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Fiscal Sustainability and the Natural Resource Curse in Resource-Rich African Countries: A Case Study of Uganda

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Fiscal sustainability has eluded most resource-rich African countries, as they have not used resource rents for social and economic development, and exhibit unsustainable debts, poverty and corruption (the “resource curse”). This article concludes that the “resource curse” is attributable to economic, legal, political and socio-cultural factors.

1. Introduction

Fiscal sustainability has eluded many natural resource-rich developing countries, such as Angola and Nigeria, which are experiencing regressive growth and significant poverty despite the vast resource rents available. These profoundly negative effects have given rise to significant debate as to how oil-rich Uganda can evade the “resource curse” and realize fiscal sustainability. There is a fear that Uganda’s previous economic gains [1] could be reversed by oil exploitation. The World Bank (2011) [2] notes the challenges that could undermine Uganda’s future development, including sustaining macroeconomic stability, a rapidly growing population, the discovery of oil reserves and increased corruption. Stevens (2003) [3] posits that countries with very large oil reserves have high public spending positions due to expectations of oil windfalls, which is a behaviour that compromises fiscal sustainability, as oil is non-renewable.

Uganda’s Albertine Graben was confirmed to have commercially exploitable oil reserves in 2004, with oil production and export expected to commence by 2015, provided the supporting infrastructure is in place. Kasande (2012) [4] notes that only 40% of the confirmed 2.5 billion barrels of oil reserves are “recoverable”. Uganda’s treasury expects an estimated USD 2 billion in annual oil revenue inflows throughout the production period of 25 to 30 years. Multinational companies (MNCs) have invested heavily in Uganda’s oil sector in anticipation of high profits. Ugandans expect oil windfalls to be spent on modern infrastructure. These stakeholder interests need to be reconciled through a stable, neutral and flexible fiscal system. The fiscal system should yield public revenues, enable investors to recoup exploration costs and provide an incentive for further oil sector investments. Nakhle (2006) [5] argues that fiscal sustainability depends on a fiscal regime’s stability and flexibility. Uganda’s oil resource social management system should, therefore, help translate non-renewable oil into durable capacity and avoid the “resource curse” and the “Dutch disease”. [6]

Abundant natural resources have inherently lead to a decline in institutional quality in developing countries and, therefore, the issue that this article investigates is whether or not Uganda can avoid the “resource curse and realize fiscal sustainability”. In answering this question, the article attempts to further policymakers’ awareness of the relative suitability of oil sector policy alternatives by: (1) examining the responsiveness of Uganda’s oil fiscal policy regime to boom-and-bust cycles; (2) evaluating whether or not Uganda’s institutional framework promotes transparency [7] and sustainable resource use; and (3) assessing the fiscal institutional readiness and robustness of Uganda to cope with oil sector challenges.

This article uses publicly available data and information [8] complemented by industry sources and the press. Assuming changes in oil prices, a steady fiscal regime, different discount rates and cost structures, the authors envisage a sustainable fiscal system by matching expected oil revenues to the non-oil primary deficit. [9] In the context of oil resource taxation, fiscal sustainability refers to the government’s ability to generate oil revenues to finance non-oil fiscal deficit.
2. The Natural Resource Curse: A Theoretical Perspective

Natural resource-rich developing countries are known to experience regressive economic growth and poor welfare. Auty (1993) [10] coined the term “resource curse thesis” to describe how resource-rich countries experience lower economic growth and welfare relative to resource-poor countries. Sachs and Warner (1995), [11] in particular, demonstrated a disconnection between resource wealth and economic growth. For instance, between 1965 and 1998, oil-rich countries experienced a decline in average per capita income of 1.3% compared to growth in average per capita income of 2.2% in non oil-rich countries. This is paradoxical, as oil-rich developing countries generate oil windfalls that should be used for economic growth and development. The “resource curse” may occur when a resource-rich country transfers its focus from the tradeables sector [12] to the extractive sector, thereby exposing the economy to volatile global prices and unstable revenue and spending patterns. Developing countries have poorly defined resource rights and distributive systems, which give rise to resource distribution inequities, conflicts over resource control, corruption and infinite rent-seeking. [13] Sala-i-Martin and Subramanian (2003) [14] have observed that resource endowments degrade institutional quality. [15] Poorly defined resource rights, therefore, make it easy for MNCs to collude with corrupt officials to carry out questionable extractive business. [16]

