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by

Dharam P. Ghai

INCOMES POLICY IN KENYA: NEED, CRITERIA AND MACHINERY

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Incomes Policy in Kenya: Need, Criteria and Machinery*[1]

Introduction

The main purpose of this paper is to discuss criteria and machinery for the implementation of an incomes policy for Kenya. Since, however, there are many who remain sceptical of the need for any sort of incomes policy, it is necessary to argue a case for it in the East African circumstances. Thus the earlier part of the paper deals with the need for an incomes policy in Kenya; while the subsequent sections dwell on the appropriate criteria and machinery for policies on wages, salaries and profits. There is no separate discussion of the peasant sector except in so far as it has implications for other types of incomes.

Need for an Incomes Policy.

The current interest in incomes policy in East Africa has been stimulated by concern over the failure of employment to expand over the last decade and the widening of rural/urban income differentials. It is felt that a continuation of the above trends would jeopardise the achievement of national economic and social goals such as a high rate of growth of the economy, rapid expansion of employment opportunities and equitable distribution of incomes. Incomes policy is, therefore, being advocated to achieve the following objectives:

a) promotion of a more equitable income distribution

b) rapid expansion of employment opportunities

c) prevention of inflation and balance of payments difficulties.

We shall consider each of these objectives in the context of the Kenya economy.

a) Income distribution

Gross inequalities of income distribution are a relatively well known and reasonably well documented feature of the East African economies.[2]

From the point of view of incomes policy, two aspects of this question are of particular interest: income differentials between unskilled urban workers and peasant farmers, and the differentials between skilled persons (salariat) and capitalists on the one hand, and wage earners and peasant farmers on the other.[3] The nature of the problem may be vividly illustrated with a few key statistics.

Peasant-Unskilled Worker Income Differentials.

The income differentials between peasants and urban unskilled workers are considerable and have been increasing in recent years. The average earnings of African employees in Kenya rose from £68 in 1960 to £135 p.a. in 1966.[4] This represents a cumulative increase of about 12% p.a. If we exclude agricultural employees, average urban African earnings rose from £97 in 1960 to £180 in 1966 - a compound increase of nearly 11% p.a. These figures cannot be taken as a measure of the increase in average wages of unskilled African employees. They have been affected, on the one hand, by the additional coverage of 1964, which had the effect of lowering average earnings by 2.7%.[5] On the other hand, the upgrading of African employees during this period, the most obvious and most important example of which is Africanisation of better paid jobs, had the effect of raising average African earnings. Unfortunately, since no data are available on the distribution of African earnings since 1960, it is difficult to separate out the effect of the latter movement on average earnings. It appears reasonable to assume that wages for unskilled urban workers have probably increased at a rate of about 10% p.a. since 1960.[6] Since the Nairobi cost of living index for wage earners has risen merely by 14% between 1960 and 1966, most of the increase being concentrated in 1965-66, it is clear that the real income of unskilled urban workers has risen by about 8% p.a. over this period.

In contrast to this, the gross domestic product (G.D.P.) measured at current prices rose by 41% or at an annual rate of 6.0% over the same period, while monetary G.D.P. increased at a slightly lower rate of 5.7% p.a.[7] Thus wages for unskilled urban workers have increased by slightly less than double the rate of G.D.P. growth since 1960.[8] It is notoriously difficult to make similar calculations for the small farm sector. Nevertheless, some rough estimates must be presented for illustrative purposes. In 1960, the subsistence output was estimated at £50.2 m, while the cash income of the small farm sector amounted to about £9.5m.[9] On the assumption that in 1960 a total of 1.04 million adult males derived their livelihood from cash or subsistence agriculture, the per family income comes to £57, the cash component of which amounts to £9.1.[10] The corresponding 1966 figures for subsistence and cash income are £75.3m and £19.7m. Assuming an adult male population of 1.24 millions, this gives us per household income of £77.4, the cash component of which amounts to £15.9. Thus average peasant household income went up by nearly 36% between 1960 and 1966, while the cash income increased by about 75%; the annual growth rates, therefore, amount to about 5 and 10% respectively. It will, therefore, be seen that while their cash incomes have grown at roughly the same rate, average total income of farmers has risen at about half the rate of unskilled, urban workers. In absolute terms, the average wage of urban unskilled worker would appear to be twice that of the average peasant household.[11] The above estimates are subject to a considerable margin of error.[12] Nevertheless, the overall picture they reveal of wide and increasing differentials between peasant farmers and unskilled urban workers is almost certainly true.[13]

Salariat and Capitalists

The second aspect of inequalities in income distribution relates to income differentials between skilled persons and capitalists, on the one hand, and unskilled workers and peasants on the other. Following Green's definition of salaries as employee incomes above £50 per month, then the 41,000 salariat, comprising about 7% of recorded employment of 589,000, received nearly 44% of total employment income in Kenya in 1964.[14] Another measure of the tremendous differentials between the earnings of skilled and unskilled employees, is given by the fact that whereas in the public sector the current wage for subordinate staff in large urban areas is £120 p.a., the starting salary for graduates is about £804, or about seven times as much. The fringe benefits, particularly pension schemes and housing subsidy, further reinforce the differential between salary and wage earners. In addition, while virtually all the salary earners are on incremental salary scales, wage earners in the lowest income brackets do not receive any automatic annual increases. In the private sector, annual increments in general are not automatic for salary earners, but the end result is not much different from that in the public sector.

