

Commentary

Overall review of the Finance Minister's speech

2007 growth: 7.1%

In 2007 Tanzania posted one of the highest growth rates of non-oil producing sub-Saharan African countries, namely 7.1%.

productivity; and lending rates that are still too high. He also noted that the current instability in international financial markets and general worldwide economic downturn could have adverse consequences for foreign direct investment. Longer term he noted the challenges of public service provision for a population expected to grow from an estimated 40 million in 2007 to 63 million by 2025.

Domestic revenue to increase by 31%

Confidence in its economy was also evidenced by the signing in February by President Bush and Kikwete of the Millennium Challenge Compact Agreement, offering grants to Tanzania amounting to US\$ 698 million over five years for infrastructure projects.

Indicative of the determination for greater financial self dependency is the target of increasing domestic revenue in 2008/09 by 31% compared to 2007/08, such that domestic revenue reaches 18.5% of GDP compared to the expected 16.7% for 2007/08, and with donor dependency reducing from 42% to 34%. These are challenging targets and the question is where will this revenue come from?

12% increase in specific excise tariffs on alcohol, tobacco, carbonated drinks

A key factor to enable economic growth is the availability and affordability of finance. Here there was good news with commercial bank credit extended to the private sector increasing by 42% in the year, and average lending rates also declining to 15.1% by March 2008.

In previous years, the budget has always seen some change to taxes on fuel, which at approximately 20% of revenue collections are a significant component of overall revenue collections.

Excise duty on mobile phone use up to 10%

Nevertheless, on Thursday 12 June the Minister for Finance and Economic Affairs, Honourable Mustafa Mkulo, highlighted key challenges to the economy including: inflation (driven in particular by prices of oil, fertilisers, industrial raw materials and food); an increased balance of payments deficit; inadequate transport and power infrastructure; continued dependence of donor funding; poor agricultural

No change on fuel taxes

	10 months to April 2008 Shs'm	% of net tax revenue
Net collections	2,762,316	
Tax on fuel		
Excise	349,971	
Road toll / Fuel levy	<u>185,147</u>	
	<u>535,117</u>	19.4%

However, there was no change to taxes on diesel and petrol, and a reduction in the taxation of heavy furnace oil (HFO).

Other major earners of revenue for the Government are the mobile phone industry, alcohol, tobacco and soft drinks, which together contribute by way of excise duty and VAT about 12% of the country's net tax revenue. (Indeed, their contribution to net tax revenue is in fact even higher once consideration is taken of other taxes that they generate for example corporate income tax and payroll taxes.) For mobile phones the excise rate is set on an ad valorem basis, whereas for the others the excise duty is on a specific basis.

	10 months to April 2008			% of net revenue
	Excise Shs'm	VAT (net) Shs'm	Total Shs'm	
Beer	81,893	47,250	129,143	
Phone / Mobile phone	32,774	68,538	101,312	
Cigarette	46,625	20,034	66,659	
Soft Drinks	<u>17,203</u>	<u>11,381</u>	<u>28,583</u>	
	<u>178,494</u>	<u>147,202</u>	<u>325,696</u>	11.8%

These businesses will be disappointed with the changes proposed.

The alcohol, tobacco and soft drinks sectors will query the rationale for a 12% increase in their specific excise duties, bearing in mind that the Minister did specifically state that the target for inflation was a rate below 7.0 percent by the end of June, 2009. If this is the case then what is planned is a significant increase in real terms, and one at odds with the commitment in the Finance Act 2005, which stated that "the specific excise duty rates imposed shall be annually adjusted in accordance with the projected inflation rate". Whatever the case, in setting excise duty rates the Minister has to consider a complex economic equation that may need to take account of the consumers' reduced spending power with so much more of personal budgets being taken up by the higher cost of necessities such as food and fuel. Too high an increase could induce an actual reduction in overall revenue if the effect on demand is disproportionate.

The news for the mobile phone sector was no better, with an increase in excise duty to 10% from 7%, taking the total indirect tax for the mobile phones services in Tanzania to 32% (i.e. a 10% duty and 20% VAT on the amount gross of excise duty). By contrast in Kenya, whilst the excise duty on mobile phone use is also 10%, VAT is much lower at 16%. However, the change in Tanzania does appear to mirror the overall cumulative cost charged in Uganda, where the equivalent excise duty is 12% and VAT is 18%. Whilst there is no doubt that mobile phones have now become significant drivers of economic growth, the Government's perspective appears to be that for a country like Tanzania with many people outside the tax net, and where an increasing amount of

consumer spending is on mobile phones, the taxes on mobile phone airtime (rather like taxes on fuel) are a pretty effective means of taxing the population at large. Interestingly, the communications sector was the economic sector that posted the highest growth rate in 2007 (20%), something manifested by mobile phone subscribers reaching 8.3 million by 31 December 2007.

