REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1978/79
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 15th June, 1978, by the Hon. Mwai Kibaki, Minister for Finance and Planning, Republic of Kenya, presenting the Budget for the Fiscal Year 1978/79 (1st July to 30th June).

Mr. Speaker, Sir,

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

The Economy

In my Budget Speech last year I was able to report to the House that our economy had recovered well from the setbacks of 1974-76. As it turned out, the recovery was even more significant than I then forecast. The provisional figures of gross domestic product for 1977—as Hon. Members will already have seen from the *Economic Survey*—indicate that our rate of growth, 7.3 per cent, was the highest we have achieved for nine years.

In addition, the terms under which we trade with other countries moved in our favour for the second year running. Our export prices increased by 42 per cent, while import prices increased by merely 8 per cent. Real incomes in Kenya increased by more than the increase in real production.

The Kenya economy has as a result been booming and in spite of the fall of coffee and tea prices, is still booming. The benefits of this boom have also been widely spread. Let there be no misunderstanding or misrepresentation about this.

Agricultural incomes increased by K£160 million. Much of that increase, of course, was received by the coffee and tea farmers. But there are 275,000 farmers growing coffee and 120,000 farmers growing tea in this country. Other crops—such as sugar, pyrethrum, maize, milk and horticulture—also did well, while the spin-off economic benefit from the high agricultural incomes has been widespread in the rural areas. The recent prosperity of the farms and villages is something that must hearten us all.

It is estimated that the terms on which the rural sector trades with the urban sector moved by over 50 per cent in favour of the rural sector during 1976 and 1977.

Agricultural production rose in volume by 12 per cent in 1977. But manufacturing production rose by 15 per cent, in spite of the loss of the Tanzanian market. The service sectors of the economy also did well even though the numbers of tourists coming to Kenya did not increase as much as we had hoped and the building industry is only now starting to pick up.

Employment increased in 1977. Indeed, the official figures mask what is becoming an increasing problem—a very real shortage of labour on the farms. The tea industry has regularly failed to produce the volume of tea it should produce because of a shortage of pickers. This has been the case on the large estates for some time and is now the case with small scale farms.

Coffee also is not always picked at the optimum time because of labour shortages and the sugar and sisal industries are unable to recruit the labour they require when they require it. We must, therefore, rethink the precise nature of our unemployment problem and the policies we need to adopt to provide jobs to those without, when the country is under-producing and under-exporting because of labour shortages.

1977 was a good year for the Kenya economy. But as I warned in my Budget Speech last year, the boom has brought its own problems. I spoke then of too much money chasing too few goods and that is what we have experienced. There have been shortages of essential goods and prices have risen faster than ever before. This time, we cannot blame rising import prices, for inflation abroad has slackened. The rise in the cost of living in Kenya has been generated in Kenya.

Inflation and Monetary Control

Inflation is now perhaps our most difficult economic problem. We cannot, however, control it by wider price controls as I have explained to Hon. Members on numerous occasions in the past. We must increase the production of goods in Kenya at competitive prices to meet the market demand and remove the present shortages. And we must retain a tight grip over the supply of money, so that it expands to facilitate the growth of the economy but does not fuel an expansion of prices as well. This is a difficult balance to maintain.

The money supply—cash in circulation and bank deposits—increased much more rapidly than was desirable in 1977—by 47 per cent. This was a direct consequence of a substantial balance of payments surplus arising from the record coffee and tea incomes flowing directly into the domestic banking system. Also, in the latter part of the year particularly, domestic private credit rose strongly to compound this trend. Fortunately, the Government Budget this year has not added to those inflationary forces to the extent I had expected in the Budget last year.

After consultation with me, the Governor of the Central Bank has acted to restrain this excessive growth of the money supply. Firstly, by increasing the liquidity ratio of the commercial banks to 20 per cent and, more recently, by imposing a 4 per cent cash ratio and a limit to the rate of growth of bank advances of 1½ per cent per month. We aim to restrict the growth of bank money to around 18-20 per cent in the coming financial year.

There is still money available in the banks for lending but increases in the total volume of lending will be restricted. Bank customers may have to shop around a little more but they should learn to do this anyway in order to ensure that they get the best service and lowest loan rates in the market.

Prices and Wages

The need for this restraint is underlined by a look at the cost of living index which rose by an average of 16 per cent last year. This rate of inflation is too high and we must aim to bring it down.

