Makerere University Convocation is indebted to the Democratic Governance Facility, the Konrad Adenauer Stiftung and the Uganda Youth Network for technically and financially supporting the events that led to the production of this policy paper. The Convocation also acknowledges the efforts of Dr. Ezra Suruma who drafted this policy note and Professor Julius Kiiza who conducted quality improvements upon the original draft.

Makerere University Convocation © 2013

All rights reserved. Reproduction of all or parts of this publication for education or other non-commercial purposes is allowed without prior written permission from the copyright holder provided the source is fully acknowledged and any alterations to its integrity indicated. Reproduction of this publication for sale and other commercial purposes is prohibited without written consent of the copyright holder.

Makerere University Convocation
Plot 52, Edge Road
P.O. Box 7062 Kampala, Uganda
Tel: +256 312 273113
Email: convocation@acadreg.mak.ac.ug
Website: www.muconvocation.org
Executive Summary

This policy paper summarizes the high-level Conference and Roundtable discussions that were organized by the Makerere University Convocation in August 2013, designed to celebrate Makerere University’s 90 years of existence. The public lecture and round-table discussions revolved around the theme ‘Oil Management and its Utilization for Economic Transformation: Lessons from Ghana’ and were graced with speeches of former Heads of State John Kufuor of Ghana and Mwai Kibaki of Kenya. The presentations and discussions have been critically analyzed to generate this policy paper. The aim is to shed some light on Ghana’s approach to oil management, document the challenges faced by Uganda; and outline lessons of good practice for oil management and its use to deliver economic transformation in Uganda.

We find that Ghana has done several things right. Following the confirmation of commercializable oil in 2007, Ghana quickly sprang into action and embarked on oil development with boldness, rapidity and a sense of determination. By December 2010, oil was already flowing. One of Ghana’s crucial oil laws – the Petroleum Revenue Management Act was late (2011) but innovative. It establishes key institutions such as the Petroleum Holding Fund (located in the central Bank of Ghana). The law provides for an Annual Budget Support (up to 70% of budget shortfall). A minimum of 70% of the fund is ring-fenced for public capital investments (such as roads), thereby liberating non-oil tax revenue to fund other key aspects of the budget.

But this is mere tip of the iceberg. Ghana’s law provides for substantial savings. At least 30% of oil revenue will be kept in a Heritage Fund. The object of this Fund is to promote inter-generational equity. Up to 70% of the savings are to be kept in a Stabilization Fund.

Additionally, Ghana has embarked on putting its governance credentials right. Oil laws and policies are arrived at via wide consultations with key national actors (such as the Council of State) donor agencies (such as NORAD and DFID) and civil society organizations (eg Revenue Watch). Nationwide Town-Hall-Style consultations were carried out.

Ghana has also established a 13-member Public Interest and Accountability Committee whose goal is to promote strong independent oversight. To crown it all, Ghana is building credible governance institutions (such as the independent Electoral Commission) and a culture of patriotic political practice. For example, political leaders have, since 1992, developed a culture of peacefully and willingly handing over power, without clinging to office ostensibly to “protect” the national oil resources from rival claimants to State House. Uganda needs to learn these lessons of good practice.

However, Ghana has its own shortfalls, which Uganda should seek to avoid. For example the practice of flaring gas is wasteful economically and environmentally, and should be avoided by Uganda. Second, Ghana is exporting crude oil, not value-added petroleum products. Uganda needs to avoid this, and emphasize refinery capability building with a view to producing and exporting value-added products that maximize job creation (along the value chain), revenues, and multiplier effects (such as using petroleum byproducts to support a national petrochemical industry).
In his remarks at Makerere University on 2 August 2013, President Kufuor observed that both Ghana and Uganda are ranked among the worst performers in the United Nations Human Development Index. In the 2012 ranking of 187 countries, Ghana ranked 135 while Uganda was worse at 161. This suggests that both Ghana and Uganda have a long way to go to catch up with the other developed countries of the world.

Uganda’s position of 161/187 is really important. It suggests that the fundamental economic problem of Uganda today is that millions of Ugandans need a lifeline right now to rescue themselves from grinding poverty. This is true not only for the 22 percent (7.5 million persons) who are below the 1 dollar per day poverty line in 2012, but also for the millions of others who do not have access to proper medical care, accessible clean water, decent housing, and the millions of children who go hungry at home and/or in school.

