REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1974/75
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 12th June, 1974 by the Hon. Mwai Kibaki, Minister for Finance and Economic Planning, Republic of Kenya, when presenting the Budget for the Fiscal Year 1974/75 (1st July to 30th June).

Mr. Speaker, Sir,

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

The Purpose of the Budget

Mr. Speaker, the Budget is an occasion when the Government announces, in detail, how it proposes to implement the economic strategy set down in the national Development Plans. This year we have published a new Development Plan designed to bring us closer to the type of society we seek on the longer-term—a society defined by our basic political objectives. Those political objectives include a free and democratic society in which the attainment of social justice and equity are an obligation on us all. In accordance with our fundamental political creed of African Socialism, every effort must be made by all, and particularly the Government, to protect the poorer, weaker members of the community. It is these poorer members of society who are in danger of being pushed aside in the rush of the richer and stronger members to protect and improve their own economic status. In the difficult economic and financial circumstances in which we now find ourselves, as a result of raging inflation throughout the world, that obligation to protect those less fortunate must be paramount in our minds.

But the Budget must not only give protection, it must also give a lead and point the way. It must direct our national energies towards the economic goals set down in the Plan, for without an expanding economy, we shall be unable to realize other economic and social objectives.

And yet, it would be a mistake to suppose that the Government, through the Budget, can do everything. As H.E. the President has said on so many occasions, it is the people themselves who, to a very large extent, determine whether or not our objectives are realized. Yet there is a naive belief still prevalent that Government can do everything; that by some magical means all problems would be solved if only the Government were more enlightened, more energetic, more efficient. I am not suggesting that we could not be more enlightened, more energetic, or more efficient—I am sure we can be. But our society and our economy is made up of Government and people, and neither can work without the other. The Government, including all Members of this House, have an obligation to lead, to persuade, to convince and to show the way that has already been illuminated by our President. It is only by our own efforts and harder work that we can improve the economic circumstances of our country as a whole.

Nothing is easy. Nothing is free. Everything has to be paid for. Many hon. Members will, I am sure, rise during the Budget Debate and ask why a road, or a bridge, or a school in their constituency has not been included in the Estimates. It is right that hon. Members should bring such proposals to us: but in spite of the progress we have made, we cannot do everything at once and at the same time. We have to draw up a list of priorities and implement projects in that order, depending on what the country can afford. Budget day is the day the planned expenditures are proposed and decisions are announced about how they are to be paid. Development involves a burden. Even at this early stage of my speech, I will not hide from you that if we are to keep up our development efforts, in spite of world inflation, an expanding population and rising social expectations, new burdens have to be imposed—that is, we have to make extra efforts. My Budget is aimed at reallocating resources for the development effort, and at distributing the burdens of that reallocation as fairly as possible.

As usual, hon. Members will have received and have, I hope, had time to study the Economic Survey for 1974 and the Estimates of Expenditure for 1974/75. Copies of the Revenue Estimates and the Financial Statement for 1974/75 are being distributed to hon. Members as I am speaking. These four documents, together with my present statement should all be considered as essential parts of this year's Budget. Although my statement will endeavour to bring together the main threads of these four documents, it is necessary, as I have advised the House on previous occasions, for hon. Members to study each of the individual parts in order to understand the whole.

The Format of the Estimates

I have referred, in Budget statements over the last three years, to the work that has been going on throughout Government to revise the format of the Estimates of Expenditure, so that they explain more clearly how Government spends its money. Hon. Members will, by now, have been able to see just how much has been achieved so far, since the Estimates for 1974/75 now before the House, are set out in the new form. The documents themselves are inevitably very much larger than hitherto, but the greater size is represented by additional information. On numerous occasions in the past, hon. Members have asked to receive more information on Government expenditure. Although it is difficult to accommodate all the individual requests that have been made to me over the years, I hope that the House will agree with me that the new form of the Estimates—the new programme lay-out—meets the main demands that have been made for additional information in the past.

The main principle behind the new form of the expenditure estimates is that they should set out details of expenditures on each individual programme undertaken by a Ministry. It is, in this way, possible to see much more clearly the purposes of Government expenditure. Some Ministries have succeeded in another objective, which is to define district programmes much more clearly. Other Ministries are still working towards this important objective and the inclusion of those details will have to wait until next year.

One consequence of the new form of the Estimates is that, whereas in the past, all Development Estimates have been considered by the House as one vote, in future, the House will be asked to consider a recurrent vote and a development vote for each individual Ministry. At the same time, separate votes for the Police, the Armed Forces and Voice of Kenya have been deleted; and those departments will be discussed by the House as sub-votes within the overall vote of the Ministry to which they belong.

The new programme lay-out of the Estimates is the result of a very considerable effort made by all Ministries and after the most intensive discussions within the Treasury, and within Ministries, on the best way to achieve the most useful and clear method of explaining Government expenditures. I think it only right that the House should recognize the considerable effort that officials have made to provide the House with information it has sought on Government spending.

RECURRENT EXPENDITURE, 1973/74

I would now like to turn to the level of Government spending in the current year, 1973/74. Hon. Members may recall that, last year, I budgeted for an increase in recurrent spending over 1972/73 of approximately 11 per cent. I emphasized then the importance of Ministries managing their programmes within the expenditure budget they were provided. Although it was necessary for me to come to the House with supplementary recurrent estimates totalling K£10.6 million, it is, I think, fair to say that Ministries have been more successful in containing their expenditures than in the past.