Wages on average rose by 12 per cent last year very much in line with the wage guidelines then operating. The wage guidelines have, however, been amended with effect from 1st January, 1978, to allow an additional element for productivity increases. Since wage awards this year will be related to the cost of living and productivity increases last year, provided we can restrict inflation this year to a lower rate, wage earners will be able to make up some of the loss of real income they have suffered in the last few years.

It will, however, be even more necessary to maintain the wage guidelines in the coming year and any suggestion of their being discarded cannot be supported, for we now face, once again, a difficult period for our economy.

The Balance of Payments

As I warned last year, coffee and tea prices fell back sharply from the peak levels of the second quarter 1977. Imports have also risen sharply and our balance of payments, although achieving a record surplus in the calendar year 1977, has been in deficit since last September. Our foreign reserves are now lower than they were at this time last year.

We cannot afford to allow a balance of payments deficit of any size to build up. This year, calendar 1978, I expect a deficit but within limits that will not seriously reduce our foreign reserves. Next year, 1979, the outlook is rather more serious.

The Kenya economy in 1978 is expected to maintain a fairly strong momentum in spite of the fall in coffee and tea prices. Good rains were experienced in 1977 and good harvests were gathered in at the end of the year and in the early part of 1978. Coffee and tea prices have fallen but they are still about twice as high as they were in 1975. Shortages of industrial commodities provide opportunities for manufacturers to raise production and the building industry is picking up again. The high incomes of 1977 are still working their way through the economy.

1979 should also be a good year generally. But the abundant rains we have enjoyed have brought problems. The coffee crop in 1978/79 will be seriously reduced perhaps by 40-50 per cent. And the lower volume of coffee available for export in 1979 will have a serious impact on our export receipts in that year, particularly if, world coffee prices were to continue to decline.

Imports have recently moved up sharply. But if Hon. Members study the composition of imports set out in the *Economic Survey*, they will observe that imports of food, consumer goods and passenger vehicles comprised only 16 per cent of the total in 1977. The rest is made up of industrial supplies, fuels, machinery and other transport equipment, all essential to the running of our economy. There is very little room within which to effect import savings—and the recent rain is likely to mean that, in some areas, we shall have to import additional foodstuffs—barley and wheat for instance.

Our policy of reducing Kenya's import dependence is still a vital part of development strategy. Our recent success can be gauged by noting that, whereas our economy expanded by over 30 per cent over the last five years, we were still, even in the import boom of 1977, importing a lower volume of goods than we were in 1972. There is, however, now very little room for further reduction and our emphasis must be to restrain the growth of imports to a lower rate than the growth of the economy.

With lower exports and little room to squeeze imports, we are therefore facing a serious balance of payments outlook for 1979. In order to overcome this, without causing a sharp setback to our recent economic recovery, we must increase exports in those areas where production capacity is available. Certainly, we must produce the full potential of our tea plantations this year and sell as much as possible of what should be a new record level of tea production overseas. We must also stop importing goods we can produce efficiently at home.

Because of the boom conditions within Kenya last year, manufacturing exports did not do well. In the changing conditions we expect in the coming year, I look for an improvement in the export performance of the manufacturing sector. In order to give our manufacturers additional encouragement, the Finance Bill contains a proposal to extend the export compensation scheme to eligible goods exported to Tanzania and Uganda.

However, even if we achieve some success in increasing other exports, we must still anticipate a sizeable balance of payments deficit in 1979. And this is the economic background within which I have had to plan my Budget for 1978/79—a fairly buoyant economy in 1978 but the prospect of a balance of payments deficit in 1979.

NEW FINANCIAL BURDENS

In these circumstances, it is necessary not only that the private sector should exercise restraint in the coming year—restraint signalled by the recent credit restrictions—but also that the Government sector should exercise restraint as well.

This restraint has been imposed in formulating the Budget for the coming year. But it has not been easy. The Government earlier incurred very substantial commitments towards large development projects and when impetus on such projects has been built up, it can be positively harmful to try to cut it back. For this reason, budgeted development spending will show a sharp increase in the coming year, as Hon. Members will have seen already from their copies of the Estimates.

It has also been necessary to accept new financial burdens—not least as Hon. Members are aware—burdens in the form of non-productive defence expenditure.

I do not suppose there are any Hon. Members of this House who do not recognize that the basic territorial integrity of this country must be protected and that external threats have necessitated a higher level of defence spending. I beg leave to doubt however, whether there are an equal number of Members who will accept that additional defence spending inevitably means a postponement of the realization of our development goals.