In February 2013, the New Vision reported a study that showed that 62 percent of the youths were unemployed, far above the officially reported unemployment rate of 4.2 percent in 2012. An additional 400,000 youths were being added to the labor force annually. The unemployed, the underemployed and the low productivity workers require urgent attention since the most important purpose of the economy is to meet the needs of its nationals. The country’s fundamental objective should be to transform this economy from one that is currently unable to meet the basic needs of its people to one that can.

Using Oil Revenue to Expand Capital and Deliver Economic Transformation

Using oil revenue to deliver durable socio-economic transformation is a difficult but not impossible task. The discovery of oil makes it possible to achieve economic transformation much faster and more decisively than ever before. Oil exports and savings from oil imports provide additional revenues to Uganda which the country can use to import modern technologies, embark on domestic innovations, promote knowledge creation, and build more factories, railways, roads, hospitals, schools and improved housing infrastructure. Investments in all these will generate massive employment and, at the same time, produce more goods and services for Ugandans.

The Gross Domestic Product (GDP) of Uganda (estimated at $19.8 billion in 2012) is an estimate of the magnitude of the country’s current economic production and a basis for measuring its annual expansion or growth. It is an estimate of the value of all goods and services produced in Uganda in a given year, and also a measure of the incomes that Ugandans receive each year. The production possibilities frontier of Uganda, that is, its maximum output or full employment GDP, can expand significantly if the oil money is used for capital investments, infrastructure development, importation and upgrading of machinery, and expansion of quality education, healthcare and other social services.
H.E. John Kufuor delivers his lecture on oil resource management and its utilisation for economic development in main hall, Makerere university
Among the vital resources Uganda is endowed with are, fertile arable land (for growing food and cash crops); water bodies (lakes, rivers, and swamps); mineral resources (iron ore, oil and gas, phosphates, copper, etc); abundant fauna and flora, sunshine, etc. With a population estimated at 35 million people mostly under the age of 30 in 2013, Uganda has a potentially resourceful population that could simultaneously serve as the means and object of national socio-economic transformation. A critical factor that needs to be imported and upgraded to fuel national transformation is capital.

Over the last few decades, Government of Uganda has depended on concessional loans from international financial institutions and grants from the donor community to fund major infrastructure projects such as road construction, electricity generation and schools. The private sector, on the other hand, has endured dependency on a shallow financial sector that ekes out short term credit at exorbitant interest rates. This means that long term investments in critical industries such as iron and steel production and fertilizer manufacturing cannot be financed because the domestic financial sector does not have the necessary funds. Even if those funds were available they would probably be too expensive judging by the historical interest rate structures in Uganda. The nation has had to depend mainly on uncertain and unpredictable foreign direct investment (that is, foreign capital) as a critical driver of growth. The inflow of oil revenue is now an opportunity to improve upon this state of affairs.

Oil Revenue Estimates

Following the discovery of oil in Uganda in 2006, estimates of oil reserves have risen from 300 million barrels (in 2006) to 3.5 billion in 2013. Government officials report that only 40 percent of the oil bearing area has been explored so far, and that the reserves could rise to 6 or even 10 billion barrels. What appears certain now is that the amount of oil reserves in Uganda is almost certain to rise. For the purpose of this
note, we shall work with the 2013 estimates of 3.5 billion barrels and a daily production estimate of 250,000 barrels a day.

The people of Uganda will wake up to the unprecedented size of money that will be coming into the country from the sale of oil. Oil will yield more money than the country has ever known. For example, if the oil companies pump and sell 250,000 barrels per day and receive about U.S. $80 per barrel, the value of this oil is $20,000,000 per day. If the Government takes 65% of this, it will take $13,000,000 per day. In a month, this will amount to $390 million and in 12 months this will amount to $4.68 billion.

