NATIONAL ASSEMBLY

OFFICIAL REPORT

Thursday, 15th June, 1995

The House met at 3.00 p.m.

[Mr. Speaker in the Chair]

PRAYERS

ARRIVAL OF HIS EXCELLENCY THE PRESIDENT

(Mr. Speaker announced the arrival of His Excellency the President, the hon. Daniel Toroitich arap Moi, M.P)

(Hon. Members rose in their places while His Excellency the President took his seat in the Chair of State)

PAPERS LAID

1995/96 Estimates of Revenue of the Government of Kenya for the year ending 30th June, 1996.
1995/96 Financial Statement.

(By the Minister for Finance)

COMMITTEE OF WAYS AND MEANS

MOTION

THAT MR. SPEAKER DO NOW LEAVE THE CHAIR

The Minister for Finance (Mr. Mudavadi): Mr. Speaker, Sir, I beg to move that Mr. Speaker do now leave the Chair.

The Minister for Finance (Mr. Mudavadi): Mr. Speaker Sir, I beg to move that Mr. Speaker do now leave the Chair.

Mr. Speaker, Sir, during the Financial Year 1994/1995, 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 three-month annualized inflation rate has flown 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 Kshs44 and Kshs47 to the dollar. Since May this year, the shilling has depreciated to around Kshs53 to the dollar as the increased demand for hard currencies coincided with the international pressures strengthening the dollar. The present level is likely to be nearer the longer-term equilibrium rates and one which should provide greater encouragement to our exporters, import-competing industries and tourism, without penalising the importers. Furthermore, we have achieved these results while servicing all our official external debts on schedule and repaying a portion of the accumulated arrears. At the same time, we have been able to maintain our foreign exchange reserves at a satisfactory level. As I forecast in my last Budget, there was an upturn in the economy in 1994, with a GDP growth rebound into 3 per cent from the near-zero growth of the previous two years. Food security was improved with a satisfactory rainfall, and exports faired well, so that our balance of payments recorded a healthy surplus of about K£250 million. Nevertheless, while these developments are welcome sustainable long run growth can be achieved only when we bring about a strong and sustainable recovery in saving and investment.

Mr. Speaker, Sir, I have much to go through this afternoon and I do not want to tax hon. Members patience too much. I shall, therefore, summarise to some extent by cutting out a certain amount of details from the published speech. As usual, I will comment briefly on the major developments in the international economic scene before turning to a more detailed review of our own economy. Then specify the policies which we intend to put in place during the 1995/1996 Financial Year and beyond, to propel the nation further along the path of sustainable long-run growth.

Mr. Speaker, Sir, the latest Estimates show that in 1994 the volume of world merchandise export 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 the world trade and services. In GDP terms, the world economy in 1994 was characterised by 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 GPD of the industrialised countries rose significantly in 1994 as these countries continued their climb out of the 1990/1993 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 continues 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.

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 vigorously pursued structural adjustment programmes have tended to grow on a more sustainable basis than those which have implemented these reforms half-heartedly or not at all.

Mr. Speaker, before leaving this brief review of international developments, I wish to alert the House to the establishment of the World Trade Organisation. This came into effective operation at the beginning of the year, and is responsible for overseeing the permanent reduction in global protection through the resolution of trade disputes between nations, with adequate procedures to enforce compliance.

While the programme of reduction in protectionist barriers under the WTO will open up new markets for Kenyan products, particularly for agricultural products and for labour- intensive manufactures, our obligations under the new arrangements will have profound implications for the regulation of our own imports and for the collection of import duties. An Inter- Ministerial Committee under the Minister for Commerce and Industry will coordinate implementation and defend our trade interests.

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 domestic 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 unrelenting 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.

The latest information indicates that most of the 3 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.

It is regrettable that this commendable performance by our farmers last year was not matched by the growth in their incomes, as world prices, including Kenya prices, were driven down by bumper harvests in the main cereal producing countries. Indeed, maize producer prices dropped to below Kshs450 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 National Cereals and Produce Board (NCPB) to purchase over 6 million bags of maize at a price of Kshs950 per bag, making up a total cost of liability of over K£300 million. This expenditure was not foreseen 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 mixed. A rise in world prices was responsible for the upsurge in export earnings from coffee while export earnings from tea improved in dollar terms despite 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 in the 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.

I am happy to note that gross fix capital formation rose by 14.8 per cent in 1994 and this was sufficiently increased 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.

Mr. Speaker, Sir, turning now to the trade area, while the surplus of the overall balance of payments fell by 38 per cent in 1994, the current account balance recorded a surplus, which was 23 per cent higher than the corresponding figure in 1993. As is to be expected following the appreciation of the shilling and the recovery of the domestic economy last year, commercial imports rose by 15 per cent. Most of these increases in imports, especially in the second half of last year, reflected a greater import of raw material and capital goods, which augurs well for the future of our industrial expansion. One would anticipate the same factors which increased exports would exercise a dampening effects on exports. So, it is gratifying to record that domestic exports also increased by 15 per cent.

As regards traditional exports, the rise in coffee prices was insufficient to counteract the decline in tea and oil prices, and the earnings from these three main traditional export commodities fell by 3.9 per cent. It is, therefore, something of a relief to find that our export earnings from non-traditional, mainly manufactured products performed well despite the appreciation of the shilling. Overall, these rose by 34.1 per cent 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. 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.