At the moment, I do not know when it will be possible for us to afford to implement the recommendations of the recent Education Commission. All I can say is that it will be essential now to restrain education spending within tighter financial guidelines than laid down in Sessional Paper No. 4 of 1975—indeed it is necessary to redefine those guidelines.

Education spending will in future be defined as a proportion of recurrent civil expenditure (excluding the Consolidated Fund Services). That proportion calculated on the 1978/79 Estimates is 32 per cent. It will not be possible to increase that percentage of spending on education in future years—indeed it may have to come down to 30 per cent.

The point I am trying to emphasize is that we can not expand defence and education spending at the same time. We are faced with a difficult problem of choice. If the present level of defence spending is inescapable, we have no option but to delay the improvement in education we all want. The police must also manage with less money and the administration of development must be restrained. Health services must be restricted. But with education and defence both now pre-empting such a large proportion of the total budget, the choice will largely be between these two services if others are not to be cut back absolutely.

STATUTORY BOARDS AND GOVERNMENT COMPANIES

There are other new financial burdens the Government has had to accept—particularly those resulting from the collapse of the East African Community. New corporations for Railways, Harbours, Post and Telecommunications and Airways have been established. The House has been asked to vote substantial funds for these organizations taken as a group. Additional funds will have to be voted next year.

The new corporations have risen from the ashes of the old and already there are clear indications that they are facing up to their problems well. I am encouraged by this. There are, however, three points that I would like to make about them and to them.

Firstly, these corporations are independent commercial organizations set up by Parliament. They should therefore strive towards financial independence and not expect to finance their development programmes from grants through the Government budget. We shall help where this is absolutely necessary but they should not look to us for money except in the most exceptional circumstances.

Secondly, they must aim to make a profit and their performance will be judged on the rate of return they achieve on the value of assets they control.

Thirdly, they must be prepared to pay profits back into the Exchequer as revenue to the Government, so that they contribute, and can be seen to be contributing, to the financial needs of this country. If some corporations require subsidies while others hang on to their profits as something belonging to them and not to the people of Kenya, there will be yet another turn of the screw on the financial resources available to finance education and other social services.

My last point regarding the payment of profits to Government applies equally to all the statutory corporations and Government companies. The rate of return received by the Exchequer on investments financed since independence is far too low. New instructions have already been issued by the Treasury to these bodies requiring that dividends shall be payable to Government as revenue and that profits shall only be retained with Treasury permission.

Subsidiary and associate companies of the development corporations will be expected to define profit objectives and to pay dividends to their parents to increase the flow of cash from the parent corporations to the Exchequer. Financial control is not something that applies only to Government. Some of the worst financial abuses now occur in public sector corporations and companies. We are determined to bring those abuses to a halt.

All our boards and companies must be brought to realize that they have been established in trust for the *wananchi* and the *wananchi* are entitled to a financial return on their investment. It is the responsibility of Parliament to determine how those funds are to be used—whether to finance new projects or to reduce taxation—and in order to enable Parliament to exercise that function, profits of statutory boards and Government companies must be paid into revenue.

POST OFFICE SAVINGS BANK

These profits represent public sector savings. We have also been giving a great deal of thought in the last year about how we can organize more efficiently the savings of the general public for development purposes. We have sought the advice of the World Bank and the I.M.F. and their advice is being studied.

The Post Office Savings Bank, recently reorganized, has finalized plans for four new saving schemes. One scheme they propose to implement is the sale of premium bonds. Premium bonds will be on sale at all branches of the bank from 1st September and if they are held for three months will qualify for cash prizes drawn by lottery. Unlike the normal sweepstake, however, the holder of a premium bond will not lose his stake and will be able to cash it at par.

Hon. Members will observe that the Finance Bill contains a small amendment to the Post Office Savings Bank Act to enable the premium bond scheme to be set up without contravening the Betting and Lottery Act.

GOVERNMENT CONTRACTS

The Finance Bill, this year also contains a number of other administrative amendments to financial legislation, not directly related to taxation. They are all concerned with improving the efficiency of financial administration and also, incidentally, the control of Parliament over financial administration.

Firstly, it has been the rule for some time that Ministries should not sign contracts with outside suppliers and contractors without first clearing with the Treasury that money was provided and available for the expenditure. That rule has not, however, always been observed and this is one reason why Ministries have from time to time overspent the sums voted by Parliament. I propose therefore to amend the Government Contracts Act so that Government contracts of more than Sh. 250,000 will not be binding unless they are countersigned by the Treasury.