This apparent contradiction is explained by the fact that the main part of the supplementary recurrent estimates brought before the House was represented by the increased cost of personal emoluments, arising out of the salary award made to lower grade civil servants and also, of course, the abolition of primary school fees in Standards I to IV. In the face of the rise in the cost of living, the salary award was reasonable and just, but if it had not been for that amount, for which Ministries could not have budgeted in the first place, the supplementary provision requested this year would have been very small indeed.

Taking into account the Supplementary Estimates, recurrent spending this year will be approximately 18.4 per cent higher than the actual spending incurred last year. But, bearing in mind the increased salaries paid to lower grades of staff and the increased cost of many supplies, this increase of 18 per cent does not represent an expansion of expenditure in real terms very different from that proposed in the Development Plan.

DEVELOPMENT SPENDING 1973/74

Although the House has approved Development Estimates totalling more than K£71 million, I do not expect development spending to exceed K£65 million in the current financial year; not much more than actual expenditure last year. Ministries have still not achieved the important objective of spending all money provided for new development projects.

On the other hand, as I have mentioned to the House on previous occasions and touched on today, Ministries are now in a position to implement a much higher level of development spending than the Exchequer can possibly afford. It is, therefore, absolutely necessary to select development projects more carefully on the basis of national priorities, and to implement the projects selected as soon as the necessary funds are voted by this House without delay. Ministries must not ask for provisions which they are not able to spend, as this will prevent other projects which are ready from going ahead.

RATE OF INCREASE IN TOTAL GOVERNMENT SPENDING

Overall, in the current financial year, the Government will have spent approximately K£230 million, about 14 per cent more than in the previous financial year. Allowing for the increased cost of salaries and supplies, this rate of increase in expenditure is not extravagant in the light of our development needs. In order to keep the budget down to this rate of growth, I have restrained new spending proposals very strictly. It has not been easy, and I know that some Ministries feel that they have been hardly dealt with.

I am, however, encouraged by an increasing awareness within Government that it is the responsibility of all Ministries, and not simply that of the Treasury, to control expenditure within the limits of what the country can afford. I am anxious that this awareness should become widespread and that everyone involved in the formulation of expenditure proposals, at whatever level of Government, should come to appreciate that the responsibility of restraining the growth of Government spending, and of obtaining a good return on any money spent, rests with every single official of the Government and, indeed, Ministers and Members of this House, and not simply with the Minister for Finance and the Treasury.

Financing of the 1973/74 Expenditure

It is fortunate that, bearing in mind the total of K£8 million supplementary expenditures approved by the House and expected to be spent, recurrent revenue has been particularly buoyant in the current year. I now expect that final receipts of recurrent revenue on an "Estimates basis" to be approximately K£172 million or nearly K£30 million higher than expected when we drew up the revenue estimates last year. The main reason for the higher level of revenue is that the rate of inflation—particularly the rate of increase in the prices of imported commodities—has been higher than we expected last year. Revenue from *ad valorem* duties goes up at the same rate as price changes—hence the increase in revenue.

The new, and much maligned, Sales Tax was particularly helpful here. Indeed, I feel strongly that if the House had not approved the new Sales Tax last year, the country would be in very severe financial difficulties now, as a result of the present inflationary situation. Although all sorts of economic ills have been laid at the door of the new Sales Tax, the effect of the new tax has been to achieve what I set out to achieve in my Budget last year—a revenue system much more elastic to the growth of money incomes than we had before; and one that does not bear on the very poorest members of the community.

As a result of the growth of recurrent revenue, I now expect to have a cash surplus on recurrent account of nearly K£24 million, which, if achieved, will represent the highest recurrent surplus ever. As has been my practice in recent years, I shall transfer the whole of any surplus left in the Recurrent Exchequer to the Development Exchequer on 30th June and I would ask the House to accept this statement as notice of my intention to do so.

The recurrent surplus is a rough proxy of Government saving, and represents an important part of the self-help efforts of the nation to finance its own development spending. In the Budget last year, I suggested that it would be necessary to depend heavily on short term (potentially inflationary) finance from the banking sector to finance the level of spending proposed by the Estimates: in the event, it seems likely that we shall manage this year without any net increase in short term borrowing. Indeed, on an Exchequer basis, I may even achieve the first overall budget surplus occurring in recent years. In the light of inflation and our balance of payments situation, of which I will speak later, this has been a very welcome and, indeed, much needed improvement.

Domestic long term borrowing is expected to total nearly K£19 million—a little less than budgeted last year. But because of the continuance of a higher level of international money rates, I have thought it prudent not to borrow from the *international* commercial money market this year as we did in 1972/73. We have, however, continued to enjoy substantial financial support from friendly countries and I expect that aid receipts in the form of concessionary loans and grants in the current year to total some K£21 million—less than 10 per cent of total expenditure. Once again, I must say how grateful I am for the financial assistance we receive from overseas. Without it, our development programme would be significantly smaller and our rate of economic growth would be lower. The people of this country enjoy a higher standard of life as a result of the aid we have received in the ten years of our independence and due recognition should be paid to this.

Overall, I can say that it has been possible to finance expenditure this year in a way that is generally non-inflationary. The steep rise in import prices, particularly crude oil prices, and the pressure this places on our balance of payments, makes it necessary that we continue with this policy.