We have unfortunately much less information on the distribution of income among unincorporated businesses (including professionals) and owners of corporate enterprises. The only readily available source of data are the income tax statistics. These show that the average income of unincorporated businesses in 1964 was £1783, while that of "controlled companies" was £4297. Assuming an average of three persons per controlled company, average income per person in "controlled companies" comes to £1432.[15] These figures illustrate the enormous gap between the incomes of capitalists and of skilled persons, on the one hand, and of unskilled workers and peasant farmers on the other.[16]

An important objective of public economic policy is to move towards a more equal income distribution.[17] It can be argued that fiscal rather incomes policy is the appropriate means to achieve a desired pattern of income distribution. Indeed fiscal policy is inherently a more effective instrument of income redistribution since it takes into account individual ability to pay whereas incomes policy works largely by affecting group or factor incomes; and there may be considerable inequalities of income distribution within a group, such as peasants or capitalists, which cannot be reduced directly by incomes policy. However, in actual practice because of the political and administrative difficulties encountered in devising an appropriately progressive tax structure, fiscal policy cannot serve as a complete substitute for incomes policy in reducing relative income differentials: this is particularly true of the gap between the incomes of wage earners and farmers. Moreover, even if there were no case in equity for initiating an incomes policy, the need for securing a rapid growth in employment would necessitate some sort of incomes policy. We now turn to this aspect of the argument.

b) <u>Employment and incomes policy</u>

Expansion of employment opportunities, along with economic growth, is an important social and economic objective of the East African countries. Yet experience in this respect has been disappointing: recorded employment in Kenya in 1965 was 10% lower than in 1960, in Uganda it had marginally declined between 1960 and 1965, and in Tanzania it fell by 14% over the same period. This despite the near boom conditions throughout East Africa since 1963.

The phenomenon of stagnation or decline in employment in the face of substantial increases in production has excited much academic speculation but so far little hard empirical research. However, there appears to be widespread agreement that the rapid increase in wages of unskilled workers in recent years has contributed in an important way to stagnation in recorded employment.[18]

More specifically, it has been argued that the rapid increase in wage rates has forced employers generally to economise on labour by using it more efficiently, has stimulated the adoption of more capital intensive techniques of production, and has probably resulted in the relative shrinkage of the labour intensive product and services sectors.

It would appear that a continuation of the past trend in wage rate increases would make it virtually impossible to achieve the target rate of increase in employment laid down in Kenya's Development Plan. In an open, predominantly agricultural economy such as that of Kenya, wage rate increases in excess of productivity increases may be expected to have an adverse effect on employment. Let us classify employees into three sectors: export sector, public sector and the rest of the economy. Employment in the export sector, and more particularly in the agricultural export sector, is likely to be very sensitive to changes in wage rates. Given constant or in some cases falling prices, excessive wage rate increases will lead to a fall in employment, caused partly by a fall in production and partly by substitution of capital for labour. In the public sector, employment in local government will also be adversely affected by a substantial rise in wage rates, as local authorities typically have highly inelastic tax systems. These two sources provide a very substantial proportion of the total recorded employment in Kenya. Employment in the other sectors of the economy may not be so sensitive to excessive wage rate increases, as it is possible to pass on the increased labour costs in the form of higher prices for goods and services. But even here, the combination of the depressive effect of fall in export earnings and competition from foreign imports, may limit price rise and hence lead to a fall in employment. It will, therefore, be seen that excessive wage rate increases will lead to a fall in employment in the short-run, and in the longer run will lower the rate of expansion of employment.

c) Inflation and Balance of Payments

Owing to lack of data, it is not possible to assess the effect on the prices of domestically produced goods and services of wage rate increases of recent years. Even if in the past, rapid wage rate increases have been absorbed through advances in productivity, the scope for similar striking improvements in productivity in the future will be less. It is, therefore, quite likely that wage rate increases of a magnitude experienced in the last six years could generate wage inflation.[19]

The likely implications for balance of payments follow directly from our discussion of the employment effects of excessive wage rate increases. The main adverse effects are likely to flow from a fall in agricultural exports and a loss in the competitive position of domestic manufactures vis-a-vis foreign imports in the East African market. There might also be a reduction in capital inflows owing to lower profitability of investment in new projects.[20] However, to the extent that foreign prices rise at the same rate at domestic prices, the effect of rapid wage increases will be felt largely through decline in agricultural export earnings. Although balance of payments is not a current constraint on the growth of the economy, it is likely to become one in the not too distant a future.[21] This, therefore, is an additional reason for initiating a policy of restraint in wage and salary increases.

