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Creating Certainty: Uganda's FY 2013/14 Post Budget Analysis

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Foreword

On 13 June, 2013, Minister Maria Kiwanuka announced a budget anticipating total resource inflows for the 2013/2014 financial year amounting to Ushs 13.169 trillion, with Ushs 9.498 available to finance discretionary Government expenditure. This represents a Ushs 1.427 trillion increase over the previous financial year's resources available for discretionary expenditure.

The Minister noted that sector performance over the 2012/2013 financial year had served as a basis for budget priorities in 2013/2014. In our analysis, we look at the private sector's view of sector performance and priorities and whether it and the government's views are aligned. We do this through the lens of our annual CEO Survey.

This year, we surveyed a total of 20 CEOs in Uganda about the strategies, risks and opportunities informing their growth ambitions. We asked how their companies are investing in growth and what the government's priorities should be to achieve growth. We also asked if they believe government has adequately worked to address these priorities.

According to Honourable Kiwanuka, the main priority in the 2013/2014 budget is to unlock binding constraints to Uganda's economic progress. We know from our survey that the private sector believes that those constraints are an increasing tax burden (according to 85% of Uganda respondents), the availability of key skills (80%), inadequate infrastructure (65%) and supply chain disruption (65%).

In her budget speech, Minister Kiwanuka articulated three very specific priorities for the year:

1. Enhance productive infrastructure
2. Increase agricultural production and productivity and
3. Support human resources development, particularly technical skills.

The sector priorities informing specific budget allocations are:

1. Infrastructure development
2. Agricultural production and productivity
3. Innovation and competitiveness
4. Health, water and education; and
5. Enhancing transparency and accountability.

In our survey, CEOs say that the government's main priorities should be improving Uganda's infrastructure (75% of respondents), reducing poverty and inequality (70%), ensuring financial sector stability (65%) and fostering a skilled workforce (40%).

Comparing the private sector's view of priorities to what the budget hopes to achieve, we believe that infrastructure is a notable area of alignment. It is viewed as a constraint to growth by both the public and private sectors and a priority sector informing budget allocation to support economic growth and development. Investments to improve transport, energy and water for production, information and communications infrastructure will help to address existing shortfalls in Uganda.

Another area of clear alignment is improving Uganda's skills base. Not only is this an area identified by CEOs in our survey as impacting growth prospects, but creating and fostering a skilled workforce is an area where 80% foresee increased investment at their own companies. The budget includes a Ushs 1.801 trillion allocation to building skills and knowledge undertaken in the education sector, or 13.3% of the total budget. Specific investments in vocational and business training for youth will help increase employment in both private and public sectors and the proposed engagement with the private sector will help to design appropriate programmes in line with labour market needs.

In our survey, respondents clearly articulate the need to reduce poverty and inequality and it is very much a government priority area as well. Each of the sector priorities in the budget will help to reduce poverty and the specific emphasis on agricultural productivity speaks to our country's need to modernise a sector that provides a meagre or inadequate livelihood for so many.

One area where there could be greater alignment is taxation, however. An increasing tax burden is a threat to growth, say our respondents. The budget articulates the intention to amend tax laws and improve tax administration to enhance compliance, and broadening the tax base has been a consistent government policy for some time. There is still considerable pressure to increase total tax collections (improving the tax to GDP ratio) through higher tax rates and this year, the budget includes excise duty increases for diesel and un-denatured spirits, re-instatement of the excise duty on kerosene and the introduction of excise duty on gambling and mobile money transaction fees.

Overall, there has been credible performance on key macro-economic indicators in FY12 although some targets still fall short. The tight monetary policy has been a huge success in bringing down the hitherto high interest rates albeit dampened credit growth; inflation fell from 18% in June 2012 to 3.6% in May 2013; the shilling remained relatively stable; our import cover in terms of forex reserves, closed the year at 4.5 months while GDP grew by 5.1% in 2012/2013 compared to 3.4% the year before. Growth and stability were mainly attributed to sector performance in agriculture, manufacturing, construction, transport, communication and real estate.

Corruption, poor financial management and governance now pose the biggest risk to our economic growth. As a result of this, we saw the suspension of budget support of USD 282 million equivalent to 1.3% of GDP last fiscal year that resulted in budget cuts to non priority sectors (cuts of about 0.8% of GDP), increased domestic borrowing (an additional 0.7% of GDP) and a failure to implement the full economic stimuli package that was planned for FY 2012/13.

The government has pledged to improve public expenditure efficiency, cash management by optimizing all resources available and implementing an action plan agreed with development partners that will restore credibility and feasibility of the national budget. We hope that if the government implements these measures, we will see a positive trend towards the country's achievement of macro-economic targets.

Achieving 7% growth and consistent, single-digit inflation will not be easy but the budget's priority areas and allocations will help to support these goals and the pursuit of the long term development agenda as envisioned in Uganda's Vision 2040.

Francis Kamulegeya
Country Senior Partner

About PwC Uganda

The Ugandan firm of PwC (and its legacy firms) has operated in Uganda for over 50 years, serving a broad spectrum of clients including, Government, Development Partners and the Private Sector. Our local capability comprises over 100 professionals possessing an in-depth understanding of local business, social, cultural and economic issues. They combine this knowledge with deep functional and industry knowledge to create the value that you are looking for.

The firm is a full member of the network of PricewaterhouseCoopers and has unrestrained access to the global network's vast resource base of proprietary knowledge, methodologies and experience.

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East Africa economies at a glance

Kenya

The Kenyan economy will grow by 5.8% in FY2012/13 compared to 4.6% in FY 2011/12. These results are mainly attributed to positive growth in all sectors of the economy with the highest growth being in energy, financial services and wholesale & retail trade sectors at 17.6%, 15.2% and 10.8% respectively. In addition the following sectors also recorded improved growth in the year compared to FY 2011/12;

- Agriculture grew by 3.8% compared to 1.5% in FY 2011/12 due to favourable weather conditions;
- Building and construction grew by 4.8% compared to 4.3 % in FY 2011/12 mainly due to increased activity in the construction industry driven by government expenditure in the sector; and
- Tourism sector recorded a higher growth of 5% in the year compared to 4.2% in FY 2011/12.

Manufacturing sector recorded lower growth of 3.1% in the current year compared to 3.5% in FY 2011/12. This was attributed to high production costs, cost of credit and uncertainties related to the 2013 general elections. In addition, inflation eased from an annual average of 16.42% in FY 2011/12 to 7.5% in FY 2012/13 due to the favourable weather conditions and tightening of monetary policies. The priority areas highlighted in the FY 2013/14 budget include the following:

Modest growth in all sectors and focus on improving productivity

- Improving productivity, competitiveness, business climate and encouraging investments and trade aimed at accelerating growth;
- Supporting small and medium enterprises through capacity building, market access and financial support;
- Efficient public service delivery through the devolved government structure;
- Maintaining a stable macroeconomic environment; and
- Extension of the tax base and increased focus on efficiency in public expenditure.

Tanzania

The GDP grew by 6.9% in FY 2012/13 compared to 6.4% in FY 2011/12. This growth was mainly attributed to a 20.6% growth in communication sector and 5% in agriculture.

Agriculture contributed 24.7% to the GDP thus has a significant impact on GDP. The priority areas for FY 2013/14 budget include:

- Improvement in energy, transportation, ICT, clean water and sewerage infrastructure;

- Focus on agriculture by improving accessibility of credit facilities by farmers;
- Assisting industries that use domestic raw materials;
- Enhancing human resources and skills development; and
- Improving availability and quality of social and financial services.

Key economic objectives in FY 2013/14 include:

- 7% economic growth in 2013 and 7.2% in 2014;
- Increasing domestic revenue collection to 20.2% of GDP in FY 2013/14;
- Maintaining single digit inflation with a target of 6.0% by June 2014;
- Maintaining a stable and market determined exchange rate;
- Reducing interest rate spread; and
- Maintaining budget deficit after grants at a maximum of 5.0% of GDP in FY 2013/14.