We have made major progress in restoring monetary discipline during the financial 1994/95. The money supply on an annualized monthly basis grew for most of the year at rates in the lower and mid-lower 20 per cent range, which compared with an average monthly annualized growth rate of over 30 per cent during the financial year 1993/94. The shilling exchange rate to the dollar continued to appreciate during the second half of 1994 as a reflection of both international and domestic fundamentals and the large inflow 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. The impact of these events was, unfortunately, destabilising on our monetary policy. Unwarranted speculation against the shilling resulted in a substantial net redemption of Treasury Bills throughout the last quarter of 1994, which sharply increased the money supply. Careful market intervention from the Central Bank of Kenya in subsequent months reduced the monetary expansion to more acceptable levels. From the peak growth of 30.8 per cent in December, 1994, the annualized monthly growth rate of money supply had fallen to only 27.3 per cent by last month. 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 gross domestic product, it nonetheless represents a great reduction from the peak of K£7,328 million reached at the end of 1993. We have been able to reduce interest rates and substantially increase the amount of credit available to the private sector. From an average of 33.6 per cent 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 over 41 per cent.

Mr. Speaker, Sir, the annual inflation rate dropped from 46 per cent in May, 1994, to a negative 1.9 per cent last month, while the three month-annualized 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 1994/95 Financial Year battle against this enemy is nearly won, the war against inflation remains continuous. 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 look-outs have been posted at strategic locations in my Ministry while the sentries are alert, and the entire Government is determined that our economy will never again be invaded by this menace.

The total outstanding public external debt is expected to stand at $5,445 million. The public sector foreign debt portfolio increased by 4.2 per cent in dollar terms during this 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 and in the payment not only of the arrears but of the main debt portfolio as well. Indeed, during this financial year we not only expected to have paid out $188 million in interest and other service charges but we have also redeemed $341 million of the outstanding external debt.

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 their 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 path, by maintaining policy consistency. In the coming financial year our aim will be threefold. In the first place, measures will be introduced to consolidate and reinforce the fiscal and monetary measures already in place so as to eliminate any wasteful use of public resources and to ensure that wananchi get the best possible return for their tax payments. This is clearly the basis of all future progress. At the same time 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 afforded by the faster growth of the world economy. Further, while bringing about these changes in the control of Government expenditure and in economic restructuring special provision will be made to ensure that poorer sectors of our national communities share in these benefits in significant ways.

Mr. Speaker, Sir, in the last two Budget Statements my theme was "economy recovery through fiscal and monetary discipline". It is now clear that we have achieved a turn around in the economy and that, indeed, both fiscal and monetary disciplines have been substantially restored. However, we must continue to give highest priority to the maintenance of economic stability, as it is only in this way that recovery can 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 them for today is "sustaining micro-economic stability for growth with social equity". I will now describe in more details the particular policies which we intend to put in place based on this general theme during the coming year and in following years.

Mr. Speaker, Sir, the central objective of fiscal policy remains the reduction of the Budget deficit and its eventual elimination. We have been pursuing this goal with systematic vigour for some years, by improving tax collection yields on one hand, and by severe control of expenditure on the other. This House recently passed the Kenya Revenue Authority Bill, which 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.

We have been able to sharply reduce expenditure on most recurrent items while increasing the allocations for operations and the maintenance expenditures and concentrating on core projects. As a result, we were able to reduce the Budget deficit, inclusive of grants, as a proportion of gross domestic product from 6.4 per cent in the Financial Year 1993/94 to 0.7 per cent this financial year. I remain confident, therefore, that we are now well on the way to eliminating the deficit completely. While the reduction in the deficit remained largely on target, there were major changes in the allocation of expenditures within the total in directions which were not originally foreseen. These changes 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.

For several years now, we have been rationalising employment in the central Civil Service both to increase efficiency and to reduce the tax burden it required to meet overall salary costs, which constituted some 60 per cent the recurrent expenditure. We have now been able to reduce staff numbers by 20,000 officers without coercion, which represents a more rapid reduction than originally envisaged. Moreover, the retraining programme which is being offered to all retirees has proved to be a success, with the majority of them being able to apply their terminal benefits, both to increase their earning capacity and to generate employment. To restore the relationship between Civil Service salaries and pensions, which has been eroded in recent years, I am now proposing to increase the pensions allocation in the Budget by about K£40 million to pay off the accumulation of pension arrears accruing to the end of 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 Kshs10 to Kshs500 per month. Furthermore, 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 Pensions (Increase) (Amendment) Bill to be tabled shortly.

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, are made possible because we have a leaner Civil Service, and will continue to offset the savings in salaries to be obtained from further construction in staff members programme for this year. The reform of the Civil Service is proceeding hand in hand with the streamlining and restructuring of the 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 all Ministries' expenditures. Restructuring plans for these and another four Ministries are now complete and will soon be implemented.

Mr. Speaker, Sir, without being repetitive, I would like to highlight our policy aim in the parastatal sector. This is three-fold, 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 their opportunities for private investment. While we are actively seeking foreign investors for our privatisation programme and welcome the infusion of additional capital which they will bring, it is our firm intention to dispose of these enterprises in such a way as to provide maximum opportunities for Kenyans to participate in the privatisation process. To facilitate this, I am appealing to our co-shareholders to forego their pre-emptive rights when requested, so as to allow the sale of their shares through the Stock Exchange to a wider cross-section of Kenyans.