The real exchange rate appreciation due to resource windfalls negatively affects the tradables sector relative to the non-tradables sector, in addition to making the tradables sector less competitive globally. Empirics suggest that oil windfalls favour non-tradables relative to tradables. Bevan, Collier and Gunning (1998) [17] explain that an expanding government leads to growth in job opportunities in urban centres, which pulls labour from rural areas. The tradables (agriculture) sector is labour intensive and supports the lives of 80% of Uganda’s population. Accordingly, its contraction would give rise to a loss of livelihoods and employment. This problem is compounded by the lack of skills of agriculture sector workers, which makes it hard for them to relocate to the non-tradables sector. The authors note that extractive sectors exhibit weak intersectoral linkages, thereby creating less employment.

This resource-induced unemployment is more harmful, as it gives rise to the greater division of society into oil sector and non-oil sector workers, thereby heightening social tensions. It also causes food deficits that must be filled through food imports, which worsen a country’s balance of payments and debt position. A resource-induced debt may result when resource-rich countries mortgage expected future resource receipts for loans. A price slump reduces oil revenues and increases a country’s inability to finance debt obligations, which threatens fiscal sustainability. Stiglitz (2000) [18] noted that government borrowing involves a transfer of resources from future to present generations, as current debts are paid by future generations. The debt dilemma is aggravated by volatility, exhaustibility and uncertainty of oil revenues. [19]

Extractive sector experts identify the “resource curse”, [20] the “resource war” [21] and “conflict resource” [22] as causes of conflict in resource-rich developing economies. According to Bannon and Collier (2003), [23] countries with primary commodity exports of around 25% of GDP and 5% of GDP, respectively, have a 33% and 6% risk of conflict. Collier and Goderis (2007) [24] observe that natural resources may provoke open separatist conflicts [25] or hidden forms of conflict. [26] Resource-rich governments use rents to build military might and a client-patron system at the expense of service delivery to maintain power. Economies dominated by extractive sectors tend to be more repressive, corrupt and badly managed. [27] Sala-i-Martin and Subramanian (2003) [28] state that oil rents are detrimental to institutional quality, as rent-seeking officials undermine a government’s efficacy and political stability. The lobbying for rents and sharing also undermines the quality of economic and political institutions. [29] The diversion of oil receipts from public to individual use through corruption reduces economic growth and increases poverty. Further, the effect of the resource curse on growth is exacerbated in countries where the quality of institutions and rule of law are poor. [30] MNCs are the agents of rich western economies that are used to exploiting and manipulating resource-rich developing governments. MNCs dominate the extractive sector of developing countries, as they have the capital equipment, manpower and technical capacity needed. Accordingly, MNCs benefit more than the host country’s citizens and encourage wasteful host governments to squander public resources. Host countries could legally compel MNCs to engage in activities that confer benefits on host countries, beyond the resource value chain, but the global political economy would make such policy positions difficult to implement.

3. Fiscal Sustainability and Natural Resource Endowments
Fiscal sustainability exists where total public spending equals non-oil revenues plus the return on the net present value of future oil revenues. Fiscal policy is sustainable if the present value of future primary surpluses equals the current level of debt. This means primary surplus targets should be consistent with primary balance. Sustainable policy can usually be pursued indefinitely without major government intervention. Balassone and Franco (2000) use Domar’s model to argue that a non-ever-rising tax ratio and intertemporal discounted budget constraint are essential for fiscal sustainability. Blanchard (1990) states that fiscal sustainability is about whether or not a government is heading towards excessive debt accumulation. Sustainable policy maintains the ratio of government net worth to GDP at the present level. Constant gross debt does not imply sustainability because any depletion of public assets can trigger new debt build-up. Blanchard (1990) adds that ascertaining the asset and liability positions of government is a determinant of sustainability. Artis and Marcellino (2000) differentiate solvency from sustainability and argue that a solvent government is one with the ability to defray its debt using future primary surpluses. A solvent government must fulfil the intertemporal budget constraint. However, stable tax and spending ratios should not lead a country to incur unsustainable debts. Oil revenue is a reasonable indicator of fiscal sustainability since it is deemed public wealth (Ahmed, 2005). Ahmed (2005) adds that new oil producing economies can achieve fiscal sustainability if they design fiscal regimes that generate oil revenues to fund non-oil primary deficit. Stevens (2003) argues that oil revenue stream is highly volatile and exhaustible, which poses the challenge of intergenerational equity. Fiscal sustainability enables government to achieve intergenerational equity. Governments must save during periods of oil revenue surpluses, which savings it must then use to defray deficits posted during periods of price slumps. If fiscal sustainability, inter-generational equity and consistency with an economy’s absorptive capacity can be achieved through fiscal policy, what is the hallmark of formulating an oil sector fiscal strategy that forges a macro balance between growth and equity? The authors answer this question by stating that an effective strategy should ensure that there is a balance between the oil sector and the tradable goods sectors. Uganda should, therefore, avoid oil sector overreliance and should not neglect the tradables sector to achieve this balance.

