REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1996/97

(1st July–30th June)

by

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SPEECH DELIVERED TO THE NATIONAL ASSEMBLY ON 18th JUNE, 1996 BY THE HON. MUSALIA MUDAVADI, MINISTER FOR FINANCE, REPUBLIC OF KENYA, WHEN PRESENTING THE BUDGET FOR THE FISCAL YEAR 1996/97

1. INTRODUCTION

As we now come to the end of the 1995/96 financial year, I am pleased to confirm that our nation has continued to make substantial advances on its road to development. I have no doubt that this achievement has been directly assisted by firm adherence to our established policy of combining economic stability, liberalisation and social equity with the progressive release of public sector resources for more productive use by the private sector.

The first evidence of this improvement is that we have been successful in bringing our economy back on to the path of higher growth. During the calendar year 1995, real GDP growth is now estimated to have been 4.9 per cent, which compares very favourably with the 3 per cent achieved in 1994, which itself was a pronounced recovery from the stagnation of previous years. As last year's growth was substantially higher than the growth in population, it represents an increase in the standard of living of every Kenyan.

Moreover, the economic foundations for further progress are substantial. We have maintained the annual rate of inflation well within single digits, with the rate averaging under 5 per cent for the 1995/96 financial year through to last month. We have reined back the growth in the money supply to levels consistent with stable growth. We have restored stability to the exchange rate, while last December, this House repealed the Exchange Control Act to realise the full convertibility of the Shilling. This provides a powerful assurance to potential investors that the structural adjustment already in place is irreversible and that our commitment to liberalisation is permanent.

We have also made further progress in reducing the budget deficit on a commitment basis from its already low levels through better revenue recovery under the new Kenya Revenue Authority and through even more rigorous control of public expenditure in every department. Moreover, despite rising servicing costs, we have continued to redeem substantial portions of our domestic and foreign debt. I am particularly gratified by the resumption in donor confidence as evidenced by their agreement in April at the IMF Board to proceed with the IMF Enhanced Structural Adjustment Facility and related funding.

Thus, without question Kenya today is much better poised for sustainable growth in the medium term. In my Budget today, I intend to ensure that the ground we have so painfully regained in recent years is secured through the prudent adaptation of existing policies to the new environment rather than by the introduction of radical changes.

I am publishing the now familiar Statistical Annex today to accompany the printed Speech. As is usual, I will start by briefly reviewing the domestic and foreign economic developments which have affected our performance last year. I start with world economic developments.

2. WORLD ECONOMIC DEVELOPMENTS

Mr Speaker, the world economy continued to be driven by a rapid expansion of trade during 1995, despite the continued volatility of the major currencies and the decline in commodity prices. According to the latest estimates, the expansion of world trade in volume terms remained encouragingly high, although there was some contraction in the growth rate to 8 per cent from the record 9 per cent recorded for 1994. A notable development was the continued weakness of the dollar against the German mark and other major currencies for most of the year which resulted in major currency flows. Another disturbing feature was the substantial fall in non-oil commodity prices which caused balance of payments problems for most developing countries, including Kenya, especially as oil prices shot up.

The slight contraction in the trade volume growth and the more serious developments in commodity prices reflected the slowing down of economic activity in most of the major industrial countries. In the USA, the GDP growth rate slowed from around 4 per cent in 1994 to an estimated 3.3 per cent in 1995 following an excessive buildup of inventories in the previous year, while the contraction in the UK growth rate was of the same order and for much the same reasons. There was a much more pronounced contraction in the German growth rate, while that of France reduced rather less sharply. Although the situation remains unsettled, it is to be hoped that these contractions do not indicate the beginning of a new recession so much as the effect of deliberate policy measures to counteract incipient inflationary pressures and thus to move these economies to more sustainable growth rates. However, the slowdown was not uniform, with some industrialised countries such as Italy actually experiencing higher growth, so that the European Union average growth rate declined only slightly to just under 3 per cent. The prolonged Japanese recession still persisted, however, as both consumer and investor confidence remained low.

For the developing countries as a group, the real average growth rate remained fairly constant at around 4.5 per cent, but as one has now come to expect, the growth rate among many of the Asian countries was much higher. Mainland China, South Korea, Malaysia, and Thailand maintained particularly high growth rates, while the growth rates were still above average in India , Pakistan, Hong Kong and the Philippines. By way of contrast, the growth rate for the Least Developed Countries was just over 2 per cent, well below their growth rates in population.

In Africa, there was a slight recovery in growth last year, but only to around 3 per cent. The non-oil countries in the region were adversely affected by the decline in the prices of their export commodities, while some countries, including some oil exporters, were also beset by civil wars and political uncertainty. The food security situation in the continent is also causing concern, as the harvests in most of the sub-Saharan countries have been reduced by drought or unreliable rainfall, resulting in increased reliance on food imports to stave off famine. The continued slowdown in net aid disbursements was also a growth depressing factor, together with the burden of debt repayments which still remain excessive. Once again, African economic growth and its share of world trade have not outpaced its population growth so that real incomes have not improved.

3. RECENT TRENDS IN THE KENYAN ECONOMY

Sectoral GDP:

Agricultural output rose by 4.8 per cent last year despite a 10 per cent shortfall in the maize harvest from the previous year's peak, although its share of GDP remained constant at 25 per cent. Apart from unfavourable climatic factors, the fall in maize production reflected the switch by some farmers to other crops following the sharp fall in prices in the previous season. Hon. Members will recall that last year the NCPB accumulated large stocks above its food security reserve requirement. However, the NCPB sold off all its surplus stock by December mainly to export markets, and it has made full payment of the arrears due to farmers for the 1994/95 season for the first time in many years without recourse to the Exchequer.

Manufacturing output rose by just under 4 per cent last year. This growth is the highest recorded since 1991 and bodes well for the continued resilience of this sector as a whole in the liberalised economy.

The construction sector grew slowly in 1995, reflecting the slowdown in public sector building activity, although there was an encouraging rise in building approvals and the output of the cement industry also grew rapidly. In the power sector, the increase in electricity generated failed to match consumption demand resulting in widespread rationing. In the transport sector, the secular switch from rail to road continued although the freight components of both sectors grew strongly reflecting sharp improvements in productivity.

The financial services sector continued to expand rapidly in 1995 and now accounts for just under 10 per cent of GDP. The profits of the banking sector have been impressive and reflect to some extent the very high level of interest rate differentials which still prevails despite appeals for greater moderation.

On the other hand, 1995 was a particularly bad year for tourism with the sector's earnings falling by around 11 per cent in shilling terms reflecting both stronger competition and the cumulative effects of adverse, if unjustified, international criticism of the domestic security situation.

Balance of payments

Mr Speaker, after the encouraging performance of the previous two years, last year's outcome was a disappointing one for our external position, with the combined capital and current account in 1995 worsening to a deficit of K£369 million from the previous year's surplus of K£265 million.

While there was a commendable increase in our exports by as much as 14 per cent in value terms, there was a sharp deterioration in the terms of trade and import values rose by almost 35 per cent, so that our deficit on merchandise account reached K£ 2.9 billion or almost double the merchandise deficit in 1994. However, the proportion of imports devoted to non-consumer goods, including capital goods and raw materials remained high, so I am hopeful that this indicates an eventual and corresponding rise in exported output.

Export volumes of tea rose by almost 25 per cent and Kenya's share of the world tea market increased significantly. However, the forex earnings from this commendable effort did not grow proportionately as world tea prices fell sharply from the previous year's level, reflecting both adverse exchange rate fluctuations and the continuation of unfavourable consumption trends. In the coffee sector, the volume of exports rose by some 11 per cent last year and there was an encouraging rise in forex earnings which would have been even greater but for the eventual collapse of the International Coffee Agreement and the consequent easing of stock disposal regimes. Demand for our horticultural exports held up very well, for both cut flowers and vegetables, as our exporters were able to adapt quickly to the new quality regulations and favourable changes in demand in the European markets, but again prices tended to ease. Manufactured exports rose by almost 20 per cent in value terms but suffered a slight fall in volume terms, which was particularly sharp in the textile sector.

Mr Speaker, I am pleased to note that Kenya's exports are becoming increasingly diversified, with the share of non-traditional products reaching 59 per cent in 1995. It is also gratifying to record that the share of African countries in our export markets has continued to rise and stood at 49 per cent last year, while our two East African Cooperation partner countries took 29 per cent.

The current invisible balance fell by over 12 per cent last year to only K£945 million, reflecting the depression in the tourism industry, which more than offset the fall in net royalty and dividend outpayments.

The adverse balance on the current account was offset to some extent by the restoration of the capital account to a surplus of K£637 million as compared to the slight deficit in the previous year. This reflected both greater repatriation of investible funds held by Kenyans abroad and other capital inflows, both of which illustrate the return of investor confidence.

Investment & saving

While progress continued to be made in this area during 1995 consequent upon the upturn in GDP growth and the improved tax allowances for savers, the scale of the improvement was disappointing and the increase was far too modest to sustain growth at a comfortable rate. As a proportion of GDP, gross fixed capital formation rose from 19.2 in 1994 to 21.6 per cent, but this was still well below our minimum medium term target of 30 per cent. However, it is encouraging to note that all of this increase came from private investment which rose by 54 per cent in real terms as against a fall in public investment of 25 per cent so that the ratio of private investment to GDP shot up from 10 percent to nearly 16 per cent.

During the same period, the ratio of gross national savings to GDP actually fell to 16.6 per cent in 1995 as compared with the 18.5 per cent recorded the previous year. This drop in the savings ratio came entirely from the private sector while the Government savings ratio more than doubled.

Mr Speaker, despite the very great difficulties of altering ingrained consumption and saving patterns, especially during the personal uncertainties generated by the current structural adjustment process, there can be no doubt in this House or indeed outside that our future prosperity depends not only on reversing this shortfall as quickly as possible, but also going far beyond that to substantially and permanently enlarge the share of private savings and investment in our economy. In this context, I note with concern that, despite my many pleas for moderation, the differential between the overdraft rate and the savings rates offered by the commercial banks remains excessive.

Inflation and money supply

Mr Speaker, my consistent policy over the last two budgets has been to contain inflation at single digit levels. As I have noted already, this target was achieved during the 1995/96 financial year, with the year-on-year rate averaging below 5 per cent for the year through to last month. During the same period, the 3-month annualised rate averaged 7.5 per cent.