Substantial progress has been made over the last financial year. Out of the 207 public enterprises available for privatisation at the start of the programme two years ago, including those in which the Government has a minority shareholding, 61 now have been sold off and up to May 1995, sales of public enterprises brought in over K£20 million to the Treasury and K£100 million to the respective holding corporations. Among the major parastatals, Kenya Airways, with its subsidiary, Kenya Airfreight Handling Limited, 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 under way 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 Kenya Ports Authority has already contracted out maintenance of its equipment and an on-going study will determine the modalities of contracting out the management of container terminals in future. The telecommunications business of the Kenya Posts and Telecommunications Corporation is to be privatized except for the few functions which pertain to national security. Accounting procedures to separate the Posts and the Telecommunications parts of the Corporation have been put in place already, so as to facilitate the operations of the two activities as autonomous businesses.

In the power sector an action plan has been drawn to facilitate the organisational separation of the generation, transmission and distribution functions prior to attracting private investment in new power generation assets. Among the smaller State enterprises, we have now disposed of or brought to the point of sale, are seven cotton ginneries and, 43 tea factories, and plans are also under way to privatise the Mumias Sugar Company. It is my firm intention to dispose of one-third of the remaining State corporations in the course of this year and based on the progress made so far, I am confident that this target can be achieved. Inaddition to these activities, we have taken firm action to stem the present drain of the revenue from operational inefficiencies, including the better management of cross-debts with other Government agencies, and the negotiation of performance contracts with the major parastatals, setting out in precise detail targets for services and accountability. The exemptions from direct and indirect taxes have been revoked and steps have been taken to recover the large tax arrears outstanding. The Government is now charging market rates of interest on any payments made by it on behalf of the parastatals, in addition to the market rates which have been charged on new loans on-lent from Treasury to the parastatals since July, 1993.

Mr. Speaker, Sir, we have been very successful during the 1994/95 Financial Year in controlling inflation, in engineering a reduction in the interest rates and controlling the expansion of the money supply and in stabilizing the exchange rate. Continued success in these fields cannot be taken for granted. So, we will continue to consolidate our gains by maintaining a tight monetary position. Nevertheless, as the demands of the public sector on the economy are expected to contract during the coming financial year, some easing of particular elements of the tight credit squeeze of last year is now possible and desirable. Total money supply is targeted to expand on average by 16 per cent in the financial. 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 to deposit a minimum level of cash balances with the Central Bank. In addition to enhancing the effectiveness of monetary policy, this requirement will benefit the banking industry as a whole because it will facilitate further reductions in due course in the cash ratio imposed on all depository financial institutions. It is our firm intention to bring about both an increase in the domestic savings ratio and reduction in real interest rates by generating a fiscal surplus to allow for a substantial net redemption of domestic debt and by funding the remaining balance through longer-term securities.

As hon. Members will recall in my last Budget, I suspended all the regulations pertaining to the Exchange Control Act. It gives me great pleasure now to announce that modalities have been worked out to repeal the Exchange Control Act in its entirety. Appropriate legislation to effect this 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 Forex bureaus. This will provide additional competition to the commercial banks in the determination of their exchange rates and of the spread between buying and selling rates which are presently high by international standards. This development will be of particular value to the 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 in-ward 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 new sources of investable 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. The Stock Market has now developed to a point where it is able to finance the core financing needs of the Capital Markets Authority without recourse to the Treasury. Accordingly, I am publishing today a schedule of fees to be charged by the Authority for the services it provides under its Act and which will also contribute towards the establishment of an investor compensation fund. However, to encourage market turnover, the Commission rates will be reduced from July, 1995.

Mr. Speaker, Sir, 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, total employment outside the rural small-scale and pastoralism sector grew by around 12 per cent to reach 3.36 million, and all of this increase came from the private sector as public sector employment remains stagnant. 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. This implies not only increased training provisions to upgrade workers' technical skills, but also the redeployment of workers to more productive activities in different occupations and regions. The on-going Civil Service Reform Programme is central to this policy. As most 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 for this reason that the Budget allocates K£72 million for primary and rural access roads. In the industrial sector, we are reviewing the National Industrial 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 in the development 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 important technical training and other skill enhancement programmes for women, and in recognition of their vital role in the rural areas, agricultural extension programmes will be specifically designed for them. The Government attaches particular importance to the development of cost-efficient and market- oriented Jua Kali enterprises which also include women's groups. The developmental advantages are substantial but there is a high degree of enterprise mortality because of poor management practices and inadequate funding. District Trade Officers are now organising appropriate management training schemes and encouraging the amalgamation of some of the enterprises into more viable groups. This policy has already yielded positive results.

Mr. Speaker, Sir, 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 socio-economic problems we face. Therefore, the budget proposals I am presenting today include additional funding for on-going efforts to up-grade the technical skills of our youth through vocational training in our polytechnics and other higher education institutions and the National Youth Service.

It is our consistent objective to remove all the administrative constraints on export competitiveness and to encourage the transition of Kenya as rapidly as possible, to an export-orientation status comparable to that presently enjoyed by some of the South Asian countries. I have no doubt that Kenya is capable of achieving this transition, well ahead of any 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. 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 physical burden on the exporting companies. As the administrative capacity of the EPPO and other agencies improves, I will consider introducing additional physical measures in the coming months. 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. This development which will encompass the MUB companies will improve the attractiveness of the various duty and the VAT remission programmes as incentives to exporters and facilitate the collection of residual duties accruing on imported materials not utilized for the intended purposes. It will, therefore, reduce the levels of economic sabotage. The Treasury is also holding discussions with potential private investors towards the establishment of Export Credit Guarantee Schemes to provide guarantees against both commercial and non-commercial export credit rates. However, hon. Members should be assured that in line with our policy, the Government will not take any equity stake in this enterprise when it becomes operational.

