REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1976/77
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 17th June, 1976, by the Hon. Mwai Kibaki, Minister for Finance and Planning, Republic of Kenya, when presenting the Budget for the Fiscal Year 1976/77 (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 rise to propose the Budget for 1976/77 as we come to the end of what, from a financial point of view, has been the most difficult year since independence. The origins of these financial difficulties are to be found in the economic blizzards that hit this country from overseas nearly two years ago. But their continued persistence in the past year has been due also to a recession in our own economy.

The economic situation forms the background against which the annual Budget is formulated. But it has been my practice in Budget speeches of recent years not to discuss this in detail. I have relied on Hon. Members to undertake their own homework by studying the *Economic Survey* for the year. This document reviews the state of health of our economy in much more detail than I am able to do within the scope of a single speech. However, although I trust that Hon. Members have already studied and absorbed the Economic Survey for 1976, I would like to emphasize some particularly important economic influences that have affected us—and are still affecting us—before going on to consider the financial outturn for the current year.

I explained to the House last year, how, when import prices rise faster than export prices, and our own production is not increasing, the country as a whole is worse off. The violent adverse swing in the external terms of trade—which is what this phenomenon is called—left many Kenyan families significantly worse off in 1974, especially families in the towns who had been affected, as well, by higher food prices that followed the necessary raising of farm prices for maize, wheat, sugar, rice and beef.

I pointed out last year that what the Government could do to alleviate the hardship felt by so many families was to encourage everyone, whether on the farms, in the factories, or in Government offices, to redouble their efforts to raise production and wealth and so overcome the loss of real income caused by the higher prices being charged for overseas supplies.

In 1975, there was a further adverse swing in the external terms of trade, although nothing like as severe as in 1974. In addition, the dry weather conditions in all areas of the country in 1974, and in many areas in 1975, reduced the volume of farm production available at a time when we particularly needed an increase.

At the same time, the reduction in family purchasing power caused a drop in the demand for the products of our factories. For the first time in our economic history even the production of beer fell, and the output of other industries, producing commodities which are perhaps less essential than beer, was also down quite sharply.

Tourism showed little growth during 1975 and the building industry was influenced by the general downturn in the economy. Government activity was also curtailed in accordance with the Budget I presented last year. Given the importance of the Government sector in the economy, this also restricted growth.

Overall, the economy grew by less than 1 per cent in 1975, less than the growth of our population. The numbers of jobs provided by the cash economy was lower. To use the popular economic jargon, Kenya experienced a recession. Taken together with the further swing in the terms of trade, this meant that the standard of living of the average family in Kenya was reduced again in 1975, even though they had suffered a more severe reduction in 1974.

It is this situation that has been uppermost in my mind as I have formulated the Budget for 1976/77.

But I am convinced that the prospects ahead of us are better. The slackening of price inflation overseas and a boom in the prices of some of our exports—particularly coffee—suggests that the swing in the external terms of trade against us may be coming to an end, at least temporarily. Indeed, 1976 may turn out to be one of those years, unfortunately all too rare, when the terms of trade move in our favour. If crude oil prices could be held at their current levels beyond the end of this year, it is possible that this favourable trend could continue for rather longer.

The outlook for domestic production is better. Providing the rains are adequate—and we were let down badly by the weather in some areas last year and the early part of this year—there are prospects for record outputs of coffee, tea, maize and wheat. Higher levels of production compared with 1975 can be achieved for many other crops. The resultant increase in farmers' incomes should in turn increase the demand for the products of our factories. Tourism has improved sharply in the first half of the year and there are prospects for an upturn in the building industry as major construction projects get under way.

Devaluation of the Kenya shilling last October, in line with a similar measure by Uganda and Tanzania, has raised the Kenya shilling income of our producers, particularly the farmers. We have reduced our reliance on imports and have the industrial capacity to take advantage of any upswing in the overseas demand for our manufactured exports. Our hotel industry has the accommodation available to absorb higher numbers of tourists and our prices now compare favourably with most other tourist centres.

Our policies towards the balance of payments have generally been successful. The deficit in 1975 was less than half that forecast; and our reliance on imports was reduced sharply. We shall still probably be in deficit in 1976 as a whole—although we had a surplus in the first five months of the year. But the deficit is under control and our foreign reserves in the Central Bank are higher than they were at the beginning of 1975. The reserves are today equivalent to over two months imports.

We cannot yet afford to ignore the balance of payments but there is, at the moment, no need to be as preoccupied with it as we were only twelve months ago. If we pursue the policy course we have set ourselves in Sessional Paper No. 4 of 1975, I am confident we can achieve a balance in our external accounts by 1978 without requiring the assistance of the International Monetary Fund as we have done in the past two years.

Prices are still rising in Kenya and this is a matter of continuing concern. Nevertheless, the rate of increase in consumer prices is now considerably lower than it was twelve months ago. Part of this improvement is due to the slackening of inflation overseas; but an important part is due to the success of our wages policy. This policy calls for significant sacrifices by the workers of this country and I would like to pay tribute to the restraint that has been maintained by the trade unions during a very difficult period for our economy.

It has been impossible to prevent a cut in real wages over the last two years but if the trade unions had attempted to fight this by ever increasing demands for higher money wages, inflation would have been very much worse than it has been, and the standard of living of everyone, including the workers themselves, would have been lower than it is now. The revival of our economy will, I hope, allow an early review of the wage guidelines with a view to improvements in real wages.

Mr. Speaker, we have faced and survived two very difficult years—years which have seen severe setbacks to our national development and these setbacks have been experienced by many, it not most, families in this country through a reduction in their standard of living. Yet I believe we are now poised for renewed advance in our development—firstly, to recover the real income lost over the last two years and then to raise real income to higher levels. By hard work and renewed effort, I am convinced we can grasp this opportunity and my Budget today is designed to help us achieve this goal.

