REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1977/78
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 16th June, 1977, by the Hon. Mwai Kibaki, Minister for Finance and Planning, Republic of Kenya, when presenting the Budget for the Fiscal Year 1977/78 (1st July to 30th June).

Mr. Speaker, Sir,

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

ECONOMIC RECOVERY

In 1974, 1975 and 1976, it fell to me to explain in the annual budget statements, the manner in which circumstances originating outside our own country had set back Kenya's own development and reduced our standard of living. This cut in real income was caused, mainly, by important prices rising faster than export prices and since these circumstances coincided with years of rather poor weather in Kenya, nearly everyone was affected.

This year, I am happy to say the position is significantly different. Our own export prices, particularly coffee and tea, have risen faster than the prices we pay for exports. The terms of trade have swung back in our favour and are now better than they were in 1972. The balance of payments, which in recent years has been of so much concern to us, is, as of now, in substantial surplus.

The recent rains have been abundant and although some areas face the problem of clearing up after flood, the country as a whole looks forward to abundant harvests.

Employment has recovered; and in some areas we may have to consider how sufficient labour can be organized to ensure that the full harvest in the fields is gathered in. Manufacturing is booming in spite of the loss, which we hope is temporary, of the Tanzania market.

The rate of growth of our economy improved from 1 per cent in 1975 to 5 per cent in 1976. We look forward to a rate of growth of 6 or 7 per cent in 1977.

Mr. Speaker, I would like to think that—to some extent at least—our present prosperity is due to the policies we followed during the recession but I have to admit that the wheel of fortune has also contributed just a little to the present situation.

In 1974 and 1975, oil prices were pushed up by four or five times. The prices of machinery and equipment that we buy from abroad went up much in line; the weather at home was unfavourable and farm production low as a result. In 1976 and 1977, the world prices of our main exports, coffee and tea, have risen to unprecedented heights and the weather in Kenya has been kinder. For the moment, the economy seems in good shape and our prospects can be viewed with optimism.

But—and there is always a but—the present prosperity brings its own problems. And because I regard these problems as potentially dangerous, I hope the House will support fully the policies and programme of action that I propose today.

THE RISK OF INFLATION

At the risk of appearing as Cassandra—the Prophet of Doom—I propose to outline these problems as I see them.

The price of coffee and tea in the world markets has been driven up to record levels. This is a happy and unprecedented turn of the wheel of fortune but has occurred as a result of special circumstances that cannot last. We cannot base our economic policies on the expectation that these prices will be maintained. Kenya tea and coffee farmers should also not expect this.

The balance of payments is in a substantial surplus. Possibly we may earn a surplus of K£100 million this year. Our external reserves stand at an all time high of K£200 million. But when coffee and tea prices go down again, the balance of payments deficit could re-occur and our reserves fall once again, particularly if we have allowed the higher incomes provided by the current high prices to be used to create a new and higher dependence on imports.

The balance of payments surplus is going straight into private bank accounts in Kenya shillings. It is not coming into the Government Exchequer. If the fortunate owners of this money all attempt to spend it at the same time, we risk having a situation of too much money chasing too few goods, causing prices to rise.

The present situation in our economy is, potentially, highly inflationary—prices could in these circumstances rise more steeply than we have ever experienced. This is not a situation any of us wish to see. But if, at the same time, the Government is in substantial deficit and needs to create money to maintain its services, it will feed that inflation even faster. Steeply rising prices are the biggest risk we face at the present time and, to avert at least part of this risk, I must consider the transfer of part of the excess liquidity in the private sector to the public sector—the Government—where there is a shortage of liquidity. Another part may have to be neutralized, temporarily, in the banking system.

Price Control

Prices have already been rising faster in 1977 than they did in 1976. I fear this situation may continue. No doubt there are still Members of this House, as well as the daily newspapers, who feel that I can somehow prevent this situation through a stricter implementation of price control. Unfortunately, as I have explained in previous Budget statements, this is just not so.