Mr. Speaker, Sir, I have already touched on the implications of the World Trade Organisation for Kenya. Now, I will deal with trade relations arrangements nearer home. Chief among these is the East African Co-operation Council composed of the three East African countries. Continuous discussions are taking place on the harmonization of tariffs, and I will be announcing some measures today in harmony with my Tanzanian and Ugandan counterparts, who are also presenting their Budgets. For the wider COMESA trade area, we will also continue to press our COMESA partners for the speedy adoption of measures required to achieve our aim of a Customs Union with a common external tariff by the year 2010. I have noted the encouraging upturn in private sector investment which took place last year and which indicated renewed growth confidence on the prospects of 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 to London for a special and successful meeting of the Confederation of British Industrialists. He has also taken the lead in addressing conferences of Kenyan companies and encouraging them to respond positively in investments terms to the improved economic climate. The message which is given at this 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 while the progressive liberalisation of the economy under the privatization programme means that there are ample opportunities for every investor. 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 are the delays in obtaining initial investment proposal, the various licences being required by the central and local government agencies and the time lost in making initial and renewal payments to the administering agencies. Many of the licences still required relate to environment or employment requirements, where the scope for their relaxation is limited. Others are imposed by local authorities for financial rather than regulatory considerations. A special task force of central and local government agencies is being formed to suggest measures to further relax and harmonize licensing regulations. Further, to ensuring that in the competitive rates for investors, Kenya is not left behind, investment approval procedures in future will be confined strictly to environmental, safety and non-financial issues.

An unfortunate side effect of trade liberalisation has been the increase in dumping activity. Fierce competition, based on quality and subsidized prices is to be welcomed as a stimulus to development. However, where manufactured goods are 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 in some industries for the benefit of a few. 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 that as we are determined to stimulate competition, we are equally as determined to stamp out unfair competition derived from such subsidies. 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 pre-shipment 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 and this practice has seriously affected the market for some of our legitimate industries, particularly, textiles. We have now reached an agreement with our neighbouring countries to tighten up controls to eliminate this menace.

Mr. Speaker, Sir, hon. Members may recall that petroleum prices and the supply of petroleum fuels were liberalised in October last year. I wish to express the Government's disappointment that the retail prices of petrol and other products have not been reduced following the liberalisation. I appeal to all consumers to exercise their new market power
to bring about moderation in these prices by confining their purchases to the cheaper outlets. At the time of decontrol, there were no facilities for handling imported Liquefied Petroleum Gas (LPG) for cooking. As a short-term measure, to ensure adequate supply of this crucial commodity, the Government now requires the oil companies to process adequate amounts of oil into cooking gas, pending the urgent installation of adequate LPG storage and handling facilities by the Kenya Pipeline Company (KPC). The KPC is also setting up its own testing laboratory to ensure quality environmental and safety standards for use by any importer of petroleum products.

I now turn to the electricity sector where, in contrast to the petroleum sector, supply and distribution still remain under the control of energy parastatals. I have already outlined our privatization 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 State programme to better reflect long-term 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 now being encouraged to participate in power generation, particularly in the 64MW geothermal plant at Ol Karia, and a second 75MW diesel generating plant at Kipevu, and additional power stations are now being planned on the basis of private sector participation. In the meantime, work is under way towards the construction of the new 75MW diesel generator at Kipevu which will shortly be brought on stream to ease the current generation capacity constraints.

Mr. Speaker, Sir, in the infrastructural area, what requires most immediate attention from the point of view of potential investors is our road network. The poor condition of the great majority of our roads directly limits the scope and increasing the cost of both our export operations and our production activities generally.

It was to provide additional funding for this purpose that the Government introduced the Road Maintenance Levy as a surcharge on petrol and diesel sales in place of the road tolls, all of which
were earmarked as Appropriations-in-Aid. During the 1994/95 Financial Year, I expect to have spent over K£75 million derived from this levy in addition to the allocation of K£42 million for road works made available to the Ministry of Public Works and Housing.

The Kenya Urban Transport Project is developing more cost-effective operation and maintenance procedures 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 the project. It will also facilitate the contracting out of certain services for maintenance functions to private operators. I would like to assure the House that all the revenues from the Road Maintenance Levy Fund are being dedicated to road maintenance. Indeed, I am now proposing to allocate an amount of 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.

Mr. Speaker, Sir, historically, the Kenyan economy has always been driven by the agricultural sector. In recognition of this, the Government has given the highest priority to its continued development. Our policy here 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, Sir, 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 farmers' incomes. The NCPB has now embarked on a programme to dispose of these extraordinary purchases as soon as possible, both internally to aid agencies and others, and also through 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 farmers' incomes, the NCPB is now taking steps to make available to the private sector that part of its storage capacity which is surplus to our strategic reserve requirements in order to supplement their own resources. In addition, 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.

Agricultural exporters from the major supplying countries have been in receipt of massive subsidies, particularly in respect of cereals, sugar and dairy products. Sometimes the benefits to the consumers are greatly outweighed by the damage to the farmers' livelihoods. Earlier this year, it was apparent that the variable duty system was being circumvented and it is for this reason that we temporarily suspended the importation of maize, wheat, milk and sugar. Conscious of commitments under the WTO, however, this import suspension is being lifted today.

Mr. Speaker, Sir, the agricultural sector has always been in chronic need of credit on reasonable terms, and the Government has supported the provision of such credits mainly through the Cereals and Sugar Finance Corporation, the Agricultural Finance Corporation, and the Co-operative Bank of Kenya. However, our experience with loan recoveries of all these institutions has been discouraging and we are, therefore, presently reviewing the situation to devise more cost-effective schemes.