It will also not be possible to grant tax exemptions within Government contracts without Treasury consent.

The Exchange Control Act will also be amended, so that Exchange Control will not be bound by Government contracts unless they comply fully with these conditions.

GOVERNMENT BORROWING

Secondly, Government borrowing. There has in the past been a great deal of confusion amongst lenders to Government, and indeed amongst Hon. Members of the House, about which Acts of Parliament apply to different types of borrowing. This is not surprising, as there is a whole host of legislation on the Statute Book applicable to Government borrowing and it is not always clear, even to experts, which Act is applicable in any particular case.

In order to clear up this confusion, I propose that all Government borrowing will eventually come within either one of two Acts. Firstly, there will be, what will be known as the External Loans and Credits Act which will cover all borrowing in foreign currency. And secondly, there will be, what will be known as the Internal Loans Act which will cover all borrowing, both long term or short term, in Kenya currency. There is also a small consequential amendment to the Exchequer and Audit Act to bring it into line with these amendments.

A consequence of the proposed amendments is that we shall also repeal and remove from the Laws of Kenya some twenty-seven redundant borrowing Acts. I hope that then both the House and our lenders will understand the borrowing legislation rather better. It will be observed that specific procedures for reporting to Parliament the amounts of borrowings drawn and outstanding each year have been provided in the two remaining borrowing Acts.

I know that Hon. Members of this House have expressed concern from time to time at the extent of the borrowing by Government. I am concerned that the House should understand more clearly how much we have borrowed at home and abroad and the amendments are designed to assist the House in this.

As a result of substantial short term foreign borrowings that have been made in the last two years, it is necessary that we monitor our borrowings carefully without any confusion in this. At the moment our external debt ratio—the ratio of debt service costs to receipts of foreign exchange—is not a problem. The Economic Survey calculates that in 1977 it was little more than 3 per cent. But as a result of recent short term borrowing, it is likely to rise over the next few years. Indeed in the current year, we project the ratio to rise to 7 per cent.

Even 7 per cent is not particularly high but the time has come to exercise greater care in borrowing short term overseas and I have decided that, for the time being, no new commitments for borrowing short term will be entered into by Government Departments or statutory corporations.

GOVERNMENT GUARANTEES

An important part of our external debt position is represented by guarantees for loan covenants granted by Parliament from time to time. As with direct borrowing, it is not always clear exactly how much has been guaranteed and is still outstanding. Accordingly, I propose to amend the Guarantee Act to make it clear exactly how much is outstanding, by way of guarantees, whether in Kenya currency or foreign exchange. Once again, provision is made for an annual report to Parliament.

INTERIM TAX LEGISLATION

Finally, on the subject of the amendments to legislation relating to financial administration. I would like to propose an amendment to the Provisional Collection of Tax Act.

At the moment, that Act allows me to impose taxes once a Bill has been published but does not allow me to set up the administrative machinery to collect the tax. Previously it was possible to use East African Community Legislation to implement changes in income

tax and customs procedures. Now we have taken over those departments this is no longer possible and I feel that our present law is an anomaly that should be corrected.

I should emphasize that none of these changes affects the constitutional right of Parliament to consider, amend, reject or approve tax legislation as is the case now.

INSURANCE

Although not included in the Budget Bills, I also propose to introduce additional legislation and directions relating to the insurance industry.

It is appropriate that branches of foreign insurance companies should now be incorporated locally. This is a simple matter and should not require legislation. I do propose, however, to introduce legislation for the stricter supervision and control of insurance business to protect local policy holders.

I am also concerned about the foreign exchange cost of insurance unnecessarily written overseas. Accordingly, I have directed that no foreign exchange will be made available for the insurance of imports from 1st July. All goods purchased by Kenya importers must be insured with companies licensed to transact insurance business in Kenya. I hope to save K£7½ million per annum of foreign exchange in this way.

Further, I am determined that a larger share of the reinsurance business shall be transacted in Kenya to conserve foreign exchange and all insurance companies will now be required to refer their external reinsurance treaties to the Kenya Reinsurance Corporation before remittances overseas for reinsurance will be permitted.

Finally, on insurance, it is important that surplus funds generated by insurance business should assist in financing economic development. Accordingly, I would like to see a greater proportion of insurance funds being invested in real property in Kenya, such as housing estates, office blocks, industry, etc.