We must place our emphasis on higher productive investment and higher output, particularly on the farms, so as to avoid importing our own food requirements and to increase exports. Our goal must be faster growth of the economy, with balance in the external accounts. To achieve this goal we must ensure that investment is directed to the development of our national resources and to the creation of job opportunities that do not depend on significant inputs of imported raw materials and capital.

Price Control

There are two points concerning investment on which I should like to comment.

Firstly, I am well aware that unavoidable delays in the administration of price controls under the Price Control (General) Order have had adverse effects on the economy. In particular, they have in many cases resulted in substantial losses in profits and this has made local manufacturers feel that Government was deliberately preventing them from earning a minimum return on their investment. This has in turn tended to discourage expansion of production resulting in a reduction in the rate of growth of employment and Government revenue. Over-protective price control policies can cause a severe curtailment in investment and result in more hurt to the very people they are supposed to serve. The price situation, I realize, has not yet improved to the extent where we can relax fully our vigilance in the matter of price controls. But I feel the time has now come when we must ease the administrative process involved.

I, therefore, propose that when a firm, producing a commodity subject to the General Price Control Order, can demonstrate that its direct costs, other than wages costs, have risen to justify a price increase under the present Order, it shall apply for that price increase as it does now. If, however, it has not received a reaction from the Price Controller within thirty days, it may go ahead and implement the increase on the assumption that approval has been given. The Price Controller will, however, continue to monitor all proposals for price increases and will reserve the right to require price reductions even after the thirty-day period has expired.

Foreign Investment Protection

Secondly, I should like to say something about the recent amendments to the Foreign Investment Protection Act. A certain amount of fear and dismay has been built up amongst foreign investors following the publication of these amendments. I would like to reassure them that such fears are quite unwarranted.

Kenya has not changed its fundamental policy towards foreign investment. Neither has it changed the way in which the Foreign Investment Protection Act has been administered since 1964. All that we have done is to remove the ambiguities that have up till now existed in the original wording of the law. We have now guaranteed the foreign currency for the repayment of loans denominated in foreign currencies. We have declined to guarantee—as we have always declined to guarantee—the foreign currency equivalent of the original equity investment expressed in Kenya shillings. In these days of wide currency variations, quite outside the ability of this country to control, it would be un realistic for us to say that we could carry the normal commercial foreign currency risk of any overseas equity investment and no Government can, or does, carry such risk.

We have also never accepted that our guarantee extended to provide the foreign exchange to cover the repatriation of capital profits but this does not mean that, in certain circumstances, this would not be allowed under normal Exchange Control procedures. We are prepared—as we have been in the past—to guarantee the eventual repatriation of the foreign exchange equivalent of the original investment expressed in Kenya shillings at the rate of exchange ruling at the time.

Foreign investment continues to be welcome here. All that we have done is to define more precisely the foreign exchange that will be guaranteed to an investor in the event that he comes to sell his investment. But we have defined the *status quo*. Nothing has been taken away from the foreign investor that he had before, although possibly he thought he was entitled to more under the Act than was in practice the case.

In any event, the fundamental climate for foreign investment in this country has not changed. A foreign investor is still welcome in Kenya. We accept that he comes to make a profit and we allow him to remit that profit at the going rate of exchange. What we cannot do is to insure him against all the commercial risks that are an essential part of any equity investment anywhere in the world. We are nevertheless convinced that within the amended legislation the investment conditions in Kenya continue to be attractive and the prospects for a reasonable return on capital have not diminished.

Control of Expenditure

Hon. Members had an opportunity a few weeks ago, when they debated the report of the Public Accounts Committee, to consider the problem of control over Government expenditure. They will be aware that I have been so concerned about the recent deterioration in financial control in the Ministries that I have asked the Controller and Auditor-General to refer instances of financial malpractice to the Public Accounts Committee of this House whenever he has reason to believe that the regulations are being broken. He will now do this as and when he feels it necessary without waiting until he makes his annual report to the House.

Because the Treasury has in the past succeeded in financing ever higher levels of expenditure each year, there are some who seem to have adopted the attitude that they can spend as much public money as they like, without regard to Parliamentary approval, and the Treasury will always find the cash somehow. These people must be disabused of this idea. They must be told firmly that they have not only disobeyed the rules governing the control of expenditure laid down by this House but they are undermining the economic and financial strength of this country. They should be dealt with accordingly.

But it is not only in the Central Government that extravagance has become prevalent. Local governments and statutory boards incur expenditure without first determining whether they have the resources to meet the bills when they are presented. On occasions, additional financial burdens have been placed on the general public without regard to the ability of the public to carry those burdens. At other times, financial management has been governed by the thought that if one's affairs become too chaotic, in the last analysis, the Government will always mount a rescue operation.

Mr. Speaker, Government is no longer in a position to rush to the rescue of every organization that gets itself into financial difficulties. There must also be some limit placed on the burden the general public are expected to bear. Central Government, local government, statutory bodies and even private firms must all cut their coat according to the cloth available. All extravagance must stop. Both wasteful expenditure and excess-expenditure must be regarded as economic crimes and treated accordingly.

Local Government Finance

I am aware that many local governments are facing severe difficulties in financing their services. This is sufficient reason for them to impose every economy. However, in the next few weeks, I expect to receive a report of an inquiry undertaken by the International Monetary Fund into the financing of local government activities. I hope that that report will offer some long term solutions to this very difficult problem. It is a problem which has been with us for a long time now and which has grown worse every year. Decisions in this area are now urgent. Certainly I can promise the local authorities that I shall study that report with the closest attention.

