REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1995/96

(1st July–30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 15th June, 1995, by the Hon. W. Musalia Mudavadi, Minister for Finance, Republic of Kenya, presenting the Budget for the Fiscal Year 1995/96 (1st July to 30th June).

Mr Speaker, Sir,

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

1. INTRODUCTION

Mr Speaker, during the financial year 1994/95 which is now ending, we have carried the process of liberalisation and structural adjustment of the economy several steps forward - each step taking us closer to the goal of opening up the economy to private enterprise and to international competition. At the same time, we have implemented short term macroeconomic management policies aimed primarily at controlling inflation and stabilising the exchange rate.

These short-term policies have yielded the desired results. The 3-month-annualised inflation rate has fallen to 4.2 per cent in May this year which compares with 19 per cent a year earlier. Between June and October last year the exchange rate appreciated steadily to restore equilibrium and then stabilised for the next six months, ranging between KShs 44 and KShs 47 to the dollar. Since May this year, the shilling has depreciated to around KShs 53 to the dollar as the increased demand for hard currencies coincided with international pressures strengthening the dollar. The present level is likely to be nearer the longer term equilibrium rate and one which should provide greater encouragement to our exporters, import-competing industries and tourism, without penalising the importers. This general stability in the exchange rate is truly gratifying when we recall the steep depreciation and wide and rapid swings in the exchange value of the shilling to which we were subjected as recently as the middle of 1993.

This House will be pleased to hear, Mr Speaker, that we have achieved these results while at the same time being able to service all our official external debt on schedule. Moreover, we have repaid a portion of the accumulated debt service arrears as of December 1993 according to the repayment terms agreed then with the donors. At the same time we have been able to prevent a deterioration in our foreign exchange reserves, and I am happy to report that these reserves, including the foreign assets of commercial banks still equal 5 months of imports cover.

Mr Speaker there are also clear indications of the upturn in the economy which I forecast in my last Budget Statement. The Gross Domestic Product grew by 3.0 per cent in 1994, a remarkable rebound from the practically zero growth which we had to endure in 1993 and 1994. Food security was improved as the output of maize recorded a sharp increase during 1994, thanks mainly to adequate rainfall following the drought conditions of the previous three years. On the export front, export earnings from coffee remained high, and there was also a strong growth in our exports of non-traditional products especially horticultural items and manufactures. Supported by these and other inflows, our balance of payments recorded a healthy surplus of about K£ 250 million.

Nevertheless, while these welcome developments indicate that the economy has emerged from the instability and stagnation of the last few years, we cannot yet be certain that it is fully back on to the path of sustainable growth. A clear indication of that, Mr Speaker, will be available only when we can bring about a strong and sustained recovery in the rates of saving and investment.

Although much has been done in recent years to encourage both domestic and foreign direct inward investment, a great deal still remains to be done. For one thing, it is essential that we establish a track record of sound fiscal and monetary management evidenced by stability of prices, interest rates and the exchange rate. We cannot force entrepreneurs into investing here - we have to encourage them, both by providing a conducive enabling environment and by assuring them that as a nation we are committed to carrying forward the process of structural adjustment to completion.

It is now recognised by both the international and domestic business communities that we have implemented many major policy reforms already - in some instances introducing reforms ahead of time and more extensively than originally envisaged in our programmes in order to take advantage of improved economic conditions. Unfortunately, however, we have been slow in implementing other parts of the adjustment process, the most notable and difficult among them being the reform and/or privatisation of public enterprises. Another area which needs urgent attention is the improvement in the efficiency and operational costs of our infrastructural services in transportation, telecommunications, power, water and other production utilities. Furthermore, investors need to have the assurance of a healthy and educated workforce, an efficient and incorruptible public administration and a framework of licensing and other regulations which does not make them feel unwelcome. All these factors are required to encourage investment which is an essential precondition for sustainable long run growth and they will continue to constitute the priorities for our policies in the coming years.

Mr Speaker, as is usual, I will first comment briefly on the major developments in the international economic scene as these set the framework within which we have to operate. I will next turn to a more detailed review of our own economy and then specify the policies which we intend to put in place during the 1995/96 financial year and beyond which will continue to propel the nation along the path of sustainable long run growth.

2. WORLD ECONOMIC DEVELOPMENTS

Mr Speaker, the latest estimates show that in 1994 the volume of world merchandise exports rose by 9 per cent, the strongest annual increase since 1976, while the value of world merchandise trade increased by 12 per cent. There was also a 6 per cent growth in world trade in services. In GDP terms, the world economy in 1994 was characterised by a continuation and indeed acceleration of recovery in the major economies, patchy growth in the rest of the world and a better, but still disappointing, performance in Africa.

In general terms the growth rate in the GDP of the industrialised countries rose significantly in 1994 as these countries continued their climb out of the 1990-93 recession. For the OECD countries as a whole the average growth rate was around 3 per cent, which compares well with the mere 1.2 per cent recorded for 1993. Growth was stronger in the United States, Canada and the United Kingdom, more moderate in the rest of the European Union and particularly poor in Japan. In the developing countries, GDP growth in 1994 is estimated to be close to the average rate over the previous two years, that is a respectable 6 per cent plus. Once again, China set the pace with well above average growth, while in the other Asian countries, growth was rather modest, averaging around 4 per cent even in the South East Asian "tiger" countries. In Latin America, there was general progress towards economic stability in 1994, with growth rates averaging 4 per cent, but this was interrupted towards the end of the year by the looming Mexican peso crisis. Growth in the Middle East continued to be adversely affected by the slump in oil prices, which mitigated the impact of the new structural adjustment programmes, so that average growth in 1994 dropped to 3 per cent.

Mr Speaker, while many developing countries achieved commendable growth rates during 1994, once again performance in Africa tended generally to lag far behind, despite a general rise in non-oil commodity prices. Growth was constricted by drought, and by a series of wars and civil unrest, the most dramatic and shameful of these being the genocidal conflicts in Rwanda and Burundi. Average GDP growth during 1994 has been estimated at around 2.7 per cent. Although this was higher than the mere 1 per cent recorded for 1993, it was still way below the minimum growth rate required to fuel sustainable development, as the population of the continent continued to expand at around 3 per cent. Per capita incomes therefore fell again in 1994, continuing the decline which has lasted now for nearly two decades. Nevertheless, there is clear evidence now that countries which have been vigorously pursuing structural adjustment programmes, liberalising their exchange rates and increasing the degree of private ownership of their economies have tended to grow faster and on a more sustainable basis than those countries which have implemented these reforms halfheartedly or not at all.

The World Trade Organisation

Mr Speaker, before leaving this brief review of international developments, I wish to alert the House to a major change in the world regulatory environment. During 1994, the last hurdles were removed for the establishment of the World Trade Organisation as the successor to the GATT. Kenya, along with the other countries participating in the Uruguay Round, signed the Marrakesh Treaty in April 1994, and as a result, the WTO came into effective operation at the beginning of this year. The implementation of the Marrakesh Treaty is of great importance as it ensures that the advance of science and technology and the spread of economic liberalisation across the globe will not be strangled by protectionist pressures of the type to which economies like ours are highly vulnerable. The WTO is charged with the responsibility for overseeing the permanent reduction in global protection through the resolution of trade disputes between nations and adequate procedures have been put in place to enable it to enforce compliance even among the major industrial powers.

Agreements have been reached on all the significant areas of dispute in international trade relations. These include safeguard provisions, anti-dumping and countervailing measures, the liberalisation of trade in agriculture, textiles, clothing and all other products, trade related investment measures, trade in most services, and the protection of intellectual property rights. In addition, the negotiated reductions in tariffs have been substantial and irreversible. In the industrialised countries, the average tariff on a trade-weighted basis is to be reduced over the next few years to under 4 per cent and almost all developing countries including Kenya have also made substantial and binding tariff concessions which have consolidated the results of their individual structural adjustment programmes.

Mr Speaker, another area of opportunity for Kenya is contained in the provisions of the Treaty which require the removal of restrictions on trade in services. On the whole, there is no doubt that Kenya stands to gain substantially from these provisions. Although final agreement has not yet been reached, the eventual opening up of the COMESA markets, in particular, to freer trade in financial services, especially banking and insurance services, will clearly assist the Government in achieving its aim of turning Kenya into a regional financial centre. The prospects of Kenya benefitting from regional cooperation in the provision of tourism services are also very good and indeed we have already entered into some such arrangements.

While the programmed reduction in protectionist barriers under the WTO will open up new markets for Kenyan products, particularly for agricultural products and for labour intensive manufactures, we must recognise that our obligations under the new arrangements will have profound implications for the regulation of our own imports and for the collection of import duties. Kenya has already invoked its entitlement to a 5 year grace period to prepare our Customs Department and other agencies for the changeover to the new import valuation procedures but it is the intention of the Government to complete these preparations well inside this grace period. It is of great importance for Kenya to make these changes as early as possible as the extent of our compliance will materially affect the inward flow of export oriented investment.

Mr Speaker, we can take some pride in the fact that, in contrast to the great majority of African countries, Kenya has no need to invoke a grace period under the WTO for the liberalisation of its inward investment controls, as these have long been fully liberalised, with the exception of inward portfolio investment, and as most restrictions have been abolished on dividend and capital repatriation. An Interministerial Committee under the Ministry of Commerce and Industry has now been set up to keep the various provisions of the Marrakesh Treaty and the operations of the WTO under continuous review, in order to coordinate implementation and to defend our trade interests.

3. THE DOMESTIC ECONOMY

Mr Speaker, Hon. Members will now have read their copies of the 1995 Economic Survey so I will be brief in my review of the economy.

The growth of 3 per cent in GDP in 1994 reflects above all the generation of more funds for productive investment by the private sector. This investment, in turn, has been made more attractive not only by our macro-economic policy mix but also by the reduction in ethnic tension which in large measure has been due to the personal and unremitting peace making efforts of

His Excellency the President. It cannot be stressed too strongly that political stability is the cornerstone of the whole economic edifice.

Sectoral GDP

The latest information indicates that most of the 3.0 per cent growth in the economy last year reflected a 3.1 per cent upturn in the real value added in agriculture (including forestry and fishing), thus reversing the previous declines caused by drought. For the first time in over three years we were blessed with adequate rainfall, such that output of maize, wheat and beans went up very substantially, and the food security situation improved dramatically.

As this House is aware, our cereal and pulse farmers have been suffering from reduced or slowly growing incomes for several years. It is therefore a matter of particular concern to the Government that this commendable performance by our farmers last year was not matched by the growth in their incomes, as world prices including Kenyan prices were driven down by bumper harvests in the main cereal producing countries. Indeed, several of these countries in an effort to offload their surpluses in the export market weakened the price further through subsidies and other unacceptable incentives. With the liberalisation of our import regime, plus the huge grain purchases by the agencies concerned with feeding the many thousands of refugees still sheltering within our borders, producer maize prices dropped to about Kshs 450 per bag in December last year which is about half the prices prevailing in early 1994. In order to stop this decline, the Government instructed the NCPB to purchase over 6 million bags of maize at a price of Kshs 950 per bag making up a total cost of over K£ 300 million. This expenditure was not foreseen in our original Budget projections and it has had a major impact on our financial outturn which I will discuss later.

The situation as regards the performance of individual sectors last year was very mixed. A rise in world prices was responsible for the upsurge in export earnings from coffee while export earnings from tea fell sharply with falling world prices. The strength of the shilling in the second half of 1994 adversely affected the profitability of horticultural exports especially in the more vulnerable vegetable sector. There was a better performance by the industrial sector, with manufacturing output up slightly and a resumption of positive growth in the building and construction sector. There was also rapid expansion in the services sector, especially for financial services and even in tourism, at least in shilling terms. Upswings were recorded in most other services and even the service output of the Government sector grew marginally.

Investment and Saving

Mr Speaker, I am happy to note that gross fixed capital formation rose by 14.2 per cent in 1994, and this was sufficient to increase the proportion of total gross fixed capital formation to GDP at constant market prices by about 1.3 per cent to 15.3 per cent. Some 53 per cent of this investment came from the private sector, indicating that both local and foreign investors have responded positively to the recent incentives and with renewed confidence in the future of our economy. It is worth noting that the proportion of total investment financed by domestic saving increased from 79 per cent in 1992 to 94 per cent in 1994.

Balance of Payments

Turning now to the trade area, while the surplus of the overall balance of payments fell by 38 per cent to reach US$ 144 million in 1994, the current account balance recorded a surplus for the second year running at US$ 121 million which was 23 per cent higher than the corresponding figure in 1993.

As was to be expected following the appreciation of the shilling and the recovery of the domestic economy last year, commercial imports rose strongly, by 15 per cent to reach K£ 5,556 million. Most of this increase in imports, especially in the second half of last year, reflected greater imports of raw materials and capital goods which augurs well for future industrial expansion.

One would anticipate that the strengthening of the shilling would exercise a dampening effect on exports, so it is gratifying to record that domestic exports also increased by 15 per cent to reach K£ 4,171 million. As regards traditional exports, the rise in coffee prices was insufficient to counteract the declines in tea and oil prices and the earnings from these three main traditional export commodities fell by 3.9 per cent to reach K£ 1,750 million. It is therefore something of a relief to find that our export earnings from non traditional, mainly manufactured products performed very well despite the appreciation of the shilling. Overall, these rose by 34.1 per cent to reach K£ 2,420 million and their share of our total exports rose from 50 per cent to nearly 58 per cent last year.

The combined impact of these import and export developments was an improvement in our visible trade deficit by 12 per cent in 1994 to K£785 million. This deficit, however, was more than offset by an increase in our net total earnings from services and receipts of current transfers. Hence the balance of the current account registered a higher surplus of K£ 291 million.

Money, Credit and Interest Rates

Mr Speaker, we have made major progress in restoring monetary discipline during the financial year 1994/95. The money supply on an annualised monthly basis grew for most of the year at rates in the lower and mid 20 per cent range which compares with an average monthly annualised growth rate of over 30 per cent during the financial year 1993/94. However, these rates still remain too high and they reflect the impact of special circumstances which should not be repeated in the financial year 1995/96.