The Economy, 1973

The out-turn of the main economic indicators in 1973 was much as I forecast in my Budget last year. In some ways a little better; in some ways a little worse. The real growth of the economy was lower than the average achieved in recent years, although at current prices, the increase in gross domestic product was estimated at about 12 per cent. For the second year running, the money incomes of farmers as a group improved faster than the incomes of the economy as a whole. The improvements were, however, uneven. Maize receipts were up by 18 per cent; sugar by 47 per cent; coffee by 34 per cent and sisal by a remarkable 278 per cent. On the other hand, wheat, pyrethrum and horticultural incomes were down and the small improvement in milk and beef incomes was entirely due to higher prices. Thus, while some farming sections were significantly better off, others did not do so well.

Manufacturing had a very good year, with the volume of production achieving a rise of over 10 per cent. Manufacturers concerned with the processing of agricultural commodities did particularly well, as did the beverages and tobacco industry.

Tourism had its worst setback for some years. The number of tourists coming to Kenya was 9 per cent lower than in the previous year. Tourist expenditure is estimated to have fallen by 11 per cent. Hotel building continued, however, in anticipation of future recovery. I am sure that those investment decisions will be justified, on the longer term; but the tourist industry may go through a difficult period as a result of economic difficulties in the countries from where our tourists originate.

All in all, the year can be regarded as one of reasonable economic progress in spite of sustained drought in many areas. The performance of the economy was, however, below the targets set out in the new Development Plan.

Balance of Payments

1973 was a year of remarkable trade expansion with the value of our exports increasing by 31 per cent, partly due to an improvement in export prices of 17 per cent (of which coffee and sisal were particularly notable) but also due to a remarkable increase of 14 per cent in the volume of our exports overseas.

The value of imports increased by 14 per cent; but since import prices are estimated to have risen, on average, by nearly 14 per cent also, this represented little increase in import volume. The volume of imports is, in fact, still lower than it was in 1971.

As a result of exports increasing faster than imports, the merchandise gap in the balance of payments narrowed. If it had not been for expensive imports of wheat and sugar, food crops which we could very well grow for ourselves, the improvement in our trade gap would have been substantially better than it actually was.

Net invisible receipts were lower, largely due to the fall in tourist income but partly due to higher payments abroad of investment income. Overall, the current account deficit was very much the same as in 1972.

Capital receipts were also much the same, although a little higher than in 1972, so that, overall, our balance of payments achieved a surplus of the same order of magnitude as in 1972.

However the balance of payments surplus in 1973 divided itself into two distinct parts. The first half of the year recorded a substantial surplus of some K£30 million, whereas, the second half of the year realized a deficit of K£20 million, giving cause for some concern. It would seem, however, that a small surplus has been achieved in the first four months of 1974. I shall return to 1974 prospects in a moment.

THE VALUE OF THE KENYA SHILLING

World currency markets remained in turmoil throughout 1973. The United States dollar declined against other major currencies for three-quarters of the year; and so long as the Kenya shilling was pegged at a fixed rate to the dollar, this meant that our currency declined as well. Two small upward adjustments of the shilling against the dollar were, therefore, made in March and June; but once the dollar recovered in the last quarter of the year, we reverted to the previous shilling/dollar parity.

The search for a more stable international monetary system seems no nearer success than it was a year ago. Indeed, the unprecedented escalation of oil prices, pushing nearly all the major industrial economies into balance of payments deficits, has introduced a new element of fundamental instability into the system. This carries serious dangers for the world economy as a whole. To the extent that the major trading nations are forced into restrictive policies to safeguard their balance of payments, developing countries such as ourselves will inevitably suffer. An international solution to this dilemma is required urgently—and I am exerting all the influence I can in international discussions on these matters. The attainment of Kenya's development objectives is heavily dependent on the maintenance of a buoyant world economy.

DOMESTIC PRICES

Undoubtedly, the biggest immediate problem we have had to face in the last year has been the steep rise in domestic prices. The cost of living has risen faster than at any time since independence. The problem has been debated in this House and in the correspondence columns of the press. Even so, it would seem that very few appreciate how little can be achieved with any system of price control, or indeed appreciate the problems we create for ourselves in other directions if we do not administer a price control programme sensibly. Further, not many seem to recognize that the causes of higher prices are external and, quite often, there is nothing we can do about them.

The phenomenon of severe inflation is world wide. In most countries, the problem is much worse than in Kenya. But this is no comfort to us. Indeed, quite the opposite since our economy is heavily dependent on imported capital and raw materials. It is the prices of capital goods and raw materials which have been rising most steeply. Since we have to import such goods, or go without and forgo development and production, we have no choice but to pay the market prices for those goods, and agree that the increased costs which they represent can be passed on in the prices of the goods made with them for sale in the domestic market. There is no alternative. Those who talk of widespread subsidies simply demonstrate their ignorance of the economic situation facing us.

A year of exceptionally dry weather in Kenya made the price situation worse. Shortages of food crops led to steep increases in the prices of vegetables and fruit, and restricted the production of crops such as wheat and sugar necessitating a higher level of expensive imports than would otherwise have been the case. Most of the cost of those imports had to be passed on in the form of higher consumer prices for bread and sugar.

Increased fertilizer, fuel, machinery and labour costs reduced the profitability of farming and Government had, in all fairness, to authorize higher producer prices for essential food commodities, such as maize, wheat, sugar and meat. But if food prices are raised on the farm, that increase has necessarily to be passed on to the consumers. On the whole, the farmer has, I feel, been treated fairly in the matter of price awards in the last year, and it is the urban consumer who has borne the brunt of rising prices. To some extent, this corrects an imbalance that had been growing between the rural and urban areas for a long time, but I believe now that the farmers must realize that they are not the only ones in Kenya who are carrying the burden of world inflation. The most important way that Government can hold down increases in the cost of living of the urban workers, is to hold down farm prices of important food commodities. The correct and fair balance between interests of the farmer and the interests of the urban worker in determining food prices is extremely difficult to find. What is clear, is that both sections have got to show restraint if we are to control domestically induced price increases.