Moreover, the strict liquidity controls we have maintained last year have limited the growth of broad money supply over the financial year as a whole to within our target range of 15 per cent.

Credit & interest rates

During 1995/96 financial year to April, the total domestic credit advanced by the commercial banks and NBFI's to the private sector for all purposes rose by 19 per cent and its share of the total credit provided increased from 66 per cent to 69 per cent, with corresponding reductions in the share of the public sector. The growth in private credit was particularly rapid during the last months of 1995, prompting the Central Bank of Kenya to intervene firmly and successfully in January and subsequent months to ward off inflationary pressures.

Despite the containment of inflation, overdraft rates rose sharply during the latter half of last year reaching the levels last seen at the end of 1994. The yield on 90 day Treasury Bills crept up to a peak of 26.7 per cent in March, but it has since fallen to around 20 per cent.

Domestic and external debt

Mr Speaker, in the 1995/96 financial year, we not only remained fully current in our external debt interest payments, but we were able to redeem some K£1.1 billion of this debt, much of which had been borrowed on non-concessionary terms in the 1980's, while refunding the remainder on more concessionary terms. In consequence, the ratio of external debt to GDP dropped from 86.0 per cent to 76.1 per cent.

We have also been successful in reducing the burden of domestic debt. During the 1995/96 financial year, redemptions of domestic debt amounted to K£411 million. We have reduced the outstanding domestic debt as a percentage of GDP to 25.9 per cent from the 27.4 per cent reached at the end of 1994/95.

4. THE POLICY FRAMEWORK

Mr Speaker, it is vital now to ensure that growth can be increased and sustained at a rate which is sufficiently high to provide greater employment opportunities for our growing workforce. Already, nearly half a million Kenyans are added to the work force each year and the present GDP growth rate of 4.9 per cent needs to be increased as soon as possible to 6 per cent and beyond, and be maintained at that level for many years to come, if the current and unacceptably high rate of unemployment is to be first contained and then reduced.

As I have reiterated many times, the Government remains steadfast in its commitment to the maintenance of economic stability as the fundamental basis upon which real growth must depend. However, experience has shown that success in economic stabilisation and liberalisation, while clearly vital to the maintenance of self-sustaining growth, is no guarantee that the growth thus achieved will be sufficiently high to match the growth in the labour supply and to enable us to devote greater resources to poverty alleviation.

The intentions of the Government in respect of our twin aims of employment creation and poverty reduction through democratic consensus were set out in February by HE The President in the Policy Framework Paper which details our programmes until the end of 1998. At the same time, HE The President established an Economic Commission under his own chairmanship to oversee the implementation of these programmes. My present growth-oriented Budget is set explicitly within this framework.

As we are all aware, the rate of economic growth hinges critically on the level of domestic and foreign investment. Foreign investment is always welcome and we have done much in recent years to encourage this, but we need also to encourage a much greater rate of productive private investment from our own resources. The process of regaining economic stability and growth over the last three years has not been easy. If the momentum achieved is to be maintained and enhanced, all leaders must do everything possible to encourage investors wherever they can be found.

In this context, and in consonance with the entire Government, I condemn strongly and without reservation the irresponsible threats against the economic role of particular races and communities. Kenya is proud to be a multiracial society where the property of all communities without exception is fully and equally guaranteed under the law. H.E. The President has recently underlined the Government's commitment to the rule of law by appointing a Presidential Commission on Human Rights and providing it with adequate funding.

Therefore, as our economy becomes more competitive, I urge every Kenyan race and ethnic group to join hands together to contribute to the renewal of investment growth which is so urgently needed. An upward shift in domestic investment is the clearest indication of confidence in our country's future, and this in turn, will powerfully enhance the attractiveness of Kenya for foreign investors.

Foreign investment will also be encouraged by our strict adherence to the protocols of the World Trade Organisation. Legislation will shortly be presented to codify rules on antidumping measures, subsidies and countervailing duties in conformity with our WTO obligations, while the Kenya Revenue Authority is being prepared to cope with the changes in the customs valuation system in good time.

The rate of growth also depends on the degree of internal economic security. Unfortunately, Kenya's generosity in accommodating the influx of refugees in recent years arising from civil strife in neighbouring countries has been abused by well armed criminal elements among them, who regard our stable, peaceful and relatively prosperous country as a tempting target for violent crime. The Government is determined to stamp out this criminal invasion and defend Kenya's renown as a haven of peace and security.

Mr Speaker, in my previous Budget Statements, I have stressed the importance of economic stability and poverty alleviation. I have not changed my mind on the importance of these factors. However, the economy is now primed for faster growth and to take maximum advantage of this situation, I will introduce further measures today to encourage the timely expansion of domestic savings and their mobilisation for private productive investment. Accordingly, my Budget theme for today is ***Macroeconomic Stability for Investment and Growth.*** I will now outline the policies which will be implemented in the various sectors of the economy in accordance with this theme, both in 1996/97 and in subsequent years.

5. FISCAL POLICY

In the coming financial year I intend to maintain a tight fiscal policy regime. This will encourage growth by ensuring economic stability and by releasing more of our national resources to the private sector to provide the wherewithal for their productive investments. At the same time, however, through the maintenance and indeed enhancement of budgetary controls, and through the increased rationalisation of spending structures, I propose to set aside additional funds for the net redemption of our domestic and foreign debt and for the improvement of social services and poverty alleviation programmes.

While maintaining financial rigour, Hon. Members will be glad to hear that I do not intend to increase the proportion of revenue to GDP, but rather to reduce it to encourage private investment.

Kenya Revenue Authority

Mr Speaker, because of bureaucratic delays and necessary staff changes, the Kenya Revenue Authority did not become fully operational for some months after its establishment in July last. Nevertheless, considerable progress has been made and there has been a significant improvement in tax yields over the past year. The measures being put in place include more effective penalty administration and other controls in respect of retail VAT assessments and the collection of VAT arrears. Tighter controls have also been introduced on import duty exemptions, particularly for diplomatic missions and agencies, and transit trade controls have been intensified in collaboration with the Customs authorities in neighbouring countries. The instalment payment system for corporate income tax has now been fully phased in and a better reporting system for tax assessment and collection has been put in place. In addition, the KRA is now streamlining the flow of statistical information on tax compliance and revenue trends which will generate ever more sophisticated fiscal administration tools.

Central Government budgetary controls

Mr Speaker, while every effort is being made to improve revenue collection, it is apparent that we have also to exercise the utmost vigilance in the monitoring of public expenditure if we are to minimise the Budget deficit, and ensure that funds are allocated on the most cost effective basis and strictly in accordance with national development priorities. In this effort, we have had considerable success. While maintaining the provision of essential Government services, we have continued to impose cost saving measures, particularly through the Civil Service Reform Programme and by the contracting out of public services which can be provided more efficiently by the private sector. We have also pressed ahead with our parastatal divestiture programme and with the reform of local government finances.

Furthermore, I am determined to ensure that all Central Government expenditure, whether for recurrent or development purposes, is strictly limited to the provisions approved by this House. The diversion of funds from established priorities, which regrettably has sometimes happened in the recent past because of inadequate expenditure control, can no longer be tolerated if we are to maintain macroeconomic stability and preserve both domestic and foreign confidence in our commitment to fiscal retrenchment and reform. To maintain even unforseen expenditures within the overall fiscal targets, I am tabling amendments today to Section 4 of the Civil Contingencies Fund Act to increase the capital limit of the Fund from K£1.5 million to K£100 million. There will be no exceptions to this limit.

The present system of monthly and quarterly ceilings for recurrent and development expenditure will be enhanced by tighter control of reimsbursements at District level. On the other hand, to accelerate the issuance of development funds to Ministries, within the fiscal limits, I am now considering the modalities for the transfer of some ordinary revenue to the Development Exchequer account. As an expression of my determination to eliminate unauthorised expenditure, as from next month I intend to publish the preliminary Budget outturn on a quarterly basis, so that Kenyans can assure themselves that our fiscal targets are being met.

I now turn to a more detailed review of fiscal policy under the three principal headings of (a) cost savings, (b) expenditure priorities and (c) the reform of tax administration. As Hon. Members are able to refer to the details in their copies of the Printed Estimates, I will limit my review to the areas of particular concern for growth and fiscal stringency.

A. *Main areas of cost savings*

The greatest scope for cost savings still remains parastatal divestiture and reform, local government reform, reform of the civil service,and Ministry outsourcing.

(a) Parastatals divestiture and reform

Mr Speaker, Hon. Members will be glad to learn that 143 public enterprises have now been disposed of or brought to the point of sale, and that the divestiture realised to date has yielded K£249 million to the Treasury, and K£125 to the public sector holding companies. In addition, major savings have been realised in recurrent and development expenditures as privatisation extinguishes debt servicing and other obligations of the Treasury on behalf of the enterprises concerned. A further K£100 million is already expected to accrue to the Treasury in the immediate future from privatisations that are at an advanced stage of preparation. The balance of 64 non-strategic paratstatals remaining out of the original 207 scheduled for privatisation will be divested during the remaining part of 1996 and during 1997. We also intend to enhance the opportunities for broad-based Kenyan participation in the parastatals being privatised. This will be accomplished by divesting through public flotation wherever possible, by further improving the transparency of the privatisation process, and by strengthening competitive bidding procedures.

During the last financial year, we have successfully divested more than 76 per cent of the Government stock in Kenya Airways and its subsidiaries, after a period of far-reaching management reform which has turned the carrier into a profitable organisation. Other major sales of public shares planned during the 1996 calendar year though public flotations include the government holdings in the National Bank of Kenya and the Kenya Commercial Bank. The Nyayo Bus Corporation will be privatised over the next few months, while divestiture plans are underway in respect of Government stock in the Chemelil and Mumias sugar companies and Kenya Reinsurance Corporation. Furthermore, the Kenya Tourist Development Corporation is already disposing of its share holdings in several lodges and hotels, including African Tours & Hotels and the Serena Properties and Lodges, again though public flotation.

Mr Speaker, the Government is determined to ensure that those parastatals which are being retained in public ownership because of their strategic significance, are rationalised so as to enhance their productivity and quality of service delivery while at the same time reducing their drain on our fiscal resources. Major improvements have been effected already by way of restructuring and rationalising their managements. Several non-core services of these parastatals are being contracted out to the private sector, to enhance cost effectiveness, encourage new private investment and better management. As the list of the initiatives to reform these parastatals is long and to avoid imposing on the patience of this House I will refer here only briefly to the more significant among them.