The arguments presented in the preceding sections have attempted to show that it would be desirable to initiate incomes policy in Kenya in order to promote a more equitable distribution of incomes, to secure rapid expansion in employment opportunities, and finally to prevent inflation and balance of payments difficulties. The following sections are devoted to a discussion of the criteria and machinery needed to implement an incomes policy designed to achieve the above objectives. We start with wages, and then proceed to a consideration of salaries, profits and prices.

National Wages Policy:

The main characteristics of the market for unskilled labour in Kenya may be restated and summarized as follows: (i) the existence of excess supply at the existing wage rate i.e. unemployment of unskilled persons

(ii) considerable divergence in wage rates as between different industries and different firms within an industry; (iii) a substantial rate of increase in wage rates in recent years despite the existence of unemployment (iv) stagnation in the volume of recorded employment. The phenomenon of increasing wages in the face of considerable and growing volume of unemployment is to be explained by the passage of successive minimum wage laws and more recently by the power of trade unions to wrest wage increases from the employers.[22]

All three objectives of incomes policy listed earlier would be furthered by a moderation of wage rate increases for unskilled persons. Can we say anything about the appropriate size of increase in wage rates? The Paretian criteria for optimum resource allocation would imply a fall in the price of labour. This is clearly unrealistic. In the predominantly private sector economy of the Kenya type, the most that can realistically be achieved is a substantial lowering of the rate of wage increases experienced in recent years. The two obvious methods of determining the advance of the incomes of unskilled workers are increases in productivity and the growth of peasant incomes. The rationale behind the productivity criterion presumably is that its application will ensure price stability. This makes sense in fully employed, developed economies where the main problem is external equilibrium; hence it is vital to secure price stability. In economies with considerable unemployment, productivity criterion does not make much theoretical sense, especially if productivity increases are brought about largely by substitution of capital for labour. In addition, there are also practical difficulties in the application of this criterion. Statistical data on productivity are scanty and for some important sectors non-existent. While, therefore, it may be difficult to base wage rate increases on productivity increases at a macro level, the productivity criterion, as will be shown below, has a role to play in providing continuing incentives for increasing labour efficiency and flexibility in wage structure at the micro level,

Since one of the objectives of an incomes policy is to reduce differentials between the incomes of smallholders and unskilled urban employees, and since the supply of labour in the employment sector is affected most fundamentally by peasant incomes, it is natural to relate wage rate increases to growth in peasant incomes. According to the Kenya Development Plan, peasant cash crop production, livestock and subsistence output are projected to increase at 1964 prices, at an annual rate of 17.8%, 10.3% and 3.2% respectively. This works out to an annual growth in peasant incomes of about 6%.[23] Allowing for a 3% annual increase in the peasant population, average peasant (household) income has been projected to rise by 3% p.a. This figure does not make any allowance for the decline in prices of agricultural products. In actual practice, peasant incomes have increased by about 7.4% p.a. since 1964 at current prices, and possibly more at 1964 prices.[24] It may, therefore, be more realistic to assume an increase in average peasant income of 4-5% p.a. If we are to prevent a widening of the relative gap in rural/urban incomes, and hopefully to narrow it in the future, the overall increase in the wage rate of unskilled employees must be limited to 4% p.a. The essence of the proposal made here is to base wage rate increases on a moving average of increase in average peasant income over the last three to four years. This will have the advantage of tying wage rate increases to increases in peasant incomes, while at the same time eliminating difficulties arising from frequent fluctuations of farm incomes.[25] Moreover, the permitted increase in wage rates can be determined fairly easily from the regularly published statistics.

Three obvious objections against the above proposal are that (a) it will have an adverse effect on the supply of labour to the employment sector, (b) it will impair incentives to raise productivity, and (c) it will introduce undesirable rigidity into the wage structure. Under the present conditions of excess supply of unskilled labour and overwhelming attraction of urban jobs, the first objection is largely academic. Should there be a scarcity of unskilled labour in the future, the problem could be met easily by permitting wages to rise faster. The other two objections are more serious and a way must be found of incorporating incentives and flexibility in the operation of the wages policy. One way of doing this would be to have a system under which wage rate increases upto a certain figure, say 3%, would continue to be subject to negotiations between employers and unions as at present; but any demands for wage increases above 3% would be submitted to a government appointed board. The board would have a discretion to award wage increases in excess of 3% and upto a maximum of 6%. In deciding on wage awards, it should be guided by the following principles; (i) if productivity increases are in excess of the permitted increases in wage rates, and if these increases could be attributed directly to increased efficiency or effort of workers, then higher increases in wage rates could be justified. This would have the important effect of providing continuing incentives for productivity increases on the part of workers.[26] Although it is difficult to state in general terms the operational rules for attributing productivity increases to different factors of production, the detailed study of individual cases should reveal the main agents of improvements in productivity. (ii) If there is a scarcity of certain types of labour, extra wage rate increases could be awarded to induce workers to take up these jobs. This would make for a more efficient working of the labour market. (iii) Higher increases might be awarded to workers at the lowest rung of the wage scale for unskilled workers, in order to reduce income differentials amongst workers themselves.