Continued focus on infrastructure and capacity building

Uganda

Uganda's GDP grew by 5.1% in FY 2012/13 compared to 3.4% in FY 2011/12. This growth is attributed to improved performance in the manufacturing, construction, transport, communication and real estate sectors. Uganda witnessed a decline in inflation rate from 18% in June 2012 to 3.6% in May 2013 mainly as a result of increased food production.

The following are the priority areas in the FY 2013/14 budget:

- Infrastructure development focusing on roads, railway, inland water, energy, oil and gas and Information and Technology;
- Human resource development focusing on education, skills and health; and
- Private sector development, employment generation and poverty reduction.

Other objectives highlighted in the budget include the following:

- Achieving real economic growth of at least 7% per annum;
- Keeping annual consumer price inflation within single digit;
- Maintaining a prudent level of foreign exchange reserves of at least 5 months import cover to mitigate external shocks;
- Maintaining a competitive real exchange rate to support the growth of exports;
- Oil and Gas – undertaking capacity building and institutional development, exploration and appraisal and refinery development;
- ICT Sector – establishment of fully serviced industrial and Information Technology parks in various regions of the country, completion of the fibre optic cable projects, and implementation of the digital television transmission; and

Focus on mid term development strategy

- Regulatory reforms – Simplifying business registration procedures, especially those affecting business start ups, and launching online services for company registration.

Rwanda

Rwanda's real GDP grew by 8% in FY 2012/13 as compared to 7% achieved in 2011/12. The strong performance was mainly driven by:

- 12.2% growth in service sector, particularly communication and transport which grew by 19.5%;
- 7.3% industry sector growth particularly due to 15.2% growth in construction; and
- 3% growth in agriculture. Exports in value terms grew by 27% in 2012. At the same time, import growth was 26% which was largely due to Government's policy to increase investment, capital and intermediate goods to boost future domestic production for both the local and export markets.

The allocation of resources in the 2013/14 fiscal year has been made taking into account the Economic Development and Poverty Reduction Strategy (EDPRS2) priorities. The thematic areas which are the core components of the EDPRS2, comprise of the following four areas:

- The economic transformation which has been allocated 28 % of the total budget. This mainly comprises of construction of power stations, electricity roll out, roads rehabilitation, construction of industrial parks and ICT sector development;
- The rural development which has been allocated RWF 164 billion equivalent to 10 % of the total budget. This mainly comprises of animal husbandry and food production;
- Productivity and youth employment which has been allocated 10 % of the total budget; and
- Accountable governance which has been allocated 2% of the total budget.

Key highlights from Kenya, Tanzania, Uganda and Rwanda

Key indicators of the performance of the East Africa economies in FY 2012/13(2011/12) are set out below. Where applicable, prior year comparatives have been included in brackets.

	Kenya	Tanzania	Uganda	Rwanda
Real GDP growth	5.8% (4.6%)	6.9% (6.4%)	5.1% (3.4%)	8% (7%)
12 month overall inflation – May	5% (16.42%)	16% (12.7%)	3.6% (18.6%)	3.3% (8.3%)
91 day TB rates – June	6.7% (9.8%)	11.91%(13.47%)	9.1% (15.7%)	11.95% (7.6%)
	Ksh	**TZS**	**Ush**	**RwF**
Annual average exchange rate to the dollar (Local currency = US$1)	85.24 (87.90)	1,587 (1,579.5)	2,575 (2,485)	641 (1,550)
Budgeted spend (billions)	1,641 (1,460)	18,248 (15,120)	13,169 (10,883)	1,653 (708)
Recurring (billions)	1,166 (1,003)	12,574 (10,592)	8,959 (5,576)	736 (708)
Development (billions)	475 (452)	5,674 (4,528)	4,210 (5,287)	803 (677)

Customs and Excise

East African Community (EAC)

Goods imported into the EAC are subject to Common External Tariffs (CET). There are several CETs that were agreed by the EAC Sectoral Council of Finance and Economic affairs.

One of the key changes is the granting of 0% import duty on certain raw materials and industrial inputs in Uganda under the EAC Customs Union Protocol. The number of items in the list which are not granted 0% import duty (Uganda list) has been reduced from 138 to 49.

Other details of the changes in the tariffs effective in FY 2013/14 will be contained in the gazette notice to be issued by the EAC secretariat.

Other proposals

Some of other changes in the customs and excise that are proposed by the respective East Africa Community countries are as follows:

Kenya

- Introduction of a Railway Development Levy of 1.5% on all imported goods.
- Exemption of duty on importation of items used to facilitate railway operations.
- Exemption of import duty on plastic bag bio-gas digesters.
- Increase in import duty on welding electrodes from 10% to 25%.

- Increase in import duty on millstones and grindstones from 0% to 25%.
- Increase in import duty on plastic tubes for packing of toothpaste and cosmetics from 10% to 25%.
- Reduction of remission on beer packed in pressurized containers from 100% to 50% of excise duty for a period of 3 years, thereafter the remission lapses.
- Introduction of remission of 50% excise duty on beer made from sorghum, millet and cassava.

Tanzania

Customs duty

Introduction of a list of items that are not deemed to be capital goods and thus not qualifying for 0% import duty.

Excise duty

- Extension of application of CET rate of 10% on wheat grain for one more year (instead of the CET rate of 35%).
- Imposing of a duty rate of 25% on rice and sugar instead of 75% and 100% respectively when imported to cover gap in the local market.
- Exemption of import duty applicable on machinery and spare parts imported by Tanzania
- Railway Limited for use in railway operations.
- Exemption of duty on plastic bag biogas digesters.
- Increasing import duty on millstones and grindstones for milling, grinding or pulping to25%.
- Exemption of water treatment effluent plant from duty.
- Continued exemption of duty to Armed Forces CanteenOrganization for a period of one year.
- Introduction of excise duty at 5% on utility vehicles (under specific HS codes) aged more than 10 years.
- Increase in excise duty on dumping of non –utility vehicles older than 10 years to 25%.
- Increase in excise duty on diesel (by TZS 2 per litre) and petrol (by TZS 61 per litre).
- Imposing excise duty (at rates from 10% to 25%) on floor coverings, articles of leather, guns, ammunition, certain aircraft and helicopters, yatch and other vessels for pleasure, rowing boats and canoes etc.
- Introduction of excise duty at 15% on certain imported furniture.
- Increase of excise duty, to apply on telecommunication services (including all mobile services, landlines and wireless telecom services) to 14.5%.
- Increase of excise duty on cigarettes whilst the excise duty on cigars remains at 30%.

Uganda

Excise duty

- Increase of excise duty on petrol and diesel by UShs 50 per litre.
- Re-instatement of the excise duty on kerosene which had been exempted from duty in 2011 at UShs 200 per litre. Increase in the excise duty on imported un-denatured spirits from 80% to 140%.
- Introduction of 20% excise duty on revenue from promotional activities akin to gambling.
- Introduction of 10% excise duty on the mobile money transaction fees.

Rwanda

- Reduction of import duty on rice in the husk, husked (brown) rice, and semi milled or wholly milled as well as broken rice to 35%.
- Reduction of import duty on road tractors and semi trailers to 0% from 10%.
- Reduction of import duty on wheat grain and wheat flour to 35%.
- Reduction of import duty on buses for transportation of more than 25 persons to 10% from 25%, and those that transport 50 persons or more to 5% from 25%.
- Increase of import duty on telecommunication equipment to 25% from 0%.
- Increase of import duty on construction materials from 0% to 25% for local investors with a minimum capital of US $100,000 in hotels and 10% for projects worth US $1.7 million and above.

Direct and indirect taxes

Kenya

Income tax

- Withholding tax on winnings from gaming and betting has been reintroduced.
- Premiums paid by employers on group life and group personal accident insurance policy covers on behalf of employees have been exempted from tax subject to certain conditions.
- A review of capital gains tax has been initiated.

Value Added tax (VAT)

- A revised draft VAT bill will be tabled for debate by parliament. The bill is aimed at simplifying the VAT rules.

