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.

NEW TAXATION PROPOSALS

Mr. Speaker, we now come to the heart of the Budget and, as usual, I would 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

On a number of occasions, in previous Budget speeches, I have discussed the reform of the external customs tariff. Hon. Members will be aware of our views that fewer distortions would be created in the way we use our economic resources if we work gradually towards a more even rate of import duty. We can no longer afford the foreign exchange to develop industries dependent heavily on imported raw materials and imported capital and the external tariff should not therefore encourage such development by nil rates of duty on such items. This does not mean that we shall not continue to require to import raw materials and capital from overseas but rather that such imports must complement and make optimum use in the production process of domestic resources, including labour and locally produced commodities. It is important that this change in industrial strategy should be reinforced by the external tariff.

Last year, I imposed a 10 per cent import duty on a wide range of raw materials. At the same time, I proposed a suspended duty of 10 per cent on a number of items of capital equipment. I said at the time that I was giving notice of my intention to impose duty on such items in the future. With effect from midnight tonight, the suspended duty of 10 per cent on capital items contained in the Second Schedule of the Customs Tariff will be imposed.

Not only will this require users of capital equipment to consider more carefully the foreign exchange cost of imported machinery but it will, I anticipate, provide me with an additional revenue of K£2½ million.

As part of the long-term programme of tidying up the Customs Tariff, I am proposing a number of other amendments relating to the Second Schedule. For the last three years, there has been a duty imposed on fertilizers under the Second Schedule but in order to hold down agricultural costs, I have used the powers provided to me under the Act to remit that tax. I propose now to regularize the position and cancel the suspended duty of 20 per cent on fertilizers. Since I have not been collecting the tax imposed on fertilizers, no loss of revenue is involved.

There have been other suspended duties that have been imposed on items of paper for some years. Since I consider that those duties should be retained over the longer term, I propose to transfer the amount of duty imposed to the First Schedule and to cancel the same amount from the Second. This is an administrative change and, since there is no increase in the total rate of duty, no additional revenue can be expected from this change.

There are still a number of specific duties contained in the Customs Tariff and which in a period of inflation should be raised from time to time in order to maintain the same impact on import demand. Accordingly, small increases in the specific rates of duty on wines, exposed film and textile fabrics are now proposed. I do not expect to obtain much revenue from these measures since the ad valorem duties relating to these items will remain unchanged.

Recently, when the House considered and approved the Customs Tariff (Amendment) Act, a number of rates of duty were created that caused some items in the tariff to be taxed at rates out of line with similar items in the same chapter. I mentioned then that it would be my intention to put this right in the annual budget and, accordingly, I am proposing minor changes in the rates of duty - generally of a rounding nature - that will have the effect of increasing duty on sugar confectionery, chocolate confectionery, essential oils, typewriters, calculating machines, glassware and radio and television sets.

At the same time, in order to protect new local industries, the rates of duty will be increased on arc welding electrodes, motor gaskets and metal containers while the rate on raw materials used in producing baby foods locally will be reduced.

A number of ad valorem duties relating to petroleum-derived products will be converted to specific duties to ease the administration of tax collection in respect of these items which, because they are produced by a multi-product refinery, are frequently difficult to value for customs purposes. There will be a small but insignificant increase in revenue as a result of this change.

Hon. Members will no doubt be aware that there have been several increases in petroleum product prices recently, arising entirely from the increase in crude petroleum prices over which we have no control. I therefore propose no increase on this occasion in the rate of duty on petrol or the other principal petroleum fuels.

Hon. Members will recall that earlier this year, the Government felt obliged to increase the price of sugar to the local consumer, so as to allow an increase in the price of sugarcane to the farmer and to the factories. But as a result of that increase, the margin in the sugar price structure taken by the Sugar Equalization Fund widened significantly. Since the price of sugar on the world market has fallen in the past year, I see no reason why cash should continue to accumulate in that Fund. I propose, therefore, to increase the rate of import duty on sugar. However the increase will be met by reducing the margin taken by the Sugar Equalization Fund, and there will be no increase in the retail price of sugar.