4. Uganda: A Case Study

4.1 Background

The search for Uganda’s oil wealth predates the National Resistance Movement (NRM) government, going back 70 years. Previous governments could not successfully explore oil due to wars, inadequate expertise and funds. The NRM commenced oil exploration in 1986 and 25 years later established the existence of commercial oil reserves, but oil production and exportation has not yet commenced. Consequently, the current deliberations regarding oil are not based on the actual flow of oil, but, rather, on public expectations.

President Museveni has continually dismissed the assertion that oil wealth may “curse” Uganda and argues that it will, instead, be a “blessing” for Uganda. Talk of an “oil curse” in Uganda is informed by the country’s past political turmoil, the “easy” rents that can be expected from oil, the government’s current wish to expand the number of districts and/or administrative units, and increasing corruption. These factors pose a real threat of an “oil curse” in Uganda. Uganda’s oil sector is regulated by the National Oil Policy of 2008 and the Petroleum (Exploration and Production) Act of 1985 Cap 150 and the Petroleum Exploration and Production (Conduct of Exploration Operations Regulations of 1993). The government plans to establish a local refinery to process Uganda’s crude oil into liquefied petroleum gas, gasoline, kerosene and lubricants for use in Uganda and within the East African Community. The refinery is expected to employ local people and provide a market for local supplies. However, the success of the oil refining business is highly dependent on access to international markets.

Oil export receipts will displace foreign loans and grants as principal sources of financing Uganda’s primary deficit, which has averaged 8% since the fiscal year 1996/97, and free Uganda from aid dependency. The Petroleum Fund will be established for proper oil revenue management and macroeconomic stability. A study by Kathman and Shannon (2011) on Uganda’s oil development indicates that domestic volatility may arise from a decline in the competitiveness of the tradable export goods sector, increased urbanization and presidential powers, reduced ability to collect non-oil tax revenues, and susceptibility to political instability.

4.2. Uganda’s soil curse indicators
Resource extraction is associated with contraction of the tradables sector, corruption, social unrest, armed rebellion and lower economic growth. These regrettable outcomes are attributed to poor human capital, inadequate capital equipment and technological capability, and are currently present in Uganda. Uganda’s oil resources are also in an ecologically and politically sensitive area bordering the Democratic Republic of Congo.

President Museveni claims to recognize the dangers inherent in the resource extraction process. Museveni’s signing of new agreements with Tullow Oil plc, however, reveals a total disregard of the parliamentary resolution to suspend new oil agreements pending enactment of the necessary laws. This action has raised concerns as to what oil will mean for Uganda’s future political economy, with some concluding that Uganda is headed for a genuine “resource curse”. The success of Norway in using oil for its social development is attributed to transparency and depoliticized processes. Uganda’s plan to adopt the Norwegian approach will, however, be hampered by the country’s geopolitics and institutional setting.

Uganda’s narrow economic base cannot absorb the inflationary and real exchange rate appreciation pressures caused by oil windfalls. President Museveni has publicly acknowledged these macroeconomic dangers, but has not provided a plan detailing how these will be managed. [52] The principal-agent relationship created in Uganda in regard to taxation requires the government to offer public services in return for tax paid. The 2005 constitutional amendments place resource ownership rights and control in the hands of the government, rather than the state. The timing of these amendments is suspect, as they came after confirmation of commercial oil deposits in 2004 and there are fears the amendments were intended to ensure that President Museveni would be able to remain in power in Uganda indefinitely, based on the assurance of massive and regular oil rents. These fears have been fuelled by Museveni’s statement that “I discovered the oil and must ensure that it benefits all before I leave power”. [55] Museveni’s government is moderately corrupt with an 8.41% rating and displays a pattern consistent with resource cursed nations, consisting of a lack of transparency, authoritarianism and corruption. [56]