Tanzania

Income tax

- Reduction of minimum tax rate on income of resident individuals from 14% to 13%.
- Reduction of skills and development levy payable by employers on gross payments to employees from 6% to 5%.

Withholding taxes

- Introduction of withholding tax at 10% on commission on money transfer via mobile phones.
- 5% withholding tax to apply on service fee compared to the current rate of 2% which only applies to those without Tax Identification Number.
- Introduction of 2% withholding tax on supply of goods to Government institutions.
- Abolishing of withholding tax exemption on leasing of aircrafts by persons engaged in air transport business.

Value Added Tax (VAT)

- VAT exemption on tourist services has been abolished.
- A special relief has been introduced for domestic textile manufacturers using locally produced cotton.

Fuel levy

- Fuel levy has been increased from TZS 200 to TZS 263 per litre.

Uganda

Income Tax

- A legal framework through which the Uganda Revenue Authority, Kampala City Council and the Uganda Registration Services Bureau will be introduced.

Value Added Tax

- The VAT exemption on hotel accommodation and tourist lodges will be removed.
- VAT on the supply of water for domestic use has been reintroduced.
- Wheat and wheat flour made from cereal grown, milled and produced in Uganda will be subject to VAT at 18%.

Stamp duty

- Increase in stamp duty on third party insurance policies for motor vehicles by Shs 30,000.

Other

- Introduction of a levy on all incoming international calls.
- Motorcycle registration fee has been increased by UShs 70,000 from UShs 130,000 to UShs 200,000.
- Motor registration fee has been increased by UShs 200,000.

Rwanda

Income Tax

- A new mineral royalty tax on different types of minerals will be introduced. For basic metals the royalty tax will be 4% of the value of the minerals extracted, while for precious metals and stones the tax will be 6% of the value.
- Double Taxation Avoidance Agreement (DTAA) with Mauritius has been terminated with effect from January 2013. The DTAA will be revised.

Value Added Tax

- A new VAT law was introduced effective 5 February 2013. This law has repealed the old VAT law and all prior legal provisions including the Commissioner General's rules and Ministerial Orders that referred to the old law.
- The new VAT law requires registered taxpayers to use electronic billing Machines (EBM) among other measures.

Miscellaneous

Kenya

Tax administration

- The powers of the commissioner to access books of account have been enhanced where tax evasion is proved in court.
- A Tax Appeals Tribunal Bill establishing a single tax appeals body will be tabled in parliament.

Others

- Insurance Act will be amended to open up the ownership of insurance companies and brokerage firms to other citizens of EAC.
- The law will be amended to remove restrictions of foreign ownership for insurance agents.
- The Capital Markets Act will be amended to provide for the issuance of regional fixed income securities.

Tanzania

Motor vehicle annual license

Licence fees have been increased by TZS 50,000 so that the rates on the motor vehicles are as follows:

- Engine capacity between 501 to 1500cc – TZS 150,000.
- Engine capacity between 1501 to 2500cc – TZS 200,000.

- Engine capacity above 2501 to 2500cc – TZS 250,000.

The licence fee on motor vehicles with engine capacity below 501 cc has been removed.

Petroleum levy

- Introduction of petroleum levy of TZS 50 per litre.

Uganda

Tax administration

- There are plans to enforce the use of the Tax Identification Number for all traders who receive trading and other licences and permits from Kampala City Council Authority and Local Governments.
- The tax authority will be cleaning up the VAT register.

Others

- Streamlining tax exemptions to minimize revenue leakages.
- Introduction of new Tax Procedure Code.

Rwanda

Others

- Directors who are directly involved in the control and mismanagement of a private company are now jointly liable for any tax liabilities incurred by the company if it is proved that they intentionally or negligently caused the company to incur the tax liability.
- Shareholders who become involved in the mismanagement of the company and/or misuses company's funds are also liable for any tax liabilities if they led to the company's inability to meet its tax obligation.
- The Rwandan investment code will be revised to adapt to the prevailing business environments.

Agriculture
Sector overview

The agriculture sector encompassing; crops, livestock and fisheries, remains fundamental to the economy with an estimated 23.9% contribution to GDP (cf. industry 26.1% and services 49.9%).

Further, the sector is of key importance as it:

- employs more than 66% of the local population,
- produces the bulk of the country's raw materials and
- accounts for over 45% of export earnings from coffee, cotton, tea, sugar, grains, horticulture, and tobacco among others

Decline in productivity and growth

Agriculture production is mainly dominated by small holder farmers engaged in food and industrial crops, forestry, horticulture and livestock farming.

Agricultural productivity has declined over the past decade for various reasons that include but are not limited to:

- poor agronomical practices, production techniques with minimal application of mechanisation,
- high dependence on the weather causing vulnerability to erratic changes,
- limited access to capital, with the available financing characterised by high interest rates,
- high cost of modern inputs, and limited extension services and
- less than optimal success from government initiatives to spur the growth of the agricultural sector.

The sector historically boasted of an impressive growth trend, averaging a 3.8% annual growth until 2005. However, overall growth in output has recently averaged at 1.3% (1.4% in 2012) falling from a record high of 7.9% in 2000 and slightly recovering to 2.6% in 2009.

This rate of growth falls below the average population growth rate of 3.2% implying a declining per capita agricultural GDP rate. This has led to reduced food security and further caused cash crop production to decline from 7.3% to 1.7%.

The outlook

Uganda's newly launched Vision 2040 envisions 'a transformed Ugandan society from a peasant to a modern and prosperous country within 30 years' and moves to transform the agriculture sector with a focus on growing industries and services. The aspiration is to transform the sector from subsistence to commercial, making agriculture more profitable, competitive and sustainable to provide income and food security.

Registered achievements over the past financial year include;

- introduction of new private sector initiatives to provide a ready market for select cash crops such as barley and sorghum,
- diversifying the export base especially into horticulture, as well as improving regional trade links and
- Competitive coffee prices backed by strong demand also improving Uganda's balance of payments.

Further, the Agricultural Sector Development and Strategic Investment Plan, envisions a more competitive, profitable and sustainable sector and has undertaken to:

- enhance productivity and profitability,
- improve access to and sustainability of markets,
- create an enabling environment for competitive environment and
- enhance institutional development in the sector.

Investment in agribusiness and agro-industry development remains expensive due to the under developed nature of the sector. Public Private Partnerships (PPPs) can potentially bridge this gap in terms of financing options but additionally to develop research, innovation and create employment.

One of the key government initiatives is the Agricultural Technology and Agribusiness Advisory Services Project (ATAAS), which is aimed at achieving agricultural transformation through enhanced supply chains, strengthening the linkages between agricultural research and extension services as well as closing the gap between generated agricultural technologies and their application by farmers.

The government has also made further efforts to increase agriculture lending particularly through the Uganda Development Bank. Leading commercial banks continue to lend to the sector and have recently been joined by Rabobank, an international food and agribusiness financier. Other sources of funding include Cooperative Unions and Saving (SACCOs)

Further, the government has committed to complete the on-going rehabilitation of irrigation schemes and has embarked on establishing new ones to increase provision of water for irrigation, and livestock.

Why invest in agriculture?

The agricultural industry in Uganda is still largely underdeveloped and as such, there is potential for significant growth. The sector continues to be a government priority for 2013/2014. The government's strategy in this regard will predominantly focus on ensuring food security and creating market surplus for agro-processing and exports.

Other factors that are drivers for opportunities and growth in the industry include:

- rising domestic, regional and international markets for agricultural commodities,
- rising global demand for food, an opportunity for increased production,
- renewed support of agriculture at national, continental and global levels and
- access to bigger markets such as the EAC, COMESA, EU, AGOA, etc.

Opportunities

Below are some of the potential opportunities in the agricultural sector.