Other measures to increase revenue include the introduction of a 2% withholding tax on payments by the Government to persons without a taxpayer identification number registration, as well as a new minimum 0.3% tax on turnover for perpetual loss makers. In addition there was reference in the speech to a review of the exemptions applicable to holders of certificates of incentives from the Tanzania Investment Centre as well as new conditions for VAT reliefs for Non Governmental Organisations. The Minister also mentioned the intention to tap revenues of regulatory authorities in excess of their budget requirements – an example of this might be the telecommunications sector, where mobile phone companies pay a levy of 1% of turnover to the local regulator.

The Minister made specific reference to revenue collection on imports not being satisfactory – something backed up by the statistics for the 10 months to April, which indicate taxes on imports falling short of budget – and listed the strengthening of excise and customs duty collections as one of the measures to be taken to improve revenue.

A Commission set up by the President to review the mining sector recently presented their report to him. Whilst the Minister

did not announce any consequent changes for the sector, he made it clear that the tax regime for mining is being reviewed and noted the intention to “set up new investment rules and regulations in mining activities”. The hope is that whatever proposals are eventually implemented, they do still encourage investment to the sector particularly at this time of higher commodity prices. Given the Minister’s emphasis on the need to encourage exports, it is critical that this sector flourishes. Indeed the Bank of Tanzania monthly economic review for April 2008 notes in its commentary on exports performance that “gold continued to dominate by accounting for about 37.9 per cent of merchandise exports”.

Catalysing agriculture remains key to catapulting the country’s economic growth. However, 2007 continued the recent trend of disappointing growth in this sector, only 4%. There were certainly many measures announced to boost agriculture – including: an increased budgetary allocation to agriculture; a commitment to ensure sufficient funds for all ongoing road infrastructure projects and to rehabilitate rural roads; and implementation of the agriculture sector development programme. The Minister noted the opportunity that increased world food prices give to stimulate agricultural production, but of concern was a suggestion of a possible export tax on cereals to discourage the exports of these. Whilst the intentions behind the suggestion are understood it would seem to possibly work against encouraging investment in the sector.

A particularly positive move is the confirmation that the VAT treatment of export of services is to

be changed effective from 1 January 2009. This will help ensure the country's competitiveness.

Ultimately, the feel of this Budget is that it does set very ambitious revenue targets. However, with the economy on a significant growth path – and with growth targetted at 7.8% in 2008 and 8.1% in 2009 - the revenue target for 2008/09 is not unachievable. Indeed, we are seeing many investors who have now been established here for a number of years showing significantly increasing levels of profits and therefore tax – something also backed up by the revenue collection statistics, which show corporate tax revenues for the 10 months to April 21% up on budget and 51% up on the prior year.

Tax Changes

Highlights based on the Finance Minister's speech

Minimum turnover tax introduced on tax loss making entities.

Minimum non taxable threshold increased to Shs100,000 per month

Excise duty on mobile phone airtime increases to 10%

Annual road licence fees slashed

Zero-rating of export of services

Income Tax

Minimum Tax on Turnover

There is bad news for loss making entities. An Alternative Minimum Tax (AMT) at a rate of 0.3% of turnover has been introduced to apply to corporate entities making tax losses for three consecutive years.

The apparent rationale behind the tax is to counter erosion of the tax base where entities make accounting profits but end up with tax losses due to generous investment incentives (such as accelerated capital deductions and investment allowances).

It is unclear whether the tax will apply equally to entities that make accounting losses.

There is also a question whether the AMT will be a final tax or can be offset against future income tax liabilities. Initial indications are that it will be a final tax, meaning that entities enjoying initial tax losses will ultimately pay more tax on the same income.

Withholding Tax on Goods and Services

Withholding tax at a rate of 2% which existed under the repealed Income Tax Act 1973 has been re-introduced on payments for goods and services by the Government to suppliers without a Taxpayer Identification Number (TIN). However, the tax deducted will now be a final tax. It remains to be seen whether this will be an incentive or disincentive for such suppliers to join the formal sector.

Exemption for units in Collective Investment Schemes (CIS)

There is good news for holders of units in approved unit trusts. Gains from the sale of such units are to be exempted from income tax. This is intended to put investors in CIS on the same footing as investors in listed securities (where gains are already exempt). It is also intended to create a level playing field and encourage the use of CIS as a means to mobilise the collective investment potential of Tanzanian individuals.