Recurrent Expenditure 1975/76

I would like now to return to the problems of the Central Government Budget. In the light of the recent debate in the House on the Report of the Public Accounts Committee, I trust that this year Ministries will not incur excess expenditures as they did last year, and that I can assume that the total recurrent expenditure I have to finance will be no higher than the revised Estimates approved by the House—that is K£248 million. This total is about 19 per cent higher than the final expenditure incurred in 1974/75. At first sight this may seem a very steep increase; but if account is taken of the wage increases paid to civil servants in 1975, which cost K£15 million, the higher prices that had to be paid by Government for purchases of goods and services, which perhaps cost another K£13 million, and the higher cost of debt servicing, say K£9 million, the real increase in the level of Government services was very low—perhaps only 2 per cent.

As I said last year, inflation has hit Government as hard as everyone else. The Treasury has had to finance increasingly higher levels of expenditure without having the satisfaction of seeing the standard of services provided by Government improve at the same rate.

DEVELOPMENT EXPENDITURE 1975/76

The House also approved development expenditures totalling K£140 million in the current financial year. But in order to keep total expenditure within the limit originally set in the Budget last year, I had to hold back the start-up of a few projects until this coming year. I expect actual development spending to total approximately K£130 million. This total will be a record development effort, representing an increase of some 42 per cent over the previous year.

The current year's Development Estimates, however, provide for very large loans to the Cereals and Sugar Finance Corporation to finance, firstly, the movement of crops, and, secondly, credit to small scale farmers. These loans totalled K£16.7 million. At the same time, loans to other public corporations totalled K£13.7 million. Out of total development expenditure this year of K£130 million, some K£52 million has been spent in the form of loans to other institutions and for the purchase of Government equity in commercial enterprises.

Thus, direct expenditure on development projects totalled about K£79 million compared with K£61 million last year, an increase of 30 per cent. Allowing for an average 20 per cent cost inflation over the year, this still represents a 10 per cent real increase in direct development spending, while the additional impact of the injection of loan money into the rural areas should have considerable developmental effect.

Perhaps, Mr. Speaker, the totals are less significant than how the money is spent. In Sessional Paper No. 4 of 1975, we said that it would be our policy to increase expenditures on agriculture and faster yielding projects, and to reduce expenditures on infrastructure, such as roads and Government offices.

The House will wish to know what we have achieved in this direction. Expenditure on agricultural projects, including lending to agricultural financing institutions, has risen from K£17 million to K£31 million. Expenditure on commercial and industrial projects has risen from K£10 million to K£15 million. Expenditure on water projects has risen from K£4½ million to K£10 million.

On the other hand, capital expenditure on new roads has been held down at about K£19 million, while expenditure on general administrative projects—largely offices—has been held at about K£6.5 million, in spite of rising building costs.

I think we can see, Mr. Speaker, that the swing in development spending in the directions we have planned is being effectively achieved. This policy must be reinforced in 1976/77.

FINANCING EXPENDITURE 1975/76

As I indicated to Hon. Members at the outset of my speech, the financing of expenditure has been more difficult in 1975/76 than in any previous year.

The recession in the economy and the drop in import volumes, went further than we had forecast and as a result the estimates of ordinary revenue may not be achieved. There has, however, been a recovery in revenue in recent weeks and I now expect the shortfall to be only about K£2½ million. Considered together with the supplementary estimates of recurrent expenditure totalling K£15½ million approved by the House, this means that the recurrent surplus available for transfer to the Development Exchequer on 30th June will be no more than about K£11 million. I had originally budgeted for a surplus of K£38 million and this difference of K£27 million clearly underlines the difficulties of which I have been speaking.

However, as usual I intend to transfer the surplus in the Recurrent Exchequer on 30th June to the Development Exchequer and I would ask the House to accept this statement as notice of my intention to do so.

But it is not only recurrent revenue that will show a shortfall. Aid receipts this year are likely to be K£18 million lower than we had estimated in the Budget last year. The reasons for this are fourfold. Firstly, there were a few aided projects amongst those whose implementation was held back until next year owing to the financial situation: here it must be appreciated that even though a project may be due to receive aid from overseas, the initial expenditure must be met by the Government which then claims reimbursement from the source of aid. A substantial element of local contribution must also be found. Secondly, there have been switches of donor policy which has led to expenditures being incurred on what were thought to be aided projects not being reimbursed. Thirdly, we budgeted for nearly K£9 million of revenue to arise from the sale of fertilizers imported under aid arrangements. Most of that fertilizer is now being sold to the farmers but the Kenya shilling receipts arising from such sales has not yet been paid back by distributors to the Exchequer. This revenue must be looked for next year. Finally, there are some K£7 million of aid claims outstanding with various donors which will be reimbursed to us in the new financial year.

Mr. Speaker, the shortfall of K£18 million in aid revenues this year, emphasizes the difficulties we have in financing the Budget with the use of donor finance. There always seems to be innumerable reasons why revenue on which the budget is dependent is not received when expected. And if it is not received when expected, the Treasury has to find a way to finance expenditure until it is.

Overall, looking at 1975/76 as a whole there is now a gap of K£31 million, compared with the Budget I presented last year. Hon. Members will wish to know how we have financed this gap. Firstly, I have borrowed locally, by way of domestic long-term stocks, some K£36 million more than originally envisaged. Domestic stock issues this year, at nearly K£53 million, will be higher than ever before but only about K£25 million will be taken up by the non-bank sector. The other K£28 million will still be held by the Central Bank on 30th June. I shall say a little more about this in a moment.

Secondly, I have drawn Kenya shillings equivalent to K£6.7 million against the allocation of Special Drawing Rights issued to us by the International Monetary Fund, and this has been credited to the Development Exchequer.

Thirdly, I have borrowed, short-term, an additional K£24 million by way of Treasury Bills, while the Cereals and Sugar Finance Corporation has made deposits with the Exchequer of K£70 million, rather more than originally envisaged.

