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REPUBLIC OF KENYA

Budget Speech

for the

Fiscal Year 1973/74
(1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 14th June, 1973 by the Hon. Mwai Kibaki, Minister for Finance and Economic Planning, Republic of Kenya, when presenting the Budget for the Fiscal Year 1973/74 (1st July to 30th June).

Mr. Speaker, Sir,

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

It has been my normal practice in the past to refer at the outset of the Budget Speech to the documents that have been distributed to hon. Members or are distributed to them as I speak. Once again, I must impress on hon. Members the importance of their studying all of these documents carefully in order to understand the Budget in total. I do not wish to discuss in detail this afternoon the contents of either the Economic Survey, 1973, or the Estimates of Expenditure for 1973/74, although, as usual, I shall make reference to those documents where their contents have influenced my thinking in drawing up the Budget.

Copies of the Revenue Estimates and the Financial Statement for 1973/74 will be distributed to hon. Members as I am speaking, and those documents in particular will enable the House to understand more easily the financial figures I shall be discussing in my speech.

The Format of the Estimates

In each of my last two Budget Speeches, I have referred to improvements being made and others planned in the format of the Expenditure Estimates. I am now able to inform the House that the Estimates of Expenditure for 1973/74 will be the last to be published in their present form. The format of the Estimates to be published for 1974/75 will be significantly different and I am confident that the House will find the additional information regarding Government spending provided by the new programme format extremely enlightening. I believe this to be in accordance with the wishes of the House in this matter.

The principal reasons for the proposed change in the arrangement of the Estimates are, firstly, to make the House and the general public better informed about how Government actually spends its money, and secondly, to provide Government with a more precise management structure and thus improve management control over the spending of public funds.

Recurrent Expenditure, 1973/74

That is for the future. I now wish to turn to Government expenditure in the current, 1972/73, financial year. During my Budget Speech last year, I advised the House that the Recurrent Estimates for 1972/73 had been drawn up to provide all the finance necessary for recurrent spending and that I expected all Ministries to restrict their operations within the limits set by their voted provision.

In the event, as hon. Members are aware, it was still necessary for me to come to the House and ask for supplementary provision for Ministries totalling over K£7 million.

On the assumption that the total provision made in the current year is fully spent, as I expect, recurrent spending for 1972/73 (including cash issues for overspending in previous years) will total about K£140 million, an increase of approximately 10 per cent over the previous year. Bearing in mind that there was a fairly substantial increase in the price of supplies purchased by Government during the year, an increase of 10 per cent in recurrent spending cannot be considered unduly extravagant, nor above what I might call the normal trend line related to national needs, and the normal expansion of the revenue. It is, in fact, a lower rate of growth than has been experienced in the last year or so.

Development Spending, 1972/73

The House has approved gross estimates for development spending totalling nearly K£73 million. I do not, however, expect that actual spending will exceed more than approximately K£62 million on a gross basis. Under-spending on this occasion is not, however, due to slackness on the part of Ministries, but is a result of deliberate action by the Treasury in controlling development spending in accordance with estimates of the financial resources available.

We have deliberately held back on some projects that were relatively less urgent, particularly those that were dependent entirely on local finance, such as new Government offices.

I am, in fact, heartened by our success in this matter, as it indicates that, when necessary, we can now control the level of Government spending to that considered desirable at a particular time. It represents a significant improvement in our techniques of economic management which we shall need to develop further for the future.

[The Minister for Finance and Economic Planning]

Total Government spending in 1972/73 is expected to be K£202 million compared with K£201 million estimated at the time of my Budget last year.

RATE OF INCREASE IN GOVERNMENT SPENDING

Mr. Speaker, lest hon. Members get the impression from these figures that we have faltered in our development effort. I must quickly point out that spending on development projects will be some 13 per cent higher than in the previous year. Recurrent spending, as I have said, will be 10 per cent higher than in 1971/72, so that, overall, Government will have spent 11 per cent more money in 1972/73 than it did in 1971/72.

The Government has more than maintained its effort in the development field. In the last three years, our economy has grown at an average rate of about 11 per cent in current money terms, yet total Government spending has increased at an average rate of 18 per cent. Recurrent spending has increased at an average rate of 15 per cent and development spending at an average rate of 27 per cent. This shows that the contribution of the Government sector in the growth of our economy has been increasing steadily.

We must, however, face the fact that the Government budget is now a significant proportion of the total resources used in the economy and that annual rates of expenditure growth of the order of 20 per cent when the economy is growing in money terms at only about 10 per cent cannot be sustained. We must, in future relate growth of Government expenditure more closely to the growth of revenue than we have been doing.

FINANCING OF 1972/73 EXPENDITURE

Recurrent revenue in 1972/73 will be very much in line with the estimate I made at the time of last year's Budget. The revised revenue estimate is K£144 million, the same as in 1971/72. Hon. Members will thus see that I have been financing a 10 per cent higher recurrent expenditure with the same revenue out-turn.

The result of this is that the growing recurrent surplus which we enjoyed in earlier years has been substantially reduced in the current financial year. I can only expect to transfer about K£5 million from the recurrent account to development at the end of June, compared with nearly K£17½ million last year. As has been my practice in recent years, I shall, however, transfer any surplus left in the Recurrent Exchequer to Development on 30th June and I would ask the House to accept this as notice of my intention to do so.

As is usually the case, the financing of the development programme has presented some difficulties. I had thought, when I presented the Development Estimates for 1972/73 last year, that I could reasonably expect to obtain about K£35¼ million from external sources in the form of grants, concessionary loans or commercial loans. Our performance this year in taking up aid available to us has been very much better than previously but we have still failed to obtain all of the aid budgeted and I expect that we shall receive about K£20 million in total compared with the original estimate of K£25 million.

In addition, I proposed that the Treasury should borrow some K£9 million on full commercial terms from the overseas money market. In the event, only K£5.7 million was taken in this form

These commercial loans represent some achievement for us, since they demonstrate Kenya's growing reputation in the world money markets. When we wish, we can now enter the money markets and find hard headed international bankers prepared to lend money to Kenya on a commercial basis.