Changes in Personal Tax rates

The monthly threshold at which the bottom tier personal income tax rate starts to apply has been increased from Tshs 80,000 to Tshs 100,000. This neatly ties in with the new minimum wage for Government employees. The tax bands have also been widened with the top tax rate of 30% now applying on income exceeding Tshs 720,000 per month (previously Tshs 540,000). The changes will mean an increase in take home pay of up to Tshs 30,000 per month

The new monthly tax table will be as follows:

Income Tshs	Tax
Up to 100,000	Nil
100,001 to 360,000	15% on excess over Tshs100,000
360,001 to 540,000	Tshs 39,000 + 20% on excess over Tshs 360,000
540,001 to 720,000	Tshs 75,000 + 25% on excess over Tshs 540,000
Over 720,000	Tshs 120,000 + 30% on excess over Tshs.720,000

Taxation of Petroleum Products

Excise duty on petroleum products

Unlike in prior years where excise duty on petroleum products was increased in line with inflation, this year there has been no such increase. To the contrary there has been a decrease of excise duty on Heavy Furnace Oil from Tshs 117 to Tshs 97 per litre. For other petroleum products, the rates remain unchanged.

Although ordinarily one would have expected the Minister to increase the excise rates, it is perhaps unsurprising that he has chosen not to do so this year. With the potential tensions around recent increases in fuel prices, as illustrated locally by the daladala strike last Sunday, keeping the status quo is a prudent move.

Taxes on Motor Vehicles

Registration fee

The registration fee for new motor vehicles has increased as follows:

- TShs 35,000 for motor cycles (currently TShs 27,000)
- TShs 120,000 for motor cars (currently TShs 90,000)

Annual road licence fee

The Minister has proposed to lower the annual road licence fee paid on motor vehicles as shown in the table below:

Engine Capacity cc	Old Rate TShs	New Rate TShs
0 - 500	50,000	30,000
501 – 1500	80,000	50,000
501 – 2500	150,000	120,000
2501 – 5000	330,000	140,000
Exceeding 5,000	175,000	150,000

Last year, there was a considerable increase in these fees and the reduction will therefore be welcome.

Excise Duty

Mobile phone airtime

The excise duty rate on mobile telephone air time has been increased from the current 7% to 10%.

This increase will be a bitter pill for both mobile users and operators, making calls more expensive and the business less profitable. The total indirect tax impost on mobile phone services in Tanzania will now shoot up to 32% (i.e. 10% duty plus 20% VAT on the duty-inclusive price) on every voucher you scratch.

Such a tax level does not appear consistent with the country's need for modern communications technology.

Excise Duty on small vehicles

The Minister has proposed the introduction of excise duty for small vehicles with engine capacities between 1,000cc and 2,000cc. Previously a single rate of 10% was levied on vehicles with an engine capacity exceeding 2000cc. When this was initially introduced, it was intended to limit pollution from large cars but now appears to have become a revenue-generating measure.

The new rates will be applicable as shown in the table below.

Engine Capacity cc	Excise duty rate on importation
0 – 1,000	0
1,000 – 2,000	5
2,000 and above	10

This is a surprise introduction and will not be welcomed by those looking forward to the purchase of their first car.

Beverages

Excise duty rates on alcoholic and carbonated beverages have been increased by 12%.

Goods	Old Rate TShs Per ltr	New Rate TShs per ltr
Carbonated soft drinks	48.00	54.00
Clear beer (unmalted barley)	173.00	194.00
Malt Beer	294.00	329.00
Wine with more than 25% imported grapes	940.00	1,053.00
Spirits	1,394.00	1,561.00

The above increase is supposed to be in line with inflation. However, the Minister stated in his speech that the inflation target for June 2009 is only 7%.

Cigarettes

Similar to beverages, the rates for cigarettes have also been increased by 12%.

Goods	Old Rate TShs	New Rate TShs
Cigarettes without filter, containing more than 75% domestic tobacco	4,775 per 1,000	5,348 per 1,000
Cigarettes with filter, containing more than 75% domestic tobacco	11,266 per 1,000	12,618 per 1,000
Other cigarettes not mentioned above	20,460 per 1,000	22,915 per 1,000
Cut rag/filler	10,333 per kg	11,573 per kg

Excise duty on cigars remains at 30%.

Value Added Tax

Zero-rating of Export of Services

A long awaited change is the zero-rating of export of services. This will be effective from 1 January 2009 once Regulations are in place.

Historically these services were subject to VAT at the standard rate of 20%. This resulted in an additional 20% cost to the overseas entity requesting such services from a Tanzanian supplier. Since the overseas recipient cannot claim back this Tanzanian VAT, this acted as a disadvantage to the Tanzanian service provider compared to service providers from other countries where exported services are generally zero-rated.

This therefore is a significant change and will definitely be welcomed by many service providers who in the past have struggled to sell their services abroad.

Other zero-rating

Locally produced sacks for packing imported bulk agricultural produce are now zero-rated.

This will promote the competitiveness of locally produced sacking.

New exemptions

The following have been added to the list of items that are exempt from VAT:

- Burning gel (Moto Poa) for domestic use;
- Compressed Natural Gas (CNG) and CNG cylinders

- Bitumen

The first two are to encourage people to be more environmentally friendly and also to reduce usage of kerosene which is expensive and imported.

