HARAMBEE

REPUBLIC OF KENYA

Budget Speech

for the Fiscal Year 1980/81 (1st July—30th June)

by

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REPUBLIC OF KENYA

Speech delivered to the National Assembly on 19th June, 1980, by the Hon. Mwai Kibaki, Vice-President and Minister for Finance, Republic of Kenya, when presenting the Budget for the Fiscal Year 1980/81 (1st July to 30th June).

Mr. Speaker, Sir,

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

Mr. Speaker, in my Budget Speech last year, I indicated that the adverse economic trends of 1978, characterized by growing balance of payments and public sector expenditure deficits were likely to continue during 1979 and 1980. I also indicated that the GDP growth rate of 6.3 per cent as projected in our Development Plan for 1979/83 was unlikely to be achieved in the short run, with an anticipated growth of only 3-4 per cent during 1979. In the light of such indications, I hope hon. Members, both old and new, have kept themselves informed of the performance of our economy during the year. I hope in particular that they have continued to study, in detail, the long term objectives and strategies defined in the Development Plan as it is only against this background that the importance of annual economic performance and changes can be gauged. I have no doubt that Members will have studied the 1980 Economic Survey as well as the Printed Estimates of Revenue and Expenditure for the next Financial Year. Of more immediate importance, however, is the need for all Members to examine closely the Sessional Paper No. 4 on Economic Prospects and Policies which is currently the subject of Debate in the National Assembly.

In view of the detailed manner in which the economic situation is described in that Sessional Paper, I shall not, today, give a lengthy analysis of our economic problems but will rather dwell on the measures which are proposed for the management of inflation and the balance of payments deficit which will continue to be with us for some time.

I wish, however, to touch on a few highlights. The year 1979 was characterized by continued external pressures arising from further substantial increases in petroleum prices and lower earnings from our principal exports. Strict measures were employed in efforts to control inflation and reduce dependence on unnecessary imports. As a result, the rate of inflation during 1979 was less than that experienced in 1978 but the economy also registered a slower rate of economic growth. Thus, while inflation, as measured by the average change in the consumer prices for lower, middle and higher income groups, rose by 8.4 per cent as compared to 12.3 per cent in 1978, the rate of real GDP growth was only 3.1 per cent as compared to 5.1 per cent in the previous year.

Total wage employment outside the agricultural sector increased by 6.7 per cent, with the most significant gains having been made in the agro-processing areas. It must, however, be appreciated that this was to some extent a reflection of compliance with the timely directive of H.E. the President for a 10 per cent increase in wage employment.

Turning to individual sectors, it is disappointing to note that Agriculture, which is the mainstay of our economy, suffered considerable set-back as a result of unfavourable climatic conditions, shortage of fertilizers and inadequate credit availability. The main export crops such as coffee and pyrethrum registered lower production while external receipts from tea were adversely affected by declining prices. The drought conditions also affected the livestock industry necessitating introduction of arrangements by Government to purchase threatened animals. The most serious development was the decline in production of grain crops which provide the basic food for our people. As a result, the Government has been forced to take urgent measures to ensure that adequate food will be available through commercial as well as concessionary purchase of maize, wheat and rice from external sources. I am pleased to confirm that these arrangements are working satisfactorily and that there is no need for us to panic or unduly worry about the availability of food. However, these purchases are exceedingly costly, as we shall see in a later part of my Speech.

Mr. Speaker, the production of the manufacturing industries also registered lower performance than in the previous year arising from the effects of the poor agricultural output as well as difficulties in obtaining imported raw materials and in maintaining export markets. Thus, the volume of output in the sector increased by only 7.1 per cent in 1979 as compared to an increase of 12.6 per cent in 1978.

The building and construction industry continued to enjoy the benefits of the 1978 coffee price windfall although construction costs also continued to rise.

After the disappointing performance of 1977 and 1978 the tourism industry managed only a modest improvement with receipts increasing by £2 million to £62 million. In the area of trade and transport only a moderate increase was recorded.