Two further points should be made: the overall annual increase in wage rates should not exceed 4%, and wages should be defined as including all fringe benefits such as holiday, working time, social security contributions etc.

Apart from the advantages of incentives and flexibility, the scheme outlined here has the virtue of involving minimal departure from the established system of wage negotiations. For its successful working, it will be necessary to provide deterrents to ensure that all wage claims are not automatically taken to the board for settlement. These could take the form of a fee, or an obligation to meet expenses, etc. in the event of no award decision by the board.

<u>Machinery for Wages Policy:</u>

It is proposed that National Incomes Board be established to implement the government's incomes policy. As far as wages are concerned, the board will be charged with the responsibility of considering wage demands in excess of the permitted increment. In addition, it will be required to formulate minimum wages and orders relating to wages and conditions of service in particular industries. The board will thus take over the functions of the Wages Council and of the Ministry of Labour in determining certain wages and conditions of service. The board should consist of three independent members of high competence and standing appointed by the government. Because of the technical nature of its functions, it will be necessary to provide it with a small professional staff with expertise in statistics, accountancy and economics. The board will keep under review trends in such significant variables as national income, peasant incomes, employment, wages, productivity, profits and prices. It will be required to issue six monthly reports, reviewing the progress of its work.

It is an open question whether the existing Industrial Court could be transformed into the National Incomes Board. The Court was established in 1964 to arbitrate on the disputes between unions and employers. However as currently constituted, it suffers from the fact that it operates without the benefit of centrally issued criteria on wages policy. Thus inevitably the Court's decisions are influenced by a desire to resolve conflicts in terms which would be acceptable to both parties. In the first two years of its operation, the wage rate increases granted often amounted to 10% or more. It has thus added to the upward bias in wage settlement already inherent in the existing machinery of wage determination. It has also suffered from the fact that it has lacked access to expert advice. If the court is to serve as an instrument of national incomes policy, it will be necessary to effect drastic changes in its present functions, staff and membership.[27]

Salaries Policy

Most of the discussions on incomes policy have tended to concentrate on wages to the exclusion of salaries and other types of income. This is unfortunate not only because of the great disparities in incomes between capitalists and salariat on the one hand, and peasants and unskilled workers on the other, but also because neglect of other incomes will seriously jeopardise the acceptance of a national wages policy on the lines indicated earlier. Before discussing the policy alternatives for salaries, it may be useful to summarise the main characteristics of the market for skilled labour in Kenya.[28]

In contrast to unskilled workers, the market for skilled labour is characterised by excess demand. The total stock of skilled labour force may be divided into three categories: local persons, expatriates provided to the public sector by foreign governments and international organizations at prices considerably below their true supply price, and expatriates recruited in the world market. Expatriates constitute a significant proportion of the total stock of skilled manpower. The public sector is by far the most important employer of skilled labour and as such effectively determines the salary and terms of service for skilled persons. Whereas the wages of unskilled workers are determined in the domestic economy, the salaries for skilled labour reflect the market conditions in Europe. The expatriate salaries are in general substantially higher than those of their local counterparts. Finally, although there continues to be a tightness in the skilled labour market, the supply position is changing rapidly with an increasing flow of local skilled persons coming on the market. Most of the following discussions about salaries is concerned with local skilled persons.

Because of the large differentials in the remuneration of skilled and unskilled employees, there is a strong equity case for reducing these differentials either by a freeze on salaries, or more effectively by an actual reduction in salary scales. However, in view of the continuing shortage of skilled manpower, we must weigh the equity requirements against the economic costs, if any, of such a policy. These may conveniently be considered under two heads: effect on the demand and the supply of skilled labour. On theoretical grounds, one would expect an increase in quantity demanded of skilled labour both because of substitution of skilled for unskilled labour and because the demand for products where skilled labour is an important input will increase relative to the demand for other products. The ability of the public sector to employ more skilled persons will also be enhanced. It is clearly not possible to estimate the magnitude of this effect. Provided the barriers to inflow of foreign skilled manpower are eased, there need be no intensification of the excess demand for labour. The economic costs of reducing the salaries of local skilled persons are, therefore, confined to the inefficient use of skilled labour. i.e. the substitution of skilled for unskilled persons. It is a matter of judgement as to how strong this effect might be. Considering the large differentials in the remuneration of skilled and other employees, it can be argued that the substitution effect may be quantitatively in-insignificant.

