SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 13TH JUNE, 1985 BY THE HON. PROF. G. SAITOTI, MINISTER FOR FINANCE AND PLANNING, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDCET FOR THE FISCAL YEAR 1985/86
(1st. July, 1985 to 30th June, 1986)

Mr. Speaker Sir,

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

## I. INTRODUCTION

Over the last twenty-two years since our nation attained Independence, the people of Kenya have demonstrated their capacity to handle successfully, numerous challenges which have faced them. The most recent, and indeed the most severe, was the drought of 1984. Mr. Speaker, I am sure I speak for all Honourable Members, and indeed the Nation, in paying tribute to those who prevented the drought from turning into a major national disaster: our Government led by H.E. the President which moved swiftly and effectively to purchase and distribute grain; friendly donors whose generous contributions consisted of grains and funds for food supply; our farmers whc responded to the long rains with their usual energy and enthusiasm, and all the people of Kenya who bore their trials and tribulations with patience and calm. We should above all thank God Almighty for giving us adequate rains this year.

Mr. Speaker, as we disengage our attention from this recent challenge, there is need to look forward to some long term challenges which must be overcome if Kenya is to resume its development into a more self-reliant and prosperous nation. Our basic economic objectives remain as they have always been since Independence -- to improve the welfare of all Kenyans. To achieve this, we need a resumption of rapid economic growth, the benefits of which must be widely and equitably distributed.

Two fundamental needs underlie all economic policy in Kenya today. First, the need to get the economy growing again. Second, the need to sustain this growth over a long period to enable the economy to accommodate a much larger population at the end of this century at a reasonable standard of living. A long period of vigorous growth -- considerably faster than the growth in population -- is essential if our economy is to generate sufficient resources to increase the incomes of all our people in Kenya; provide education, better health, water supplies and other basic needs; and begin to reduce heavy dependency on foreign assistance.

As I stated in my budget speech last June, the economy was at last pulling out of the recession which had started during the 1979 oil crisis. We then were looking forward to renewed growth, but as I also warned in that speech, the failure of the long rains was going to put a strain on the economy. We successfully surmounted the adverse effects of the drought. Indeed, we are greatly encouraged by the fact that our capacity to bear this burden was greatly strengthened by the constant support and guidance of H. E. the President. I am sure Hon. Members will join me in paying tribute to H. E. the President for steering the Nation through the crisis and for his continued enlightened guidance of this Nation.

In spite of these setbacks, I believe the economy is in a good position to recover from the drought, put other problems behind us, and launch a period of economic progress as laid down in the Development Plan, 1984-1988. In that connection, we hope to achieve the growth targets set for the last three years of the Plan, that is, 5.3% per year. To achieve that target, it will be necessary to mobilize domestic resources more effectively for investment, to direct those investments in more productive undertakings; to increase utilization of the already installed capacity; and to resume economic growth in an environment of stable prices. Hence, the theme of my Budget message today is "Mobilization of domestic resources for renewed growth". It is my hope that as a result of the measures I shall announce later today, Kenyans will seize the opportunity to save and utilize our scarce resources for economic recovery.

THE INTERNATIONAL ECONOMY

Mr. Speaker, during 1984, the industrialized countries experienced an extension and intensification of economic recovery, especially the United States, where Gross National Product grew by almost 7%. However, the effects of American growth were not widely shared. Although Japan enjoyed growth of almost 6%, Europe's recovery lagged, with just over 2% growth, and the OECD countries together expanded by just under 5% in 1984. With a significant slowdown already underway in the United States, we expect less expansion in 1985, perhaps with an overall rate of growth of 3% for the OECD economies as a whole. Thus the industrial countries will probably not provide the conditions for a developing country export boom this year.

An encouraging aspect of the recovery has been the continuing control of inflation. Consumer prices increased by only 3.3% in the United States during 1984, despite the strong economic expansion, and by 5% for the OECD countries as a group. Price increases are expected to remain moderate for this year and next, reducing the impact of imported inflation to the developing countries.

Commodity prices, helped by the economic recovery, rose by 2.6% during 1984, but remain 14% below the 1980 level. Coffee and tea were among the strongest commodities last year: coffee prices rose 10% on average and were 6% above their 1980 level, while tea prices surged ahead by 50% in 1984, and were 54% above the 1980 average.

Exchange rate movements, especially of the U.S. dollar, have been headline news for several months. The dollar gained 8% in weighted average terms against American's trading partners during 1984, and has enjoyed a remarkable 44% gain since 1980. Despite the recent weakness in the dollar, it has maintained its strength to date. The dollar's strength, together with the U.S. economic recovery, have provided an export boom for those countries able to sell in the American market. These include several newly industrializing developing countries, but has been of less advantage to primary exporting countries like Kenya.

The dollar's surge carries two dangers for developing countries. First, it has raised the spectre of protectionism in the U.S. and Europe, as American industries face increasing import competition. Second, in world currency markets, what goes up generally comes down, and sometimes rapidly. The fear of a steep drop in the value of the dollar makes markets potentially unstable. For developing countries, it becomes difficult to plan policies that affect, or are affected, by international trade and foreign exchange markets.

Financial markets have continued to be influenced heavily by the American budget deficit, which was equal to 5% of gross national product in 1984. The U.S. Prime bank lending rate averaged 12% in 1984, as government competed for available funds. This was below the 1981 high of almost 19%. However, inflation was also lower and so the real cost of borrowing, at 9.7% was actually higher in 1984 than in previous years. Interest rates in other markets reflected the U.S. situation, making borrowing expensive for developing countries.

The debt problems of developing countries, which reached a climax in the early 1980s, eased somewhat last year. The larger debtors, especially in Latin America, undertook strong stabilisation measures to reduce domestic spending and increase exports. Some had substantial success. But with interest rates remaining high in real terms, rescheduling and other forms of debt relief left a heavy debt burden on developing countries and restricted effective access to capital markets.

Export receipts of developing countries increased by 9% last year, but were only 10% higher than the levels attained in 1980. With import prices now 7% lower, there has been a 17% gain in the purchasing power of exports since 1980. But this is not sufficient to finance the import costs for satisfactory economic growth. The expected decline in economic growth in the industrial countries this year and next holds little hope for major gains in developing countries' exports.

The economies of developing countries are so diverse that few, if any, generalizations apply to them all. The little information available for 1984 suggests that the newly industrializing countries in Asia and Latin America probably fared well last year, while the oil exporters suffered sharp reversal and were forced to retrench. The majority of developing countries are still primary product exporters for whom world markets are certainly better than in previous years, but whose economies have on average gained only modestly in 1984.

Mr. Speaker, I would like to go out of tradition and briefly review the economic conditions facing sub-Saharan Africa. Last year, drought was the dominant concern in Africa south of the Sahara. The Food and Agriculture Organization lists 21 countries as affected by drought, of which 15 have been struck by drought for two consecutive years. Six of these have been acutely hurt by drought. For these 21 countries, grain output in 1984 was 21% below the average of the previous 5 years. These statistics cannot convey the human suffering caused by drought, nor suggest the long-term deterioriation of people's well-being or the depredations to their land and environment. Drought in Africa has truly become a major world problem.

For these countries, the trend in both exports and imports has been downward since 1980. Drought has hit exports from many countries and therefore reduced their purchasing power for imports. This decline has been an important factor for the very poor performance of African economies. For Sub-Saharan Africa as a whole, average income per capita has actually fallen by 4% since 1970; taking just the oil-importing African countries, the decline has been twice as great, i.e. 8% over the same period. Now that oil prices have stabilized, and if the drought ends in most countries, it will still take major and sustained efforts by the people of Africa and their Governments, as well as substantial help from their friends overseas, to revive their economies.