If the price of maize to farmers is increased, the price of maizemeal must, in the end, rise as well. This year, the farmers have been given increases in the prices of maize, wheat, milk and meat and all of these commodities have risen in price in the shops. The prices of other domestic raw materials, and raw materials imported from abroad, also continue to rise; and I have little choice between permitting the final products made from these raw materials to rise in price as well and forcing the manufacturers concerned into bankruptcy and wrecking our economy.

Price control can sometimes delay price increases. It can sometimes mitigate increases by squeezing manufacturers' and traders' margins. But price control cannot persist in delaying price increases or squeezing margins without harming the consumers we try to protect. For the result would be the removal of products from the market; and harm to our economy through bankruptcies and the discouragement of investment and employment creation because production becomes unprofitable.

There is no magic wand I can wave to make these realities go away. I have to face them and so must Honourable Members of this House. As I have explained in previous statements, our policy is to concentrate the attention of price control on those items which figure significantly in the normal monthly expenditures of the low wage earner. We cannot attempt to control the prices of everything.

Fiscal and Monetary Policy

What I can do, and what I propose to do, is to neutralize some of the liquidity which is creating much of the inflationary pressure by asking the Governor of the Central Bank to increase the proportion of liquid assets the banks are required to hold against their deposit liabilities from 18 per cent to 20 per cent. I shall also consider how I can reduce the overall pressure on prices by the tax proposals I shall announce today.

But apart from adjustments of monetary and fiscal policy, I—as Minister for Finance—cannot prevent prices from rising in some degree without asking the people of this country to accept new burdens which, in present circumstances, I do not feel justified, in asking them to accept. I can, however, try to restore some balance in the face of some of the inequity that has arisen in our economy from the recent period of inflation and from the sudden and unexpected increases in some peoples incomes.

In addition, individual families can institute their own anti-inflation programme. They can refuse to purchase goods they feel have been unfairly priced in the shops and they can try always to buy in the cheapest shop. Further, every family should aim to have its own kitchen garden and hedge the inflation risk by producing for itself at least part of its basic food requirements.

Unfortunately, the present prosperity in Kenya is not being enjoyed by everyone. The coffee and tea farmers are receiving incomes undreamt of a year ago. Maize, milk and wheat farmers are receiving good prices and, if they farm well, can make good profits. The same can be said of farmers growing pyrethrum, rice and horticultural crops.

Manufacturers on the whole are doing well, although the closure of the border with Tanzania has reduced market outlets for a few firms. Overall, exports to Tanzania in 1976, represented 6 per cent of our total exports but less than 3 per cent of total manufacturing output. And although the present situation is not of our making, if we have to, we can manage without the Tanzania market without too much harm to our economy.

Wage Guidelines

Our farmers and manufacturers are faring quite well at the present time. The wage earners have not, however, done quite so well, although, even here, the statistics in the *Economic Survey* suggested that average earnings of wage earners have been rising faster than average prices. As a group, workers seem to have fared rather better than I had previously thought.

Even so, I am persuaded that the time has come to amend the wage guidelines that are set out in instructions to the Judge of the Industrial Court. And although it will still be necessary to continue to restrict wage increases to something less than the full rise in the cost of living, I propose, that so long as our economy is growing in real terms, and workers in individual industries can demonstrate that they have contributed to that increase in productivity in 1977, this productivity element will be taken into account in assessing increases in wages in 1978. This will enable the workers to share in the rise in national prosperity.

Pensions

There is, however, one group in our society that has been hit particularly hard by recent inflation and that is the pensioners. They have had to exist on fixed pensions since 1962, during which time there has been a very substantial rise in the cost of living. The British Government has now accepted full responsibility for the pensions of former British civil servants who worked in Kenya and, accordingly, I feel able to announce that as soon as the necessary legal formalities have been carried out, all pensions payable by the Government in Kenya will be increased by 25 per cent.

INVESTMENT AND SAVINGS

If we are not to dissipate, through inflation, the benefits of the present commodity boom, it is important that the main part of the higher money incomes now available should be saved and utilized for investment while we can afford it. We have barely succeeded in maintaining domestic investment in real terms over the last three difficult years and we have, therefore, some leeway to catch up. The additional money now in the economy should not be spent on *pombe* and expensive motor cars that contribute nothing for the future.