The shilling exchange rate for the dollar continued to fall during the second half of 1994 as a reflection of both international and domestic economic fundamentals to which I have already alluded. From a monthly average of KShs 56.2 to the dollar in June last year the rate appreciated to a peak of KShs 42.3 in October reflecting the large inflows of foreign exchange from donor agencies and from increased coffee and tea earnings, together with other sources, which destabilised the foreign exchange market for a short time and caused the shilling to appreciate rapidly. There was however a reversal of trends beginning early May when the shilling depreciated rapidly to reach levels above KSh.50 to the dollar once again. This was partly due to the appreciation of the dollar in the international market plus domestic factors including massive increase in demand for foreign exchange from importers and retention of export proceeds abroad. Following the correction, the shilling exchange rate has started showing signs of stability and now stands at KShs 53 to the dollar.

The impact of a high value shilling on our monetary policy was unfortunately destabilising. Despite the correction to end the October speculation brought about by vigorous intervention by the CBK in the exchange markets, there was widespread belief that the exchange rate remained substantially overvalued and that therefore an even greater correction was to be expected in the near future. The result was a substantial net redemption of Treasury Bills throughout the last quarter of 1994 (despite an improvement in their yields) which resulted in sharp increases in the money supply. This grew rapidly at an annualised rate of 30 per cent during the last quarter of 1994. Careful market intervention by the CBK in subsequent months has now reduced the monetary expansion to more acceptable levels. From the peak growth of 30.8 per cent in December, the annualised monthly growth rate of money supply had already fallen to only 27.3 per cent by April 1995.

Mr Speaker, substantial gains have been made in curtailing growth in the stock of domestic Government debt. This stood at K£ 5,751 million by the end of December 1994. Although this level is still high, at about 29.5 per cent of GDP, it nonetheless represents a great reduction from the peak of K£ 7,328 million reached at the end of 1993. While the reduction in the stock of debt was programmed, further reduction was hampered by the large payments for the support of maize prices to which I alluded earlier. Indeed, these pressures induced us to make a conversion of the overdraft in the cash book, amounting to some K£ 1,100 million into a loan which was taken up by the Central Bank in the form of long term stocks. Despite these extraordinary factors, however, appropriate measures were taken to redeem all the resulting securities held by the Central Bank by the end of the year. At the same time, there has been a substantial reduction in the stock of Treasury Bills brought about by large scale redemptions beginning in November 1994.

Mr Speaker, the current volume of domestic debt is still very high and needs to be reduced substantially. In pursuit of this objective, my fiscal policy has been to introduce more stringent fiscal control and Budget monitoring measures targeted at eventually achieving a budgetary surplus.

The need for prudence in the control of the money supply in the light of these developments reduced our ability to bring about a sharp reduction as we would have wished in Treasury Bill rates and hence in interest rates generally. However, progress continued to be made despite these developments and we have been able to reduce interest rates and thereby substantially increase the amount of credit available to the private sector. From an average of 33.6% in July last year, overdraft rates had fallen to under 22.8 per cent by April this year while over the same period credit to the private sector rose by 41 per cent.

Nevertheless, the substantial difference between bank overdraft rates and savings rates remains a matter of concern. The average lending rate during the financial year 1994/95 remained high at 23.3 per cent while the rates paid by the banks to savers averaged only 10.8 per cent, giving a spread of around 12.5 per cent. I appeal to the financial community to follow the logic of events more closely and to reduce this spread significantly so that savings and investment can both benefit.

Inflation

Mr Speaker, in my last Budget Statement I regretted that we had not been able to achieve our target of reducing the 3-months-annualised inflation rate to below 10 per cent. In May 1994, Hon Members will recall that this rate was 18.7 per cent. In fact, I was overly cautious in my inflation prediction as the 3-month rate proved to be negative for the rest of that year. Indeed, the annual inflation rate dropped from 41 per cent in May 1994 to a negative 1.9 per cent last month, while the 3-months- annualised rate has now been reduced to 4.2 per cent, well within our target of single digit inflation.

The struggle against inflation has often been likened to a war. If the former military Members of this House will not mind my borrowing this analogy, it can be said that although the 1994/95 financial year battle against this enemy is nearly won, the war against inflation remains continuous!

Mr Speaker, since the reduction in inflation is of critical importance for the encouragement of savings and the release of funds from consumption to investment, it is worth reminding this House of the principal reasons why the rate fell as it did. The main factor was the reduction in excess demand brought about by stringent control over Government spending which resulted in the sharp fall in the growth of the money supply, despite the large provision for the support of maize prices referred to earlier. Another factor was the encouragement of savings through the maintenance of positive real interest rates and the continued enforcement of the 18 per cent cash ratio. Savings were encouraged also by the perception of a more secure banking environment through the actions by the Central Bank to discipline individual errant banks. Yet another significant factor was the slow, but fairly steady, appreciation of the shilling, which, with the reduction in import duties in the 1994 Budget, sharply reduced the cost of imported goods.

The resurgence of GDP growth in 1994 to 3.0 per cent owed much to the control of inflation. However, we are aiming for even higher economic growth rates in the medium term. The achievement of these targets will depend in a critical way on our continued success in fighting inflation and thus reducing uncertainties and facilitating faster decisions on both savings and investments. Accordingly, Mr Speaker, the measures I will introduce today will further strengthen our weaponry in this war. The enemy has been substantially weakened, but he still lurks in the shadows and experience has shown that he can regain his strength with frightening suddenness. Continued vigilance is therefore essential. I assure this House that keen lookouts have been posted at strategic locations in my Ministry, that the "sentries" are alert and that the entire Government is determined that our economy will not again be invaded by this menace.

Financial Sector Developments

Mr Speaker, during the 1994/95 financial year, the Central Bank continued to utilise its powers effectively to ensure that our financial institutions continued to be prudently managed. We all recall the worrying times during the financial year 1993/94 when the soundness of our financial system seemed to be in question as several banks and other institutions went into liquidation. Prudent monetary policies, including the careful control of the money supply have put those days behind us for good. While the stability of the monetary system has greatly improved, continued vigilance is essential here too and the Central Bank is ready to intervene actively when required.

As a further means to the same end, non-bank financial institutions have been encouraged to convert to full banks and or to merge with existing banks. Already four such institutions have changed their status in this way. To facilitate this process, no new banking licenses were issued during the 1994/95 financial year. The steady growth of stock exchange business during the 1994/95 financial year has been a cause of particular gratification. Hon. Members will recall that in my last Budget I removed stamp duty from short-term commercial paper and this, with the exemption of stock exchange transactions from VAT, has clearly contributed towards the uninterrupted expansion in this business.

External Debt

Mr Speaker, at the end of the 1994/95 financial year, the total outstanding public external debt is expected to stand at US$ 5,545 million. The public sector foreign debt portfolio increased by 4.2 per cent in dollar terms during the 1994/95 financial year, reflecting the rescheduling of the arrears agreed last year with the Paris Club donors. However, Hon Members should note that we have remained current since then in the payment not only of the arrears, but of the main debt portfolio as well. Indeed, during the financial year 1994/95 we not only expect to have paid out US$ 188 million in interest and other service charges, but also to have redeemed US$ 341 million of the outstanding external debt.

4. THE POLICY FRAMEWORK

Consistency with Equity

Mr Speaker, the ultimate goals of our policies remain those of a self sustaining high rate of economic growth to be achieved through progressive liberalisation and structural adjustment, together with the eradication of social injustice and poverty in all its forms. Kenyan and foreign investors should note that the Government remains firmly committed to these policies and it is our intention to continue to guide the nation on a steady course by maintaining policy consistency.

Mr Speaker, in the coming financial year, our aim will be threefold. First, measures will be introduced to consolidate and reinforce the fiscal and monetary disciplinary measures already in place so as to eliminate any wasteful use of public resources and to ensure that the wananchi get the best possible return for their tax payments. This is clearly the basis of all future progress. Second, we will further expand the extent of economic liberalisation, and press ahead with the programmed restructuring of our economy in favour of private enterprise so that we can all benefit fully and quickly from the trade and investment opportunities afforded by the faster growth of the world economy. Third, while bringing about these changes in the control of Government expenditure and in economic restructuring, special provision will be made to ensure that the poorest sections of our national community share in these benefits in significant ways. Over the last three years, the low income groups have suffered disproportionately from the drought and the overriding requirements of structural adjustment. Today, I will introduce measures to improve their lot.

Mr Speaker, in my last two Budget Statements my central theme was *Economic Recovery through Fiscal and Monetary Discipline.* It is now clear that we have achieved a turnaround in the economy and that indeed both fiscal and monetary discipline have been substantially restored. However, we must continue to give the highest priority to the maintenance of economic stability as it is only in this way can the recovery be sustained in coming years. That said, the improved economic situation permits us to take further steps towards the alleviation of poverty and the improvement in social equity. Accordingly, my Budget theme for today is ***Sustaining Macroeconomic Stability for Growth with Social Equity.*** I will now describe in more detail the particular policies which we intend to put in place based on this general theme during the coming year and in following years.

Fiscal Policy

Mr Speaker, our central objective of fiscal policy remains reduction of the Budget deficit and its eventual elimination by the end of the 1995/96 financial year. This is so because a large fiscal deficit usually means the excessive siphoning of investible resources from the private sector on which all growth ultimately depends and their allocation to Government departments which often are not able to utilise them as productively. We have been pursuing this goal of fiscal deficit reduction with systematic vigour for some years now by improving tax collection yields on the one hand, and by severe control of expenditure at every level on the other.

Mr Speaker, during the past financial year, these measures were largely successful. Tax collections increased substantially last year, despite the fact that in many cases the tax rates had been substantially reduced. This increase therefore reflects, in large measure, the greater administrative efficiency achieved by the revenue departments and by the Tax Policy Unit in my Ministry, which the Government wishes to acknowledge here. This House recently passed the Kenya Revenue Authority Act which will come into full force at the beginning of the new financial year. The KRA will bring under one administration the collection of the major taxes and provision has been made for it to employ high powered staff to minimise tax evasion. I am confident that the revenue yields will increase in consequence and Hon. Members will be pleased to hear that the anticipation of these higher yields has been factored into my taxation proposals today.

We have been able to sharply reduce expenditure on most recurrent items while increasing the allocations for Operations and Maintenance expenditure (defined as non-wage recurrent expenditure less current transfers) to better ensure that returns were maximised in other expenditure areas. Furthermore, we continued to concentrate 75 per cent of total development expenditure towards core projects and ensured their full funding, while maintaining this expenditure constant as a proportion of GDP. Overall, Mr. Speaker, we were able to reduce the Budget deficit (inclusive of grants) as a proportion of GDP from 6.4 per cent in the financial year 1993/94 to 0.7 per cent in the financial year 1994/95. I remain confident, therefore, that we are now well on the way to eliminating the deficit in the 1995/96 financial year.

While the reduction in the budget deficit remained largely on target, there were major changes in the allocation of expenditures within the total in directions which were not originally foreseen. Although interest rates on Government debt continued to fall, the actual payouts were higher than expected because of the requirement to purchase maize, and the need to compensate civil servants with higher wages. These higher than expected outlays were accommodated in part by delays and adjustments in some development expenditures and savings from lower than anticipated payouts on behalf of the parastatals and for other debt servicing.

Mr Speaker, I would like to outline now some of the strategies which I will put in place this coming financial year to eliminate the budget deficit altogether. Of prime importance will be our commitment to engineer a major reduction in the Government's domestic debt by increasing the schedule of repayments, and by reducing our public sector borrowing requirement. This activity, in turn, will bring about a further reduction in interest rates. Already, this policy has had a significant impact on the expenditure position since January this year and during the 1994/95 financial year as a whole we expect to have repaid interest and principal on domestic debt amounting to K£ 1,779 million. This policy will be continued at a slightly more intensive level throughout the 1995/96 financial year in order to recover the ground lost during the maize price crisis.

Civil Service Reform

Mr Speaker, all employers have to manage the use of their staff as efficiently as possible if they are to maintain their personnel costs within reasonable limits. Being the largest single employer in the country, the Government has a particular responsibility to do the same. For several years now we have been rationalising employment in the central Civil Service with a view to increasing efficiency in carrying out the essential functions of Government, while at the same time reducing the tax burden required to meet overall salary costs which in the last financial year constituted some 60 per cent of recurrent expenditure.

This exercise is to be completed in three stages by the end of the decade, with the emphasis in the first stage on cost containment through reduction in staff numbers, shifting the emphasis to performance improvement and the development of greater policy analytic capability in the second stage, which in turn will enable us to introduce much more widespread and effective financial and management delegation in the third stage. Mr Speaker, we are now entering the second year of the first stage, which is to be completed in two years time. This stage calls for the reduction of at least 48,000 civil service positions by mid 1997, which is equivalent to almost 20 per cent of the June 1993 staffing levels.

Retraining and terminal gratuities are being offered under the programme to all retirees so that the manpower resources to be released will contribute to our national development more effectively in the private sector. The retraining programme has proved to be a great success. Spot checks have revealed that the majority of retirees have been able to apply their benefits both to increase their earning capacity and to generate employment.

By the end of the 1994/95 financial year, we will have been able to reduce staff numbers by some 20,000 officers without coercion, which represents a more rapid reduction than originally envisaged. The total cost of this reduction in terms of gratuities, training provisions and pensions came to K£187 million which was nonetheless close to the original estimate, as a higher than anticipated reduction was accounted for by natural wastage and redeployment. Similar reductions are to be expected in each of the next two financial years.

Mr Speaker, it has been our long standing policy to upgrade Civil Service pension allowances in line with increases in salaries. Unfortunately, there have been delays in making the full adjustments necessary since the last salary review in 1991. It is manifestly unfair that the lifetime efforts of public servants in the cause of our national development should not be suitably rewarded. To remedy these anomalies, I am now proposing an increase in the allocation in the Budget by about K£ 40 million to pay off the accumulation of arrears of pensions accruing to the end of the 1994/95 financial year in three annual instalments. In addition to this increase, with effect from 1st July 1995, the minimum pension will also be adjusted from the current low level of KShs 100 to KShs 500 per month. Hon. Members will be glad to hear that former Hon. Members will have their parliamentary pensions adjusted in the same proportion in accordance with the proposed Pensions (Increase) (Amendment) Bill, to be tabled shortly.

While with the fall in inflation there is no justification for compensation, I will be allocating a sum of K£ 100 million, within the wages bill, for a 50 per cent increase in medical allowances for civil servants and teachers. Furthermore, several employment benefits, especially housing allowances are being fully monetised. These developments and others to be announced later, which are made possible only because we have a leaner civil service, will continue to offset the savings in salaries to be obtained from the further contraction in staff numbers programmed for this year.