The assessment of parastatal cross debts and tax arrears is now complete and the process of settlement is well under way. Performance contracts have been developed or are at an advanced stage of preparation in respect of the Kenya Post & Telecommunications Corporation, the Kenya Railways Corporation and the Kenya Ports Authority. The Kenya Ports Authority and the Kenya Railways have contracted out the maintenance of their equipment to private maintenance contractors. Other operational restructuring activities in progress include the separation of rail passenger services from freight services in Kenya Railways; the separation and liberalisation of post and telecommunications services in the Kenya Posts & Telecommunications Corporation; the private management of container terminals of the Kenya Ports Authority and the separation of electricity generation, transmission and distribution in the Kenya Power & Lighting Company and other power sector parastatals. The Kenya Power & Lighting Company is also in the process of inviting private investment in the new power generating capacity. The complete commercialisation of the activities of the National Cereals & Produce Board is in progress. We will be introducing legislation to provide for the clearcut separation of regulatory and commercial functions and to eliminate monopolies in the parastatal sector where it makes economic sense to do so. To commercialise the six large parastatals, they have been exempted from the provisions of the State Corporations Act. These exemptions will enhance the autonomy and accountability of their management through performance contracts.

(b) Contracting out of public services

Mr Speaker, in addition to the contracting out of maintenance and other services by the strategic parastatals, there is considerable room for the outsourcing of non-core services hitherto provided directly to the public by the Ministries and other central government agencies. As well as contracting out maintenance operations, all Ministries are now committed to relaxing their restrictions on private sector provision of services relating to marketing, training, extension work, research, auditing, inspection, computerisation, publishing, etc.

In the coming year, I intend to use my powers under the Stamp Duty Act to contract out the selling of revenue stamps so as to improve their distribution throughout the country and thereby minimise the loss of revenue from unpaid stamp duty.

(c) Local government reform

Mr Speaker, the Commission of Inquiry on Local Authorities made its Report to H.E. The President at the end of last year. In making its recommendations, the Commission devoted particular emphasis to methods for improving the financial viability of local government, an issue which is of vital importance to the Treasury because of their large debts to the Exchequer through various agencies, the great bulk of which is deemed to be irrecoverable.

Over the last decade, the Central Government has been shouldering directly an ever increasing proportion of the financial burden of providing services at the local level, including education, health, environment protection and agricultural extension work, while carefully scrutinising the budgets of the local authorities themselves. This trend has come about precisely because the financial management of the local authorities was found by painful experience to be inadequate to the task. In general, this finding was amply confirmed by the Commission.

It is also clear that the inability of the local authorities to raise sufficient local revenue to pay for their residual services while paying off their accumulated debts is not simply a matter of the limited scope of the local revenue sources. It is much more the case that these sources are not exploited efficiently. Furthermore, unfortunately, some councillors and civic officials have betrayed their trust and exerted pressure to favour their personal and political ends.

The present situation is most unsatisfactory, but major improvements are already in hand. The remedial measures now being taken under the Local Government Reform Programme include activities to increase the efficiency of local authority service delivery management, to improve their revenue assessment and expenditure controls, and to provide greater capacity for revenue recovery, together with a crash training programme for revenue and spending officers. The Local Government Reform Programme provides a sound basis for the rationalisation and harmonising of central and local government fiscal relations. Furthermore, the successful Urban Transport Infrastructure Project is being used as a model both to develop programmes for all key infrastructural sectors, on the one hand, and to increase the capacity of the local authorities for project planning and financial management generally. The duplication of local and central Government licensing, which is a significant irritant to investors, is being reduced pending eventual elimination. In the meantime, to minimise the licensing burden on businesses, the local auhorities should consolidate their own licenses so that only a single payment is required. Moreover, the application of cessage on agricultural crops will be restructured to minimise its effect on exported produce while yet generating additional revenue.

(d) Civil service reform

As Hon. Members are aware, we are now completing the third year of the seven year programme of Civil Service Reform, which has resulted in a 20 per cent reduction in staffing numbers from the base level of June 1993. I would like to stress, however, that the reduction in civil service numbers is far from being a simple across-the-board exercise, with a rule of thumb reduction percentage being applied indiscriminately. It is indeed a thorough reform of the entire provision of civil service functions throughout Government. It is based on the development of staffing norms derived from meticulous task analysis at every level, together with radical organisational and financial restructuring. Furthermore, the programme takes explicit account of the potential for more efficient service delivery through private sector contracting. Contrary to misrepresentations in some quarters, the objective is not to reduce the provision of essential Government services, but actually to improve services through a more rational use of scarce resources.

Retrenchment expenditure since the start of the programme on directly related pensions, terminal grants and retraining costs has now amounted to some K£279 million and this investment has already yielded annual net savings in salaries and allowances of the order of K£72 million, which implies a present payback period of well under 4 years. In the coming financial year, as we complete our programmed reductions in civil service numbers, I anticipate that the net savings will increase further and the payback period to contract correspondingly. I propose to set aside some K£50 million for this purpose during the next financial year.

Mr Speaker, we have taken special care from the start of the programme to safeguard the availability of key cadres at both junior and senior levels in priority staffing areas. These priority areas have now been identified throughout the civil service and a skills retention programme is being implemented with special emphasis on training and performance related pay.

Indeed, it is our intention to institute performance related pay structures throughout the public sector over the next few years wherever this is administratively feasible. To this end, we are currently introducing a more sophisticated computerised payroll monitoring system, which should be put into full operation during the coming financial year.

The restructuring of the Ministries and the agencies for which they are responsible is proceeding on schedule, with the rationalisation plans for the first six Ministries due for full implementation during the 1996/97 financial year, while the exercise has been initiated already in most other Ministries.

B. Main expenditure priorities

Mr Speaker, the Government must not only reduce the costs of its operations as much as is possible, but also ensure that the structure of its expenditure is in full conformity with its developmental priorities. The recently concluded Public Expenditure Review was based on the principle of shifting funds heavily towards the maintenance of the essential Government functions of security, social services, infrastructure, agricultural development and environmental protection. This Review forms the basis of my proposals for the coming financial year and its scope has been extended to cover the rest of the century.

As a result of the Review, the share of development expenditure in the total will be increased and further measures will be taken to preserve the priority allocation for the 75 per cent of this which is committed for the core projects. We are also taking steps to ensure that all public sector projects, including those of the parastatals, pass much more stringent tests of economic viability than in the past.

The apportionment of Government expenditures among these core functions also depends on the extent to which the beneficiariescan contribute some of their own money without undue hardship. The most obvious areas for such cost sharing initiatives of course are those which are widely used by the general public, especially those relating to the social services and agriculture, which in the recent past have also constituted our principal expenditure priorities. Debt servicing expenditures also bulk large in our fiscal programme. Unfortunately, there is much less scope for cost sharing initiatives there!

a) Poverty alleviation

Mr Speaker, visible poverty alleviation is essential both in its own right and to create a national consensus in support of structural adjustment measures. Over the last financial year we have fostered a more rapid growth in micro enterprises through the National Jua Kali Programme. Vigorous training programmes have been initiated for the benefit of both the urban and rural poor, and for increasing the economic status of women. However, I am disappointed with the degree of progress achieved, especially as this is the United Nations Year for the Reduction of Absolute Poverty, whose objectives we fully support.

In part the unsatisfactory outcome reflects the poor response of the donor community to our careful evaluation of priority needs, which meant that much greater strains were put on our own limited resources than we could accommodate without violating our overall economic objectives. Nonetheless, progress has been made, and I am confident that all the programmes we initiated last year will yield more tangible and positive results this coming year and next.

In the coming year, I am proposing to make a special allocation of K£160 million for particular poverty targeted programmes as well as increasing the general provisions for the social services. To spread the financial burden as equitably as possible, my proposals today include both direct interventions and the active encouragement of local initiatives through technical and other assistance, thus maximising the employment creating impact.

In the rural areas, increased funding is being provided for priority interventions to rehabilitate minor roads and stock routes; to increase the availability of low-cost crop storage facilities; to improve access to unpolluted water for human and livestock use; to expand the school feeding and immunisation programmes; to enhance district and locational health care and to encourage workshops for artisans, especially in women groups. In the urban areas, I propose to fund greater public efforts relating to the installation of water treatment plants and water kiosks. The Cooperative Societies and other institutions will be encouraged to finance low cost housing developments. Financial and technical assistance will also be provided to alleviate the educational and other problems of street children, jua kali enterprises and women groups.

While these measures are of critical importance, to be fully effective they must take place in the context of faster and sustained economic growth. Thus, we have been careful to maximise employment and training opportunities in our poverty alleviation programmes so as to maximise their contribution to GDP growth through sustainable self help.

(b) Employment creation

Mr Speaker, the private sector continues to lead in employment generation while public sector employment is being contained. While the growth in overall employment is gratifying, it is apparent that the pace must be sharply accelerated if it is to make a material difference within the next few years to our excessively high levels of unemployment and poverty.

The existing employment generating programmes, over and above those associated with the Civil Service Reform Programme, include measures to improve both geographical and occupational mobility generally through enhanced communications and employment-focused technical and management training, together with special credit and extension schemes oriented towards the development of artisanal women groups, jua kali operators and our youth.

I am making increased budgetary provisions for all of these programmes in the coming financial year. As the employment generating potential is greatest in the informal sectors, I propose to make a substantial increase in the funding of the public institutions which have been established specifically to provide credit to small scale and micro enterprises. To further encourage these enterprises, special efforts will be made in the coming year to increase their ability to compete for Government procurement contracts at both District and Central level, by simplifying red tape without sacrificing quality standards.

The National Youth Development Fund is already making a valuable contribution to the funding of schemes to promote youth employment. I propose to set aside K£10 million initially to supplement the Head of State's efforts towards the establishment of this Fund, whose objective is to promote employment for the youth through the Self Help Groups. This Fund will be made operational through the DDC mechanism. I would also like to reiterate here that this programme does not bear the face of any political party.