Last year, this did not happen. On a national accounts basis, domestic savings rose by nearly 60 per cent but this money is now lying with the commercial banks and represents very substantial potential purchasing power. We must direct these bank balances into longer term forms of saving.

A great deal of thought has been given in Treasury over the last year to the means of saving available to the people in the rural areas. I am sure much more can be done. I shall shortly introduce into the House a Bill to reorganize the Post Office Savings Bank to enable the bank to play a more positive role in this area.

The bank will not only administer savings accounts, as it has in the past, but will, in addition, sell fixed term savings bonds, and also premium bonds run like a national lottery. The Finance Bill contains a proposal that interest on Post Office savings accounts should not be chargeable for income tax.

At the same time, we are investigating how we can form a new nation-wide building society that will accept deposits from the people and which will also lend money for house-building throughout the country, not just in Nairobi and Mombasa.

The market in Government stocks has already seen some revival in the last year and I am now anxious to build on that revival and improve the marketability of our stocks, thus increasing their attractiveness. To this end, the Development Estimates of my Ministry include a provision to enlarge the Government Stock Support Fund. This will enable the Treasury to support the market in Government stocks more positively than in the past. Investors will from now on be able to purchase Government stock confident that a market will exist for them to liquidate their holdings in advance of normal maturity if this should prove necessary. Interest yields on Government stocks are now attractive compared with other savings alternatives and I am confident that we can now sell stocks in greater volume than we have in the past and at the same time create an active two-way market in Government issues.

Government stock issues of various maturities are now available on tap from the Central Bank.

THE EXTERNAL SURPLUS AND GOVERNMENT REVENUE

It is perhaps natural that the general public should form the opinion that because our external reserves at the Central Bank have risen so sharply in the last year, the Government Exchequer now has all the money it needs. Unfortunately this is not so. Although Kenya's personal incomes in money terms have risen faster than we forecast a year ago, Government revenue has not kept pace and I do not expect that the Exchequer will receive much more than was originally estimated last year.

This represents our most difficult problem and one which carries serious dangers for the future of our society. There is little doubt that the revenue should have improved in line with the improvement in personal income. Why has it not done so? It is difficult to avoid the conclusion that the main reason is that there is now a significant body of persons in this country who are not paying the taxes they are legally required to pay. Deliberate tax evasion is now a serious problem and one I cannot ignore.

This year, there is an estimated increase in income tax receipts of some K£10 million. About half of that increase has been paid by salary earners by way of PAYE, leaving only about K£5 million of the increase being derived from other individuals and companies. Yet we know that coffee income last year rose by K£68 million and tea income by K£10 million. Operating surplus in the economy as a whole in 1976 was estimated to be K£120 million higher than in 1975. Clearly if we only collected an additional K£5 million in income tax out of this total, we are not collecting the tax due.

THE FINANCIAL OUTTURN 1976/77

Perhaps at this point, I should turn to the Budget outturn for the current year, 1976/77. Recurrent revenue as I have said, is expected to be much in line with the original estimates. Recurrent expenditure will be K£24 million higher than provided for in the Budget last year, but as the House is aware, virtually all of this increase has been caused by the unfortunate need for us to spend more money on safeguarding the security of the nation through increased defence expenditures.

The recurrent surplus I had looked for last year will not, therefore, be available. There may be a small surplus. If there is, it will, in accordance with our usual practice, be transferred to the Development Exchequer on 30th June.

Development revenue has, once again, not materialized to the extent estimated in the Budget. There will be a shortfall of external grants and loans, compared with the Estimates for 1976/77, of some K£14 million. The reasons for this are the same as I explained in some detail last year—project delays, disbursement delays and the failure of Ministries to claim aid when due to us. Aid receipts will be lower than last year in money terms.