However, international money rates are currently extremely high and it is not my intention to borrow at commercial rates regularly for general budgetary support, as I fear that we should very quickly create external debt servicing problems for ourselves if we were to do this on any scale. We shall, however, consider this source of finance for particular projects which can themselves generate sufficient resources to pay full commercial rates of interest, particularly when such projects can show us a balance of payments saving.

As I said a moment ago, spending on some of the new development projects has been held back in the current financial year, and I have been able to cover the greater part of the Exchequer cash deficit by domestic long-term borrowing. Indeed, local long-term borrowing of new money is expected to achieve a record K£21 million in the current financial year. There were, however, some special factors which enabled me to achieve this total, particularly the availability of surplus cash in the East African Community pension funds.

It had been my intention, as Members may recall, to cover part of the Exchequer deficit this year by a fiduciary loan from the Central Bank. In the event my residual cash needs have been less than expected and I have covered this by an increase in the Treasury Bill issue. I do not now expect to borrow any funds from the Central Bank, but, since I use the Central Bank as a source of residual financing, I cannot be definite about this until I see actually how much money will be required in the Exchequer to meet our needs at the end of the financial year.

THE ECONOMY IN 1972 AND THE GROWTH OF REVENUE

As I have indicated, we shall in future have to plan the growth of Government expenditure more closely in line with the growth of the economy and the revenue. The principal reason for this, of course, is that Government will then be able to finance its expanding services from domestic revenues and our need for external finance will gradually decline as we wish. There are, however, other factors which influence Government revenue and which are well illustrated by events in our economy during 1972/73.

Hon. Members will have read in their Economic Survey that 1972 was in many ways a very good year for our economy. The overall rate of growth at 6.9 per cent in real terms or, 12.3 per cent in current money terms, was above average. Of equal importance was the

[The Minister for Finance and Economic Planning]

fact that the impetus for this growth was based on a record agricultural year with agricultural income up by a stupendous 22 per cent. Manufacturing and construction may not have achieved such high rates of growth as they have in some earlier years, but still enjoyed a good year for all that. The impetus of tourism slackened towards the end of the year, but taking the year as a whole, our tourist industry once again broke all records.

Why then did Government revenue fail to expand with the expansion of the economy? The reason lies in the fact that in the previous year, 1971, the country ran into the most serious balance of payments difficulties it had suffered since independence and stabilizing measures were necessary in order to correct that imbalance on foreign account. I described the reasons for the 1971 balance of payments difficulties in some detail in my Budget Speech last year and I explained then why it was necessary to use particular corrective measures. We can now say that the measures taken by the Government at the end of 1971 were highly successful on the short-term in that a balance of payments deficit of K£28 million in 1971 was turned into a balance of payments surplus of K£9 million in 1972.

However, with Government revenue still highly dependent on customs duties, measures to restrict the flow of imports inevitably also restricted the overall Government revenue. Thus, whereas in 1971/72 revenue from import duties was over K£30 million, we do not expect to receive more than K£27 million in the year just coming to a close. Without the measures to restrict the growth of imports, we might otherwise have expected to earn K£34 million from customs duties in 1972/73, so that the loss of revenue from our control measures can be considered in the region of K£7 million. If that K£7 million had been available to me in the current year, the financing of the 1972/73 Budget would have been that much easier. The recurrent surplus would have been maintained nearer its previous level.

No country, not even the biggest as recent events have shown, can afford to ignore a growing deficit on its external account. A small country, such as ourselves, with very limited reserves and export prices heavily dependent on fluctuating commodity markets must be prepared to intervene actively to maintain a balance on its external account, if it is not to exhaust all of its foreign exchange reserves and be reduced to trading externally on a day-to-day cash basis. This situation has occurred in quite a few developing countries and the experience is not one we would wish to share.

Accordingly, we must accept the fact that many of our programmes can only be implemented so long as the balance of payments allows. This is one of the inescapable facts of our economic life. We can, however, also devise a revenue system less dependent on the volume of imports and this is one reason why the sales tax has been introduced recently. This is also behind some of the changes I am going to propose in the structure of income tax.

THE BALANCE OF PAYMENTS, 1972

Our success in bringing the balance of payments back under control in 1972 was a major achievement, even though the means we had to employ have been painful here and there.

It is perhaps worth examining for a moment changes in the balance of payments in 1972. As a result of import control and credit restrictions and perhaps some de-stocking on the part of the private sector, the value of imports in 1972 declined by some K£10 million compared with 1971. At the same time, exports improved by some K£16 million due to higher export surpluses produced by the agricultural industry and a welcome improvement of 8 per cent in average export prices. These two trends taken together—the fall in imports and the rise in exports—meant that the merchandise account of our balance of payments improved by K£25 million and this improvement was reflected in a reduction in the current account deficit by some K£30 million to K£25 million. Capital receipts rose by an estimated K£4 million, mainly due to higher capital receipts in the Government sector and, overall, there was, as I have said, a swing of K£37 million in our external accounts between 1971 and 1972.

VALUE OF THE KENYA SHILLING

This achievement on the balance of payments was obtained in a year of great difficulty in the international financial markets, and as hon. Members will be aware, the worsening international monetary situation led to a second devaluation of the United States dollar in February this year.

After a very careful assessment of all the factors involved, together with our Partner States in the East African Community, the Kenya shilling was also devalued in February in order to maintain a constant parity with the United States dollar.

Taking into account the range of reactions to the dollar devaluation on the part of our trading partners, it would seem that Kenya achieved an overall devaluation of perhaps 6 or 7 per cent making a total of about 13 per cent since December, 1971.

The devaluation of the Kenya shilling means that in Kenya shilling terms, the income of our farmers is fully maintained. Indeed, as a result of subsequent firmness in commodity markets, our farmers are, in many instances, significantly better off as a result of our decision. At the same time, the competitive position of our manufacturers and our tourist industry is fully maintained in the face of the devaluation undertaken by countries in competition with us. I am sure we took the right decision.

The decision was not, however, an easy one, since it was inevitable, whichever decision we took, that there would be some adverse effects on our economy. But opportunities for expansion have been created: our relative competitiveness has been improved. We look to our producers to seize the opportunity available to them.