Mr Speaker, the reform of the civil service is proceeding hand in hand with the streamlining and restructuring of individual Ministries. The two largest Ministries in expenditure terms are the Ministry of Health and the Ministry of Agriculture, Livestock Development and Marketing, which together account for more than one third of non-interest central Government expenditure. Restructuring plans for these Ministries are now complete and will be implemented during the coming year. The other Ministries due to complete their restructuring include (1) Finance, (2) Land Reclamation, Regional & Water Development, (3) Public Works and Housing (4) Lands & Settlement.

Reform of State Enterprises

Mr Speaker, the restructuring and privatisation of State Owned Enterprises is a complex process and it is worth while to take a little time to remind ourselves of the purpose behind this exercise. As His Excellency the President stated in his Madaraka Day Speech, our policy aim is threefold, namely to reduce their financial burden on the Treasury, to improve the delivery efficiency of public services provided by them, and to restructure the public enterprise sector so as to enhance the opportunities for private investment. All three aims are important and interdependent.

Mr Speaker, realisation of these aims is a complex process as our public enterprises are spread over very many sectors and activities. The multiple objectives of a sale of public enterprises are that the nation gets the best value for money from the disposal of state owned assets, the contribution of these enterprises to the economy is enhanced, and that the services now provided by these enterprises will continue to be available reliably and at reasonable cost. To meet these objectives, we must often undertake fundamental restructuring prior to the sale of the large enterprises to ensure their future as going concerns. This process of financial and managerial restructuring renders the privatization time schedules long and uncertain, especially for some of the large and complex enterprises.

Restructuring of enterprises requires induction of new managerial and technical know-how, and fresh investment capital. For this purpose we actively seek foreign investors when implementing privatization. While we welcome foreign investors for above reasons, it is our intention to dispose of government shareholding in enterprises in such a way as to provide maximum opportunities to Kenyans to participate in the privatisation process. One constraint to realization of wide-spread Kenyan participation that we have faced is the legal pre-emptive rights of our co-shareholders. While the co-shareholders hold legal rights, I appeal to them to forego their rights when requested in the spirit of enhancing national participation. Their co-operation will assist the Government to sell shares through Nairobi Stock Exchange to Kenyans on whose behalf the Government holds the shares.

It was for this reason, Mr Speaker, that I mentioned in my opening remarks that progress in this area may have been slower than hoped for. Nonetheless, Hon. Members will be aware from recent public announcements that substantial progress has indeed been made over the last financial year in the programme of privatising and restructuring of State Enterprises. At the start of the programme some two years ago, we had 207 public enterprises available for privatisation, including those in which the Government had a minority shareholding. By last month, 61 of these had already been sold off, generating a total of K£20 million to the Treasury and a further K£100 million to the Industrial Development Bank, the Industrial and Commercial Development Corporation, the Kenya Tourism Development Corporation and other holding corporations.

Among the major parastatals, ***Kenya Airways,*** with its subsidiary Kenya Airfreight Handling Ltd has been brought to the point of sale which should be completed before the end of this calendar year. The restructuring of ***Kenya Railways*** is underway, the first stage of which will be the separation of passenger services as an autonomous business and the contracting out of the maintenance of its locomotives early next year. The privatisation of its subsidiary, Gulf Marine Services, is also imminent. The ***Kenya Ports Authority*** has already contracted out maintenance of its equipment and is in the process of further improving these contracting out arrangements. A study to evaluate the potential for the privatisation of the container terminal and other activities has been completed.

In recognition of both the vital importance of efficient telecommunication services for our development and the huge sums needed for its improvement, the Government has made a decision to privatise the telecommunications business of the ***Kenya Post & Telecommunications Corporation*** except for the core functions which pertain to national security. Accounting procedures to separate the posts and telecommunication parts of the Corporation have been put in place already so as to facilitate the operation of these two activities as autonomous businesses. Separating of the two parts of the business of the Corporation will ensure that rapid growth and modernization of telecom services is not inhibited.

In the ***power sector,*** an action plan for the reform of the organisation, management and financial structure of all the power sector companies has been drawn up to facilitate the organisational separation of the generation, transmission and distribution functions prior to attracting private investment from independent power producers in new power generation assets.

Among the smaller State Enterprises, three cotton ***ginneries*** have been sold off and a further four have been brought to the point of sale. A study for privatising ***sugar factories*** has been completed and plans are well under way to privatise the Mumias Sugar Company. The transfer of Kenya Tea Development Authority shareholding in its 43 ***tea factories*** to smallholders is complete. Indeed, Mr Speaker, it is the Government's intention to dispose of one third of the remaining State enterprises in the course of this year and, based on the progress made so far, I am confident that this target can be achieved.

In addition to these activities, Mr Speaker, we have taken firm action to stem the drain on the revenue from past inefficiencies. A cross-debt study was completed to determine the debts owed by Parastatals and Ministries and Government departments to each other. An Arbitration Committee and a Clearing House to manage settlement of cross-debts is to be established. Performance contracts have now been negotiated with the major parastatals setting out in precise detail targets for services and for accountability the Government can expect from them. The performance contracts also specify the level of compensation they are to receive from the Treasury towards the subsidised cost of socially necessary services. By realising savings in these corporations we will substantially increase budgetary resources for health and education services while their improved efficiency will also make our manufacturing enterprises more competitive.

Indirect subsidies to parastatals in the form of exemptions from direct and indirect taxes have been eliminated and steps have been taken to recover the large tax arrears outstanding. Since the introduction of the fee of 2 per cent imposed for new guarantees given by the Government to public enterprises the number of such requests has been drastically reduced. In addition, from January this year, the Government is charging market rates of interest on any payments made by it on behalf of the parastatals. New loans onlent from Treasury to the parastatals are already being charged market rates of interest since 1st July 1993. Furthermore, parastatals operating in competitive markets have been given a high degree of autonomy in setting their tariffs according to commercial considerations.

Mr Speaker, in the case of agricultural commodities, Hon. Members will recall that the monopolistic position of the Kenya Planters Cooperative Union in coffee milling, and those of the Kenya National Trading Company, the National Cereals and Produce Board and the Kenya Cooperative Creameries in the distribution of sugar, maize and milk respectively, were eliminated last year. This liberalization of distribution and importation has regrettably resulted in some cases of price speculation and dumping. Vigorous action is being taken against those involved in dumping and importing sub-standard commodities, which I will refer to in a few moments, but these are strictly temporary inconveniences and they will not divert us from our long term goal of liberalisation to strengthen competition.

Monetary Policy

Mr Speaker, as I have mentioned earlier, we have been very successful during the 1994/95 financial year in lowering inflation, reducing interest rates, controlling the expansion of the money supply and stabilising the exchange rate. However, continued success in these fields cannot be taken for granted. Indeed, the increased instability in the world monetary system, characterised by massive currency switches, severely limits our freedom of action now that we have liberalised the exchange regime. Another worrying factor is the expansion of the money supply, which in some months last year was excessive and the average growth for the year as a whole remained too high for comfort. We will need, therefore, to consolidate our gains by maintaining a tight monetary position during the 1995/96 financial year in order to provide sufficient leeway for the resumption of high rates of GDP growth. Nevertheless, as the demands of the public sector on the economy are expected to contract during the 1995/96 financial year, some reprogramming of the incidence of monetary stringency is possible, and some easing of particular elements of the very tight credit squeeze of last year is now desirable so that maximum advantage can be taken by the private sector of the new growth opportunities.

Mr Speaker, the objective of monetary policy during the 1995/96 financial year will be to maintain the rate of inflation within the single digit range. Consistent with this objective, total money supply is targetted to expand on average by 16% in the financial year. This will be achieved mainly through a substantial reduction in credit provided by the banking system to the Government. Moreover, with effect from July 1995, all Non-Bank Financial Institutions will be required in a phased manner to maintain with the Central Bank a minimum level of cash balances in order to further contain monetary expansion. In addition to enhancing the effectiveness of monetary policy, this requirement will benefit the banking industry as a whole because it will facilitate further reduction in the cash ratio imposed on all depository financial institutions.

This ambitious programme, Mr Speaker is yet consistent with our firm intention during the coming fiscal year to bring about both an increase in the domestic savings ratio and reduction in real interest rates. As already noted, the overall method of achieving this will be by engineering a fiscal surplus so as to bring about a substantial net redemption of domestic debt. Furthermore, a higher proportion of the balance will be refunded in terms of longer term maturities. In addition, the terms on which Ministries can access the Government's preferential overdraft facility at the Central Bank are being reviewed in order to reduce such access and to speed up repayments.

Financial Sector Reform

As Hon. Members will recall, in the 1994 Budget, I suspended all the regulations pertaining to the Exchange Control Act. Mr Speaker, it gives me great pleasure now to announce that appropriate modalities have been worked out to repeal the Exchange Control Act in its entirety. Appropriate legislation will be tabled in Parliament before the end of the current session. To move further on the road towards the complete liberalisation of the foreign exchange system, the Central Bank is already issuing licences for foreign exchange bureaux. These will provide additional competition to the commercial banks in the determination of the rate of exchange and of the spread between buying and selling rates which are presently high by international standards. This development will be of particular value to our tourists, most of whom wish to exchange only modest sums at any one time.

As part of this progressive liberalisation, I am easing the restrictions on inward portfolio investment. From today, the limit on portfolio investment by foreigners in Kenyan companies quoted on the Stock Exchange will be raised from 20 per cent to 40 per cent and the limitations on individual portfolio holdings will be raised from 2.5 per cent to 5 per cent. These changes will open up many new sources of investible funds for Kenyan companies and should help to push down interest rates further. The limitation of individual portfolio holdings will continue to ensure that Kenyans are able to play their full part in the development of their own stock exchange. These measures go far to complete the global integration of the Kenyan economy.

Mr Speaker, the capital markets sector plays a key role in mobilising both local and international financial resources for productive investment. During the 1994/95 financial year, there has been a substantial increase in the volume of stock exchange transactions following the improved regulation under the Capital Markets Authority. The Exchange has now developed to a point where it is able to support the core financing needs of the Authority without recourse to the Treasury. The Authority needs funds to train and retain a team of high calibre professionals within a highly competitive environment. The stock exchange is operating in a largely tax free environment so it is reasonable to expect those who benefit from these tax exemptions to contribute to the further development of the institution within which they operate.

Accordingly, I am publishing today a schedule of the fees to be charged by the Capital Markets Authority for the services it provides in accordance with the Capital Markets Authority Act which will thereby enable it to move rapidly towards complete self financing and also contribute towards the establishment of a Compensation Fund for investors. In order to encourage market turnover, the current level of commission rates will be reduced with effect from July, 1995. To further the development of this sector, the Government is encouraging the establishment of an independent central depository for the mobilisation of financial securities, which will minimise risk in clearing, settlement and registration time and thereby help to increase the turnover at the Exchange. I will table appropriate legislation for this as soon as modalities for establishing such a facility have been drawn up. The private sector is also urged to establish a Credit Rating Agency to improve risk assessment for debt securities and thereby facilitate their trading in the Exchange.

Mr. Speaker, to streamline the collections of the Reinsurance Premium Tax and to ease the cash flow position of insurance companies, I am allowing this tax to be paid on a quarterly basis instead of monthly as hitherto. I am also directing the Insurance Advisory Board to work out the modalities for establishing a Policy Holders Protection Fund to protect policyholders in the event of the collapse of their insurers. Finally, to further increase the soundness of the financial system, steps will be taken to strengthen the powers and effectiveness of the judiciary in enforcing contractual obligations. In this regard, two judges of the High Court have been assigned specifically to handle commercial cases.

Policies on Employment

Mr Speaker, it is encouraging to note that the resumption of growth last year had a positive impact on employment generation. This demonstrates that our structural adjustment programme is performing as intended by increasing job opportunities in both the formal and informal sectors. During the 1994/95 financial year, the number employed outside the rural small scale and pastoralist sector grew by around 12 per cent to reach 3.36 million. Within this total, the employment in the informal sector, excluding self employed and unpaid family workers, rose by 22 per cent to reach 1.79 million while in the modern sector, wage employment grew by 2 per cent to reach 1.5 million. All of this growth came from private sources as public sector employment remained stagnant.

Mr Speaker, the goal of our employment creation policy is not only to increase the number of jobs but at the same time to bring about the improvements in the average productivity of labour which are necessary for us to maintain our growth momentum and to remain competitive in export markets.

Apart from providing increased resources to upgrade workers' technical skills, this policy seeks to redeploy workers to more productive activities in different occupations and regions. Our Civil Service Reform Programme is central to this policy of re-deployment. As the bulk of our people earn their living from the land, our efforts to improve the productivity of the agricultural sector through improved access to market centres and improved extension and other services have direct implications for employment growth. It is against this background that the allocations in the Budget for primary roads and rural access roads is increased from K£59 million this year to K£72 million in 1995/96. In the industrial sector, we are improving labour mobility by reducing rigidities in the labour market while increasing the opportunities for both technical and managerial training to provide greater career flexibility. To complement these efforts, the Government is also reviewing the National Industrial Training Levy System and the trade testing and certification system as a first step towards the radical overhaul of our national training strategy.

We will also continue our efforts to ensure that women participate and benefit equally from the development and political process. Our consistent approach is to integrate women into mainstream activities rather than to create special employment programmes for them. However, special emphasis will be put on technical training and other skill enhancement programmes for women and in recognition of their vital role in the rural areas.

Mr Speaker, the Government places particular emphasis on the development of cost efficient and market oriented jua kali enterprises, which of course often include women's groups. The sector uses less capital per worker and the ratio of value added to fixed assets is higher than in formal enterprises. The jua kali sector also makes extensive use of recycled and locally available inputs and has extensive forward and backward linkages. The Government is already implementing a major programme funded by the World Bank for improving productivity in this sector.

However, the jua kali sector suffers particularly from low productivity, erratic quality control and consequently from limited product and customer markets. It also suffers from very limited access to credit, inadequate management skills and poor market organisation. These factors have contributed to the very high rate of enterprise mortality. District Trade Officers are now organising appropriate management training schemes and encouraging the amalgamation of some enterprises into more viable groups. This reduction in fragmentation has already yielded positive results in terms of reduced enterprise mortality and improved employment.