However, if food manufacturers continued to import sugar on their own account, as they do now, they would incur higher costs as a result of this increase in duty which would lead to pressure for higher manufactured food prices. Accordingly, I propose that manufacturers should revert to the system of buying sugar operative up to two years ago, under which manufacturers bought their sugar at the equalized price from the KNTC. Sugar supplies are now adequate and the import price is low enough to

Amongst the numerous miscellaneous amendments in the Customs Tariff contained in the Finance Bill there are a number of unimportant cuts in duty relating to such items as brewers' malt, bakers' yeast and gelatin. Also, I propose to amend the wording of the tariff to enable lower rates of duty to be charged on the raw materials that are used by local manufacturers to make baby foods. In addition, I propose to reduce the duty on weighing machines and on office dictaphone equipment. At the same time, in this Olympic year, I propose to reduce the rate of duty on boxing gloves and specialized sports footwear to 10 per cent, from 50 per cent and 40 per cent respectively. I hope these changes will give added spurs on our athletes to obtain more medals at Montreal.

Finally, on the Customs Tariff. The Customs Department will be faced with difficult administrative problems when the new commercial vehicle assembly plants start up production in the next year. The Customs Department will be faced in particular with the problem of deciding whether the spare parts contained in any one wooden crate are specialized assembly kits or just spare parts. There would be occasions when genuinely no one could give a truthful answer as to what the spare parts will eventually be used for. In this difficult situation, I propose to take the easy way out and to equalize the rate of duty on commercial vehicles, passenger vehicle kits and all motor vehicle spare parts. This equalized rate will be 25 per cent. The effect of this move will be that the rate of duty on imported made up commercial vehicles will remain unchanged; the rate of duty on passenger vehicle assembly kits will rise from 15 per cent to 25 per cent; while the rate of duty on all motor vehicle spares will fall from 33⅓ per cent to 25 per cent. Overall I expect this measure to cost the revenue approximately K£800,000.

I am prepared to forego this considerable sum, not only to overcome the Customs Department's administrative problems, but also, by providing for cheaper motor spares, to give greater encouragement to car owners and the local vehicle repair industry to place more emphasis on the repair and maintenance of the existing stock of motor vehicles in the country rather than the continual importation of new vehicles. I hope in this way we can achieve some saving in foreign exchange. The rates of duty on imported passenger cars will remain unchanged.

Mr. Speaker, all the numerous changes in the Customs Tariff are set out in detail in the Finance Bill. It is not possible for me to refer to them all today. Taken together, however, I expect to obtain an increase in Customs duty of K£4.30 million.

SALES TAX

I would like now to turn to the Sales Tax. Hon. Members will recall that the law was changed last year to require that manufacturers paid tax on their raw materials and this was then subsequently refunded when tax was paid on the final article. The purpose of that change was to close a tax loophole that was being seriously abused. The effect of the change, inevitably however, led to some complication in the administration of the sales tax and, where it is possible to do so without loss of revenue, I propose to simplify the system by exempting raw materials from sales tax where those raw materials have no alternative use in domestic consumption. Accordingly, the Finance Bill contains a long list of raw material items which I propose should be added to the Second Schedule of the Sales Tax Act and thereby exempted from tax. Since any sales tax paid on these raw materials now is required to be refunded under the law, there should be no loss of revenue involved in this change - only a simplification in the administrative procedures.

Secondly, in relation to sales tax, I propose to impose tax, at the standard rate, on dried vegetables. This will have little or no impact on domestic prices but will enable the dried vegetable factory to take advantage of the export compensation legislation. This will be of significant benefit to them and also to the farmers who supply vegetables to the factory.

Finally, but I am afraid yet again, I have to increase the rate of sales tax on beer. The beer tax will rise by 10 cents per half litre bottle. But because of the significant increase in the cost of brewing, the price of a half litre bottle will rise by a total of 25 cents. The revenue will get 10 cents of this and the Breweries 15 cents. The revenue is expected to gain by K£1.6 million per annum. It is my hope that part of the gain to the Breweries will be used to offset the increased costs which distributors now have to meet.