Development expenditure will be much the same as provided in the original Estimates. This represents underspending of K£18 million compared with the Revised Development Estimates considered by the House in April. Such underspending is disappointing, since it means that some development projects, authorized by Parliament, have not been implemented.

Overall, I expect to end the financial year 1976/77 with a residual deficit of some K£37 million, higher than the K£11 million I aimed for in my Budget last year. This is disappointing. The deficit will be financed by an increase in the Treasury Bill issue from K£50 million to K£75 million and some run-down in the Exchequer cash balance.

The Exchequer Deficit

I spoke earlier today about the inflationary risk we ran by incurring an Exchequer deficit that has to be financed through the banking system. I spoke at length about this in my Budget Statement of last year. I am concerned that we do not seem to be able to bring this under control.

It is a matter of concern. But if I am to improve basic Government services, if we are to rebuild the development impetus that was largely lost between 1974 and 1975, it is going to be quite impossible for me to reduce the size of the deficit from its present level.

In previous years, I have expressed concern about the control of expenditure by Ministries. I am, therefore, pleased to be able to report to the House that there appears to have been a marked improvement in this matter in the last year. The cash control system introduced by the Treasury last July seems to have kept expenditure within the limits sanctioned by Parliament and I expect excess expenditure this year to be much reduced. This is a matter that must gratify us all.

Our major concern must now be the problem of tax evasion. The tax departments have been instructed to go after this and ensure that the revenue due to Government is collected.

The Income Tax Department is being strengthened to enable them to do this and new customs control procedures—especially at Nairobi Airport—are now under discussion.

But in the end, if our nation is to maintain its security and improve education and health services for the people, tax has to be paid as a matter of national duty. It is no good people complaining they are being harassed by the tax departments, when they are, at the same time, actively trying to evade payment of tax and thus avoid their own national duty in this respect.

New Financial Obligations

This problem has become particularly urgent—apart from the question of equity—because of the heavy new financial burdens it has been necessary for the Government to take up in the past year. These burdens include, not only increased defence expenditure as a result of the heightened tension around our borders, but also the burden of a new airline because of the collapse of the East African Airways; the burden of a railway, vital to our economic interests, which had been allowed to run down to a dangerous level through disputes in the East African Community.

Defence, Kenya Airways and Kenya Railways will inevitably cost this country substantial sums in the next few years but I am confident that, given your support, we shall, as a result of these expenditures, have a stronger and more self-reliant economy.

The new Kenya services will, I hope be more responsive to the needs of our own economy—and will, I trust, be rather more efficient that the East African organizations that preceded them.

The Problem of the East African Community

In the last year, we have been forced to undertake much serious heart searching about the future of the East African Community. It is a matter of considerable sadness to Kenya that both of the other partner states have, at different times, closed their borders against the free passage of our trade and the free passage of our people. The border with Tanzania still remains closed and assets owned by Kenyans remain expropriated. Transit trade by road with Zambia from Kenya has been cut off in flagrant breach of international practice. Access to our markets in Malawi, Zaire and Burundi remains hindered.

What sort of economic community is this? What community of interest can be found in the destruction of trade, the expropriation of assets and a refusal to meet on a political level to discuss these problems in the spirit of African Unity?

The measures taken by Tanzania against us are aimed at destroying the standard of living of the people of Kenya. We cannot let this happen and will not let it happen.

For some time we have followed different political philosophies than our neighbours and our economic policies have moved steadily farther apart. But there has, until recently, been a fundamental community of interest in maximizing the general welfare of the people of East Africa and willingness to work together to achieve this. That community of interest and willingness to work together no longer exists. We are, I have to say, on our own; and we shall have to adjust our policies accordingly.

The Government will shortly introduce a Bill into Parliament to set up the Kenya Railways as a new statutory organization. We have already set up Kenya Airways as a wholly Government owned company, since it was essential to move quickly in this matter when East African Airways collapsed.

No action has yet been taken in regard to the General Fund Services and the other East African Corporation operating in Kenya, since we have hoped that the political will would still exist to keep them operating on an East African basis. The General Fund Services must, however, be funded by 1st July if they are to continue: and if no decisions to this end are taken within the next few days, Kenya will have no option but to take such measures as are necessary to preserve services essential to the well-being of our economy.