All this borrowing, should have enabled the Exchequer to build up its cash balances substantially but, unfortunately, over and above the increased deficit incurred this year, I have had to fund the uncovered excess expenditures incurred in previous years as well.

The dependence of the Exchequer last year, and this year, on borrowing from the banking system has been far too high. It represents a form of financing which is dangerous to the economy through the inflationary pressure it places on prices and the balance of payments. It also leads to restrictions on the volume of credit that can be made available to the private sector and holds back productive development. But given the expenditures incurred by Ministries over and above those planned in the Budget, and the shortfall in revenue, both domestic and external, I have had no alternative but to follow this course. If the situation cannot be corrected by other means, I will have, in the Budget today, the alternative of increasing taxation.

RECURRENT EXPENDITURE 1976/77

These thoughts have influenced the determination of the ceilings of expenditure for 1976/77 to which I shall now turn.

Hon. Members will by now have seen from the Estimates of Expenditure they received earlier this week that I propose that the House should authorize recurrent expenditure up to a total of K£271 million.

This represents a growth in expenditure of merely 8.9 per cent in cash terms; and if allowance is made for higher prices to be paid by Government departments for goods and services, it represents very little real expansion in the level of Government services—perhaps 2 or 3 per cent. Some Ministries can expect to achieve no real growth in services at all and this fact will, I hope, serve to underline our firm intention to exercise every economy possible in the coming year in general administrative government spending.

Last year I made a plea to civil servants and Ministers for a *Harambee* effort to restrain expenditure within the amounts provided by the printed Estimates. As Hon. Members are aware that plea fell on deaf ears, and the House was faced, two months ago, with supplementary expenditure requests of more than K£15 million. Even now I cannot guarantee to the House that some Ministries will not incur excess expenditures above the revised estimates.

The failure of Ministries to control their expenditures within the Estimates approved by the House will, if left unchecked, undermine the financial strength of this country. I cannot continue to finance excess expenditures by printing money and I register a further plea to all ranks of the civil service to take positive steps to control their expenditure within the limits to be approved by the House over the next few weeks. Until I am confident that we have regained control over expenditure, the present restrictions on recruitment to the civil service and on the purchase of new vehicles will be retained.

Whatever it means to a Ministry's level of services, it must manage its expenditure so that it does not exceed its budgeted provision. I am not suggesting that this is easy. This year it will be particularly difficult. Accounting officers will, however, be judged on their performances in this and they will then have to account to Hon. Members of this House through the Public Accounts Committee.

I do not propose to discuss the Recurrent Estimates in detail, as the House will have the opportunity to do that when it goes into Committee of Supply. However, Hon. Members may like to note that in conformity with the policy outlined in Sessional Paper No. 4 of 1975, education expenditures at K£72.3 million have been held within 27 per cent of the total estimates. This is still too high a proportion and the escalation of the share of education costs in the total Budget must be put under better control.

DEVELOPMENT EXPENDITURE 1976/77

Given the shortfall in revenue available to the Exchequer at existing tax rates, and our recent heavy reliance on financing through the banking system, I should have reduced the level of development spending in 1976/77 in order to keep the books in balance. I am, however, reluctant to do this, particularly if it delays the restructuring of our economy, as described in Sessional Paper No. 4 of 1975, or delays the recovery of the economy from its recent recession.

After very careful thought I have therefore fixed the level of development spending, as Hon. Members will have seen from their copies of the Estimates, at K£128 million. This is about the same as the total I expect will be spent in 1975/76; but if adjustment is made for the abnormally high level of loans to other sectors this year, direct development spending will rise quite sharply.

I mentioned a few minutes ago that direct development spending this year is expected to be about K£79 million. In 1976/77, I expect the total to be about K£98 million. If this is achieved, direct development spending should rise by about 24 per cent. Even in real terms, discounting for price increases, this will be a significant expansion.

At the same time, we should not forget, Mr. Speaker, that in the current year, work on two major development projects, financed mainly outside the Budget, will accelerate sharply. These projects are the Mombasa-Nairobi Oil Products Pipeline and the Gitaru Hydro-Electric Scheme. In addition, there will be a rising stream of expenditures in the rural areas financed by the Rural Development Fund, again outside the Budget.

If expenditures on these projects are added to the total of direct development spending, it can be seen that there will be a major expansion of development effort in real terms during the current year.

Because the loans granted to the Cereals and Sugar Finance Corporation in 1975/76 will not be repeated in the coming year, total expenditures in the agricultural sector will appear to fall. But this is misleading, as direct Government expenditures on rural development are planned to increase.

The development vote of the Ministry of Agriculture will be increased from K£18.1 million to K£21.7 million while that for the Ministry of Lands and Settlement will rise from K£4.8 million to K£6.8 million. The expenditure of these two Ministries, taken together, will increase by 24 per cent.

Expenditure on new water schemes will rise by 57 per cent, due partly to higher expenditures on small rural water schemes but particularly also due to accelerating expenditure on the Sabaki Scheme at the Coast. Expenditure on co-operative development will rise by three times.

Education development expenditures will rise by over two times, while health development expenditures will rise by 39 per cent.

Clearly, in order to accommodate these increases in development spending on agriculture, settlement, water, co-operatives, education and health, we have had to hold back expenditures in other areas. In accordance with Sessional Paper No. 4, we have held expenditures on roads and buildings steady in current price terms—which in real terms mean they are reduced. In addition, road expenditures will give greater emphasis to the gravelling and rural access road programmes.

We have this year cut expenditures on airports and I am looking for further reductions in this sector next year. By reductions in the provision for loans to other corporations and for purchases of equity, the development expenditures of my own Ministry and the Ministry of Commerce and Industry have been reduced.

