REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1975/76
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 12th June, 1975, by the Hon. Mwai Kibaki, Minister for Finance and Planning, Republic of Kenya, when presenting the Budget for the Fiscal Year 1975/76 (1st July to 30th June).

Mr. Speaker, Sir.

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

THE ECONOMY

Mr. Speaker, I do not intend this year to review recent happenings in our economy in detail, since they are set out fully in the "Economic Survey, 1975", made available to Hon. Members. Also, I do not intend this year to comment in detail on our economic policies, since these are described in Sessional Paper No. 4, only recently laid before the House.

I must, however, emphasize again to Hon. Members the calamitous impact that external events have had on our economy in the last year. We have been beset by world economic storms of a severity unparalleled in the history of this country as an independent nation. We have, however, survived these storms and as I shall indicate in my speech today we have survived with our financial independence still intact. But, Mr. Speaker, we have had to lower our development sights, at least temporarily. The international economic situation has made the timely achievement of our economic and social goals very much more difficult.

I appreciate that it is all too easy to blame ones own problems on other people. Indeed, there may be a feeling—even in the House—that the Government is trying to divert the responsibility for the country's undeniable economic problems from itself on to external economic forces over which, we say, we have no control. To any Hon. Members who feel that the Government has been trying to pass the blame for our economic problems on to others without justification, I would ask them to read—many times if necessary—Chapter 7 of the "Economic Survey" of 1975, the Chapter that covers External Trade.

From that Chapter, Hon. Members will see that average import prices in 1974 rose by 61 per cent—yes, Mr. Speaker, 61 per cent. Even without the increase in oil prices which we all know about, import prices rose by 42 per cent. Mr. Speaker, there can be few other countries whose total package of imports rose in price as much as this in the past year.

While import prices rose by 61 per cent, export prices rose only 30 per cent. The economists call this type of phenomenon, in which import prices rise faster than export prices, an adverse swing in the terms of trade. In practical terms for the man in the street, it means that we have to export a greater share of our domestic production to purchase the same volume of imports. If domestic production is not rising fast enough to provide for this higher real cost of imports, the volume of goods left over for consumption by the people will fall. In plain terms, people will be worse off: their standard of living will go down.

That the standard of living of many people in Kenya has gone down in the last year will be no secret to Hon. Members of this House. Prices have gone up faster than money incomes for many of us, and many of us are worse off in consequence. It would be foolish to deny the obvious.

What may not be so obvious, is that when the external terms of trade swing against us by 18 per cent, as they did in 1974, and when our own production increases by less than 4 per cent, as it did in 1974, the total real income of the country as a whole is reduced and there is nothing that any one—not even a Government—can do to alter this fact.

All the Minister of Finance can do—as I shall try to do in my Budget this year—is to ensure that any overall fall in real income the country suffers is borne, as far as possible, by the people able to afford it; and to endeavour to mitigate the impact on those least able to afford it. Let me be frank, however, that even in this there are limits to what can be done, particularly when at the same time, we are trying to improve the conditions of living of people in the rural areas relative to people in the towns.

In the present circumstances, it is essential to our economic strategy that we do not have to import our own staple food requirements. In order to maintain and, hopefully, to increase production on our farms we have had to allow prices for farm produce to rise in order to cover increases in farm costs. Retail prices of locally produced food have risen in consequence. Wage earners in the towns have been hit by these rising food prices. Wages—even with the recently announced increases—have not always kept pace with this rise in the cost of living. But if we are ever to stop the inflationary spiral in this country, the inescapable reduction of real income has to be borne by someone.

If farmers' incomes are maintained at a reasonable level, non-farm incomes must fall in real terms. Non-agricultural profits are already falling and will bear part of the burden. The better off wage-earners in the towns must also bear part. Until production rises faster, or until the swing in the terms of trade comes to a halt, there is, I am afraid, no alternative.

A reduction in real income is an inescapable burden that has to be borne by some group or groups within our society. My problem today is to try to allocate that burden as fairly and as justly as possible.

I have taken the unusual step, right at the outset of my speech, of emphasizing to Hon. Members the fundamental problem that faces me in putting together the Budget for 1975/76. It is vital that Hon. Members should understand this problem. I must, therefore, urge, Mr. Speaker, that Hon. Members study the Economic Survey for 1975 with even greater care than usual: and that they remember the facts I have just outlined when considering what is included, and what is not included, in the Estimates of Expenditure for 1975/76.

If, Mr. Speaker, I have already cast a feeling of gloom over the House, it is because I feel—and feel strongly—that it is my duty to place the facts as I see them before Hon. Members, however unpleasant these facts may be.

All is not gloom, however: there are some signs that the worst may be behind us. Although inflation continues unabated in the industrial countries as a whole, and the prices we pay for imported capital equipment continue to rise, some industrial countries are succeeding in bringing down the rate of increase of their prices.