4.3. Uganda’s petroleum fiscal regime

Uganda’s petroleum fiscal regime is based on production sharing agreements (PSAs) with state participation and emphasizes fiscal responsibility. Further, it is responsive to changes in “profit oil”. The regime is intended to deliver 65% and 35% of “profit oil” to government and companies, respectively. Sound fiscal policy can turn non-renewable oil into durable capacity. The African Development Bank (AfDB) (2009) notes that the choice of fiscal regime depends on proxies for profit, the rate of return and government take. [59] Uganda’s PSAs include ring fencing, which ensures companies cannot use one oil field’s profits to offset the costs of other oil fields. Uganda’s fiscal regime (see Table) is typical for oil producing and exporting developing economies, comprising, inter alia, signature bonuses, surface rentals, royalties and ring fencing.

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Fiscal instrument</th>
<th>Rate</th>
<th>Base</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Signature bonuses</td>
<td>USD 0.5 million</td>
<td>On contract signing</td>
<td>Meets administrative costs; amount based on costs incurred</td>
</tr>
<tr>
<td>2.1</td>
<td>Surface rentals</td>
<td>Specific per sq. km</td>
<td>First exploration period USD 2.50 per square km and/or year</td>
<td>Development area subject to a production licence of USD 500 per sq km</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Second exploration period USD 5 per square km</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Third exploration period USD 7.50 per square km</td>
<td></td>
</tr>
<tr>
<td>2.2</td>
<td>Royalty incremental</td>
<td>5%</td>
<td>P less than 2,500 barrels</td>
<td>Royalty paid monthly</td>
</tr>
<tr>
<td></td>
<td></td>
<td>7.5%</td>
<td>P between 2,500</td>
<td></td>
</tr>
</tbody>
</table>

4.3.1. Uganda’s petroleum fiscal regime

The table above shows Uganda’s petroleum fiscal regime, which includes signature bonuses, surface rentals, royalties, and ring fencing.
This fiscal regime is intended to promote macroeconomic stability and fiscal sustainability. For instance, advances paid in the form of signature bonuses will be reimbursed to companies by allowing future cash flows to be discounted at higher rates, which is an incentive for oil companies to invest more. Royalties will generate government revenue as soon as production commences and will enable oil companies to make minimal payments for oil extracted. A politically responsible oil fiscal regime must capture true benefits and costs by reflecting economic benefits and costs plus social benefits and costs.

### 4.4. Public expenditure

The absorption capacity of the domestic economy determines whether or not locally spent oil receipts will give rise to distortions and compromise fiscal sustainability. In Uganda’s case, the absorptive capacity is

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Rate</th>
<th>Description</th>
<th>Notes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income tax</td>
<td>30%</td>
<td>Oil profit earned</td>
<td>All companies in Uganda</td>
</tr>
<tr>
<td>Withholding taxes</td>
<td>15%</td>
<td>Dividends, management fees and interest paid</td>
<td>Rate depends on applicable tax treaty, if any</td>
</tr>
<tr>
<td>State participation</td>
<td>15%</td>
<td>Carry forward basis</td>
<td>Costs recoverable include interest rate at LIBOR from production</td>
</tr>
<tr>
<td>Decommissioning costs allowance</td>
<td>100%</td>
<td>All costs incurred deductible from income</td>
<td></td>
</tr>
<tr>
<td>Cost recovery</td>
<td>60%</td>
<td>After royalty deduction</td>
<td>60% of capital and operating costs</td>
</tr>
<tr>
<td>Ring fencing</td>
<td></td>
<td>Applicable to each contract area</td>
<td>Calculations done on contract-by-contract basis where a licensee has more than one contract area</td>
</tr>
<tr>
<td>Production sharing</td>
<td></td>
<td>G (43.5%), Co. (56.5%)</td>
<td>P less than 5,000 barrels</td>
</tr>
<tr>
<td></td>
<td></td>
<td>G (46%), Co. (54%)</td>
<td>5,000&lt;P&lt;10,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>G (51%), Co. (49%)</td>
<td>10,000&lt;P&lt;20,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>G (56%), Co. (44%)</td>
<td>20,000&lt;P&lt;30,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>G (61%), Co. (39%)</td>
<td>30,000&lt;P&lt;40,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>G (66%), Co. (34%)</td>
<td>P&gt;40,000</td>
</tr>
<tr>
<td>Initial allowance</td>
<td>75%</td>
<td>Total cost incurred</td>
<td>Oil companies are rural-based</td>
</tr>
</tbody>
</table>