(c) Education

Mr Speaker, it has been noted on many occasions, and with truth, that investment in education is the most important single factor underpinning growth. It is for this reason that the Government has always made generous budgetary provision for this sector. During the coming financial year, I am proposing to increase the overall education budget by 10 per cent to K£1.7 billion, of which some K£1.5 billion will be for salaries and other recurrent expenditures.

Our budget priority continues to be the improved provision of basic education in order to effect a significant reduction in illiteracy rates in the near term and to make further progress towards our goal of universal primary education. The scale of the effort required is enormous and our policy has been to supplement public funds by encouraging cost sharing initiatives by parents wherever possible in the harambee tradition. However, in many rural areas and in the urban slums, the dependence on public funds is almost total.

In the coming year, the numbers and subject range of the textbooks being supplied to schools from public funds will be increased, while further efforts will be made to moderate the costs of books and other school items paid for by parents. Funding for the school milk and feeding programmes is being increased in the ASAL areas, and the school bursary programme for secondary education is being doubled.

The polytechnics and institutes of technology constitute another area where cost sharing initiatives have been successful. About one third of the institutions are already entirely self supporting, but much more needs to be done, and I am making a substantial additional provision today for the remainder.

During the coming year, as part of the ongoing process of decentralising financial responsibility, these bodies will have complete authority over their fees. However, the Government will continue to monitor the situation carefully and intervene whenever there is evidence of exploitation, especially in the poorer areas.

Expenditure decisions are also being decentralised in the tertiary education sector. During the coming financial year, the University Councils will have complete autonomy in the determination of their tuition, accommodation and catering fees. To reinforce financial discipline, the Higher Education Loans Board has been given adequate powers to step up its loan recovery rate and commercial banks are invited to participate more actively in student financing.

(d) Health

Mr Speaker, the Government has been progressively increasing the budgetary provision in this sector to improve both facilities and the proportion of critical medical staff in the population. The coming financial year will be no exception. I propose to increase the health budget by 19 per cent to K£669 million.

The Government intends to keep the growth of this expenditure within realistic bounds through increased fiscal rationalisation. To that end, we are introducing greater financial autonomy at District level and more self financing through increased user charges. Moreover, we are reorienting funding priorities towards preventive care rather than hospital care, and targeting a much higher rate of treatment cost recovery from the National Health Insurance Fund. Arrangements are now in hand to improve the cost effectiveness of hospitals, both by increasing the degree of specialisation in the use of their equipment and human resources and by allowing their Boards much greater freedom to relate charges to costs. In particular, sweeping restructuring programmes are being implemented at the KNH and other referral hospitals to allow them to concentrate more cost effectively on their referral functions rather than on the provision of general health services.

We are also committed to the encouragement of improved insurance cover provision for curative care, both through the National Hospital Insurance Fund and through private insurers. The operational autonomy of the NHIF is being increased and amendments will shortly be tabled to the Act to extend its coverage to the self employed and to jua kali workers. To encourage the wider utilisation of private insurance schemes, particularly for hospitalisation, I am now directing the Commissioner for Insurance to ensure that the health and medical organisations concerned operate under the provisions of the Insurance Act.

(e) Agriculture

Mr Speaker, I propose to increase the funding for all agricultural activities in the coming financial year by a further 7 per cent to K£409 million.

Our policy emphasis has concentrated on improving the lot of the small farmer through improving marketing and purchasing arrangements, by providing upgraded seeds and other inputs for enhanced productivity, and by developing specialised credit facilities. We are also determined to ensure that Kenya's food security is maintained by strategic stockholding and by the prudent regulation of subsidised imports. There can be little doubt that the measured and progressive liberalisation of this sector over recent years has contributed substantially to the attainment of these ends.

Over the years, the Government has subsidised the provision of seeds and other inputs. In line with the pursuit of fiscal efficiency, it is our intention to gradually phase out these subsidised elements and to organise research and extension work increasingly on a cost sharing basis. The first steps in this direction have been taken already such that I expect to offset agricultural support costs in 1996/97 by savings from cost sharing arrangements. Hon. Members should be reassured, however, that these measures will take fully into account the ability-to-pay and that they will not be implemented in ASAL and other disadvantaged regions.

(f) Debt servicing

Mr Speaker, we have been consistently prudent in containing the expansion of our debt to levels supportable within our means, while meeting all our repayment obligations on time.

At the end of the 1995/96 financial year, our total public sector debt stood at some K£24.8 billion and of this, some K£18.5 billion or 75 per cent represented foreign debt. To put things in another perspective, the foreign debt amounted to nearly four times our merchandise export earnings in 1995, and 23% of those export earnings were committed in advance for prompt settlement of our external debt interest and repayment charges.

Although these figures are huge, they are not alarming. Over 80 per cent of this debt is on a concessional basis. These figures also reflect a deliberate policy of borrowing to accelerate development and thus yield a surplus over debt servicing, including repayments. In this effort we have been successful. In the last two years, we have expanded the economy while at the same time reducing our external debt burden from over 91 per cent of GDP in 1993/94 to only 76 per cent in the current financial year. Moreover, the measures now in force are expected to reduce the external debt-to-GDP ratio to some 68 per cent by 1998 and the export earnings ratio to below 20 per cent.

Mr Speaker, I have affirmed many times that the redemption of our domestic debt has the higher priority as we seek to release more of the nations resources for private sector use. Nevertheless, the redemption rate of our domestic debt is constrained by the need to control the expansion of the money supply to non-inflationary levels. I have already noted our success during 1995/96 in reducing the domestic debt-to-GDP ratio by fully 1.5 per centage points, with corresponding savings on interest costs. Monetary considerations permitting, I intend to make further reductions in the domestic debt-to-GDP ratio during the coming financial year.

C. Main areas of tax administration reform

Mr Speaker, I have already noted the improved rate of collections under the KRA reflecting the greater internal efficiency of the tax departments, albeit with some delay. This has permitted the development of more cost efficient collection and refunding methods. The PIN system is now in operation. This led to the introduction of the income tax instalment payment and self assessment systems. These modernisations have brought Kenya into conformity with best international practice and at the same time simplified the assessment difficulties faced by the taxpayer. The PIN system also facilitates the faster administration of tax refunds, particularly by the VAT Department where the backlog of the past is now being reduced to moderate levels. Additional funding is being earmarked to permit further reductions this coming year.

The verification services of the Export Promotion Programmes Office have been contracted out to a trade survey company to enhance the collection of residual revenues, eliminate economic sabotage, and accelerate the cancellation of the security bonds taken out by exporters and other eligible persons. The volume of work involved is very great as there are now some 350 companies regularly using the various EPPO duty/VAT remission programmes. They benefitted from remission of duties and taxes to the order of K£ 200 million last year. Despite some initial delay necessitated by the staff recruitment problems of the contractor, the verification exercise is now being pursued urgently on a crash programme basis.

Hon. Members will be aware of the steps taken in February to reduce the congestion at the Port of Mombasa by the imposition of a penalty of 20 per cent on imports of cars without proper preshipment inspection documents and a 10 per cent penalty on all other such imports, in addition to the normal preshipment inspection charge of 2 per cent. I can report that these measures have had a dramatic impact on the congestion levels while increasing the collection of revenue. They have also substantially improved the detection of corruption by both officials and companies and enabled the authorities to take early and decisive action.

To further enhance the effectiveness of the PSI system, computerised procedures are now being implemented to improve the speed and accuracy of the reconciliation after shipment between the preshipment inspection and Customs valuations and the import entry documents to make it even harder to defraud the revenue at the point of entry.

6. MONETARY POLICY

Money supply and inflation targets

Mr Speaker, the tight fiscal policy which I intend to maintain during the coming financial year will be complemented by an equally tight monetary policy, focused as before on the control of inflation. My objective, as before, will be to restrain the annual inflation rate within single digits, that is to the levels which we have experienced throughout the 1995/96 financial year. In the higher growth economy which I now predict, the maintenance of this low inflation rate will be no mean feat, but in my view it is an achievable one.

To monitor monetary policy more effectively, the CBK will utilise various benchmarks, particularly its own Net Domestic Asset level. This has already been reduced from its peak of K£3.3 billion in December last to some K£2.5 billion now and further reductions will be made in the coming financial year. These reductions will reflect the tighter controls now in place restricting the use by Ministries of the CBK overdraft facility.

Reform of the financial sector

Mr Speaker, the Central Bank of Kenya is the principal agency charged with maintaining the soundness of our currency, price stability and the integrity of the financial system. The importance of this activity to our economic wellbeing and economic survival has been demonstrated dramatically in recent years and requires no emphasis in this House. The Government is determined to provide every facility necessary to enable the CBK to work effectively.

To reassure investors and the general public that our anti-inflationary policies will continue with unremitting vigour, I will be tabling amendments to the Central Bank Act which will increase its statutory powers in these areas and render it answerable directly to Parliament. The amendments clarify the monetary management functions of the CBK more precisely and loosen its relationship with the Treasury.

I have expressed my concern many times about the failure of the financial sector reforms to bring down commercial bank interest rates to acceptable levels and to narrow the large gap between overdraft and savings rates. Nonetheless, the banks have proved resistant to appeals to make substantial and sustained changes in the desired directions. To encourage competition in this area and provide saving opportunities for the general public, the CBK is encouraging the development of new financial instruments. Already, the minimum purchase values of Treasury Bills have been reduced. Secondary markets for Treasury Bills are being developed and steps will be taken soon to allow their trading on the Nairobi Stock Exchange. To further widen the range of short-term instruments available, during the coming financial year, the CBK will introduce Repurchase Agreement (REPO) facilities for Government securities and facilitate their widespread availability throughout the financial system.

The CBK is also tightening its prudential controls to enforce more adequate reserves provision by the commercial banks against non-performing loans and to ensure that they progressively reduce the proportion of these loans in coming months to no more than 5 per cent of their total portfolio. At the same time the minimum capital requirements for banks will be raised from the present 7.5 per cent of deposits to 8 per cent in conformity with the Basle Committee recommendations.

The Insurance Act now enforces higher levels of prudential management and brings the industry fully into the current liberalised foreign exchange environment. I anticipate that the industry will respond energetically to the new business opportunities by increasing the range of insurance services they provide, and, in particular, I am looking forward to the greater utilisation of performance bonding insurance instruments to reduce collateral requirements and other borrowing costs through credit enhancement.