Oil prices have not come down, but neither have they continued to rise as they did throughout 1974. It is my hope, and I am sure, the hope of many countries, that recent talk on the possibility of increasing oil prices later in the year will not materialize. Sugar prices and wheat prices on the world markets have fallen back from the peaks they reached last year. Steel and fertilizer prices are not rising so steeply. The downturn in the world economy, which threatened serious world depression towards the end of last year, may possibly have passed its worst and there are now indications that an economic revival may be expected.

In our own economy, it has been necessary to place some check on economic growth in order to reduce our purchases of imports. But, provided that the weather is favourable and agricultural production can be raised faster than previously planned: and provided our economy can be restructured, so as to consume less imports, I am confident that we can bring our balance of payments under control; and that a faster rate of economic growth can be resumed.

In short, although we have to face up to very difficult problems in the Budget today, the outlook for the future is not entirely dismal. If we face these problems with courage now and restructure our economy as proposed in Sessional Paper No. 4, our primary development goals are still within our reach, even though some of them may be achieved a little later than we had hoped.

We are not, however, out of the wood yet: and before considering the levels of expenditure and revenue proposals for next year, I would like to comment on our balance of payments position and prospects.

The Balance of Payments

The unprecedented rise in import prices caused severe pressure on our balance of payments in 1974. Total import costs rose by 65 per cent, although the volume of imports rose by only 4 per cent. We were able to pay those higher import costs, partly with the rise in our export prices—although there was a disappointing lack of increase in export volumes in 1974, and partly with an increase in the foreign exchange income we earn for services undertaken within the East African Common Market. But even after those increased receipts, we were left with a deficit of some K£37 million, a situation we have never had to face before.

I consider it important, Mr. Speaker, that Hon. Members should know how we financed that deficit of K£37 million. We drew down the foreign assets of the commercial banks and the Government by some K£4.3 million. We drew credits from the International Monetary Fund, including our own gold tranche and the "Special Oil Facility" to the extent of K£19.1 million; and we were able to profit by a swing in the currency exchange rates by some K£4.3 million. This meant that of the total deficit of K£37 million, only a sum of K£8.6 million was financed by a reduction in the balance sheet value of assets held by the Central Bank.

At the end of May, 1975, our foreign exchange reserves were equivalent to more than two months imports. This is lower than we should like to see but still a reasonable reserve.

In 1975, we anticipate a further substantial balance of payments deficit. But provided export prices do not fall further, I am confident that we can finance the main part of this deficit by the use of facilities available to us as members of the International Monetary Fund. We expect to draw down our Central Bank Reserves by only K£10 million in the current year, although our deficit may be in the region of K£35-K£40 million.

Clearly, we cannot continue to manage our economy on the basis of persistent balance of payments deficits of this order. We have to get it right. We have to bring our external accounts back into balance. The credits we have received from the International Monetary Fund are merely short-term credits to allow us time to do this. In any case they must be repaid sooner or later. Whatever we may think of the causes of our present balance of payments problems, we are left with no alternative but to correct the situation ourselves if we are to preserve our economic independence.

There is going to be a cost involved in doing this, a cost that must be reflected in our standard of living. There is no point in any of us trying to hide this. The least hurtful way this cost can be borne—indeed overcome—is for everyone to work that much harder: to produce that much more: to produce at a lower real cost and to undertake services more efficiently. If we can accelerate the rate of increase of real wealth in this country, standards of living can still rise—and we can correct our balance of payments deficit at the same time.

It will be most unfortunate if, after a year of abnormally low economic growth in 1974, we should have to face another year of relatively low growth in 1975. This can only make our difficult task harder. Agriculture has benefited from significant increases in prices and manufacturing should be more competitive in the light of the steep import price increases and the recently introduced export subsidy. The recent wage increases should not be allowed to become merely an increase in the cost of production but must be viewed as a major incentive for all workers to increase productivity by redoubling their efforts. Markets exists for our products: our producers must raise production to meet those market needs.

We must restructure our economy to use less imports, to produce our own food and to increase our exports. We outlined our economic strategy in Sessional Paper No. 4 and I do not propose to go over the same ground today. Today, I am concerned with the implementation of that strategy in practical terms.

I propose, therefore, to consider immediately the Budget outturn for 1974/75 and the prospects for 1975/76.

Recurrent Expenditure 1974/75

In the current Financial Year, we expect to spend a total of K£203 million on recurrent services, an increase of nearly K£40 million or 24 per cent over the previous year. This is a very substantial rise in spending, but bearing in mind the increase of K£14 million or 34 per cent in the cost of education, occasioned by the abolition of primary school fees in standards one to four, and the increase in the cost of supplies generally, there has been only a small increase—perhaps 2 or 3 per cent—in the real level of services other than education. This is less than we proposed in the Development Plan. Inflation has hit Government as much as anyone else.