The exemption of bitumen is intended to lower the cost of road construction. However, we do not see this objective being fully achieved as the VAT on inputs for companies supplying bitumen will now become irrecoverable and this cost will therefore be passed on to the consumer of the bitumen.

New special relief

Supplies to Moto Poa Ltd of ethanol, dyestuff and thickening agent as inputs for production of Moto Poa burning gel.

Removal/Amendment of special relief

The Minister has stressed that the Government is reviewing all tax exemptions with a view to elimination.

Item 10 of the Third Schedule to the VAT Act which provides for special relief to NGOs and religious organisations has been amended to reduce perceived abuse.

Item 11 of the Third Schedule to the VAT Act has been deleted as it is already covered under item 10

Customs Duty

Changes in East Africa CET rates

The table below summarises the changes in the import duty rates for various products.

Goods	Old Rate %	New Rate %
Hand hoes	10	0
Inputs imported by TANELEC for manufacturing transformers and switch gears	10	0
Barley imported by brewery companies of up to 20,000 metric tons to December 2009	25	0
Data processing machines	10	0
Sodium Sulphate	25	10
Garbage collection vehicles imported by local authorities or its approved agents	25	0
Crude palm oil	10	0

The Economy

Economic growth of 7.1% compared to 6.7% in 2006

Headline inflation increased to 9.7% in April 2008, up from 7.0% in December 2007

Domestic revenue collection in 2007/08 was Tshs 3,502.6 billion, the 2008/09 target is Tshs 4,728.6 billion.

Introduction of a new methodology to calculate sectoral contribution. This brings the contribution of agriculture to GDP down from 44% to 25.8%.

Per capita income increased to Tshs 548,388 in 2007 from Tshs 478,434 in 2006, equivalent to an increase of 14.6% at current prices.

Highlights based on speeches by the Minister of Finance and Economic Affairs on 12 June 2008.

Past Performance 2007/08

The economy of Tanzania is estimated to have attained real GDP growth of 7.1% during 2007 compared with the growth rate of 6.7% attained in 2006.

The increased growth momentum is based on an increase in economic activities in communication (20.1%), mining (10.7%), financial intermediation (10.2%), trade (9.8%), construction (9.7%), and agriculture (4.0%) sectors.

The economy continued to experience inflationary pressure emanating primarily from the rise in oil prices in the world market and rising food prices. The rate of inflation reached 9.7% by the end of April 2008.

In 2007/08, the Government planned to collect Tshs 3,502.6 billion in domestic revenue, and it is expected that this target will be surpassed by June 2008.

Overall budget performance has been positive. This is mainly due to efforts by the Government in implementing a range of policy and institutional reform measures to improve the business environment, broaden the tax base and restructure the tax system.

Challenges ahead

Despite achievements in economic growth and revenue collection some challenges remain. These include:

- The resources required for financing MKUKUTA significantly exceed national capacity. More involvement is needed from the internal and external private sector in implementing the strategy;
- Budget execution in infrastructure is constrained by a shortage of contractors with the required capacity, skills, equipment and experience;
- The need to increase Government capacity for self – reliance and move away from donor dependence;
- The execution of the budget faces risks if prices of fuel, foodstuffs, raw materials and inputs continue to rise.

Budget Objectives 2008/09

The 2008/09 budget will continue to implement national plans as stipulated in the CCM Election Manifesto, National Development Vision 2025 and MKUKUTA.

The 2008/09 Budget Framework

The 2008/09 budget sets out the following targets:

- GDP growth rate of 7.8% in 2008;
- Control inflation at below 7.0% by end June 2009;
- Contain the growth rate of M2 within a band of 23.9% in 2008/09;
- To increase domestic revenue from 16.7% of GDP in 2007/08 to 18.5% of GDP in 2008/09;
- Maintain adequate official foreign reserves of a value equivalent to not less than five months worth of imports of goods and non-factor services;
- To continue implementing the policy of a market-determined exchange rate with the Bank of Tanzania intervening to smooth any volatility;
- Accelerate reforms to the requisite legal and regulatory frameworks for enhancing access to credit by the private sector.

Revenue

The budget policy measures on revenue are focused on domestic revenue collection. The Government plans to collect domestic revenue amounting to Tshs 4,728.6 billion during 2008/09 representing an increase of more than 30% on the current levels. Furthermore, the Government expects to raise Tshs 58 billion from the sale of its 21% shares in the National Microfinance Bank (NMB). The specific details of the revenue enhancing measures are set out in our highlights of direct and indirect tax changes.