Another argument against lowering relative price of skilled labour that is often put forward relates to the adverse effect this will have on its supply. There are two aspects of this question: effect on the existing stock and on the future flow of skilled labour. It is not possible to say a priori how sensitive is the international mobility of local skilled labour to changes in salaries. Because of the close links among the three East African countries, one would expect a certain amount of mobility within East Africa. But Tanzanian salaries for local skilled persons are already considerably below their counterparts in Kenya and Uganda. It is, therefore, doubtful whether there would be much outflow of skilled persons from Kenya to other parts of East Africa. Similarly, unless there is a drastic reduction of salaries, say by 50%, it would appear that the outflow of local skilled persons in the foreseeable future to countries outside East Africa need not present much of a problem.[29] Should there, however, be a serious drain of local skilled manpower, it is open to the government to raise the price of emigration by say, the imposition of an emigration tax.[30]

The adverse effect of a reduction in salaries on the future supply of skilled labour is likely to be negligible. Not only are the returns to skills so relatively high that only a drastic reduction of salaries will significantly affect the attractiveness of acquiring skills, but under the present system in Kenya most of the costs of higher training and education are borne by the state. The main constraint on the supply of skilled labour is provided by the capacity of the training institutions and not by lack of demand for such facilities. It seems unlikely, therefore, that say a 10 to 15% reduction in the salaries will have much of an impact on the flow of skilled manpower.

It does not, therefore, seem to me that the economic costs of a reduction in salaries will be significant. To the extent that there are marginal adverse effects, they are likely to be outweighed by the gains resulting from this policy. These gains are:(i) a more equal distribution of income (ii) greater acceptance of controls on wages (iii) enhancement of the ability of the public sector to expand its social and economic services and undertake development projects (iv) favourable impact on imports of consumer goods.

As far as the existing stock of local skilled labour is concerned, any proposal for reduction in salaries will naturally generate fierce opposition. Moreover, the salariat are strongly entrenched in positions of power and policy-making; in the absence of a powerful political leadership, dedicated to egalitarian principles, it may prove virtually impossible to enforce a reduction in the earnings of the salaried group.[31] The second best alternative of a freeze in salary scales may prove more acceptable. But under the present system, this automatically ensures to most salary earners, at any rate in the public sector, an annual increment of 2 to 5%.[32] Thus if incomes policy is to be effective in reducing differentials between skilled and unskilled persons, it is essential to reform the salary structure either by abolishing the principle of automatic increments and equating increments up the scale to promotion, or by granting increments every three years or so, thus effectively reducing the annual increment.

The prospects of enforcing a reduction in the salaries of new entrants to the labour force appear more favourable. This may be achieved effectively by any of the following three methods: (i) lowering of the current salary scales, either by having lower salary or higher qualifications for the same job; (ii) financing of higher education by loans, which would be repayable over a specified period and carry a rate of interest;[33] (iii) a compulsory national service for a specified period, at a salary below the current rates.[34] If the objective is to reduce the present value of the stream of earnings of skilled labour by a certain figure, this could be achieved theoretically by all three methods.[35] However, there are some important differences among them with respect to incidence, equity and administrative and economic efficiency.

The first alternative of a straight salary cut will presumably apply in the first instance to new employees in the public sector; it may prove difficult to enforce the cut on the private sector directly. On the other hand, since it is the public sector which effectively determines the salaries for skilled employees, the salaries in the private sector may be adjusted downwards in line with those in the public sector. From an administrative point of view, this alternative is superior to loans and national service. Likewise, it would appear to involve smaller "psychological costs" for those affected by it than the other alternatives. National service could be so devised as to be applicable to all new entrants to the skilled labour force. While it has this advantage over other alternatives, it is likely to raise considerable administrative problems, and if experience in other countries is any guide it may also be wasteful in the use of the skills made available. Furthermore, it will probably be less acceptable to those affected by it than the other schemes in so far as the latter interfere less with the individual choice of occupation.

The loan scheme can only apply to those whose higher education has been financed by the state. Thus a considerable number of those taking up salaried jobs will, therefore, be outside its scope.[36] This in itself might generate considerable resentment and hostility to the scheme. It is also likely that a loan scheme might involve greater psychological costs and thus have a more adverse effect on the supply of skilled manpower than the other methods of reducing the earnings of skilled labour. Finally, there is a lag of several years before a loan scheme can become effective in reducing salaries.