Mr. Speaker, Sir, rising population pressures, migration and rapid urbanisation have increased the need for urgent action to address Kenya's environmental problems. In accordance with the National Environment Action Plan which was adopted last year, it is our policy, as soon as proper modalities are in place, 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 the energy sector projects.

Mr. Speaker, Sir, the 143 Local Authorities countrywide are responsible to the public for the provision of a wide variety of services. Demand for these services has been rising rapidly in recent years as there has been a continuous migration of population to the towns. However, the existing sources of their revenues have not been adequate to cope with upsurge demand. Consequently, they have run up persistent deficits while the quality and availability of the services provided has tended to fall far short of acceptable standards.

The total debt owed by the Local Government Loans Authority now exceeds K£300 million of which approximately two-thirds in arrears are considered to be 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 the foreign creditors on its behalf. Moreover, the inability of the Local Authorities to repay their loans from the National Housing Corporation has severely impaired the solvency of that agency, quite apart from the added burden it has placed on the Treasury. The situation cannot be left to deteriorate further.

As has been recently announced, His Excellency the President has set up a Commission of Inquiry to review and make recommendations on the structure, powers, legal framework, functions, licensing, financing and staffing of Local Authorities. Moreover, the Commission will examine the modalities of upgrading Mombasa, Kisumu, Nakuru and Eldoret to City status and to decentralise the management of the City of Nairobi into boroughs. The Commission will draw upon the work of the Kenya Municipal Reform Programme.

Mr. Speaker, Sir, I now turn to the area of poverty alleviation which is an important aspect of my Budget theme for today. It is this general area which is to receive priority in the allocation of the additional resources made possible by our return to part of growth.

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. Clearly, the resumption of growth which we are not 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 to reduce 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 of or removal of Government welfare subsidies.

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 may 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 the National Conference on the Social Dimensions of Development which was held in October, last year. He then went on to represent Kenya at the meeting on Social Development held last March in Copenhagen, where he emphasised his deep concern that the short-term changes necessitated by the reforms were having a disproportionately adverse impact on some of the disadvantaged groups who will be unable to make the necessary adaptations in reasonable time without special help. 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 the Printed Estimates that I have set aside K£377 million for 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 year 1997/98 Financial Year. As this is about half of the K£2,344 million which was the estimated requirement for this project, the Government has also invited the donors and the private sector to contribute to bring the projects to a successful completion within the programmed time-frame. This year's Budget provisions 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 materials for health services in rural areas and 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. Funds are also earmarked for the rural industries, for employment generation programmes, development of Jua Kali enterprises, bursaries for poor students in the universities and for severance payments for civil servants retiring under the Civil Service Reform Programme.

Mr. Speaker, Sir, the poor are always with us. The Government determines 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.

Mr. Speaker, Sir, we have seen that 1994 was a turnaround year for the Kenyan economy, with GDP growth reaching an estimated 3 per cent following two years of stagnation. There is little doubt that high growth has 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 exports. 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 that 5 per cent and that the growth rate will accelerate further in 1996 to around 5.6 per cent.

The present policy framework, together with the measures which I am announcing today, will enable us to contain the three months annualized inflation rate within the single digit level during 1995 and beyond. I expect the real GPD growth rate for the Financial Year 1995/96 to be slightly higher than for the 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.

Mr. Speaker, collections of ordinary revenue are now expected to be somewhat higher than in the printed estimates at K£6,330 million, despite the liberalisation of petroleum prices in October, and the discontinuation of the Refinery Throughput Tax from November. As inflation in GDP growth is on target, by far the most important factor in generating this increase was by improvement in collection efficiency following the comprehensive utilisation of the PIN and better than expected yields from the PAYE tax amnesty. There has also been an improvement in employment and salaries, and increased collections from the parastatals. At the same time, we have had the first full year of operation of the new pre-shipment inspection procedures, which have increased valuations, while the reduction in import duties 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, representing an increase in real terms of nearly one-third above the level of the Printed Revenue Estimates. I now expect to collect K£1,063 from import duties, which is 14 per cent above the Printed Revenue Estimates. Excise duties are now expected to yield K£960 million or about 10 per cent below the previous estimates.

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 the Kenya Posts and Telecommunications Corporation (KPTC). 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.

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

Mr. Speaker, as hon. Members will see from their copies of the Printed Expenditure Estimates, the supplementary appropriations involved an additional expenditure this financial year of some K£560 million in the Recurrent Vote, to provide mainly for additional salary allowance payments to teachers and doctors and for the Civil Service retrenchment programme. However, reallocation 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. 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 in the Printed Expenditure Estimates.

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 National Cereals and Produce Board 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 the 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. These expenditures increased by K£38 million mainly due to faster direct payments on ongoing projects.

In summary then, 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.

Interest payments on domestic borrowing amounted to K£1,170 million, which was K£161 million lower than anticipated, while foreign interest payments (including arrears) at K£520 million were slightly smaller than expected. 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 per cent of GDP. However, the domestically financed Budget deficit will be lower at around K£141 million or 0.7 per cent of GDP.

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. Within the overall debt reduction programme, it is my intention today to give priority to the contraction of domestic debt.

Mr. Speaker, although debt reduction remains our overriding priority, it is also my intention to achieve this in such a way as to improve social equity.

Salaries and allowances for civil servants and teachers will continue to dominate my expenditure in the coming financial year. Since I fully expect to maintain inflation at low levels, there is little justification, as I stated earlier, for further increases in basic salaries.