I wish I could say to hon. Members that I can see some improvement in the price situation. Frankly I cannot. The prices of crude oil and other vital imported commodities such as fertilizers, paper and machinery continue to rise. Present indications are that the average price of all our imports taken together, excluding crude oil, will rise by approximately 15 to 20 per cent in the current year. There is no way whatsoever of isolating the Kenya consumers from these price increases.

The time has come, I feel, for us to reassess exactly what we can hope to achieve by price control policy. Attempts to control the prices of all commodities can themselves create shortages. Price control can delay the timing of price increases but, in the end, if the product is not to disappear from the shops altogether, an increase has to be authorized. We can reduce the mark-up allowed for importers, manufacturers or retailers but we run the risk of creating a situation in which importers do not import; manufacturers do not produce, or at least do not expand investment; and retailers do not stock.

All these situations have occurred in the last year and some may be occurring now. In these circumstances, I begin to feel that we might best realize our objective of restraining increases in the cost of living by concentrating our attention more on those few commodities which are most important to the cost of living of the wage earner. We should examine the complete price structure from farm to consumer of items, such as maize meal, wheat flour, bread and meat; and be less concerned with the prices of the full range of all commodities, most of which are beyond the budget of the average worker anyway.

Wage Policy

It is appropriate now that I should say something about wage policy in present inflationary conditions. During the last few months, we have clarified the instructions given earlier to the Industrial Court on the determination of wages. Although it is not our wish to see existing wage agreements broken, we have said that the Court need not object to increases in wages designed to compensate the workers for increases in his cost of living. No one can deny that the wage earner has been hit by the increase in the cost of living over the last twelve months. But then, very few people—except some of the farmers enjoying unusually high export prices—have been able to avoid some reduction in their standard of living over this period. This is unavoidable when the movement of the external terms of trade is adverse, for there is a loss of real income in the country as a whole. This loss of real income for some people, has been worse than the official statistical averages indicate, since producers of coffee, sisal and more recently tea, have been able to increase their incomes faster than prices. As a result, they are better off—which tends to mask the fact that others are worse off.

Until we raise production to replace the loss of real income caused by the adverse movement of the terms of trade, there is no way that a reduction in the standard of living for some can be avoided. All we can do, and all I can try to do, is to see that the people whose standard of living is reduced are those that are best able to afford it. It is for this reason, that the Industrial Court has been asked to give preference in its awards to the lowest paid workers.

Employment Policy

A primary concern of both wage policy and budget policy is to create a climate of economic growth in which the number of jobs increase to absorb the regular increase of those seeking work. During the last year, Government received a very interesting report from the International Labour Organization on Employment Policy in Kenya. This House had the opportunity of debating that Report and the related Sessional Paper prepared by the Government. In large measure, the Government accepted the findings of the Report and is now in the process of implementing them.

The Mission's Report recommended a fairly significant restructuring of the fiscal system and the expenditure priorities of the Government. I had already started on that programme of fiscal reform, in particular the introduction of the Sales Tax, before receiving the I.L.O. Report; but in some areas, particularly the reform of the external tariff, I have still some way to go. The Expenditure Estimates, this year, reflect an attempt to give greater priority to projects that will have employment impact in the rural areas, although it is not easy to swing the balance of spending priorities as quickly as we would like. We have tried to cut down on expenditure on office buildings, and gradually we shall reduce our expenditures on the trunk road system in order to afford more widespread improvements in rural roads.

If our employment policy is, however, to be successful and provide a means of livelihood for all who are unable to work on the land, it is essential, as the I.L.O. Report emphasized, that wages are not pushed up to the extent that employment of labour becomes uneconomic. It will be no help to the country if two people are employed at Sh. 1,000 a month when five people are pushed out of employment because the employer cannot afford to employ at that wage.

It is the wish of any sensible person that real wages in this country should be raised. We can, however, only raise real wages to the extent that the real income of the country can afford such an increase. It is for this reason that we have a wage policy as defined in the guidelines of the Industrial Court. We are concerned with the interests of the mass of the wage earners, not just the relatively few in a strong industrial bargaining position and already enjoying relatively high wages compared with other groups.

1973 was one of the most successful of recent years as regards job creation by the economy, that is, without special measures such as Tripartite Agreements. About 42,000 additional jobs were filled in the formal sector of the economy of which 23,000 became available on large farms and settlement schemes. Unfortunately, we do not have estimates of the number of jobs created in the small farm sector, but indications of labour shortage during the picking season for coffee and tea, and the expansion of sisal and sugar production, suggest that there was a significant expansion in small farm employment also

ECONOMIC PROSPECTS

If it were not for the difficulties anticipated in respect of the balance of payments, I would expect the next twelve months to be a period of reasonable income and production for the Kenya economy. Agricultural output should be maintained overall, with higher sisal, pineapple, sugar, livestock and, perhaps, maize production, offsetting lower production of coffee and tea. Export prices, particularly of sisal, coffee and tea are good.

Manufacturing should have a good year, provided we can obtain the needed raw materials. The Manufacturers' Export Compensation Scheme, recently passed by this House, could give great impetus to industrial production, if manufacturers take advantage of the opportunities available as soon as the scheme is put into effect, which I expect to be in a matter of days now. The new increased capacity at the oil refinery and the opening of the Webuye Paper Mill will also give additional impetus to production.