Mr. Speaker, much has been said and written about the plight of Sub-Saharan Africa. Both the World Bank and the Economic Commission for Africa Conference of Ministers have recently produced reports which present a realistic assessment of the alarming prospects facing the continent in the next decade. In order to avoid disaster, these reports call for efficient use of resources; greater donor support and flexibility of aid commitment and disbursement procedures; better utilization of existing infrastructure and increased net capital inflows to the region to at least the 1980-82 level.

While the donors have responded generously to help overcome the drought, the level of net aid to Africa, which reached a peak in the early 1980s, is forecast to fall to less than half that level during the next two years. The World Bank has undertaken an important initiative to halt this downward drift of net aid flows to Africa by establishing a special fund for African development. The Bank has met with initial success, although to date, not all donors are participating. I would like to take this opportunity to express our gratitude to the Bank for establishing the Fund and to those donors who have generously responded to this worthy cause.

I would also like to point out that the crisis confronting Africa needs to be addressed urgently if Africa is to resume her economic growth. A clear, coherent action by the international community has not yet emerged to address the problems facing Africa. There is concensus on what needs to be done to resume sustained growth in the continent after more than a decade of not just stagnation, but actual retrogression. Views on timing and priorities may differ. But delays in taking action can no longer be justified on the grounds of major disagreements in diagnosis and prescription. Clearly, African countries have never abdicated their primary responsibility for dealing with the problems they face. But it has to be acknowledged that given the magnitude of the problems, it is essential for the international community to respond positiviely to the problems. We believe the Joint Program of Action proposed by the World Bank provides a reasonable basis for action by the international community. It is both timely and feasible and must be implemented as a matter of urgency.

## III. THE DOMESTIC ECONOMY

### (a) Economic Performance

Mr. Speaker, I have already alluded to the adverse impact of drought to Kenya's economy during 1984. Although we have been living through the drought and its consequences for a year, it is only now, with the recent publication of the 1985 Economic Survey, that the precise impact of the drought on economic performance in 1984 has been measured. It is my hope that Honourable Members will take time to read their copies of the Economic Survey. Permit me Mr. Speaker to touch only on the highlights of Kenya's economic performance last year.

Failure of the rains caused the maize and wheat harvest to fall about 40% below normal levels in 1984. Drought was also responsible for around a 25% depletion in livestock across the country. Some of these losses were due to premature slaughtering of livestock that resulted in a 60% increase in marketing of livestock products. This tempered the effect of the drought on farmers' and herders' incomes in 1984, but it will reduce livestock output for the next few years. Farmers' incomes were further bolstered by strong prices for coffee and more than a doubling of the average price for tea. Despite this, the net result was that value added in agriculture declined by 3.7% in 1984 after three years of satisfactory growth. The fall in agricultural production was in turn largely responsible for the virtual stagnation of Gross Domestic Product in 1984, which grew by only 0.9%.

Although no Kenyan can be pleased with this economic outcome it could have been much worse. A number of factors helped to ameliorate the worst effects of the drought, prevented it from turning into a famine, and indicated some underlying strengths of the economy that will help to restart economic growth in 1985 and beyond. These factors included the high stocks of grain maintained by the Government before the drought; the high level of foreign exchange reserves which were bolstered by the high coffee and tea export prices; the reallocation of Government expenditure from other projects to meet drought requirements; the ample short rain; and finally the sound and dedicated management of the economy by all the parties involved.

#### (i) Income and Employment

As I have already indicated, GDP grew by a disappointing 0.9 per cent which would normally have resulted in 3 per cent fall in per capita income. However, for the second consecutive year, our terms of trade improved by 17 per cent in 1984. When the Gross Domestic Product is adjusted for this favourable change in our terms of trade, per capita income actually grew by 3 per cent during 1984.

In addition to this improvement in income, wage employment in the modern sector grew marginally by 2 per cent in 1984. Although this rate was substantially lower than that of 1983, the informal sector grew by a commendable 8 per cent. This fast growth in informal sector employment may be attributed to H.E. the President's continued concern that local authorities should reduce evictions of people who are legitimately earning their living through this kind of self employment. Hon. Members are already debating the Sessional Paper on employment which,

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when approved, should create more jobs in this sector of the economy, and indeed in the economy as a whole.

(ii) Savings and Investment

Mr. Speaker, Kenyans saved 19% of Gross Domestic Product in 1984 and, with the help of donor financing, invested 21% of GDP. Although this represented no increase over 1983, it is another surprising and encouraging sign of underlying strength in the economy when the effects of the drought are taken into account. However, it is tempered by the fact that all the growth in real investment came from public sector investment. In future, the private sector must contribute more to investment if economic growth is to be revived and sustained.

Kenya has been devoting a high proportion of GDP to investment for the past decade, yet has not been able to translate this into high growth rates of either income or employment. This points to a crucial requirement for renewed growth; both Government and the private sector must use our investible resources much more productively than in the past. At the same time, we need to increase domestic savings in order to reverse a recent tendency for investment to decline as a share of GDP and to depend relatively less on foreign aid and investment to finance growth. Many of the policies of structural adjustment adopted over the past few years, and the continuing policies I will announce today, are intended to accomplish these ends.

(iii) Money, Prices and Wages

As a result of improved net foreign assets and increased domestic credit, total money supply grew by 13 per cent compared to 5 per cent in 1983. Thus, money supply grew by an average of 9 per cent per annum over the last two years; with credit to the private sector growing by 11% per annum. Therefore, the Government has, within tight financial constraints, left increased credit to the private sector.

The consumer price index reflects this tight fiscal and monetary stance: after rising by 22% in 1982 and 14.6% in 1983, the index rose by only 9.1% last year. The further drop in the rate of inflation, despite exchange rate adjustment effected during 1984, and drought, is a further indication that the structural adjustment measures which the Government has pursued since 1979 have been effective.

Total wage earnings in the modern sector increased by 12 per cent, roughly the same growth rate as the previous year. Furthermore, for the first time in three years, the downward trend in real wages was reversed. Average real earnings grew by 0.4% last year compared to a decline of 7 per cent in 1983.

(iv) Balance of Payments

The prospects for a vigorous economy also depend critically on continued strength in our balance of payments, which depends largely on prices of coffee and tea. Despite large food imports there was considerable improvement in our balance of payments position. The value of exports rose by 19 per cent while that for imports increased by 21 per cent. The overall balance

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of payments surplus stood at K£39 million compared to K£69 million in 1983. Thus, we finished 1984 with reserves of K£312 million or 3.4 months' worth of imports.

(b) Outlook for the Immediate Future

Mr. Speaker, I have already briefed the House on the performance of the economy last year. We should therefore now pause to reflect what the immediate future holds for the economy. As a result of satisfactory long rains, agriculture should grow at around 4.5% in 1985 in real terms. Manufacturing and tourism sectors are also expected to perform satisfactorily. As a result, the economy is expected to grow at around 5% in 1985 — a rate significantly higher than the growth rate of population. Several problems will, however, need to be addressed to if we are to achieve this performance.

Firstly, the balance of payments: although export prices of coffee and tea remain fairly high, tea prices have fallen considerably during the first quarter of this calendar year. It is difficult to estimate the extent to which this trend will continue. Neither does the maintenance of high dollar give us much room for comfort. Thus, although our foreign exchange reserves are satisfactory and the balance of payments might remain satisfactory this year, 1986 is expected to be a difficult year on external payments front.