It is instructive to compare this money with the Government's revenues today. In 2012/13 fiscal year, the Uganda Revenue Authority is expected to collect about Shillings 7.3 trillion. In U.S. dollars, this is about $2.8 billion dollars. The total amount of money which the Government spends every year, inclusive of what it borrows from foreign sources such as the World Bank, the African Development Bank and grants from other countries, all total to about $4 billion dollars. Thus, the claim that oil revenues will cause over-heating in the economy is misleading. It appears to be premised on shaky empirical grounds. If government shifts from foreign aid to petroleum dollars, the net increase in the economy will be $4.68 billion less $4 billion, which is $0.68 billion.

In another scenario, if the Government could get 80% of the oil revenues its daily revenues would be $16 million, the monthly revenues from oil would be $480 million and the annual revenues would be $5.8 billion.

Considering yet another relatively optimistic income scenario whereby production rises to perhaps 500,000 barrels per day and the price of oil rises to perhaps $100 per barrel as indeed it did in 2013; this would now lift daily revenue values to $50 million per day. At the 80% government oil revenue rate, the government could conceivably take in $40 million daily. This translates to $1.2 billion monthly and to $14.4 billion annually.

Of course the oil exploration companies will, under the provisions of the Production
Oil Management and Its Utilization for Economic Development

Sharing Agreements, recover their costs of oil exploration. Current estimates have been put at $1.5 billion so far (2013). This money is referred to as “cost oil”. The balance from oil sales, after subtracting cost oil, is “the profit oil” that is shared between the oil companies and the government. The ratio of sharing is specified in the Petroleum Sharing Agreements (PSAs). Usually government takes 80 percent of the profit oil.

An important matter that has to be clarified by government is the period over which the companies will be allowed to recover their costs. In other industries, the costs of oil exploration and production would be spread over some agreed period and would not be deducted in a very short time. If they were this would significantly reduce the funds available to the government in the early years. It will be helpful for the public to know the agreed methods of cost oil recovery and the capacity of government to audit the oil companies to ascertain that the costs are correct and not overstated.

However, the government will still have substantial revenue balances even if the entire cost oil of $1.5 billion is taken in one year. As we have hinted already, the production of 250,000 barrels a day at the current prices of about $100 per barrel fetches a gross value of $9 billion per annum, assuming 360 days of production per annum. The deduction of $1.5 billion in cost oil would still leave a gross amount of $7.5 billion.

From Oil Money to Domestic Capital (for National Transformation)

Oil money must now be turned into domestic capital especially for key economic sectors namely agricultural mechanization and transformation, iron and steel, industrial manufacturing, energy generation, transport and communications infrastructure, financial deepening; education and health transformation, and housing improvements.

In pursuit of the aforementioned, institutions must be created through which capital will be channeled to the public and the private sectors. This means that there is an overwhelming case for taking a second look at the proposed Public Finance Bill that went before Parliament in 2012. The Bill proposes to establish a Petroleum Fund in the Bank of Uganda with two accounts – a Petroleum Revenue Holding Account and a Petroleum Investment Reserve Account.

There is need for specification in the Bill that the funds in the Petroleum Fund will be translated into domestic capital for national development. Although it is proposed that Parliament would have the power to appropriate funds from the Petroleum Fund into the Consolidated Account of Government, there is no stipulation that part of the money so appropriated will go into capital expenditure, public or private. In the light of the critical imperative to create capital for both the public and the private sectors, it may be a matter of great importance to specify the rate of capital formation that is expected from oil funds.

Parliament needs, as a matter of extreme importance, to devise a formula for capitalizing institutions that will channel capital to the private sector. The private sector in Uganda is still weak and needs to be assisted to access adequate, cost-effective capital. For example, a better capitalized Housing Finance Bank may be required for both construction funds and mortgage funds. Farmers will need an Agricultural Bank that is customized to suit the unique challenges (such as unpredictable weather) that confront the farming sector. In the same spirit, manufacturers will benefit from a specialized Industrial Development Bank.

The other institutions that would need to be recapitalized are the Uganda Development Bank and the East African Development Bank. These should be revitalized to finance the iron and steel industry, the fertilizer plants, the electricity generation stations and local road and building contractors throughout the country. This systemic
infusion of capital in both the public and private sectors should form the basis for more investment and more sustainable employment opportunities for millions of Ugandans.