Mr Speaker, the unemployment problem has particular poignancy in respect to our youth. It is estimated that nearly 60 per cent of our population is under 20 years of age and so youth unemployment is one of the most critical socioeconomic problems we face. Therefore, the budget proposals I am presenting today include funding for our ongoing efforts to upgrade the technical skill of our youth through vocational training in our Harambee Institutes of Technology, Youth Polytechnics and other higher education institutions for which a total of K£ 10.5 million is included in the Budget. Funding has also been provided to increase the annual intake into the National Youth Service from 2,000 to 3,000 trainees each year. This will create a larger pool for further training in specialized skills.

Export Promotion Policies

Mr Speaker, the commitment of the Government to the promotion of exports is well known, as is the fact that our prosperity depends in a unique way on our ability to export profitably. Indeed, it is our consistent objective to remove all administrative constraints on export competitiveness, and to encourage the transition of Kenya as rapidly as possible to an export-oriented status comparable to that presently enjoyed by some of the South East Asian countries. I have no doubt that Kenya is capable of achieving this transition well ahead of any other COMESA country and, indeed, of any country in Africa, as our exporters have demonstrated their resilience time and time again, especially in the face of the economic difficulties we have experienced in the recent past.

In accordance with our steady progression towards sustainable export development, sweeping changes were introduced in the last Budget to improve the enabling environment for our exporters. Tariffs were substantially reduced and restructured, export duties were abolished, capital allowances were improved and measures were taken to improve the provision of short-term export finance. Major improvements were also introduced into the foreign exchange and insurance regulations and local supplies to companies manufacturing under bond were zero rated for VAT. It is clear from our export performance last year that these policies are already having a positive impact. As I have noted already, exports of goods increased in dollar terms by 24 per cent in 1994.

Mr Speaker, I have referred already to the recent destabilisation of the world currency markets which has resulted in the appreciation of the shilling. Most of our export prices are denominated in hard currency and competitive pressures put severe limits to the extent to which they can be adjusted upwards to maintain shilling profit margins. The magnificent achievement of our exporters in the face of the appreciation of the shilling deserves special commendation. I wish to assure them all that the Government fully appreciates the difficulties they have encountered thereby. We are committed to realizing a smooth transition to a more competitive exchange rate as soon a possible, and we have moved some way in this direction in recent weeks. However, it must be recognised that our ability to intervene effectively in the currency markets is limited both by the need to preserve our current liberalisation momentum and by our very limited influence on global market pressures.

The recent fluctuations in the exchange rate for the shilling have had differing impacts on manufacturing and other exporters. While manufacturing export companies have been able to take advantage of the recent strength of the shilling to reduce their import costs and thereby to maintain their competitiveness, the import cost element is comparatively small for horticultural producers and for other exporters of agricultural products and of basic raw materials, so that their export profits have been seriously impaired.

The appropriateness of the existing export incentives to the current situation is being kept under constant review. Today, I will introduce several measures to reduce the fiscal burden on exporting companies including the reduction of tariffs on a wide range of raw materials and capital goods. As the administrative capacity of the EPPO and other agencies improves, I will consider introducing additional fiscal measures in the coming months.

Mr Speaker, I am pleased to announce that arrangements have now been put in place for the contracting out of the verification functions of the EPPO in connection with the various duty/VAT remission programmes and that the EPPO staff has been strengthened to supervise this. This development will improve the attractiveness of the various duty/VAT remission programmes as incentives to exporters and to other approved users by speeding up the reconciliation process so as to reduce the delays many of them have experienced in the cancellation of their security bonds. At the same time, the new arrangements will facilitate the collection of residual duties accruing on imported materials not utilised for the intended purposes and thereby sharply reduce the levels of economic sabotage.

The contracting out of the EPPO verification functions has been extended to encompass the manufacturing-under-bond companies. While the great majority of these companies are dedicated exporters who export 100 per cent of their output, there is evidence that a few companies have abused their privileges to facilitate fraudulent sales into the home market. The enhanced verification capability will ensure that such criminals are swiftly and surely brought to book.

Mr Speaker, the Treasury is holding discussions with potential private investors towards the establishment of an export credit guarantee scheme. This would offer guarantees against both commercial and non-commercial export credit risks. However, Hon. Members should be assured that, in line with our policy, the Government will not take any equity stake in the enterprise when it becomes operational.

Trade Relations Policies

Mr. Speaker, I would like to turn now to the important area of trade relations. I have already dwelt at some length on the implications of the World Trade Organisation for Kenya and so now I will deal with particular trade relations arrangements nearer home.

Chief among these is the East African Cooperation Council composed of the three East African countries. The importance of these discussions is highlighted by the fact that in 1994 Tanzania and Uganda together accounted for over 52 per cent of our African exports and for about 24 per cent of our total exports. Furthermore, our export trade with Africa and with our East African partners, in particular, comprises a much higher proportion of non-traditional products, especially high-added-value manufactured products with good backward economic linkages.

Continuous discussions are taking place at the Council Headquarters in Arusha on the harmonisation of tariffs. Mr Speaker, we are already far down this road and I will be announcing some measures today in harmony with my Tanzanian and Ugandan counterparts, who are also presenting their Budgets today .

Measures which have been adopted already by COMESA to facilitate intra-regional trade include (1) harmonised transit road charges, (2) the adoption of the Road Customs Transit Declaration Document and of (3) the Single Goods Declaration Document, together with (4) the impending adoption of the Customs bond guarantee scheme. Among the other measures which are under active discussion that may be mentioned include double taxation agreements and cross listings on regional stock exchanges. The Government will continue to press our COMESA partners for the speedy adoption of these and other measures required to achieve our aim of a customs union with a common external tariff by the year 2010

Investment Promotion Policy

Mr Speaker, our long standing investment promotion policy is threefold, namely (1) to encourage inward and domestic investment by removing fiscal and other regulatory constraints which increase investment risk, (2) to give priority in approvals in all sectors of the economy to job creating, domestic resource utilising, infrastructural and export-oriented investments and (3) to facilitate the privatisation of the State Enterprises and other services to which I have already alluded.

I have also noted the encouraging upturn in private sector investment which took place last year and which indicated renewed confidence on the prospects for our resurgent economy. The commitment of the entire Government to investment promotion was demonstrated in a conclusive way last November when His Excellency The President led a high powered delegation of economic Ministers and other senior officials to London for a special and very successful conference of the Confederation of British industry. His Excellency The President has also taken the lead in addressing conferences of Kenyan companies and encouraging them to respond positively in investment terms to the improved economic climate.

The message which is given at these and other fora continues to be that Kenya's growing internal market and rising manufactured exports to Africa and elsewhere provide a solid basis for profitable business. Moreover, the liberalisation of the economy in terms of the tariff and exchange regimes, the rationalisation of trade licensing and the removal of discretionary clauses in the tax laws have substantially reduced the level of business risk here, while opportunities for corruption have been reduced through increased transparency and greater vigilance. At the same time, the availability of over 200 State Enterprises for privatisation plus the high levels of privatisation and competition now being put in place in respect of the infrastructural parastatals means that there are ample opportunities for every investor.

Mr Speaker, these are indeed enviable components of an investment promotion strategy but there are still areas of concern which need to be addressed and which directly inhibit the effectiveness of our promotional efforts. Among these is the delays in obtaining initial investment approvals and the various licences still required by central and local government agencies, and the time lost in making initial and renewal payments to the administering agencies.

To take the licensing issue first, while several licensing requirements have been reduced since my last Budget through the amendments to the Trade Licensing Act, further work remains to be done in this area. Many of the licences still required relate to environment or employment requirements where the scope for their further relaxation is limited. Others relate to community concerns of the local authorities and in some cases the licences required by them simply duplicate the licenses being issued by central government agencies and are imposed for financial rather than regulatory considerations. I will shortly refer to the important measures which I am now proposing to improve the organisation of local authority financing which should reduce the need for such duplicative licenses. Efforts are also being made to improve the administration of those licences which need to be retained. A Special Task Force is being formed of central and local government agencies to make recommendations for further relaxation and harmonisation of licensing regulations.

Further, Mr Speaker, the investment approval procedures currently applied include an element of vetting the commercial viability of the proposals. While this procedure was necessary in the initial stages, there is something invidious in the situation where civil servants approve the commercial soundness of the investment decisions made by the private sector. To ensure that in the competitive race for investors Kenya is not left behind, investment approval procedures in future will be confined to environmental, safety and other non-financial issues.

Industrial Policy

Mr Speaker, the progressive reduction in our tariffs and the removal of exchange and import restrictions is designed to improve resource allocative efficiency in our economy by stimulating greater competition. As we have seen, there is clear evidence that our industries are now adapting to the less protective domestic environment by cost cutting and the adoption of more efficient technology, while at the same time there has been a sharp increase in the number of companies actively engaged in production for export despite the high value of the shilling.

While these developments are encouraging, an unfortunate side effect of trade liberalisation has been the increase in dumping activity. Fair competition based on quality and unsubsidised prices is to be welcomed as a stimulus to development. However, where manufactured goods are being sold here at prices which are made artificially low by hidden or overt subsidies from the governments in their countries of origin, it is necessary to impose countervailing duties to prevent permanent damage being inflicted on some industries for the benefit of a few. It is regrettable that some countries, including some in our own continent, remain active in unfairly subsidising their exporters despite their solemn undertakings to the contrary. The Government has already taken action to impose countervailing duties where such cases have been brought to its attention. I would like to assure this House just as we are determined to stimulate competition, we are equally determined to stamp out unfair competition derived from such subsidies.

Mr Speaker, a large proportion of the goods landed at Mombasa and other ports are destined not for Kenya, but for transit to our neighbouring countries. Such goods therefore are not subject to the preshipment inspection requirements affecting most imports intended for Kenya and they do not pay duty. Unfortunately there is evidence that a significant proportion of the transit imports are fraudulent in that they are actually intended for sale inside Kenya. This practice has seriously affected the markets for some of our legitimate industries, particularly textiles. Discussions are now at an advanced stage with the customs authorities in our neighbouring countries to tighten up controls to eliminate this menace.

Energy Sector Policies

Mr Speaker, the Government recognises the critical importance of the energy sector in our economy and has embarked on a major programme of reform to enhance the efficient provision of petroleum and electricity through the commercial sector. Hon Members may recall that petroleum prices and the supply of petroleum fuels were liberalised last October. Since then, individual companies have been free to import and to set their own prices, while the privileged positions of the National Oil Company of Kenya and the Kenya Petroleum Refineries Limited in the supply of crude oil and refined products to the domestic market were removed. Furthermore, in order to encourage the KPRL to restructure its operations, the refinery throughput tax was abolished last year and was replaced by a temporary and diminishing duty on imported petroleum fuels.

Mr Speaker, I wish to express the Government's disappointment that the retail price of petrol and other products has not been reduced following the liberalisation. I appeal to all consumers to exercise their new market power to bring about a moderation in these prices by confining their purchases to the cheaper outlets.

At the time of decontrol there were no facilities for handling imported LPG used for cooking. As a short-term measure to ensure adequate supplies of this crucial commodity, the Government now requires the oil companies to process adequate amounts of crude oil into LPG pending the urgent installation of adequate LPG storage and handling facilities by the Kenya Pipeline Company (KPC). The KPC capital requirements for these developments are being met from the Petroleum Development Levy Fund. However, the Government encourages private investors to participate in this investment.

I turn now to the development of the electricity sector, where in contrast to the petroleum sector, the supply and distribution still remains under the control of the energy parastatals. I have already outlined our privatisation and restructuring plans for this sector so I will be brief. A comprehensive reform package to enhance the efficiency of this sector with the participation of private investors has now been put in place. Electricity tariffs are being adjusted in a staged programme to better reflect long-run marginal costs and these costs in turn are being reduced through major staff retrenchment, contracting out of non-essential services and organisational restructuring.

Private investors are being encouraged to participate in power generation, particularly in the 64 MW geothermal plant at Ol Karia and a second 75 MW generating plant at Kipevu, and additional power stations are now being planned on the basis of private sector participation. The generation tariff offered to the private sector companies will be determined through an international competitive bidding process. In the meantime, work is underway towards the construction of the new 75 MW diesel powered facility at Kipevu, which will shortly be brought on stream to ease the current generation capacity constraints.

Road Improvement Programmes

Mr Speaker, the infrastructural area which requires most immediate attention from the point of view of potential investors is our road network. Kenya now has some 63,000 kilometres of classified roads of which only some 14 per cent are bituminised. Although substantial sums have been allocated by the Government towards highway maintenance in recent years, these have not been adequate to prevent a general deterioration in the quality of our major and minor roads, not only in terms of surfaces and operational widths, but also in terms of drainage facilities and road signs. The poor condition of the great majority of our roads directly limits the scope and increases the cost of our export operations and of our production activities generally.

It was to provide additional funding for this purpose that the Government introduced the Road Maintenance Levy in the last Budget as a surcharge on petrol and diesel sales in place of the road tolls, all of which was earmarked as Appropriations-in-Aid. During the 1994/95 financial year I expect to have spent over K£75.0 million derived from this levy in addition to the allocation of K£41.53 million for road works made available directly from the Treasury to the Ministry of Public Works.

The Kenya Urban Transport project is introducing new finance and action oriented construction, operation and maintenance programmes in the transportation sector in Nairobi, Mombasa, Kisumu, Nakuru and Eldoret and many other towns. An amount of K£ 12 million from the Road Maintenance Levy is being allocated to this project. The programme is designed to enhance capacity and improve the deployment of technical staff through the development of more cost effective operation and maintenance procedures. It will also facilitate the contracting out of certain maintenance services to private operators. It is our intention to extend the scope of such contracting out for road maintenance functions in the near future.

Mr Speaker, to underline our commitment to devote adequate funds for road maintenance, I am now proposing to allocate K£ 156 million for this purpose during the next financial year, of which K£95 million will be derived from the Road Maintenance Levy Fund. Finally, I would like to assure this House that all the revenues from the Road Maintenance Levy Fund are being dedicated to road maintenance.

Policies on Agriculture

Mr Speaker, I have noted already that the agricultural sector provided the greatest stimulus to the recovery of the economy in 1994. This is not surprising as the sector contributes about 27 per cent to our GDP, accounts for about 60 per cent of our export earnings and absorbs about 70 per cent of our labour force. Historically, the Kenyan economy has always been driven by the agricultural sector and in recognition of this, the Government has given the highest priority to its continued development. Our policy here since Independence has consistently focused on three interlinked elements, namely the maintenance of food security, the generation of rural employment, and the alleviation of rural poverty.