The policy of political brinkmanship with regard to the affairs of the East African Community has continued far too long. We must either go forward together in harmony or Kenya must go forward alone.

DEVELOPMENT PLAN 1979/83

The future of the East African Community services will be considered in detail in the new Kenya Development Plan, covering the period 1979/83, now under preparation. It will be necessary for them to be integrated within the overall plan more carefully than in the past, whether they are to continue as Community services or be incorporated into normal Government services.

The theme of the new Plan will be the alleviation of poverty through the creation of income earning opportunities for every Kenyan and the provision of other basic needs, such as nutrition, health, education, water and housing. In both these aims, the emphasis will be on the dispersion of opportunities and services throughout the rural areas, with particular emphasis on the medium and low potential land areas.

Local ideas for development at the district level are now being collected through the District Development Committees, so that these can be taken into account in drawing up the national Plan.

The new Plan is, as I say, now under preparation and is due to be published towards the end of next year.

RECURRENT EXPENDITURE 1977/78

I now turn to the more immediate matter of Government expenditure in 1977/78.

Firstly, Recurrent Expenditure. The total gross recurrent expenditure of Ministries in 1977/78 is estimated to be K£268 million. This total can be compared with approved recurrent expenditure in the current year of K£250 million, an increase of 7.2 per cent.

The Estimates include provision for the salary increase to lower paid civil servants, announced recently. When this is taken into account, together with the increased cost of other Government supplies, non-defence expenditures will rise by approximately 6 per cent in real terms. This is a more significant advance than has been achieved in the last two years.

Generally, we have, I think, been able to steer the increases in expenditure into the right areas; and the difficulties that have been experienced in the last two years in operating newly completed development projects with recurrent expenditure being held under rigid ceilings, should be alleviated to some extent.

Recurrent expenditure of the Ministry of Agriculture increases by 35 per cent, of Health by 14 per cent, of Tourism and Wildlife by 76 per cent, of Education by 13 per cent. Education expenditures will be 31 per cent of the total, slightly exceeding our target ceiling of 30 per cent.

The cost of Consolidated Fund Services must be considered over and above the expenditure of Ministries. This will increase sharply from K£49 million to K£90 million.

The reasons for this are—firstly, a sharp increase in the cost of interest on loans taken out in past years; secondly, the cost of the pension increases I mentioned earlier; but thirdly, and mainly, the higher cost of loan repayments.

LOAN REPAYMENTS

Loan repayments will cost K£42 million in 1977/78 compared with K£1[illegible] million in the current year. There are special reasons for this steep increase. Firstly, there are two old London public issues due for redemption in May, 1978. We have provided K£14 million for this redemption in the Estimates but we shall liquidate some K£10 million, built up in past years in the sinking funds, to finance this exercise. This K£10 million is included in the Revenue Estimates.

In addition, I feel we should take advantage of the healthy state of our external reserves to repay the more expensive loans taken out in the past. Accordingly, we have included provision for the premature repaying of loans totalling K£11.4 million. Our debt commitments in future years will be reduced by these repayments now.

I.M.F. FACILITIES

Further, although no provision is included in the Estimates, since this is a Central Bank rather than a Government responsibility, the House will be pleased to learn that I have agreed with the Governor that he should repay, to the International Monetary Fund, the Extended Fund Facility and the 1974 drawing of the Fund Oil Facility. Repayment of these I.M.F. facilities will run down our external reserves by some K£19 million but since the reserves have recovered from the low level of 1974/75, I think it only right that we should repay the facilities we drew from the I.M.F. during those difficult years. We shall still have, outstanding with the Fund, facilities totalling some K£29 million and these will be repaid in accordance with the normal rules of the Fund governing these facilities.

The assistance we were able to obtain from the International Monetary Fund over the 1974-76 period proved invaluable to us. Our standard of living would have fallen much more sharply than it did if it had not been for our membership of this organization; and if the Fund had not taken steps to increase the range and amount of facilities available to countries hit by the economic storms of the last few years. We shall draw up our new Development Plan with greater confidence knowing that the Fund is there to support us if similar international economic storms occur again.