[The Minister for Finance and Economic Planning]

IMPORT CONTROL

I would like, at this point, to say something about import control procedures. As I said earlier, the import control measures introduced in December, 1971, were very effective in achieving our balance of payments objectives through 1972. Even so, we continued to be worried that a foreign exchange drain was still being caused by a limited number of importers over-invoicing their goods or arranging for under-supply of goods compared with the goods being paid for. In order to prevent this abuse, the Government contracted with the General Superintendence Company of Geneva to inspect all shipments of goods destined for Kenya before they leave their ports of origin. The administrative procedures introduced to implement this inspection service have, I must say in all frankness, been over-cumbersome, and delays in the processing of forms have led to a serious shortage of a number of commodities in our economy. These administrative procedures have now been re-examined and amended and I am optimistic that the system will now operate speedily and more smoothly.

I must emphasize that the procedures relating to the inspection of imports are not designed to control or restrict genuine imports in any way. The procedures have, therefore, been reduced to an absolute minimum.

The schedule of items subject to import quota or other restrictions introduced in 1971 still operates, but the number of items subject to control is being reduced and a more liberal allocation of licences is being made in the light of our improved balance of payments situation.

PRICE CONTROL

Rising prices is one of the most intractable problems facing the whole world at the present time—it is not a problem confined to Kenya. Indeed, as I have already noted, the major cause of our price difficulties over the last two years has been rising import prices. I am, of course, aware that the introduction of sales tax has also led to further price increases. Import control and a shortage of imports have also not helped, as traders have taken advantage of the fact that some commodities were in short supply, and increased prices in order to secure a windfall profit on a restricted volume of imports available for sale.

Even so, our record on consumer prices compares well with most other countries in the world over the last year. While other countries have faced prices increasing at a rate of 8, 9 even 10 per cent per annum, in the last year our new wage earners index increased by less than 5 per cent and the middle income index by about the same amount. People enjoying expatriate standards of living have had to face a higher rate of price increase as a result of higher import prices but the people as a whole have not suffered as much as is sometimes suggested.

I am, however, convinced, and I am sure that many hon. Members agree with me, that traders have been pushing up prices to an extent unjustified, either by higher import costs or increased taxation. These factors have been used as excuses for unjustified price increases.

Such action is illegal and cases have been brought to the courts to underline this. It is, however, clear that our price control machinery is having the greatest difficulty in controlling price increases, except over a rather limited range of commodities. We are, therefore, improving and strengthening the administrative and legal machinery that deals with price control. I have already asked the Provincial Administration to help us in the enforcement of price control legislation.

Price display legislation will be re-enforced with much greater vigour and I would like to ask manufacturers to mark maximum retail prices on their products before they leave the factory. I also hope that manufacturers will assist us in enforcing those maximum prices throughout the country. It is my wish that it will be possible for us to move in these directions on a voluntary basis but if this is not successful, it may be necessary to amend the law to enforce these ideas.

EMPLOYMENT POLICY

The past year has been marked by the submission to us of the very valuable report on employment and incomes submitted to the Government by a team of experts organized by the International Labour Organization. This report has been debated at length in the House and it would seem that there is fairly general agreement with the conclusion of the report that the problem in Kenya is more one of inadequate income than unemployment in the sense that this word is used in an industrial economy. The development strategy of growth adopted by the Government since independence is supported by the findings of the report. The report does, however, draw attention to problems arising in the distribution of income and wealth in this country and the fact that certain sections of the population have realized a disproportionate benefit from the economic growth experienced over the last ten years. I am concerned that we should take measures to correct some of these inequities and this, in part, is what my Budget is about. But more of that later.

STATUTORY ORGANIZATIONS

Mr. Speaker, if we are to maximize our efforts to raise the level of employment and to reduce the degree of inequity in our society, we must also redouble our efforts to eliminate all waste, corruption and inefficiency from the public sector. I spoke earlier about the improvements we propose to introduce in Government budgetary procedures designed, as I said, to raise the level of management efficiency within Government and provide the tools to put our own houses in order.

I am, however, becoming increasingly worried about the deterioration of financial control and general efficiency in the statutory organizations. Urgent action must be taken to arrest this situation and bring it under control before it deteriorates further.

[The Minister for Finance and Economic Planning]

In future, money will only be advanced to statutory organizations on clearly stated terms. We shall examine their budgets in greater detail and their accounts will be subject to audit by the Controller and Auditor General. Further, in order to ensure greater public accountability their annual reports will be subject to Parliamentary and public debate.

LOCAL AUTHORITIES

The local government situation is not very much better. In January 1970, the Central Government took over from County Councils the responsibility for education, health and roads. We must now define the residual functions of local authorities more precisely and then assist them to budget for those activities in such a way that their own revenues will cover the cost of those functions without incurring continued recurrent deficits.

And even more importantly, we have to establish more precisely the sources of revenue which will be reserved for local authorities to develop without encroachment by the central government. It is my wish that county councils, in particular, should try to move away from their present dependence for revenue on agricultural cesses, since this is likely to retard the development of agricultural production.

I am aware that the abolition of GPT will aggravate the problem of financing the services of the municipalities. I have, however, provided K£2 million in the Expenditure Estimates for grants-in-aid to the municipalities in order to reimburse them for the GPT revenue they will lose in the first half of 1974. I shall be prepared to continue a system of grants-in-aid to the municipalities for a total of five years, but during that period I will expect the municipalities to have developed their own independent sources of revenue, particularly the land rate, in order to replace the Government grants-in-aid completely.

THE FINANCING OF THE EAST AFRICAN COMMUNITY

H.E. The President advised the House at the commencement of this Session that a national Income Tax Bill will be brought to this Assembly and that the Kenya Regional Office of the East African Income Tax Department would become a department of the Kenya Treasury.

That Income Tax Bill is now moving towards the final stage of drafting and will be published and debated in this House shortly in order to become law with effect from 1st January, 1974.

The formal transfer of the Department to the Kenya Treasury will also take place on 1st January, 1974 and the expenditure estimates of my Ministry will provide for six months of expenditure by the new Kenya Income Tax Department. In the meantime, the existing department will work closely with us to smooth the transfer.

Once the three East African states have their own income tax laws and their own departments of income tax, it would be inappropriate that automatic deductions should be made for the General Fund of the Community from the tax collected on the profits of manufacturing and finance companies. It has, therefore, been agreed between the Partner States, that with effect from 1st January, 1974, the average amounts deducted from income tax for the purposes of the General Fund in each State over the last four years will be deducted from their gross collections of customs and excise over and above deductions from customs and excise made under the usual formula.