The weight of the arguments presented above is in favour of relying on direct salary cuts as a means of reducing the income of new entrants to the skilled labour force in preference to national service or loan financing of education. A reasonable figure for salary reduction might be 10 to 20%, the rates increasing progressively for higher salaries. Most of the entrants to the skilled labour force would in fact fall in the lower brackets of the salary structure in the early years. The initiative for salary revision would clearly have to come from the Government and would in the first instance apply to the public sector. The National Incomes Board would be charged with the function of reviewing matters relating to salaries; and one of its first tasks in this connection would be to devise techniques and procedures for extending the revised salary scales to new skilled employees in the private sector.

Profits and prices policy.

It is more difficult and less desirable to have the same sort of controls on profits as have been proposed for wages and salaries. For one thing, profits fluctuate a good deal from year to year, rising sharply in boom years and falling in recession. Secondly, the rate of profit on the capital employed varies enormously from firm to firm, and from industry to industry, reflecting differences in risk, managerial efficiency and sheer luck. Thirdly, since profits are the main source of investment funds in the private sector, any kind of direct control over them could have serious adverse effects on private investment. It would, therefore, be preferable to adopt indirect measures to achieve the main objectives of incomes policy with respect to profits.

If the proposed policies on wages and salaries are accepted and implemented, it is possible that there may be a rise in the share of profits in national income. This would probably be acceptable in a largely socialist economy. But in a predominantly private enterprise economy such as that of Kenya, a rise in the share of profits, while desirable from the growth point of view, will worsen income distribution and jeopardise wages policy. In order to deal with this situation, it will be necessary to rely on fiscal and prices policy. The corporate tax is already quite high in East Africa, amounting to 40% of net profits. Taking into account the surtax on distributed dividends, the effective rate of taxation of business profits probably amounts to more than 50%. Thus the government will be one of the principal beneficiaries of a rise in the share of profits. It is doubtful whether corporate tax can be raised much further without affecting foreign private investment in the country. On the other hand, there is considerable scope for further reform of the business tax system. The most urgent need in this area is the improvement of procedures for the assessment of incomes of private companies and unincorporated enterprises, in order to reduce tax evasion through underdeclaration of incomes.

The role of the price policy is to ensure stability in the worker's cost of living index, which is essential for the success of the wages policy, and to prevent the earning of excess profits by firms enjoying monopolistic powers. The government is already responsible for the fixing of prices of a wide range of goods, which figure heavily in the budgets of low income groups. Supplemented by selective subsidies of a temporary nature, this should enable the government to achieve reasonable stability in the low income cost of living index.

It is more difficult to devise means to control the pricing policies of monopolistic firms. A substantial proportion of the manufacturing and services sector is dominated by monopolistic and oligopolistic structures. Unlike many industrial countries, East African countries do not have any public bodies whose function is to keep a check on the activities of monopolistic firms. This role could be performed by the proposed National Incomes Board. The main objectives here are to ensure that the market power is not used to raise prices when there is no adequate justification for it, and more positively to induce firms to reduce prices when productivity increases are in excess of wage rate increases and other costs have not risen. The implementation of these policies, however, is likely to prove extremely difficult. It is easier to prevent unjustified price increases then to secure price reductions.[37] If the board is to discharge its functions adequately in this respect, it would need to have access to detailed data on the cost and price structure of a wide range of industries. Planned variations in import duties and direct pressure on firms would be the main means of influencing the price policy of firms. In addition the government could use its immense powers as a purchaser of these goods and services to encourage price reductions.

Conclusion:

It has been argued above that in the interests of equity and a rapid expansion of employment, it is desirable to introduce controls to slow down the increase in wage rates to 4% p.a. A proposal designed to achieve this objective involving minimum interference with the existing machinery of wage negotiation was put forward. With respect to salaries, the best practicable alternative would appear to be to freeze the salary scale at its existing level for the present holders of salaried jobs, and to lower the salaries for future entrants to the skilled labour force. Profits should be regulated through a combination of fiscal and price policies.

FOOT NOTES

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1. The Report to the Government of the United Republic of Tanzania on Wages, Incomes and Prices Policy, by International Labour Office, (Government Printer, Dar es Salaam, 1967), and the accompanying White Paper on Wages, Incomes, Rural Development, Investment and Price Policy, (Government Printer, Dar es Salaam, 1967), were unfortunately published only after this paper had been substantially completed. It has, therefore, not been possible to comment in detail on the analysis and recommendations of these important documents. It is, however, gratifying to note my own analysis of the problem confirmed by the authoritative I.L.O. Report.

2. See, among others, D.P. Ghai, Some Aspects of Income Distribution in East Africa, East African Institute of Social Research, E.D.R.P. paper 52, (Mimeo) for racial inequalities; Report of the Salaries Review Commission, 1967, Kenya Government, pp. 15-23 (Government Printer, Nairobi) for rural-urban differentials. R. H. Green, Wage Levels, Employment, Productivity and Consumption, in Education, Employment and Rural Development, edited by J.R. Sheffield (East African Publishing House, 1967) for wage and salary differentials.