Secondly, the budgetary deficit: although we have maintained the deficit at manageable level, the effects of the drought are still with us and additional unbudgetted expenditure will continue to be required until this year's crop is harvested. Even after this crop is harvested, additional expenditure will be required to buy grain and provide for its storage as we attempt to build adequate strategic reserves. It is clear that Government revenues cannot grow fast enough to meet these additional requirements. There will, therefore, be need to reduce further on Government expenditures.

Thirdly, there is the problem of unemployment. Rapidly growing population is the main cause of unemployment. The House is currently debating a Sessional Paper on ways and means of alleviating this problem, and it is my hope that arising from the deliberations of this House, effective measures will be adopted to tackle unemployment. Other measures which I will announce later today will have the effect of increasing employment during 1985/86 and beyond.

Finally, it is now expected that agriculture will recover from the 1984 drought and again contribute to economic growth in 1985. However, some delayed impacts of the drought will restrain agricultural growth for another year or so, especially in the livestock sector.

For the immediate and the long run, agriculture must be the leading sector in Kenya's economic development. The potential exists for expansion of food crops to feed the growing population, of export crops to fuel development in other sectors of the economy, and of industrial raw materials to feed an expanding manufacturing sector. This potential will be realized through a continuation of agricultural policies already in place, and especially on favourable farm gate prices for the major agricultural products; close atention to improvements in marketing arrangements for farm inputs and commodities; prompt payments to farmers, and adequate provision of credit. These will require additional funding, and I have endeavoured to reflect this in the Printed Estimates for 1985/86.

## POLICY FRAMEWORK

Mr. Speaker, my Budget message is "mobilization of resources for renewed growth". Over the last five years, an array of policy measures and institutional arrangements have been put in place first to stabilize the economy, and second to encourage its growth. The main aim of today's budget is to consolidate on the measures already in place, and to set down procedures for their implementation. In pursuit of this effort, the Government will lay emphasis on four fronts:

First, it will be necessary to ensure that agriculture grows on sustained basis between now and the turn of the century. Rapid growth of agriculture will be necessary to feed a growing population and to create jobs in the countryside, and thereby contain the influx of job seekers to the cities. To achieve this the productivity of both farmers and their land must increase. In addition, agricultural marketing and distribution infrastructure including KGGCU, will be strengthened. Thus for the foreseeable future, agriculture will continue to be the mainstay of the economy

Second, it will be necessary to stimulate growth in other productive sectors of the economy. To this end, manufacturing, tourism, and service sectors, especially the informal sector, will need to grow rapidly in order to create additional employment opportunities.

Third, it will be necessary to undertake new investments in physical infrastructure and related services to support new urban based activities.

Fourth, it will be necessary to make the investments, both public and private, in those activities which yield highest returns, and ensure that operational efficiency throughout the economy is improved.

The means of achieving renewed growth remain those of the last two years: maintaining our level of domestic savings and efficient deployment of those savings. This should be done in both the public and the private sectors of our economy.

Within the public sector, Government must spend prudently, so that its revenues finance all but a small part of its expenditures and its deficit remains manageable. Over the past two years, Government has managed to reduce its deficit to under 10% a year. This has been a considerable accomplishment - one that lays the foundation for renewed growth. This year's Budget represents a continuation of the stabilization programme of the past two years.

Mr. Speaker, given the scarcity of resources available for spending by Government, it will be necessary to optimise returns from public expenditures. Towards this end, Treasury has embarked on a programme of rationalizing Government expenditures. This will be done in four ways.

First, we intend to concentrate Development Expenditures on projects already under way until these have been completed; second, we shall delay the start of new projects, until the backlog of current projects is substantially reduced; third, in selecting projects for early completion, priority will be given to those that promise high rate of return on the investment; and finally, we shall set aside adequate Recurrent Expenditures for the operation and maintenance of projects that are completed, so that they can realise their full potential.

Mr. Speaker, one area which will receive special attention in budget rationalization is employment. There is evidence that government employment has expanded excessively. Presently, staff costs are absorbing about two-thirds of the revenues available to finance currenct public services. As a result, we are not providing the civil service with the complementary resources it needs to be productive, on either the recurrent or development side.

This development is not surprising to anyone who has compared the growth of public and private sector wage employment in Kenya over the past ten years. Total wage employment grew by 2.8 per cent per year between 1974 and 1984 with the Government increasing its labour force at 7.4 per cent per year. I am sure Hon. Members will join with me in assessing the implications of all these figures: a continuation of the recent growth path of government employment is a financial and even a mathematical impossibility. What is more, if we want to avoid landing in the predicament where much of the civil service sits around drawing its salaries, unable to perform economically meaningful services for the population, we must take forceful action. Specifically, new measures are called for to contain the growth of Kenya's civil service, even allowing it to shrink somewhat as retirements, resignations and other departures exceed new hiring.

Hon. Members will recall that I commented last year on the unsatisfactory state of parastatal debt to the Government. I noted that many parastatals were acting as though loans voted to them by Parliament were grants, and that others were tardy in remitting their service payments. I announced a series of measures to correct the situation, among them establishment in Treasury of a computerised internal debt monitoring system that would invoice parastatal borrowers through their parent ministries. I am glad to report that this system is now in place, and the first invoices have recently gone out to several ministries. Other parastatals can expect to receive their invoices in the near future. The system computes amounts due in accordance with banking principles, with interest accruing daily on overdue balances. I am confident that revenue receipts on account of interest and loan redemption during the coming year will reflect the operation of the new system.

The new financial year will see the promulgation of a standard loan agreement, already prepared, which must be negotiated between any parastatal borrower and its parent ministry with Treasury approval, before Treasury will release loan funds. Treasury will insist on retroactive execution of similar agreements in cases where no written record of loan terms can be found. The standard agreement embodies the penalty interest rate on payment arrears which I announced last year.

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Mr. Speaker, I am concerned about the financial management of parastatals which are audited by private auditing firms on a daily basis. Although the Office of the Controller and Auditor-General finally issues the report on the status of their accounts, I am convinced that the Office is sufficiently over-stretched on government auditing to supervise the operations of these parastatals adequately. In view of this, and considering the large amount of public funds invested in these parastatals, I shall be tabling a bill in this House shortly to provide for the establishment of the Office of an Auditor-General (parastatal). The proposed Auditor-General (parastatal) will be responsible for auditing all parastatals on a daily basis.

Finally, a word on external borrowing: new calculations in Treasury indicate that our external debt service ratio -- the ratio of public debt service in foreign exchange to Kenya's exports of goods and services -- is quite high. Fully 27 per cent of our export receipts last year had to be diverted to finance service of external public debt. This year and next, the ratio will rise to 28 per cent. However, a substantial proportion of external commercial borrowing incurred during late seventies and early eighties will be repaid during the next year or two. If export performanace continues to be satisfactory, we expect to reduce this ratio to less than 20% by the end of this decade as projected in the Development Plan, 1984-88.

Mr. Speaker, the House will remember that major adjustment policies have been pursued in the last two Budgets and in other Government forums during that period. The most important of these have been exchange rate flexibility, import liberalization, export promotion, interest rate adjustment, wage restraint and agricultural pricing.

