



Comments on Petroleum Revenue Management in the Draft Ugandan Public Finance Bill 2012

March 2012

Executive Summary

Oil production in Uganda, anticipated to start in 2015, will have a significant impact on its economy and society. Given the uncertainty of future production and prices, it is extremely difficult to predict how much oil revenues the government of Uganda will collect. Published estimates range between \$2¹ and \$3.5² billion over the 10 years of peak production (starting between 2018 and 2022), however the amount collected could be higher or lower depending on oil prices, the implementation of fiscal rules, the government's capacity to collect, and whether certain fields come on line. Given the current government budget (2011/12) of 10 trillion Ugandan Shillings (approximately \$4 billion), oil revenues may increase the government's budget up to 50-90 percent during peak production, and could contribute to 10-15 percent of GDP.

As Norway, Ghana and Trinidad and Tobago have shown, having a strong legal framework for managing these revenues is fundamental for transforming oil wealth into long term development. Oil revenue volatility can make budgeting difficult and lead to wasteful spending. Poor management can lead to debt crises, unmet expectations and political instability. The World Bank has stated that managing oil revenues is one of Uganda's overriding development challenges.³

On January 29th the new Public Finance Bill was presented to cabinet. Chapter 7 of this Bill is devoted to Petroleum Revenue Management. The current draft meets basic transparency requirements, prohibits the

¹ According to the World Bank, "government revenue at peak production could be over US\$2 billion per year". Uganda Country Assistance Strategy, April 27, 2010.

² IFPRI Discussion paper: Managing Future Oil Revenue in Uganda for Agricultural Development and Poverty Reduction at <http://www.ifpri.org/sites/default/files/publications/ifpridp01122.pdf>

³ Uganda Country Brief at

<http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/AFRICAEXT/UGANDAEXTN/0,,menuPK:374947~pagePK:141132~piPK:141107~theSitePK:374864,00.html>

collateralization of oil revenues and establishes a petroleum investment reserve. However many features of the bill depart from international good practice in oil revenue management. To ensure that oil revenues contribute to Ugandan development and that Uganda escapes the problems faced by so many other resource-rich countries, we suggest that parliament:

- 1. Introduce a mechanism to address oil revenue volatility and smooth public expenditures.** Short- and medium-term expenditure volatility can be addressed by means of a fiscal rule or the creation of a stabilization fund. Longer term expenditure can also be smoothed using a fiscal rule in combination with the Petroleum Investment Reserve (PIR).
- 2. Develop clear rules and guidelines for investing the proceeds of oil for growth and sustainable development.** The public finance bill could link oil revenues entering the budget to domestic investment in line with the National Development Plan. The bill should also introduce a system governing procedures for financing NATOIL in order to balance the national oil company's financing priorities against national social spending priorities.
- 3. Strengthen transparency and oversight rules to ensure oil is managed for the interest of all Ugandans.** The transparency provisions can be further strengthened by making disclosure of contracts, payments, production and in-kind oil receipts mandatory. Oversight can be strengthened by setting up an independent supervisory committee, representing a range of stakeholders, and ensuring the independence of other oversight bodies.
- 4. Review the revenue sharing regime to establish a widely accepted rules-based, predictable and transparent system.** Parliament could commission a study on the consequences of the regime for local governments and kingdoms. This study could help to build consensus on the revenue sharing regime among all stakeholders before it is put into law.

Revenue Watch Institute (RWI) Comments on Petroleum Revenue Management in the Draft Ugandan Public Finance Bill 2012

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Introduction

In 2006, oil was discovered in the Lake Albert basin along the border between Uganda and the Democratic Republic of Congo. Since that historic find, Uganda has proceeded with preparations to exploit the nation's oil. Provided it is well managed, this one-time windfall could position Uganda to accelerate growth and reduce petroleum import costs, currently at around \$600 million annually.

An early production scheme slated for mid- to late-2009 was indefinitely postponed due to volatility of gas prices and the global financial downturn. The credit crunch had severe economic implications for the region's extractive industries, with less financing available to sustain operations or development by smaller companies. These and other uncertainties led to changes in the assignment of oil blocks, with the UK's Tullow Oil using its preemption rights to take over Heritage Oil's stake in two blocks. In 2011, Tullow sold two-thirds of its stakes to larger oil players Total and CNOOC. In addition to Tullow and Heritage, major oil companies Tower Resources and Dominion Petroleum Ltd. are also operating in Uganda.