It is, however, agreed that this should be regarded as merely an interim arrangement to provide for the financing of the General Fund; and a more permanent and equitable arrangement will be worked out before the next financial year.

ECONOMIC PROSPECTS

I would now like to turn to the prospects for our economy in 1973 and the likely growth of the central government revenue. I have already explained that in spite of over 12 per cent rate of growth of our economy at current prices in 1972, the revenue has not expanded in the 1972/73 financial year. This is in itself a matter of concern.

The economic outlook for 1973 is less good but still quite reasonable, at least in current price terms. After an increase in agricultural income of 22 per cent in 1972, the weather does not seem to have been kind to the farmers this year but I still hope that we shall record some further increase in the volume of production. Overall, it seems that as a result of firm export prices, there will be a further rise in farm income in 1973 of perhaps 6 to 8 per cent.

The growth of manufacturing output is expected to be below the average of recent years and the value of production is forecast to rise by perhaps 7 per cent.

The construction industry is expected to move ahead again as approved building plans get into the construction stage. The shortage of housing in Nairobi and elsewhere and the increased availability of housing finance should provide impetus for further expansion here.

Tourism in the first half of the year has been affected by events outside our control. The series of international conferences scheduled in Nairobi in the second half of this year is, however, expected to influence the tourist figures for the year as a whole. I still look for a new record in the tourist statistics in 1973.

Considered overall, 1973 may see a rate of growth in the economy of perhaps 8 to 10 per cent at current prices, although perhaps only 5 to 6 per cent in real terms.

The balance of payments now looks more healthy. After the reasonable surplus on external account earned in 1972, we moved into substantial surplus in the first half of 1973. An increasing volume of imports will certainly arrive in the second half of the year—indents authorized already indicate a value of imports

[The Minister for Finance and Economic Planning]

over the next twelve months well in excess of any previous year's figure. But so long as export prices and volume are maintained at recent levels, I do not think we need to be too concerned on account of the balance of payments as a whole. I am looking for a surplus at least as high as in 1972 but we shall continue to watch the situation closely.

THE FINANCIAL OUTLOOK 1973/74

The recovery of the flow of imports in 1973/74 should also lead to a recovery in import duty revenue. But as I have explained, we shall have to provide for greater sums from our customs and excise revenue to finance the General Fund Services of the East African Community.

The new Sales Tax is estimated to bring into the Exchequer some K£22 million in 1973/74 although, as I have announced, I shall give up about K£10.5 million in Consumption Tax and Graduated Personal Tax. The Sales Tax should yield much more in subsequent years.

A further K£1 million gross revenue will enter into the Exchequer Account in the form of income tax as a result of gross tax collections being paid to us direct rather than net of collection costs and General Fund deductions as at the present time.

When the tax measures, I have already announced, are considered together with the natural growth and next year's expected recovery of revenue, I estimate that I will receive about K£160 million, some K£16 million or 11 per cent more than this year even if I make no further changes in taxation this year at all. This gives me a good start in formulating my new Budget.

EXPENDITURE 1973/74

I would now like to comment briefly on the expenditure estimates, copies of which were distributed to hon. Members two days ago. As last year, I shall leave the detailed description of individual Ministry estimates to my colleagues when we come to the Committee of Supply. I shall at this time simply consider the expenditure totals.

Total expenditure in 1973/74 on a gross basis is estimated at a little less than K£222 million, about K£20 million or 11 per cent higher than in the current year. Recurrent expenditure at K£154 million and development spending at K£68 million will both be about 11 per cent higher.

THE FINANCIAL REQUIREMENTS 1973/74

Let me remind the House of the basic Budget arithmetic. Expenditure is estimated to rise by K£20 million while recurrent revenue at existing rates is estimated to increase by K£16 million. Other things being equal, the overall deficit, as measured by total expenditure less recurrent revenue, will rise by about K£4 million.

At the same time, development revenues are expected to be lower in 1973/74. External receipts as set out in the Development Estimates are estimated at K£24 million compared with K£26 million in the current year, a reduction of K£2 million.

I aim to raise K£20 million by way of domestic long-term borrowing, about K£1 million less than in the current year, when I was able to take up some K£6 million from surplus balances in the East African Community Pension Funds.

Overall, it would seem that recurrent revenue and long-term borrowing will rise by K£13 million, while expenditure is estimated to rise by K£20 million. There is, therefore, a gap of K£7 million.

THE STRATEGY OF REFORM OF THE FISCAL SYSTEM

Before I turn to the financing of this gap I should like to disclose to the House my general thinking towards further fiscal reform in Kenya.

In the ten years since independence, we have raised the annual level of Government recurrent revenue by over two and a half times—a rate of growth in excess of that of the gross domestic product in current money terms. This increase in the revenue has financed the expansion of Government services proposed in the First Development Plan and the Kanu manifesto at the time of independence. Recurrent surpluses have been earned which have provided a significant contribution to development financing, an essential part of our policy of steadily increasing self-reliance in financial affairs.

We must, however, face the fact that this substantial increase in the national revenue has only been achieved at a cost. Tax rates have been pushed to high levels which has involved real sacrifice by the people of this country. However, we cannot eat our cake and still expect to have it—we cannot demand higher levels of Government services and a greater degree of financial self-reliance and expect to achieve these aims without sacrifice.

The people of Kenya have indicated quite clearly that, given the choice, they want more schools and more trained teachers; they want more hospitals and more trained doctors; they want better roads and more efficiently maintained roads; they want law and order and security in their daily lives. There is no doubt that the people have been, and are, prepared to make sacrifices to achieve these few basic services which they regard as an essential part of life in the new Kenya. They are entitled to receive those services.

Both my predecessor as Minister for Finance, and more recently myself, interpreted the people's choice in this matter positively and raised tax rates on a number of occasions. There are, however, limits to the extent I can now push this process further. We, in the Treasury, have, therefore, been undertaking a fundamental rethinking to determine where we should go from here. I suggested earlier this afternoon that we shall need to control future increases in expenditure more closely in line with the growth of the revenue. However, we have to consider also how best to achieve the maximum growth in revenue, on the assumption that I cannot go on lifting rates of taxation indefinitely.