Development Expenditure 1974/75

The House has approved Development Estimates in the current year totalling K£97 million. However, I do not expect that expenditure will exceed K£88 million, a rise of some 30 per cent over last year. Although inflation has undoubtedly affected the cost of development projects, there has still, I feel, been some real increase in development spending, although probably less than I had hoped when the Development Plan was published.

Financing of the 1974/75 Expenditure

Fortunately, recurrent revenue has been buoyant and as a result, I hope to achieve a surplus over recurrent expenditure of some K£36 million, even higher than the record surplus of K£25 million last year.

As has been the practice in recent years, the whole of the Recurrent Account surplus on 30th June will be transferred to the Development Account and I would ask the House to accept this statement as notice of my intention to do so.

The recurrent surplus is important to us. This year, it has financed over 40 per cent of our development spending. Of the other 60 per cent, over half has been financed by loans and grants from overseas. The remainder has been financed by domestic borrowing in Kenya, of which K£16 million has been raised by long-term borrowing.

Short-term borrowing from the banking system, together with the drawings on our cash balances, has been higher this year than last, although I still hope to keep the total to around K£10 million.

In order to contain inflationary pressure in this country, it is important that I do not increase the money supply by borrowing heavily from the banks.

Recurrent Expenditure 1975/76

I propose now to turn immediately to consider the level of spending proposed for the coming Financial Year. Hon. Members will, I hope, have had time to study the Estimates of Expenditure for 1975/76.

They will have seen that I have proposed a total recurrent expenditure of some K£230 million, 13 per cent higher than this year. Of the increase of K£27 million, at least K£12 million will be required to meet the cost of the recently announced pay award to civil servants. If we take into account the higher prices to be paid for vehicles and fuel as well as other supplies, it is apparent that no real expansion of Government recurrent services can be looked for next year.

This restraint on recurrent spending is necessary in a year of low economic growth, if the budget deficit is not to increase during a period of balance of payments deficit. But in order to hold down recurrent spending to the level proposed, it has been necessary to restrict new recruitment in the Civil Service and the purchase of new vehicles. The need to restrain expenditure within the levels of the printed estimates will require economies in spending to be made by every public servant. We can no longer tolerate, or even afford, the civil servant, who spends public funds regardless of the budget he has been provided with.

It is essential to the economic strategy we outlined in Sessional Paper No. 4 that recurrent spending is held in line with the growth of the economy. The whole Government machine—civil servants and Ministers—must be organized into a "Harambee" effort, under the watchful eye of the Public Accounts Committee, to ensure that this objective is achieved this year. The importance of this cannot be overstressed. The Treasury will examine ways of ensuring that Ministries cannot continue recklessly making commitments for which no financial provision is provided in the hope that additional funds will be provided in Supplementary Estimates.

Education expenditure—which is discussed particularly in Sessional Paper No. 4—will rise by 16 per cent, a rate still higher than that for total spending. However, provided the Ministry of Education does not ask for supplementary provision this year—and it is imperative that it does not—we shall have contained the education budget to about 28 per cent of total recurrent spending which is consistent with the long-term objectives set out in Sessional Paper No. 4.

DEVELOPMENT EXPENDITURE 1975/76

Development Expenditure in 1975/76, as Hon. Members will have seen from the printed Estimates, is expected to total K£136 million. This total is over 50 per cent higher than the level of spending expected in the current year and is much higher than the total of any earlier year. In spite of our problems, I am determined that we must maintain the impetus of our development drive and the Estimates are proof, if this is needed, of this determination.

There is, however, one special item included in the Estimates which tends to create a somewhat exaggerated picture of the spending proposed in the coming year. This item can be found in the vote of the Ministry of Finance and Planning and covers a loan of K£16.7 million to the Cereals and Sugar Finance Corporation.

This very large loan appears for two reasons. Firstly, because of the financial squeeze in the country over the last year, the normal sources of funds available to the Corporation have tended to contract. The Corporation has only fulfilled its obligations this year to finance the movement of wheat and maize and farm credit by borrowing short-term funds from the Exchequer. If the Corporation is now to fulfil a wider role, particularly as a channel of funds to the agricultural credit institutions, it must be given a significant sum of permanent capital with which to work, so as not to be restricted by the fluctuations in the availability of short-term funds.

Secondly, recognition of the serious problems caused in the Kenya economy by the rise in oil prices, has led to offers of balance of payments assistance from international institutions. In order that this assistance is used in a way that does not lead to additional purchases of imports, thus providing no balance of payments benefit, I decided that they would be used to provide the capital needed by the Cereals and Sugar Finance Corporation to expand agricultural production through crop financing and agricultural credit.