Thus, Mr. Speaker, although the development expenditure estimates at first sight may seem to provide for no expansion, a closer study shows that this is not so and that we have, as promised, swung the emphasis of the development programme further towards rural development in general and productive rural development in particular.

At this point of my speech, I would like to remind Hon. Members what I said at the beginning. The reduction in real incomes suffered by most people in this country in the last two years has been in the forefront of my mind as I have formulated my proposals. Although our economy would benefit from the additional stimulus of higher Government spending, I am reluctant to add any significant amount to the burden of taxation of the average family at this time. Yet the need to control inflation and the deficit on the balance of payments means I must minimize the proportion of Government expenditure financed by printing money.

When the two factors are considered together, I have but little room to manoeuvre. My only course is to maintain the strictest control over the increase in total Government spending. This I have done. If the recurrent and development estimates for 1976/77 are added together, total expenditure can be seen to rise by only K£18 million or 5 per cent compared with that for the current year.

This is the smallest increase in Government spending that we have seen for many years. In a period of continuing inflation, it represents little or no real growth. But as I have tried to explain, our object will be to get a better return from the money we spend. There is still considerable scope for this and I believe that the economy can derive stimulus from the expenditures that I have proposed.

Development Revenue 1976/77

Mr. Speaker, I would like now to consider the revenue I can expect to receive to finance development.

I estimate aid revenues—external loans and grants—at K£54 million, a little more than this year. I know that Hon. Members are often concerned about the amount of aid we receive from overseas and it is right that they should be concerned. But the aid we have accepted from the multilateral financing agencies and friendly nations overseas has not mortgaged our future to any dangerous extent. An increasing amount of aid—over K£20 million in the coming year— is now provided by way of grants that do not have to be repaid, and the terms of much bilateral lending has also softened. It is now the rates of interest charged by the multilateral institutions, such as the World Bank, that is of greatest concern to us.

Hon. Members may have noticed from Chapter 6 of the Economic Survey that external debt servicing charges of the Government in 1975 were equivalent to only 2.8 per cent of our export income. Even if our share of East African Community debts and non-Government debts guaranteed by Government are considered as well, the ratio is less than 5 per cent. Few developing countries can claim a debt service ratio as low as this and we have no cause for concern regarding our ability to repay the loans we have incurred up to now.

Domestic long-term borrowing achieved a new peak this year. I am, however, concerned that, in recent years, the only significant subscriber to Government stocks has been the National Social Security Fund and that other financial institutions, such as the insurance companies, have invested their surplus funds in property or left them on deposit with the banks. A greater part of those surplus funds must be drawn into the development effort. In the past year, interest paid on Government stocks has been increased significantly and it is now closely in line with interest paid by other financial institutions.

But in order to increase the attractiveness of Government stocks, we must first create a more active market for them. At the present time, institutions such as insurance companies—and even the general public—

are reluctant to purchase and hold Government securities in case they have unexpected calls for cash they cannot meet. I have therefore asked the Governor of the Central Bank to use the resources of the Central Bank to operate a system which will make Government stocks more attractive to such institutions and members of the public. Details of these new arrangements will be announced shortly.

In addition to this, I am firmly of the view that we must encourage the general public to invest in Government stocks to a greater extent than they do. My Ministry is now actively examining a proposal to sell Government stocks in small units—say Sh. 100 or Sh. 200—across the counter of the Post Office and commercial banks, so that a greater part of the people's savings can be diverted into the national development effort than is the case at the present time. I hope that it will be possible for me to make a statement on this matter in the near future.

In the meantime, I have to take a fairly cautious view of the amount of Government stock that can be issued. For the purposes of the Budget, I have assumed new issues totalling K£25 million, all of which, I hope, will be taken up by the general public and non-bank institutions. I hope also that the Central Bank will be able to reduce its holdings of Government stock by additional sales to the general public.

Finally, on development revenue, I have set up a special revenue vote to receive the proceeds of the sale of fertilizer of which I spoke a few minutes ago. The proceeds of these sales—estimated at K£10 million—must be brought into the Exchequer in the coming year and I am making the Accounting Officer in the Ministry of Agriculture personally responsible for seeing that this is done.

Taking external loans and grants, domestic borrowing and the proceeds of the sale of fertilizer together, I can expect a total development revenue, excluding any recurrent surplus, of K£85 million.

THE BUDGET GAP 1976/77

Mr. Speaker, Hon. Members should soon be able to see how much of the Budget will have to be financed from recurrent revenue—taxes, licences and fees.

I have to finance total expenditure in respect of 1967/77 of K£398 million. In addition though, I have to anticipate that the House will approve appropriations totalling K£17 million relating to excess expenditures incurred in previous years—mainly 1974/75. In total, therefore, I have to seek finance for the Exchequer to cover K£415 million.

I have just explained where K£85 million of development revenue will be found, so I am left to find K£330 million.

As I advised Hon. Members earlier, I regard the present level of borrowing by Government from the banking system as too high. It must come down. I propose to aim to limit this type of borrowing to about K£10-12 million in respect of 1976/77 expenditure but the K£17 million relating to earlier years will be financed in the same way. Total short-term borrowing will therefore be about K£27 million, net of changes in the Exchequer cash balance. If Hon. Members have been able to follow this, they will see that I am now looking for approximately K£303 million of recurrent revenue.

Fortunately, the outlook for the economy in 1976/77 is, as I have indicated, rather better than a year ago. Accordingly, the outlook for revenue is also a little better. I have estimated that ordinary recurrent revenue will increase by 8 per cent and provide me with K£268 million of the sum I am seeking. Appropriations-in-aid on recurrent account should provide me with another K£23 million. Total gross recurrent revenue should, therefore, rise by 10 per cent to K£291 million overall and leave me with a residual gap to close of K£12 million.