A welcome development during the year was the slight reduction in the very large unfavourable trade balance. This resulted from a decline of 6.3 per cent in import values and an increase of 4.3 per cent in export earnings. The trade deficit thus declined from £265 million in 1978 to £207 million in 1979. The lower import levels were the result of the tighter import restrictions introduced at the end of 1978, while the increase in export earnings can largely be attributed to exports of maize, petroleum products, hides and skins and chemicals. With import of goods and external payment for merchandise reduced from £723.3 million in 1978 to £667.9 million in 1979 and export earnings rising from £366.5 million in 1978 to £380.3 million in 1979 the deficit on the trade account improved from £356.8 million to £287.6 million. Despite lower volume of trade, a fall in actual aid receipts and only a marginal increase in tourism earnings, the current transactions on invisibles produced a net surplus of £103.6 million compared to £104.3 million in 1978. However, a major factor in this turnround from an overall deficit to an overall surplus was the substantial increase in the inflow of capital arising from the extended repayment time on trade credits and the limitations on remittances which ensured that part of the profits of international enterprises were re-invested in our economy. Inflow of long term public capital was also boosted by drawdown of £37.2 million from the Euro-currency credit of $200 million.

MONEY SUPPLY AND CREDIT

The improved balance of payments situation was reflected in the increase in total money supply in 1979 with net foreign assets rising by 68 per cent from £106 million in 1978 to £179 million in 1979. This, in turn, tended to increase liquidity in the banking system. In an effort to encourage banks to increase their lending the liquidity ratio requirements were lowered from 18 per cent to 16 per cent in July, 1979. By the end of December, the actual liquidity ratio had declined from 26 per cent to 23 per cent.

The import restrictions and general recession in the economy resulted in the slow growth of domestic credit to the private sector which increased by only 9.8 per cent. Similarly, net credit to the Central Government rose by only 7.3 per cent although credit to other public bodies doubled during the year. With the relaxation in the import restrictions towards the end of 1979, credit to the private sector increased more rapidly in the last quarter of the year.

Internationally, 1979 was a year characterized by continued instability in foreign exchange markets, fanned by further substantial oil price increases and high inflation rates in many countries. In the face of overwhelming balance of payments problems, many developing countries have resorted to increased external borrowings on ever-hardening terms, thus raising their debt servicing burdens to almost unmanageable proportions.

Faced by the same situation here at home, we found it necessary to maintain the foreign exchange conservation measures introduced in 1978 and to make only a limited use of external borrowing on commercial terms.

I am happy to state that due to effectiveness of these measures, and to accelerated use of concessionary credits and facilities provided to us by the international financial institutions as well as bilateral sources, we found it necessary to draw down only $100 million out of the $200 million commercial credit arranged with a consortium of banks in London in July last year. These measures helped to contain the balance of payments situation in the short run and an overall surplus of £35.8 million was recorded in 1979 as compared with an overall deficit of £81.5 million in 1978.

All in all, the year saw a certain amount of re-establishment of stability in the monetary and balance of payments areas as well as a firmer grip on inflation, but at a cost to economic growth. Gross Domestic Product measures in real terms rose by only 3.1 per cent during the year as compared to 5.1 per cent in 1978.

OUTLOOK FOR 1980

Mr. Speaker, hon. Members may perhaps feel that we make too many dismal forecasts which never really materialize and that we perhaps "cry wolf" too often. It is, however, most important for us to appreciate that we have in the past been exceedingly fortunate in having unusually good weather conditions which have ensured adequate agricultural production and abundant food supplies. In forecasting a very difficult year for us in 1980, therefore, I wish to draw attention to the external and domestic factors which will increasingly impinge on the economy. The external factors will be conditioned by the drastic oil price increases in November last year and in January and May this year. These have, once again, sparked off another spate of high inflation leading to recession in most countries. Already, yet another round of increases has been triggered by announcement of a $2-$4 per barrel rise in oil prices with effect from July this year. General lack of economic growth and increasing balance of payments problems in developed countries will result in reduced aid flows, while the present high interest rates in the international money markets will strongly militate against any further commercial borrowing.

On the domestic front, several internal factors will constrain the development of the economy. The most immediate of these is the current serious shortage of domestic food grain. In order to alleviate this, imports of food have been arranged and these will cost the country at least £35 million this year. The delay in arrival of the long rains this year will affect overall agricultural production, although the rains appear to be sufficient and the effects may not be too serious.