Dairy

- Huge potential in dairy and dairy products; Uganda produces 1.5 bn litres annually with the potential to more than double this amount
- Cheese production
- Cream and ice-cream
- Establishment of collection centres and distribution facilities

Meat and meat products

- Beef exports - 12 m cattle, 13 m Goats, 38m poultry, all with potential to more than double
- Modern abattoirs
- Leather processing
- Small ruminant production
- Commercial breeding and production of semen for local and export market

Fisheries sub sector

- Manufacture of value added fish products like canned fish, fish sausages, fish soups, etc. (382,000mt of fish landed annually)
- Aquaculture development –premium species e.g. cage fish, eel fish, etc.
- Dry/smoked fish for local and regional markets

Agribusiness services

- Cold chain
- Packaging
- Inputs manufacture; e.g. tractors, vaccines, irrigation equipment, chemicals
- Agricultural insurance
- Agricultural banks
- Construction of warehouse chain facilities across the country

Conclusion

Agriculture plays a vital role in transforming Uganda's economy particularly because about 85% of Uganda's population lives in the rural areas and depends on agriculture as a source of livelihood.

Agriculture is not only a source of income and employment but further enhances the quality of life and generates demand for manufacturing and industry. The current farming systems should therefore be transformed into commercial focused systems, based on market intelligence, specialisation and application of modern inputs and technologies.

Manufacturing

Background

The manufacturing sector is one of the engines of growth in developing countries. It fuels growth, productivity and employment and strengthens agriculture and service sectors. In Uganda, the manufacturing industry consists of: pharmaceuticals, plastics, beverages, agro processors, etc. Manufacturers contribute to mobilising domestic resources, harnessing productivity, creating wealth and spurring economic growth. The Minister noted a rebound in economic growth during the year and in particular, recovery in the manufacturing sector of close to 4.2%. Nevertheless, this growth was hindered by various challenges and therefore manufacturers would have liked the 2013/2014 National budget to allocate resources to the following:

- Reducing the high cost of doing business to enable competitiveness of their products in light of the integration process,
- Increasing disposable income through supporting the productive sectors and
- Stimulating increased production while controlling macro economic fundamentals.

Key developments in the sector

Energy

The Government realised that access to electricity is essential for economic development for agro processors and industrial processing alike. It therefore implemented some of the prior commitments for example the commissioning of the Bujagali

Hydro Power Project. In addition a number of small renewable hydropower projects delivering a total of 68.5 MW to the national grid have been commissioned.

This resulted in a reduction in the energy shortages during the past year due to the 250MW that were added to the grid. However, it is estimated that the demand for energy will increase at a rate of 12% per year which means that the current increased capacity will be exhausted by 2016/2017.

In this year's Budget, the Government committed to reducing the energy shortage by implementing a number of interventions which include construction of the Karuma Hydro Power Project, installation of pre-paid meters by Umeme to increase efficiency in electricity use, etc. It is expected that the manufacturing sector will register great improvement in the current year if these measures are implemented.

Despite the reduction in energy shortages, the cost of the energy in Uganda remained high. The cost of energy formed 15-65% of the overall cost of production, a high level as compared to low energy costs stream economies like India and China whose cost of energy is in the range of 2-5%. Affordable electricity is vital for economic growth such as by facilitating value addition, industrialisation and environmental preservation and improving the welfare of the general population.

The sector was therefore looking forward to Government interventions that would increase the power supply. These include options like contracting with private producers to obtain another 50Mw from the sugar factories, following up the construction of 600MW Karuma Hydro Power Project, completing preliminary designs for the 600MW Ayago and 140MW Isimba Hydro Power Projects, providing financial support for the construction of 125 MW of renewable Mini Hydro Projects and implementing a PPP approach for the development of energy with issuance of energy bonds and other interventions which Government promised in the 2012-2013 Budget.

Transport

The cost of transport contributes approximately 45% of the costs of production and manufacturers would like to see it come down to a maximum of 10%. This can be achieved by investing in the rail, water ways / ferry, and improving / rehabilitating the road network.

Skills education and health enhance national development

Uganda requires skilled labour to compete in the East African Community's Common Market. Therefore the Government should develop programmes to support internship, industrial trainings and apprenticeships which can be achieved through allocating sufficient resources to the Skilling Uganda Programme.

The focus should be put on maintaining our professionals to discourage their influx to the Diaspora. This can be accomplished by the Government improving access to business finance especially alternative means of financing to the commercial banks. The Government can also allocate resources to the areas discussed above to support the growth of SMEs to overcome their main challenges which are the high cost of finance, inadequate entrepreneurship skills and the high costs of production.

Tax Policy issues

Tax administration should look beyond concentrating on compliant taxpayers. Currently 30% of taxpayers contribute almost 90% of total tax revenues. This is a result of the over-centralisation of decision making among very few individuals. Uganda needs a framework where tax policy advice to the Minister rests with a combined team from the tax policy department, tax administrators and taxpayers to facilitate the advantages of a broadened decision making process.

Budget highlights and the impact on the sector

There were no specific incentives for the industrialisation of Uganda but the Government acknowledged the need to address the challenge of high production costs through infrastructural development of the energy and transport sectors. Specifically:

Railway transport: The Government has pledged to rehabilitate the country's railway network, and fast-track the rehabilitation of Tororo-Packwach and Kampala-Kasese railway lines. Also, the Government is set to provide for the commencement of a design of Gulu – Atiak – Nimule –Juba railway, to be constructed jointly by UG Vs.SS and to complete the design of the Standard-Gauge Kampala–Malaba railway line (251km).

Water transport:The Government has pledged to invest in new ferries and expedite the repair of the old vessels on Lake Victoria to improve access to water transport. It also proposes to rehabilitate, insure and invest in new ferries Lake Victoria.

In order for Government to support the industry in achieving increased growth and create a competitive and export-oriented industrial sector, it should formulate clear strategic interventions at the sector levels and allocate more resources to the following:

- Reducing the high cost of doing business to enable competitiveness of their products in light of the integration process,
- Increasing disposable income through supporting the productive sectors and
- Stimulating increased production while controlling macro economic fundamentals.

Challenges within the sector

The manufacturers continue to face constraints like poor infrastructure, unreliable power and water supply due to the lack of direct Government support in the following areas:

- Viable strategies and policies set to be followed as the route for the industrialisation process,
- Laws, bureaucracy and gaps in the corporate governance of the responsible institutions for registration and licensing, which tend to be outdated and
- Fundamental resources like finance, skilled labour, equipment which are in short supply and low growth of the stock market.

Electricity

Background

Access to reliable and affordable electricity is vital for all businesses, and success of business is fundamental to the economic development of any country. Recent pronouncements in Uganda's Vision 2040 indicate that the Government has acknowledged and prioritised the role of electricity in the nation's development. This ambitious vision aims at increasing Uganda's installed electricity capacity by over 5000% (to 41,738 MW) in the coming three decades.

To put the vision in context, Uganda's electricity generation installed capacity is currently estimated at 800MW whereas the effective capacity is much lower at 500MW. Generation is still largely from hydro (86%) with thermal and biomass accounting for 10% and 4% respectively.

The most recent data places peak demand between 475MW and 506MW which has translated in a slight surplus and in turn has eased the electricity supply situation in the country. However, demand for electricity in Uganda is estimated to grow at an average of 10% annually meaning that it is expected that electricity demand will overshoot supply in the next few years – unless steps are taken in the short term to address energy efficiency and to increase the amount of power being supplied to the national grid.

Key issues for the sub sector

Many key players, including the Electricity Regulatory Authority ("ERA"), have considered the following as the key issues for the industry:

- Limited public and domestic investments in the electricity sector has hindered the construction of new generation plants resulting in insufficient power generation for both domestic and industrial consumption. This is partly driven by the high cost of debt to the electricity sector due to high perceived risks of investment coupled with the long tenure of projects. The result is that the power generated comes at a considerably higher price than in countries where sufficient investment has been made in the sector. For example at $0.12 (commercial) and $0.19 (domestic) per kilo watt hour, electricity prices in Uganda are up to 60% higher than in South Africa.

- Low electrification levels - only 12% of Uganda's geographic mass is covered by modern electricity and 90% of the population still depends on traditional biomass to support household consumption while only 1 in 15 people in rural areas have access to modern electricity. A key perpetuating factor is the high level of poverty and low per capita income with gross national income per capita estimated at $510 – effectively posing questions of affordability to the rural electrification initiatives.
- High electricity losses (losses in transmission between sources of supply and points of distribution and in the distribution to consumers, including pilferage) – electricity losses in Uganda are approximately 26%. The sub-Saharan average for electricity losses currently stands at 12%. What makes Uganda's case peculiar is that an estimated 50% of the electricity losses are due to pilferage.