Tourism may not enjoy a year of significant growth but the decline in tourism seen last year should not be repeated.

Building and construction may turn back a little as Government's self-imposed restrictions on its own building programme makes itself felt. There are, however, still substantial housing projects underway.

Overall, if it were not for the balance of payments, and problems arising from continued inflation, I would expect an average year.

However, as I have already warned the House, the balance of payments outlook for the next twelve months is grim. The cost of oil imports is expected to rise by at least K£50 million in a full year and, although we shall recover part of that sum from higher exports of petroleum products manufactured at the Mombasa refinery, we shall still be left with a foreign exchange deficit on oil account of some K£15 million. In the past, we have generally achieved a foreign exchange surplus from our trade in oil products.

The period of economic readjustment in the face of what is rightly described, "as the oil crisis" will be painful. At this time last year, crude oil purchased for refining in Kenya cost $1.59 per barrel. That same crude oil today is costing $9.66 per barrel, and the price is still tending to rise. Apart from hydro-electricity, the modern sector of our economy is almost completely dependent on energy derived from petroleum. Even if we cut back the somewhat extravagant use of motor-cars in this country, we would find it difficult, if not almost impossible with present knowledge, to forgo the use of diesel fuel that powers our tractors and railway locomotives; aviation kerosene that fuels the planes bringing tourists; and industrial fuel oil that drives our factories and thermal power stations. An increase in the price of energy by six times in a space of twelve months is a crisis indeed. It is the opinion of the World Bank, an opinion which I share, that Kenya has been harmed relatively far worse than most other countries by the oil situation.

Yet the prices of other imports are also still rising steeply, and we would have been in serious balance of payments difficulties already if it had not been for the fact that coffee, tea and sisal prices have improved sharply in 1974 to off-set these higher costs. Naturally, we hope that our export prices will remain at their present levels, or even improve further, but there are already indications that the prices of primary commodities generally are falling back. Unfortunately, there is little indication that the prices of manufactures are coming back at the same time.

ECONOMIC STRATEGY

We have no option, Mr. Speaker, but to base our economic strategy in 1974/75 on the need to preserve a balance on external account. I hope, however, that we can achieve this without any serious restriction on imports through licensing, and that we can achieve the balance we are seeking through restructuring of the Government budget, restricting demand for imported consumer goods, particularly petroleum products, and by increasing our borrowing from the international agencies as a stop-gap while we endeavour to reorganize our economy to the new situation that faces us.

I propose to ask the World Bank for a programme loan and the International Monetary Fund for a loan under the special oil facility that has been proposed to help all countries facing this wholly unexpected but devastating increase in oil prices. If we are not to bring development to a complete halt, a country such as ours must have time to allow our more fundamental measures to work. I hope I can secure such loans to give us this time.

We have already taken steps to be more selective about the new projects included in the Development Estimates, in order to achieve a higher rate of economic return from our expenditures. We propose to postpone building projects that can, without too much hardship, be held back for a year or so. Further, I have placed under requisition K£11 million of expenditure contained in the current year's Development Estimates. I shall speak about this in more detail later on. The forward Budget for 1974/75, on which we are already working, will be reviewed even more stringently, in order to give priority to projects that have a low foreign exchange cost and which will give us a higher economic return.

I am not convinced that we receive all the foreign exchange that we should from tourists who come to Kenya. Accordingly, to protect our balance of payments, and in order to increase our benefits from this industry, regulations will be published whereby tourists will be required to pay all their hotel bills and domestic tour bills with foreign exchange. In addition, all hotels and tour companies will be required to conduct all foreign exchange and other financial transactions over a single bank account which will be open to inspection by the Exchange Control.

On the more positive side, the Export Compensation Scheme for manufactures will be brought into effect as quickly as possible. I look to our manufacturers to respond to the incentive this will provide.

CREDIT AND SAVINGS POLICY

In view of the sharp increase in the import bill and consequent fall in our foreign reserves, it must be expected that domestic credit will be tight. I shall, therefore, say something about how I propose that the limited amount of credit will be used.

In present circumstances, the requirements of the Cereals and Sugar Finance Corporation for the finance of domestic crops must have priority, and any Government needs must also be met without excessive expansion of the money supply. Accordingly, domestic credit to the private sector from the banking system will only be permitted to increase this year at an annual rate of 12 per cent.

In order to achieve this, the Central Bank will review all borrowing limits allocated to foreign controlled companies to ensure that local borrowing by any such company is brought back to 20 per cent, where this figure is exceeded, of the amount of the foreign investment, unless there are very strong reasons to justify exceptional treatment.

If it is necessary to tighten credit further than I envisage now, it may well be necessary to set a standard below 20 per cent: we shall adopt a flexible attitude to this. There has been pressure from foreign-controlled companies who wish to take advantage of the low rates of interest ruling in Kenya to borrow substantial sums from the local banks; but citizens and locally-controlled businesses must be given priority in the allocation of domestic credit.

Further, the banks will be required to raise their minimum lending rates, from 7 per cent to 8 per cent. This increase will mainly be felt by the large companies, especially foreign-controlled ones, which now borrow at the "prime rate". It will also add to the borrowing costs of some Government institutions. However, the increase in the minimum lending rate should not, *and I underline this*—lead to proportionate increases in other lending rates. Further, the increase in the prime rate should allow the banks to put up the rates allowed on savings and deposit accounts, with the minimum rate being fixed at 5 per cent. The Central Bank will issue the necessary instructions to the commercial banks.