Source: The PSAs of Uganda and Income Tax (1997) Act

P = Daily gross production

G = Government take

Co. = Company Take (taxed at 30%)

All other tax deductions as permitted by the Income Tax (1997) Act. [60]
limited by underdeveloped stock, commodity and capital markets. Oil money retained in a Petroleum Fund will be invested abroad. As Lawrence Kiiza, the Director of Economic Affairs, Finance Ministry states "we must draw a plan and save part of the oil money, and invest the other to be able to sail through difficult times like when oil prices and volumes reduce". [61] Uganda will use oil revenue for priority expenditures on electricity from hydro sources, solar energy, biomass and nuclear energy as envisioned in the National Development Plan. Bevan, Collier and Gunning (1998) [62] note that oil windfalls often tempt government to increase public expenditure, which creates increased opportunities for bribery and unproductive spending. [63]

4.5. Transparency and accountability

Transparency [64] and accountability [65] can be effective in reducing political corruption and rent-seeking behaviour and help manage stakeholder [66] expectations. The signing by the government of secret PSAs with oil companies is justified by confidentiality clauses and the need to ensure national security. Data on the economic profile, the latest technical and scientific capabilities and shareholder details must be published to avoid suspicion and mistrust. Experience reveals that the transparent management of resource revenues ensures credibility whereas secrecy breeds suspicion and conflict. [67] The government has acknowledged the lack of effective communication with the Parliament and the general public on oil matters. [68] Secrecy may give rise to resource waste, as it could tempt the government to divert some oil receipts from critical social needs.

4.6. Oil governance structures

Uganda is currently reviewing its old legislative framework to provide for the creation of a National Oil Company and Petroleum Authority as vehicles for oil resource management. The concern is whether or not the proposed legal regime [69] will help to prevent potential abuse of Uganda's oil sector and avert the "oil curse". Oil sector success depends on a strong political will and safeguards against the profusion of state organs and corruption. Policymakers must have good oil market intelligence systems to make sound policies. The creation of a National Oil Company implies the government will have direct involvement in oil business, which creates inefficiencies, and encourages corruption and rent seeking, due to bureaucracy. The overlapping duties of the Petroleum Authority and other public agencies are a clear way for MNCs to exploit matters by playing one government agency against another.

5. Comment

5.1. Uganda's petroleum fiscal regime

Uganda's fiscal regime is based on production sharing, with an oil company committing resources to oil exploration that entitles it to share in the oil discovered until its investment is recovered. Thereafter the oil company continues to get a smaller return on the initial capital invested. Uganda's PSAs enable the government to monitor exploration work and the expenditure of oil companies. They entitle the government to royalties on gross production and a 15% participating interest in the National Oil Company initially paid for by licensed oil companies. PSAs allow oil companies to recover up to 60% of gross production after the deduction of royalties. The oil profit after cost recovery, is shared between the government and the oil company. The oil companies' take is 74% and 42% of barrels produced before and after cost recovery, respectively, thereby implying that the government take is 26% and 58%, respectively. The government's take depends on oil quantities extracted, the costs incurred, discount rates and oil prices, which should be monitored to deter oil companies from understating output and/or overstating costs. This excludes corporate tax at 30% of the company take in respect of barrels of oil, royalties of between 5% and 12.5% of gross production before cost recovery and dividends of 15% on government equity in the National Oil Company. Accordingly, including corporate tax, royalties and dividends and assuming a daily production of 200,000 barrels per day, the government's take is 76.2% of daily oil production. The agreements made in 2001 were intended to attract oil companies and new PSAs should yield a higher government take.

Capital gains tax at 30% is imposed whenever an oil company sells its shareholding interest. The Bank of Uganda (2011) [70] report indicates that the Ugandan government has collected a total of USD 449.4 million from oil companies in capital gains taxes and USD 4.23 million in non-tax revenues. [71] Uganda's fiscal regime recognizes that the oil sector will impose new costs and burdens on Ugandans and allocates 15% of gross oil receipts to local governments. The PSAs require local content [72] development so as to ensure that extra benefits, beyond oil value chain, [73] accrue to Uganda. For instance, joint ventures between local firms and MNCs should enhance local capacity. In addition to resource value chain needs,
local content must consider a country’s comparative advantage.