In total, the budget revenues will be as follows:

	<u>Tshs bn</u>
Domestic Revenue	4,729
Grants and Loans	2,429
Privatisation Proceeds	<u>58</u>
Total Revenue	<u>7,216</u>

The level of donor dependence is expected to continue to reduce, with a significant drop from 42% in the current year to 34% in 2008/09. It is noteworthy that recurrent expenditure will be fully funded by domestic revenue.

Expenditure

The Government is proposing to spend Tshs 7,216 billion in 2008/09 as follows:

	<u>Tshs bn</u>
Recurrent	4,727
Development	<u>2,489</u>
Total Expenditure	<u>7,216</u>

Government expenditure in 2008/09 will continue to focus on the expenditure policies implemented in 2007/08 with more emphasis placed on economic growth, improvement of social well being, devolving power to the people through decentralisation by devolution, good governance and accountability, and attaining the macroeconomic targets. Furthermore, allocation of funds is in line with the priorities and national plans outlined in the 2007 National Economic Survey. Areas of priority include the following:

- 19.8% of the budget on education;
- 13.5% of the budget on roads;
- 11.1% of the budget on health;
- 6.4% of the budget on agriculture;
- 3.2% of the budget on water;
- 5.3% of the budget on energy.

Further the Government will continue to focus on other special programmes for social and economic development, such as:

- The Tanzania Mini-Tiger Plan 2020;
- Tanzania Social Action Fund (TASAF);
- The Property and Business Formalisation programme;

- The National Programme for Employment Creation.

Other priority expenditure will cover strengthening the business environment, good governance, debt services, pensions and health insurance.

Credit and Money Supply

For the period ending December 2007, broad money supply (M2) grew at an annual rate of 28.8% compared to 13.7 % for the period ending December 2006. The annual growth rate of extended broad money supply (M3) was 21.4% for the period ending December 2007 compared to 22.0 % for the period ending December 2006. The increase in the growth of M2 was attributed to strong growth in demand deposits following a large increase in the commercial bank credits to private sector.

The increase in credit extended to the private sector was attributed to increased competition among commercial banks and an increase in the number of people using banking services.

The interest rate on government securities declined from an average of 17.1% in June 2007 to 11.4% at the end of December 2007. Similarly, the lending interest rates offered by commercial banks declined from an average of 16.0% at end June 2007 to 15.1% in March 2008.

Balance of Trade

The performance of the external sector was disappointing due to a continued increase in the current account deficit, from US\$ 1,379.3 million in 2006 to US\$ 2,056 million in 2007. This is equivalent to an increase of 49.1%. The increased deficit was primarily driven by increases in the value of imports of goods and services compared to the value of exports.

The value of merchandise imports (fob) increased from US\$ 3,864.1 million in 2006 to US\$ 4,826.9 million in 2007 following an increase in

importation of transportation equipment, machinery, building and construction equipment in line with the growth of economic activities in the mining, communication and manufacturing sectors and the continued increase in the global price of oil.

However, in 2007, there was an encouraging trend in service receipts mainly driven by tourism, trade and transportation (particularly transit traffic from Dar es Salaam to neighbouring countries). Travel (tourism) and gold receipts continued to dominate the export sector accounting for 26.7 percent and 20.4 percent, respectively¹.

Despite the deficit, foreign reserves increased by 21.9 % to US\$ 2,755.2 million in 2007, from US\$ 2,260.1 million in 2006. The reserves position in 2007 was enough to cover 4.6 months of imports of goods and services. However, further investments need to be made in the manufacturing of additional goods for export.

As at 31 December 2007, the national debt had declined by 2% from US\$ 7,188.4 million in December 2006 to US\$ 7,041.2 million.

Sector policies and programmes to support budget initiatives

Agriculture, Livestock, Forestry and Hunting

Economic activities in the above areas grew by 4.0% in 2007 compared to 3.8% in the previous year, boosted by growth in crops and livestock production activities. The growth was slightly off-set by a decrease of production in the forestry sector due to the temporary ban on the export of logs.

The revised national accounts methodology, using 2001 constant

¹ Bank of Tanzania, Monthly Economic Review, April 2008

prices, indicates that the contribution of agriculture to the economy has declined from 44.7% of GDP to 25.8%. This large decline highlights that other economic activities have grown at a higher rate than agriculture. The slow growth rate of agriculture continues to be a concern, not only in terms of poverty reduction but also as regards issues of food security.

The Government proposes a number of measures for 2008/09 to increase productivity and growth in the agricultural sector. These include the development of irrigation infrastructure, implementation of the Agriculture Sector Development Programme (which includes increased use of fertiliser and improved seeds, and the development of crop markets) and the review of logging and hunting licences.

Fishing

Fishing activities only grew by 4.5% in 2007 compared to 5.0% the previous year. This was attributed to a decrease in demand for fish products in the world market.