EXCISE DUTY

I explained at some length why I propose to increase the import duty on sugar and how this would have no impact on retail prices. The same increase announced in the sugar import duty will be imposed on the sugar excise; and once again there will be no effect on the retail price. In revenue terms this is, however, a significant measure, for I hope to draw K£5 million into the Exchequer away from the Sugar Equalization Fund as a result of this change.

SECOND HAND MOTOR VEHICLE PURCHASE TAX

In recent years, I have found it necessary to increase substantially the rates of import duty on imported motor cars. The effect of this, together with inflation, has meant that the prices of second hand cars has risen substantially and significant profits have been made by many when they come to sell in consequence - particularly on the larger cars. There is, at the present time, a second hand motor vehicle purchase tax under which the purchaser of a motor vehicle is required to pay Sh. 400/- when a motor vehicle is transferred to him. I now propose that there should be a graduated scale for the second hand motor vehicle purchase tax. This will start for the smallest cars of under 1200 cc. engine capacity at the present rate of Sh. 400/-, and will rise evenly to a rate of Sh. 800/- for the largest cars with an engine capacity of more than 2250 cc. I do not expect to earn a lot of revenue from this measure but I believe it is an important one on equity grounds.

ENTERTAINMENT TAX

The price of cinema and theatre tickets has risen steeply in the last few years but the rate of entertainment tax on the higher priced tickets has remained at a fixed rate. I propose, therefore, to extend the entertainment tax scale to cover these higher valued tickets and there will, therefore, be a small increase in their price, although no increases are proposed in the rate of tax relating to the cheaper tickets.

TRAFFIC AND TRANSPORT LICENSING FEES

In an inflationary age, when the price of everything rises, it is necessary to review, regularly, fixed fees payable for various Government services and to revise them upwards broadly in line with changes in other prices if we are not to subsidize services which can pay for themselves. As part of this general exercise, the Minister for Power and Communications has signed regulations to increase the rate of fees provided under the Traffic Act and the Transport Licensing Act. The most notable change this will involve will be an increase in the annual driving licence fee from Sh. 20/- to Sh. 40/-, with the Triennial Licence rising to Sh. 100/-. I do not intend to read out all the other increases since Hon. Members can see them in a Legal Notice published today. They are also set out in the Financial Statement.

OTHER GOVERNMENT FEES

For similar reasons, wildlife and hunting fees will also be increased and certain other Government fees are likely to be increased in the coming months. These will be announced as various reviews now under way are completed.

I hope the Exchequer will gain K£600,000 from these various fee increases.

LOCAL MANUFACTURERS EXPORT COMPENSATION

There is one small technical amendment I propose to make to the Local Manufacturers (Export Compensation) Act. With effect from today, manufacturers who claim remissions from duty under Section 7 of the Customs Tariff Act will not be permitted at the same time to claim the export subsidy. Manufacturers have not been able to claim the export subsidy if they were claiming a refund of duty under the Local Industries (Refund of Customs Duties) Act and it is only reasonable that the same condition should apply in respect of remissions of duty. There will be a small saving of revenue from this proposal.

INCOME TAX

Finally, Mr. Speaker, I come to the Income Tax. The House has recently considered and approved a number of important changes in the Income Tax law. It is therefore unnecessary for me to impose many further technical changes at this time. There is, however, one significant tax loophole which I think I should close and that relates to the deductibility of the cost of lease hire arrangements in respect of motor vehicles. I have, quite deliberately, in recent years placed a severe limit on the capital value of a motor vehicle that can be deducted from income under the Second Schedule. Many firms have, however, chosen to circumvent that restriction by choosing not to buy a vehicle for their employees but to arrange for the lease of the vehicle from a third party. Since the cost of that lease hire arrangement has been deductable, it has been possible for firms to arrange luxury motor cars, expensive in foreign exchange, for their employees at substantial cost to the revenue. With immediate effect, this will no longer be permissible.

At the same time, I have instructed the Commissioner of Income Tax to ensure that where an individual enjoys the benefit of a motor car provided by his employer, the full value of that benefit should be added to the individual's cash income and assessed for tax, rather than the somewhat nominal figures that have been used by the Department in recent years which have had little regard to the inflation of motor car prices.