To some extent, at least, this large loan to the Corporation represents a transaction between different Government accounts, since it will replace funds already made available by the Government. The loan will, even so, allow the Corporation to expand its activities to assist in raising the level of agricultural production.

However, a fairer comparison of total development spending next year compared with this might be obtained if we leave this loan out of account. If we do this, and adjust for similar transactions last year, new development spending is shown to rise from K£86 million this year to K£119 million next year, a rise of 38 per cent. This is still a significant increase but in the light of price rises and the necessity to continue our programme of national development, one that is fully justified.

The sectors which will receive higher development allocations next year are, notably, water, with an increase of over K£9 million; commerce and industry with an increase of K£5 million; agriculture with an increase of K£4.5 million and Finance and Planning with an increase of K£5 million, largely on account of finance needed for the new fertilizer plant. These are all productive sectors which require additional funds in accordance with our revised economic strategy.

On the other hand, the allocation to roads, which received priority in earlier years, shows no increase this year, not even to cover the increase in construction prices. We have, however, allocated more for road maintainance in the Recurrent Estimates. The administrative ministries have also been held back, since we cannot afford to use our scant resources on non-essential office building at this time.

Considered as a whole, the development spending proposed follows the guidelines and strategy laid down in Sessional Paper No. 4.

REVENUE PROSPECTS 1975/76

Overall, Mr. Speaker, compared with this year, I require an additional K£27 million for recurrent spending and an additional K£48 million for development. This means I require, in total, an additional K£75 million. This is a very large requirement indeed and one which is going to be difficult to find. How am I going to raise it?

The outlook for the growth of incomes in 1975/76 is not good. This must in turn affect the growth of revenue. Profits are tending to fall, and lower real incomes mean lower spending on luxuries, resulting in lower indirect tax receipts.

Most of the normal growth in the revenue in 1975/76 will come from the effect of existing *ad valorem* taxes on higher priced goods and from the impact of existing progressive income tax rates on higher money incomes. Overall though, when these and other factors are taken into account, I do not expect ordinary revenue to expand by much more than about K£12 million at existing tax rates.

However, I anticipate higher revenues on two other accounts. Firstly, I expect appropriations-in-aid to rise by over K£3 million. Total gross recurrent revenue will thus be about K£15 million higher in all.

Secondly, because of a realization throughout the world that Kenya has been particularly hard hit by recent world economic events, the volume of aid to be provided by the international agencies and friendly countries will show a significant increase in the coming year.

I have negotiated a programme loan of 30 million dollars with the World Bank, and other agencies have offered us assistance to meet our balance of payments gap. The Kenya shilling counterpart of that assistance will come into the Exchequer. In total the level of external revenue available for development should rise from K£30 million this year to K£69 million next year, an increase of K£39 million.

Mr. Speaker, I appreciate that many Hon. Members may be concerned at this sharp escalation in the amount of money we shall draw from overseas. But I must ask Hon. Members to consider the alternatives carefully before they start to protest.

Without those funds, we shall be unable to cover the balance of payments deficit. The only alternative to a severe drain on our remaining foreign exchange reserves would be, firstly, to cut back imports to the point where our economy was starved of raw materials and capital equipment. The effect of this would be to create a severe recession with serious implications on employment and incomes. I am determined to avoid that.

Secondly, I should either have to cut back Government spending to the extent that the development effort was significantly reduced or I should have to raise taxes to levels that would reduce the standard of living of *wananchi* to unacceptable levels. Most probably, I should have to do both. The effect of such measures would also be to create a recession. Accordingly, I do not believe that this alternative would be wise either.

Mr. Speaker, at this point I must restate my firm belief that we must lower our relative dependence on external funds to finance development. But I also believe that, in the particularly difficult circumstances in which we find ourselves, we must take advantage of the offers of assistance from abroad to give us time to achieve the restructuring of our economy within the economic strategy described in Sessional Paper No. 4. Without this assistance, our development would move backwards not forwards, and much that we have achieved in the years since independence would be placed in jeopardy.

When it is appreciated that K£14 million of estimated external finance in 1975/76 will be in the form of grants with no liability for repayment, it will be realized that it would be foolish to turn such money away.

Perhaps, Mr. Speaker, I should recapitulate the figures. I have to finance an increased expenditure of K£75 million. Recurrent revenue is expected to rise by K£15 million. External aid should rise by K£39 million. Domestic long-term borrowing I expect to be much the same as this year, K£17 million. This means that I am forecasting total revenue to increase by K£55 million. I am therefore faced with a gap of K£20 million.

Budget Proposals for 1975/76

With our present balance of payments deficit, I should reduce the present level of borrowing from the banking system. To budget to increase it by the amount of my forecast gap in these circumstances would be irresponsible. I have, therefore, no alternative but to increase taxation to cover the revenue shortfall.