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.

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 Appropriations-in-Aid of K£1,122 million.

To summarise, I expect 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.

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. This is an increase of nearly 17 per cent.

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. On the basis of the growth projections, I am expecting that the collection of ordinary revenue will yield K£6,682 million, which is the equivalent of 28 per cent of the projected GDP.

The most rapid growth in revenue collection is expected to come from Import Duty and Value Added Tax which I expected to increase 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.

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 shilling while consumption of beer and cigarettes fell because of the continued contraction in per capita incomes. These developments are likely to have a negative impact in the coming year on the collection of excise duty.

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 of 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 yield from other 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.

I further estimate that receipts from the dividend payment by the Central Bank of Kenya 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 these revenues, I expect another K£343 million to be provided to the Exchequer from Appropriations-in-Aid. Thus, I expected 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.

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 modernization in order to make it fairer, more efficient and economically more effective. Under this tax modernization programme, the taxation capacity has been significantly raised. Prior to 1993/94, ordinary revenue collections had never exceeded 24 per cent of Gross Domestic Products (GDP). By contrast, in 1993/94, ordinary revenues reached 27.9 per cent of GDP. This financial year, I expect ordinary revenues to exceed last year's level. This remarkable achievement has been attained by a combination of lowering and rationalising tax rate structures, expanding the taxation bases and, most importantly, strengthening tax administration. 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 Revenue Authority will provide the vehicle for professional and equitable adminstration of 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. As specified in the Kenya Revenue Authority Act, the Authority will receive a base level of funding of 1.5 per cent of its budgeted revenue collections based on the Printed Estimates. This amounts to K£95.4 million for 1995/96. Therefore, the funds available for tax administration will increase to more than double those in the past. With these additional resources, I will be expecting increased revenue yields in excess of K£200 million from the more effective tax collection. These additional revenues are built into the estimates of the increased revenues required for 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. 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 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 compliance with the tax laws of Kenya.

Another major innovation in tax administration has been pre-shipment inspection programme for customs evaluation (PSI). This PSI programme has helped directly and indirectly to raise the customs revenues on non-oil imports by more than 20 per cent. These increased revenue collections were more than double the cost of the PSI programme. The implementation of this programme will become more rigorous over the coming years as full compliance of the PSI documents is undertaken with the Customs Department.

Mr. Speaker, Sir, as is conventional, I will 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. Following tradition, 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, to bring 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 in line with current price levels, I am proposing that all fines, penalties and fees at least, be doubled. 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, it has come to my attention that the approval and clearance procedures for imports for use by diplomatic missions and the 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 Treasury will also introduce 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 the Customs and Excise Act to rationalise the provisions for exemptions for the imports of aid-funded projects and the personnel entering the country to assist in their implementation, as well as for returning residents and persons arriving in Kenya for the first time as residents.

Sixth, in my speech last year, I announced that the reconciliation and export inspection work under the EPPO duty/VAT exemption programme for imports used in the production of exports and under the Manufacturing Under Bond Programme for exports would be contracted out in order to improve the customs controls and service to exporters. The contract has been finalised and work under this contract will commence in July.

Seventh, while customs controls on imports improved during the past year, the incidents of transit and export fraud, unfortunately, rose. The Customs Department has already moved to implement tighter controls and 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 pleased to announce that as part of the growing co-operation within the region, the governments of Kenya and Uganda have come to an 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 on export and transit trade between Uganda and Kenya. Second, Kenya will receive copies of the Ugandan pre-shipment inspection documents for imports destined for Uganda. Clearly, any shipments arriving in Kenya in transit to Uganda that do not have the required pre-shipment inspection documents will be subject to detailed examination and strict controls. Third, 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 commodities such as industrial machinery and raw materials, however, the Commissioner will not demand full coverage of the duties and taxes at risk.

Mr. Speaker, Sir, these measures will help expose the fraudulent importers 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.

Eighth, 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.

Ninth, the World Customs Organisation has agreed that effective from 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 have little or no effect on the tariff rate structures for import duties, excise duties and VAT. 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 proposals that have direct revenue consequences. First, to move the rationalisation of import tariff one more step towards reaching a four-rate system, including duty-free, I propose lowering by five percentage points the rates in the 4530 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 per cent. Second to lower the duty burden on capital equipment, I am proposing to lower the duty rates on all capital equipment in the 15 per cent band to 10. In addition, the tariff rates in food preparation machinery and computer equipment currently in the 20 per cent band will also be reduced to 10 per cent. 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 converters and large transformers to five per cent. 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 five or 10 per cent 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 promise 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 preserved for protection of domestic industry.

The general tariff rate changes I have just announced will not only rationalise the rates structure but will also promote the efficiency of the economy. With the lowering of import duty rates on capital equipment and raw materials, Kenyan manufacturers will become more competitive in the world market. Fifth, to help selected domestic producers, I am proposing some further duty rate changes. To assist the local assemblers of lorries and buses, I propose to lower the tariffs on the completely knocked kits for these vehicles by five percentage points. To help domestic manufacturers, I am proposing to raise import duty rates on nails, wire made from iron or non-alloy steel, and cardboard containers.

Kenya has an nascent wines industry and I am proposing to lower the duty rates on oak casks and staves to 15 per cent to help this sector mature. Sixth, to reduce the costs of road transportation to lower-income persons, I propose further reductions to the tariff rates on bicycles from 30 to 15 per cent, and motorcycles from 45 to 25 per cent. Seventh, 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. Equally, 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. This item will also be zero-rated under the VAT, and I expect to see hon. Members switching the styles of their spectacles in the coming year.