GPK 808—350—6/76

NEW TAXATION PROPOSALS

Mr. Speaker, this is the problem we have to face for the rest of this afternoon, and as usual, I ask that the remainder of my speech should be regarded as being notice of a motion to be moved before the Committee of Ways and Means.

THE CUSTOMS TARIFF

For the last three or four years, I have discussed the reform of the external tariff. This is regarded as an essential component of our programme to restructure the economy, so as to reduce dependence on imports on the longer term. But also to increase the competitiveness of Kenya industry, so that it looks outward to the markets of the world and not simply inwards at a highly protected domestic market.

Important parts of this tariff reform programme have been put in place over the last three years but I wish to press further ahead today.

There are, in the Finance Bill, several hundred changes in rates of import duty. Almost all of these are of no great significance. Many changes are included simply to achieve consistency and conformity in the tariff. I do not propose to read out each of these changes now, since it is easier for Hon. Members to read them for themselves in the Bill. I shall, however, refer to some of the highlights.

Firstly, import duty on a wide range of imported raw material items will be raised from 10 or 15 per cent to 20 per cent. At the same time, import duty on a further range of raw materials will be reduced from 40 per cent to 30 per cent, or from 30 per cent to 20 per cent.

I am aware that there is a body of opinion, particularly amongst our manufacturers, who feel that all raw materials should be free of import duty. But if we are to build up a manufacturing sector based on domestic resources - processing our own agricultural and mineral products - and reduce the proportion of manufacturing production based on raw materials imported from overseas, it is important that raw materials should be dutiable as other imported goods.

The process of readjustment in the manufacturing sector to reflect the new emphasis of our industrial policy may, in a few cases, be painful. But on this occasion, although the number of raw materials affected may be large, the impact on industrial costs has been minimised by leaving out many of the more important items.

Secondly, there is a further range of motor spares that were not affected by the reduction in duty to 25 per cent last year. These will now be reduced to 25 per cent, so that all motor spares and motor kits will be dutiable at this rate.

On the other hand, four wheel drive vehicles will now be taxed at the rate of two wheel drive vehicles of the same capacity. There seems no good reason, why four wheel drive vehicles -- often these days luxury vehicles - should now be taxed at a preferential rate. However, I should emphasize that where four wheel drive vehicles are now assembled in Kenya, as is the case for a number of vehicle types, this represents no change in duty. Where the vehicle is imported fully made up, there will, however, be an increase in duty.

The import duty on maize, rice and millets will be raised to 20 per cent. Since we are now broadly self-sufficient in these products, this will not hit the average man in the street. But where a consumer insists on purchasing imported rice in preference to the local Mwea-Tebere and Kano rice, he may have to pay a little more.

There will be a number of increases in duty to provide greater protection to infant industries. The duty on hand tools will rise from 10 per cent to 20 per cent. On locks, from 15 per cent to 40 per cent; on dumpers, from 15 per cent to 40 per cent and on wheelbarrows, from 10 per cent to 30 per cent.

In this category of protective duties, comes textiles. We have had a textile industry in this country for some time but it has recently expanded very considerably. We are now largely self-sufficient in textiles and garments. But it seems that some people still insist on buying from overseas. This is now unnecessary. And I feel it is fair that, at least as a temporary measure, duties on textiles and garments should be increased. The duty on woven fabrics will be increased from 45 to 60 per cent; on knitted fabrics from 45 to 55 per cent; and the duty on imported clothing from 50 to 70 per cent. In addition, specific rates of duty will be introduced to prevent the dumping of these products at uneconomic prices.

There has been a rather dubious business in secondhand clothing for some time. The objects of the business seem more concerned with circumventing the foreign exchange regulations than providing cheap clothing to the man in the street. In future, imported secondhand clothing will be charged duty at 100 per cent of the c.i.f. value or the specific rate of the goods when new, whichever is the greater.

An even more dubious business is carried on importing secondhand newspapers and magazines. These too will be dutiable at 100 per cent.

Finally, for purposes of the revenue, I propose to increase the rate of duty on imported spirits and tobacco. The duty on spirits will rise by Sh.10/- per proof litre which will add about Sh.10/- to the price of a bottle of whisky or brandy. The duty on imported cigarettes and manufactured tobacco will rise by Sh.20/- per kg., which will add Sh.1/50 to the price of a packet of imported Benson & Hedges.

On the other hand, since Tanzania now refuses to sell its raw tobacco to Kenya manufacturers, and we have to import from overseas, I have thought it necessary to reduce the duty on unmanufactured tobacco to the raw material rate of 20 per cent.

Finally, on import duty, I have decided to impose a duty of 20 per cent on aircraft and marine engines. In this country, these must be considered as luxury items and it is only reasonable that they should bear tax.

Considered together, the proposals relating to import duties will, I hope, provide an additional K£5 million for the revenue. All these changes in import duty will come into effect at midnight tonight.

AIRPORT PASSENGER TAX

Mr. Speaker, we have now almost completed the construction of the new airport terminals at Nairobi and Mombasa. These contracts have been very expensive but should improve considerably the facilities for our tourists. I feel it only reasonable therefore that the people who use the airports should pay a little bit more than they do now. Accordingly, I propose to raise the Airport Passenger Tax from Sh.20/- to Sh.40/-. This change will affect passengers passing through the airports after midnight tonight.

I hope to earn for the revenue an additional K£500,000 from this.

SALES TAX

I now turn to the Sales Tax. There has been some avoidance of tax - though not all of it deliberate - through the system of manufacturers' refunds. The law will, therefore, be changed, so that where licensed manufacturers sell taxable raw materials direct, rather than use them in their own production, they will be required to charge tax on these sales.