5.2. Petroleum revenue governance

A large portion of the oil companies’ take will be repatriated and only the government’s take will significantly affect Uganda’s macroeconomic variables. Uganda’s draft oil revenue management law provides for the creation of a Petroleum Fund for optimal resource utilization, fiscal sustainability and intergenerational equity. After studying petroleum funds in a number of countries, Davis et al. (2001) conclude that, funds “are, however, not an easy -nor necessarily an appropriate- solution to fiscal policy problems faced by these countries”. [74] These authors reasoned that circumstances that frustrate sound fiscal policy would also undermine the effectiveness of funds.

Like the Norwegian Fund, [75] Uganda’s fund should be linked to the national budget and oil funds appropriated according to budgetary guidelines. [76] However, Uganda’s weak laws and institutions imply that a petroleum fund is not a panacea for bad governance. Uganda’s adoption of the Norwegian fund model could be unsuccessful, as Norway had functional institutions prior to oil discoveries. This is true despite the fact that Uganda’s oil revenue account is ring fenced to ensure fiscal discipline. [77]

Theoretically, petroleum funds act as stabilization and savings funds for fiscal sustainability and intergenerational equity, respectively. Uganda should also create a women empowerment fund using part of its oil receipts, as studies show a strong correlation between development outcomes and the degree of female empowerment in a household. [78] The share of oil receipts to oil-hosting local governments should match the costs of restoring local infrastructure and community livelihoods. Ahmed and Singh (2003) [79] argue for oil production excises to address externalities. Uganda could opt for “in-kind savings”, [80] in lieu of saving in a Petroleum Fund to eliminate corruption and rent-seeking, and also adopt a non-oil fiscal deficit rule [81] to achieve public finance sustainability.

5.3. Political, economic and ecological issues

Uganda lacks capital equipment, the technical and human capacity to exploit oil and will rely on MNCs, which will cause capital flight, neo-colonialism and undermine Uganda’s sovereignty. Oil resources are economic assets, and political and military weapons. [82] The competing claims for title ownership in regard to hydrocarbons between government, landowners and MNCs may give rise to conflict and political instability in Uganda. Uganda can set limits on exploitation, as it is not suspended in a state of inactivity and by learning it can embark on a purposeful course to reduce oil surplus outflow and redirect it for social needs. On the ecological front, oil exploration involves significant oil flaring and gas venting that is not outlawed by the legal regime. Instead, oil flaring and gas venting in excess of what is permitted for normal operational safety will be allowed at the discretion of the executive of the Ugandan government. The authors note that fiscal sustainability and intergenerational equity demands that oil sector shocks, including its negative effects on ecology, are managed effectively and efficiently.

5.4. Opportunities

The oil sector represents an opportunity for Uganda to pay off its public debts, accumulate social and physical capital, and exploit local ingenuity through equity participation. The “oil revolution” may help Uganda minimize its perennial “brain drain” through investments in tradable sectors with strong forward and backward linkages.

5.5. Obstacles

The oil sector faces obstacles, such as limited local participation, capital flight caused by a lack of local capital and technical capacity, higher public administration costs due to an expanding government, limited local absorptive capacity as a result of the limited size of the local financial and capital markets, and political corruption due to a lack of political will to build strong institutions and laws. Nigeria’s poor institutional quality has resulted in low long-term annual growth of 0.5%. [83] The host communities’ fear of a loss of livelihood due to water pollution and a loss of land to investors may result in social tensions, which could disrupt oil activities.

5.6. Overcoming obstacles

Uganda should refrain from incurring debts using future oil revenue, but should, rather, use oil revenue to expand the tradables sector. It should enact predictable oil revenue management regulations and laws, [85] seek financial and technical assistance to enhance local skills and capabilities, encourage local
firms to enter into partnerships with foreign oil firms, base oil revenue spending decisions on absorptive capacity, integrate the oil sector into the national economy, and limit growth in public administration costs.

6. Conclusions

Oil is an opportunity for Uganda to generate funds to finance fiscal deficit, and to develop technical skills and infrastructure. The challenges include ensuring fiscal sustainability and intergenerational equity, institutional quality, positive growth and ecological balance. The policy implications for similar resource-rich developing economies in Africa and elsewhere include ensuring prudent resource revenue use to meet fiscal sustainability and intergenerational equity goals, developing local capabilities, enacting appropriate and flexible resource management laws, compensating and resettling communities displaced by resource discovery, and reviewing national curricula to include resource management training.