Industry and construction

Mining and quarrying

Mining activities failed to register as high a growth rate this year in comparison with previous years. In 2006 the sector grew by 15.6% whereas this year a growth rate of 10.7% was registered. This can be attributed, in part, to a decline in recovery of gold and diamonds. Between the last quarter of 2007 and the same period in 2006 recovery decreased by 34.7% for gold and 41.6% for diamonds². In addition, there were no major new developments coming on-stream this year.

Manufacturing

The manufacturing sector grew by 8.7% in 2007, compared to 8.5% in 2006. The increase was attributed to sustainability in industrial production following improved access to electricity, in contrast to the shortages experienced in 2006, and the increase in investment in Export Processing Zones.

In 2008/09 emphasis will be placed on Special Economic Zones, and implementing strategies to sustain trade and investment partnerships with China, the Middle East and other Asian countries.

Construction

In 2007, the construction sector grew at a rate of 9.7% compared to 9.5% in 2006. This was driven by the construction of roads and bridges, residential and non-residential buildings and land development.

Recognising the importance of infrastructure for economic growth, considerable focus has been placed on construction for the upcoming year. In the 2008/09 budget, roads have been allocated 13.5% of the total budget.

Services

Communications

The communication sector grew by 20.1% in 2007 compared to 19.2% in 2006, outpacing all other economic activities.

Transport

Transport services grew by 6.5% compared to 5.3% the previous year. The increased growth rate was attributed to the rehabilitation of roads, railways and airports, an increase in domestic and international flights, and the resumption of central railway passenger transport.

² Bank of Tanzania, Quarterly Economic Review, December 2007

Electricity and gas

In 2007, the total contribution by the energy sector to GDP was 1.5% compared with 1.4% in 2006.

Education

The growth rate in the education sector was 5.5% in 2007 compared to 5.0% in 2006. This increase was mainly a result of the implementation of primary and secondary education development programmes, and increased recruitment of teachers.

In the 2008/09 budget education is allocated more funds than any other sector reflecting the government's understanding that education is the key for economic development.

Health

Health services grew at 8.8% in 2007 compared to 8.5% in 2006. The growth was based on the implementation of vaccination, malaria, tuberculosis, and HIV/AIDS programmes.

In the 2008/09 budget the Government will continue to implement various public and primary health programmes including the Integrated Management of Childhood Illnesses Programme and strengthening medical research.

Cross-cutting issues

Aside from the sectoral activities, the Government also plans to undertake significant steps to address several cross-cutting issues that impact on the economy. These include:

- Raising awareness of the 2006 National Population policy (particularly in light of the current 2.9% population growth rate);
- Implementing the National Policy for Employment and its Strategy;
- Coordinating economic empowerment programmes;

- Implementing the Second Strategy for Preventing HIV/AIDS Infections in 2008 – 2012;
- Developing programmes for empowering women economically, and strengthening gender focal points at all levels;
- Continuing to implement the National Environment Conservation Policy and its strategies.

Conclusion

The budget for 2008/09 will be executed in a period when the whole world is faced with the challenge of instability in international financial markets, and the rising prices of oil, cereals, food, and other agricultural and industrial inputs. The government is considering several steps to mitigate some of the risks posed by the above challenges including:

- Reducing dependence on external resources;
- Controlling inflation by strengthening the management of money supply;
- Increasing local production of food crops as a source of food and revenue.

The economy is diversifying with a notable move from the dependence on agriculture, to the growth of the industry, construction, mining and service sectors. Overall, the Government is moving in the right direction by investing in areas that will pave the way to sustainable development, e.g. health, education, infrastructure, agriculture, water and energy and allocating about 64% of the 2008/09 budget to these sectors.

East African Highlights

A synopsis of the salient features in the budget speeches delivered by the Finance Ministers of Kenya, Uganda and Tanzania

The economies of the East Africa region continue to grow and provide an enabling market for business

The strategies of the respective governments continue to be consistent with plans previously made under the Millennium Development Goals

The three countries continue to streamline customs charges on various products

East African economies at a glance

Kenya

Over the past few days, the Kenya Government has launched the Vision 2030 which aims to make Kenya more globally competitive and internally prosperous.

The economy grew by about 7% in 2007. However, in the first quarter of 2008 Kenya experienced unprecedented unrest after disputed general election results. The unrest disrupted food production and other economic activities in most parts of the country pushing up food prices. The situation was further compounded by rising fuel costs. As a result of these events the expected growth in the economy in 2008 is now estimated at between 4.5% and 6%.

The proposed budget for 2008/2009 is built along the theme of **'Working together to build a cohesive, equitable and prosperous Kenya'**. It aims at an economic recovery program to address the downturn in the economy following the post election violence and to lay the foundation

consistent with achieving the Vision 2030 targets.

Agriculture, tourism, and transport and communication continue to be the main stays of the Kenyan economy contributing 22.7%, 16% and 14.9% respectively to GDP.