To further strengthen the financial soundness of the insurance industry, the bank guarantee required from insurers by the Commissioner of Insurance on initial registration will now be raised to K£ 25,000. Furthermore, the minimum balance kept at the CBK by general insurers will be raised to K£ 200,000 while the long-term insurance balance remains unchanged. The value of the professional indemnity policy taken out by brokers is also being increased to K£ 200,000 and they too will be required to provide a minimum bank guarantee of K£25,000. On the other hand, I am proposing to reduce the compulsory levy for the College of Insurers to 0.2 per cent of gross premium income which can now be passed on to policy holders. At the same time, I am arranging for the College to offer certificates by examination for insurance agents, who will be subject to registration based on this certification as soon as practicable, but certainly before the end of 1997. The Government is a also considering proposals for the introduction of a compensation scheme for injuries resulting from motor accidents. The new arrangements will necessitate major amendments to the Insurance Act which will be tabled as a matter of urgency.

I am also tabling an amendment to Section 67C of the Insurance Act to give adequate powers to Statutory Managers to declare a moratorium in companies in financial difficulties and also to safeguard the interests of policy holders. In this regard, I have today authorised the Commissioner of Insurance to appoint a Statutory Manager to take over immediately the Kenya National Assurance Company which is wholly owned by the Government. This decision should now remove any uncertainty over the status of the Company.

The pensions sector is a major component of the financial system, and to prevent exploitation it is appropriate now to tighten up the minimum standards for all pension schemes. During the course of this year, I will table a Pensions Scheme Regulation Bill to specify structural and performance conditions for registered pension plans. I will also provide for administration of this Act under an authority.

As part of the general reform of this sector, I will shortly be tabling amendments to the NSSF and Income Tax Acts to convert the NSSF into a more autonomous tax-exempt agency. However, to prevent a recurrence of the controversial investment activities of the past and to better secure its financial base, the NSSF will be obliged to invest its revenue mainly in Government securities, until investment regulations covering all pension funds can be finalised under the proposed Pensions Scheme Regulation Act.

The capital markets sector continues to develop at a rapid pace following the reforms introduced over the last four years. By stimulating both borrowing and investment it has materially underpinned the success of the liberalisation programme. Plans for the introduction of a Central Depository for the clearing and settlement of securities are well advanced. Further developments, which are now being reviewed for possible introduction in the coming year, include increased competition in brokerage activities and the use of brokers to trade in Treasury

Bills. I am also giving consideration to the promotion of venture capital funds.

7. OTHER POLICIES

Industrial and infrastructural development policy

Mr Speaker, the structural adjustment programme has already improved the cost efficiency and export competitiveness throughout the economy, particularly in the manufacturing industry. The contribution of the manufacturing sector to exports has risen year by year along with its employment contribution. Nevertheless, industrial productivity remains low and the share of manufacturing in the economy has remained stagnant for some years at under 14 per cent. It is clear that much more needs to be done if the sector is to be relied on to underpin our targeted GDP growth rates on a sustainable basis and thus enable us to attain the status of a Newly Industrialised Economy within a reasonable time frame. The programme for achieving this is now being elaborated in a Sessional Paper which will be presented in due course.

Mr Speaker, the Government is sometimes accused of neglecting infrastructural improvement. In fact, nothing could be further from the truth, and I would like to take a little time to demonstrate the seriousness of our commitment here. During the 1996/97 financial year, over K£1.1 billion is to be spent on new infrastructural development in education, health, water development, agriculture, road building and other public works, which constitutes nearly 60 per cent of the entire development budget. Moreover, this sum does not include the vast sums to be spent on the maintenance of existing infrastructural facilities by the strategic parastatals and other agencies.

In the coming year, expenditure on routine road maintenance will be increased by some 20 per cent and major improvements will also be undertaken to the main Nairobi/Mombasa Highway and other trunk roads, while funding will be restored for all the new road projects which were suspended last year. A strategic plan for the road sector has now been prepared which will fully finance routine and periodic road maintenance by the turn of the century, improve funding and priority setting in the immediate term, and involve greater use of the private sector in both road maintenance and construction.

The locomotive maintenance requirement of Kenya Railways is being contracted out to the private sector to improve locomotive availability. I have budgeted K£15 million next year to support this. In addition, the marine services operated by Kenya Railways at Lake Victoria are to be privatized. To improve the financial viability of the Corporation, the Board and management of Kenya Railways is now free to determine tariffs, routes and services on a commercial basis.

Kenya's position as the hub of East Africa in air services for both tourists and freight has come under increased competitive pressure in recent years from neighbouring countries. A critical factor here is the quality of the infrastructure at our major airports, particularly as regards navigation aids, cold storage facilities, and cargo and luggage handling equipment. A modernisation and rehabilitation of these facilities has just been completed at Moi International Airport in Mombasa. These facilities will also be upgraded at the Jomo Kenyatta International Airport in the coming year, while the early completion of the new airport at Eldoret will open up western Kenya to international trade and tourism.

Following the personal initiative of HE The President, international expertise is being acquired for the improved management of the Container Terminal at Mombasa Port.

In 1996/97, the Kenya Posts & Telecommunications Corporation will be restructured into three separate entities dealing respectively with the postal sector, the telecommunications sector, and the regulation of public and private operators in these sectors. The proposed reforms are expected to attract new private investment and technology to these sectors in the immediate term.

Mr Speaker, to improve the cash flow of the Kenya Power & Lighting Corporation in the coming year while providing greater resources for maintenance and new investments, steps are being taken to adjust electricity tariffs as soon as possible to the equivalent of 75 per cent of long-run marginal cost. The new 75 megawatt diesel powered station at Kipevu will soon be brought into full operation. Plans are at an advanced stage to contract an independent power producer to supply an additional 50 megawatts as a stop-gap measure, while bids have been invited for the construction of the Ol Karia and Kipevu power stations with a combined capacity of some 140 megawatts. Plans are also being finalised for the establishment of three more large, privately owned and operated generators before the end of the century.

Major developments are taking place also in the petroleum sector. Among other developments are the proposed facility for importing LPG, the product testing laboratory, and the early extension of the Mombasa-Eldoret oil pipeline to Malaba and on to Kampala in line with our regional cooperation.

With the decontrol of oil prices now well established, I am proposing amendments to the Petroleum Development Fund Act. First, as the National Oil Corporation of Kenya is now a marketing company, it is no longer appropriate for it to collect the Petroleum Development Levy from its competitors. Effective from 1st July 1996, this levy will be collected by the KRA. Second, the objectives of the Petroleum Development Fund will be changed to reflect the new market realities. Funds will be restricted to activities that do not compete with, but rather support the private sector.

I propose to increase the budget for water development next year by 8 per cent to K£282 million, with major allocations for water improvements in Nairobi, the Coast and many other areas. Our target is to ensure that at least 75 per cent of our people have easy access to organised clean water points by the end of next year.

Export promotion policies

Mr Speaker, a major development in the trade relations area, which was again initiated directly by HE The President in conjunction with his Tanzanian and Ugandan colleagues, was the formal resuscitation of East African cooperation in March last through the establishment of the Secretariat of the East African Cooperation Council, which is headed by a Kenyan. In my last Budget Statement I referred to some of the harmonisation measures already in place. I am pleased to announce that an agreement has been reached on full regional convertibility of our currencies. This will be implemented from July 1st this year, with trade and other transactions among the three countries able to be settled in national currencies. The Central banks of the three countries will annouce the modalities. Other trade cooperation measures will include: the exchange of detailed information for policy coordination, and agreement on the harmonisation of tariff structures and rates in preparation for the early elimination of intra-regional tariffs, together with the standardisation of country of origin criteria; cooperation in the prevention of transit trade and export fraud; and the preparation of income tax treaties for the prevention of double taxation.

Kenya has fully implemented the programme of COMESA tariff preferences and further reductions in these duties will be introduced in the course of next year. We are committed to the maximum cooperation with our COMESA partners and it is a matter of regret that while Kenya is fully current in its subscription obligations etc., our promptness in settlement has not been copied by many COMESA States. Urgent diplomatic efforts are now being made to address this shortfall.

Mr Speaker, because of the undoubted importance of the tourism sector in our economy, we have consistently devoted substantial sums to its advancement. The establishment of the Tourism Promotion Board respresents a major step forward. We can look now to much more effective focus of our promotional efforts under its professional guidance.

Environment policy

Mr Speaker, the Government attaches great importance to the harmonisation of rapid growth and industrialisation with environmental protection, because all Kenyans have a right to live in a country where rapacious exploiters of natural resources are kept at bay, where renewable resources are in fact renewed and where the beauty of our scenery and wildlife is preserved for themselves and for future generations. Moreover, the viability of our tourism industry which is our largest single earner of foreign exchange is completely dependent on the prevention of environmental degradation.

As the detail of the environmental programmes are set out elsewhere, I will limit myself today to confirming that I propose to set aside substantial funds for projects specifically related to environment development. To make the taxpayers contribution stretch as far as possible, I expect to recover a higher proportion of these funds than in the past from increased tourist charges and more effectively targeted cost sharing measures.

8. PROGNOSIS

General outlook

Mr Speaker, the resumption of real per capita growth last year was a welcome development for us all. It was accompanied by, and indeed facilitated by a very low inflation rate and a high degree of exchange rate stability, combined with lower direct and indirect, taxes and the maintenance of monetary discipline. Moreover and not least, it was accompanied by a further switch of resources from public to private use, and yet another reduction in the Budget deficit. I expect the economy to perform even better in the current year as the implications of the present policy mix complete working themselves into the system.

Even now there are signs of a significant recovery in both domestic and foreign investment, particularly in export-oriented manufacturing industries. Exports should be further encouraged by the expected recovery of the industrialised economies. They will also be stimulated by the improved trading arrangements both globally under the World Trade Organisation and regionally through COMESA and the revived East African Cooperation. Agricultural production of tea, coffee and horticultural products this crop year is already high while the cereal and dairy sectors are also recovering with the resurgence of world prices. There are good prospects too for a moderation in petroleum prices. Tourism earnings should also improve with the higher levels of promotion and the more favourable exchange rate. Accordingly, a return to an overall surplus on our balance of payments can be confidently anticipated in 1996 and in following years.

Over the 1996 calendar year, the GDP growth rate is now expected to reach 5.5 per cent while in the 1996/97 financial year it is forecast to be even higher at 6 per cent.