In the Public Finance Bill, the proposed investment of the petroleum funds in the reserve account suggest that much of that money will be invested in securities abroad. These overseas investments are defended by the foreign intellectual orthodoxy backed by their local allies as a means of avoiding inflation, overheating or waste in the domestic economy. What is hardly emphasized is that money invested by Uganda and other poor countries in foreign securities is, in effect used to finance foreign investment as opposed to national development. This is the money poverty-stricken countries literally donate to the already rich countries (who invoke “global” “best-practices” economics wisdom as the guiding principle). This is wrong. What is a global best practice is not necessarily good enough for poor countries that still suffer huge capital, infrastructure, and human capital deficits/deficiencies, all of which require massive investments.

Thus, in the case of Uganda, it makes national developmental sense if Uganda disobeys the dominant economics wisdom (dominated by conservative Chicago-like economics, IMF/World Bank ideology, and local neoliberal economics). Priority in Uganda must shift to the use of our petroleum funds to deliver national socio-economic transformation, not the subsidization of foreign interests. This requires ensuring that the funds that will be appropriated by Parliament each year from the Petroleum Fund into the Budget is adequate to fund national developmental priorities – permanent roads and railways, energy, industrial capacity development, healthcare, and education at all levels (basic, post-primary, BT/TVET, and tertiary levels). In short, it does not make developmental sense for Uganda to send its hard-earned petroleum monies overseas at a time when substantial public and private investments are needed to increase the productive capacity of the national economy, create employment, and deliver structural socio-economic transformation. If petroleum revenues are used productively, Uganda will be able to transform itself from a backward poor country into “an independent, integrated and self-sustaining economy”. Thus, objective number 5 of the NRM 10-point program, which until now had appeared unattainable, will finally become a reality.
There are people who say that the oil revenues will be a curse that will cause a lot of social and economic dislocations instead of improving the quality of life for most Ugandans. However, there are others who believe that this windfall will provide the government with the resources it needs to significantly improve the lives of masses of Ugandans and set them on a path to sustainable development. Who is right?

First, oil can become a curse when a significant part of the society abandons what they have been doing in order to go after the oil money. In Nigeria, for example, shortly after the OPEC oil price increases of the mid-1970s, Nigeria, then a major oil producer, began to receive significant revenues from oil. As a consequence, many rural farmers began to abandon their farms and migrate to the urban areas and to the oil fields. The result was a near complete destruction of what had once been one of the most productive agricultural sectors in West Africa, as well as severe urban congestion. Today, Nigeria continues to suffer from some aspects of the "oil curse."

It is almost certain that people, who are living marginally on the land and just eking out a living from what is essentially subsistence farming, will see their children leave for the oil fields with no intention of ever returning to the farms. As the shift from agriculture to oil grows, Uganda will most likely become like Nigeria, where oil revenues make up about 97% of the country’s earnings from exports. That means that traditional exports, such as coffee, tea, maize, and bananas will become less and less important as Uganda shifts to an oil-based and oil-dominated economy.

Oil and Corruption

The oil curse may manifest itself by increasing the level of public corruption as state elites seek to illegally access oil taxes and royalties that accrue to the government. Basically, as
the oil money flows to the national treasury, corrupt state officials are likely to engage in various schemes and attempts to steal the money—that is, to illegally redistribute it in their own favor. Such corruption, of course, will not be limited to the central government, nor to any specific government ministry. Every governmental jurisdiction in Uganda is likely to be affected—from the central government in Kampala to local governments in the rural areas. And so will private entities that will be called upon to participate in the implementation of public projects financed by the oil money.

Uganda’s poor public bidding and procurement processes have already created many problems for the country. Examples include the mismanagement of the $200 million that had been allocated to the Commonwealth Heads of Government Meeting (CHOGM) of 2008; the $55 million allocated for the national ID project and more recently the theft of donor funds by officials in the Office of the Prime Minister. Yet, all these are relatively small amounts of money compared to what is to be expected from oil revenues. If the Uganda government could not allocate $200 million efficiently, it is unlikely that government will handle $2 billion, or $4 billion or even $10 billion without leakages.