FINANCIAL OUTTURN 1977/78

I would now like to turn to the financial outturn for the current year 1977/78. Recurrent expenditure of Ministries is estimated to reach K£373 million—K£100 million higher than the amount shown by the Estimates laid in the House this time last year.

Some K£72 million of that unbudgeted expenditure is represented by additional defence spending. K£12 million was caused by the take-over of the General Fund Services of the East African Community and K£16 million was represented by other supplementary expenditure, of which about half were necessitated by the security situation around our borders.

In a normal year, K£100 million of additional expenditure would have presented us with an impossible financing problem and it was, therefore, fortunate that it was a boom year for our economy. Revenue as a result was much more buoyant than forecast and since the General Fund Revenue came directly into the Exchequer, we have been able to finance this additional expenditure burden.

Overall, I now expect that the current account surplus will be higher than originally forecast, perhaps K£63 million. As usual, any surplus in the recurrent account on 30th June will be transferred to the Development Exchequer and I would ask the House to take this as notice of my intention to do so.

On development account, we originally budgeted for expenditures of K£197 million. Supplementary estimates raised that total to K£235 million. By the time we receive the final accounts for the year, I doubt, however, whether development spending will exceed K£185 million.

This underspending on development can be looked at in two ways. On the one hand, we have to regret that development projects approved by Parliament have not been implemented on time. But on the other hand, if all the development spending voted had been implemented, we would have been presented with a very difficult financing problem.

Once again aid receipts have been very much lower than originally estimated—K£48 million against K£69 million. To a large extent the lower aid receipts are due to the slower than expected implementation of projects as already mentioned.

Short term commercial loans have been used to finance purchases of railway locomotives and defence equipment to the extent, perhaps, of K£47 million. We have also been able to borrow a record amount through Government stocks in the buoyant monetary conditions of recent months.

When all these factors are considered together, I expect to end the financial year with a residual budget deficit of only about K£9 million. It is possible that we could by 30th June achieve an overall surplus.

The dependence of the Budget on the banking system this year has been very much lower than I originally forecast. In the monetary conditions prevailing, this has been a good thing and, overall, I think we can allow ourselves some mild congratulations that the Budget has worked out as well as it has. I have to admit, however, that this year, luck has been on our side.

EXPENDITURE 1978/79

And so we come to the new financial year 1978/79, when, as I have already indicated the wheel of fortune may turn against us, with lower commodity prices and a drastically reduced coffee crop.

The total expenditure of Ministries provided in the Recurrent Estimates is K£376 million, virtually no increase on the actual level of expenditure I expect this year. However, the Estimates provide for a reduction in defence spending; and civil expenditures—if I may introduce this term—will increase from K£272 million to K£298 million, a rise of about 10 per cent. Taking into account that no provision has been made for increased salaries this represents perhaps an increase in civil expenditure in real terms of 6 or 6½ per cent.

Consolidated Fund Expenditures will be much the same as this year, taking into account some underspending this year and lower debt repayments next year.

On development, as I indicated earlier, estimated expenditure is sharply up—from K£185 million to K£258 million, some 40 per cent. Much of this increase represents a revote of underspending this year, particularly underspending on the larger projects such as the Upper Tana Reservoir.

I do not propose to say more about the details of either recurrent or development spending at this stage. We shall debate the spending allocations in the Committee of Supply and I shall hold the matter over until then.

It is sufficient at this time merely to note that in this Budget I have to finance total expenditure of some K£712 million. The rest of my speech will be concerned with how I propose to do this.

EXTERNAL REVENUE 1978/79

Firstly, development revenue. The external revenue undrawn in the current year will be available for 1978/79 and I estimate that we should draw down K£69 million compared with K£48 million this year.

Of the total of K£69 million, some K£21 million is receivable as grant and the other K£48 million as loans on concessionary terms. In the past year, one more country, Sweden, has agreed to provide all its aid to Kenya on grant terms. Others have eased the terms on which they make loans to us. A further easing of aid terms overall is vital if we are to undertake the development of the marginal areas of Kenya.

In order to finance the purchase of railway and defence equipment, further drawings will be made against commercial loans negotiated in previous years. This will finance approximately K£33 million of the expenditure total.

Thus, of our aggregate gross expenditure of K£712 million, we expect to use external revenue totalling K£102 million, some 14 per cent of the total. I am thus left to find K£610 million from local sources.

INTERNAL REVENUE 1978/79

In spite of lower coffee and tea prices, I estimate that local revenue, including local appropriations in aid, should provide some K£516 million. Long term borrowing by way of stock issues from the non-bank sector should provide me with a further K£36 million making a total of K£552 million.