Before I announce how I propose to finance this shortfall, I would ask you, Mr. Speaker, to regard the remainder of my Speech as being Notice of a Motion to be moved before the Committee of Ways and Means.

I have in budget speeches over the last three years explained at some length the long term strategy I have followed to reform the taxation system. Some of those reforms, such as the sales tax and the revised income tax have—in part at least—already been introduced. My proposals today should also be seen in terms of this same long term strategy. Some of my proposals will be designed to correct anomalies or simplify the collection of taxes but I regard such simplification as being a worthwhile objective in itself and part of the overall strategy. Indeed such simplification may result in improved collections and slight gains in revenue. But faced with the substantial deficit I have described, I shall need more than a mere windfall in tax collections.

The Income Tax

I will start by considering the income tax. I propose to introduce two new withholding taxes. The first of these will be a withholding tax of 20 per cent on payments made to non-resident entertainers. At the present time foreign entertainers—performers of all kinds including professional sportsmen—come to Kenya, are paid for their services aud leave before their income can be brought to tax. I am therefore proposing that they should be taxed before they receive their money and the revenue will, I expect, gain by about K£30,000.

Secondly, I propose to introduce a withholding tax of 15 per cent on insurance commissions paid by insurance companies to resident individuals. The present position is that many of these commissions are not declared for tax purposes by the recipients. The proposed withholding tax will have the double advantage of ensuring, firstly, that tax is charged and, secondly, that the recipients are identified and their income brought under assessment. Since resident withholding taxes may be set off against tax charged under assessment, it is difficult to estimate with any accuracy how much revenue will be earned from this measure but I am expecting at least K£70,000.

These two new withholding taxes will be imposed from mid-night tonight.

As was foreshadowed in the Development Plan, and again in Sessional Paper No. 4, I have been reconsidering the usefulness of the investment allowance provided under the Second Schedule to the Income Tax Act. At the current corporation tax rate, the allowance represents a 9 per cent subsidy for new investments in buildings and machinery. In our present balance of payments situation, a continuing general subsidy to what is mainly imported capital in addition to all the other investment ncentives, is difficult to justify. Furthermore, a general subsidy to capital when we are anxious to create more jobs—not have jobs taken away by machines—is also difficult to justify.

Accordingly, I propose that with effect from 1st January, 1975, the allowance will only be applicable to new investment in rural areas, that is outside the municipalities of Nairobi and Mombasa. Thus, the investment allowance will cease to be a general subsidy for capital, and will become a special subsidy for the dispersal of new investment away from the two main industrial centres in line with our declared policy of encouraging wider distribution of industries. I believe that the allowance can still perform a useful economic function in this way and will, for the time being, be retained for this purpose.

A transitional provision is included in the Finance Bill to enable the allowance to be claimed for investments in Nairobi and Mombasa where contractual commitments have been made before 13th June, 1975.

There will also be a minor amendment to the investment allowance for shipping to allow the purchase of second-hand ships without the refittment requirements that exist in the law at the present time.

I now move to a more substantial area. As foreshadowed in Sessional Paper No. 4, and indeed in previous budget speeches, I have been considering the question of capital gains taxation. At the present time, a company's trading profits are brought to tax but any profits realized on the sale of assets remain untaxed. This is, I believe, wrong. With effect from 1st January, 1975, gains and losses realized on the sale of all assets (except motor cars) will be included with chargeable income under the Income Tax Act and taxed at the corporation rate.

I am estimating an additional revenue of K£2 million from this measure and K£2.1 million from all the proposed income tax changes taken together.

Capital Gains Tax

Turning now to individual gains, every Hon. Member of this House must be aware that there are people in this country who have becon conspicuously rich, even though we have a very high p rate income tax. Some people have become rich by vading as well as avoiding tax. Others have made substantial capital profits on property or shares which are not, at the moment, subject to tax. I would have liked to have brought those profits within the definition of chargeable income for income tax on individuals, as I now propose for companies. But I am not yet sufficiently confident that it has been possible to raise the capacity of Income Tax Department to enable it to undertake this additional task.

I therefore propose to tackle the problem with what might be regarded as an interim solution. A new Parliamentary Bill is published today to provide for a new tax to be charged on the sale of property or shares by individuals. The new tax will take effect from midnight tonight.

There are four main parts to the new Bill. Firstly, a tax of 15 per cent of the value of real property and shares will be charged on all transfer instruments submitted to the Collector of Stamp Duties for stamping when property and shares are sold. The tax must be paid before the instruments are stamped.

Secondly, a tax of 15 per cent will be charged on the value of all real property and shares of deceased persons before assessment for Estate Duty.