The key messages from the issues above cannot be taken in isolation. It is worthwhile to consider if the key issues in the Ugandan electricity sub sector are unique to the country.

Globally, it is widely acknowledged that substantial and diverse investment is required in the energy sector. It is anticipated that the global energy sector will require a $32.8 trillion investment by 2035 to achieve energy transformation – with 51% of that investment in the electricity sub-sector. Energy transformation aims to achieve new renewable energy, efficient transportation and storage of energy resources, smart grids and meters, and decentralisation of energy generation – among others.

Progress recorded

It is important to note that significant progress has been made in alleviating the key issues. Notably, electricity supply has increased over the current fiscal year and electricity losses have continued to decline.

1. **Electricity supply:**

   The key priority in the electricity sub-sector for the medium to long term has been to increase electricity generation, supply and access in the country. The commissioning of the Bujagali hydropower project (250 MW) in October 2012, as well as the Buseruka (9MW) and Nyagak I (3.5MW) mini hydro projects, was vital in this respect.

   The second notable progress for the current fiscal year has been in the operationalisation of the

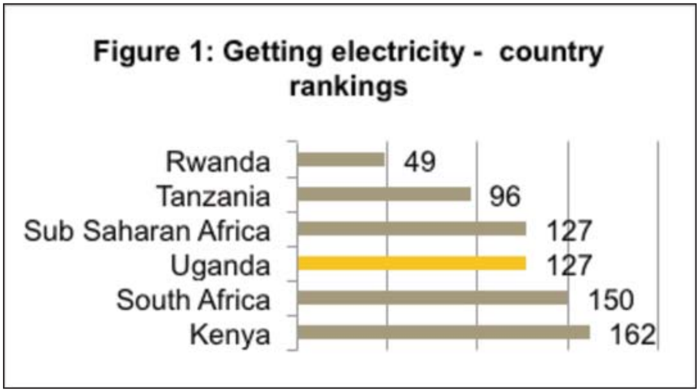
   Uganda Energy Credit Capitalization Company aiming to enhance the flow of private sector financing resources towards renewable energy projects as well as rural electrification efforts. This Government owned company aims to give access to credit enhancement instruments directed at reducing the risk of lending, leasing and guaranteeing long term energy projects and to support private sector investment in mini hydro plants.

2. **Grid expansion:**

   Uganda Electricity Transmission Company (UETCL) has over the past five years invested over $400m in the grid expansion plan to provide adequate transmission infrastructure to meet the load demand requirements. The ongoing expansion is aimed at doubling the transmission grid from 1,400km to approximately 2,800km for high voltage and to 25,000km for low to medium distribution lines. This network is expected to improve power supply, quality, efficiency, and reliability in line with regional standards.

3. **Electricity loss:**

   Distribution losses in Uganda stood at 38% by 2005 therefore the current state of 26% is a significant



improvement. According to its 2012 Annual Report, the Ugandan electricity utility company, Umeme, attributes this decline to investment in the networks to address technical losses, an automated meter reading system for industrial consumers and the installation of prepayment meters for domestic consumers.

Other considerations for the sub sector

Doing business

Electricity is seen as a key driver for economic development. Whether electricity is reliably available or not, the first step for a customer is always to gain access by obtaining a connection. In the recent IFC publication, Doing Business 2013, Uganda is becoming less competitive as a country to do business in due to many factors – mainly the ability to access reliable electricity.

It takes 91 days for an entrepreneur in Uganda to connect a warehouse to electricity, and so Uganda stands at 127 (and has dropped three spots) in the ranking of 185 economies on the ease of getting electricity (figure 1). According to the same publication, the connection period is considerably lower in neighbouring Rwanda at 31 days.

Tariff review

During the ending fiscal year, the ERA proposed an Automatic Tariff Adjustment (ATA) to provide for monthly adjustments to the retail tariffs as opposed to quarterly adjustments. The ATA is a cost recovery mechanism where consumers benefit from reductions and companies (generation, transmission and distribution) recover the increases in costs arising from fluctuations in macroeconomic factors such as inflation, fuel prices and exchange rates.

Neighbouring Kenya and Tanzania have implemented similar mechanisms and consultations are still on-going with various stakeholders to achieve the same in Uganda, especially given the negative public reaction the proposal has received thus far.

Messages from the budget

The 2013/14 budget emphasises the Government's priorities in the increasing electricity generation capacity and transmission network, increasing access to modern electricity through rural electrification and renewable energy. In so doing, the Government will be keeping with the topical issues for the industry.

Budget focus

The budget proposes the following key initiatives:

Budget Focus	Anticipated Impact
Commence the construction of the 600 MW Karuma hydro power dam	This is a medium term project which is expected to generate electricity in the next five years. With the demand for electricity growing at 10% per annum approximately 280MW of additional demand will have been created by the time this plant is commissioned, making it a timely project (if executed according to plan). Construction on the project was expected to commence in FY2012/13 but the project was delayed by procurement challenges. Additional electricity generated will support rural electrification and further support industry and the development of new sectors like oil and gas. The construction itself brings employment opportunities for artisans and experts on the project but also provides an avenue to support local production of cement, steel, etc.
Finalise arrangement for the 600MW Ayago and 180MW Isimba hydro power projects	These projects once completed (in approximately ten years) will contribute to a more permanent solution to electricity generation. It is anticipated that by the time these come on board, thermal power plants will be fully decommissioned. It must be remembered that whereas Uganda is expected to be oil producing by this point, burning oil to produce electricity always presents an opportunity cost from lost revenue. The challenge will be to deliver these projects efficiently with minimal delays and cost over runs that were characteristic of the Bujagali project.
Additional allocations to the Rural Electrification Programme – UGX. 25.73 Bn	The REP is a key focus of the Vision 2040. On top of providing a real option for rural urbanisation, the REP also presents a feasible avenue for increasing per capita electricity consumption. At 215 KWh per capita, Uganda's electricity consumption is low even by the sub-Saharan average of 552KwH and the world average of 2,975KwH. Increased per capita consumption of electricity has been cited as a key impetus for development in countries like Malaysia and Korea. Additionally REP would support two key national focuses: agriculture and industry. Particular to agriculture, increased access to electricity could spell improvement in the competitiveness of and value addition to Ugandan goods. For industry, an improved transmission network will lead to increased grid access in remote areas, thereby providing wider choice for location of factory premises closer to the source of raw materials.

Budget Focus	Anticipated Impact
Leverage the Global Energy Transfer Feed-in Tariff (GETFiT) Programme to support construction of 15 mini-hydropower projects to deliver a total of 125MW over the next three years.	The GETFiT programme aims to spur independent power producers to invest in local power sectors by supporting payment of above market premiums for renewable energy projects through feed-in tariffs. The programme also mitigates risk for developers, financiers and investors by creating finance-ready incentives backed by appropriate guarantees. Given the incentives the programme extends, quick take-up is expected. Uganda has eight mini hydro power projects in operation with a collective installed capacity of over 70MW, meaning local capacity exists. It will be interesting to see if this opportunity is exploited by local or foreign investors.
Umeme has been required to install 15,000 pre-paid meters.	Pre-paid metering is seen as a key step in ensuring increased efficiency in electricity use, and in reducing distribution system losses. This move is expected to have the most immediate impact over the coming fiscal year in improving electricity reliability. Additionally, part of the proceeds raised from Umeme's recent IPO is expected to be invested in the repair, upgrade and expansion of the ageing distribution network which will reduce these losses further. Umeme expects to bring down energy losses to 14.7% by 2018 which could release up to 100MW of electricity.

In conclusion

The United Nation's Sustainable Energy for All Initiative (SE4ALL) aims to achieve universal access to modern energy services, energy efficiency and double the share of renewable energy by 2030.