The shortage of rain also caused serious disruptions in the generation of electric power and led to rationing for over two months earlier this year. This has caused considerable harm to the growth of the manufacturing and tourism sectors, the effects of which will be felt throughout this year and part of next year. In addition, it has been necessary, in the face of anticipated accelerated inflation, to increase wages to our lowest paid workers. It is anticipated that inflation will in any case be higher due to the recent oil price hikes which have yet to work their way through the economy. The rate of inflation, measured as the increase in the cost of living index, is therefore, likely to be at least 15 per cent in 1980.

As indicated earlier, no major recovery is anticipated in the agricultural sector and a growth rate of only 3 per cent in output appears likely. Although major crops such as coffee, sugar-cane and sisal may record higher levels of production, this will not be sufficient to offset the anticipated fall in wheat, livestock and dairy production and probable stagnation in the output of other crops. The recent upward trend in the prices of coffee and sisal will hopefully continue through 1980 giving a slight increase in farmers' incomes to compensate for their higher production costs.

The manufacturing sector should benefit from the recent relaxation of import restrictions which will improve availability of raw materials and intermediate goods. However, with marginal growth in agriculture outputs, the disruptions in electricity supply and consumer demand reduced by inflation, the manufacturing sector's GDP growth in 1980 is expected to be only about 7 per cent compared with the long term average rate of growth of 9.5 per cent cited in Sessional Paper No. 4.

The recovery in the building and construction sector will be slowed down in 1980. There is already a noticeable slackening in the demand for properties and the Government's investments in infrastructure is also expected to reduce in the coming Financial Year. Consequently, GDP growth in this sector is expected to be only about 5 per cent.

The transport and trade sector will perhaps benefit somewhat from the minor increase in agriculture output and larger volumes of exports and imports. The level of output in these sectors should therefore improve with a GDP increase of 4.5 per cent over 1979.

Considerable concern must be expressed in connexion with the tourism sector. The effects of the recent electricity rationing and food shortages have already begun to be felt and there have been fairly large cancellations of tour arrangements during this year's peak season. With the continuing general recession in the rest of the world, and particularly in the advanced economies which are the main source of our tourists, it will be difficult to recover the reductions in tourism receipts already experienced. The overall performance of the sector will, therefore, be low with receipts being at about the same level as last year.

BALANCE OF PAYMENTS

In the context of the sectoral expectations outlined above, it is clear that a balance of payments surplus such as experienced in 1979 will not be realized in 1980. With the already announced increases of over 35 per cent in crude oil prices, our oil import bill will rise substantially. At the same time the global increase in oil prices is bound to lead to increases in the price of other essential imports. The emergency food grain imports will also require extra foreign exchange outlays. The on-going commitments on security, infrastructure and private sector capital investments will continue to demand the use of a high proportion of foreign reserves in view of the largely commercial nature of the facilities available. The overall import bill will therefore rise substantially.

The value of imported goods and non-factor services is expected to increase by about £171 million from £740.2 million in 1979 to £911.3 million in 1980. The Current Account deficit is thus expected to worsen from £184.0 million in 1979 to £244.1 million in 1980.

On the Capital Account, it is anticipated that a large portion of the trade credits extended as part of the import restrictions in 1979 will have to be repaid this year.

The net inflow of capital will therefore be lower with an estimated overall deficit of £110 million compared to an overall surplus of £70.7 million in the past year. Although our reserves are somewhat above the minimum requirement, additional external financing of about £94 million would still have to be found. I expect some of this financing to come from programme aid and standby facilities under agreements with the World Bank and the International Monetary Fund as well as other donors who have been very helpful and understanding in the past years.

Everything considered, the year 1980 is bound to be a very difficult year for the Kenya economy. It will require a combination of measures including some amount of economic adjustments and restraint in public spending, to deal with these problems. Most of the proposals that I shall be making later should be seen in that context.

Mr. Speaker, in the context of the somewhat gloomy economic situation I have just outlined, it is clear that the country needs to implement a set of measures which will ensure that there is no further erosion of the economic gains which we have made over the last sixteen years. And in so doing, we must maintain a sense of balance. Firstly, in our efforts to maintain a high rate of investment, we must not lose the fundamentally sound economic policy and management prudence which have given us such significant benefits in the past. Secondly, in giving priority to the immediate problems we must not lose sight of the long-term needs of this country and the strategies for dealing with the increasing international and domestic challenges. And thirdly, we must at all times look for and seize all opportunities which may be available for strengthening our economy to meet these challenges. These challenges and opportunities for responding to them effectively are outlined in Sessional Paper No. 4 and my proposals today are aimed at putting into action some of the options described in that Paper. Briefly, these may be summarized as—