Of these measures, substantial work remains to be done on import liberalization. Mr. Speaker, I have continuously emphasized that import liberalization has two aims: first, to give manufacturers and farmers more ready access to the imported inputs they need; and second, to rationalize the protection granted to some industries and induce them to increase their efficiency while reorienting them towards the export market. These aims have been approached on two fronts. First, we have liberalized import licensing and greatly improved the efficiency of its administration. Through the progressive shifting of import items from more restrictive Schedules (2A and 2B), we have reached the point where 65% of all items are now on the less restrictive Schedules (1A and 1B). This more ready access to inputs has given manufacturers more confidence in their production plans and must be continued -- indeed, extended -- as part of Government's programme to stimulate private investment and restructuring.

The second approach to import liberalization involves tariff reform. In the past two Budgets, we have concentrated on reducing the duties on many imported inputs, and thereby to reduce the costs of manufacturing and farming. Our aim is definitely not to eliminate protection. Rather, it is firstly to reduce protection in cases where it is excessive, and secondly, to make it more uniform across industries. Perhaps it is necessary to point out here that we have embarked on an intensive study of the manufacturing sector that will help us determine what the ultimate protective structure should be and guide us in the future.

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Mr. Speaker, the outcome of import liberalization programme will be to make manufacturing inputs readily available and through competition, lower domestic costs of production. This in turn will make our manufactured products cheaper and assist in our export drive. The export drive in turn will rest in four approaches: export compensation, manufacturing in bond, the "green channel" and the Preferential Trade Area (PTA). Export compensation is designed to make up for the added costs to exporters due to duties on imported inputs and the high costs of many inputs manufactured in Kenya. Thus, as long as we need to tax imported inputs in order to raise revenue, and until Kenya industry completes its restructuring process and becomes much more efficient, export compensation will be a necessary inducement for exporters. It is, therefore, important that potential investors see this as an integral, long-term part of our economic policy.

The House will recall that I promised to introduce manufacturing in bond during the last Budget. I am glad to report to this House that we have made considerable progress on manufacturing in bond and we expect to establish a workable system very soon. The Preferential Trading Area for Eastern and Southern African States has been established and we are negotiating changes which will provide meaningful access for Kenyan manufacturers. This will not only assist in promoting export growth and diversification, but also in exposing Kenya manufacturers to the kind of competititon that will promote greater efficiency.

Mr. Speaker, the final elements I wish to touch upon are interest rates, wages policy, and agricultural pricing policy: Interest rates are regularly adjusted in order to promote saving throughout the banking system and to screen out less productive investments. I have already mentioned that the key to renewed growth in Kenya is increased productivity. To achieve this, we need virtually to double the rate of return on investments made in Kenya. Higher interest rates help accomplish this by making it unprofitable for those with low rates of return to borrow. Although it is generally felt that low interest rates promote more investment, it is also true that much of this investment does not contribute to higher growth in Kenya. Thus higher rates encourage precisely those investments that we want made and not others. Our aim has been to keep interest rates higher than the rate of inflation, something we have now achieved and must maintain.

Wage restraint has been a long-standing and successful part of our economic policy. We must continue to restrain wage increases in all sectors in order to control inflation, promote job creation and ensure that those not covered by formal wage agreements — especially farmers and workers in the informal sector — do not get left far behind in their standards of living.

Finally, agricultural pricing policy has for the past several years granted increases to farmers sufficient to maintain their incomes compared to the prices of the inputs they purchase. I have also indicated that agricultural prosperity is central to achieving accelerated growth, expanding and diversifying exports, creating employment, achieving food security, and improving rural-urban balance. Favourable agricultural prices -- with increases granted promptly to cover increased costs of production and increased costs of living — are in turn a key to agricultural prosperity and need to remain a central facet of our economic polic-

And I am confident that Honourable Members will continue to support the Government's policy of passing on the full cost of production of agricultural production to the consumers when this becomes necessary.

Mr. Speaker, the policies I have just summarized have been widely accepted. Some of them have been implemented effectively. Others need to be implemented more energetically. Our general stance during the coming financial year and beyond will be to focus on these measures and implement them systematically and effectively.

## V. FINANCIAL OUT-TURN 1984/85

### (i) Recurrent Revenue

This year's ordinary recurrent revenue was estimated at K£998 million plus Appropriations-in-Aid of K£50 million making a total of K£1,048 million. This recurrent revenue was to comprise of K£279 million from Customs and Excise; K£325 million from Sales Tax; K£256 million from Income Tax and the balance of K£138 million from other minor taxes, dividends, charges and fees. Mr. Speaker, I am pleased to inform the House that, in spite of the difficult drought conditions experienced last year, the revised total revenue figure is now K£995 million -- just K£ 3 million below my last year's estimate.

There will, however, be substantial shortfalls in import duty, excise duty and sales tax, but they will almost be compensated by the over-collection of income taxes, export duty and other minor taxes. This shortfall is mainly due to the reduced demand for luxury consumer items which bear a higher rate of tax and the recent drought which affected domestic sugar production. I now expect to receive K£260 million from Customs and Excise, K£302 million from Sales Tax, but I expect Income Tax to increase to K£270 million with an over-collection of K£14 million, while other minor taxes are expected to raise K£163 million, with an over-collection of K£25 million mainly attributable to increased dividends from parastatals and export duties on coffee and tea.

### (ii) Recurrent Expenditure

Turning now to expenditure, it will be noted that this year's Printed Estimates of Recurrent Expenditure were estimated at K£690 million excluding the Appropriations-in-Aid. The Consolidated Fund Services were to take another K£372 million making a total Recurrent Expenditure of K£1,062 million. The House will remember that in 1984, there were three issues which necessitated Government to incur increased expenditure; namely the importation and timely distribution of food as a result of the drought, the compensation to Uganda in respect of settlement of assets and liabilities of the former East African Community, and the preparation for the introduction of 8:4:4 system of education. To meet these expenditures together with other unavoidable expenditures mainly in training institutions and supply of drugs, it became necessary for this House to approve Supplementary Estimates amounting to K£51 million. I had also to finance Excess Votes and Under Issues on prior years amounting to K£38 million. Furthermore, Consolidated Fund Services took an additional K£9 million for loan repayments. I, therefore, expect the net Recurrent Expenditure to be K£1,160 million.

However, issues from Recurrent Exchequer are now estimated at K£1,151 million compared to the total revenue of K£995 million. I will, therefore, have no surplus in the Recurrent Exchequer Account to transfer to the Development Exchequer.

(iii) Development Expenditure

The 1984/85 Printed Development Estimates projected gross expenditure of K£353 million including Appropriations-in-Aid of K£163 million. Recently, the House approved Development Supplementary Estimates of K£11 million. I also expect additional Appropriations-in-Aid amounting to K£71 million from various sources as detailed in the Development Supplementary Estimates, making a total gross Development Expenditure of K£435 million. This increased Appropriations-in-Aid is largely attributable to the recently concluded IDA loan for small scale farm credit; materials for the national grid extension scheme; petroleum storage facilities;and Kiambere hydroelectric power project. However, it is estimated that only K£429 million will be issued from the Development Exchequer.

I, therefore, expect to contain the overall deficit at K£220 million which is 4.8% of G.D.P. This level of budgetary deficit has been attained despite drought related spending pressures which I have already alluded to. Notwithstanding this achievement, however, I would like to see the deficit brought down even further in the years ahead.

## VI. FORECAST OUT-TURN 1985/86

(i) Expenditure 1985/86

I would now like to turn to the issue of Government expenditure in 1985/86. As Hon. Members will have seen from their copies of Printed Estimates already tabled, gross Recurrent Expenditure of Ministries is estimated at K£1,196.4 million, comprising of net expenditure of K£1,148.2 million and Appropriations-in-Aid of K£48.2 million. Thus, the estimated issues from the Recurrent Exchequer will be K£1,148.2 million. This estimated Recurrent Expenditure represents a decline of 0.3 per cent over the revised estimated issues for this financial year.