3. In the terminology used here, skilled persons (salariat) are defined to include professional, managerial, administrative and technical personnel; while wage earners comprise the rest of the employees including not only the unskilled workers but also what is often called the middle-level manpower such as clerks, salesmen, primary school teachers, artisans, minor technicians etc.; where the argument relates to unskilled workers among wage earners, they are so distinguished in the paper.

4. All these figures unless otherwise stated are obtained from Economic Survey, Kenya, various years.

5. In 1964, the average earnings of the additional coverage of 39,300 African employees was £56 compared with £70 for other employees. Since the additional coverage represented an increase of 13.5% in the enumeration of African employees, it pulled the average earnings down by 2.7%.

6. Analysis of the Industrial Court wage awards since its establishment in 1964, and of four important firms since 1960 shows that wages of unskilled employees have increased by about 10% p.a.

7. This apparently surprising result is due to the fact that whereas subsistence output was depressed in 1960, it was at a record level in 1966. All these figures are based on the old G.D.P. estimates.

8. The same sort of picture emerges both in Uganda and Tanzania. In Tanzania the average yearly increase in cash wages has been 17% between 1960 and 1966, while G.D.P. at current prices has risen annually by 6.7%; I.L.O. Report, op. cit. p. 4; Background to the Budget, 1967-68 (Government Printer, Dar es Salaam).

9. For a variety of reasons such as the failure to estimate rental income and the inadequate coverage of cash sales, this is almost certainly an under-estimate of the real income of peasant farmers.

10. Calculated from the Revised Development Plan, Kenya, p. 102.

11. It must also be remembered that whereas average wage represents the earnings of a single person, the average peasant income is a return to the labour (and land) of the entire household. Thus the differences in the average income of the unskilled urban worker and the peasant are substantially greater than suggested by the above figures.

12. Apart from statistical weaknesses, there are many other factors which make a simple comparison between incomes of peasants and urban workers hazardous; see Report of the Salaries Review Commission, op. cit., pp. 20-21.

13. Similar trends are observable in Uganda and Tanzania: see J.B. Knight, The Determination of Wages and Salaries in Uganda, Table 3, in Bulletin of the Oxford University Institute of Economics and Statistics, Vol. 29, No. 3, 1967 pp. 233-264, and I.L.O. Report, p. 5: "There seems no doubt that there is a very large discrepancy between the living standards of the average wage earner and the average smallholder, and that this discrepancy has substantially increased in recent years." According to the Report whereas wage earners in 1966 were over twice as well off in terms of real income as in 1960, "it does not appear that the smallholder's average real income for 1966 is likely to be more than 5% above 1960-62 figure."

14. R.H. Green, Wage Levels, Employment, Productivity and Consumption, op. cit. tables I and II.

15. A company is controlled unless there is a public holding of more than 25% of the voting power and of equity; public for this purpose excludes relations and nominees of other persons. This distinction between controlled and non-controlled companies has now been abolished.

16. The figure on average capitalist income must be treated with caution. Income tax statistics exclude very small enterprises and thus exaggerate the average income of unincorporated enterprises. On the other hand, they almost certainly understate the true income of both unincorporated enterprises and controlled companies.

17. This is defined as bending inwards of the Lorenz Curve of income distribution.

18. See, for instance, Economic Survey, 1967, Kenya, pp. 85-86; Work for Progress, Uganda's Second Five-Year Plan, p. 146; I.L.O. Report, op. cit. pp. 8-9, where it is stated that econometric analysis shows that at current levels of labour efficiency in Tanzania, and at the recent rates of improvement in labour efficiency, if average wages and salaries etc. rise by 15% p.a., employment will fall by 5% p.a.; if the former rise by 10% p.a., the latter will fall by 2½% p.a., and if they rise by 5% p.a., employment will rise by 5% p.a. Azarias Baryaruha, "Factors Affecting Industrial Employment. A Study of Ugandan Experience 1954-1964," p. 80 Oxford University Press, Nairobi.

19. It appears that this may already have started in Tanzania: see I.L.O. Report, p. 11.

20. The force of all these arguments is increased by the recent devaluation of sterling and the non-devaluation of East African currencies.

21. According to the projections made in the Development Plan, the 1964 surplus on current account of £10.6 m. is expected to be converted into a deficit of £26.5 m. by 1970.

22. I have discussed this phenomenon in some detail in my paper, "Analytical Aspects of an Incomes Policy for Kenya", pp. 7-10, Discussion Paper No. 50, Institute for Development Studies, University College, Nairobi (mimeo) For a similar explanation of rising wages in conditions of excess supply of unskilled labour in Uganda, see J.B. Knight, Determination of Wages and Salaries in Uganda, op. cit. He attributes the rise to government policy, trade union pressures and employers' enlightenment.