Eighth, the match industry has experienced some problems from import competition over the past year. Therefore, I propose to introduce alternative specific import duties to prevent any under-valuation of imported 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 strick controls to prevent diversion of goods from transit shipments and from imports under the exports promotion programmes that I have already announced, I am proposing to introduce an alternative duty rate on used clothing to prevent under-valuation for customs purposes.

Mr. Speaker, Sir, clothing, textiles and footwear brought into the country ostensibly for donation to the poor and needy are finding their way into the place. These undutied imports provide unfair competition to the local industry and have crippling effects on jobs for Kenyans. Accordingly, no further exemptions will be allowed on imports of clothing, textiles and footwear that are donated or aid-funded, unless such imports are allowed during a national emergency to assist or to assist refugees in an officially recognised camp. In addition, as is the case with all goods brought to the country duty-free for donation, resale of such goods requires duties to be paid at that time. 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. Clothing can be imported as long as the required duties are paid.

Finally, the importation of agricultural products subject to the variable duty has caused a number of problems over the past year. While the variable duty rate structure has provided a fairly effective protection against low cost imports caused by the strong shilling during recent months, the 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 rates will be charged in addition to the *ad valorem* rates 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 per cent of the legislated duty rates. The current provision allowing variation of any duty rate by 25 per cent of the legislated rate will be amended to increase permitted variation to 30 per cent. 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 an officially recognised refugee camp 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. 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.

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 to its administration and the paying public to gain experience with its operation. With the establishment of the Kenya Revenue Authority, I feel confident that the VAT Department will have the capacity to handle an even larger 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. The coverage of designated goods, that is goods taxable through to the retail level, will be expanded to all goods except for those that are on the VAT exempt schedule, primarily unprocessed products of the agricultural, fisheries, forestry and livestock sectors, and two, all commodities in chapters one to 21 of the harmonised cod;, that is all food items. The definition of these additional goods will become effective on 1st September, 1995.

Second, along with this expansion in the VAT base, I am equally proposing major changes in the VAT rates structure. The standard rates of VAT will be reduced from 18 per cent to 15 per cent. The high rates will be lowered from 30 to 25 per cent and the low rates will be raised from 5 to 6 per cent. 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 the manufacturers and other businesses under the VAT unnecessary in establishing the minimum turnover level for compulsory registration under this tax. I am, therefore, proposing a simplified system under which registration will be required if the combined turnover of taxable goods and services exceeds Kshs2 million in a year.

Four, as I emphasised in my speech last year, I am determined to gain the maximum compliance to payment of VAT, particularly at the retail level. In addition to the more vigorous enforcement that I expect under the Kenya Revenue Authority, I am proposing to increase the penalties and fines under the VAT. To keep the values of fines and penalties in line with the current price levels, I propose to at least double the levels of all fines and penalties. Automatic minimum penalties of Kshs10,000 will be introduced for failure by registered traders to issue a VAT invoice or to maintain proper VAT records. 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, the Commissioner has powers to collect unpaid taxes up to an amount of Kshs20,000 summarily as a civil debt. I propose to increase this amount to Kshs100,000 to ease the recovery of arrears.

Sixth, the VAT Act is silent on the correct procedure for the Commissioner of VAT to dispose of goods forfeited to, or sized 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.

Seventh, the Commissioner has powers to require persons owing money to a taxpayer in VAT arrears to pay the money directly to the Commissioner to recover the unpaid taxes. I am proposing amendments to clarify and tighten the VAT Act to improve the effectiveness of this appointment of agents to recover VAT arrears.

Eighth, to assist local fishermen and to encourage them to buy locally-made nets, I am proposing to lower the VAT rates on fishing nets from 18 per cent to per cent. Ninth, to lower the cost of animal feed preparations for farmers, I propose to zero-rate all animal feed preparations.

Tenth, 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 artwork, 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. The changes to the VAT rates that I have announced today will take effect from midnight tonight. The measures that I have introduced to the VAT will lower revenues by K£13.3 million.

Mr. Speaker, Sir, I have only a few changes in the Excise Duty to announce today. First, to date, sales of cosmetics have been taxable at the retail level at the VAT rate of 30 per cent. This has caused difficulties in collection and for the retailer having to have 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 15 per cent, and to make cosmetics subject to a 10 per cent Excise duty rate. Secondly, 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 trader, I am proposing to lower

the Excise duty rate to 10 per cent. These amendments to the Excise duty will raise an additional K£17.4 million in revenue.

Under the Tax Modernisation Programme, the Income Tax Department has performed admirably. It has persistently 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 instalments 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 have been incorporated, and unincorporated businesses are now filing tax returns. At the same time, these base expansions have allowed reductions in tax restructures.

It was only eight years ago when the top tax on individual income was 65 per cent. It was only six years ago that the company tax rate was 45 per cent. Those dark ages of taxation seem to be light years away now.

First, as I promised last year, the drought levy imposed last year to help pay for the drought relief efforts would only last one year. For companies with accounting periods ending after 1 July, 1995, the company tax rate will return to 35 per cent. Second, for individuals, the additional two-and-a-half percentage points on income above Kshs19,500 will fall away at the end of this year. The top marginal tax rate on the income of individuals will now come down to 35 per cent from 1 January, 1996 on wards.

