



Can Uganda's Oil Endowment Support its Economic Development?

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RECOMMENDATIONS

- Existing policies governing Uganda's imminent oil boom should be implemented in full. The Extractive Industries Transparency Initiative should be adopted in accordance with the Oil and Gas Policy of 2008, and government information should be granted more freely in accordance with the Access to Information Act of 2005.
- Pre-emptive measures should be devised to shield Uganda's economy, most notably its agricultural sector, from higher liquidity in the oil industry and the resulting inflationary pressures.
- Policy gaps regarding the establishment of stabilisation and petro-funds should be addressed ahead of oil production.

EXECUTIVE SUMMARY

Global energy security concerns have fuelled the exploration of oil in Uganda. Since 2006 sizeable oil deposits have been found in the country, indicating that Uganda's once agriculture-based economy is on the brink of a rapid transformation in favour of its natural resources sector. Whether this discovery of oil will support the economic development of the country remains to be seen. Uganda is in a favourable position because regulations and procedures for the management of natural resources have already been put in place. However, persisting opacity within governance structures, worrying gaps in the current legislation and on-going violent conflict are but a few of the challenges that the country must overcome if it is to avoid the resource curse. This briefing considers the potential for Uganda's new-found oil wealth to be governed in such a way as to foster economic growth and development that will benefit all Ugandans.

GLOBAL ENERGY SECURITY CONCERNS – A KEY DRIVER FOR UGANDA'S OIL EXPLORATION

Although first undertaken in 1925, oil exploration in Uganda only began in earnest in 2003, prompted by the confluence of oil scarcity and rising oil prices. Although the BP Statistical Review of World Energy 2010 reveals that African reserves account for only 9.6% of global petroleum reserves, the rate at which the continent has produced new finds has made it an emerging hotspot. Several large discoveries have been made off Africa's west coast, including the 1.8 billion barrel find off Ghana's coast. However, the most significant of recent discoveries was made inland, with the 2.5 billion barrel find by Tullow Oil plc in the Albertine Graben area of western Uganda. Potential revenues from this deposit are substantial: at \$74 per barrel, this discovery is worth \$148 billion, or enough to fund Uganda's current national budget for 42 years without donor funding.² There can be little doubt that oil production in the

area will create a surge in government receipts, but whether the Albertine Graben discovery will support the economic development of the country is less certain. Countries such as Nigeria, Angola and the Sudan have set poor precedents, where oil production has done little to improve social indicators. To avoid following in the footsteps of its neighbours, Uganda needs to learn from growth miracles such as Norway, which used its oil endowment to grow. Once one of the poorest countries, today Norway has one of the highest per capita incomes in Europe.

OIL FOR DEVELOPMENT

Uganda's economy is largely dependent on its agricultural sector, which currently employs over 80% of the working population. Its major exports are coffee, tobacco and cotton, while most farming products, such as maize, are consumed locally. Although more needs to be done to ensure lasting economic prosperity and to reach its Millennium Development Goals (MDGs), Uganda has achieved some significant developmental successes. The proportion of the country's population living in poverty decreased from 57% in 1992 to 31% in 2006.³ Furthermore, between 1990 and 2007 the country's Human Development Index rose by 1.59% annually, from 0.392 to 0.514 today,⁴ indicating a marked improvement in the nation's overall social well-being. The recent discovery of oil in the Bunyoro region is fortuitous, and presents an opportunity both to accelerate growth and to improve social outcomes in a single leap. However, the concerns of conflict and repression remain, and tribal and ethnic tensions are already emerging over how future benefits from the discovery will be allocated. Uganda's development challenge is to reap the oil dividend in a manner that promotes peaceful and equitable outcomes.

A sudden glut of liquidity that arises from a surge in oil revenues is prone to mismanagement, and examples abound of the resource curse, or how an abundance of natural resources can undermine development. However, the resource curse is not inevitable. On the contrary, the role played by institutions can determine whether a resource-rich country experiences a 'blessing' or

a 'curse'.⁵ Resource wealth, in and of itself, has little effect on growth, which is to say that simply having an abundance of resources tucked beneath its soil will make a country neither better nor worse off – as one might easily predict. Rather, the curse operates indirectly through corruption and poor quality institutions, creating the reinforcing cycle whereby weak institutions lead to low long-term investment, such as in human capital,⁶ which in turn creates greater resource dependence and further weakens institutions. Therefore, in essence, the curse is a test of how well a country is able to govern its resources and the rents or proceeds which flow from them.

AVOIDING THE RESOURCE CURSE

Uganda has the opportunity to choose a prosperous fate by governing its oil resources prudently and efficiently. In so doing, the country's policy should be cognisant of the various forms that the curse can take, in particular Dutch disease, systemic volatility, rent seeking and external debt.

Dutch disease was first used to explain the poor economic performance of the Netherlands after the discovery of an abundance of natural gas. The resource curse is when the non-traded or resources sector crowds out (or constricts) the traded (or, in the case of the Netherlands, manufacturing) sector. The risk for Uganda's agricultural sector is a 'resource pull' effect, where wages in the oil mining sector could rise above average, creating the incentive for skilled or semi-skilled labour to leave agriculture. Furthermore, should the Ugandan Shilling be allowed to appreciate rapidly on the back of booming oil exports, the stronger currency could cause agricultural exports to contract. The dominance of agriculture in the economy makes Uganda particularly susceptible to the Dutch disease, both through labour and currency effects. Therefore, policymakers should be prepared to implement buffer systems to shelter the economy from inflation in the resources sector.