This reduction is accounted for by: first, the substantial reduction in Consolidated Fund Services as a result of the redemption of the first Eurodollar loan this financial year; and second, reduction in drought related expenditure including food importation and disaster relief.

Development Estimates for 1985/86 call for an expenditure of K£388.8 million including Appropriations-in-Aid of K£101.4 million. This represents a decline of 11% over this year's Printed Estimates. This reduction is accounted for by the phasing out of expenditures on energy projects which I alluded to earlier and which are nearing completion.

Mr. Speaker, I need not analyse further the details of either recurrent or development expenditure for now. Hon. Members will discuss this in depth when they debate the Appropriations Bill. Suffice it to say that I intend to finance a total expenditure of K£1,585.2 million. The rest of my Speech will outline how I intend to do this.

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(ii) External Revenue

As I have already indicated, Kenya continues to enjoy friendly and cordial relations with the international community who have generously contributed to the development of this country. I am sure the nation will join me in expressing our gratitude to those foreign governments and institutions who have spared no effort in coming to our assistance at times of difficulties. We are also grateful to H.E. the President who has worked tirelessly to maintain peace and to spread our Nyayo philosophy of peace, love and unity beyond our borders, thus strengthening our cordial international relations.

Mr. Speaker, I have already indicated that it is our policy to give priority in external borrowing to those on-going projects which promise high returns. Using this criteria, I expect to draw some K£202.5 million from external sources during the next financial year. Of this, 49% will be in the form of grants and 51% in the form of concessionary and programme loans. Thus, I expect to finance 13 per cent of my total expenditure from external sources. 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£1,382.7 million.

(iii) Domestic Borrowing

As I have already indicated in setting out the policy framework for this year's budget, it continues to be our policy to contain Government budgetary deficit to prudent levels in order to reduce its inflationary effects. In furtherance of this policy, it is necessary that next year's deficit be kept low. It is also necessary that the deficit be financed from less inflationary sources. In view of this, I propose to borrow some K£50 million by way of long-term Government stocks from parastatals and other savings institutions and an additional K£175.0 million in Treasury Bills from banks and financial institutions. An additional K£2.0 million will be raised through sales of Tax Reserve Certificates. Thus, I propose to raise K£227.0 million by borrowing locally.

(iv) Internal Revenue

I estimate that ordinary revenue, at current rates of taxation will provide some K£1,102.0 million. Appropriations-in-Aid will provide another K£49.6 million making a total of K£1,151.6 million. I have already indicated that I shall draw some K£202.5 million from external sources and an additional K£227.0 million from domestic borrowing. I, therefore, have a gap of K£4.1 million to finance from additional taxation. The rest of my Speech will outline how I intend to do this.

## VII. TAXATION PROPOSALS

Mr. Speaker, I have appraised the House on the international economic situation, the economic crisis facing Sub-Saharan Africa, the state of our economy and the policies we intend to pursue in the context of the prevailing situation. I have also indicated that I have a financing gap of K£4.1 million. I now turn to my taxation proposals and, as usual, I would ask Mr. Speaker, Sir, that the rest of my Speech be regarded as Notice of a Motion to be moved before the Committee of Ways and Means.

### (a) Customs Tariff

The House will recall that during the last two Budgets Government has effected substantial reductions in tariffs on inputs used by a wide range of industry. There has also been an increase in the rate of export compensation. Both these measures have increased the competitiveness of our exports. These measures were also helped by the adjustment of the Kenya Shilling which took place over this period.

In spite of these measures our industries still enjoy high levels of protection -- higher than consumers have to pay. In this year's Budget I am proposing a package of changes in both customs tariffs and import policies in order to carry further the system of restructuring incentives. This package will also consolidate the gains of the past two years.

Firstly, import tariffs on a wide range of items, namely, raw materials, intermediate inputs to industry, and capital goods, will be reduced by an average of 12% of the existing rate where they are currently above 25%. This will provide substantial benefits to manufacturing sector as well as to large sections of the construction trade and to parts of the agricultural sector. By reducing the cost of industrial inputs manufacturers of both import competing goods and exports will benefit significantly.

Secondly, Hon. Members are no doubt aware that the Government has recently authorised local assembly of passenger cars. This has necessitated the introduction of appropriate duty structure to ensure that the Exchequer does not lose revenue rightly due to it as a result of the inadequancy in the current tariff structure. I have, therefore, decided to align the rates of duty on passenger cars so as to reduce the current duty differential between imported complete cars and those which will be locally assembled. In doing this, and in pursuit of the tariff restructuring policy which I have already outlined, it has been deemed necessary to equalise duty on cars of varying engine capacities. Therefore, with effect from midnight tonight, all passenger cars imported in complete form will be dutiable at 50% irrespective of their engine rating. At the same time, in order to provide incentive to local assembly of cars, all passenger cars assembled locally will have their duty lowered from 35% to 25%.

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Thirdly, access to necessary imports is being liberalize through the shifting of a further 317 items to Schedule 1A of the Import Schedules. Thus a large number of consumer goods which are currently protected by both high tariffs and import restrictions will be shifted to the more liberal import licensing schedule. However, to ensure that local manufacturers of these items are not adversely affected, the tariffs in these items will not be lowered. I should point out that in many cases the local manufacturer receives very high levels of protection against import competition, and has done so for a long time. In my judgement, time has come when these firms should start to experience a bit of competition, but in a manner which is fair to the investor as well as the consumer. Items shifted to the Schedule 1A list in every case will have tariff rates which provide local producers with adequate levels of protection.

Mr. Speaker, on several occasions, industrialists have, rightly, complained to me about situations in which the tariff on inputs is greater than on output. I am sympathetic to this situation, and the entire thrust of the reform measures we have taken in recent budgets is to deal with this problem. Until we have finished the rationalisation process, however, it is inevitable that anomalies will remain. But we shall correct these anomalies as they arise.

Finally, the public will have noticed that East African Industries Limited has made strenuous efforts in promoting domestic production of rape seed and sunflower to replace imported palm oil as raw material for the manufacture of kimbo. In order to assist the company in this important endeavour and encourage our farmers to grow these crops, I am removing duty on rape and sunflower seeds.

Mr. Speaker, the measures I have just announced, which take effect from midnight, tonight, will reduce the cost of import to the manufacturer and consumer by K£12 million. The Exchequer will lose a corresponding amount of revenue.

(b) Excise Tariff

Mr. Speaker, I would now like to make a minor amendmen to the excise tariff on cigarettes and tobacco. Hon. Members will agree with me that cigarettes and tobacco are not only a luxury but also a major source of Government revenue. It is therefore necessary that their prices should be kept in line with domestic inflation and that the level of revenue derived from this source be maintained in real terms. In order to attain thes objectives, I propose to raise the levels at which the current rates of excise duty apply by an overall weighted average of 12.1 This will have the effect of raising the price of some popular brands of cigarettes such as Nyota by 50 cents per packet, Sportsman by sh.1/- per packet, Embassy by sh.1/50 per packet, and the high class brands of Rex and State Express by sh.1/50 and sh.2/50 respectively. Out of the increased receipts arising from this measure, the tobacco manufacturer and traders will receive 38 per cent while the balance of 62 per cent will go to the Exchequer as revenue.