There is now an even greater need to mobilize savings for development, and I propose to introduce legislation to increase the deposit rate paid by the Post Office Savings Bank in line with that of the banks. The more savings we can mobilize within Kenya, the less will be our need for foreign capital.

The tightening of credit will create financing problems for a number of foreign companies, particularly those that are concerned with purchasing imports at inflated prices. I appreciate these problems but those companies must appreciate why we are having to do this. Many foreign firms try to operate in this country on a capital base, as represented by their shareholders' funds, which is unreasonably small. They must, therefore, try to put this right by retaining a greater part of the profits they earn; so that they can finance their own operations with less dependence on local credit. However, where a foreign firm needs more time to do this, but is making genuine efforts towards this end, the Central Bank will allow such firms to borrow overseas at rates of interest higher than those now permitted.

In the difficult balance of payments situation in which we find ourselves, we have a need, even more than in the past, for additional investment from overseas. We are, however, now unable to provide domestic credit to finance the operations of foreign investors in Kenya and they must, therefore, find that credit outside Kenya and bring it with them to finance their operations here. This is not a measure aimed against foreign investment. It is simply designed to give priority in the use of Kenya savings, to Kenya-owned businesses. Foreign investment is as welcome in Kenya as ever. Until the credit situation eases, however, they must be prepared to find any finance they require abroad.

EXPENDITURE 1974/75

But if, through restrictions on the supply of money, I place some restraint on the private sector, I must also try and restrain the Government sector in the coming year. This is, however, difficult, if the overall level of Government services is to be maintained, and if the new Development Plan is to get under way. The problem is made particularly difficult by the inexorable growth of education expenditures. In 1964/65, just after independence, gross recurrent spending on education, when local authorities were largely responsible for primary education, represented 7½ per cent of total recurrent spending. This year, the proportion is 25 per cent. Next year, the proportion will be 27 per cent. Even allowing for the earlier neglect of education and the importance that we all attach to providing good schooling for our children, we must define some limits to expenditure on education. We are now providing the first four years of primary education to everyone without fees. The opportunities exist for any child of ability to go to secondary school. The most able of all can go on to University. But there is now a real risk that the expansion of secondary and University enrolment is proceeding at a rate which the country cannot afford. As a result, other services, such as agricultural credit, are not receiving a reasonable share of the resources available. Education must be planned within the structure of overall national resource availability, if we are to exercise control over recurrent spending generally, and if we are to follow a balanced development strategy.

In the coming year, 1974/75, total Recurrent Expenditure, net of Appropriations-in-Aid, as you can see from your copies of the Estimates, will be about K£170 million. On a gross basis, this represents expenditure of K£186 million, an increase of 12.6 per cent over Recurrent Expenditure this year. Half the increase in voted expenditures will be spent on education. As I have just said, this is a matter to which we must all give the most heart searching thought. Effectively, proposed recurrent spending next year is lower than the planned recurrent expenditure for 1974/75 indicated in the Development Plan, if adjustment is made for price changes. If our overall economic strategy is to be successful, it is, however, essential that this restraint is imposed.

Total Development Expenditure, gross of Appropriations-in-Aid, is shown in the Estimates as K£[illegible] million, an increase of 37.5 per cent over the expected level of spending this year. In a period of restraint, this might seem, at first sight, to be an unreasonably rapid rate of increase in spending, but if you look closely at the Estimates, you will observe that I have *"requisitioned"* some K£11 million of the expenditure provided. Those projects marked as being requisitioned will not be permitted to proceed until Treasury approval is given explicitly. The reason for this is that we are in the process of negotiating aid finance for projects costing some K£7 million but project agreements have not yet been finalized and signed. Once we have firm commitments from a donor in the form of a final project agreement, the requisition will be lifted and the project allowed to go ahead. This means that we shall be able to match revenue with expenditure.

There is also a K£4 million item requisitioned which has nothing to do with aid finance. This provides, in the Vote of the Ministry of Agriculture, for a loan to the Central Agricultural Board. The purpose of this loan will be to fund the longer term debts of the Central Agricultural Board relating to short term crop advances, so that these debts are not carried by the Cereals and Sugar Finance Corporation beyond a single season. This can be regarded as a book transaction between two Government accounts and there will be no net economic effect arising from the expenditure.

Ignoring details such as I have just described, the Estimates taken together provide for expenditure of K£274 million, nearly 20 per cent higher than the current year. In spite of our difficulties, I am determined that we shall continue with the task of national development. Although I have placed a restraining hand on Recurrent Expenditures, I am still seeking to move forward, on the Development side, as proposed by the new Plan.

The Financial Outlook

Overall, Mr. Speaker, I require an additional K£20 million for recurrent spending and an additional K£23 million for development spending. How are we going to pay for this?

The financial outlook for the coming year is, in part, dependent on the extent to which I have to hold back the expansion of the economy in order to preserve a balance on external account. Generally, as I have indicated, the outlook for production and income overall is reasonable. Similarly, the outlook for the revenue would also be quite fair, except to the extent that it is necessary to restrict the economy to safeguard the balance of payments.

There are, however, three special factors that will restrict the growth of revenue in 1974/75. Firstly, the windfall payments of 1970 company tax the revenue has received over the last four financial years will have come to an end. We have been collecting about K£3 million a year from these windfalls which will no longer be available.

Secondly, I have to allow for the fact that the export compensation payments to manufacturers will be deductable from Customs and Excise Revenue. This is more difficult to estimate but I have allowed K£3 million for this also—although I hope to recoup part of this amount in the form of taxation of higher profits.

