export cess. Local tanneries have therefore been making exorbitant profit margins at the expense of the farmer. In order to discourage this deliberate exploitation of the farmers, I propose to abolish export cess on hides and skins. The abolition will cost the Exchequer some K£500,000 in foregone revenue.

Mr. Speaker, taken together, the new taxation measures I have announced today will provide me with an additional K£39.8 million, thus closing the gap.

Mr. Speaker, it is Government policy not to tax food and there is no intention to do so in the foreseeable future. Increased food prices are occasioned either by increased costs of imported raw materials over which Kenya has no control, or the need to give incentives to our farmers to produce more. It is only by encouraging the farmers to produce food at a faster rate than that of our population growth that Kenya can avoid food shortages as has been experienced in certain countries. However, although Government has continually emphasized this point, it is unfortunate that price increases on basic esential commodities are wrongly regarded as "Mini-Budgets", even by some Hon. Members of this House.

Mr. Speaker, coincidentally with the presentation of this Budget, the price of the raw materials used in the manufacture of edible fats and soaps have dropped. As a result of this, I would like to give a small concession to consumers of edible fats and soaps. The main raw material for the manufacture of these products is palm oil whose price has dropped slightly over the last three months as a result of bumper harvest in the producing countries. Taking this into account, I propose to reduce the price of Kimbo by Sh.1/70 for the 500 gm. tin and that of Lux and Rexona by approximately 40 cents with pro rata reductions in other sizes of Kimbo and types of soap. However, because of the small margins enjoyed by retailers of these products, I have directed the Price Controller to effect these reductions within the next eight days. In the meantime, and pending the Gazettement of these reductions, I have to-day published a Legal Notice reducing the ex-factory price of edible fats.

CONCLUSION

Mr. Speaker Sir, fostering an economic framework which promotes sustainable growth and provides employment opportunities is the biggest challenge currently facing this nation. In the short run, the international economy is providing two windfall gains: lower oil prices and higher coffee prices. These have provided the Government with breathing space to consolidate the stabilizarion efforts of the last five years and formulate a policy framework for 1986/87 and beyond. Accordingly, the Government has established short-term monetary and fiscal policies to stabilize the economy. With economic stability in place, the Government is now in a position to devote more attention to Kenya's long-term economic problems, following the approach of Sessional Paper No. 1 of 1986.

In furtherance of these objectives, I have to-day increased budgetary allocation to agriculture as the mainstay of the economy; taken the first steps towards budget rationalization; accorded increased fiscal incentives to labour-intensive industries locating themselves in the rural areas in order to improve rural-urban balance; given fiscal and financial incentives to the informal sector in order to encourage self-employment; and initiated moves towards the development of money and capital markets.

I have also drawn the attention of the House to the important role played by the stabilization programme which Kenya has undertaken over the last three years. This programme has been very successful and it is mainly because of the stabilization achieved to-date that Kenya is in a position to take advantage of the now improved terms of trade. We must, therefore, continue to ensure that the underlying measures necessary to maintain sustainable growth are not overlooked in the face of temporary favourable conditions like the ones we are enjoying today.

It is because of our adherence to this economic philosophy that, in spite of the very difficult conditions we have faced in recent years, Kenya is still able to provide its population with basic needs at reasonable cost. Mr. Speaker, we could not have achieved this success without the understanding, dedication and wise guidance of H.E. the President. He has demonistrated his commitment to serve this nation and we should emulate his example. We can only do this if we are all committed to work together to the best of our abilities in the NYAYO philosophy of peace, love and unity.

Mr. Speaker, I beg to move.