Revenue in 1995/96

Mr Speaker, during the 1995/96 financial year the total gross revenue collections increased by some 16 per cent over 1994/95 to K£7.3 billion. This is also some K£88 million higher than amount in the Printed Estimates. This highly satisfactory outturn reflects both the upturn in economic activity, the wider tax base and the increased collection efficiency of the Kenya Revenue Authority. It also reflects a higher than expected dividend from the CBK and excess Appropriations-in-Aid from various Ministries. Of this total, income tax amounted to K£2.3 billion, VAT to K£1.4 billion and customs and excise duties to K£2.2 billion

Recurrent expenditure in 1995/96

Total recurrent expenditure in 1995/96 is now expected to come to K£6.1 billion, of which K£1.6 billion represents interest payments on both domestic and foreign debt. Net issues should amount to K£3.9 billion, of which K£2.4 billion represents the allocations for salaries and the civil service reform programme.

The Supplementary Appropriations this year involved an increase in recurrent expenditure of K£260 million. However, stringent economies in other areas, including considerable expenditure rescheduling, enabled us to offset this additional expenditure by savings of K£193 million, thus reducing the net increase in recurrent expenditure to K£67 million.

Payments under Consolidated Fund Services are now expected to be significantly higher than the K£1.6 billion in the Printed Estimates by virtue of higher than anticipated interest payments on Treasury Bills plus the carry-over of excess votes and under issues dating back to the 1992/93 financial year.

Development expenditure in 1995/96

Development expenditure this year is expected now to amount to K£1.7 billion. There was an increase of K£173 million in the development expenditure authorisations for agricultural support services, for the national registration exercise, and for the construction of Eldoret Airport. This increase was offset again by savings through deferrals elsewhere in the development budget amounting to K£132 million so that the net supplementary appropriations were reduced to K£41 million.

Deficit anticipated in 1995/96

Mr Speaker, as a result of the above developments, I now anticipate that I will have to finance a total expenditure in the 1995/96 financial year of K£7.8 billion. This implies that the deficit for the year on a commitment basis, but excluding grants will amount to some to K£414 million. This is substantially lower than anticipated in last year's Printed Estimates and it represents a significant reduction in the deficit to GDP ratio to 1.9 per cent from the 2.6 per cent prevailing in the previous year. Inclusive of grants, the deficit on a commitment basis is expected to amount to K£68 million. The net domestic financing requirement will allow a reduction in domestic debt of K£284 million.

Deficit target in 1996/97

Despite this carryover, the 1996/97 budget will aim at an even smaller proportionate and absolute deficit (on a commitment basis and excluding grants) of K£389 million or 1.7 per cent of GDP. Including grants, the budget will have a small surplus of K£42 million. This projection includes the settlement of some K£169 million of pending bills accumulated in previous years. The net domestic finance requirement is expected to shrink by K£12 million.

Revenue in 1996/97

Mr Speaker, total revenues in the coming financial year are targeted to increase by a further 4 per cent to K£7.6 billion. This represents some 28.1 per cent of GDP, a significant reduction from the total revenue ratio of 29.8 per cent of GDP in 1995/96.

Income tax yields are expected to decline slightly to K£2.3 billion, while VAT collections should increase to K£1.5 billion, and customs and excise duties should also increase to K£2.5 billion. These estimates take account of a revenue loss of K£405 million which is expected to result from the conversion of the NSSF into a tax exempt pension fund, the accelerated payment of VAT refunds, and the completion of the phased introduction of the instalment payments of taxes on business income. Privatisation proceeds accruing during 1996/97 are expected to amount to some K£150 million. These will be used for debt redemption to lower interest expenditures rather than for current expenditures.

External revenue balance in 1996/97

With the strengthening of donor support, I expect a substantial increase in grant income to K£430 million of which programme grants are expected to amount to some K£103 million. The disbursement of programme loans should amount to a further K£173 million. By way of contrast, total external repayments in 1996/97 are budgeted at K£1.1 billion. During the year, the Government will not contract any non-concessional debt, and will seek to improve the concessionality of its loan portfolio through rescheduling and refinancing.

Overall expenditure plans for 1996/97

Mr Speaker, total gross expenditure in the 1996/97 financial year will be limited to some K£7.9 billion or 29.5 per cent of GDP, proportionately much less than the 31.5 per cent of GDP spent in the previous year. Of this, recurrent and development expenditures will be limited to K£6 billion and K£1.9 billion respectively, representing in reases of under 2 per cent for the former and fully 10 per cent for the latter. The budget will reflect the objectives set out in the February Policy Framework Paper by preserving the allocations for operations and maintenance and development expenditures, by ensuring full funding for the core projects, and by improving the allocations towards the social sectors and poverty alleviation programmes. The development expenditure estimates include specific provisions for the funding needed to fully commercialise NCPB by the end of 1996.

(a) Recurrent expenditure

Mr Speaker, the recurrent expenditure estimates for the 1996/97 financial year include domestic interest payments of K£ 900 million and foreign interest payments of K£510 million.

Wage and salary costs are expected to increase by some 7 per cent over last year's level to some K£ 2.5 billion, which is the equivalent of 9.2 per cent of GDP, a somewhat smaller ratio than the 9.5 per cent of last year. This estimate is based on the target civil service staffing of 212,400 by June 1997, a reduction of over 20,000 from the December 1995 level. It takes into account both normal drift and the reform of the pay structure to incorporate performance related elements. Even so, there will be no general wage increase during the 1996/97 financial year, and no further general increase in medical or housing allowances, except to the extent to which housing costs are switched from government provided to owner occupied housing. On the other hand, the allocations for pensions at K£185 million are estimated to be 42 per cent higher in 1996/97 as compared with last year. This takes into account the retroactive adjustments envisaged in my Budget last year, which are expected to amount to K£30 million in the coming financial year and a further K£30 million carryover in the following year. Hon. Members will be happy to hear that I will shortly be tabling the Pensions (Increase) Amendments Bill, 1996, to give effect to these changes.

Other recurrent expenditure includes an allowance of K£15 million for drought relief. It also includes a substantial increase in operations and maintenance expenditure, an estimated K£16 million for the registration of voters for the forthcoming elections, plus some K£75 million for the funding of the Kenya Revenue Authority, and another K£75 million for the settlement of pending bills from the recurrent budget.

Within the recurrent budget, specific measures will be taken to improve the quality of the expenditures. Thus, routine road maintenance expenditure will be increased by some 20 per cent to K£215 million in line with our commitment to achieve full funding of all road maintenance requirements by the year 2000, while a further K£50 million will be spent on trunk roads and rural access roads. Some K£130 million will be earmarked for the Nairobi and Coast Water Supply Projects while another K£95 million will be budgeted for major water projects in other areas.

Mr Speaker, there will also be a substantial increase in the allocations for those programmes which directly affect the poor. Special poverty alleviation allocations over and above the poverty targeted allocations in the regular social spending budgets will amount to K£160 million in the 1995/96 financial year. Expenditures for school milk and feeding programmes and for the provision of school books and equipment in disadvantaged areas will be increased by 47 per cent to K£24 million over the 1995/96 level, and funding for the secondary school bursary programme will be doubled to K£20 million. In the health area, the share of spending of preventive health in the rural areas and in the deprived urban areas will be increased. Moreover the poverty alleviation budget will include an estimated expenditure of K£20 million for the maintenance of roads and water projects in the rural areas, an allowance of K£6 million for site and service improvement for low income housing in urban areas and allocation of K£10 million for youth development programmes.

(b) Development expenditure

Mr Speaker, the estimated expenditure of Appropriations in Aid and all other development issues together will come to some K£1.9 billion or 7 per cent of GDP in 1996/97 line with our commitment in the Policy Framework Paper.

The development expenditures in the 1996/97 financial year will include a provision of K£15 million for the maintenance of the strategic maize stock, central government payments of K£80 million in respect of guaranteed loans to parastatals, an allocation of K£15 million for the first stage settlement of outstanding payments under the Exchange Risk Assumption Fund, an estimated expenditure of some K£100 million for the completion of Eldoret airport and the national identity cards project, and a further K£100 million for the contingency fund.

(c) Residual financing

To achieve the revenue and deficit targets a residual gap of some K£128 million will have to be financed by additional measures in the coming year, of which some K£85 million will be met from increased ordinary revenues and K£43 million from additional appropriations in aid. I will now describe how I propose to achieve this.

9. TAXATION PROPOSALS

Mr Speaker, before I present my taxation proposals, I wish to make some observations about the performance of the revenue system. Prior to 1993/94, ordinary revenue collections were typically below 23% of GDP. However, for three years now, including 1995/96, ordinary revenues have been around 28% of GDP. This high revenue burden has been necessary to bring the deficit under control. Now that we have been successful in stabilising the economy, I am pleased to inform the Honourable Members, that I am able to ease the planned revenue burden for 1996/97 to about 26% of GDP. This should provide the private sector with more resources to invest and create jobs. This is consistent with my Budget theme.

Despite the successes in revenue raising, the modernisation process of the tax system will continue. To improve the efficiency and fairness, it is still necessary to continue the process of lowering and rationalising tax rates and expanding the base. Particular emphasis will continue to be put on strengthening the administration in order to bring those who have managed to evade taxes in the past into the net.

Mr Speaker, the financial resources for the KRA in are being brought closer to their target level of 1.5% of the estimated revenue collections. The organisational structure of the Authority is being put in place. New professional and technical staff are being hired. I am expecting, indeed I am demanding on behalf of all Kenyan taxpayers, that the KRA raise the efficiency and effectiveness of tax collections, and also improve the service provided to taxpayers in order to make compliance with the tax laws simpler and cheaper. At the same time, while the KRA is responsible for administration of the tax laws, the Ministry of Finance remains responsible for tax policy and, in fact, the overall revenue system. In the context of the Civil Service Reform Programme, the strengthening and rationalisation of the Ministry of Finance is an urgent and important goal that will receive priority attention in the course of next year in order to support the tax policy and other economic management responsibilities of the Ministry.

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

I. *Customs Measures*

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

First, the KRA is now working in close co-operation with the Kenya Port Authority to introduce a new cargo control system at the Port of Mombasa to facilitate the movement of cargo, to increase cargo security and to prevent cargo from leaving the port area without the payment of proper duties and taxes. As part of this system, shipping agents shall be required to supply all bills of lading in addition to ships' manifests to Customs and the Port Authority. Customs shall be applying the penalties already in the law for failure to supply complete documentation ahead of cargo being off loaded.