(i) acceptance of the fact that the external economic environment will continue to be adverse and that our economy must be properly structured to absorb the inherent shocks. This requires stringent and enforceable measures to reduce our external deficit by maximizing our foreign earnings and reducing dependence on non-essential imports. This can be achieved by a more dynamic and export-oriented industrial policy which encourages the use of domestic inputs and labour while still providing adequate reward for capital and technology without allowing an unnecessary drain on our domestic and external resources. It also implies that efficiency and innovation towards these goals would be properly rewarded;

(ii) greater use of fiscal and monetary instruments in order to promote higher domestic production and attract more external capital inflows. Coupled to this would be incomes and wages policies which encourage greater use of labour as well as increasing productivity in all sectors by rewarding higher output;

(iii) greater support for agriculture with a view to increasing productivity of idle or underutilized land to achieve higher output of marketable surpluses of both export commodities and food crops;

(iv) deliberate and firm measures to restrain the increased consumption of petroleum-based energy by making optimum use of what we must import while accelerating the development of alternative energy sources, including production of power alcohol, hydro and geothermal electricity and use of solar energy.

The measures with which we shall be most concerned today involve structural adjustments of the economy and include a review of the industrial protection policies, the cost and utilization of capital and credit as well as import and export management policies.

As the Government has stated on many occasions, the past and present strategy for industrial development has been based primarily on import substitution and on the need to attract foreign capital and technology. To achieve this, a wide range of protection measures have been used, including complete bans on certain import items, refund or remission of duties on capital goods and raw materials, provisions for local manufacturers to issue Letters of No Objection for importation of competing items, and a complex system of import licensing and allocation of foreign exchange. Although this system has succeeded in encouraging establishment of many medium- and small-scale industries its scope for further expansion is now nearly exhausted. In addition, it has created certain most undesirable features including cases of excessive profitability based on inefficient production and poor quality goods. With high returns on capital within a closely safeguarded and protected domestic market, some manufacturers have not found it necessary to look outward for export markets. Since the collapse of the East African Common Market, many industries have sought increased domestic protection to make up for the lost markets instead of seeking alternative markets further afield. This is a situation which cannot be allowed to continue and I shall be dealing with this later in my Speech. At this stage, I merely wish to point out that some of the above practices have been the cause of major frustrations to importers of intermediate goods and raw materials required by our growing industries. In addition they have been the source of widespread malpractices.

For several reasons including those I have just mentioned, the Government's Scheme for incentives to promote exports through Export Compensation has not been entirely successful. One other reason for the poor performance of that Scheme is the delay in compensation payment resulting from a lengthy and cumbersome method of submitting and approving of claims. I, therefore, intend to simplify the Export Compensation claims procedures as follows: Exporters will still be required to submit export declaration forms and to complete CD 3 Forms as at present. Payment of compensation will, however, be made by the Central Bank of Kenya, acting as agent of the Treasury, upon confirmation from the exporter's bank that foreign exchange has been received and that the values tally with the amounts stated in the CD 3 Forms as certified by the Customs Department. This should reduce the period of payment of claims to about three weeks from the date of confirmation of receipt of foreign exchange by the exporter's commercial bank. I shall announce other measures in respect of this Scheme later on in my Speech.

FINANCIAL OUT-TURN 1979/80

Mr. Speaker, in the last Budget Speech, I estimated a total recurrent revenue of K£520.73 million. Of this, K£160 million was to be raised from Customs and Excise, K£148 million from Income Tax and K£145 million from Sales Tax. The balance of K£66.73 million was to be generated from various other sources of revenue. The increased economic activity following the relaxation in December of import controls has had dramatic effect on overall revenue during the second half of the financial year. The higher level of imports during the first few months of this year has increased customs duty and sales tax collection and it is now expected that receipts on customs duty will exceed the target by K£5 million. Due to the power crisis that prevailed during the first quarter of this year, the manufacturing sector was adversely affected and receipts from sales tax can only be expected to meet the target of K£145 million. Receipts from Income Tax are already ahead of the target and as at 31st May, 1980, stood at K£153 million. It is, therefore, anticipated that total receipts for the year will exceed the target by K£17 million.