Existing barriers to electrification such as difficulty in energy planning, high perceived risks to investing in energy and low per capita income amongst others ought to be addressed at both policy and grass root levels in order for Uganda to take part in this initiative.

Positively, Uganda's Vision 2040 augurs the same messages on renewable energy, rural electrification and energy efficiency. The budget as a short term tool of Vision 2040 concentrates on energy efficiency and extension but lays down strong roots in solving the strategic issues in the sub sector, such as generation.

In this respect, it is a positive budget for the sector. The focus will be on improving the efficiency of execution which has historically bogged down this sub sector, as well as many Government initiatives and programmes.

Oil & Gas Sector

Background

The Oil and Gas sector is one of Uganda's biggest future bets, if not the biggest. Currently, no oil is being commercially produced and production is not expected to start until the appropriate infrastructure has been put in place. However, the current level of activity, both in the foreground and the background, in this sector is extremely high. The first commercially viable oil deposits in Uganda were first discovered in 2006 in three blocks within the Lake Albert basin. Seven years later, there are now over 10 blocks where oil has been discovered with more oil discoveries expected.

Out of a total of 90 exploration and appraisal wells that have been drilled in the country, 79 wells have encountered oil and/or gas. This represents a success rate of at least approximately 87%.

Less than 40% of the entire Albertine Graben area has been appraised and it has been confirmed that Uganda has over 3.5 billion barrels of oil in the Albertine Graben which translates into approximately about 1.2 billion barrels of recoverable oil equivalent. The established reserves can support an average commercial production and refining rate of about 200,000 to 250,000 barrels of oil per day.

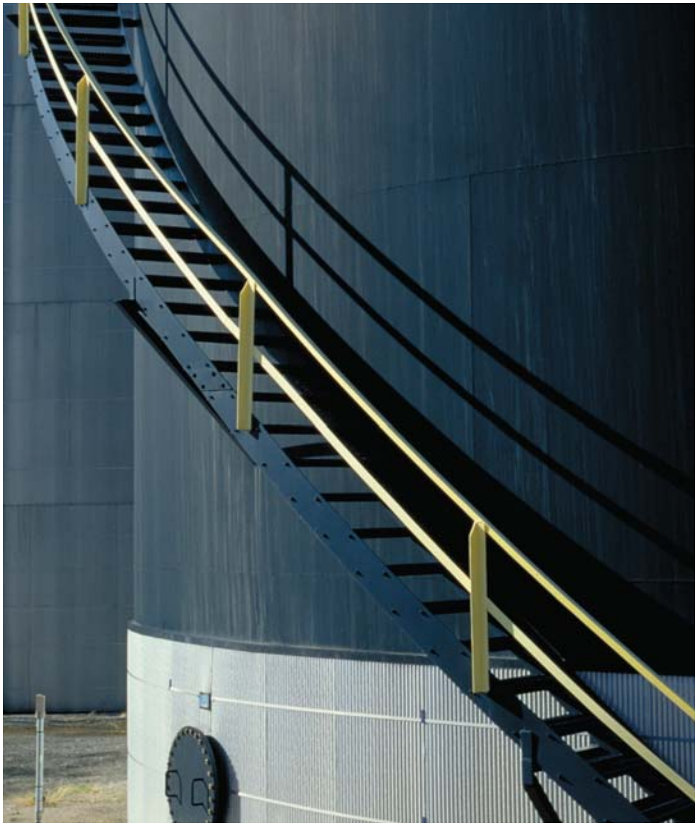
The Government of Uganda predicts that the estimated oil production will cumulatively make up 4% of GDP by 2020, 37% by 2030 and 74% by 2040.

There are currently three operators who hold exploration licences in the sector: Tullow Oil, TOTAL and CNOOC. There are a number of subcontractors who service the contractors such as Baker Hughes, Weatherford, Halliburton and Schlumberger.

With an established level of reserves at 3.5 billion barrels, the next phase of activity is commencement of oil production. This will however have to be preceded by construction of appropriate infrastructure. Government has engaged in comprehensive discussions and consultations with the various stakeholders and consultants on whether investment should be made in developing a crude oil export pipeline in Uganda or an oil refinery. Having weighed the pros and cons of both options, the Government has decided to invest in both the crude export pipeline together with a midsize oil refinery.

The economy and Government plans for the sector

During the financial year 2012/2013 the Government had two priorities. Priority number one was to expedite the process of establishing a strong legal and regulatory framework as well as institutions responsible for policy setting, regulatory and state participation. Priority number two was acceleration of the construction of the oil refinery. The Government continued implementation of the National Oil and Gas Policy (the Policy) by finalising the formulation of the regulatory



framework. The Petroleum Department implemented the National Content in the sector by actively monitoring capacity building and skills transfer by the oil companies and their service providers. Licencing of new exploration areas was suspended to finalise the enactment of the new petroleum laws providing for open competitive bidding.

The key Government priorities for the financial year 2013 to 2014 will include implementation of the National Oil and Gas Policy, further exploration, fast tracking the construction of refinery, and finalising the legal, regulatory as well as the institutional framework, accelerating construction of the Kenya-Uganda oil pipeline, and undertaking the feasibility study for the Uganda-Rwanda oil pipeline. To ensure prudent management of the oil resource and stimulate development in the key sectors of the economy the Government will also focus on capacity building in the entire petroleum chain.

In the short term the Government intends to utilise the reserves discovered to implement large scale commercialisation as a source of energy in power generation. In the medium term the Government has decided to construct a refinery to produce petroleum products for the domestic and regional market. The Government is in the process of procuring a Transaction Advisor to advice on the structure of the refinery, the best contracting arrangements, and pricing of crude oil and refined products. The Transaction Advisor will also develop a project financing structure, secure investment partners, and advice on the process of formation of the Joint Venture Refining Company and financial closure.

Despite the fact that the Government has reduced budgets for other sectors the budget allocation to the sector has been increased from USH 13.29 billion in FY2012/2013 to USH 18.29 billion in FY 2013/2014. This is because the Government understands the importance of this sector in driving other sectors and the economy. The budget allocation for the construction of the refinery has been increased from USH 14.9 billion to USH 35 billion. Allocations to other priority programmes under the sector have been increased from USH 87.98 billion to USH 103 billion.

In terms of investing in the oil pipeline infrastructure, feasibility studies are still on-going regarding the type and route of the oil pipeline. However it is currently estimated that the oil pipeline will be between 1,200 to 1,600 kilometres long and 60-80cm wide, with a full capacity of 250,000 barrels a day. In terms of the route, the options currently being discussed are either through Tanzania to Dar-es-Salaam port or through Kenya to Mombasa or Lamu ports.

For the oil refinery investment, its economic success will be largely dependent on the size of demand for its product. This includes both the local market and the demand in the region particularly Rwanda, Burundi and the Democratic Republic of Congo. The average rate of return for oil refineries in the world is 10% and the oil partners believe Uganda is in line to achieve this average depending on demand.

According to Government, the refinery will be developed on a Private Public Partnership basis through a joint venture company. The shareholding participation will be 60% by the private sector and 40% by the public sector. Government is currently in the process of hiring a Transaction Advisor who will guide in key aspects of the refinery such as structure, contracts and pricing framework. The gazetted refinery land will also have provision for an airfield, waste management facilities and other associated oil and energy industries.

The oil partners in Uganda estimate that Uganda's local demand is expected to range from 30,000 barrels per day in 2015 rising to 40,000 barrels per day in 2025. For the external demand in the region, there are currently only highly speculative and inconsistent estimates based on a wide range of assumptions.

There are also a number of factors such as the wider fiscal framework that are yet to be addressed which greatly affect the success of an oil refinery. One of these key factors is the difference in VAT treatment between the supply of crude oil which is subject to VAT at 18% and non-crude oil products which are currently VAT exempt. If this stays as it is, it would result in non-recoverable VAT costs on refinery expenditure and production which would severely affect the viability of the refinery.