Second, as an extension of this cargo control system and to encourage rapid clearance of imports, I am proposing to tighten the control of goods not entered for clearance within 21 days of discharge after arrival at the port. Two public notices will be made of such unentered goods in place of the current single Gazette notice. The first will be a notice in the press warning importers to clear their goods within 21 days of this notification. Any goods still remaining unentered after this warning period will no longer be available to the importer, but will be Gazetted for auction with the proceeds going to duties, taxes, sale expenses, port charges and general customs revenues. Provisions are also being made for the contracting out by the KRA of the auctions of such unentered, abandoned and seized goods to professional private auctioneers to increase the revenue yield. In addition, customs warehouse rents at the port will be raised to discourage unnecessary delays in entering and clearing goods.

Third, I propose to introduce new legal provisions explicitly covering the preshipment inspection programme. In so doing, I am also introducing some changes to the PSI programme. Effective on 1st July 1996, the two percent fee charged for processing the Import Declaration Form will no longer be collected by commercial banks. Instead the KRA will be responsible for fee collection when the goods are entered and the fee will be charged on the full customs value at that time. In addition, the import declaration form (IDF) will be sent directly by the importer to the preshipment inspection company to initiate inspection. IDFs will be required and the fee payable on all types of imports requiring preshipment inspection. The PSI companies, however, will only inspect shipments above a minimum value. This minimum inspection limit will be raised from an f.o.b. value of $500 to $1,000. These measures will speed up the processing of import documents and improve the collection of the IDF fee. I am making a separate press release that will explain these changes in more detail. Furthermore, the Treasury, KRA and PSI companies will work jointly over the next year to enhance the reconciliation of all PSI documents with Customs entry documents to ensure full compliance with the programme.

Fourth, Mr Speaker, the bonded warehouse provisions for imports have been abused and have contributed to speculation on imports. While the KRA will continue to improve its controls on warehousing, I propose to expand the restrictions on the types of goods allowed into bonded warehouses. Goods that are not identifiable by marks such as serial or model numbers and cannot be readily accounted for will not be entered into bonded warehouses. Items that are inflammable, corrosive, explosive or perishable are also excluded. In addition to these general principles, I am also amending the regulations to explicitly exclude goods such as vehicle and dry cell batteries, tyres, used motor vehicles, office supplies (including stationery), and food products (including maize, wheat, powdered milk, rice and sugar).

Fifth, the effort to tighten controls on duty exemptions that has been ongoing since 1992 will continue. This year the focus is on official aid funded projects. To ensure that duty free equipment is being used as intended on the aid-funded project, the bonding of equipment will now be followed up by investigation and verification on site before the bond is released. Where motor vehicles or earth moving equipment are purchased duty free with aid funds, these will no longer be permitted to be registered in the contractor's name. They can only be registered in the name of the project funded by an aid agency, the Government or a non-profit organisation specified in a Gazette order. In addition, automotive fuels and lubricants will only be exempted where a specific provision is made in the legal notice covering the project.

Mr Speaker, early this year I made an announcement that donated motor vehicles would no longer receive duty exemptions unless after rigorous examination it could be determined that these vehicles are truly intended to serve strictly charitable purposes. This policy will be followed even more vigorously in future, and to ensure that the vehicles used are for the intended purposes, the KRA will follow up with investigations.

Sixth, to improve controls on imported vehicles the Certificate of Clearance issued by Customs is being redesigned to strengthen controls on the registration of motor vehicles that have cleared Customs.

Seventh, to prevent leakage of goods imported for the Navy, Army and Air Force Institutes (NAAFI) and the Armed Forces Canteen Organisation (AFCO), all such goods shall be required to bear the mark of NAAFI or AFCO to identify the importing organisation. Henceforth, only AFCO shall be allowed to clear goods imported for AFCO use.

Eighth, to improve controls over transit traffic, licensed customs agents clearing goods in transit will be required to have an additional licence.

Ninth, in international trade certain containers are used repetitively and hence are allowed to move duty free. I propose to allow specially designed containers supplied by foreign buyers such as those used for flower exports to enter duty free. I am also proposing to allow containers designed for transporting semen for artificial insemination to be imported free of duty subject to the approval of the Director of Veterinary Services.

Tenth, to widen the range of agencies, in addition to the Family Planning Association, that are approved to import contraceptives duty free, I propose to also include the Ministry of Health and any other agency approved by the Treasury.

Eleventh, I am proposing to allow spouses of returning diplomats to import a motor vehicle duty free under the same conditions as the diplomatic officer.

Twelf :o provide greater competition in cargo handling services, I am now proposing to allow tran .heds to be located outside of the traditional air-side and port areas provided that the Commi oner is satisfied that sufficient security arrangements are in place to protect revenues.

T .eenth, where the Minister has the powers to restore seized goods to their former owners, propose that these can only be exercised following receipt of a written application made th igh the Commissioner.

Fourteenth, I intend to clarify the time periods of ownership of motor vehicles of returning residents where the vehicle was purchased under hire purchase terms.

Fifteenth, where application is made for motor vehicles specially designed for the disabled to be imported duty free, the case will first be reviewed by the Commissioner to determine the validity of the application before Ministerial approval is granted for an exemption.

Sixteenth, I propose to remove the limit on the duty free value of cars over 2,500 ccs imported by returning residents in light of the lower rates and liberalised market conditions.

Seventeenth, to assist in the promotion of road safety, I am proposing to allow the duty exempt importation of speed recording and ignition key recognition devices.

Finally, in recognition of the removal of foreign exchange controls, I propose to amend the provision requiring goods exported by manufacturers required to show that payment in foreign exchange was received.

Mr Speaker, I now turn to my customs proposals that have direct revenue consequences.

First, the rationalisation of import duties will be continued to improve the effectiveness of customs collections and to make domestic businesses more competitive. I am proposing to lower the top rate of 40% to 35%. In addition, the 10% band will be lowered and merged with the 5% band. Items in the 10% band are mainly capital goods items and primary raw materials. A few items in the 10% band that are not capital goods or primary raw materials will be shifted to the 15% band. These cost-saving measures should give a significant boost to local industry.

Second, Mr Speaker, in line with the broad rationalisation changes just announced, I am proposing that the import tariffs on certain capital equipment items still remaining in the 25% band be reduced to 15%. These include items such as hand tools and wheel barrows widely used in the rural and informal sectors. The tariff on a number of primary raw materials used mainly in the plastics and the spinning and weaving sectors will be reduced from 15% to 5%. In addition, where goods in the 25% band are generally exported or do not require import protection, I propose to lower their rates to 15%.

Third, I propose to increase the protection offered to some specific sectors to provide transitional assistance to improve their efficiency to face international competition in the future. Import duties on some lines of paper and paperboard will be raised, while the import duties will be lowered on the lead mix used in making motor vehicle batteries, and on plastic bottles for the cosmetic sector.

Fourth, Mr Speaker, Kenya is a sports loving nation. I propose to lower the tariffs on sporting equipment to 15% where the rates are currently in higher tariff bands.

Fifth, to improve customs compliance on used clothing imports, I am proposing to drop the alternative specific duty rates. Only the *ad valorem* customs and VAT rates will apply.

Sixth, to allow local manufacturers to compete with imports, I am proposing to allow local makers of shading netting or reinforced plastic sheeting for agricultural or horticultural use to apply under EPPO for duty free importation of their raw materials. To further facilitate EPPO operations, I am reducing the minimum amount of raw material imports per application under the Essential Goods Production provisions from one million to two hundred thousand shillings.

Seventh, I am proposing to set the tariff rates on major agricultural commodities at the following *ad valorem* rates. The import duty rate on maize and wheat will be 15%; on powdered milk, 25%; and on sugar and rice, 35%. In addition, alternative specific duties will be retained, but at lower effective rates, to protect against undervaluation. As already announced, these commodities will no longer be allowed into bonded warehouses in order to limit speculative hoarding.

Eighth, with the lower import duty rates now applicable and significantly lower prices of jet fuel prevailing since the decontrol of oil product prices, Mr Speaker, I am proposing that the value of customs duty for air freight again include one-half of the freight charge as was the case prior to 1991.

Finally, Mr Speaker, kerosene has been free of duty for the last few years. While the duty-free status of kerosene has been beneficial to the poor, it has also resulted in a diversion of kerosene into industrial uses; into mixing with diesel or petrol as an automotive fuel; and into smuggling into neighbouring countries. Honourable Members will be interested to note that Tanzania charges a total of about 16% in duty and taxes, while Uganda charges a duty of 115% on kerosene. The expansion of alternative uses of kerosene have resulted in a enormous increase in kerosene sales at the expense of alternative dutiable petroleum products with a huge loss of revenue and increased pollution of our atmosphere. I am therefore proposing to charge an import duty of Ksh 3.00 per litre (which is an effective duty rate of about 18%) on kerosene.

Mr Speaker, the import duty rate changes that I have just announced will become effective from mid-night to-night. These customs measures, on a net basis, will reduce revenues to the Exchequer by K£1.8 million in 1995/96.

II. ***Value Added Tax and Excise Measures***

Mr Speaker, since the introduction of the Value Added Tax in 1990, the VAT has undergone a systematic expansion of its base and rationalisation of its rate structure. I am proposing to take a few further steps in the development of the VAT. First, to continue the rationalisation of the VAT and move towards a more uniform rate structure, I propose to lower the top rate from 25% to the standard rate of 15%, and at the same time to raise the lower rate from 6% to 8%. This will markedly simplify VAT administration. Traders will have fewer tax rates and refund claims will be reduced.

Second, I am proposing only minor expansions to the VAT base. Taxable services will now include actuarial services and material testing services, but excluding testing for medical, dental and agricultural purposes. To harmonise the taxation of goods at the retail level, certain additional types of juices will become designated goods so that they are also taxed at the retail level like other beverages.

Third, I am proposing to raise the VAT rate on hard fats from the lower rate to the standard rate of 15%. At the same time, the VAT rate on vegetable oils will remain at the lower rate in order to encourage the consumption and production of vegetable oils.

Fourth, I propose to charge the lower rate of VAT on oil cake. This will allow the input taxes arising in producing oil cake to be deducted which should help lower the costs of animal feeds made from oil cake.