Thirdly, although a tax of 15 per cent on the realization value represent a fairly low rate of tax in the light of the rise in property and share values in recent years, individuals (or trustees of estates) may, claim a refund of the tax they have paid on the transfer of property or shares, up to the extent they can demonstrate to the Controller of Inland Revenue that the tax they have paid under the initial charge of 15 per cent was greater than an amount equal to 35 per cent of the actual capital gain realized. In simple terms, no one will be asked, in the end, to pay more than 35 per cent of the difference between what he paid for a property and what he received when he sold it.

Fourthly, special arrangements will be made for imposing the tax on transactions carried out on the Nairobi Stock Exchange. Subject to conditions that will be set down in regulations to be published once the Bill is enacted, I propose that certain agreed portfolios of shares quoted on the Nairobi Stock Exchange will be regarded as a single esset for the purposes of the tax.

Accordingly, tax will only be charged to the extent that shares are sold and the proceeds not reinvested in other shares. The rate of tax to be charged when sales proceeds are not reinvested will be 35 per cent of the actual capital gain realized over the adjust cost of the shares.

The details of how the capital gains tax will work in relation to "qualified investment accounts" is somewhat complicated and I will postpone an explanation of this until the House comes to consider The Capital Gains Tax Bill at a later date.

In order to ensure that this measure does not cause any undue hardship I propose to exempt from the new Capital Gains Tax, all real property transactions of under Sh. 10,000, one owner-occupied house for each family and the first sale of land after it has been registered.

It will therefore be seen that the Capital Gains Tax is not one that will hit the average person in this county. It will only affect people who have more than one house, own shares or deal in land. I do not expect to earn a great deal of revenue from the measure—I am provisionally estimating an amount of only K£1 million.

However, this is a case where I believe that principle of equity in our society is more important than the revenue to be gained from a particular measure. Our taxation system will be a fairer one once the House agrees to enact this measure.

CUSTOMS TARIFF

I have explained on previous occasions to the House my views on the need to reform the customs tariff. Reference was made to this question again in Sessional Paper No. 4 A start was made to tackle a general reform of the Customs tariff in the last two budgets. In concert with my colleagues in Uganda and Tanzania, I propose now to move further with the reform programme this year.

A duty of 10 per cent will be imposed on a wide range of items in the tariff that are duty free now. Most of these items come into the category of raw materials and capital equipment, since consumer items are already subject to duty

There will, possibly, be a great deal of debate and argument about the principle of taxing these items, and the effect that it may have on industrial costs. I do not wish to repeat the arguments I have advanced before on this subject I will confine myself to emphasizing one or two points.

The industries we need most in Kenya today are those that are based on our own resources, not based on imported raw materials. If we are to restructure our economy to use less imports—as we have to—we must also accept the fact that there are some industries we just cannot afford to have. A relatively low tariff of ten per cent on the nil items proposed in the budget today should not have serious cost effects for the industries concerned and I do not propose to entertain any wholesale representations for consumer price increases on account of this.

If the new rate of duty forces the manufactures to reconsider the sources of their raw materials and the amount of capital and labour they use in their production processes, it will have served a useful purpose. If it encourages Kenya industries to replace these imports by local production, this will be an additional benefit.

The list of nil items to be subject to the new 10 per cent duty is too long to be read out this afternoon and I must ask Hon Members to look for this detail in the Finance Bill. None of the items is important in every day life of the consumer and the direct cost of living effect of the measure will be nil. On the other hand, because of the wide range of items included in the list, I am looking for a benefit to the revenue of K£5½ million per year.

There is a further range of machinery items now imported free of duty which, I believe, should also be taxed. I have, however, not imposed such a tax today but I am giving notice of my intention to do so some time in the future by adding these items to the Second Schedule of the Customs Tariff This Schedule allows me to provide for a suspended duty—for these items at a rate of 10 per cent—which can be imposed at a later date by notice published in the Gazette and placed before the House.

In order to simplify the administration of the tariff, number of specific—fixed rate—duties, which are no longer operative as a result of the rise in import prices, have been deleted. *The ad valorem* duties already provided as an alternative, will stand alone This represents an administrative simplification and should therefore save collection costs but very little additional revenue is involved.

Hon. Members, will by now understand the extent to which our present economic problems are due to our economy using too many imports. In some cases there is not much we can do to reduce that dependence, but in other cases we could rely much more on our own industry. A case in point is the clothing industry which is labour intensive and based on locally produced cloth I see no reason why we should continue to import so much clothing from overseas and accordingly I propose to raise the *ad valorem* duty on clothing from 45 per cent to 50 per cent. The specific rates of duty on clothing will be dropped from the tariff. I estimate that the Exchequer may earn up to K£200,000 from this proposal

Hon. Members will perhaps be aware that we do not produce wine, nor very many spirits in Kenya. Yet these items continue to add significantly to our foreign exchange costs. Imported wines and spirits must come into the category of luxury items and I propose to raise the rate of duty on wines from 66⅔ per cent to 75 per cent and on spirits from Sh. 48 to Sh. 50 per proof litre. Any person who can afford to have a glass of wine with his meals can no doubt afford these modest increases in tax. These increased taxes will I estimate earn the revenue an additional K£100,000.