I have therefore, a gap of about K£58 million. Last year I said in my Budget Speech that I was prepared to take a risk and finance K£60 million through the banking system. But as I have explained earlier, it has in the event only been necessary to depend on the banks for only K£9 million.

Even so, as Members are already aware, the rate of inflation in Kenya is already high and it would be imprudent of me to pump in another K£58 million into the money supply and cover my budget gap simply by creating new money.

This has faced me with a difficult decision. With high inflation and the prospect of a sizeable balance of payments deficit, I cannot rely entirely on deficit financing. I have to take out of the monetary system a reasonable part of the budget gap.

Last year, I was able to reduce the liquidity in the banking system by asking the banks to subscribe to Government stock. Some K£19 million was raised in this way. I feel I cannot use this device to the same extent this year but even so, I am seeking approximately K£5 million more from the banks. I propose to do this by requiring that all banks maintain a fixed percentage of their deposit liabilities in Government stocks.

NEW TAXATION PROPOSALS

Mr. Speaker, I am still left with a budget gap of K£53 million. The remaining part of my speech will be concerned with how I propose to close that gap. As usual, I ask that this part shall be regarded as being notice of a motion to be moved before the Committee of Ways and Means.

CUSTOMS AND EXCISE

Last year, when I introduced the Customs and Excise Department Bill to provide a legal framework for the establishment of Kenya's own Customs and Excise Department, I advised the House that it was my intention to publish a Customs and Excise Bill to replace East African Customs legislation.

A new Customs and Excise Bill is published today. It has taken longer than I had envisaged to prepare but the new Bill goes much further than had been our original intention. The new Bill brings together and codifies all existing customs and excise legislation. It aims to replace ten separate Acts: six Acts within the Laws of Kenya and four Acts within the laws of the East African Community.

But the new Bill not only aims to codify all existing Customs and Excise laws, it also aims to up-date the law and introduce improvements where these are felt to be appropriate. In particular, it aims to tighten up customs procedures, so as to prevent the abuse that we know has crept into the system in the last few years.

The new Customs and Excise Bill will apply the customs tariff equally to all countries - including Tanzania and Uganda. The free trade area and customs union of the East African Community has broken down completely and we have to accept that reality.

The new Bill does, however, contain a section - 118 - which will allow Kenya to enter into agreements with any other country for the mutual relief of import duty. We are prepared to talk to other countries on a bilateral or multilateral basis, including Tanzania and Uganda, about such agreements.

In addition, the Bill introduces a new customs list designed to provide a much more detailed trade classification than has been available hitherto. Since trade statistics will in future be based on the new classification, investors, market developers, trade planners and the commercial world generally will be able to obtain much more detail on Kenya's external trade than has been possible up till now. The new tariff and statistical code numbers should be brought into use by importers and exporters immediately.

IMPORT DUTIES

Generally, the rates of import duty provided in the First Schedule of the new Customs and Excise Bill are the same as under existing legislation. I have, however, taken the opportunity to introduce a number of changes, so as to push ahead further with the programme of tariff reforms I have followed over the last few years.

Since it would be difficult for Hon. Members to identify the proposed changes in import duties within the mammoth new customs schedule, I have set them out separately in the Financial Statement and these will be available to Hon. Members at the end of my speech. I do not, therefore, intend to read out all the changes individually.

However, this year I have reduced the rates of duty on many more items than I have increased. Rates of duty on many food items are lowered from 50 per cent to 25 per cent. Amongst this list will be found vegetables, fruit and nuts, fruit juices, sauces, extracts and jellies.

Duties on soaps, candles, film rolls, polishes and creams are reduced to 30 per cent.

There are a number of pharmaceutical items - penicillin, antibiotics, etc., for which duty is removed altogether.

There are also raw material items where duty is reduced to 20 per cent; and a number of other items where varying rates of duty on similar types of machinery or components have been centralized on 20 per cent - some items up, some down. Amongst the latter can be found iron and steel rods, electric motors, television and radio parts for assembly.

The rate of duty on domestic sewing machines is reduced to 20 per cent; on typewriters, calculating machines, accounting machines, cash registers and duplicating machines to 30 per cent. Duty on computer tapes is reduced from 40 per cent to 20 per cent.

All these reductions of course have to be paid for. There are a few increases in duty, specifically designed to raise revenue.