Fifth, to ease VAT administration problems, I am proposing to exempt from VAT a number of basic commodities including wheat, wheat flour and bread, maize and maize flour, rice and milk.

Sixth, to help combat malaria, I propose to zero rate mosquito chips and coils.

Seventh, Mr Speaker, from time to time groups of professionals in the travel and tour business visit Kenya to learn about the tourist attractions of our country so that they can promote tourism to Kenya. To encourage this valuable tourism promotion, I am proposing to zero rate the hotel and restaurant services provided to such visiting groups where their tours have been organised with local associations and approved by the Director of Tourism.

Eighth, to speed up tax collections, I propose to bring forward the monthly VAT payment date from the 27th to 20th day of the month following tax collection by a registered business. Similarly, excise duties will be payable on the 20th instead of the 21st day of the month following collection.

Ninth, when a business that is registered for VAT is sold but continues its operations, the VAT Act allows its stocks to be transferred without incurring VAT. I am proposing to extend this provision to the transfer of other assets of the business to simplify the sale of ongoing registered businesses.

Finally, Mr Speaker, a major concern for many businesses, particularly exporters and makers of zero-rated goods such as pharmaceuticals has been the back log of VAT refunds that has built up over the past year. This back log arose following a temporary suspension of VAT refund payments to deal with some fraudulent dealings uncovered in the refund system. The KRA is now working to strengthen the VAT verification and audit capacity for both refund and regular VAT traders. I have made provision of K£600 million in the VAT revenue estimates to reduce the back log in VAT refund payments during fiscal 1996/97. I, therefore, want to assure the export and other businesses affected that they should invest and conduct business in the confidence that these refund payments will be met over the coming year. At the same time, I would warn any intended evader of VAT that the chances of being caught and penalised are rising by the day as the KRA strengthens its audit and enforcement capacity.

Mr Speaker, the changes in the rates of VAT that I have just announced will take effect from midnight to-night. The measures that I have introduced into the VAT and excise duties will raise an additional K£51.2 million in revenues.

Income tax measures

Mr Speaker, fairness and efficiency are two hallmarks of a good income tax. An important way of achieving this is minimising the number of low income earners directly involved in the income tax. My first new measure, therefore, is to increase and simplify the tax reliefs offered to individuals. I propose to replace the family, single, and insurance reliefs with one personal relief of Ksh 7,200 that will be available to all individual taxpayers. Men and women will now receive equal reliefs for equal income - the income tax is finally becoming gender sensitive! Individuals with monthly incomes up to Ksh 6,000 will be free of income tax. This will remove about 140,000 low income workers from tax paying status next year. It will also significantly simplify the Pay-As-You-Earn system as it will no longer be necessary for employers to certify the marital status of their workers.

Second, to protect against inflation-induced bracket creep, I propose to expand the tax brackets by 5% from K£3,900 to K£4,104. In addition, a new 30% bracket will be inserted to reduce the number of middle-income earners falling into the top marginal tax rate bracket.

Third, I am proposing to lower the final withholding tax rate on qualifying dividends paid to residents from 7.5% to 5% in order to reduce the double taxation on income derived from equity investments.

Fourth, interest income has not been effectively taxed, especially that earned by individuals. To rectify this and simplify the administration, I am proposing to raise withholding tax on interest income from 10% to 15%. At the same time, however, interest earned by individuals will become qualifying interest such that the 15% tax will be a final tax where interest is earned from a financial institution. The tax rate on housing bonds will remain at 10% to encourage investment in these instruments.

In addition, it has come to my attention that large sums of money are being held in bearer certificates of deposit by high income earners. To ensure that they pay their fair share of tax, the withholding tax rate on these bearer instruments will be set at 20%. Again this will be a final tax where individuals earn interest on these instruments from financial institutions.

Fifth, to encourage the development of the equipment leasing market, I propose to lower the withholding tax on equipment supplied by non-residents from 30% to 15%. The withholding rate on immovable property such as land and buildings, however, will remain at 30%.

Sixth, to throw the tax net wider, I am proposing to introduce a withholding tax of 5% on royalty payments to residents. This withholding tax can be offset against the tax assessed on the annual return of the recipient of the royalty.

Seventh, with the increasing value of employer-provided motor vehicles now required to be recognised as employee benefits, I am proposing to raise the limits on the capital expenditures on passenger cars qualifying for wear-and-tear allowances from Ksh 100,000 to Ksh 500,000 in 1997, and then further to Ksh 1,000,000 in 1998.

Eighth, to speed up tax collections and to harmonise with the payment dates for VAT and excise duty announced earlier, I propose to move forward the payment date for quarterly instalment payments from the end of the month to the 20th day for instalment payments in the

6th, 9th and 12th months of the current year. The payment in the 4th month will remain at the end of the month to coincide with the final self-assessment tax payment for the year. In addition, to simplify the payment of instalment tax which is now well institutionalised, I am proposing that instalment tax returns will no longer be required. Pay-in slips will be used and instalment tax payments will be reconciled at the time of submission of the end-of-year self-assessment return.

Ninth, the principle of taxing employee benefits at the higher of the cost to the employer of providing the benefit or the prescribed value is already established in the Income Tax Act. I am proposing an amendment to clarify that this principle applies to all types of benefits.

Tenth, last year I introduced the ability to set-off the import duty paid on approved capital equipment imports for large scale investment projects against the subsequent tax paid from the income tax earned from the project. I am proposing two amendments. The first clarifies the carry-forward provisions for import duties in excess of the income tax paid in a year, and the second allows the off-set against the income tax generated from related or similar investments where the imported capital equipment is invested in an expansion or replacement project.

Eleventh, last year I introduced an advanced tax to be paid by owners of passenger-carrying Public Service Vehicles. I am now proposing to expand this to cover goods-carrying heavy commercial vehicles.

Twelfth, over recent years new specific fines and penalties have been introduced to cover the new procedures such as self assessment and instalment payments, but the general fine for offences under the Income Tax Act has remained unchanged. I am, therefore, proposing to increase the maximum fine from Ksh 4,000, a level unchanged since 1974, to Ksh 100,000.

Finally, Mr Speaker, I am proposing a number of measures affecting the pension sector. As promised last year, I am proposing to raise the deductible contribution limits for registered pension and provident funds and registered individual retirement funds from Ksh 60,000 per year to Ksh 90,000 per year. In addition, to remove the double taxation of unregistered pensions, I am proposing amendments to make unregistered pension payments free of tax where they are paid by non-exempt companies and where no deductions were taken for the contribution and the income earned by the fund has been subject to tax.

I am also proposing amendments to the pension benefits rules. First, I am relaxing the contribution limits to defined benefit pension plans in cases where an actuary determines that higher contributions are required for reasons other than enrichment of the promised benefits or additional past service liabilities. Second, where a defined contribution fund has a reserve fund, this fund will not be counted as unallocated surplus as long as the reserve fund is less than ten percent of the market value of the fund. In addition, when a member of the fund receives retirement benefits, the member must be awarded a share of the reserve fund in proportion to his or her current share of the accumulated funds allocated to all the members. As I announced earlier, I intend to bring to Parliament a Pension Scheme Regulation Act which will go further in prescribing and protecting the pension rights of Kenyans.

Finally, as already announced the National Social Security Fund will undergo reform. In light of this reform, I am proposing to change the tax treatment of NSSF effective from the 1st January 1997. First, both employer and employee contributions will become tax deductible under the limits for defined contribution registered pension funds. Second, lump sum benefits will qualify for an exemption on the first Ksh 360,000 of the payment bring them in line with other registered pensions, and any pensions that the NSSF may pay in the future would also qualify under the annual Ksh 150,000 limit for registered pensions. Third, the income earned by NSSF will be tax free as long as the NSSF complies with rules relating to the publication of its audited accounts and the full allocation of income to the accounts of its members.

Mr Speaker, the measures that I have just announced will raise an additional K£15.1 million in revenues.

Other measures

Mr Speaker, road maintenance is a clear priority of the Government. To bring the state of the road system back to a satisfactory level demanded by Kenyans requires increasing amounts to be allocated to road maintenance. Expenditures have risen each year: in 1994/95 K£102 million was spent, this year K£181 million is expected to be spent, and next year K£215 million is budgeted. These higher expenditures unfortunately require corresponding increases in the road maintenance levy. To raise 74% of the total revenues required for road maintenance expenditures, or K£159 million, through the road maintenance levy requires that I raise the levy by Ksh 0.7 per litre. Therefore, the levy on petrol will be Ksh 2.7 per litre, and on automotive diesel, Ksh 2.2 per litre.

Mr Speaker, the various fees for the registration and licensing of motor vehicles, for drivers' licences, and those relating to the sale and transfer of motor vehicles have remained unchanged for a number of years. I propose therefore to increase the fees under the Traffic Act and the Transport Licensing Act, and to bring amendments to raise taxes under the Second-Hand Motor Vehicles Purchase Tax Act.

Finally, to ensure that our nation gets better returns from the employment of expatriates, I am proposing to increase the fees charged for entry permits under the Immigration Act as well as fees charged for issuing identity cards under the Aliens Registration Act.

Mr Speaker, these miscellaneous measures will raise an additional K£63.5 million in revenues.

10. CONCLUSION

Mr Speaker, in reviewing the measures I have outlined, Hon. Members will be aware that these reflect a consistent pattern of policy dating back to the mid eighties. I am gratified with the positive reaction of the donors to my presentation of our policies to the Consultative Group in March this year. I now renew my call to the donors to further support our development efforts.

While we recognise that the last few years have been difficult ones for investors, these are now behind us. Accordingly, I call on all Kenyan enterprises to shake off the past and exploit the new opportunities to the full and I warmly extend this call to foreign investors to join with us in wealth creation.

In this context, I call on the financial institutions of all types to underpin investment and savings by developing innovative and customised financial packages, especially for exporters and the expanding jua kali sector. I also call on our East African partners to join wholeheartedly with us in the development of our region through the harmonisation of policies on trade, investment and the movement of peoples.

The Budget I am presenting to this House is a sober and realistic basis for maintaining economic stability and encouraging the investment which all of us desire and so I am confident that it will command all party support. The coming financial year, the economic seedlings we have so carefully nurtured will grow into fruit bearing trees - a whole forest of them! Thus I call on all Hon. Members to make their personal contributions to this husbandry so that the nation can reap an abundant harvest.

Mr Speaker, I beg to move.