Third, to accord relief to the low-income workers, I am proposing to increase the personal relief by 20 per cent. The married relief will increase from Kshs5,460 to Kshs6,552, while that for single and married women will increase from Kshs3,636 to Kshs4,368. This means that the minimum taxable income for married men will rise to Kshs5,460 and that for all other individuals to Kshs3,640. This increase in relief 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 investments in companies, I propose to reduce the tax rate on qualifying dividends paid to residents from 10 per cent to 7.5 per cent.

Fifth, the instalment tax system was first introduced in 1990 as a single instalment. 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 per cent instalment payment will be required after four months, but the 50 per cent instalment payment required after six months will drop to a 25 per cent payment. This final system will allow for a smooth stream of tax payments over the course of the year, with four 25 per cent 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.

Sixth, employer-provided benefits have increasingly been brought under full taxation. In the case of motor vehicles, however, benefit values prescribed by the Commissioner have not been increased since 1992. They also significantly undervalue the benefits 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 per cent of the initial capital expenditure by the employer on the motor vehicle. This minimum monthly benefit will rise to 1.5 per cent in 1997, and 2 per cent in 1988 and subsequent years.

Seventh, I am proposing to liberalise the basis of the extra 40 per cent investment deduction available to investors in Manufacturing-Under-Bond (MUB) export facilities. Currently, to obtain the extra 40 per cent investment deduction, MUB 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 installed in any building, whether owned or leased, as long as the Customs has licensed the factory for manufacturing under bond for export.

Eighth, to help attract large-scale private 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 will entail expenditure on productive physical assets in excess of $5 million within a two-year period, and that the project will generate net economic benefits for the country.

Ninth, 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 all presumptive income tax has attractive features in relieving the administrative burden from the 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 rate of 2 per cent, down from the previous higher rate of 5 per cent. The structure will essentially stay the same as before, except that Customs and Excise Department will become an authorised agent to collect presumptive income tax on direct exports of agricultural produce.

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 from 1st January, 1996. This advance tax will be treated just like a withholding tax, and hence, will be offset against instalment and final income tax payable for a year. The advance tax rates on goods-carrying vehicles (vans, pickups and lorries) will be Kshs500 per tonne of load capacity, while on passenger-carrying vehicles (saloons, station wagons, minibuses, buses and coaches), the rates will be Kshs240 per passenger capacity. For both types of vehicles there will be a minimum tax of Kshs1,000 per year.

Eleventh, Mr. Speaker, Sir, Kenya has opened up its economy to trade in goods and capital funds. To ensure that Kenya gets its fair share of taxes on the income earned abroad, while at the same time the tax system does not unnecessarily hinder the Kenyans investing or foreigners investing in Kenya, I propose to commence the negotiation of double taxation treaties with our major trading partner countries, particularly our neighbouring countries. Such treaties will serve to foster the growth of business between our countries.

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. It has also 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, while these assets are clearly connected with the conduct of their business in Kenya. I am, therefore, proposing amendments that will require such branches of foreign banks to report for tax purposes, income earned on deposits, property and other assets held outside the country.

Thirteenth, Mr. Speaker, Sir, to continue the phasing of tax deductible pension contributions that begun in 1991, I propose to increase the limits for tax deductible contributions to registered pension funds and individual retirement funds from Kshs36,000 to Kshs60,000 per year. The ultimate objective is to raise the limit for deductible contributions to reach the overall contribution limit, which currently stands at Kshs180,000 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 an employee. Since limits now apply to the total 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.

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 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, Sir, the provision of adequate housing in Kenya is a pressing one. To assist in 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 Kshs60,000 to Kshs300,000 per individual investor.

Second, the most difficult obstacle to overcome for 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 of up to Kshs30,000 a year to a 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. I feel confident that this registered home ownership savings scheme will not only assist many Kenyans to purchase the first permanent house, but also channel savings into the financial institutions that are providing mortgages. The measures I have just announced will raise an additional K£91 million for the Exchequer.

Mr. Speaker, Sir, I now want to enumerate other measures that I propose to introduce that will have revenue consequences. First, to increase the funds available for roads maintenance, I am proposing to increase the Road Maintenance Levy by 50 cents per litre. This will increase the levy on petrol to Kshs2.00 and that on automotive diesel to Kshs1.50 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 1 per cent 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 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 the country, I am proposing that this reinsurance premium tax be payable on a quarterly as opposed to monthly basis. Finally, the building society licence 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.

Mr. Speaker, Sir, after this unavoidably lengthy review of my taxation proposals and the policies and economic factors on which they are 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.

Mr. Speaker, Sir, as I did last year, I am publishing a longer version of my speech together with a statistical annex which summarises the Budget environment in numerical and graphic form. The economy is moving in the right direction and improved living standards are within our grasp. However, 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.

Mr. Speaker, Sir, I call on all hon. Members, irrespective of their parties, 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, Sir, I beg to move.

The Vice-President and Minister for Planning and National Development (Prof. Saitoti): Seconded.

(Question proposed)

DEPARTURE OF HIS EXCELLENCY THE PRESIDENT

Mr. Speaker: Hon. Members, I would like to remind the House of the provisions of Standing Order, No. 12. When His Excellency, the President leaves or enters the Chamber, hon. Members shall remain standing in silence.

I hope all hon. Members will observe---

An hon. Member: The hon. Members from KANU side do not observe silence.

Mr. Speaker: Order! It is now the pleasure of His Excellency the President to take his leave.

(Hon. Members rose in their places while His Excellency the President left the Chamber)

ADJOURNMENT

Mr. Speaker: Hon. Members, it is now time to adjourn the House. The House is adjourned until Tuesday, 20th June, 1995, at 2.30 p.m.

The House rose at 4.40 p.m.