Uganda

The Ugandan Government has continued with its commitment to a stable macroeconomic environment. The unrest in the first quarter of 2008 in Kenya had a knock-on effect in Uganda. Despite these events, interest rates on Government borrowings and commercial lending have remained fairly stable. Underlying inflation is currently at 8.6%, which is higher than the target of 5%.

The economy is expected to grow by 8.9% in the current financial year compared to 7.4% in 2007. The growth is attributable to good performance in trade, mining, construction, manufacturing, transport and communication, and expansion of the financial services sector.

The Uganda Revenue Authority performed well in the period with revenue collections being 3% above the target. The tax amnesty, which ran from July-December 2007 resulted in tax collections of US\$ 41 billion. Given the performance in the year, the Government is confident it will meet 70% of its total planned expenditure for 2009 using domestically-raised revenues.

increasing fuel prices. However, it is anticipated that the effects of the higher fuel prices may be offset by a good harvest in the year.

The budget continues to focus on the CCM Election Manifesto of 2005, the MKUKUTA and the Millennium Development Goals. The areas of priority continue to be those identified in 2007/08 budget with an addition of Energy. These are:

Tanzania

The economy grew by 7.1 % in calendar year 2007 compared to 6.7% in 2006.

Inflation rate decreased to 7.0% from 7.3% in 2007. It is expected that in 2008 the country will face inflationary pressure, due to

- λ Education
- λ Roads
- λ Health
- λ Agriculture
- λ Water
- λ Energy

Key highlights from the Kenya, Uganda and Tanzania economies

Key indicators of the performance of the East African economies are set out below. Where applicable, comparatives have been included in brackets.

	Kenya	Uganda	Tanzania
Real GDP growth	*7% (6.4%)	*8.9% (7.4%)	7.1% (6.7%)
Inflation:			
λ Underlying	5.7% (5.5%)	8.6% (5.9%)	**na
λ Overall	9.8% (14.5%)	11.2% (5.6%)	7% (7.3%)
91 day TB rates	6.87% (5.83%)	8.2% (9.3%)	11.4% (14.9%)
	KShs	US\$	TShs
Exchange rate to the dollar (Local currency = \$1)	66 (69)	1,679 (1,729)	1,244 (1,261)
Budgeted spend (billions)	759.8 (693.5)	6,143 (5,025)	7,216 (6,067)
Recurring	563.6 (491.9)	3,372 (2,378.5)	4,726 (3,866)
Development	196.2 (201.6)	2,771 (1,745.7)	2,489 (2,201)

* Estimate

**Not available

East African customs highlights

Customs

Kenya

Import duty on wheat grain to be reduced from 35% to 10% (or US\$ 50 per tonne) for a period of one year.

Import duty on 'easy opening ends' for cans used for food packing to be reduced to 10% from 25%.

Import duty on cement to be reduced from 40% to 25%.

Trucks specially designed for collection of garbage and imported to collect garbage are to be exempted from import duty.

Import duty exemption on the following items:

- λ milk tankers
- λ gym equipment for hotels
- λ computer printers and telecommunication equipment

Uganda

Exemption of duty and tax payments on construction materials for persons investing in hotels, hospitals and to a limited extent educational institutions, to be extended for one more year.

Trucks specially designed for collection of garbage and imported or purchased by local authorities or

persons contracted by the local authorities to collect garbage are to be exempted from import duty.

Import duty exemption on the following items:

- λ milk tankers
- λ gym equipment for hotels
- λ deep cycle batteries that are not sealed for use with solar equipment
- λ computer printers and telecommunication equipment

Import duty on cement has been reduced from 40% to 25%.

The Government will cease to meet the cost of taxes and levies payable by exploration companies to different arms of the government.

Tanzania

Under the East African Customs Union proposals, import duty will be exempted or removed on:

- λ Hand hoes and other agricultural implements
- λ Inputs imported by TANELEC for manufacturing of transformers and switch gear
- λ Up to 20,000 MT of barley imported by brewery companies
- λ Data processing machines
- λ Vehicles specifically designed for garbage collection procured by local authorities

Direct and indirect taxes

In this section, we highlight the key changes in the direct and indirect tax regimes in each of the three East African countries.

Kenya

Corporate tax

Accumulated losses will be now be taken into account in determining the thin capitalisation status of a company.

Withholding tax on dividends received by a financial institution is not final tax. Dividend income will be subject to corporate tax as business income.

The interest and penalties chargeable for late payment of all taxes shall not exceed 100% of the principal tax amount.

Personal tax

Employers can appeal against the Commissioner's decisions on matters relating to PAYE. Previously employers could only appeal against penalties and interest, but not principal tax.

Excise duty

Excise duty on malt beer and non-malt beer increased from KShs 50 to KShs 54 per litre, and KShs 26 to KShs 36 per litre, respectively.