The revenue system we now require is one more responsive to increases in the national income and yet reasonably stable when set-backs occur in particular sectors. The revenue must rise faster than national income, so that Government spending overall can increase at a rather faster pace than the overall rate of growth in the economy.

Revenue should be earned automatically by the tax system as the economy expands; so that the Finance Minister can avoid having to raise tax rates or to introduce new taxes every year. The tax system should be reasonably constant in changing circumstances without the need to make wholesale changes from year to year. Businesses and individuals should be able to plan in an environment of reasonably constant tax laws. We have not achieved this in recent years because of the need to transform the tax system in the direction we require over a period of time. More changes are, I am afraid, in prospect this year, but when these have been introduced I very much hope that we can enter a period of relative quiet as far as the tax laws are concerned.

But apart from providing an adequate growth in revenue, the tax system we require in the new Kenya society should be progressive, meaning that the rich pay a higher percentage of their income in taxation than do the poor. The system should also be equitable, providing that individuals and businesses in similar economic circumstances should pay equal taxes.

The system should also be easy to understand, so that we may reasonably expect individuals to comply with the tax laws. I believe that the more simple and the more equitable the tax system we devise, the greater the chance of obtaining compliance with the tax laws, so that tax evasion which is a deplorable and anti-social activity, is reduced to a minimum.

Finally, we must use the tax system to encourage the efficient use of economic resources. For example, our tariffs and taxes should not encourage the excessive use of imported raw materials and capital goods: the system should not discriminate against production for export: and it should not discourage the use of labour.

The tax system we inherited at independence was not sufficiently elastic to changes in income, particularly because its reliance on import revenue meant that, as local industry developed, customs revenue could only be maintained by increasing the level of the tariff. It has not been particularly equitable either in that low income earners have sometimes paid higher proportions of their income in tax than persons in the middle or higher income ranges.

But perhaps the major fault of the existing fiscal system is that it has tended to create a highly protected inward-looking manufacturing industry in Kenya. Industry has been able to set up behind high tariff walls simply to manufacture products for sale in the restricted East African common customs area. Product quality and manufacturing service have all too frequently been secondary considerations in the mind of the manufacturers who tend to squeal every time they are touched by competition from outside and to run to the Government to bale them out everytime they run into trouble. To use the modern idiom, there is a danger of having too many "lame duck" industries in this country.

To a large extent, we have created this situation ourselves. In our eagerness to industrialize and change the structure of our economy after Uhuru from its over-dependence on exported primary commodities, we have perhaps listened too eagerly to the blandishments of prospective investors. We have been told all too often that if we provide blanket protection for a new product, find half or more of the capital requirements for a new investment and give full investment protection for the remainder, we shall get a new project of immense economic benefit to Kenya. Sometimes this is true, but at other times, the cost involved in setting up these new projects has been greater than we should reasonably be expected to pay—high cost products, mediocre quality, exclusion of consumer choice, high import content, high repatriation of profits and very little employment content. Is this the economic development we want? I say NO!

Please do not get me wrong on this. It was necessary after independence to accelerate industrialization. To a large extent it was necessary to create a protected market to initiate many new investments. It was also right that our investment agencies such as ICDC and DFCK should participate in the financing of many of these projects. Many manufacturers are now doing a good job—producing a quality product at a reasonable price. Some have succeeded in developing export markets outside East Africa. Industrial employment has risen by about 50 per cent since 1963.

The points I am trying to make now are, firstly, we are now going to consider the economic cost of all new project proposals much more carefully than in the past, particularly when the project is dependent on a protected local market for its sales, whether this is in the form of high tariffs or import control. Secondly, as I gave notice in my Budget Speech last year, we shall gradually open up the Kenya market to outside competition and expect local producers to stand up to that competition.

The reason for this new line towards local manufacturing is not that we have changed our mind towards the development of industry in Kenya but that we have thought rather more about the *type* of manufacturing development we require. Most industrial development since Uhuru has been directed towards import saving, although the foreign exchange cost of some of these projects has been higher than the foreign exchange benefits.

If we were to persist in this approach, the prospects for future growth in manufacturing would be limited: industry would be able to grow only as fast as the

[The Minister for Finance and Economic Planning]

growth of the Kenya or East African market. To break out of this trap into which so many other developing countries have fallen, we have to change the present industrial psychology in Kenya that looks only inward to the Kenyan or, at best, East African market. Industry can now expand to enable us to fulfil our industrialization goals only if it changes its attitude and increasingly looks outward towards the export markets beyond East Africa.

This is one reason why we shall take a tougher line in granting industrial protection in the Kenya market. But this will not be enough. Government must provide a carrot to lead as well as a stick to drive. It is not enough that we should support the Export Promotion Council and promote Kenya participation in trade fairs. We must do something more positive to influence the relative profitability of selling in export markets compared with selling in the local markets.

Mr. Speaker, hon. Members may feel that I have drifted away from my description of the reformed fiscal system I am seeking. But this is not really so. Those hon. Members who have followed the main trend of my thoughts will realize that I am moving towards a simplified tax system that provides the growth of revenue I require without continual changes in tax rates. In addition, I am moving towards a tax system that encourages a better allocation of our national resources, one that will actively facilitate the achievement of our national goals.

FINANCIAL PROPOSALS

How then do I propose to achieve the fiscal reforms I am seeking? Before outlining my proposals, I would like to ask you, Mr. Speaker, to regard the rest of my speech as being Notice of a Motion to be placed before the Committee of Ways and Means.

I have, of course, already disclosed a significant part of my proposals earlier in this session. The Consumption Tax imposed at specific rates on a limited number of consumer items has now been replaced by a 10 per cent Sales Tax on nearly all manufactured commodities.

Graduated Personal Tax is to be abolished with effect from 31st December this year. Provision for this change is contained in the Finance Bill as promised earlier. None of us liked this tax and all of us will be pleased to see it go.