This measure on excise tariff which takes effect from midnight will provide the Exchequer with an additional K£6.9 million in revenue.

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have, therefore, always ensured that they buy the chassis
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Compensation

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It is for this reason that various measures have
place to provide manufacturers with appropriate
Among these incentives are the continued reduction
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nsidered the merits and demerits of this additional
and have come to the conclusion that it should be
immediate effect. However, all outstanding payments
ncluding increased exports for the financial year
ne, 1985.

(c) Sales Tax

I would now like to turn to sales tax. Firstly, wines: the House will recall that last year, I increased the rate of sales tax on wines from around 30% to 75%. This increase, though justified, has created a disincentive to make wines from local fruits. As Hon. Members are aware, sales tax is levied on the ex-factory selling price in case of local manufactures and on C.I.F. plus duty on imported goods. In the case of wines, it has come to my notice that the tax paid on domestically made wines is significantly higher than that on imported wines because of the fact that tax on local wines includes tax on overheads and profit. It is, therefore, more profitable to import wines than to make them from local fruits. To correct this anomaly, I propose to reduce sales tax on wines to 35% in order to encourage local production of this product. However, in order to maintain the current level of revenue derived from imported wines, I propose to increase import duty on wines in such a way that the current rate of the combined tax remains unchanged.

Secondly, passenger cars: I have already indicated that I propose to unify the rates of duty on passenger cars irrespective of their engine rating while maintaining adequate protection for locally assembled passenger cars. Mr. Speaker, while it is my intention to lower marginally the cost of passenger cars, the Exchequer would lose substantial revenue if the current rates of sales tax on unassembled passenger cars were to remain. Therefore, in order to maintain satisfactory levels of revenue while giving the motorist slightly better deal, I propose to raise the rate of sales tax on unassembled passenger cars from the current 30% to between 40% and 250% depending on the engine rating. Correspondingly, I propose to adjust sales tax on imported completely built passenger cars from (70-240) per cent to (40-400) per cent. The effect of these measures will be that total tax on passenger cars will be reduced from the current (147-818) per cent range to (110-650) per cent range depending on the engine capacity of a vehicle. Considering that there has been very little passenger car importation, I do not expect to lose any substantial revenue by these changes. In fact, I expect to gain substantial revenue as local passenger car assembly picks up and the demand increases as a result of reduced tax rates.

Thirdly, sales tax on beer: those who are still with me will have by now noticed that I have reduced tax on various items. It isonly fair that the Exchequer be somehow compensated by increasing sales tax on luxury consumer goods like beer. Consequently I propose to raise the rate of tax on beer by 30 cents per litre. In addition, Kenya Breweries has requested a price increase of 10 cents per half-litre bottle to meet increased costs of barley and other manufacturing costs. The Government has, after careful consideration, accepted their request and the price of beer will, therefore, go up by 25 cents per half-litre bottle with pro-rata increases in other sizes with effect from midnight, tonight.

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Finally, the rate of sales tax on complete buses is 30% while that of bus chassis and bus body when sold separately is 17%. Bus operators have, therefore, always ensured that they buy the chassis and the body separately in order to escape the higher rate of tax on completely built buses. I have considered this revenue loophole and, since I do not intend to hike public transportation costs, I have decided to lower the rate of tax on buses to 17%. This will enable bus operators to buy completely built-up buses from the same manufacturer without incurring additional tax and expenses.

Considered together, these changes in sales tax, which take effect from midnight, tonight, will provide the Exchequer with K£20 million in additional revenue.

(d) Export Compensation

Mr. Speaker, the Government accords high priority to export promotion. It is for this reason that various measures have been put in place to provide manufacturers with appropriate incentives. Among these incentives are the continued reduction in duty on imported raw materials, the establishment of PTA, exemption of exports from sales tax and, most important, the payment of export compensation on exported eligible goods. These measures have not yet boosted our exports to the level I would like to see and I am therefore making additional amendments to the Local Manufactures (Export Compensation) Act in the hope that these measures will give the impetus to increased exports in the following ways:

It will be recalled that some three years ago the Act was amended to provide for incremental export compensation. The rate of this compensation is currently 10 per cent of any increase in the value of goods exported in a fiscal year over the value of goods exported in the previous fiscal year. The incremental compensation was also to be paid to new exporters. As the exporters are already aware, it has taken the Customs & Excise Department a long time to effect the additional compensatory payments mainly as a result of the problems associated with satisfying ourselves that those claiming it are eligible. Indeed we have had unfortunate experience with fictitious claims based on dubious exports.

Although payments have already started, there are several reasons which cast doubt on the advisability of maintaining this additional compensation. Firstly, the additional compensation is being paid mainly for price variation, and not for increased exports. Therefore, as a result of inflation and adjustment of Kenya shilling, additional compensation becomes due and payable without physical increase in exports. Secondly, since new exporters are eligible for this compensation, all an existing exporter needs do is to change his company's name every year in order to qualify. Thirdly, there is the potential danger that an established exporter could use the compensation as a good reason to lag payments in order to qualify for the payment. This would not be in the interest of our balance of payments.

I have considered the merits and demerits of this additional compensation and have come to the conclusion that it should be abolished with immediate effect. However, all outstanding payments will be paid including increased exports for the financial year ending 30th June, 1985.

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Finally, I propose to increase the general rate of export compensation from 15% to 20%.

Mr. Speaker, I would like to take this opportunity to challenge local manufacturers to take full advantage of these new measures and embark on a sustained export programme. Only by boosting our export potential can we sustain growth of our economy.

These measures on export compensation will cost the Exchequer K£5 million in lost revenue.

(e) Income Tax

I shall now turn to income tax. Over the years, the Income Tax Act has been amended regularly with the view to making it easier to administer and occasionally to compensate the taxpayer for inflation. I propose to continue this trend this year.

Firstly, section 19A of the Act was introduced in the Finance Act of 1984 to deal specifically with the taxation of cooperatives. I am proposing to make a few amendments to that section, but these amendments are entirely intended to clarify and tidy up the drafting of that section without making any substantive change in the Act.

Secondly, I propose to amend paragraph 38 of the First Schedule to provide that where any company has proved beyond doubt that it promotes development of residential housing,then I shall advise the Commissioner to make it eligible to operate tax-free interest Housing Development Bond Accounts.

Thirdly, Hon. Members will agree with me that this Budget would be incomplete if it did not address itself to our agricultural sector. We are all aware that after the devastating drought of 1984 our farmers have been financially strained, and many are still pondering over the losses they incurred. Despite these setbacks our farming community has taken full advantage of the long rains. In response to the efforts taken by the farmers, and in order to give them a shot in the arm, I propose to increase farm works deduction in such a way that they can write off all their allowable capital costs against profits in three years instead of five years as is the case now. To give the farmers early benefits of this measure, I propose to backdate it to January this year. The immediate effect of this proposal is that farmers will pay less tax on their 1985 profits. Although I stand to lose some revenue, I expect the loss to be more than compensated by increased agricultural output.

Fourthly, it has been our practice in the past to review tax payable by individuals in order to compensate them for inflation. The last time that this was done was in 1981 and, although the rate of domestic inflation has been almost halved since that time, it is necessary to maintain this trend. I, therefore, propose to give further tax relief this year by widening tax brackets by £300 so that the first K£1,800 instead of the first

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K£1,500 will be taxed at Sh.2/- per pound. The next bracket of £1,800 will be taxed at Sh.3/- and so on moving up in slabs of £1,800 upto £12,600 which will be taxed at the top rate of Sh.13/-. Thus a taxpayer earning K£2,400 and currently paying tax of Sh.5,700/- will pay Sh.5,200/- thereby saving Sh.500/-. I am, however, leaving the tax rates undisturbed rising from Sh.2/- to Sh.13/- for every Sh.20/-. The same brackets and rates will apply to a wife's employment income. This change will have the effect of increasing the disposable income to the taxpayer.