The Excise duty rate on all alcoholic spirits and wines is to be computed, based on alcoholic proof.

Excise duty on cigarettes increased by approximately KShs 7 per packet.

Local manufacturers using plastic bags may claim a refund of excise duty.

All wireless telephone services to be charged excise duty at the rate of 10% of their excisable value.

All imported used computers shall attract excise duty at the rate of 25%.

VAT

VAT on international air travel to be zero-rated.

Exported services now subject to VAT where the service is provided within Kenya.

Bread and milk zero-rated for VAT purposes.

Banking

Minimum core capital for banks and mortgage finance institutions to be increased from Shs 250 million and Shs 200 million respectively to Shs 1 billion over the next two years.

Proposed amendments to Central Bank Kenya Act to expand the ability of the Central Bank to manage liquidity through accepting deposits from commercial banks and issuing bills outright or through repurchase arrangements.

Capital Markets

Minimum paid up capital for brokers and investment banks increased to Shs 50 million and Shs 250 million respectively over three years.

No single shareholder should control more than 25% of the brokerage firm's or investment bank's share capital.

Insurance

Investment limits by general insurance companies in any one financial institution increased from 5% to 10% of admitted assets.

Insurance companies now required to settle claims within 90 days of liability being determined in court. On default, the Commissioner of Insurance can levy a fine of up to 5% of the outstanding claim.

The basis of computing corporate tax on life insurance business to be modified.

Miscellaneous

The government is to remove the requirement for traders to affix adhesive stamps to cash receipts.

Overall number of licenses required by business to operate in Kenya continues to be reduced through interaction with key regulators.

Uganda

Income derived from the management, operation, and running of schools and tertiary institutions will be exempt from Income tax.

For purposes of equity between international airlines and resident airlines, the Minister has proposed that the income of resident airlines be exempt from income tax. These entities shall also be exempted from withholding tax on payment of lease rentals.

Income arising from investments in new agro processing entities that commence operations after 1 July 2008, are exempted from income tax. This exemption is conditional on the investments being located at least 30 km outside the district of Kampala, and dealing in produce grown in Uganda.

Excise duty

The minister has proposed to introduce excise duty on diesel for generators of 100 KW or more.

Excise duty on beer made from local raw materials has been reduced from 30% to 20%, whilst excise duty on cigarettes is to be raised.

VAT

The definition of plant and machinery in the VAT Act will be revised to include essential industrial spare parts, whilst the

following products are now exempt from VAT:

- λ Heavy fuel oil (HFO) that is mainly used by thermal plants for power generators and for other industrial purposes
- λ Table salt
- λ Trucks of loading capacity of 3.5 tonnes

Other taxes

Given that the Income Tax Act was enacted when no petroleum discoveries had been made, the Minister has proposed an amendment to the Income Tax Act to align it with the petroleum production sharing agreements.

Interest income derived out of deposit auctions issued by Bank of Uganda for purposes of liquidity management are to be exempt from withholding tax (WHT). It is unclear whether this income is now subject to the full rate of tax since WHT was a final tax.

The Income Tax Act will be amended for local service tax to be deducted from a person's taxable income. Local Services tax was introduced in 2007.

Environmental levy on used cars aged eight years and above to be increased to 20% from 10%.

The Minister has recommended write-off of arrears of duty and tax relating to the principle, interest and penalty that had accrued up to 30 June 2002.

The Uganda-Belgium Double Tax Agreement has been presented before Parliament for ratification.

Tanzania

The Minister has introduced an Alternative Minimum Tax (AMT) at the rate of 0.3% of turnover on corporate entities making tax losses for three consecutive years.

There has been a widening of the personal income tax bands with the highest band reached with a monthly income of TShs 720,000, compared with the previous amount of TShs 540,000. There have been no changes to the Skills and Development levy.

VAT

The following exported services will now be zero-rated

- λ services of consultants, engineers, lawyers, accountants and other similar services
- λ telecommunication services
- λ radio and television broadcasting services
- λ services rendered by intermediaries
- λ ancillary transport services

Locally produced sacks for packaging imported bulk agricultural produce have been zero-rated.

The Minister has proposed to exempt VAT on:

- λ burning gel for domestic use
- λ Compressed Natural Gas (CNG) and CNG cylinders to be at par with LPG
- λ bitumen

Excise duty

Excise duty rates on carbonated soft drinks, alcohol and cigarettes have been increased by 12%.

The excise duty rate on mobile phone services has increased from 7% to 10%.

There is a reduction of excise duty on Heavy Furnace Fuel from TShs 117 per litre to TShs 97.

The single excise duty rate of 10% on motor vehicles has been amended to introduce a three tier structure of 0%, 5% and 10% where the rate increases with the engine capacity.

Customs

Proposals have been agreed for amendment of the Common External Tariff rates under the East African Community Customs Management Act.