EXPORT COMPENSATION PAYMENTS

In order to encourage local industry to look with greater determination towards the export markets, I propose to introduce, shortly, a Bill into this House that will have the effect of reimbursing selected manufacturers for taxes paid in the local market when their products are sold outside East Africa. The effect of these proposals will be that, in the selected industries—generally those now subject to sales tax—the f.o.b. value of exports will be increased by 10 per cent by means of reimbursement payments. The effect of the scheme will be the same as a 10 per cent export subsidy.

The new export payments scheme will extend initially to a range of exports worth some K£25 million per year and I hope that legislation can be drafted and considered by this House to enable it to become effective from 1st January, 1974.

The new compensatory payments for industrial exports will, to a large extent, replace the present arrangements for refunds under the Local Industries (Refund of Customs Duties) Act and remissions of duty under the Customs Tariff Act. I hope to devise a system which will get the payments to exporters without the long delays and complicated procedures that are required at the present time.

Naturally, a scheme of this type will cost a great deal of money. The net cost in the first full year is estimated at about K£1 million and this cost will, of course, rise as the export incentive leads to higher export values.

The proposed export payments represent a positive step by the Government to change the whole psychology of industrialization in Kenya. We must become export orientated if we are to industrialize at a faster rate. However, the Government can only provide the incentive. It will then be up to industrialists to go out and seek new export markets if they are to obtain the benefit of the cash I am putting aside to pay for this scheme.

EXPORT TAXES

Mr. Speaker, at a time when I propose to introduce export refunds, it would be illogical and inequitable to continue to impose export taxes. Accordingly, I propose that the present taxes on coffee and sisal exports should be abolished as from midnight tonight. This move will hand back to the farmers about K£700,000 a year, although I hope to claw some part of this total back into the Exchequer in the form of higher receipts from tax on profits. Hon. Members can consider this measure as a fiscal tidying up operation consistent with the overall policy thinking I have outlined.

CUSTOMS DUTIES

I have tried to explain to the House some part of our thinking on the impact of the customs tariff on the allocation of economic resources in this country. I am drawn to the conclusion that our long-term objectives would be reached more easily with a more even tariff structure than we have at the present time—a narrower spread between rates of customs duty. In order to implement such a programme, it will, however, be necessary to persuade our common market partners that it is in their interests also. Such a programme could also not be followed through in one or two years—it will take a much longer period.

However, as an earnest of my intentions in this matter, I propose to reduce the level of customs duty on a range of minor products, mainly used as raw materials in local manufacturing. All the materials in the list have a duty now of more than 40 per cent. I propose that the duty should be reduced down to 40 per cent.

I do not propose to read out the list in full. Hon. Members can see it in the Financial Statement and the Finance Bill. None of the items by itself is particularly

[The Minister for Finance and Economic Planning]

important in our economy and the total revenue I am giving up on all items taken together is not estimated at more than K£120,000 per year. However, the fact that reductions are being made will perhaps provide a firm indication to hon. Members that I mean it when I say that I wish gradually to reform the external tariff.

I am proposing no increase in rates of fiscal entry in the First Schedule of the customs tariff this year but in order to meet a commitment towards Pan African Paper Mills in respect of paper, and towards Tanzania in respect of certain fertilizers, suspended duties already provided in the Second Schedule of the Customs Tariff will be implemented as from midnight. The effect of this will be that the total duty on four categories of paper will rise to 20 per cent. Also, the total duty on fertilizers coming within the descriptions of ammonium sulphate, triple superphosphate, diammonium phosphate and complex NPK will also rise to 20 per cent.

There is one other change I propose in the customs tariff which is of some economic importance. At the present time, Government departments and the East African Community, including the corporations may import goods on a duty free basis. When most Government supplies were unavailable locally, there may have been justification for this, but more recently when local products of adequate quality have been available, Government departments have been among the worst offenders for buying overseas. Accordingly, the Third Schedule of the Customs Tariff will be amended to provide that virtually all Government and East African Community purchases will have to be made on a duty paid basis in future. By removing the exemption from customs duty, I am also by the same stroke removing Government departments' present exemption from Sales Tax. We shall, of course, have to provide for additional sums in the Expenditure Estimates to cover the cost of import duty and sales tax involved, but the important factor in this is that Government departments should have to face the same price choices as anyone else. These measures accord with my general policy of using the fiscal system to encourage the right allocation of resources in our economy.

At this point, I should perhaps mention to the House that the Customs Tariff Act and the East African Treaty will be amended to provide that all customs revenue derived from East African Community imports will be paid direct into the General Fund of the Community and not into national revenues.

EXCISE

I turn now to the Excise. The introduction of the Sales Tax will require us to look more closely at the function of the excise for the future but this year there is only one amendment of substance I wish to propose to you. This relates to the cigarette and tobacco excise.

The inter-action of the various cigarette and tobacco taxes has become increasingly complicated and inflexible in recent years and there has for some time been a need for reform. The introduction of Sales Tax has made this imperative as the combined impact of sales tax and excise on cigarette prices would have been such as to cause an overall loss of revenue which I cannot afford.

Accordingly, I propose to introduce a new cigarette and tobacco excise on an *ad valorem* basis from midnight tonight. The effect of this will be to reduce excise to off-set part of the Sales Tax, so that the only cigarettes to go up in price will be the four most expensive brands, that is "State Express" by 25 cents for 20, "Rex" by 30 cents, "Senate" and "Embassy" by 10 cents. Pipe tobacco, particularly the expensive brands, will go up by a little more, to bring taxation on this item up to the level of the cheapest cigarettes: pipe tobacco has been somewhat under-taxed up till now. All other prices will remain unchanged. I am afraid I cannot weep too many tears for all those traders who have taken a gamble on all cigarette prices going up.

The new *ad valorem* excise scale should provide for a steady increase in tobacco revenue over the years. In 1973/74 I hope to earn an extra K£½ million from cigarette and tobacco revenue when sales tax and excise are considered together.

STAMP DUTY

On occasions, in past budget debates, some hon. Members have pressed me to introduce a capital gains tax. There are considerable merits in such a tax and I would certainly not exclude its introduction some time in the future. However, a capital gains tax would have to be implemented by the Income Tax Department and I am persuaded that since we are setting up our own Income Tax Department this year and also implementing a completely new Income Tax Act, it would be unreasonable to burden the department with a new form of taxation of which they have no experience.