1. The macro-economic and structural reforms of the past decade saw Uganda post impressive economic growth rates from increased exports of agricultural commodities.


4. Kasande is the Refinery Project Manager of the Ministry of Energy and Mineral Development. He disclosed this while speaking at the Open Minds forum organized by the Uganda Revenue Authority in partnership with the Institute for National Transformation on the topic, Black Gold in Uganda: Matching Expectations with Opportunities, Kampala Serena Hotel (15 Feb. 2012).


6. This phenomenon occurred in the Netherlands in 1959, when the discovery of large natural gas reserves led to a shift in focus to exploiting gas for export, which undermined the ability to export non-gas products due to an appreciated Netherlands currency, thereby resulting in the contraction of the non-gas export sector and a recession. Accordingly, this means that non-extractive sectors of resource-rich countries are "crowded out" by the extractive sectors.

7. This means that the information regarding oil and gas transactions is available to key stakeholders, including the general public. Transparency and accountability are usually achieved...
through stakeholder involvement.

8. See the peer-reviewed and scholarly literature on Uganda’s oil and gas sector and reports of the following institutions: the International Monetary Fund (IMF), Development Finance International, the Commonwealth Secretariat, civil society organizations, such as the Advocates Coalition for Development and Environment (ACODE), the African Development Bank (AfDB), the Bank of Uganda, the Finance Ministry, the Mineral Development Ministry, the Reports of the Parliamentary Committee on Natural Resources, as well as the Center for Africa studies peer-reviewed and scholarly literature on Uganda’s oil and gas sector.

9. Primary deficit is fiscal deficit less interest payments made by government to creditors on its borrowings.


12. The economic theory of “comparative advantage” means that if a country finds it cheaper to extract its natural resources, relative to other commodities, it should concentrate on producing and exporting natural resources and importing other products. National oil companies, often criticized as inefficient and backward, were established based on this line of thinking.

13. Rent-seeking is a phenomenon whereby public resources are spent by the government in such a way that confers special financial benefits or other advantages on powerful individuals or groups of individuals in society at the expense of the general public. It is common for developing country governments to give cash hand outs to “favoured” individuals or “special interest” groups or lobby groups in addition to making “favourable” public policy decisions, for example, in relation to taxation, expenditure and regulatory policies, to the same groups at the cost of the taxpayer.


15. Institutional quality is reflected in the degree of protection of property rights and the strength of the rule of law.

16. Ayres, who worked with the World Watch Institute, has reported widely on these collusive operations in many parts of the world (see E. Ayres, *The Hidden Shame in the Global Industrial Economy*, 17 World Watch Mag. 1 (2004), available at www.worldwatch.org/node/543).


19. Stevens, *supra n. 3*.

20. The resource curse effects often undermine the quality of governance and economic performance, thereby increasing the exposure of countries to conflict.

21. This is where conflicts arise over the control and exploitation of natural resources, as well as the allocation of their revenues.

22. Conflicts may be prolonged as a result of access to natural resource revenues by the opposing parties.


25. Examples include the conflict in oil-rich Cabinda province in Angola and the 1960s Biafran war in Nigeria waged to control oil.

26. An example is the clashes between different public agencies over budgetary allocations.

The results of Uganda’s oil exploration activity, which was started in the early 1920s by the then government geologist E.J. Wayland, indicated there were considerable quantities of hydrocarbons in the Albertine Graben. Although some hydrocarbons were found during the first drilling of wells in 1938, no additional tests were carried out. Further oil exploration was carried out in the 1940s and 1950s and several shallow wells were drilled principally for stratigraphic purposes. The oil exploration activity in Uganda was interrupted by World War II, but the resumption of the activity in the early 1980s led to the acquisition of aeromagnetic data across the entire Albertine Graben region (The Daily Monitor (Mar. 2012)).

President Museveni had argued more broadly that “[t]here is a lot of nonsense that the oil will be a curse. No way. The oil of Uganda cannot be a curse. Oil becomes a curse when you have got useless leaders and I can say that we don’t approach that description even by a thousandth of a mile.”

Political corruption in Uganda has been attributed to weak institutions due to a strong presidency and a lack of political will to deal with this, as well as the NRM’s long period in power.