Similarly, those that can afford to purchase the larger motor cars, expensive in foreign exchange, and expensive users of high cost oil, must be prepared to pay for the privilege or use a smaller car. Most people in this country cannot afford any means of transport at all. I therefore propose that import duties on the larger cars should be raised as follows—

for cars exceeding 1500 c.c. engine capacity but not exceeding 1750 c.c. the duty will rise from 55 to 60 per cent;

for cars exceeding 1750 c.c. but not exceeding 2000 c.c., the duty will rise from 60 to 75 per cent;

for cars exceeding 2000 c.c. but not exceeding 2250 c.c. the duty will rise from 75 per cent to 100 per cent;

for the very largest cars, exceeding 2250 c.c., duty will rise from 100 per cent to 150 per cent;

for the smaller cars—those under 1500 c.c.—the duty will remain unchanged.

I am looking for an additional K£700,000 from these higher duties.

Finally, on customs, we have to face up to the fact that imported oil represents nearly one quarter of our total import costs and even after allowing for the foreign exchange we earn from exports of petroleum products, two-thirds of our 1974 balance of payments deficit was due to oil. We just cannot afford this. We have got to cut down on our fuel consumption. In order to achieve that cut, I have, I am afraid, to announce further increases in the oil duties.

The import duty on motor spirit will rise to Sh. 600 per cubic metre, which will mean that the price of petrol will go up by 24 cents per litre.

The duty on kerosene will rise to Sh. 200 per cubic metre, leading to a price rise of 7 cents per litle. That on light diesel oil will go up to Sh. 400 per cubic metre, leading to a price of 11 cents per litre. Finally, the duty on petroleum gas will rise from 18 cents to 20 cents per kilogram. These are very steep increases in tax rates, but as nation we are faced with an oil bill we cannot afford. Last year we managed to halt the rise in oil consumption. This year, I aim to bring it down.

There is one further measure relating to petroleum taxation. Up till now, owners of light aircraft have been able to purchase their aircraft fuel free of tax, simply because under international agreements we have to allow tax free fuel to international airlines. This fuel for light aircraft is imported and costs us precious foreign exchange and this luxury form of travel should not remain untaxed. The exemption will be withdrawn and tax will be charged on aviation spirit at the same rate as motor spirit.

Although the primary object of increasing the taxation on petroleum fuels is to reduce consumption, I estimate that the revenue will benefit by some K£5½ million from these proposals.

All the measures I have announced relating to the Customs Tariff will come into effect at mid-night tonight. Taken together, I estimate that they will bring me a total of K£12 million in the new financial year.

TRADITIONAL LIQUOR TAX

I shall now turn to the Traditional Liquor Tax. This tax has always presented us with collection problems, ever since it was first introduced four years ago. The reasons for introduction of the tax were quite clear. I felt it only fair that all types of liquor should bear some tax, even our own traditional beers, when they were produced outside the household on a factory scale of production.

I still hold this view, but a fixed rate of tax of 20 cents per litre is perhaps not the best way to charge a tax on products which vary quite substantially in price and which are produced and sold under varying conditions.

I propose, therefore, to abolish the Traditional Liquor Tax and to replace it with a sales tax of 25 per cent. Since sales tax is not chargeable on manufacturing establishments with a turnover of less than Sh. 100,000, small brewing establishments will be automatically exempted from the tax. Accordingly, it will fall on the larger, factory type, establishments only.

The amount of tax on the cheapest beers such as that produced by local authority breweries should be very much the same as now, but the more expensive and sophisticated traditional beers may suffer a little more—and it is only fair that they should do so.

I may raise a little more revenue by this change but I don't anticipate that very much will be involved.

EXCISE TARIFF

Since the introduction of the Sales Tax in 1973, there has been dual form of taxation on certain locally produced products to the extent that some are subject to excise and sales tax at the same time. I hope gradually to overcome this anomaly and I propose to make a start this by abolishing the excise on biscuits, soft drinks and matches.

I shall be giving up K£1.2 million of revenue from this concession which, as you will appreciate, I can ill afford. I therefore propose to double the rate of sales tax chargeable on soft drinks and matches at the same time which will give me most of the revenue back again.

This is not entirely a book-keeping operation—giving with one hand and taking with the other—since the abolition of the excise will improve the competitive position of local manufacturers and at the same time allow all the tax to be collected by one department instead of two, thus saving collection costs. As regards soft drinks and matches the new measures should not result in any retail price changes. You will also notice, I have not increased the sales tax on biscuits, so that we should be able to look for some small price cuts here.