Firstly, I propose to set up a higher rate of import duty, 85 per cent, for wine imported in bottle. I am leaving bulk wines at the existing rate of 75 per cent, so there will be a duty advantage to Kenya Wine Agencies and wine consumers to purchase wines bottled and packed locally.

Secondly, the import duty on spirits - whisky, brandy, etc. - will be increased by Sh.5/- per proof litre.

Thirdly, the duty on imported cigarettes will be increased by Sh.100/- per kilogramme, with increases also in cigars and pipe tobacco. For reasons I shall explain in a moment, these increases in tobacco duties will not be as heavy as they may seem at first.

Taking all the changes in import duties into account, including the charging of duty on goods imported from Tanzania and Uganda and the payment of export compensation on eligible goods exported to those countries, I expect the revenue to be increased by approximately K£0.4 million more than it would have achieved anyway.

EXCISE

Over and above the changes in import duties, I propose to make two changes in the rates of excise.

Firstly, in order to simplify tobacco taxation, I propose to amalgamate the present sales tax and excise on cigarettes and tobacco into a single excise duty. The new single rate of excise will be a little higher than the present rate of excise and sales tax taken together; so that the price of a packet of Sportsman or Embassy will rise by 50 cents allowing for a small increase to the manufacturer. More expensive brands such as "555" will increase in price by Sh.1/- per packet, while the cheapest brands will increase by 25 cents per packet.

Secondly, the rate of excise on locally manufactured spirits - such as gin and vodka - will be increased by Sh.2/50 per proof litre.

Taken together, but without taking into account the abolition of sales tax on cigarettes, the increases in excise will bring an additional K£6.4 million to the Exchequer.

SALES TAX

I propose that there should also be increases in sales tax, particularly those items that bring in the most revenue.

The rate of sales tax on petrol and diesel oil will increase by 10 cents per litre. Taking into account some allowance for higher costs of processing and moving oil, the cost of these fuels in Mombasa will rise by 13 cents, and in Nairobi by 14 cents per litre.

The specific rate of sales tax on lubricating oils and greases will also increase by a few cents.

Once again, I am afraid, I have to look to beer. Beer prices in Kenya are cheaper than most other parts of the world and consumption continues to rise rapidly. The Exchequer must maintain its share of the total retail price, and allowing for a small increase to Kenya Breweries a bottle of Tusker or White Cap will be 40 cents more expensive from tomorrow.

I have not increased the taxation of motor cars for a couple of years and the demand for vehicles is greater than can be met from the present foreign exchange allocation. I, therefore, propose to raise the rate of sales tax on passenger vehicles, other than the larger buses, from 15 per cent to 20 per cent. Since this is an *ad valorem* rate of tax, the increase in car prices will vary from model to model. The cheapest cars will incur the lowest increases in price.

I have already mentioned the small increase in rates of import
[illegible] There will, in addition, be an

The effect of these combined increases will be that the price of a bottle of imported whisky will rise by about Sh.8/-, or a little bit more allowing for higher import costs that have not yet been passed on in the price. Locally manufactured spirits will probably go up by about Sh.5/-, while wines will go up depending on the quality of the wine and whether it is imported in bottle or in bulk.

I have already mentioned the abolition of the sales tax on cigarettes and tobacco and the consolidation of the tax with the excise. In addition, I propose to continue with the procedure I have followed over the last two years of exempting raw materials from sales tax where these do not enter directly into consumption. There is a list of such manufacturers' raw materials set out in the Financial Statement, including crude vegetable oils and bottle stoppers.

In addition, I propose to exempt from sales tax completely a larger number of small manufacturers. At the moment, any manufacturer whose turnover does not exceed K£5,000 per year is not required to deduct and pay sales tax. I propose to raise that limit to K£10,000 which will have the effect of removing some 500 small manufacturers from the scope of the sales tax altogether. This will, I hope, be a boost to small industry in this country and since the collection costs of sales tax from small firms is relatively high, I do not expect any significant loss of revenue.

Overall, the changes I have proposed today in the sales tax will bring an additional K£7.3 million to the revenue in a full year.

INCOME TAX

I now turn to the income tax. There are a few technical changes contained in the Finance Bill which are consequential on the collapse of the East African Community. Amongst these is the new definition of income for tax purposes which, with effect from year of income 1978, will be restricted to income arising in Kenya and not to income arising in the partner states as a whole.