Systemic volatility refers to the unpredictable nature of movements in commodity prices and is especially problematic when revenue from commodities is built into public finances. If

government expenditure is overly dependent on rent from resources, spending on public infrastructure becomes erratic when commodity prices experience large swings. Ugandan policy should thus be careful to uncouple public spending from movements in the oil price, through the implementation of stabilisation funds. When used effectively, these funds are able to pool uncertain inflows so that known or certain withdrawals can be made at regular intervals, thus smoothing the consumption of oil revenues. Proper implementation of stabilisation funds would thus make public expenditure more reliable and allow for better planning.

Perhaps the most infamous cause of the resource curse is rent seeking, when corrupt officials and various interest groups compete to capture the rent from resources, by engaging in wasteful activity such as conflict and sabotage. Whether motivated by greed or grievance, the culture of rent seeking in one sector soon spreads to a much wider area of the economy, as interest groups begin to target more productive sectors to further their cause. When the overall cost of rent seeking is greater than the windfall from the resource, the net effect produced will be one of slower, or even negative, economic growth. Naturally, strong institutions are instrumental in discouraging looting or rent-seeking behaviour, while peace dividends, in the form of tangible development outcomes, are an important tool that should be utilised to avoid social unrest and conflict.

Lastly, borrowing based on a resource boom (where the high price of a commodity is used as collateral to secure loans) could easily cause a country to become over indebted. When commodity prices dip and government receipts drop, a country that has borrowed imprudently will struggle to meet its debt obligations. As a result, assets from priority sectors such as health and education are diverted in order to cover the debt – a reality which Uganda has already faced. In 1991 Uganda became the first nation to qualify for the Heavily Indebted Poor Countries (HIPC) initiative, when its debt obligation escalated to over 80% of its export revenues. It received a total of \$1.3 billion relief on a debt burden of

\$2.6 billion,⁷ and has since implemented stricter limits on new borrowing. Yet, despite the HIPC initiative and tighter debt management controls, the country still struggles with debt sustainability. Therefore, policymakers should be very wary of pairing volatile oil revenues with fixed debt obligations.

UGANDA'S LEGAL AND POLICY ENVIRONMENT

Significant progress has been made to improve transparency in the governance of Uganda's resources. Most prominently, the Access to Information Act (AIA) was passed in 2005, giving citizens the right to view even restricted government information, if the information is shown to be in the public interest. However, access fees and insufficient procedural guarantees discourage most Ugandans from exercising this right. Approved by cabinet in January 2008, Uganda's Oil and Gas Policy (OGP) contributes to transparency, as it recognises the need for national participation and provides for the implementation of the Extractive Industries Transparency Initiative (EITI). This is an improvement on the 1985 Petroleum Exploration and Production Act, which did not address any 'downstream' activities, such as local consultation in the decision-making process. However, the OGP has been criticised for being vague and incomplete, not clarifying the role of local communities (amongst other oversights), and failing to indicate the extent to which locals will be consulted and the benefits they will receive.

Another important legislation is the draft Petroleum Exploration, Development, Production and Value Addition Bill, disseminated for comment in May 2010, which sets the conditions for the governance of Uganda's resources. However, although well drafted, the bill also leaves a number of transparency issues unresolved. It does not address the creation of a centralised fund to account for receipts, nor does it include any auditing process to which such a fund (should it be created) could be subjected.⁸ The bill essentially provides for public monitoring of the overseeing body that would regulate resource rents, but

does not allow for the public to scrutinise the revenues themselves. Another concern is the lack of provisions to disclose revenue data generated by the industry as a whole, which deviates from international best practice. In some instances, the bill seems to be more restrictive than the AIA. It thus remains to be seen whether access to restricted information under the bill will be granted if it is shown to be in the public interest.

Uganda's oil policy is perhaps most silent on the creation of petro and stabilisation funds. This might be because issues of revenue management are to be included in a forthcoming revenue management bill. Thus far little attention has been paid to the need to put aside savings, or create stabilisation funds, to smooth oil revenues. Furthermore, questions about when and under what conditions withdrawals can be made from these funds still have to be addressed. Uganda's policy also leaves gaps in fiscal provisions such as royalties, taxes and surface rents, which are left open-ended to be finalised in the contracting phase. The reasons for this are unclear but what is certain is that these loopholes create room for corruption in the governance process.

CONCLUSION

The current policy governing Uganda's natural resources leaves many important issues unresolved. The major areas of concern that require further attention include the management of future revenues, as well as community and social impacts. Despite the existing gaps, Ugandan policy does a fair job of promoting transparency in its governance structures. However, the implementation of this policy has been weak. Certainly, to maintain genuine transparency will require much greater commitment to the application of policy recommendations (such as the EITI) and access to information. Resource wealth, when governed poorly, is known to evoke a curse. The country is thus doing well to prepare its legal and policy environment for

the introduction of an oil export sector ahead of production. Nevertheless, strong institutions will be indispensable to creating positive growth outcomes and ensuring that the country's oil wealth helps, rather than hurts, efforts to achieve the MDGs.

ENDNOTES

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- 3 World Bank, Country Assistance Strategy for the Republic of Uganda for The Period FY 2011–2015, 2010, http://siteresources.worldbank.org/UGANDAEXTN/Resources/Uganda_CAS.pdf?resourceurlname=Uganda_CAS.pdf.
- 4 United Nations Development Programme, 'Uganda, the human development index – going beyond income', in *Human Development Report 2009*, <http://hdr.undp.org/en/reports/>.
- 5 Brunnschweiler C & E Bulte, 'The resource curse revisited and revised: A tale of paradoxes and red herrings', *Journal of Environmental Economics and Management*, 55, 3, 2008a, pp. 248–264.
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