The Act will also be changed to make it completely clear - although it always should have been - that sales tax becomes payable by a manufacturer immediately he commences production.

Last year, I exempted from sales tax a range of raw materials to reduce the administrative cost of issuing refunds. That move has, I think, been helpful to our manufacturers. This year, the Second Schedule of the Finance Bill includes a further range of raw materials which will be added to the list of exempt raw materials. This will, I hope, further reduce the problem of delays in manufacturers' refunds generally.

Mr. Speaker, although the price of crude oil has continued to rise there has been no increase in petroleum taxes for a couple of years. But if I am to maintain the buoyancy of the revenue, I must adjust specific rates of tax regularly in line with price changes, so that the proportion of the price taken in tax remains constant at least.

I must, I am afraid, therefore, increase the tax on petrol by 20 cents per litre. In addition, a sales tax will be introduced for the same reason on light diesel fuel at a rate of 10 cents per litre and there will be a small increase in the rate of sales tax on lubricants and greases.

Finally, but with regret, I have to increase the sales tax on beer yet again. The price of a half litre bottle will rise by 30 cents as a result of an increase in the sales tax by this amount.

The increases in the rates of sales tax on petrol, diesel fuel and beer, which will come into effect at midnight, will, taken together, provide an additional K£10.25 million per year. The exemptions for raw materials will not involve a cost to the revenue, since tax on these would have been refunded anyway.

EXCISE

I have already announced an increase in import duty on imported spirits. I am at the same time increasing tonight the excise on local spirits - gin and vodka - by Sh.6/34 per proof litre. This will lead to an increase in the price of local spirits of approximately Sh.6/- to Sh.7/- per bottle.

Two years ago, I abolished the excise on matches, biscuits and mineral waters and said that I would tax these local products under the sales tax. Today, I propose to continue with this process and abolish the excise on textiles, soap and paints. There will be no increase in the sales tax on these products.

Textile manufacturers should thus save 30 cents per metre and although import duties on textiles have been raised, it should be possible for local manufacturers to reduce prices, as a result of the cut in excise, rather than increase them as a result of higher duty on imports.

Similarly, I look for reductions in the prices of soaps and paints.

Taken together, the changes in the excise will cost the Exchequer K£1.6 million.

EXPORT DUTIES

I have spoken at some length today about the impact on our economy of the recent high prices ruling in world markets for coffee and tea. As I explained, there are substantial dangers for us in the present high level of income. If inflation were to take off in this country, the present level of incomes being enjoyed by coffee and tea farmers would become meaningless in real terms, and once world prices fall back - as they must do - the farmers would be caught in a very difficult position - together with most other people in this country.

Coffee prices have risen about five times in the last two years and tea prices have more than doubled. Most producers of these crops should now be paying income tax but, as I have pointed out, it is apparent from the revenue that only a proportion are doing so.

I feel it only right on grounds of equity that coffee and tea farmers enjoying this sudden windfall income should make some contribution to the rest of the country - so long as these high prices last.

I, therefore, propose that there should be an export tax on coffee and tea. No tax will be charged if the price drops below K£1,000 per tonne - a price some twice as high as that ruling two years ago in the case of coffee, or last year in the case of tea. But so long as the price in Kenya remains above K£1,000 per tonne, there will be an export tax of 15 per cent of the excess of K£1,000.

Thus, in the case of coffee - where tax will be collected in the Nairobi Coffee Auction - when the auction price is K£2,400 per tonne, the tax will be £210 per tonne, or less than 10 per cent. In the case of tea, tax will be charged on export declarations at the port of shipment and if the f.o.b. price is K£1,200, the tax will be no more than K£30 or 2½ per cent. At the moment, most teas are selling below this level and little or no tax will be charged unless the price of tea rises again. I do not regard these rates of taxes as particularly onerous in present circumstances, when prices are moving in the markets, in one day, by more than the rates of tax proposed. I regard this tax as only fair to the members of the community who are not coffee or tea producers.

Income Tax will not, of course, be chargeable on the value of the crop deducted as export tax, so to the extent that coffee and tea farmers are paying income tax, the new tax burden will be less than the amount of export duty chargeable.

Considered on its own, I think I may look for K£15 million from the export tax, depending on the trend of world prices. If the price of both coffee and tea falls below K£1,000, the revenue will gain nothing. The proposals will be effective immediately.

INCOME TAX

I turn now to the income tax. As money incomes have risen in Kenya over the last few years, many more people have become eligible to pay income tax. This was what we intended when the Kenya Income Tax Act became effective in 1974, for it was our objective to broaden the base of the tax to make it responsive to the rise in personal incomes, even though many people would only be paying a few shillings a year.

The in-roads of inflation have, however, perhaps pushed this process too far. The real value of personal reliefs has been significantly eroded in the last few years and the value of the small tax contribution from the lowest income earners may now be less than the cost of collecting it.

I am, therefore, persuaded that the time has come to raise the level of personal reliefs. However, I also feel that the opportunity should be taken to simplify the whole system of reliefs. At the present time, the Income Tax Department spends too much of its time validating claims for additional child relief which in the end makes little difference to the amount of tax collected or the amount of tax relief claimed by the individual.

I, therefore, propose that the system of reliefs should assume - what is very broadly true - that all families have children. Rather than have married relief of K£36 per year and various amounts of child relief of up to K£36 per year for four children, I propose that there will be one rate of relief of K£84 per year for all families. This will be known as the "family relief" and can be claimed by every married couple required to pay tax.

At the same time, the relief for single persons will be raised from K£18 per year to K£30 per year and a "special single relief" of K£36 per year can be claimed by single persons with children.

As part of our policy to encourage long-term saving, I also propose that the maximum amount that can be claimed as "insurance relief" will be raised from K£18 to K£24 per year. This will allow the tax payer to claim against insurance premiums of up to K£240 per year.