Thirdly, *appropriations-in-aid*, which are used to finance ministry expenditures directly, will be more than K£3 million lower next year. There are a number of reasons for this amongst which, of course, are the lower receipts from school fees. Since I have been considering gross expenditures, I must take those lower appropriations into account.

When all factors are taken into consideration, I expect ordinary revenue to increase from K£172 million in the current year to K£185 million next year, an increase of K£13 million. Appropriations-in-aid will be K£3 million lower. Gross revenue, therefore, is estimated to rise by only K£10 million.

Fortunately I have reason to expect that the volume of aid next year may be K£8 million higher than in the current year. I am confident of securing K£25 million, and as I indicated a moment ago, if aid under negotiation is not finally secured, the projects earmarked in the Estimates to be financed by such aid will not be permitted to go ahead. Some K£6 million of aid comes into this category but I am confident that the main part of this will be secured and there is reason to believe that an even higher total may be available. I have taken no account of any special World Bank or I.M.F. loans such as I mentioned a moment ago.

This year, I have secured K£19 million by way of long-term domestic borrowing. Next year, I am aiming at K£20 million.

Thus, from revenue sources available to me I expect to collect an additional K£19 million, compared with an increase in spending of K£43 million. There is a gap of K£24 million, or K£20 million if I exclude the K£4 million book transaction of which I spoke a moment ago.

Financial Proposals

A gap of K£20 million is a very large one—certainly much more than I can finance through the banking system, without risk in present economic circumstances. Before I explain how I propose to cover the cost of the additional expenditures, I would ask you, Mr. Speaker, to regard the rest of my Speech as being Notice of a Motion to be moved before the Committee of Ways and Means.

Before I outline the particular measures I propose to cover the gap, I would ask, Mr. Speaker, that all hon. Members recall what I said about the purpose of my Budget right at the beginning of this speech. I said the Budget should, among other things, be used as an opportunity to fulfill our obligations to the poorer members of the community. In times of economic difficulties, it is sometimes impossible to isolate everyone completely—but at least I shall try today.

With a Budget gap as large as I have indicated, there is, I am afraid, no escape from new taxation measures. I have strived, however, to find new sources of revenue that fit in with the overall fiscal strategy I described at some length last year, to the extent that this will not undermine the standard of life of the poor. I feel in these circumstances that I can tax the non-essential expenditures, some of which members of this House have themselves suggested could bear a higher level of taxation.

BETTING TAX

Firstly, I propose to raise the rate of tax on off-course betting from 5 per cent to 7½ per cent. This is not a major measure, and is only estimated to provide me with an additional K£80,000 but if people can afford to lose their money by betting, they can also afford to lose a little in extra taxation and contribute to the welfare of their fellowmen!

SALES TAX

Secondly, I propose to raise the rate of sales tax on beer, cigarettes and tobacco, and petrol.

The price of a half litre bottle of beer will go up by 25 cents, of which the revenue will earn 21 cents. The remaining 4 cents will compensate the breweries for part of the cost increases that I have insisted they carry in recent months. From this measure, I expect the Exchequer to earn an additional K£3.4 million.

The price of cigarettes will go up by varying amounts depending on the brand. A packet of Sportsman—the most popular brand—will go up by 25 cents. More expensive brands will go up by 50 cents a packet; the cheapest brand by 15 cents. Imported cigarettes—if smokers can't live without them—will go up by Sh. 1 per packet. There will also be a change in the cigarette and tobacco excise but the price changes I have just outlined will follow from the combined effect of the proposed change in sales tax and excise taken together. The Exchequer will gain over K£1 million from increased tobacco taxes.

Petrol taxation—and the price of petrol—will rise by 20 cents per litre. As I described earlier, the oil crisis is to a large extent the root cause of our own present problems. I must, therefore, enforce greater economy in the use of petrol. Those that are not prepared to economize will have to pay higher taxation. I also propose that the normal rate of Sales Tax should apply to all lubricants and greases which are free of Sales Tax at the present time. I expect the Exchequer to profit by K£3.3 million from increased taxation of petrol and lubricants.

Thirdly, I propose to create a higher rate of sales tax for a number of items of personal expenditure which in present circumstances must be regarded as luxuries. The rate of sale tax will be raised from 10 per cent to 15 per cent on the following items—wines, spirits, travel goods, domestic refrigerators and washing machines, other electrical appliances, cameras, films and photographic equipment, watches, gramophone records, cassettes, tape recorders, dictating machines, mechanical handling equipment—and finally—motor cars. I hope to raise an additional K£800,000 from the increased rate of sales tax on what I believe must be regarded as "luxuries".

In addition on Sales Tax, I propose to make one fairly major concession. Manufacturers who produce tax exempt goods are not at present permitted to register as manufacturers under the Act. As a result, they are not able to purchase their raw materials free of tax as they would if their own products were taxable. I now propose that the law should be changed to enable them to do so and I calculate that this will reduce raw material costs of the firms involved by K£600,000. We shall of course expect those cost savings to be passed on the consumer—most of them should relate to agricultural chemicals and supplies.

Taken together, the changes in Sales Tax, I have announced this afternoon, are estimated to provide the revenue with an additional K£7.6 million in 1974/75. They will take effect from mid-night tonight.

INCOME TAX

Although our new Kenya Income Tax Act has only been in operation for a few months, there are one or two anomalies I should like to clear up. I will not describe all these proposals in detail, since they are set out in the Finance Bill published today, but they are designed to clarify certain sections of the law where difficulties of interpretation have arisen and to ease the working of the law.