However, I believe that it is still reasonable to tax some greater part of the profits resulting from urban property transfers and I propose with effect from midnight to raise the rate of Stamp Duty on conveyancing of property in municipal areas. The rate of stamp duty on such transactions will be approximately 3 per cent rather than approximately 2 per cent as now. The rate of stamp duty to be paid on property transfers outside the municipalities remains unchanged.

INCOME TAX

Finally, I turn to the Income Tax and I should like to give hon. Members some insight into our thinking on the new Income Tax Bill which I hope to introduce into the House very soon and also outline the rates of Income Tax that will be levied with effect from 1st January, 1974.

First of all let me say in order to correct any misunderstandings, that we are at one with Tanzania and Uganda about changing the arrangements for collecting income tax. The establishment of national income tax departments does not mean that the East African Community is breaking up—simply that different economic policies sometimes require a different approach to problems of tax collection. I cannot give you full details

[The Minister for Finance and Economic Planning]

of income tax arrangements next year simply because we are still discussing problems of tax co-ordination with Uganda and Tanzania. We are all agreed that this co-ordination should continue now and in the future and a new East African Joint Tax Board is being set up to achieve this.

However, in future, for tax purposes the term "resident" will mean resident of Kenya, rather than resident of East Africa as now. Even so, residents (of Kenya) will continue to be charged tax on income accrued in or derived from East Africa. This means that residents will be assessed as at present on their total East African income but instead of tax being allocated between partner States as now, Kenya, as state of residence, will give a set-off for any tax withheld at source on certain types of income arising in or derived from another partner state.

Non-residents will be charged only on income accrued in or derived from Kenya. The charge will normally be made by a withholding tax at a rate varying with the type of income.

One of the major changes in the proposed new Bill will relate to the treatment of retirement benefits. The reason for this is that it has been uppermost in our minds in drafting the new Bill to simplify the income tax system in Kenya, and a disproportionate part of the complications in the present Management Act arise from the existing pension provisions.

In future no deductions will be given in respect of contributions to pension funds, provident funds, and of provision for retirement annuities except for compulsory contribution to statutory schemes such as the National Social Security Fund. However, the first K£2,500 of pension and retirement annuities received by a resident will be exempt from tax. Pensions and annuities paid to non-resident pensioners will be subject to a withholding tax of 12½ per cent.

Taken together, these measures will lead to considerable simplification of the tax law and in addition will provide me with an additional K£150,000 revenue in 1973/74 and an estimated K£800,000 in subsequent years. It should be noted, however, that the resident pensioner will be better off.

Rents will be subject to a non-resident and inter-state withholding tax of 30 per cent. This new tax will provide me with an estimated K£150,000 in 1973/74 and K£300,000 in subsequent years.

There will be a number of changes in the law that will mainly affect business taxation. A carry forward of deficits will only be permitted for five years. Payments for management services provided by a branch of a company to another branch of the same company will not, however, be an allowable expense in arriving at chargeable income.

Rates of investment deductions will remain unchanged but rates of other capital deductions will be varied in respect of industrial buildings and hotels. The style and techniques of building in Kenya at the present time are such that the usable commercial lives of these buildings are longer than they used to be. This fact should I feel be reflected in the rates of depreciation deductible in arriving at chargeable income. Industrial buildings will be allowable at a rate of 2½ per cent of original capital cost and hotel building at a rate of 4 per cent of original capital cost.

I do not expect to get additional revenue from this change in 1973/74 but I should obtain an extra K£350,000 in subsequent years.

In order to close a tax loophole, I propose to provide that where assets are hired and subsequently sold to the lessee or his associate at less than market value, the difference between the sale price and the market value of the asset will be chargeable to tax on the purchaser of the asset.

Non-resident withholding taxes will remain unchanged at existing rates, except, as I have noted, there will be new non-resident withholding taxes on rents at 30 per cent and pensions at 12½ per cent.

I cannot at this stage disclose rates of inter-state withholding taxes, since I hope we can reach agreement on a common level within East Africa, so that a common level of relief can also be applied for taxes imposed by other partner states.

Resident withholding taxes will remain unchanged—12½ per cent on dividends and interest.

The rate of company tax will also remain at its present level of 40 per cent, except that branches of foreign companies will be taxed at a rate of 47½ per cent. At the present time a locally incorporated subsidiary of a foreign company pays company tax on its profits and also withholding tax on its dividend remittances overseas. As a result it pays more tax than the foreign owned branch which pays tax only on its profits. I feel it right that I should correct this situation by taxing branches of foreign companies at a rate which is equivalent to that of a foreign-owned subsidiary that remits all its profits in the form of dividends.

Finally, I come to personal or individual income tax. We in the Treasury have given the deepest thought to the fundamental objectives of personal income tax in our new Kenya society and many alternative proposals have been examined and rejected for one reason or another. In this process there were a number of fundamental aspects of income tax which dominated our thinking.

There are approximately 2 million families in this country; but only about 100,000 individuals pay income tax. Average family income in Kenya in 1972 was approximately K£220, but that figure masks the undoubted fact that 80 per cent of the population live on an income very much less than that average. Yet in 1972 the majority of families were not required to pay income tax until they achieved an income of K£990 per annum—a figure four times as high as the average family income and probably ten times as high as the income available to the poorest 80 per cent of families. My conclusion from these figures is that the income

[The Minister for Finance and Economic Planning]

threshold at which an individual starts to pay in income tax is too high since people who in terms of average income in this country are rich are exempted from paying income tax at all.

There are other considerations. The present system of family allowances provides a greater amount of tax relief for the richer man than it does for a poorer man, since tax is relieved at the highest rate paid by the individual not the lowest. My conclusion from an examination of this situation is that the tax relief for a wife or for a child should be the same for everyone whatever his income.

Finally, I have to take account of the fact that for those few—I might even say those fortunate few—who are required to pay income tax, the level of taxation is high—amongst the highest in the world. If we are to retain incentives for hard work without evasion of tax, rates of income tax cannot be pushed higher. Indeed, I accept that there is a case for some relief in the light of other tax measures.