Mr Speaker, as I noted earlier, the Government took the extraordinary step of purchasing surplus maize through the NCPB during the 1994/95 financial year in order to prevent a serious fall in farmer incomes caused by the combination of high domestic production on the one hand, and huge imports for relief and commercial purposes on the other. The NCPB has now embarked on a programme to dispose of these extraordinary purchases as soon as possible by selling maize both internally to aid agencies and others and also for export. The proceeds from these sales will be used immediately to clear the arrears due to farmers.

It is possible that the current surplus will be maintained. To provide adequate storage capacity in the immediate term and thus help to maintain farmer incomes, the NCPB is now taking steps to make available to the private sector the part of its storage capacity which is surplus to our strategic reserve requirements. The private sector is also being encouraged to enter the maize export markets in a major way so long as this does not compromise our food security.

I have already referred the need for countervailing duties to prevent the dumping of subsidised manufactured goods into Kenya. Unfortunately, Mr Speaker the provision of subsidies is not confined to manufacturers alone Agricultural exporters from the major supplying countries in N. America and the European Union have also been in receipt of massive subsidies, particularly in respect of cereals, sugar and dairy products. Sometimes the benefits to the consumer are greatly outweighed by the damage to farmers livelihoods. Indeed, as we have seen recently with the attempted importation of contaminated milk, the benefits to the consumer from cheap prices can be completely illusionary. Earlier this year, it was apparent that the variable duty system was being circumvented, and it is for this reason that we suspended the importation of maize, wheat, milk and sugar. Conscious of our commitments under the WTO, however, this import ban will be replaced by a new duty structure today which will facilitate the lifting of this suspension.

Mr Speaker, the agricultural sector has always been in chronic need of credit on reasonable terms, while the particular conditions of agricultural production have limited the availability and increased the cost of the credit provided by the banking system. In recognition of the strategic importance of the agricultural sector, the Government has supported the provision of such credit mainly through the Cereals and Sugar Finance Corporation, the Agricultural Finance Corporation and the Cooperative Bank. However, our experience with the loan recoveries of all these specialist credit institutions has been discouraging. Hon. Members are aware that the Treasury has to guarantee these institutions against most defaults and this has had serious repercussions on our fiscal deficit. We are, therefore, presently reviewing the situation to devise more cost effective financing.

Policies on the Environment

Mr Speaker, while giving development the highest priority, the Government is acutely conscious of its grave responsibility to preserve our national environment for the benefit of future generations. Rising population pressures, migration and rapid urbanisation have increased the need for urgent actions to address Kenya's environmental problems.

The National Environment Action Plan which details specific programmes in this area was adopted last year. Complex institutional modalities are now being put in place to ensure the widest possible participation and consensus which is essential for the success of the environmental decision making process. When this process is completed, it will be our policy to require all new development and investment projects, whether public or private, to be subject to environmental impact assessment and monitoring. Such environmental assessment is already in place for all energy sector projects.

Local Government Reform

Mr Speaker, it is estimated that almost 21 per cent of the population now live in towns which compares with just over 18 per cent five years ago. Put another way, the urban population has shot up in this period by 1.2 million or by 29 per cent. Further, Kenya now has 143 Local Authorities comprising municipal councils, county councils, town councils and urban councils which are responsible to the public for the provision of a large variety of services. These include primary and pre-primary education, health, housing, water, sewage disposal, road construction and maintenance. Demand for these services has been rising rapidly in recent years as there has been a continuous migration of population to the towns.

To finance these services, Local Authorities are empowered to collect land rates, licence and cess fees in addition to the service charge. They are also entitled to borrow from donors and from the Local Government Loans Authority. However, the existing sources of Local Authority revenues are narrow, and the Authorities have not been able to finance a service provision from their revenues adequate to cope with this upsurge in demand. Consequently, they have run up persistent deficits, particularly on their capital accounts. These budgetary pressures have meant in turn that the quality and availability of the services actually provided has tended to fall far short of acceptable standards. Moreover, the administration of several of these fees and cess charges has sometimes proved to be a significant hindrance to the development of a competitively efficient export-oriented businesses.

Mr Speaker, in addition to the sometimes disastrous impact this service deterioration has had on ordinary wananchi, the poor state of local authority services acts as a significant deterrent to potential investors.

The total debt owed by the Local Government Loans Authority now exceeds K£ 300 million, of which approximately two thirds is in arrears. This debt is considered uncollectible, leaving the Treasury without an important source of revenue. In addition, Hon. Members will be saddened to note that the Nairobi City Council itself has an outstanding external debt portfolio of K£ 138 million, and the Treasury is obligated to shoulder the burden of paying off foreign creditors on its behalf. The National Housing Corporation has also borrowed money from external creditors as well as from the Treasury in order to build houses and to provide housing loans managed by the Local Authorities. The inability of the Local Authorities to repay their loans has severely affected the solvency of the National Housing Corporation, quite apart from the added burden it has placed on the Treasury.

As has been recently announced, His Excellency the President has set up a Commission of Enquiry to review and make recommendations on the structure, powers, legal framework, functions, licensing, financing and staffing of local authorities at all levels countrywide. Moreover, the Commission will examine the modalities for upgrading Mombasa, Kisumu, Nakuru and Eldoret to city status and for decentralising the management of the city of Nairobi into boroughs.

The Commission will draw upon the work of the Kenya Municipal Reform Programme which is already bringing about radical institutional and financial reforms in the major Councils to start with. The KMRP is focused on the improvement in financial relations between central and local governments and between the Local Authorities themselves. It will also enhance Local Authority staffing and training and improve their revenue generating capacity both by a thorough examination of their local revenue generating potentials and by overhauling their financial and management procedures.

The financial and organisational restructuring of the Local Government Loans Authority is already at an advanced stage and steps have been taken to upgrade the technical competence of its staff. In addition, the Ministry of Local Government is now engaged in a radical review of the relationship of property rates to site values so as to enhance local collections and it is also examining the distribution of responsibility for the provision of certain services between neighbouring Local Authorities. Furthermore, the Ministry of Local Government in due course will be tabling legislation to establish a Local Authority Service Commission with powers to recruit and discipline Local Authority staff so as to reduce corruption and maladministration.

Poverty Alleviation Policies

Mr Speaker, I turn now to the important area of poverty alleviation policies which is an important aspect of my Budget theme for today. We are seeking to ensure that the poor are included in the growth process by orienting our policies for investment and accelerated growth so as to encourage an emphasis on labour-intensive technologies and rural development subject to the overriding need to improve productivity.

As Hon. Members are aware, the stagnation of the economy in recent years has had particularly unfortunate effects on the poorest and weakest sections of our society. For these people, the resumption of growth is the overriding precondition for bringing about a sustainable improvement in their quality of life. It was to revitalise the economy through more efficient resource allocation using market forces that we proceeded as vigorously as we have done in the direction of structural change and liberalisation. Clearly the resumption of growth which we are now achieving will be beneficial to these marginalised groups in the long run through the "trickle down effect". In the short run, however, the adjustment process has meant reduced provision in some areas of basic needs and services for the poor through the introduction of cost sharing in health and education, through job losses brought about by retrenchment and by the reduction or removal of Government welfare subsidies.

Mr Speaker, I would like to stress again as I did at this time last year that even in the short term, the "trickle down effect" is having a positive impact in many cases on the quality of life of disadvantaged groups, as the social improvements and safety nets incorporated in the structural adjustment process itself have been targeted for their particular benefit. Nevertheless, much more remains to be done.

It was in recognition of the need to cushion the poor as much as possible against their particular short-term difficulties with the liberalisation programme that His Excellency the President convened and chaired the National Conference on the Social Dimensions of Development, which was held in October last year. This Conference brought together the Government, donors and NGOs and focused on practical steps needed to help the weaker groups to adjust to the reforms. He carried the same message to the World Conference on Social Development held in Copenhagen in March last year where he further highlighted the problems we face in terms of health, education and population control and their impact on the unemployment situation facing the affected groups. These groups were identified as (1) the landless, (2) women heading households, (3) children and school leavers, (4) the elderly poor, (5) pastoralists and some small-scale farmers, (6) the handicapped and above all (6) the unemployed. These groups were also independently identified as needing special attention in the Kenya Poverty Assessment Report recently issued by the World Bank.

Hon Members will see from their Printed Estimates that I have set aside K£377 million for these special poverty alleviation projects in the 1995/96 financial year. Similar sums will be allocated in later years to bring the total funding to K£1,175 million by the 1997/98 financial year. This is about half the K£2,344 million which was the estimated requirement for these projects. The Government has invited the donors and the private sector to contribute to bring these essential projects to a successful completion within the programmed time frame. Hon. Members should note, however, that in the interest of fiscal responsibility, existing budgetary procedures will be adhered to and the Sector Ministries will control the actual implementation.

The provisions included for this purpose in this year's Budget proposals include bursaries to poor parents for payment of school fees in secondary schools and funds for the supply of textbooks, for the school milk and feeding programmes, and for the supply of school equipment. Further allocations are provided for an increased supply of drugs and other material for health services in rural areas and in Nairobi, for improved maintenance of roads and water projects in rural areas, for site and service improvements in relation to housing for the urban poor. Additional funds are earmarked for rural industries, for employment generation programmes and for the development of jua kali enterprises. There are also provisions for bursaries for poor students in the universities and for severance payments for civil servants retiring under the Civil Service Reform Programme.

Mr Speaker, the poor are always with us! Actions to alleviate absolute poverty must be continuous and sustained at the highest level consistent with our overriding need to ensure economic stability and growth on which everything depends. The Government is determined that the poorest sections of our national community will share in our renewed prosperity and be assisted in their turn to contribute effectively to its further expansion.

5. PROGNOSIS

General outlook

Mr Speaker, we have seen that 1994 was a turnaround year for the Kenyan economy, with GDP growth reaching an estimated 3.0 per cent following two years of stagnation. We have seen too, that this recovery was accompanied by lower inflation, the recovery of investment, and the reduction of the fiscal deficit. The main sectoral features of this growth were a rebound in agricultural production and a sharp growth in earnings from exports, particularly of non-traditional products.

There is little doubt now that these favourable trends have been continued into 1995. Rainfall has been adequate for the present growing season and the renewed growth in foreign markets has stimulated exports particularly of non traditional products. Imports of capital goods and raw materials have increased particularly rapidly in recent months and these will shortly be translated into higher production.

These developments reflect the substantial easing of the major economic constraints which have limited growth in the past. Indeed, on the basis of the most recent information, I now expect that the rate of real GDP growth in 1995 will be higher at 5.0 per cent and that the growth rate will accelerate further in 1996 to around 5.6 per cent.

Mr Speaker, I have already noted that we had achieved negative inflation by the end of the calendar year 1994 and that we are already well within our target range of single digit inflation on a 3-months-annualised basis. Further progress downward will be difficult in the immediate term as there have been increased prices for certain items including cooking gas, petrol, drinks, tobacco and non maize food items, together with higher telephone and electricity costs. The slow drift downwards in the shilling exchange value will also generate inflationary pressures by increasing import costs, and the continuance of the global instability in the currency markets gives cause for concern. Nevertheless, I expect that the present policy framework, together with the measures which I am announcing today, will enable us to contain the 3-months-annualised inflation rate within the single digit level during 1995 and beyond. The GDP deflator is expected to fall from the calendar year 1994 level of 25 per cent to only 9 per cent in 1995 and from 16 per cent in the 1994/95 financial year to only 5.3 per cent in 1995/96.

I expect the real GDP growth rate for the financial year 1995/96 to be slightly higher than that for calendar year 1995 at around 5.3 per cent. This assumption has been taken into account in my projections of the fiscal outturn for 1995/96. Before turning to these, however, I will review the expected revenue and expenditure outturn for the current year. I begin as usual with the revenue situation.

Recurrent Revenue in 1994/95

Mr Speaker, in the Printed Revenue Estimates for last financial year, collections of ordinary revenue were estimated at K£ 6,045 million. In fact, collections are now targeted to be higher at K£ 6,330 million, despite the fuel tax cuts accompanying the liberalisation of petroleum prices in October, and the discontinuation of the Refinery Throughput Tax from November. The most important factor in generating this increase was the improvement in collection efficiency following the comprehensive utilisation of the PIN, better than expected yields from the PAYE tax amnesty, and the wider coverage of other enforcement programmes. There has also been an improvement in employment and salaries, and increased tax collections from the parastatals. At the same time, we have had the first full year of operation of the new preshipment inspection procedures which have increased valuations, while the reduction in import duties since in the last Budget has contributed towards a sharp reduction in uncustomed imports.

It is now estimated that the yield from income tax in the financial year 1994/95 will be K£ 2,473 million or 39.1 per cent of total ordinary revenues. This compares with the previous estimates of K£ 1,868 and represents an increase of nearly one third. I now expect to collect K£ 1,063 million from import duties, which is 14% above the Printed Revenue Estimates of K£ 935 million. Around three quarters of this will represent non oil duties. Excise duties are now expected to yield K£ 980 million or about 10 percent below previous estimates. Sales of excisable goods have proved to be fairly stagnant in recent years, but are expected to pick up in the coming year.

Collections from VAT are expected to fall sharply below the printed estimates. Domestic VAT collections are expected to show a shortfall of 18 per cent below the Printed Revenue Estimates, so as to reach only K£ 680 million, because of arrears from a few leading parastatals, particularly from the KP&TC. Strenuous efforts are now being made to recover this shortfall within the next few months. VAT collections from imports are also expected to fall below the Printed Revenue Estimates. I now expect to collect only K£ 570 million from this source in the financial year 1994/95, that is a shortfall of 15 per cent.

Mr Speaker, in the Printed Revenue Estimates no income was expected from the dividend payable by the Central Bank of Kenya (CBK). Nevertheless, the CBK operations have proved to be highly profitable, and I now expect to collect K£ 42 million this year. On the other hand, ordinary revenues from all other sources are expected to show a shortfall of 5 per cent to reach only K£ 522 million.

Recurrent expenditure in 1994/95

Mr Speaker, as Hon Members will see from their copies of the Estimates, the supplementary appropriations involved an additional expenditure this financial year of K£ 560 million in the recurrent vote, to provide mainly for additional salary and allowance payments to teachers and doctors, and for the civil service retrenchment programme. However, reallocations within the existing Budget provisions generated savings of K£ 106 million so that the net increase in budgeted expenditures came to only K£ 457 million. However, the carryover financing of the excess votes of 1990/91 and 1991/92 required an additional K£ 93 million.