Fifth, Mr. Speaker, having given the working population some compensation for the rising cost of living, it is only fair that we do not forget those who have retired after serving this country with loyalty and dedication. Indeed we owe our prosperity to their unflenching service in the past. I am, therefore, proposing to amend the law in order to increase the amount of tax free pension income from K£2,500 to K£5,000. In addition this amount will not be taken into account when calculating income tax which the pensioner may be required to pay on other incomes.

Sixth, and as I have already indicated, it is government policy to encourage industrialisation especially in the rural areas. One such form of encouragement is the investment deduction which is allowed to new industries setting up factories outside Nairobi and Mombasa. This deduction is given as a bonus over and above normal depreciation of cost of factory premises and machinery installed therein. This bonus has been maintained at 20% of qualifying expenditure for many years. In order to boost rural industrialisation, I propose to increase the rate of this deducation from 20% to 50%. This investment deducation also applies to tourist hotels and I hope it will encourage the construction of more hotels and lodges in the country's game reserves to cater for the increasing tourists.

Finally, capital gains tax: I have received numerous representations from members of the public, companies and the Nairobi Stock Exchange requesting me to consider abolishing capital gains tax on the grounds that the tax inhibits capital and share mobility and therefore economic growth. I also do know that there are very good reasons for maintaining the tax. However, there seems to be general concensus that the tax does, to some extent, inhibit trading in real estate - and hence development. I have carefully weighed the pros and cons of this tax and decided in line with my this year's Budget theme, to suspend it with effect from tomorrow. We shall, however, continue to watch the situation carefully to see if its abolition will bring us the development promised by its opponents. In view of the current low rates of this tax, I expect to lose minimal revenue from this measure.

Taken together, the measures I have announced today on income tax will cost the Exchequer some K£14 million in lost revenue.

Mr. Speaker, I would now like to turn to a number of Miscellaneous Taxes.

(f) Hotel Accommodation Tax

Legal Notice No. 178 of 1980 exempts from tax any premises with less than ten beds for hire, situated in a market established within a jurisdiction of a County Council. This measure was intended to assist the small time businessmen seeking to establish themselves in rural areas. However, it has been abused by unscrupulous businessmen who remove extra beds during the day only to return them at night.

In order to close this loophole I have decided to revoke this legal notice with effect from midnight tonight. This revocation will provide the Exchequer with an additional K£100,000.

(g) Second-Hand Motor Vehicles Purchase Tax

Hon. Members will recall that second-hand Motor Vehicles Purchase Tax has not been adjusted over the last six years. During this period, the cost of registration has gone up mainly as a result of the increased transfers arising out of the fact that there has been limited importation of new cars. It is only fair that the Exchequer maintains its fair share of this increased motor trade. I, therefore, propose to reclassify the various sizes of motor vehicles into realistic engine categories and effect a modest increase in transfer tax. It is also proposed to increase second-hand motor vehicle dealer's licence fee from sh.1,000/- to sh.2,000/-. Considering the high prices that the second-hand motor vehicles are fetching, I consider this increase reasonable.

As a result of these minor changes, the Exchequer will realise an additional K£75,000 in revenue.

(h) Traffic Act

Mr. Speaker, fees and other charges levied under the Traffic Act have remained stagnant for some years. In the intervening period, the cost of maintaining roads has increased considerably as is evident from the Vote of the Ministry of Transport and Communications. You will also have read in the newspapers about the increasing number of forged licences. In order to close this tax loophole and raise additional revenue, I propose to effect the following measures:

First, as the cost of materials for making number plates has risen considerably since 1979, I propose to raise number plates charges from sh. 150/- to sh.250/- per pair and sh.100/- to sh.150/- per single plate.

Second, I propose to effect a modest increase in licence fees covering all classes of vehicles. These increases will be graduated to maintain the current structure where the higher the engine rating or the heavier the vehicle, the higher the cost of road licence fee.

Third, Mr. Speaker, and in order to ensure that I realise the proposed revenue in full, the law will be amended to provide introduction of a non counterfeit "Validation Licence

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Certificate" which will bear the same number as the licence and which will be affixed to the identification number plates

It is estimated that these changes will provide the Exchequer with an additional K£2.5 million in revenue.

(i) Video Tax Bill

Mr. Speaker, the public will have noticed the recent mushrooming of video cassette libraries throughout the Republic and particularly in the major urban centres. The effect of this is that there has been a major reduction in cinema audiences. Cinema operators have complained to me on the grounds that these video libraries offer the same films but, unlike cinema, they do not pay entertainment tax. The situation is, therefore, inequitable. I have examined the complaint carefully and I am convinced that the cinemas have a case. Besides, those who can afford the luxury of watching films in the comfort of their sittin rooms can also afford to make a contribution to the Exchequer.

I have therefore today published a new Bill intended to introduce an annual licence fee of Sh.2,000/- on every video library irrespective of where it is situated. In addition, I propose to introduce a tax of Sh. 4/- to be paid every time a vide cassette is leased. In order to give time to video libraries to register and for the Controller of Inland Revenue to set up the necessary administrative machinery to collect this tax, the Bill shall come into force on 1st. July, 1985.

I expect to raise K£40,000 from this source.

(j) Stamp Duty Act

Fees charged under the Stamp Duties Act have not been revised since 1973. However, during this time the cost of registering various instruments falling under this Act has continued to increase. Unless these charges are regularly adjuste to keep up with rising costs there is a danger of subsidizing services which ought to pay for themselves. I have also abolished capital gains tax and there is need to recoup revenue lost in this regard. In view of these reasons, I propose to raise the rates of stamp duties in the manner indicated in the Schedule to the Finance Bill.

I expect to raise an additional K£3 million from these adjustments.

(k) Insurance & Hire Purchase Companies

Licence fees charged under Insurance Companies Act and the Hire Purchase Act have remained at very low levels in spite of the growing business being enjoyed by these companies. I therefore propose to increase licence fees on insurance companies from sh.10,000/- to sh.100,000/- while that of hire purchase companies will be increased from sh.1,000/- to sh.4,000/-.

I expect to raise an additional K£207,200 from these increased fees.

(l) Building Societies Act

Although some building societies perform functions which are very similar to financial institutions licensed under the Banking Act, the law does not provide for annual licence fees as is the case with the financial institutions. I suspect this is the major reason why there has been a rapid expansion of these societies.. Although this in itself is a move in the right direction, there is need to ensure that those societies which perform similar functions as financial institutions are treated similarly in their contributions to the Exchequer. These societies should, therefore, pay licence fees equal to that paid by financial instituions. However, in view of the fact that there are some societies which have been registered solely to assist their members acquire houses, I think it would be unfair to require these to pay a high annual licence fee. I am, therefore, proposing to introduce an annual licence fee for building societies of sh. 50,000. The necessary amendments to the law will be worked out such that all building societies will be required to obtain the first annual licence by January, 1986. In order to encourage mobilization of savings in the rural areas, no licence fees will be levied on branches of building societies, outside Nairobi, Nakuru, Mombasa and Kisumu where the fee will be sh.20,000.