Here then is what I propose for 1974. The present system of personal allowances will be replaced by a system of fixed tax relief depending on family circumstances. The amounts of relief will be—

For a single person	K£18
For a married person	K£36
For each child (up to a maximum of four)	K£9

The system will work as follows. Rather than add up your income and then deduct the value of personal allowances from your income as now, the tax-payer will work out the tax due on his total income and then deduct the appropriate family relief from his total tax bill. This means that the lower income tax-payer will get exactly the same tax relief for his wife and children as will the higher income tax-payer.

It will also mean that the threshold income levels at which a person starts to pay income tax for the first time will be as follows:—

For a single person K£180 per annum (compared with K£224 now).

For a married person with no children K£360 per annum (compared with K£492 now).

For a married person with four children K£720 per annum (compared with K£990 now).

These figures will mean that some people who do not pay income tax now will be brought into the system for the first time in 1974.

The new tax burden for these families will, however, be very low; for I propose to introduce a new personal tax scale from the same date. The new scale has been designed to dovetail in with the new family reliefs and will start with the first K£1,200 of income being taxed at no more than Sh. 2 in the pound. Thereafter the rate of tax will rise evenly by Sh. 1 in the pound on each additional K£600 of income up to an income of K£8,200 per annum. Between K£8,200 and K£10,000 per annum tax will be charged at Sh. 13 in every pound and all income above K£10,000 will be taxed at a fixed rate of Sh. 14 in the pound.

There is one further—restricted—concession I have to announce. Owing to the way the tax law works, the professional self-employed person has for some time been very much worse off than the same professional person in employment—or indeed any other employee or any other self-employed person. Those professional self-employed persons will now be significantly worse off since they will not be able to deduct any provision for retirement from their taxable income as now. I consider, therefore, that there is a case for special treatment for the professional self-employed person if Kenya is to retain sufficient doctors, accountants and lawyers. Accordingly, self-employed persons in professions scheduled under the new Bill will be allowed to deduct up to K£700 per annum from their income as a housing deduction so that like their employees part of the cost of their housing is deductible against the profits of the firm.

Where does all this leave the individual tax-payer? The amount of tax a person pays depends still on his income and his family circumstances. It is, therefore, difficult to generalize. I can, however, say that no one should pay more income tax in 1974, than he pays in income tax and GPT combined in 1973. Since the entry income point at which a person starts to pay income tax will be lower in 1974, a number of persons will pay income tax for the first time. The amount they will pay, however, will be less than they pay in GPT now and it will, of course, vary directly with their income which GPT generally at this level does not. For instance a married man with four children earning an income of K£900 per year does not now pay income tax: in 1974, he will pay K£18 or Sh. 30 per month. I do not think this, an average rate of tax of 2 per cent, is an onerous burden or one that is unfair.

From the K£900 per annum man paying tax at 2 per cent, the tax scale will rise progressively so that the K£4,000 per annum man will pay about 20 per cent of his income in tax and the lucky few earning K£10,000 per annum will pay about 41 per cent. The rich will pay very much more than the poor but rather more people will pay a little than has occurred in the past. I now hope that we have a tax system that will stand us in good stead as our economy develops. Considered as a whole, the proposals to be contained in the new Income Tax Bill represent a fairly substantial concession in personal income tax which will only be recovered in part by higher taxation of business profits. Overall, I estimate that I am giving away nearly K£2 million in 1973/74.

These then, Mr. Speaker, are my taxation proposals for this year. They are, as I am sure no one will deny, far reaching changes in the tax system. As I hinted last year, I have swung the Kenya fiscal system much further in the direction of indirect taxation. In that way everyone will pay tax but only to the extent they are able to spend.

[The Minister for Finance and Economic Planning]

I do not claim that people are not going to pay more tax—overall taxation is increased in 1973/74 by about K£5 million but I do claim the increase in taxation will be paid by the richer members of society judged by the criteria I set out earlier. Very careful examination of household budgets of the lower income groups shows conclusively that these people will pay less tax overall in 1974 than they do in 1973.

Too frequently, Mr. Speaker, tax-payers look simply at the new measures that hit them and completely forget the other measures that are to their advantage. I do, therefore, appeal to everyone to consider my package as a whole—Sales Tax certainly, but also GPT, export tax, stamp duty, customs duty, excise and income tax, not forgetting the export compensation scheme designed to bring additional employment benefits. I believe that the proposals I have made measure up to the objectives of tax policy I outlined earlier.

I appreciate that it is not very comfortable for the tax-payer to live through a stormy period of fundamental fiscal change. I hope that once the new income tax law is introduced, we can achieve calmer waters with fewer radical changes for a few years. There are still some loose ends that will have to be tidied up and the reform of the customs tariff has still to be tackled.

The introduction of sales tax taken together with the abolition of GPT and consumption tax meant that I had increased taxation in a full year by K£9.5 million. The measures I have announced today—excluding accounts for the export payments—mean that I have given up a total of K£2.7 million revenue. Allowing K£2 million for the abolition of GPT paid to municipalities, (K£4 million in a full year), the measures I have announced this year represent an increase in taxation of K£4.8 million. This figure can be compared with the total net estimate of taxation revenue for 1972/73 of K£125 million: it represents an increase in taxation of less than 4 per cent.

Mr. Speaker, hon. Members will recall that towards the end of the first part of my speech, I said that I was faced with an expenditure/revenue gap of K£7 million. They will also see that I have done nothing to close that gap and indeed I have widened it by giving away K£2.7 million—to create a total gap of nearly K£10 million. Changes in the accounting of revenue such as I have described, will bring back K£3 million and I am, therefore, still left with a gap of K£7 million.

In order to close this gap of K£7 million, I shall have to rely to a greater extent in 1973/74 than in the current year on short term borrowing from the banking system, either in the form of Treasury Bills or Central Bank loans. Since I have turned to the banking system for only limited assistance in the current year and the rate of growth in our economy may be lower in 1973/74 than in 1972/73, I am convinced that it is reasonable that I should cover the budget gap in this way on this occasion.

My budget can, therefore, once again be considered as a budget for expansion. A budget for further attainment of our national development goals, particularly for an improvement in the quality of life of the poorer people of this country.

It is my sincere belief that we have now achieved a fairer system in which everyone pays tax in accordance with his ability to afford tax. The system should also be better adapted to the needs of our society over the longer term, both in respect of the growth of the revenue and the development of our economy.

Mr. Speaker, I beg to move.