For the consolidated fund services, I now anticipate a saving of K£ 127 million from the levels in the Printed Expenditure Estimates because of reduced interest payments on Treasury Bills, and the high value of the shilling which lowered the cost of foreign borrowing.

Further savings are likely to accrue from the strict limitation of issues to essential expenditures narrowly defined. Taking account of excess votes and under issues, I expect gross recurrent expenditure this year to amount to K£ 5,448 million, or about 4 per cent more than the Printed Expenditure Estimates.

Development expenditure 1994/95

Mr Speaker, supplementary appropriations for development expenditures during the 1994/95 financial year came to K£ 116 million, most of which was required for the financing of the maize purchases by the NCPB to which I referred earlier.

Additional expenditures were also incurred under this vote for the settlement of arrears of payment on construction projects. However, the need to finance the maize support programme without exploding the fiscal deficit has meant that some K£ 126 million of other development expenditures have had to be postponed. The overall impact of these changes has meant that net development expenditures fell by K£ 10 million below the levels of the Printed Expenditure Estimates.

Appropriations-in-aid in the development budget represent direct payments by donor agencies for development projects. The budgeted expenditures increased by K£ 38 million mainly due to faster direct payments on ongoing projects.

In summary then Mr Speaker, as a result of these changes I expect to spend K£ 875 million as net development expenditures in the 1994/95 financial year which is 8 per cent below the level of K£ 949 million in the Printed Expenditure Estimates. In addition, I have made provision for the carryover of excess development votes for 1990/91 and 1991/92 in the amount of K£ 26 million.

Overall, I expect the gross development expenditure this year to be around K£ 1,592 million.

Financing in 1994/95

Interest payments on domestic borrowing are expected to amounted to K£1,170 million, or K£ 161 million lower than anticipated, while foreign interest payments (including arrears) at K£ 520 million were slightly smaller than anticipated.

Deficit in 1994/95

As a result of these developments, I expect the total revenue including Appropriations-in-Aid, during the 1994/95 financial year of K£ 6,638 million to fall short of total expenditures of K£ 7,063 million. Therefore, the deficit on a commitment basis and including grants is expected to be K£ 204 million, or 1.0 per cent of GDP. However, the Budget deficit financed from domestic sources will be lower at around K£ 141 million or 0.7 per cent of GDP.

Expenditure 1995/96

Mr Speaker, our most important fiscal objective in the medium term is to eliminate the Budget deficit, or at the very least, to reduce it to insignificant proportions in terms of our GDP. The objective is to reduce domestic and foreign borrowing so as to release more resources for productive private sector investments and to hold inflation down to low levels. To achieve this, we have to balance our expenditures and available resources so as to attain a sizeable surplus which can be allocated to the reduction of the public sector borrowing requirement. Already tight controls are in place to limit the overall expenditures by Ministries and to ensure that their expenditures are concentrated heavily on the financing of core functions of Government and core projects.

Within the overall debt reduction programme, it is my intention today to give priority to the contraction of domestic debt. I therefore plan to reduce the stock of domestic debt by K£175 million and to this end I am currently negotiating funds with our donors.

Mr Speaker, I would like to assure Hon. Members that the reduction in our foreign borrowing requirement is also a critically important objective. The flow of donor funds is welcome in that it enables us to accelerate our development process and to overcome short-term resource deficiencies. However, our fiscal absorption capacity is limited by the need to contain inflation and to find counterpart financing. We have therefore insisted that donor funds be allocated only to priority projects for the assistance of the poor and for the improvement of our infrastructure.

Mr Speaker, although debt reduction remains our overriding priority, it is my intention to achieve this in such a way as to improve social equity, which Hon. Members will recall is one of my major Budget themes for today. Our return to the path of growth has meant that there is scope for a greater reapportionment of expenditures in favour of the disadvantaged groups in our society. In my Budget today, I have included important allocations for this purpose spread over a number of Ministries. In making this provision, however, care has been taken to maintain the soundness of our production base as only in this way can we continue to generate sufficient resources to sustain improvements in living standards on a lasting basis.

Mr Speaker, salaries and allowances for civil servants, teachers and university staff will continue to dominate my expenditures in the coming financial year. We have been continually compensating these groups to the extent permitted by our limited resources for the increases in the cost of living. Since we have achieved a substantial reduction in the rate of inflation, and as I fully expect to maintain it at low levels during the coming financial year, there is little justification for further significant increases in basic salary levels. However, substantial provisions are being made for the monetisation of housing, health and other benefits and also for improved pensions.

Finally, Mr Speaker, I would like to refer to the issue of donor participation in our development programmes, an issue which is often misunderstood and unnecessarily politicised by some vested interests. We Kenyans should be mature enough to recognise that the flow of bilateral donor funds to developing countries is integrated with the trade and commerce flows and with the employment situation in the donor countries. It is also very much influenced by the budgetary constraints which are faced by the donors themselves.

As for multilateral institutions such as the World Bank and the African Development Bank, these are in a sense *our own institutions* and we as members are entitled to avail ourselves of loan funds not only for development projects, but also for financing some of the past loans. It is for this reason that the Government is in continuous dialogue with these institutions and arrives at an agreed policy framework for the disbursement of loan funds. As far as specific projects are concerned, these institutions are governed by their own lending procedures which we follow in implementing specific projects. Let me also add that the Government is very selective and careful to ensure that the funds available are allocated to the most important projects, especially to projects which will benefit the poor and improve our infrastructure.

As usual, I will not go through the detail of the various votes in the Printed Estimates which have been distributed to this House although I assure Hon. Members that ample time will be provided for them to air their views.

Mr Speaker, during the financial year 1995/96, I expect the total gross recurrent expenditures of Ministries to amount to K£ 4,256 million of which Appropriations-in-Aid are expected to finance K£ 361 million. The projected total expenditure on consolidated fund payments is expected to amount to K£ 1,618 million. Development estimates are expected to come to K£ 1,961 million which includes an Appropriations-in-Aid of K£ 1,122 million.

To summarise, Mr Speaker, I expect to have to finance a total gross expenditure during the 1995/96 financial year of K£ 7,882 million. I will now describe how I propose to finance these expenditures.

External Revenue in 1995/96

Mr Speaker, my proposals today reflect the substantial increase in donor funding which I expect during the coming financial year. In addition to the K£ 236 million which is likely to be disbursed as programme finance for general budget support, funding for development projects exclusive of food aid for drought relief and refugee feeding is expected to increase from K£ 1,282 million in the revised estimates for this year, to K£ 1,497 million, that is an increase of nearly 17 per cent.

Internal Revenue in 1995/96

Mr Speaker, our revenue collection potential depends first and foremost on the capacity of our economy to generate wealth through the provision of goods and services. I have noted already that I expect real GDP to pick up momentum this coming financial year and grow at 5.3 per cent. The GDP deflator is expected to increase by at 6.2 per cent and the value of imports to grow by 23 per cent. On the basis of these projections, I am expecting that the collection of ordinary revenue will yield K£ 6,682 million which is expected to exceed 28 per cent of the projected GDP.

The most rapid growth in revenue collections is expected to come from import duty and Value Added Tax based on the increased import levels accompanying the economic recovery. Accordingly, collections from import duty are now expected to come to K£1,189 million, while the total Value Added Tax yield from both domestic and imported goods and services is expected to be K£ 1,369 million. As a proportion to total ordinary revenue in 1995/96, therefore, the shares of these two taxes are expected to rise from 16.8 last year to 17.8 per cent for import duties, and from 19.3 to 20.4 per cent for VAT.

Mr Speaker, despite the significant overall recovery in the economy last year, there were some activities, particularly in the export sector, which were constrained by the high value the shilling. In addition, growth in consumption of items such as beer and cigarettes was slow because of the continued contraction in per capita incomes. These developments are likely to have a negative impact in the coming year on the collections of excise duty and corporate tax from the companies concerned. While excise duty collections are expected to grow moderately to reach K£ 1,045 million in the 1995/96 financial year, the growth in income tax (excluding PAYE) is now expected to be marginal with revenues only reaching K£ 1,683 million. PAYE revenues are estimated at K£ 735 million for next year. While the share of excise duty in total collections is expected to remain virtually unchanged at 15.6 per cent in the 1995/96 financial year, the overall collection of income tax (including PAYE) is expected to fall from nearly 39 per cent in 1994/95 to about 36 per cent in 1995/96.

I further estimate that receipts from the dividend payment by the Central Bank will come to around K£ 95 million, while other dividends and profits are expected to generate some K£ 20 million. Receipts from all other taxes and incomes in the 1995/96 financial year are expected to amount to K£ 545 million.

In addition to the these revenues, I expect another K£ 343 million to be provided to the Exchequer from Appropriations-in-Aid. Thus, I expect to collect a total revenue of K£ 7,025 million which leaves a residual gap of K£ 150 million to be financed through new measures. I will now describe how I propose to do this.

6. TAXATION PROPOSALS

Mr Speaker, before I present my detailed taxation proposals, I wish to review some of the broad principles that underpin these measures. As members of this House are aware, the tax system has been undergoing a systematic process of modernisation, aimed at creating a fairer, more effective, and economically more efficient system. The taxation capacity has been significantly raised in recent years. Prior to 1993/94, ordinary revenue collections had never exceeded 24% of Gross Domestic Product. In 1993/94, ordinary revenues reached 27.9% of GDP. This financial year I expect ordinary revenues to exceed last years level. This remarkable achievement has been attained by a combination of lowering and rationalising tax rate structures and expanding the taxation bases. A key component of expanding the tax bases has been the strengthening of tax administration which is the foundation of good tax policy. This strategy will be taken a few major steps further with my proposals in this Budget. I am determined to spread the burden of taxation further on to those who evaded carrying their fair share in the past.

Mr Speaker, as I promised this House in my Budget Speech last year, I have brought legislation to the House to enact the Kenya Revenue Authority. This legislation will become effective on 1st July this year. The Kenya Revenue Authority will provide the vehicle for professional and equitable administration of the taxes. It will aim not only to collect taxes more effectively and efficiently, but also to provide better service to the taxpayer to make complying with the tax laws simpler and cheaper. The KRA will be responsible for collection of income taxes, VAT, customs and excise duties and a number of other levies and charges including those under the Traffic and Transport Licensing Acts. As specified in the KRA Act, the Authority will receive a base level of funding of 1.5% of the revenues estimated in this Budget. This amounts to K£95.4 million for 1995/96 which will be available to the Authority in equal instalments effective from 1st July. An initial provision has already been made for funding of the KRA. The funds available for recurrent expenditures on tax administration will increase to more than double those in the past. With these additional resources available to the KRA, I will be expecting increased revenue yields in excess of K£200 million from more effective tax collection. These additional revenues are built into the estimates of the increased revenues required from each type of tax that I will announce shortly.

On the side of tax policy, the Department of Fiscal and Monetary Affairs will also be strengthened in the coming year. This will include bringing the terms of employment of the officers working in the Tax Policy Unit in line with those in the KRA in order to motivate and retain these staff.

Mr Speaker, it is no secret that amongst our tax officers we have had a minority who have been willing to collude with taxpayers to defraud the Treasury and place a heavier tax burden on their fellow citizens who pay their tax honestly. Let me assure all Kenyans that such corrupt activities will not be tolerated under the KRA. The personnel policies of the KRA will be fair, but swift and sure in relieving corrupt revenue officers of their positions. At the same time, the KRA will be expected to collect taxes in a fair and firm manner. Whether a taxpayer is a private sector company or a parastatal, the company and its senior officers will be dealt with in the same fashion to ensure full compliance with the tax laws of Kenya.

The KRA will be building upon improvements in tax administration that have been introduced under the Tax Modernisation Programme. One major innovation that commenced last year was the preshipment inspection programme to ensure the proper classification and valuation of imports for customs purposes. Reviews of the performance of this PSI programme reveal that it has been very effective. It is estimated that, directly and indirectly, it helped raise customs revenues on non-oil imports by more than 20%. This means that the increased revenue collections were more than double the cost of the PSI programme. I expect that the implementation of this programme will become more rigorous over the coming year as full reconciliation of the PSI documents is undertaken with the Customs documents. Mr Speaker, I will be announcing the implementation of further important initiatives to tighten tax collections in the next year.

Mr Speaker, as is conventional, I would now ask that the remainder of my Speech be regarded as Notice of a Motion to be moved before the Committee of Ways and Means.

I. Customs Duties

Following tradition, Mr Speaker, I will first present proposals that affect Customs procedures and other technical matters, and then I will turn to proposals with direct revenue consequences.

First, the maximum fines and penalties as well as the fees for licensing warehouses, customs clearing agents and other related activities under the Customs and Excise Act have not been reviewed for some five years. To bring these in line with current price levels, I am proposing that all fines, penalties and fees at least be doubled. I also propose to clarify that the late payment penalty of 3% per month is chargeable from the initial entry date and not merely from the date when Customs demands payment. Second, I am proposing to introduce penalties where the agents or masters of vessels or aircraft fail to properly account for goods reported for delivery or actually delivered at a port of entry.

Third, Mr Speaker, it has come to my attention that the approval and clearance procedures for imports for use by missions and agencies with diplomatic standing, aid agencies, and aid-funded organisations and their high officials has become somewhat confused and subject to abuse. I have instructed officers of the Ministry of Finance to work in co-ordination with the Ministry of Foreign Affairs and International Co-operation to ensure that only imports for the use of missions and agencies that have been Gazetted under the Privileges and Immunities Act will have their duty free imports approved by the Ministry of Foreign Affairs and International Co-operation. The Ministry of Finance will also be introducing stricter internal controls to remove import abuses in connection with aid-funded and donated goods.

Fourth, duty-free shops have not been operating under satisfactory customs control. I am therefore proposing to introduce the concept of a duty-free shop explicitly into the Customs and Excise Act such that the operations of these shops will be under controls similar to those of all bonded warehouses. Fifth, I propose to introduce amendments to Part A of the Third Schedule of the Customs and Excise Act to rationalise the items dealing with exemptions for the imports of the aid-funded projects and the personnel entering the country to assist in their implementation. These amendments also clarify the distinctions between persons changing residence to Kenya for the first time and residents returning to Kenya after a spell outside of the country.

Sixth, persons changing residence to Kenya for the first time have to date generally been treated the same as returning residents who have been outside of Kenya for at least two years in respect of the allowable duty-free importation of personal and household effects. Both groups have been required to have used the goods for a minimum of 360 days prior to importation. I propose to introduce clearer distinctions in Part B of the Third Schedule for these two groups. In particular, the first-time arrivals changing residence to Kenya will be required to have used their household effects for only 90 days prior to arrival in Kenya.