In terms of expenditure, it is estimated that the development of the Lake Albert Basin for its oil resources will require a total of USD 18 billion - USD 22 billion dollars. This includes upstream, pipeline, refinery, infrastructure and export terminals development costs, with approximately 50% of this cost all allocated to upstream development. It is estimated that around 750-800 wells will be required with 500 of these being oil producing wells, while drilling activity is expected to take a period of 13 years with 8 rigs operating simultaneously.

From an infrastructure perspective, the partners estimate that expenditure of USD 300 million will be required for the project with additional expenditure of USD 700 million on regional upgrades. The key infrastructure development is the development of roads for local and regional transportation of goods and materials.

The Lake Albertine region is approximately 1,200 km from the final ports of export at the coast, which takes approximately 7 days to cover. This is even expected to take longer considering the transportation of heavy goods during the development phase resulting in approximately 2,000 truck deliveries per month. This means that significant investment in upgrading and improving the roads network is crucial for the sector. Estimates of the amount of goods required during development include approximately 850,000 tonnes of equipment, 300,000 tonnes of excavations and 125 million litres of fuel.

In light of the above, it is evident that the investment demands of oil and gas in Uganda are quite significant, of which not all of it can be internally financed. It is therefore expected that external financing will be required from development and financial institutions over the next three to five years.

Regulatory matters

Passing of the new laws to govern the sector

The Government made significant progress in the last financial year by putting in place the legal framework that will govern the sector before Uganda moves to the production stage. The new laws are a step forward in addressing concerns from the public, the Parliament and Civil society regarding the insufficient laws governing the sector.

These laws are key to establishing the necessary structures required for the management of the oil resource as well as regulating the operations of licensees and other players in the sector. The public is waiting with keen interest for the Petroleum Revenue Management Bill to be passed as this will provide the public with answers about whether the oil revenues are going to be utilised for the benefit of Ugandans to contribute to early achievement of poverty eradication and create lasting value to society.

The Petroleum Exploration, Development and Production Act, 2012 (PEDP Act) was passed by Parliament in December 2012 while the Petroleum Refining, Gas Conversion, Transportation and Storage Act was passed in April 2013. The PEPD Act gives effect to Article 244 of the Constitution of Uganda, operationalizes the policy, establishes the Petroleum Authority of Uganda and provides for the formation of the National Oil Company under the Companies Act of Uganda. The Petroleum Authority will monitor and enforce compliance in the sector while the National Oil Company will manage the State's commercial interest in the sector in all phases of the petroleum value chain.

The PEPD Act among others provides for the terms and conditions for award of petroleum rights in open bidding; conducting operations based on international best practice; training and employment of Ugandans as well as technology transfer; national participation in petroleum activities; health and safety standards; protection of environment and decommissioning. When licencing for petroleum rights resumes, applications for licensing will be open and on competitive bidding.

Competitive bidding will ensure that the process is transparent and the country gets the best oil companies. It will also allow for multiple licensees within exploration areas and allow for smaller and more exploration areas. Restrictive bidding will only be considered where it is necessary and beneficial to the country. It is expected that the next licensing round will attract new players in the upstream phase in addition to the existing three licensees who are Tullow, Total and CNOOC.

The Petroleum (Refining, Gas Conversion, Transportation and Storage) Act provides for the value addition of the petroleum resource as stated in the National Oil and Gas Policy. The Act will facilitate development of oil and gas infrastructure such as the refinery, the oil pipeline, gas processing plants and storage facilities. The Act will also provide for national participation, incentives and licencing for investors in the sector, conditions for third party access to common infrastructure, health and safety, and environmental protection. It is anticipated that the licensing round will attract investors in the midstream phase (refinery and the pipeline).

The most contentious provisions of the new laws are the national content requirements. Both laws will require oil companies and their contractors and subcontractors to give preference to goods which are produced or available in Uganda and services which are rendered by Uganda citizens and companies.

Where goods and services required by the contractor or licensee are not available in Uganda, the goods or services will have to be provided by a company which has entered into a joint venture with a Ugandan company. The Ugandan company will be required to have a share capital of at least 48% in the joint venture. If implemented as-is, this new requirement will affect all companies that provide services and goods to oil companies in Uganda as they will be mandated to enter into joint ventures with local partners.

Taxation issues

Following the discovery of commercial oil reserves in Uganda, in July 2008, the first set of tax laws providing for taxation of petroleum operations was published in the Income Tax Act (ITA). These provisions were amended in July 2009 and July 2010.

Given that the Government has made significant steps in establishing a legal framework to regulate the sector, plans are under way to put in place appropriate infrastructure in preparation for oil production. It is expected that one of the next areas of focus will be to review the tax laws that govern the sector.

Some of the key areas that need to be addressed include taxation of Ugandan branches of non-resident subcontractors, determination of a capital gain arising from disposal of an interest in a petroleum agreement, deductibility of certain expenditures incurred by the contractors where they are not specifically provided for under the petroleum tax provisions, the tax returns that contractors are required to file with the URA, heavy penalties and fines for non-compliance especially given the heavy filing burden currently placed on the contractors, clarity on determination of chargeable income subject to tax and the format of the tax returns to be filed by the contractors, VAT on imported services, recoverability of input VAT incurred prior to production, VAT treatment on importation of petroleum exploration, drilling and production equipment, VAT treatment of crude oil and other refined products, customs and import duty on importation petroleum exploration, drilling and production equipment, etc.

Challenges

Financing of the oil and gas infrastructure

The major requirements needed for the construction of the refinery and the associated infrastructure are finance and human resources. Accordingly, the biggest challenge facing construction of a refinery in Uganda is inadequate infrastructure and financing. This is because Uganda does not have the funds to finance the infrastructure for petroleum development and production nor does it have the required human resources to manage construction and operations of the refinery alone.

In addition Uganda is landlocked which means that petroleum products will need to be transported through the neighbouring countries of Kenya or Tanzania using pipeline, road transport or railway systems to Mombasa or Dar es Salaam ports. Before production starts Uganda will need to import materials for refinery construction. The road network to the location where the refinery will be constructed is not in place. The infrastructure in the neighbouring countries is also inadequate and insufficient resulting in very high costs of transportation.

To address the financing challenges the Government plans to construct the refinery on a Private Public Partnership basis through a joint venture. The proposed shareholding is 60% private and 40% public. The Government is proposing to invite the East African Community partner states to participate with 10% of the public shares. It is also important to note that last year there were major discoveries in Kenya which means that Uganda has to compete for funding and technical expertise for developing the necessary infrastructure for oil production with Kenya.

Consultations with the Partner states are underway to determine the best arrangement for Development of Regional Refineries. Involvement of the Partner states is in line with the Strategy for Development of Regional Refineries developed by the East African Community in 2008. The overall objective of the strategy is to harmonise development of refineries and associated supporting infrastructure in East Africa to attain value addition to the petroleum discoveries in the region and ensure better security of supply for the region.

The vision for the strategy is 'To achieve maximum value addition to the regional fossil fuels for improved quality of life for the people of East Africa.' The strategy addresses issues relating to the establishment, location, ownership structure, operational logistics and capacity of the refineries and supporting infrastructure. The strategy recommended upgrading the Mombasa refinery and constructing a refinery near the oil fields in Uganda in order for the oil discoveries to provide the optimal benefits to the people of Uganda and the region.

The strategy also recommended constructing a pipeline from Kenya to Kampala as well as carrying out a feasibility study for a Kampala-Kigali- Bujumbura pipeline. The key stakeholders who are expected to finance the construction of the refinery together with the associated infrastructure include the East African Community Partner states, the people of East Africa, Development Partners, countries neighbouring the East African region and investors. Investors include oil companies, financial institutions, private investors, pension funds, etc.

Shareholding requirements in the new regulatory framework

The shareholding requirement in the new laws is a big challenge as there are very few Ugandans with enough capital and resources for the capital intensive investments required in the sector. Much as the Government intentions are good the requirement to have local shareholding in all companies providing goods and services in the oil companies will most likely not achieve the desired benefits to Uganda but rather act as a disincentive to foreign investments in the sector.