Hon. Members will, no doubt, recall that the present rates of income tax, after the first K£1,200 of income, rise regularly by Sh. 1/- for every additional K£600 of income. This scale of tax was reasonably progressive when first introduced but now, after the real value of K£600 has been eroded by four years of inflation, the tax curve in practice becomes significantly steeper in real terms.

As a result, persons in only middle level positions are having to pay rates of tax that they would not have had to pay a few years ago when doing the same job with the same real pay. The standard of living of such tax payers - and I would emphasize that I am talking about the people who obey the law and pay their taxes - has dropped simply because of steepness of the tax curve and the impact of inflation on their money incomes.

I am, therefore, persuaded that I must give some relief to middle income tax payers as well as those at the bottom of the scale. Accordingly, I propose to stretch out the tax bands from K£600 of income to K£1,200 of income. But in order that higher incomes will not obtain a disproportionate benefit, the rates of tax for each band of K£1,200 of income will rise from Sh.2/- to Sh.3/- in the pound but then to Sh.5/-, Sh.7/-, Sh.9/- and Sh.10/- in the pound. Between income of K£7,200 and K£9,600 tax will be Sh.12/- in the pound and all incomes over K£9,600 will pay tax at Sh.13/- in the pound.

Mr. Speaker, the effect of increasing the personal reliefs and stretching out the tax bands will be to give some relief to every income tax payer. An estimated 50,000 low income earners will cease to pay income tax altogether and overall I estimate the proposals will cost the revenue K£4½ million per year at present levels of money incomes. These changes will come into effect on 1st January, 1978.

Real incomes, eroded by the steepness of the tax curve in a period of inflation, will not be restored. But I believe it to be fair to give some relief to those that are paying tax as required by law in the lower and middle income groups.

There is one other income tax problem I would like to mention and that relates to the tax payable on the wives' income.

Under the provisions of the Income Tax Act, the income of a married woman, who is living with her husband, is deemed to be the income of the husband for the purpose of determining his total annual income which is chargeable to tax.

When a wife is gainfully employed her employer deducts monthly tax from her wages under the P.A.Y.E. scheme.

Following the end of the year, when the wife's salary is added to the husband's income, there is normally an underpayment of tax which the husband is required to pay in two equal instalments. Many tax payers have complained that this procedure creates considerable hardship.

In order to ease the burden, I have instructed the Commissioner of Income Tax to devise a system, whereby, on the written authority of the wife, tax can be deducted from her salary by her employer at a higher rate fixed by the Income Tax Department. This scheme will be introduced with effect from 1st January, 1978, and the necessary forms will be issued to all employers for distribution to married women employees in October or November of this year. It will be entirely up to the wife whether she wishes P.A.Y.E. tax to be deducted from her salary at a higher than normal monthly rate or not. But if families take advantage of this new procedure they can discharge the whole of their tax liability for employment by way of P.A.Y.E. and so avoid the problem of a tax demand at the end of the year.

This package of tax changes represents my proposals for 1977/78. If we consider the increases in tax and the reductions in tax together, I aim to obtain an additional K£24½ million for the revenue. This is a fairly steep increase in total taxation but will leave me short of the budget needs.

The most important measure is clearly the new export tax on coffee and tea but I repeat my earlier remark that the amount of the tax will be less than some of the weekly fluctuations in the markets. It will not, therefore, be particularly onerous.

Otherwise, I have increased the tax on petrol, beer and spirits but reduced the tax on textiles, soap and paints.

There are numerous changes in import duties, but none of these should affect the average man in the street at all significantly. There is no need for anyone to buy imported textiles and clothing now, or imported cigarettes. The Airport Passenger tax will be largely paid by our tourists and if any residents can afford to fly overseas they can afford to pay Sh.40/- airport tax. Similarly, if people can afford to buy and use small motor boats and aeroplanes, they can afford to pay tax on the spare parts.

The total direct effect of my proposals on the cost of living of the wage earner will be small.

Some 50,000 low income tax payers will be taken out of the income tax altogether and every income tax payer will pay a little less in 1978.

Looking at the Budget as a whole, the additional K£24 million I hope to obtain from tax increases will only reduce my K£58 million gap to K£34 million. The remaining part, I propose to finance by way of Treasury Bills and a decrease in Government cash balances.

There can be little doubt, Mr. Speaker, that my Budget this year is a budget for expansion. Expenditure will increase by 25 per cent but current revenue by only 20 per cent. The residual budget deficit will widen.

I am, therefore, as I have freely admitted, taking fairly big risks in this year's Budget. I am taking a risk that ministries will contain their expenditure within the increased provision made for them in the Estimates without asking for more.

I am taking a risk that there are sufficient unemployed resources in the country that can be put to work by this higher Government spending without causing serious inflation.

Mr. Speaker, in this expansionary budget, I am taking the risk that the unemployed resources in the country shall be put to work by higher Government and private spending without causing serious inflation. In this way we shall, as we must, recapture the development impetus which we had enjoyed from the year of independence up to 1973 but which we had unfortunately lost over the last three years. We must sustain a higher rate of economic growth because it is only by so doing that we can translate the KANU Manifesto into reality and thus build the Kenya we want.

And the Kenya we want is one in which every citizen shall be free to pursue his or her legitimate ambition and be able to attain it regardless of his race, tribe or religion. The Kenya we want is one in which it is enough to be a loyal Kenyan citizen in order to enjoy fully all the freedoms that our Constitution, which we are all sworn to defend, guarantees. The Kenya we want is one in which under the leadership and the inspiration of our beloved President Mzee Jomo Kenyatta, we shall continue to march forward to ever greater prosperity.

Mr. Speaker, I beg to move.