23.

	1964: £ m	1970: £ m
Subsistence Output	68.5	82.4
Cash crop production	10.5	28.1
Livestock	3.4	6.1
Total	82.4	116.6

24. Based on old calculations of G.D.P.

25. The I.L.O. Report recommends that minimum wages should be fixed in relation to smallholder's income. But it proposes a different system - the proficiency wage - for determining wages above the minimum. The overall ceiling of 5% annual increase presumably reflects the maximum increase in wages and salaries bill consistent with projected increases in employment.

26. Productivity may increase for several reasons: additional effort or efficiency of workers, more and better equipment per worker, and improved management. There is no reason why workers should get extra benefits for productivity increases brought about solely by more capital and better management. It is one of the weaknesses of the I.L.O. Report that in arguing for a closer relation between wage and productivity increases, it does not distinguish among different causes of increases in productivity.

27. For a detailed analysis of the working of the Industrial Court, see Dharam Ghai and Charles Hollen, "Kenya's Industrial Court - an Economic Analysis", forthcoming Discussion Paper, Institute for Development Studies, University College, Nairobi.

28. These are described in detail in my paper, Some Notes on Labour Markets in East Africa, Staff Paper, Institute for Development Studies, University College, Nairobi (mimeo).

29. It would be interesting to see the extent of outflow of skilled manpower in Tanzania following the recent reduction in salaries of senior Civil Servants. My own impression is that it has been negligible. It is doubtful whether there has even been a net flow from the public to the private sector where salaries have been maintained at their old level.

30. Several developing countries, such as U.A.R. and India, which have suffered considerably from "brain drain", do already operate some controls on the flow of skilled labour. If developed countries do not permit the inflow of unskilled labour in the "interests" of their economy, is it that outrageous to suggest that developing countries might impose controls on the outflow of skilled labour to safeguard their economies?

31. This is no doubt the reason why, barring a few exceptions, most African countries have failed in their attempts to reform their salary structures inherited from the colonial era.

32. The annual increments built into various salary scales appear to be quite haphazard; they bear no relation to considerations of equity or economic efficiency.

33. For a detailed discussion, in the Kenya context, of the financing of higher education through loans, see Daniel C. Rogers, "The Returns to Investment in Higher Levels of Education in Kenya," Discussion Paper No. 59, Institute for Development Studies, University College, Nairobi, (mimeo).

34. Tanzania has utilized both lower salary scales and national service to reduce the earnings of skilled workers. In October, 1966 the Tanzanian government announced salary reductions ranging from 20% in the case of ministers and top civil servants down to 3% in the case of civil servants earning from £660 to £900 a year. At the same time, national service was introduced; college and university leavers were required to serve for two years at 60% of their normal salary. The first proposal applies to both the existing stock of local skilled force as well as to new entrants; while the second proposal applies only to the latter.

35. Let the stream of earnings under the present salary scale be represented by $X_1, X_2, \ldots\ldots X_n$

The present value (P.V.) of earnings $= \frac{X_1}{(1+r)} + \frac{X_2}{(1+Y)^2} + \ldots . \frac{X_n}{(1+r)^n} = X$

Let us assume that it is proposed to reduce the P.V. of this stream of earnings by Y. This can be done either by a straight salary cut, by loan financing of education, or by national service.

Alternative 1: salary reduction

Let us assume a proportionate salary reduction of m%

Therefore, P.V. of salary reduction $= \frac{mX_1}{(1+r)} + \frac{mX_2}{(1+r)^2} + \ldots . + \frac{mXn}{(1+r)^n} = Y.$

The value of m can be determined from the above equation.

Alternative 2: loan scheme

Let i be equal annual instalments for h years towards loan repayment.

Therefore, P.V. of loan instalments $= \frac{i}{(1+r)} + \frac{i}{(1+r)^2} + \ldots \frac{i}{(1+r)^h} = Y.$

The value of i can be determined from the above equation.

Alternative 3: national service

Let national service rate represent p% reduction in salary over f years.

Therefore, P.V. of reduction in salaries $= \frac{pX_1}{(1+r)} + \frac{pX_2}{(1+r)^2} + \ldots\ldots$

$$+ \frac{pX_f}{(1+r)^f} = Y.$$

The value of p can be determined from the above equation. The maximum reduction in salaries cannot exceed the amount of the loan granted. In the above analysis, we have abstracted from the complications introduced by taxes.

36. Strictly speaking, this will be true only if training and educational institutions charge true economic costs to the students. Under the present system, even those who are supposed to be paying their own way, do in fact enjoy considerable hidden subsidy from the state.

37. This certainly appears to have been the experience of the National Board for Prices and Incomes in U.K.; See its General Report, April 1965 to July 1966 (Cmnd. 3087), pp. 18-21.