As the country tries to implement local content and national participation, it is important to recognise the role of foreign direct investment and benefits in areas such as skills and technology transfer. The Government should instead ensure transparency and openness in awarding contracts. Another effective way of implementing national content is by monitoring and enforcing skills and technology transfer. In this way, citizens will benefit through capacity building and quality services.

Taxation

If the current tax regime remains the same, the cost of doing business in the sector will significantly increase. This will also create uncertainty in the sector which is a disincentive to investments. Some of the key challenges currently facing the sector are further explained below:

i) Under the existing tax regime, VAT has become a cost on investment due to challenges to the ability to recover VAT both on local supplies and imported supplies. As a result most costs relating to exploration, development and production of oil and gas in Uganda have gone up by 18%. Such huge costs of investments create uncertainty in the sector and work to discourage investment. Under general principles of VAT, VAT is a consumption tax collected by businesses, and paid ultimately by the final consumers.

ii) Currently the VAT treatment of crude oil and other refined products as well as VAT treatment of various equipment across the value chain are not provided for under the tax legislation. This uncertainty has to be addressed before construction of the pipeline and refinery begins as well as before production of crude oil begins.

iii) The number of returns that oil companies are required to file with the URA under the tax legislation creates an additional administrative burden and cost to companies. The requirements are almost impossible for the oil companies to comply with and yet failure to comply gives rise to significant penalties.

To address the above challenges, it is important for Government, specifically the Ministry of Finance. to engage the various stakeholders in the sector such as the Ministry of Energy, the URA, the contractors and subcontractors operating in the sector to understand the challenges facing the players in this sector and how they affect their businesses. A number of proposals have been submitted to the Ministry of Finance by various stakeholders in the sector and it is hoped that these will be considered before passing amendments to the current tax provisions.

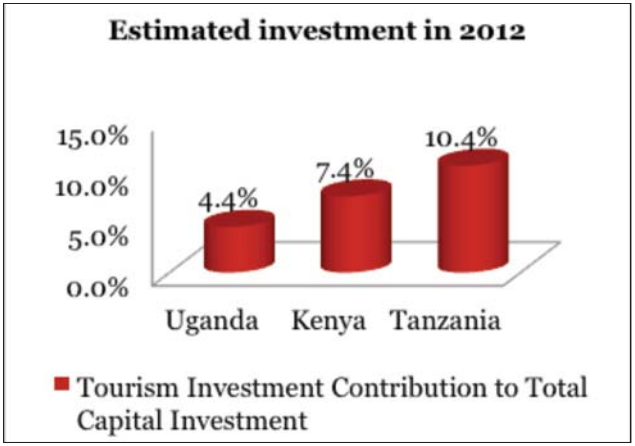
Tourism

Overview of the sector

The tourism sector has continued to grow over the last five years and in 2012 contributed US$735 million to GDP.

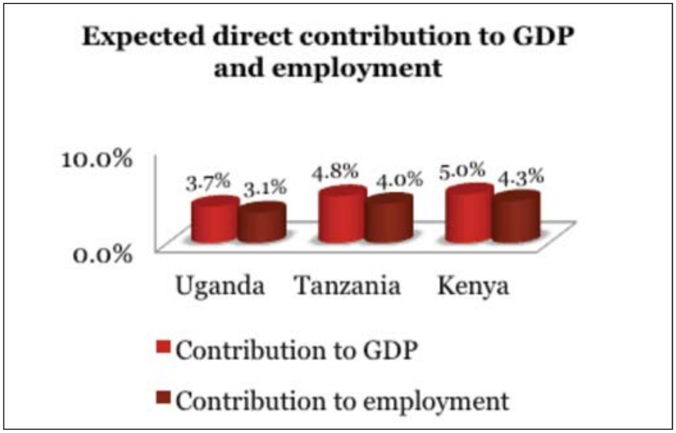
According to the World Travel and Tourism Council, the Ugandan tourism industry's contribution to GDP will marginally decrease from 2012 to 2013. This comes as no surprise, given that the Government's expenditure on tourism, trade and industry is expected to decrease from USH 75 billion in 2012/2013 to USH 54 billion in 2013/14. This is notwithstanding the fact that the direct expenditure on tourism alone in 2013/14 is not expected to change from the USH 12 billion that was allocated in 2012/13.

The graph below indicates that Uganda's investment in the tourism industry is still considerably lower than that of its immediate neighbours.



Source: World Travel and Tourism Council

Given the stagnation in the levels of investment in tourism, Uganda continues to lag behind her neighbours in this sector. The following analysis demonstrates that in 2012, tourism in Uganda contributed less to GDP and employment than it did in Kenya and Tanzania.



Source: World Travel and Tourism Council

Increasingly, Uganda is becoming a well established destination and has won accolades such as:

- The most preferred tourism destination for the year 2012 as ranked by Lonely Planet; and
- One of the top 20 global tourism destinations in the year 2013, according to National Geographic.

With the optimal level of investment, tourism can play a more prominent role as a key source of domestic earnings, foreign exchange and employment.

Some of the key attractions that Uganda has to promote and offer include:

- Game viewing - safaris in parks such as like Murchison Falls, Kidepo, Queen Elizabeth, Lake Mburo and Kibale present a variety of species and beautiful sceneries.
- Gorilla tracking – the mountain forests of the Bwindi Impenetrable National Park are renowned for tracking gorillas.
- Bird watching – the diverse variety species in Uganda would be sought after by any bird enthusiast.
- Other activities like ecotourism, white water rafting, canoeing, boat ridding and bungee jumping are contribute to the country's tourism industry.

Future outlook

The Government of Uganda, through the 2013/14 budget and National Development Plan, acknowledges the importance of the tourism is a key part of the economy. However, constraints such as poor road networks, limited Information and Communication Technology (ICT), an inadequately trained work force and limited promotion of Uganda as a destination of choice for tourists continue to hamper growth in this sector.

The increase in expenditure for works and transport from USH 1,651 billion in 2012/13 to USH 2,395 billion in 2013/14 will be vital for developing Uganda's infrastructure, which is a key necessity for growth in the tourism sector.

Further, even with a decrease in the budget allocation for tourism, trade and industry from USH 73 billion in 2012/13 to USH 54 billion in 2013/14, the funds directly allocated to tourism of USH 12 billion have remained consistent with the prior year. This is further testimony to the Government's commitment to boosting the tourism sector.

However, the above measures are not likely to result in a transformational change in Uganda's tourism sector. Indeed, the World Travel and Tourism Council has projected tourism's direct contribution to Uganda's Gross Domestic Product and employment will decline in 2013, in comparison to 2012.

With increased and targeted investment, tourism can be pivotal in promoting stability and development through providing jobs, generating income, diversifying the economy, protecting the environment, and fostering cross-cultural awareness. In order to maximise the potential that the tourism industry in Uganda has to offer, the Government should, among other measures, undertake the following initiatives:

- increase the level of direct investment in the tourism industry – as highlighted above, the budget allocation to the tourism industry has not changed significantly;

- continue promoting Uganda as a destination of choice for tourists – the Uganda Tourism Board and the Uganda Wildlife Association should focus more on leveraging Uganda's competitive advantage and promoting the country as the destination of choice;
- provide a robust regulatory framework and favourable tax incentives to maximise both the investment in the sector and the number of visitor exports. The proposed elimination of the VAT exemption on hotel accommodation should be subjected to wider consultation before it is implemented;
- provide incentives to promote domestic tourism – the levels of domestic travel and tourism in Uganda are still considerably low, despite the growth in household income and a burgeoning middle class;
- ensure that the discovery and exploration of oil does not result in a degradation of national parks and other tourist attractions; and
- develop the transport network with a view to improving accessibility to tourist destinations within the country – since the transport sector continues to take up a major share of the budget allocation, Government should put more emphasis on infrastructure that has a direct positive impact on the tourism sector. Some of the projects that have been earmarked in the 2013/14 budget include: maintenance of the road access to Kidepo Valley National Park, works on the Ishasha-Katunguru road and construction of the Kisoro-Mgahinga, Kyenjojo-Hoima-Masindi and Kabwoya- Kyenjojo roads.

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