(m) Liquor Licensing Act

Licence fees charged under the Liquor Licensing Act were last increased in 1979. Bar owners have of course had their retail margins increased each time that we have awarded a price increase to Kenya Breweries. It is only fair that the Government shares in these margins. I, therefore, propose to increase liquor licensing fees by 50%. This increase will give the Exchequer an additional K£200,000 in revenue.

(n) Trade Licensing Act

Mr. Speaker, I have introduced measures which, as I have already indicated, will speed up economic recovery. In the process of this recovery, I expect traders to realise increased margins as the economy improves. However, trade licence fees have not been adjusted over the last six years. In order to maintain Government share of the increasing trade margins, I propose to double trade licence fees. This will provide an additional K£ 1 million in revenue.

(o) Banking Act

Mr. Speaker, newspaper reports on financial institutions have generated fear among the public for the safety of their deposits and raised doubts about the management capabilities of some of the institutions. This has resulted in the movement of funds to the older or better established banks and financial institutions. One of the major causes of this uncertainty has been the recent problems facing one of the financial institutions. In the industrialized countries, the collapse of banks and finance houses is a phenomenon which has been accepted in financial circles and measures have been put in place to deal with this kind of problem. However, the recent crisis has caused a major stir in public and private financial circles more so because the event is the first one of its kind in the history of banking in Kenya.

As originally enacted, the Banking Act was intended to regulate a small financial sector. With the recent rapid growth of banks and financial institutions, it is now necessary to take steps to stem off some of the weaknesses arising from rapid growth of the banking industry. For some time, the Government has been concerned about the potential instability in the banking industry arising from this growth. Major studies have already been undertaken and more efforts have been made to examine the financial conditions of various banks and financial institutions and pinpoint their weaknesses.

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Amendments to the Central Bank of Kenya Act and the Banking Act, designed to strengthen the Banking industry, have been considered and some have already been passed by the House. The recently enacted section 20(1) of the Banking Act, for example, empowers the Central Bank to appoint an advisor to a bank or financial institution if the affairs of the bank or financial institution are not being conducted in a satisfactory manner. If a bank or an institution deteriorates significantly, the Central Bank can assume or appoint any other competent person to assume the management and conducts the affairs of a bank or financial institution. However, it is clear from the studies I have just referred to that it is necessary to enact new measures to ensure that the financial system develops on a sound, equitable and fair basis in the future. Accordingly, I have today published the Banking (Amendment) Bill which, when approved by this House, will take us further in this direction.

Mr. Speaker, the Banking (Amendment) Bill contains substantial provisions which cannot be fully dealt with in today's forum. I shall have time to explain these amendments in detail when the Bill is debated in this House. I would, however, like to highlight the main provisions of the Bill. These include adequate capital requirements, maintenance of asset quality and appropriate liquidity levels; minimum qualification for management cadres and key personnel; prudent lending policies and maintenance of strong internal controls; penalties for abuses of ceilings on interest rates and for flouting the law; new powers to deal with insolvent banks and financial institutions; a programme of disengagement for those institutions which are highly dependent on parastatals deposits; mandatory Deposit Insurance Scheme for all banks, financial institutions and Deposit taking Building Societies operating in the country; and increased powers to deal with building societies.

Mr. Speaker, while still on banking, I would like to mention something about agricultural credit. Currently, banks and financial institutions are required to lend 17% and 10% of their deposits to agriculture respectively. I am sorry to have to report that some banks and financial institutions have not met this requirement. In view of the importance of agriculture to the economy I am directing the Central Bank to ensure that this lending requirement is complied with. Those banks and financial institutions which are unable to meet the target directly should make their contribution indirectly through other institutions involved in agricultural lending.

I think the Hon. Members will agree with me that while most other sectors of the economy have experienced reduced profits in the recent past, the banking industry has continued to enjoy sustained level of profits. It is only fair that the Exchequer shares in these high profits. Accordingly, I propose to raise licensing fees charged to banks and financial institutions from sh.150,000 to sh. 200,000 for headquarters; sh.75,000 to 100,000 for branches within municipalities; sh.30,000 to sh, 50,000 for branches in town council areas and sh. 15,000 to sh. 20,000 for branches in urban council areas. In order to encourage banks and financial institutions to establish branches in the rural areas, no fees will be charged on branches established in market centres.

The increased licence fees on banking licences will provide the Exchequer with an additional K£220,000.

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## CONCLUSION

Mr. Speaker, the primary objective of this year's budget is to consolidate further the gains we have achieved during the last two years and reinvigorate economic recovery after last year's devastating drought. I have emphasized the need to revive and promote agriculture as the mainstay of the economy. I have also given the public tax relief and reaffirmed our commitment to control inflation so as to maintain sustainable economic growth. Lastly, I have outlined the measures the Government intends to take to restructure production and system of incentives intended to promote growth of the manufacturing sector.

The measures I have announced today will provide further rationalization of the incentives for manufacturing industry, will increase the availability of goods in the economy, will stimulate production for both the domestic and the export markets, and should, on balance, reduce domestic costs of production in the manufacturing sector. Those producers who have been conscientious about containing their costs of production, and who have sought ways of increasing efficiency and productivity of their labour force and their capital stock will be in a position to benefit most from this package of incentives.

Mr. Speaker, mobilization of domestic resources implies, not only an increase in the resources devoted to investment and development, but a relative decrease in our dependence on foreign resources. It suggests the need to increase domestic savings -- both from Government, through prudent expenditure policies, and from private firms, farms and households -- so that relatively less foreign aid and domestic investment is required to achieve growth. Domestic mobilization of resources also suggests the importance of promoting exports and conserving imports so as to preserve our foreign exchange.

The theme of "Mobilization of Domestic Resources for Renewed Economic Growth" is a central requirement for attainment of the basic development goals of Kenya Government as outlined in the current Development Plan, such as employment creation, food security, and a more equitable distribution of income, especially between rural and urban areas. Thus, the structural adjustment policies I have outlined today are designed to enhance employment creation in agriculture, industry and service sectors of our economy. Agriculture remains the largest sector of Kenya's economy -- the source of most of its jobs and most of its exports -- and must grow vigorously if the rest of the economy is to prosper.

Taken as a whole, the new taxation measures introduced today will bring an additional K£3.4 million in revenue. The balance of K£0.7 million will be financed from change in Exchequer cash -- thus closing the gap. This represents an overall deficit of 4.3 per cent of GDP in 1985/86. I would have liked to see a lower deficit but, considering the adverse effects of the drought which will take some time to remove, the need for increased Government services will continue to be necessary. I am however, convinced that, with the expected economic recovery, this level of deficit is sustainable.

Mr. Speaker, the Budget policies I have outlined today do not exhaust all the important structural adjustment policies that are required to be considered in the coming financial year. The Treasury is currently coordinating the preparation of a Sessional Paper on the major policy issues raised in the 1984-1988 Development Plan and will present a draft during the first half of the coming financial year.

In conclusion, Mr. Speaker, I have today outlined policy measures which I believe will consolidate the gains achieved under the programmes of stabilization and structural adjustments of the economy. Indeed, I have spoken on policies aimed at getting the economy growing by means of a general expansion in Agriculture and Industry. Further, I have expressed my optimism that, in spite of the recent setback, the economy is in a good position to recover from the drought, put other problems behind us and launch a period of economic progress. As we move on the road to progress, we are comforted by the enlightened leadership of H.E. the President whose NYAYO philosophy of Peace, Love and Unity remains a guiding star.

Mr. Speaker, I beg to move.