And now, Mr. Speaker, we come to the rate of income tax on companies and individuals. The collection machinery in this respect has continued to improve and this has resulted in improved revenue accrual from income tax in the current year. I therefore do not propose any changes in the rates of income tax this year.

THE EFFECT OF THE TAX PROPOSALS

Mr. Speaker, these then are the taxation measures I wish to propose to the House this year. In total, they should provide the additional K£12 million of revenue I was seeking. Apart from the increase in the price of beer, few of the measures will affect the average <u>wananchi</u>. Half the revenue increases will be obtained through a squeeze on the Sugar Equalization Fund which will not affect the price of sugar to the consumer, unless and until the import price of sugar rises again and there is a shortfall in domestic sugar production.

The second hand motor vehicle tax has been increased for larger cars but the tax on motor spares has been reduced. Tax on commercial vehicles remains unchanged, whether for fully assembled vehicles or for assembly kits. Tax on passenger vehicle assembly kits has been increased but the rate of tax is much less than for fully assembled passenger vehicles which remains unchanged.

Motorists will have to pay an additional Sh. 20/- per year for their driving licence but anyone who can afford to drive should be able to afford what is less than 80 cents per week for the licence to do so. Overall, I am giving back to the motorist rather more than I am taking from him this year.

Most of the changes in the tax are of a minor administrative, tidying up nature. Few people will be affected by them. There is some increase in the level of protection for the textile industry; and for the motor gasket, infant food and metal containers industries. There is however no good reason why the prices of these locally produced goods should rise.

The 10 per cent import duty on capital equipment may cause some manufacturers to rethink their capital programmes but it should not affect the cost of living of the consumer.

Overall, Mr. Speaker, the cost of living effects of this Budget are minimal.

Mr. Speaker, this has not been an easy Budget to compile. On the one hand, I have felt that it was inappropriate this year to increase the tax burden on the average family, although others, I am sure, will argue I should have done so. On the other hand, I had to reduce the residual Budget deficit, below the levels it has reached in the last two years. The conflict between these two Budget requirements could only be resolved by exercising the strictest control over the growth of departmental spending.

I am aware that I have restrained the growth of expenditure and reduced the Budget deficit at a time when our economy is just emerging from its most severe recession since independence. It is my judgement, however, that we have now passed the worst of that recession and that the growth of agricultural incomes and the greater stability in the external terms of trade will allow the economy to expand on a broad front without a further inflationary boost from Government expenditure unbacked by revenue. This year I look to our farmers, our manufacturers and our service industries to provide the principal impetus for growth.

But the Government will not be passive. This is a K£400 million budget and will represent expenditure equivalent to one-third of our gross national product. Yet Government's impact on the economy will be even greater than this when we consider projects outside the Budget, where Government has acted as a catalyst for private investment or as an organizer of funds for major public sector projects such as Gitaru and the oil pipeline.

I am therefore convinced, Mr. Speaker, that this is a Budget for further expansion, if also a Budget that endeavours to impose a sense of realism on our spending departments.

Mr. Speaker, we have talked all afternoon about the problems of raising money to finance our development effort. Money is important, but there are other assets which may be imponderable or intangible but which are nevertheless more fundamental for the attainment of our goals: we must continue to give our total loyalty to our leader and Father of the Nation, Mzee Jomo Kenyatta who, even during the worst economic circumstances, has always told the people of Kenya the whole economic truth, i.e. that there are no short-cuts to development, that development is a matter of personal will and dedicated struggle and not something that can be had for nothing. We must continue to pursue our goal of building an open and free society which is democratic, African and socialist. We must maintain discipline in the way in which we conduct our affairs, particularly our financial affairs. We must redouble our efforts to raise the level of production in our country, for despite all the political slogans, our goal of economic equality and greater prosperity for all citizens cannot be achieved unless we attain greater productivity. We must continue to hold in check our individual or personal ambitions so that we can continue to act with a sense of mutual responsibility particularly for the poorer members of our society.

Mr. Speaker, it is because of my conviction that we Kenyans shall continue to harness and husband these assets that I remain optimistic that we can now look to a more prosperous future.

Mr. Speaker, I beg to move.