Commentators who allege that the oil curse cannot occur in Uganda have not given convincing reasons for their optimism. Many of these optimists have been basing their statements on the presumption that the NRM is a peoples’ movement, which has the best intentions for the people. But, as the saying goes, “the road to hell is paved with good intentions.” Even a government of the people, by the people, for the people, carries within itself the seeds of turning oil into a curse. This is particularly true if effective accounting and accountability systems are not in place and/or are not observed. Matters become worse if the moral culture that is necessary to monitor and enforce the proper use of large government allocations to the ministries is still missing.
Accountability Platforms

It is rather perplexing that the government of Uganda is going to be receiving all the oil revenues at a time when there are outstanding cases of theft of public funds. On the basis of historical evidence, there is a clear basis for worry that this money could be stolen by government officials and politicians.

One of the ways to resolve the problem of accountability is to bring Ugandan citizens on board via revamped peoples’ institutions. If Ugandans become shareholders in the Uganda Development Bank, Housing Finance Bank, National Social Security Fund, the National Medical Insurance Fund, East African Development Bank, the National Pensions Fund, the Uganda Agricultural Bank, the Industrial Bank and other relevant institutions, they will gradually acquire power to demand for accountability from the managers of those companies and to sack them if they do not perform to expected standards. Not only will these institutions provide essential services to all Ugandans, they will also reduce the pressure on the mainstream government to bear the burden of accountability for all the oil revenues.

Another important weapon the people of Uganda can employ against corruption is to provide social security to all Ugandans.
That the government should provide a social safety net for its citizens is generally accepted in virtually all developed countries, including especially those in Europe (e.g., Germany, France, the Scandinavian countries and the United Kingdom). Even before the government devises stronger laws to deal with corruption, it should consider putting in place arrangements to provide pensions for the old, medical insurance for the sick, and above all, employment for the citizens. Without some minimum provisions for access to basic needs for all, corruption is unlikely to be eliminated or even reduced. The failure of society to provide a minimum income safety net encourages citizens to resort to any means to survive. Only when such a minimum access to income is provided can the war against corruption be effectively strengthened and unapologetically executed with broad public support. The ongoing experiment by government to pay a cash stipend to the elderly people who are poor is therefore a step in the right direction.

The Problem of Conflicts

There is ample evidence of oil-rich countries that have suffered from perennial political instability and persistent social conflict. Among the mineral rich and oil rich countries that have experienced substantial conflict in recent years are Libya, Iraq, Angola, Nigeria, Democratic Republic of Congo and Sudan. The association of oil with conflict and bloodshed cannot and should not be dismissed without serious examination. The sources of conflict tend to be a combination of domestic discontent and international interests that may exploit such discontent.

The prospect of enormous wealth from oil triggers excitement among the citizens who have lived in considerable poverty in past decades. There is now hope that poverty can be eliminated. If it is not, or if the distribution of wealth is perceived to be unfair, then a campaign for redistribution is almost certain to begin. Such campaigns may be abetted by foreign companies which may wish to support domestic organizations that promise to give them opportunities to access the oil wealth on more favourable terms.

Problem of Supervising Oil Companies

The governance of oil-rich countries may be further complicated by the lack of capacity in the host country to supervise the oil companies. In Uganda there have already been significant conflicts with the oil companies over their refusal to pay capital gains taxes arising from the sale of some of the recently discovered oilfields. Other areas of potential difficulty are the measurement and recording of the quantity of oil pumped out of each oil well, the true costs of exploration and the computations of royalties and taxes from oil.

The supervision of the oil companies and the avoidance of corruption among government officials who deal with them (to determine their production and export levels and the taxes due to the government) are fraught with dangers for Uganda. The failure to manage these issues could trigger domestic discontent and bloodshed with implications for the already fragile Great Lakes regional stability.

Lessons of Good Practice from Ghana

The story of oil discovery and development in Ghana shows that the country has done several things right. Following the confirmation of commercial quantities of oil in 2007, Ghana quickly sprang into action and embarked on oil development with boldness, rapidity and a sense of determination. By December 2010, oil was already flowing. One of Ghana's crucial oil laws – the Petroleum Revenue Management Act was late (2011) but innovative. The Act establishes key institutions such as the Petroleum Holding Fund (located in the
central Bank of Ghana). The law provides for an Annual Budget Support (up to 70% of budget shortfall). A minimum of 70% of the fund is ring-fenced for public capital investments (such as roads), thereby liberating non-oil tax revenue to fund other key aspects of the budget.