Other revenue receipts are expected to meet their targets or exceed them. Notable among these are export duty and miscellaneous revenue which will exceed their targets by K£2 million and K£5 million respectively. This is as a result of the stable coffee prices which have prevailed in the last year and the import pre-payment deposit scheme which has increased exchange control fees. All in all, the revised revenue estimates will be K£549.47 million—an increase of K£29 million over my last year's estimate. The gross estimates of revenue including Appropriation-in-Aid will therefore be K£592.68 million.

Turning now to Expenditure, the 1979/80 Printed Estimates indicated Recurrent Expenditure including Appropriation-in-Aid of K£416 million. The Consolidated Fund Services took another K£86 million. Owing to unforeseen commitments, including large expenditures on emergency food imports and increased famine relief operations, Parliament has already been requested to authorize additional expenditure under Supplementary Estimates No. 2 of K£25 million. Given the current rate of spending, it is estimated that a total amount of K£539 million will have been issued by the end of June. This figure includes Excess Votes approved by Parliament as well as Under Issues for 1977/78 Financial Year. Thus from the projected current revenue of K£592 million, approximately K£53 million will be available for transfer to the Development Exchequer.

The 1979/80 Approved Development Estimates projected an expenditure of K£250 million including K£24 million Appropriations-in-Aid. As at the end of May, only K£138 million had been issued, leaving a balance of K£88 million to be issued in the month of June. It is apparent that this large amount cannot be spent in one month and I must, as usual urge Ministries to speed up the rate of implementation of development projects. It is anticipated that by the end of June only an additional K£47 million will have been issued—thus reflecting an under-expenditure of K£41 million compared to K£39 million surrendered in 1978/79.

PROJECTED OUT-TURN 1980/81

EXPENDITURE 1980/81

I would now like to turn to the year 1980/81.

As hon. Members will have seen from their copies of Printed Estimates, Recurrent Expenditure of Ministries is estimated at K£551 million excluding K£33 million Appropriation-in-Aid. This figure includes a provision of K£110 million for Consolidated Fund Services and Excess Votes of K£3 million from previous years. This represents an increase of K£54 million or 11 per cent above what I expect Ministries to draw this year. Considering the normal annual salary increments for civil servants of about 5 per cent and the increased expenditure arising from both rising costs of other services and restructured Ministries, this proposed Recurrent Expenditure is in real terms the same as this year's. Ministries will, therefore, be expected to maintain services at about the same level as this year with no increase in budgetary provision.

Last year, I drew the attention of the House to the high rate of increase in provision for Consolidated Fund Services as a result of debt repayments of quick-maturing commercial loans which were necessary to safeguard our territorial integrity. I also appraised the House on the need to borrow commercially abroad in order to meet our import bill. The effect of repayments of these commercial loans is reflected in the increased provision for Consolidated Fund Services of K£110 million.

Development Estimates for 1980/81 call for an expenditure of K£244 million excluding Appropriations-in-Aid of K£30 million but including Under Issues from last financial year. Although this figure is almost equal to what is voted this year, it is about K£43 million over what I expect Ministries to spend this year.

I do not intend to analyse further the details of either recurrent or development expenditures for now. Suffice it to say that I intend to finance a total expenditure of K£858 million. The rest of my speech will outline how I intend to do this.

EXTERNAL REVENUE

As I said last year, some friendly donor countries are not only prepared to increase aid to Kenya but are also willing to convert some portion of the aid from project specific to programme aid at this time of balance of payments crisis. I estimate that we shall draw K£107 million next year. Of this, K£30 million is receivable as grants, K£64 million as concessionary loans tied to particular projects and K£13 million shall come from the World Bank and I.M.F. as part of programme loan to ease our balance of payments problem. I would like to take this occasion to once again express the appreciation and gratitude of the Government and the people of Kenya for this generous gesture from our friends abroad.

Thus, I expect to use external resources of K£107 million or 12 per cent of K£858 million. I am therefore left to raise K£750 million locally.

INTERNAL REVENUE

I estimate that ordinary revenue, including local Appropriations-in-Aid should provide some K£591 million at present rates of taxation. Government stock issues should provide another K£35 million from the non-bank sector, making a total of K£626 million.

I have therefore, a gap of K£124 million. I have consistently warned the nation of the dangers inherent in trying to finance such a large deficit from the banking system. I shall, therefore, have no alternative but to rely more on increased taxation to close this gap.

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