But the programme to restructure our economy, so as to be less reliant on imports, and so as to restore the rate of economic growth we enjoyed in the years up to 1973, must continue. The current, temporary, situation of high coffee and tea prices should not mislead us into thinking that we can abandon these policies. It does, however, provide us with an opportunity to press ahead more rapidly if we use these reserves wisely.

I am, therefore, relieved that we shall be able to reduce some of the indebtedness we incurred over the last few years; and also that we can avoid taking up certain new loans that we thought would be necessary to maintain an essential minimum development effort.

Development Expenditure 1977/78

How shall we press ahead with our development? The development effort by the Government, as expressed by the amount of expenditure provided in the Development Estimates for 1977/78 shows an increase of 53 per cent compared with the expected level of expenditure in the current year.

Even allowing for higher prices, this represents a substantial increase in real development spending and goes some way towards making up for the ground lost over the last three years.

This year should see the completion of several major projects that have been important items in the Development Estimates of recent years. These include the new Nairobi and Mombasa Airport Terminals and the Mombasa-Nairobi Oil Pipeline. I shall be glad to see these expensive projects behind us and look forward to some pay-back from them.

These projects, however, will be replaced by other new large projects such as the Sabaki Water Scheme, new or expanded sugar factories at Mumias, Nzoia and South Nyanza, new aircraft for Kenya Airways and new locomotives for Kenya Railways. The major dam construction at Gitaru will continue, while the Upper Tana and Bura irrigation developments will get under way.

On a Ministry basis, the development vote of the Ministry of Water Development will be larger than any other and will double compared with the current year. The Agriculture development vote, the second largest, will increase by 26 per cent, excluding the provision for the new sugar factories which will be found in the estimates of the Ministry of Finance and Planning.

The development vote of the Ministry of Housing and Social Services is doubled, since we have included additional provision for loans to the National Housing Corporation and H.F.C.K. in order to direct part of the present high level of liquidity into the improvement in housing standards. Provision for additional civil service housing has also been included in the vote of the Ministry of Works.

Considered overall, I think we have worked out our development priorities for next year about right. The proposed expenditures are in broad conformity with the reassessment of our development priorities in Sessional Paper No. 4 of 1975.

Total Expenditure 1977/78

I do not propose to say any more about the details of expenditure proposed for 1977/78, since there will be an opportunity to discuss these in the Committee of Supply.

This year, 1976/77, total Government expenditure will have risen no more than an estimated 13 per cent. Allowing for price increases, and taking out the increase in defence expenditure, this represents no increase in real Government expenditure at all. But as I explained in my Budget statement of last year, I did not feel, then, able to authorize a higher level of spending, since I felt that I could not increase taxation when the ordinary man in the street was having such a difficult time, and I could not finance increased expenditure by creating the money through the banks because of the inflationary risk that would involve.

In 1977/78, the inflationary risk remains, as I have already explained. But taking into account the high level of savings held in bank deposits, I have authorized expenditure proposals for consideration by this House —excluding debt repayments—of K£513 million, an increase of 25 per cent compared with this year.

This is a very substantial increase and one which I admit, quite frankly, carries substantial risks in terms of inflationary pressure. I believe, however, that, this year, the risks are worth taking to get our development moving again. And I believe also that we can contain the risks through the policy adjustments I have already announced—such as the increase in the liquidity ratio designed to restrain the expansion of bank credit, the promotion of long-term savings and the early repayment of external loans to neutralize additional liquidity created—and through additional measures I shall announce in a moment.

The Government is not embarking on a spending spree, but we have undoubtedly lost ground in our development effort in the last three years and I would like to see that ground recovered while there is a sudden windfall improvement in our economic circumstances.