But this is mere tip of the iceberg. Ghana’s law provides for substantial savings. At least 30% of oil revenue will be kept in a Heritage Fund. The object of this Fund is to promote inter-generational equity. Up to 70% of the savings are to be kept in a Stabilization Fund.

Additionally, Ghana has embarked on putting its governance credentials right. Oil laws and policies are arrived at via wide consultations with key national actors (such as the Council of State) donor agencies (such as NORAD and DFID) and civil society organizations (eg Revenue Watch). Nation-wide Town-Hall-Style consultations were carried out.

Ghana has also established a 13-member Public Interest and Accountability Committee whose goal is to promote strong independent oversight. To crown it all, Ghana is building credible governance institutions (such as the independent Electoral Commission) and a culture of patriotic political practice. For example, political leaders have, since 1992, developed a culture of peacefully and willingly handing over power, without clinging to office ostensibly to “protect” the national oil resources from rival claimants to State House. Uganda needs to learn these lessons of good practice.

President John Kufuor, in his address at Makerere University, indicated that Ghana has joined the Extractive Industries Transparency Initiative (EITI). He also indicated that Ghana has established a strong domestic body to oversee the oil revenues: Uganda should address its governance deficiencies (including, but not limited to the problem of systemic official corruption) by, among other things, weighing the advantages and disadvantages of joining the international oversight bodies such as the EITI that may help to gather data on the mining operations of the oil companies and also to monitor and report on the utilization of oil revenues.

The most unique feature of Ghana's petroleum revenue management regime is found in the creation of the Public Interest and Accountability Committee (PIAC), a 13-member body comprising the Bar Association, Ghana Journalists Association and others, to monitor government in its management of the revenues from oil.

From Ghana to Malaysia to Norway and Alaska, there are examples of best practices from which Uganda should learn as it struggles to establish good governance and use petroleum revenues to deliver durable growth, inclusive development and structural socio-economic transformation.

However, Ghana has its own shortfalls, which Uganda should seek to avoid. For example the practice of flaring gas is wasteful economically and environmentally, and should be avoided by Uganda. As Oil in Uganda (August 2013) notes, gas is “not the main meal, but a useful side dish” (page 1).

Additionally, Ghana is exporting crude oil, not value-added petroleum products. Uganda needs to avoid this, and emphasize refinery capability building with a view to producing and exporting value-added products that maximize job creation (along the value chain), revenues, and multiplier effects (such as using petroleum byproducts to support a national petrochemical industry).
Conclusions and the Way Forward

The essential policy guidelines as we move forward may be summarized as follows:

1. Uganda’s Human Development Index rank of 161 out of 187 countries is unsatisfactory. Uganda should aim to move from the bottom 25 nations into the top 25 nations that provide a better quality of life for their people. For the first time in its history Uganda has the means to generate full employment and to expand its production possibilities frontier by channeling its oil revenues into new and cheaper capital. The country should strengthen the existing financial institutions and create new ones. The old and the new institutions must be charged with the duty of channeling capital into both the public and the private sectors, with a view to promoting structural socio-economic transformation.

2. The magnitude of oil revenues is unprecedented in Uganda and poses a serious challenge for the government given recent instances of corruption. Consequently, government should be modest enough to simplify the problem of accountability by involving the general public and the private sector. It could also consider creating a diversified oversight body similar to the one in Ghana and examine the pros and cons of membership in the Extractive Industries Transparency Initiative (EITI).

3. In light of the tendency for oil rich countries to experience political instability and conflict it is highly advisable to plan to gradually respond to the legitimate expectations of Uganda’s citizens in meeting minimum needs such as quality education at all levels and health care. The design and faithful implementation of a program aimed at promoting equal opportunities for all, as provided for in the Constitution of Uganda, through the provision of quality subsidized education and training, employment, social security, universal pensions, universal medical insurance as well as a uniform regional distribution of public infrastructure could go a long way in defusing potential conflict and assuring a peaceful and progressive governance for Uganda.
Makerere University Convocation
Plot 52, Edge Road
P.O. Box 7062 Kampala, Uganda
Tel: +256 312 273113
Email: convocation@acadreg.mak.ac.ug
Website: www.muconvocation.org