Seventh, Mr Speaker, in my Speech last year I announced that the reconciliation and export inspection work under the EPPO duty/VAT exemption programme for imported inputs into the production of exports and under the Manufacturing Under Bond programme for exports would be contracted out in order to improve the administrative controls and service to exporters. The contract has been finalised and work under this contract will commence in July. As with the PSI programme, I expect to get a significant pay-back from reduced revenue leakage as full accounting will be required of all duty exempt imports. Any exempt imports not used for exports or other permitted uses are subject to duty. As part of the implementation of this contract, a thorough review of all EPPO procedures will be undertaken so that more efficient and flexible procedures can be introduced as well as extensions of the programme to a wider spectrum of exporters.

Eighth, Mr Speaker, as the customs controls on imports improved during this past year with the implementation of the new PSI programme, the indefatigable smuggler went to work to seek alternative ways of evading payment of duties and taxes. As a result, the incidence of transit and export fraud rose this year. Customs has moved to implement tighter controls. I expect that these controls will be even more effective under the new Revenue Authority. In addition, I am announcing a number of new measures to stamp out these fraudulent activities. I am determined to bring this situation under control rapidly and firmly. I am pleased to announce that as part of the growing co-operation within the region, the Governments of Kenya and Uganda have come to agreement to develop co-operative procedures to control transit and export frauds involving our two countries.

This agreement includes, first, the exchange of customs information between Uganda and Kenya. Uganda will be aware of the goods entered into Kenya for shipment to or through Uganda. Kenya will receive confirmation that goods have actually been received in Uganda. And a similar process will exist for goods shipped to or through Kenya from Uganda. The second component is that Kenya will receive copies of the Ugandan preshipment inspection documents for imports destined for Uganda. Clearly, any shipments arriving in Kenya in transit to Uganda that do not have the required preshipment inspection documents will be subject to detailed examination and strict controls. In addition, the transit control system will be underpinned by a strengthened bonding system. With immediate effect, only bank bonds will be permitted for transit goods, and in some cases the Commissioner may call for cash bonds. I expect banks to exercise due diligence in issuing transit bonds. Where transit shipment documents are in good order on low risk goods such as industrial machinery and raw materials, however, the Commissioner will not demand full coverage of the duties and taxes at risk.

Mr Speaker, these measures will help expose the fraudulent importer without hindering the flow of trade. I want to express my thanks to the Minister for Finance in Uganda for his co-operation. I look forward to growing co-operation in trade, customs and other taxation matters with neighbouring countries.

Ninth, the Customs Department has had problems with importers who demand release of goods prior to payment of duties. I am proposing to make it clear that prior release procedures are restricted to only gold bullion, currency, coins and perishable goods. Tenth, proper red and green channel self-declaration systems are being constructed at Moi and Jomo Kenyatta Airports for opening during the course of this year. I am amending the Customs regulations to give the proper legal basis to the red-and-green channel system.

Eleventh, the World Customs Organisation has agreed that effective 1st January 1996 some significant changes are required in the tariff classifications under the Harmonised System that is used by all member countries. These technical changes will have little or no effect on the tariff rate structures for import duties, excise duties and VAT. Accordingly, to effect these classification changes, I intend to bring to Parliament later this year a technical Bill that will amend the tariff classifications in line with the duty and tax rates approved in the Finance Bill.

Mr Speaker, I now turn to my major Customs proposals that have direct revenue consequences. First, to move the rationalisation of the import tariff one more step towards the goal of reaching a four-rate system (including duty free), I propose lowering by five percentage points the rates in the 45%, 30% and 20% bands. This will reduce the number of rate bands from seven to six. The new import duty rate bands will be: free, 5%, 10%, 15%, 25% and 40%.

Second, to lower the duty burden on capital equipment, I am proposing to lower the duty rates on all capital equipment in the 15% band to 10%. In addition, the tariff rates on food preparation machinery and computer equipment currently in the 20% band will also be reduced to 10%. And to encourage the private sector to participate more actively in electricity generation and supply, I propose to lower the import duty rates on electrical generators and convertors, and large transformers to 5%.

Third, to assist domestic industry, I propose to lower the duty rates on a range of primary raw materials by a further five percentage points to the 5% or 10% band. These include primary forms of rubber, aluminium, lead, tin, zinc, raw hides and skins, and hot-rolled steel coil. Fourth, to further rationalise the tariff schedule, I propose to lower the tariff rates on a range of commodities that are generally exported or not imported where they fall in the high-rate brackets reserved for protection of domestic industry.

Mr Speaker, the general tariff rate changes I have just announced will not only rationalise the rate structure, but they will also promote the efficiency and competitiveness of the economy. With the lowering of import duty rates on capital equipment and raw materials, Kenyan manufacturers will become more cost competitive in world markets.

Fifth, Mr Speaker, to help selected domestic producers I am proposing some further duty rate changes. To assist the local assemblers of lorries and buses, I am proposing to lower the tariffs on the completely knocked down kits for these vehicles by five percentage points. To help domestic manufacturers, I am proposing to the raise import duty rates on nails, wire made from iron or non-alloy steel, and cardboard containers. Kenya has a nascent wine industry. I am proposing to lower the duty rate on oak casks and staves to 15% to help this sector mature.

Sixth, to reduce the costs of road transportation to lower income persons, I propose to reduce the tariff rates on bicycles from 30% to 15%, and on motor cycles from 45% to 25%. Seventh, Mr Speaker, I am proposing to lower duty rates on some additional health and safety items. To lower the cost of safety equipment for marine navigation, I am proposing to introduce an exemption for lighthouses, buoys, and equipment for guide vessels. To reduce the cost of spectacles for correcting vision, I am proposing to expand the duty free provisions for spectacles to include contact lenses and spectacles made from materials other than glass. These vision-correcting items will also be zero rated under the VAT. Eighth, Mr Speaker, the match industry has experienced some problems from import competition over the past year. In addition to more strict import controls on these imports that have already been implemented, I propose to introduce alternative specific import duties to prevent any undervaluation of import matches for Customs purposes.

Ninth, the textile industry has been suffering from some unfair import competition over recent years from undutied imports. In addition to the stricter controls to prevent diversion of goods from transit shipments and imports under the export-promotion programmes that I have already announced, I am proposing to introduce an alternative specific import duty rate on used clothing to prevent undervaluation for customs purposes. It has also come to my attention that clothing, textiles and footwear brought into the country ostensibly for donation to the poor and needy are finding their way into the market place. These undutied imports provide unfair competition to the local industry and are having crippling effects on jobs for Kenyans. Accordingly, no further duty exemptions will be allowed on imports of clothing, textiles and footwear that are *donated or aid-funded* unless such imports are allowed under a national emergency or to assist refugees in an officially recognised camp. In addition, as is the case with all goods brought into the country duty-free for donation, resale of such goods requires duties to be paid at that time. Mr Speaker, these measures should not be construed to mean that the Government is out to kill the market for used clothing or "mitumba," as it is popularly known. Such goods can be imported as long as the required duties are paid.

Finally, Mr Speaker, the importation of agricultural products subject to the variable duty (maize, wheat, sugar, rice and milk) has caused a number of problems over the past year. While the variable duty rate structure, as reformulated in September 1994, has provided fairly effective protection against low cost imports caused by the strong shilling between October 1994 and May of this year, this structure has proved technically difficult to administer and will provide inadequate protection under projected market conditions. I am, therefore, proposing to introduce a new, simpler system with immediate effect.

The import duty rates under the new system will consist of a combination of specific and *ad valorem* rates. For maize, sugar, rice and milk, the specific rates will be set at values at or above the variable duty values Gazetted for effect at the beginning of June. These specific rates will also be compared to the duty chargeable under *ad valorem* rates, and the higher duty will be charged. For wheat imports, given the prevalence of subsidised wheat exports in the world market, the specific rate will be charged in addition to the *ad valorem* rate to offset the export subsidies. To give the flexibility needed to provide adequate protection for these agricultural sectors, I am proposing to introduce a provision that will permit these duty rates to be *increased* by up to 75% of the legislated duty rates. This ability to increase duty rates will also apply to used clothing. The current provision allowing variation of any duty rate by 25% of the legislated rate will be amended to increase permitted variation to 30%. In addition, I am proposing to remove import duty exemptions from donated or aid-funded importations of maize, wheat, sugar, rice and milk, unless they are destined for officially recognised refugee camps or a national emergency has been declared. With these new protective measures in place, I am announcing, with immediate effect, the lifting of the temporary suspensions on the importation of maize, wheat and sugar.

Mr Speaker, the import duty rate changes that I have just announced will become effective from midnight tonight. These Customs measures will reduce revenues to the Exchequer by K£10 million in 1995/96.

II. Value Added Tax (VAT)

Mr Speaker, the Value Added Tax has now been in operation for over five years. The base of this tax has gradually been expanded to give time for the VAT administration and the tax-paying public to gain experience with the operation of the VAT. With the establishment of the Kenya Revenue Authority, I feel confident that the VAT Department will have the capacity to handle an even larger tax base, and to become more active in controlling VAT evasion, particularly at the retail level.

First, I am proposing to take a final step in expanding the VAT base on the supply of goods. Over the years the range of designated goods -- that is goods taxable through to the retail level -- has been expanded. I am now proposing to expand the coverage of designated goods to *all* goods *except* those that are on the VAT exempt schedule (primarily unprocessed products of the agricultural, fishery, forestry and livestock sectors) and all commodities in Chapters One to Twenty-One of the Harmonised Code -- that is all food items. The designation of these additional goods will become effective on the 1st September 1995. I encourage all traders (other than those dealing only in exempt goods or excluded foodstuffs) to approach the Commissioner of VAT as soon as possible to commence the registration process.

Second, Mr Speaker, along with this major expansion in the VAT base that I have just announced, I am proposing equally major changes in the VAT rate structure. The standard rate of VAT will be reduced from 18% to 15%, the high rate will be lowered from 30% to 25%, and the low rate raised from 5% to 6%. These rate changes aim to increase the voluntary compliance of the public in paying the VAT.

Third, the expanded coverage of the retail sector makes the distinction between manufacturers and other businesses under the VAT unnecessary in establishing the minimum turnover level for compulsory registration under the VAT. I am therefore proposing a simplified system under which registration will be required if the combined turnover of taxable goods and services exceeds two million shillings in a year. This compares to the current separate minimum turnover levels of nine hundred thousand shillings for manufacturers and 1.8 million shillings for all other businesses.

Fourth, Mr Speaker, as I emphasised in my Speech last year, I am determined to gain the maximum compliance with the VAT, particularly at the retail level. In addition to the more vigorous enforcement that I expect under the KRA, I am proposing to increase the penalties and fines under the VAT. To keep the values of fines and penalties in line with current price levels, I propose to at least double the levels of all fines and penalties. In addition, to promote higher levels of compliance with the VAT, especially at the retail level, a number of new penalties are proposed. Key to the operation of the VAT is the issuance of VAT invoices and the maintenance of proper records. Automatic minimum penalties of ten thousand shillings will be introduced for failure by a registered trader to issue a VAT invoice, or to maintain proper VAT records. Mr Speaker, I would also like to remind all registered retailers that they are required to quote their prices inclusive of VAT -- it is an offence to do otherwise. I expect the Commissioner of VAT to take the strongest measures allowed under the law against retailers who persistently quote one price for cash and another if an invoice is issued. This practice not only defrauds the Exchequer, but it also gives an unfair competitive advantage to the fraudulent trader.

Fifth, Mr Speaker, as I have made clear, it is an offence for a registered trader not to issue a VAT invoice when goods or services are supplied. On the other hand, the law has not made it clear that it is also an offence to issue a VAT invoice when none is required. I propose to clarify that the tax collected by means of a false VAT invoice is due to the Commissioner of VAT and the trader will be charged with an offence. Sixth, the Commissioner has powers to collect unpaid taxes up to an amount of twenty thousand shillings summarily as a civil debt. I propose to increase this amount to one hundred thousand shillings to ease the recovery of tax arrears.

Seventh, Mr Speaker, the VAT Act is silent on the correct procedure for the Commissioner of VAT to dispose of goods forfeited to or seized by the VAT Department. I am therefore proposing to introduce provision in the VAT Act for disposal of such condemned goods by auction in a manner similar to that under the Customs and Excise Act. Eighth, taxpayers charged under the VAT Act discovered an unintended loophole in the law to stay court cases against them. The law has allowed a case to be stayed merely on an intention to appeal to the VAT tribunal on an issue involved in the suit. I am proposing that such stays of suits should only be based on actual, and not intended appeals to the Tribunal.

Ninth, under section 19 of the VAT Act, the Commissioner has powers to require persons owing money to a taxpayer who has VAT arrears to pay the money directly to the Commissioner to recover the VAT arrears. I am proposing amendments to clarify and tighten this section to improve its effectiveness in recovering VAT arrears. Tenth, Mr Speaker, it is important that VAT officers are aware of the extent their personal liability in the conduct of VAT collection. I am therefore proposing to introduce into the VAT legislation provision to clarify the personal liability of VAT officer when he does not act in good faith. The provision is consistent with that already passed under the Kenya Revenue Authority Act.

Eleventh, to assist local fishermen, and to encourage them to buy locally made nets, I am proposing to lower the VAT rate on fishing nets from 18% to 6%. Twelfth, to lower the cost of animal feed preparations for farmers, I propose to put all animal feed preparations on the zero rate schedule. Thirteenth, to further rationalise the VAT rate structure, I propose to move a number of motor vehicle parts currently at the low rate to the standard rate.

Fourteenth, while advertising services are subject to VAT, some disputes have arisen as to the inclusion of services related or connected to advertising such as window dressing, commercial art work, market research or shopping news services. I propose to make it clear that such services connected with advertising are subject to VAT. Finally, to assist the water supply sector, I am proposing to exclude water drilling services from the taxable services provided by contractors.

Mr Speaker, the changes to the VAT rate that I have announced to-day will take effect from midnight tonight. The measures that I have introduced to the VAT will lower revenues by K£ 13.3 million.

III. Excise duties

Mr Speaker, I have only a few changes in the excise duty to announce to-day.