In addition, the opportunity has been taken to extend the definition of Kenya for income tax purposes to the continental shelf, since there is some possibility of resource development offshore of Kenya in the years ahead, and we should make it clear now that Kenya proposes to exercise tax jurisdiction over the continental shelf in that event.

Secondly, I am now convinced that the system of tax clearance certificates introduced some years ago has served its purpose. The cost of administering the present scheme outweighs any revenue benefits. Accordingly, the requirement that all residents travelling overseas should obtain a tax clearance certificate is abolished with immediate effect. I am sure that this move will be appreciated by the travelling public.

I propose, however, to reserve one safeguard for the revenue. When an individual applies to Exchange Control for emigration treatment, he will be required to show that he has cleared off any income tax liability before Exchange Control permission will be granted for an emigration allowance.

Thirdly, I propose to close a tax loophole under which shareholders of private companies have avoided tax under section 24 by converting themselves into public companies. Section 24 deems dividends to have been paid to the shareholders even though they may not be declared. That provision will now apply to public companies as well as private companies. No genuine company that retains profits for development need be concerned by this amendment. It is simply an anti-avoidance measure.

Fourthly, I am convinced that farm employees who are required to live on a farm under the terms of their employment are taxed unfairly when they are charged for the value of their house at 15 per cent of their emoluments. I propose, therefore to reduce the housing charge for agricultural employees to 10 per cent of emoluments.

Fifthly, the allowance for tax free fringe benefits has remained unchanged at Sh.1,000/- per year for many years. In the light of inflation, I propose to raise this amount to Sh.2,400/- per year which will allow works canteen lunches and similar minor fringe benefits to be free of tax.

I explained to the House last year that I was concerned at the amount of tax evasion in Kenya and that this was having the effect of reducing the revenue received by the Exchequer. Increased efforts by the tax department in the last year have significantly reduced the impact of evasion and income tax receipts have been much closer to the total that should be collected.

Revenue is, however, still affected by taxpayers delaying their tax payments beyond the date they are due and my sixth income tax measure today is to increase the penalty for late payment of tax from five per cent to ten per cent of the tax due.

This will not affect any law abiding taxpayer who pays on time but anyone who is late in his payments will suffer a heavier penalty than previously with effect from next year.

My next income tax proposal is also concerned with tax avoidance. It has been possible under the existing Act for the taxpayer to run a business at a loss and to deduct that loss from other taxable income, so that he ends up by paying little or no tax, although it is obvious to all that he enjoys a very high standard of living.

With effect from 1979, that will no longer be possible. Losses of business income will only be allowed for set off against profits of that type of business and not against other income. Business losses can still be carried forward but not set off against employment income, rents, etc. This is, I think, an important improvement in our tax legislation.

My last change for this year affects the income tax chargeable on capital gains. There has been some technical difficulty over the working of the section of the Act that limits the rate of tax chargeable on this type of income. I, therefore, propose to drop that section - 34A - and to simplify the system by charging to tax only one-half of the gain realised by an individual on the sale of property. This will have the effect of reducing the impact of tax on capital gains for everyone, not just those paying tax at the top rates. I am making this change retroactive to year of income 1978.

continue in force for 1979.

And so Mr. Speaker, these are my taxation proposals for the coming year. In total, I expect to increase taxation by approximately K£14 million, and thus reduce the Budget gap to about K£40 million. This is still a higher gap than I would like to see but we are working with forecasts of national income even more uncertain than usual.

If coffee production is not as bad as we now fear, if the recovery of coffee prices in the last couple of weeks is something more than temporary or if exports of non-traditional products can be expanded at a faster rate, the Budget deficit could be smaller than now seems likely.

In some ways, this year's Budget is highly technical with the emphasis being on the reform of tax and financial legislation rather than the introduction of substantial new tax measures. Provided the House approves the measures I propose, some 37 separate pieces of legislation will be removed from the statute book and replaced by legislation that will be more easily understood by Hon. Members of this House and the general public.

Although we shall still no doubt make changes in our taxing Acts from time to time, the main thrust of our tax reform programme has been completed with the implementation of Kenya legislation for income tax, sales tax and now customs and excise.

Our economy has recovered well from the strains of 1974-76. It is now stronger than it was then. As I explained, however, the forecast is for new difficulties ahead in 1979. I believe we are now better placed to face those difficulties and I am confident that we can face them without undue hardship.

At the end of this year, we shall publish our fourth Development Plan to map our path for the next five years. My Budget is designed to prepare the way for the new Plan.

Mr. Speaker, I beg to move.