SALES TAX

Lastly, I turn to the Sales Tax. When this legislation was enacted two years ago I provided that registered manufacturers could purchase their raw materials free of tax under an exemption certificate granted by the Commissioner. It is apparent that the use of these certificates has, in many instance, been abused and manufacturers have, in a number of cases, purchased raw materials tax free and then sold them retail or wholesale without further processing as required by the law.

I cannot allow this to continue; yet I do not want to add to the costs of genuine manufacturers by placing the sales tax on their raw materials. I propose therefore to change the law, so that the manufacturer will pay the tax on his raw materials when they are purchased or imported, but he will be allowed to reclaim, as a refund, the tax in respect of such raw materials when he pays the tax on his own manufactured products.

The manufacturer will have to demonstrate that the tax claimed in respect of raw materials bears a correct relationship to the tax being paid on final manufactured products. The genuine manufacturer will be no worse off but the cheap will be caught out.

I am still some way short of my revenue objective of K£20 million and I must therefore turn my attention to *rates* of sales tax. I have no wish to change the general rate of 10 per cent at this time, but I believe that when I am short of revenue, I must seek that shortfall by increasing taxes on luxuries.

I have already increased taxes on cars and petrol, and am proposing to tax capital gains. I now propose to raise to 20 per cent the rate of sales tax on the following items which I consider must come into the luxury or labour saving category—toilet waters and perfumes, films, leather goods, jewellery, lifting equipment, domestic refrigerators and washing machines, hi-fi equipment, cameras, clocks, gramophone records and boats. I have already announced a similar rate of sales tax for soft drinks and matches. Taken together I estimate that the revenue will gain some K£2.15 million from these increases in sales tax.

Finally, I am afraid I must turn my attention to beer. The consumption of beer has continued to grow at a startling rate and although I have no intention of saying that *wananchi* are not entitled to a bottle of beer—I enjoy one myself—beer must still be regarded as one of the non-essentials and therefore subject to tax at rates higher than other products. With effect from midnight tonight, the price of malt beer will go up by 40 cents per bottle, of which the revenue will get 20 cents and the Breweries 20 cents to cover increases in costs—particularly sugar—which I have asked them to carry in recent months. The revenue will gain by an estimated K£3 million from this measure.

All changes in sales tax will take effect tonight. Taken together, the increases I have announced are expected to bring the Exchequer an additional K£5½ million.

Mr. Speaker, taken together, the tax measures I have announced this afternoon represent a very substantial increase in taxation. In all they amount to an increase of about K£19 million. Contrary to what some people may think, this is still a large sum in Kenya.

Yet apart from the increase in the bear tax none of the increases will directly affect the average *wananchi* trying to maintain his family on the average income of this country. Richer people will have to pay more for their wine, whisky and hi-fi equipment. They will have to pay more for their large cars and the petrol they put in them. They will also have to pay tax when they transfer property and shares. Companies will have to pay tax when they dispose of assets at a profit. They may also have to pay more for raw materials and some of their capital equipment.

But the average farmer in the rural areas and the average wage earner in the towns is concerned with none of these things. He is concerned to have a roof over his head and sufficient food for himself and his family. I have taxed none of these things today. To emphasize this point, and my genuine concern for the difficulties the poorer members of our society have had to face in the last year, I propose as my final tax measure to abolish the present sales tax on bread and on margarine and kimbo. As a result the price of a loaf of bread will go down by 10 cents, a tin of margarine by 55 cents, and a tin of kimbo by 55 cents. With this change, no basic foodstuffs consumed by *wananchi* will now suffer any tax at all. These tax cuts will cost K£2 million.

It will be apparent to those Hon. Members who have been able to follow my arithmetic, that I am proposing to increase taxation by K£17 million, compared with a revenue shortfall of K£20 million. I propose to finance the difference of K£3 million by additional short term borrowing. Net short term borrowing from the banking system in 1975/76 can, I hope, be contained within a ceiling of K£13 million, a figure consistent with our Plan strategy and Sessional Paper No. 4. This level should not cause any undue pressure on our balance of payments.

Mr. Speaker, my budget this year has taken quite a lot more from the taxpayers taken as a group. But as I explained at the outset of my speech, this was unavoidable in the light of the economic problems our country has to face at the present time. It has, however, also been possible to give a little back to everyone through lower prices for fats and bread. I would have liked to have done more to reduce the cost of living, particularly for the poorer members of our society, least able to cope with the problems of inflation.

I hope, Mr. Speaker, that I have been able to convince Hon. Members that I have distributed the additional tax burden fairly. It is my sincere belief that this is so.

Mr. Speaker, I beg to move.

GPK 942—2m—6/75