First, to date sales of cosmetics have been taxable at the retail level at the VAT of 30%. This has caused difficulties in collection and for the retailer having to mark up different products in one store by different VAT rates. To alleviate these problems, I am proposing to make cosmetics subject to the standard rate of VAT, now at 15%, but to make cosmetics subject to a 10% excise duty rate on imports and locally manufactured products. Provision is also made under the Customs and Excise Act for local cosmetic manufacturers to produce all types of cosmetic products in one factory licensed for production of excisable goods.

Second, compliance problems have been experienced with the collection of excise duties from mineral and aerated water bottlers and from brewers of non-malt beers such as Chibuku. To encourage compliance and improve the competitive market position of the honest traders, I am proposing to lower the excise duty rate from 20% to 10%.

Mr Speaker, these amendments to the excise duties will raise an additional K£17.4 million in revenues.

IV. Income tax

Mr Speaker, under the Tax Modernisation Programme the Income Tax Department has performed admirably. It has consistently been able to exceed its revenue targets as it has made good use of the new collection tools provided to it. It has implemented the instalment and self assessment tax system. It has issued PIN numbers which are now required to identify taxpayers on all tax documents. The tax base has been expanded by making the full value of employee benefits generally enjoyed by the high income employees subject to tax. Larger numbers of incorporated and unincorporated businesses are now filing tax returns. At the same time, these base expansions have allowed reductions in tax rates. It was only eight years ago when the top tax on individual income was 65%. It was only six years ago that the company tax rate was 45%. Those dark ages of taxation seem to be light years away now.

First, Mr Speaker, as I promised last year, the Drought Levy imposed last year to help pay for drought relief efforts, will only last one year. For companies with accounting periods ending after the 1st July 1995, the company tax rate will return to 35%. Second, for individuals, the additional two-and-a-half percentage points of tax on incomes above K£19,500 will also fall away at the end of this year. The top marginal tax rate on the income of individuals will be 35% from 1st January, 1996 onwards.

Third, to accord relief to the low income workers, I am proposing to increase the personal reliefs by 20%. The married relief will increase from Ksh 5,460 to Ksh 6,552, while that for singles and married women will increase from Ksh 3,636 to Ksh 4,368. This means that the minimum taxable income for married men will rise to Ksh 5,460, and that for all other individuals to Ksh 3,640. Mr Speaker, this increase in the reliefs will result in some 130,000 fewer individuals coming under the coverage of the PAYE.

Fourth, to reduce the double taxation of income derived from equity investments in order to encourage more equity investment in companies, I propose to reduce the tax rate on qualifying dividends paid to residents from 10% to 7.5%. This measure recognises that the dividends should always be paid out of after-tax company income, or otherwise be subject to the compensating tax.

Fifth, Mr Speaker, the instalment tax system was first introduced in 1990 as a single instalment payment. In 1994, it was expanded to three instalments. Today, I am proposing the last step in the phase-in of a complete instalment tax system -- four instalment payments will be required in 1996. For businesses with accounting periods commencing on or after 1st January 1996, a new 25% instalment payment will be required after four months, but the 50% instalment payment required after six months will drop to a 25% instalment payment as well. This final system will allow for a smooth stream of tax payments over the course of a year with four 25% instalment payments after the 4th, 6th, 9th and 12th months. The delay of the first payment to the end of the fourth rather than the third month is designed to allow for completion of the determination of the tax liability for the previous year before the first instalment tax becomes payable. This liability is a key ingredient in determining the required instalment payment.

Sixth, employer-provided benefits have increasingly been brought under full taxation. The value of the benefit required to be included income for motor vehicles has tended to lag behind the capital and operating costs of motor vehicles. The minimum benefit values prescribed by the Commissioner have not been increased since 1992 and also significantly undervalue the benefit derived from luxury vehicles in any size class of vehicle. I am therefore proposing to phase in a floor value for the Commissioner's benefit values. For 1996, the benefit of an employer-provided car will have a minimum value per month of 1% of the initial capital expenditure by the employer on the motor vehicle. This minimum monthly benefit will rise to 1.5% in 1997 and 2% in 1998 and subsequent years.

Seventh, Mr Speaker, over recent years measures have been introduced to broaden the base of the investment deduction. This year I am proposing to liberalise the basis of the extra 40% investment deduction available to investors in Manufacturing-Under-Bond export facilities. Currently, to obtain the extra 40% investment deduction investors have to use *new* machinery in *newly* constructed buildings. In future, MUB investors will be able to get the extra investment deduction on expenditures on new or old machinery in any building, whether owned or leased, as long as Customs has licensed the factory for manufacturing under bond for export.

Eighth, Mr Speaker, to help attract large scale, private sector investments to Kenya, I am proposing to introduce a new measure that will allow the investor to recover the value of import duties paid on imported capital goods for the project against his income tax liability. A qualifying investment project will have to provide evidence that it will entail expenditures on productive physical assets in excess of $5 million dollars within a two year period, and that the project will generate net economic benefits for the country.

Ninth, Mr Speaker, effective in January 1994, the presumptive income tax on agricultural produce ceased to be collected. From 1994 onwards farmers have become liable to submit income tax returns like any other business. It has become clear both to the tax administrators and the taxpayers that the old presumptive income tax had attractive features in relieving the administrative burden from unincorporated farmers. What was unattractive about the presumptive income tax was the tax rate which, particularly in years of depressed prices, was too high for the lower income farmers. To recapture the benefits of the presumptive income tax, I am proposing to reintroduce it, but at a lower tax rate of 2%, down from the previous higher rate of 5%. The structure will essentially stay the same as before except that the Customs and Excise Department will become an authorised agent to collect presumptive income tax on direct exports of agricultural produce.

Tenth, Kenya has a thriving business sector in road transport. Unfortunately, this sector has been reluctant to share its income with the Treasury for the benefit of all Kenyans. To bring owners of public service vehicles into the tax net, I am proposing that a small advance tax be payable at the time of licensing a vehicle as a public service vehicle effective 1st January 1996. This advance tax will be treated just like a withholding tax, and hence, will be offset against instalment and final income taxes payable for a year. The advance tax rates on goods carrying vehicles (vans, pickups, and lorries) will be Ksh 500 per tonne of load capacity, or Ksh 1,000 per year, whichever is the higher. On passenger carrying vehicles (saloons, station wagons, minibuses, buses and coaches), the rates will be Ksh 240 shillings per passenger capacity, or one thousand shillings per year, whichever is the higher.

Eleventh, Mr Speaker, Kenya has opened up its economy to trade in goods and capital funds. In this more liberalised economic environment, Kenyans will be seeking to benefit from economic opportunities in other countries as well as at home. Careful and detailed consideration will be needed to ensure that the tax system is modified over time to ensure both that Kenya gets its fair share of taxes of the income earned abroad, and that at the same time the tax system does not unnecessarily hinder the Kenyans investing abroad or foreigners investing in Kenya. One sure step that Kenya must take without any hesitation is to seek to negotiate double taxation treaties with its major trading partner countries, particularly its neighbouring countries. Such treaties will serve to foster the growth of business between our countries. I propose to commence this exercise in the coming year.

Twelfth, Kenya generally taxes income accrued in or derived from Kenya. In the case of resident corporations, this is extended to include the income from all business activities both inside and outside Kenya. In the case of non-resident businesses, foreign companies that are not incorporated in Kenya, but have permanent establishments here, special provisions are made concerning businesses in different sectors to ensure that the income that is effectively connected with the conduct of business in Kenya is recognised here for tax purposes. Mr Speaker, it has come to my attention that foreign banks with branches in Kenya are not currently required to report the income derived from assets of the Kenyan branch held outside of the country. I am therefore proposing amendments that will require such branches of foreign banks to report such income for tax purposes in Kenya.

Thirteenth, Mr Speaker, since 1991 the system for tax deductible pension contributions has been in the process of being phased in. Today, I propose to continue this process. The limits for tax deductible contributions to registered pension funds and individual retirement funds will be raised from Ksh 36,000 to Ksh 60,000 per year. The ultimate objective is to raise the limit for deductible contributions to reach the overall contribution limit which currently stands at Ksh 180,000 per year. I am committed to achieving this objective within the next five years.

Currently, for registered provident funds, there is a limit to the amount of the benefit payment that can be made out of contributions made by an employer on behalf of a employee. Since the contribution and deduction limits now apply to all the contributions made by or on behalf of an employee to both provident and pension funds, this restriction is no longer necessary. I, therefore, propose to delete it from the retirement benefit rules.

Mr Speaker, private pensions are expected to grow in number and size. They will not only contain increasing amounts of Kenyans' funds for their retirement years, but also an increasing amount of Kenya's future tax revenues. Both the individual beneficiaries of these funds and the Government have a keen interest in these funds being properly managed and protected. Planning has commenced to meet the growing need to develop comprehensive regulatory legislation and administrative capacity for the pension sector.

Finally, Mr Speaker, the provision of adequate housing in Kenya is a pressing one. To assist with relieving this problem I am proposing two measures under the income tax. First, the limit on qualifying interest from housing bonds has not been increased since 1987. Therefore, the annual limit will be raised from Ksh 60,000 to Ksh 300,000 per individual investor.

Second, the most difficult obstacle to overcome for a first-time home owner is to accumulate a large enough down payment to raise a mortgage on a house purchase. Therefore, I am proposing to introduce a new measure to give tax assistance for saving towards the first purchase of a house. Individuals who currently do not own a house will be able to make annual tax deductible contributions of amounts up to Ksh 30,000 a year to registered home-ownership savings plans at financial institutions that offer mortgages on a regular basis. These tax deductible contributions can be made for up to ten years after first establishing a plan and the income earned on the contributions accumulate tax free. At any time during this ten year period, the accumulated funds can be withdrawn tax free to purchase or construct a permanent house. After ten years the funds will have to be withdrawn and if they are not used to acquire a home within a year of withdrawal, they will become subject to tax. Mr Speaker, I feel confident that this registered home-ownership savings scheme will not only assist many Kenyans to purchase their first permanent house, but also channel savings into the financial institutions that are providing mortgages.

Mr Speaker, the measures that I have just announced will raise an additional K£ 91 million for the Exchequer.

IV Other measures

Mr Speaker, I now want to enumerate other measures that I propose to introduce that will have revenue consequences.

First, last year the road maintenance levy was introduced under the Road Maintenance Levy Fund Act to ensure a pool of funds for the urgently needed repair of our roads. To increase the funds available for this purpose, I propose to increase the road maintenance levy rates by fifty cents per litre. This will increase the levy on petrol to two shillings a litre, and that on automotive diesel to one and one half shillings per litre. The road maintenance levy is expected to contribute K£ 95 million toward road maintenance expenditures in the coming fiscal year.

Second, to improve the collection of rents from Government lands enhanced collection powers are required under the Lands Act. Currently, the penalties for late payment of rents have not proved to be collectible. To rectify the situation, I am proposing to introduce a simple penalty structure of one percent for each month that rental payments are late. In addition, the Commissioner of Lands will be given powers to levy distress or place claim against a property where rents and penalties remain unpaid after written demands for payment have been ignored.

Third, to assist with the enforcement of stamp duty collections, I am proposing to reduce the period for appealing against an assessment from 60 to 30 days.

Fourth, to simplify the payment of the tax on premiums paid to reinsurance businesses outside of the country, I am proposing that this reinsurance premium tax be made payable on a quarterly as opposed to monthly basis.

Finally, the building society license fee schedule is being amended to allow for different annual licence fees to be paid for branches established in municipal, town or urban council areas.

These other measures that I have announced will raise an additional K£65 million for the Exchequer.

7. CONCLUSION

Mr Speaker, after this unavoidably lengthy review of my taxation proposals and of the policies and economic factors on which they have been based, it is well to remind ourselves of our recent history and of our overall Budget objectives. Last year, we began to recover our economic strength following a two year period of stagnation which itself had followed a two year period of declining growth. The prospects for growth this year are better still, and we now expect high rates of growth to continue in subsequent years. However, we must recognise that this recovery was by no means inevitable or automatic. It has been assisted by and continues to be fundamentally dependent on the control of inflation, the retrenchment of Government demands on our economic resources, and the maintenance of confidence by both Kenyan and foreign investors in the commitment of the Government to macroeconomic stability in the context of a liberalised and consistent policy framework.

I have shown today that inflation has been overcome and that strong measures have been put in place to prevent it rising again. I have described how a great deal of Government retrenchment has already taken place, and how further retrenchment measures are being pursued with vigour, especially in terms of debt reduction, civil service reform and privatisation. I have also demonstrated that our renewed growth has been achieved within a consistent policy framework which is firmly based on macroeconomic stability and liberalisation, and I have emphasised our determination to pursue this course steadfastly. We have come far along this road during the financial year just ended, but we are nowhere near the end of our journey.

While these factors are critically necessary to our continued growth, Mr Speaker, difficult as they are to maintain, they are insufficient to guarantee success. Of even greater importance is the maintenance of peace and security within our borders. This in turn depends on the widespread perception that serious efforts are being made to ensure that the poorest sections of our society are able to share in the fruits of renewed growth. It has been an important part of my task today to make provision for this end to the full extent of the resources now available, both through tax adjustments in favour of the lower paid and through greater funding for targeted programmes. The Government has acknowledged that improved productivity in the widest sense among our poor is essential to generate and to maintain the growth momentum. It is only right, therefore, that their share in the proceeds should be protected and enhanced in conformity with their production potential.

Mr Speaker, the economy is moving in the right direction and improved living standards are within our grasp. But however much we wish to encourage this process, the Government is only one among many players in the growth arena. The private sector must demonstrate greater enthusiasm for growth, greater managerial competence, a greater work ethic, and greater dedication to achievement if our development goals are to be achieved within a reasonable time frame. I am encouraged by the clear evidence that the private sector is already responding well to the policies in place, and I am confident that my new measures today will provide a further impetus to their efforts. Our development strategy is export-led growth, and I have particularly high hopes that our export industries, whether agricultural, manufacturing or service based, will be able to take early advantage of our export incentives and of the newly liberalised global trade regime to increase their earnings.

As I did last year, I am publishing today a **Statistical Annex** which summarises the Budget environment in numerical and graphic forms.

Finally, Mr Speaker, it is for the politicians of this country to provide the leadership to bring all our people as quickly as possible into the high growth environment which is now available to them. I call on all Hon. Members of whatever party to join with us wholeheartedly in our common programme of national development. This year, we have primed the economic engine so that it is ready to move rapidly ahead. Let us now work together in the harambee tradition to ensure that the coming year will be recorded in our economic history as the year of take off.

Mr Speaker, I beg to move.