UG: Petroleum (Exploration and Production) Act of 1985 Cap 150, Chapter 150 of the Laws of Uganda 2000. This law is soon to be repealed by UG: Petroleum (Exploration, Development, and Production) Bill 2012, which would provide for the creation of a Petroleum Authority and the National Oil Company, when passed into law; UG: Petroleum (refining, gas processing and conversion, transportation and storage) Bill 2012, once enacted into law; UG: Petroleum Resources Bill 2010; UG: Financial Resources and Benefit Sharing Bill 2010; and UG: Petroleum
(Exploration, Development, Production and Value Addition) Bill 2010, as well as The National Oil and Gas Policy of 2008.


49. The East African Community consists of Burundi, Kenya, Rwanda, Tanzania and Uganda. South Sudan has applied to join the Community.


52. Id.

53. Id.

54. Since the government collects taxes from the public/taxpayer to provide public services, it is regarded as an agent (or manager) and the taxpayers/public are the principals (or owners). As such, the government is accountable to taxpayers in regard to the use of tax revenues collected.

55. Kathman & Shannon, supra n. 51.

56. Id.

57. The amount of production, after deducting 'cost oil' (a portion of oil produced that the operator applies on an annual basis to recover defined costs specified by the PSA (an agreement between the parties to a well and a host country regarding the percentage of production each party will receive after the participating parties have recovered a specified amount of costs and expenses)), which is to be divided between the participating parties and the host government under the PSA (see Schlumberger Oilfield Glossary available at www.glossary.oilfield.slb.com).

58. The government's take in other countries, such as Ireland and Venezuela, usually ranges from 25% to 90%, and is often responsive to movements in oil prices, costs, output and discount rates.

59. AfDB, supra n. 45.


62. Bevan, Collier & Gunning, supra n. 17.

63. Nigeria built the Ajakouta steel complex in the 1970s using oil money and the complex has, to date, never produced a single commercial ton of steel (Sala-i-Martin & Subramanian, supra n. 14).

64. Transparency implies that decisions are taken and enforced in accordance with the rules and regulations. It also means that reliable and timely information is freely available and accessed directly by key stakeholders in an adequate and understandable form. The term has taken on a particular meaning in recent times. Internationally, transparency focuses on identifying corrupt practices and governments. The implication is that a lack of transparency gives rise to political corruption.

65. Accountability means institutions are responsible for their actions and involves identifying with, and being responsive to, the citizens' aspirations; it cannot be enforced without transparency and the rule of law.

66. Oil sector stakeholders include local communities, civil society organizations, the broader Ugandan public, national and local government, the Parliament, oil companies, and the local private sector and business community.

67. AfDB, supra n. 45.

69. The Petroleum (Exploration and Production) Act of 1985 CAP 150, which is to be repealed by the Petroleum (Exploration, Development, and Production) Bill 2012; the Petroleum (refining, gas processing and conversion, transportation and storage) Bill 2012, once enacted into law; the Petroleum Resources Bill, 2010; the Financial Resources and Benefit Sharing Bill 2010 and Petroleum (Exploration, Development, Production and Value Addition) Bill 2010; as well as the National Oil and Gas Policy of 2008.


71. Non-tax revenues include annual surface rentals, training fees, signature bonuses, permit fees and well data.

72. The tools used to build local content include creating local jobs; using local suppliers; supporting training and local skills development; creating enterprise centres; establishing supplier forums; entering into mentoring programmes for local entrepreneurs; providing seed capital, tax incentives and concessions; production sharing requirements; technology transfer requirements; procurement and contract strategies and the creation of enterprise centres and free trade zones (*see* AfDB, *supra* n. 45).

73. Oil and gas value chain includes (1) upstream activities of licensing, oil exploration and oil development; (2) midstream activities of oil refining, gas processing and transportation; and (3) downstream activities of oil distribution, sales and marketing.


75. AfDB, *supra* n. 45.

76. Bank of Uganda, *supra* n. 70.

77. Id.


80. This would mean “leaving the oil in the ground unextracted” as a form of saving. This would involve imposing oil exploitation caps and limiting the exploration areas at any given point in time.

81. The non-oil fiscal rule involves the accrual of budget surpluses during oil windfalls and deficits in oil revenue slumps.


84. Indonesia harnessed its oil revenue windfall by keeping the exchange rate competitive and ensuring the health of the agricultural sector by investing in technology, ensuring access to inputs and the provision of extension services (*see* A. Gelb, *Oil windfalls: Blessing or Curse* (Oxford U. Press for World Bank 1988).

85. *See* draft amendments to incorporate oil revenue management issues into the Public Finance and Accountability Act (the Bank of Uganda, *supra* n. 70).