More substantively, I propose to make two changes in income tax that will affect the revenue. In a period when I am asking everyone to show restraint—particularly the wage earner in his wage demands—I feel that I must place some greater restraint on profits. Accordingly, the rate of tax on company profits will be increased from 40 per cent to 45 per cent and the rate of tax on the profits of foreign branches will be raised from 47½ per cent to 52½ per cent. These changes will apply to the year of income 1974.

I am, however, persuaded that there is a case of exempting the profits of life insurance companies from the proposed increase in corporation tax and I am setting a special rate of corporation tax of 40 per cent for profits earned by *resident* companies on their life funds.

In addition, from mid-night tonight, the rate of tax on dividends paid to non-residents will go up from 12½ per cent to 15 per cent. This tax can of course be avoided so long as profits are retained in the business and dividends are not paid. The rates of withholding taxes on resident dividends will also go up to 15 per cent but, as now, those dividend taxes will be set off against personal tax under assessment, so that, in the end, no additional tax will be paid by a resident individual.

I estimate that the increased taxation on profits and dividends will earn the revenue K£3½ million.

CUSTOMS DUTIES

I spent some time during my speech last year explaining why I thought our external tariff had become outmoded and why it was leading to some misallocation of resources in our economy. Under the East African Treaty it is, however, necessary that we introduce any changes in concert with the other partner states. To this end, agreement has been reached to study the impact of a general reform of the external tariff on an East African basis.

In the meantime, we are generally agreed that there is a need to reduce the level of protection afforded by the tariff on food items. We, therefore, propose, jointly, that the rate of duty on meat, fish, and milk products in the first three chapters of the tariff will be reduced from 50 per cent to 25 per cent. In addition, the duty on fixed vegetable oils will be reduced from 40 per cent to 20 per cent and the duty on margarine will be reduced from 50 per cent to 25 per cent.

I gave notice last year that I intended to reduce some of the higher protective duties in the tariff: the reductions this year are an earnest of my intentions for the future. Our economy must become more competitive.

There are a number of other minor changes none of which have any significant revenue effects and which are largely designed to correct anomalities in the tariff. They are all listed in detail in the Finance Bill.

Two will, however, perhaps be of interest to some of the ladies. The Customs Department have had great difficulty in knowing where to classify false eyebrows, false eyelashes and hair switches. These vital female accoutrements will from now on be classified with wigs and taxed at 30 per cent. Also, the rate of specific duty applying to individual items of women's outer garments will be raised to the same level as for men's outer garments, that is Sh. 6. In these days of uni-sex, the Customs are unable to decide, always, whether a garment is for a male or a female. By taxing male and female garments at the same rate the difficulty is removed.

Taken together the changes in the Customs tariff this year are relatively minor. Overall, I am giving up K£100,000 of revenue.

These then are my Budget measures. In all, I expect to raise a total of K£11.4 million from the higher taxes I have announced today. Even so, this will still be insufficient to cover the gap of K£20 million I mentioned earlier. The difference of some K£9 million will, if necessary, be financed by an increase in short-term borrowing from the banking sector. I believe that this level of short-term borrowing need not be dangerous to our general financial strategy and to increase taxation more than I have proposed would cause some hardship.

As things stand now, if you drink, smoke or drive, you will have to pay more in taxation. If you are among the fortunate few who can afford cameras, refrigerators, tape recorders and the like, you will also pay more tax. If you own a company earning profits, your company will pay more tax. If, however, you are an average Kenyan, struggling to make a living from the land, you cannot afford the things I propose to tax this year. I have not taxed food—indeed some of the food taxes have been lowered—I have even not taxed *pombe*—when made at home. There is a burden of additional taxation to bear; but the people who will have to bear this increased taxation are I believe the ones that are best able to afford it. And this is in accord to the well-known principle of social justice—namely, "from each according to his means".

I am prepared to risk the charge that my Budget is taxing the pleasures in life, and is therefore a "spoil-sport" Budget. In times of difficulty, those that can afford it must give up some of their pleasures, so that others do not go short of food. In the circumstances, I believe my Budget is fair, and I believe it carries a stage further my long-term programme of fiscal reform. It will enable us to continue to implement the important parts of our development programme in spite of all the economic difficulties we face.

Mr. Speaker, I have talked about the very difficult economic problems that we face in the coming year. I would like to reaffirm my conviction that we shall pull through. Our success is, I feel, assured for two reasons: First and foremost, we shall continue to enjoy the strong and dedicated leadership of the Father of our Nation who for fifty years has always given us the inspiration to overcome problems far greater in their magnitude and intensity than those that we now face. With him at the helm the ship of state will, without doubt, maintain course and sail to the harbour through the economic storms that we face. Secondly, Mr. Speaker, we shall pull through because we are a free people in a free society and I personally have the greatest faith in the ability and willingness of our people to work harder and produce more. In a free society such as ours, every individual citizen will work hard in the full knowledge and confidence that he will enjoy the fruits of his labour in tranquillity.

Mr. Speaker, this Budget will be the last one that I present before all of us members of this House go back to the people in search of a new mandate. It is fitting, therefore, that on behalf of each one of us, I should reaffirm our faith in the Parliamentary Democracy. Mr Speaker, despite all the problems, delays, and frustrations of democratic decision-making processes, our Nation must, at all costs, continue to defend and extend the democratic institutions whose foundations we have so firmly laid over the last ten years. So it is my hope and prayer that the processes of elections will be conducted in an atmosphere of peace and freedom and in the spirit of true sportsmanship—and may the best man win!

Mr. Speaker, I beg to move.