As I have explained, I do not expect these circumstances to last; and I do not, therefore, believe that we shall be able to sustain a rate of expenditure at this level next year. But let us seize the opportunity provided by the higher coffee and tea prices to make up some of the lost ground, and to press ahead with the economic adjustments that will be necessary to sustain our economy at a higher level in the difficult years that will undoubtedly face us when our commodity prices drop back again.

Development Revenue

The problem is of course to finance this increase in expenditure. It is to this that I now turn.

Firstly, development revenue. I could not have proposed such a sharp increase in development expenditure unless I could anticipate a significant increase in revenue from external sources.

The Development Estimates project that external aid will total some K£69 million, compared with the revised estimate for the current year of K£40 million, an increase of K£29 million.

Most of this increase will be derived from the multilateral institutions, such as the World Bank, the International Development Association and—of particular importance next year—the European Economic Community. E.E.C. have agreed to provide substantial development grants that will not have to be repaid.

In spite of my proposals to repay certain debts before they are due, and to decline to take certain loans previously negotiated, net drawings on external loans are estimated to increase by some K£20 million. Honourable Members will have noted, however, from the *Economic Survey* that the external debt ratio—the ratio that measures the foreign exchange burden of public sector external debt—has continued to decline and now stands at 2.5 per cent. Kenya has one of the lowest debt service ratios among developing countries and can, when necessary, afford to borrow overseas.

We shall in the coming year take up about K£9 million by way of suppliers credits provided by overseas suppliers.

I mentioned earlier the measures we propose to increase the attractiveness of Government stock. We have, therefore, budgeted for total sales of stock of K£32.5 million to non-banks, compared with an estimated K£28 million in the current year.

THE BUDGET GAP 1977/78

In aggregate, taking external and domestic revenue together, I am budgeting for a total of development revenue from non-banks, excluding any recurrent surplus, of some K£112 million. There will, therefore, be a development deficit of K£85 million which I have to cover.

In addition, I have to anticipate the House might approve appropriations, totalling up to nearly K£16 million, relating to excess expenditure incurred in previous years.

Overall, considering these expenditures, the development deficit and recurrent spending proposals of K£358 million, I now have to find nearly K£460 million.

Of this total, I estimate that ordinary recurrent revenue will provide me with K£335 million, which together with the appropriations-in-aid set out in the Recurrent Estimates of Expenditure, makes a total of K£356 million, a shortfall of K£103 million.

This K£103 million represents the problem of this year's Budget. It is a very sizeable problem—a gap equivalent to 20 per cent of total Government expenditure in the coming year.

It will be apparent to Hon. Members that I cannot finance 20 per cent of total Government expenditure through the banking system. Tax increases are inevitable this year.

However, the Central Bank have agreed to support the proposals to repay a number of existing high interest external loans. They have also agreed to finance from the external reserves the purchase, for cash, of supplies that would otherwise be purchased by new external loans. The Central Bank will provide a Kenya shilling loan of K£25 million specifically for this programme. Since all of this money will go out of the economy it will not represent an increase in liquidity.

In addition, I propose to ask the commercial banks to provide the Exchequer with a loan of K£20 million. This represents only part of the excess liquidity in the banking system at the present time and need not represent a serious burden for the banks. A five-year stock will be issued for this purpose and I shall ask the banks to subscribe in proportion to their deposit liabilities.

By means of the Central Bank loan and commercial bank loan, I will reduce the gap from K£103 million to approximately K£58 million.

GPK 928—350—6/77

NEW TAXATION PROPOSALS

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

THE CUSTOMS TARIFF

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

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

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

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

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

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

Secondly, there is a further range of motor spares that were not affected by the reduction in duty to 25 per cent last year. Th

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

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

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

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

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

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

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

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

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

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

AIRPORT PASSENGER TAX

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

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

SALES TAX

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

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

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

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

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

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

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

EXCISE

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

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

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

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

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

EXPORT DUTIES

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

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

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

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

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

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

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

INCOME TAX

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

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

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

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

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

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

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

As a result, persons in only middle level positions are having to pay rates of tax that they would not have had to pay a few years ago when doing the same job with the same real pay. The standard of living of such

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Mr. Speaker, I beg to move.