Tullow has announced that it expects to start production in 2015, though delays in approving the field development plan might push this date forward. As is, only 10,000 barrels per day are expected to be produced in the first year, resulting in \$12 million per month accruing to the Government through the last few months of 2015.⁴ On the current schedule, this field will increase production to 125,000 barrels per day by 2020. Should other fields come on line, peak production in Uganda could reach up to 210,000 barrels per day around 2022. Although the production figures are still highly uncertain, oil revenues may increase the government's budget by 50 to 90 percent and make up 10 to 15 percent of GDP during peak production.

If used wisely, this significant revenue stream can help transform the Ugandan economy and contribute to scaling up much needed public investment, as outlined in the NDP. If managed poorly, it can harm other sectors of the economy and lead to political and economic instability. Legislating how oil revenues should be used for the benefit of current and future generation of Ugandans is an important first step.

⁴ "Uganda will earn sh922m per day from oil", *New Vision*, March 4, 2012 at <http://www.newvision.co.ug/news/629389-Uganda-will-earn-sh922m-per-day-from-oil.html>

Petroleum revenue management legislation should help Uganda manage several specific characteristics of oil revenues:

- **Oil revenues are volatile:** When revenue volatility is transmitted to the annual budget, the result is often poor public spending decisions when revenues are high and painful cuts when revenues decline. These “boom-bust” cycles harm economic growth and development.
- **Oil revenues are finite:** If all oil revenues are consumed today, future generations will be no better off than those living today. Moreover, when oil production starts to decline, the government may find it difficult to cut spending, leading to a repeat of past public debt crises.
- **Oil revenues can harm other industries ('Dutch disease'):** Inflow of oil revenues can lead to real exchange rate appreciation, which can be harmful to Ugandan exporters. In many oil-rich countries, there is also a tendency to focus on the oil sector to the exclusion of other productive sectors, such as agriculture and manufacturing, that generate more jobs and whose benefits are more widely shared. Nigeria, Gabon, Russia and Ecuador are cases in point.
- **Oil revenues can lead to political instability:** In many oil-rich countries, companies and individuals focus on securing a share of oil revenues rather than building businesses. Governments also often focus on the oil sector. This can result in conflict over who controls and benefits from the resource.

The current Petroleum Revenue Management (PRM) chapter in the Public Finance Bill goes some way to addressing these risks by protecting oil revenues from being used as collateral on public debt, providing some guidelines on the investment of revenues saved in an oil fund and including basic transparency and oversight mechanisms. However the PRM chapter could be strengthened to:

1. Address oil revenue volatility and smooth public expenditures
2. Ensure proceeds from oil revenues are invested for growth and development
3. Strengthen oversight and transparency rules to promote accountability in oil revenue management
4. Establish a widely acceptable rules-based and transparent revenue sharing scheme

The commentary is structured along these four themes. Within each, specific provisions are introduced that can help to strengthen the PRM chapter. Key recommendations for each of these provisions are highlighted throughout the text. Table 1 provides an overview of the focus areas and specific provisions. The table also indicates to what extent these provisions are incorporated in the current version of the PRM chapter.

Table 1: Gaps in the current PRM chapter of the Public Finance Bill

Focus area	Provision	In current PRM chapter?	Section (sub-section)
<i>1. Addressing oil revenue volatility and smoothing public expenditure</i>	i) Rules for revenue forecasting and a fiscal rule for medium-term expenditure smoothing	No	-
	ii) Fiscal rules for long-term expenditure smoothing	No	-
	iii) Fund governance and investment rules	Partly	62-71
	iv) Limit the use of oil as collateral	Yes	58 (3b), (4)
<i>2. Revenues invested for growth and development</i>	i) Link spending from oil revenues to domestic investments as outlined in the National Development Plan (NDP)	No	-
	ii) Rules on retention of revenues by the National Oil Company to balance the investment need in the oil and gas sector and other sectors of the economy	No	-
<i>3. Strengthening public accountability</i>	i) Transparency provisions	Partly	60, 69, 70-72
	ii) Oversight mechanisms	Partly	56, 57, 60, 65
<i>4. Rules-based transparent revenue sharing scheme</i>	i) Determine widely accepted rules for sharing petroleum revenues to reduce conflict	Partly	73, Schedule 6

Key Provisions for Ugandan Petroleum Revenue Management

1. Address oil revenue volatility and smooth public expenditures

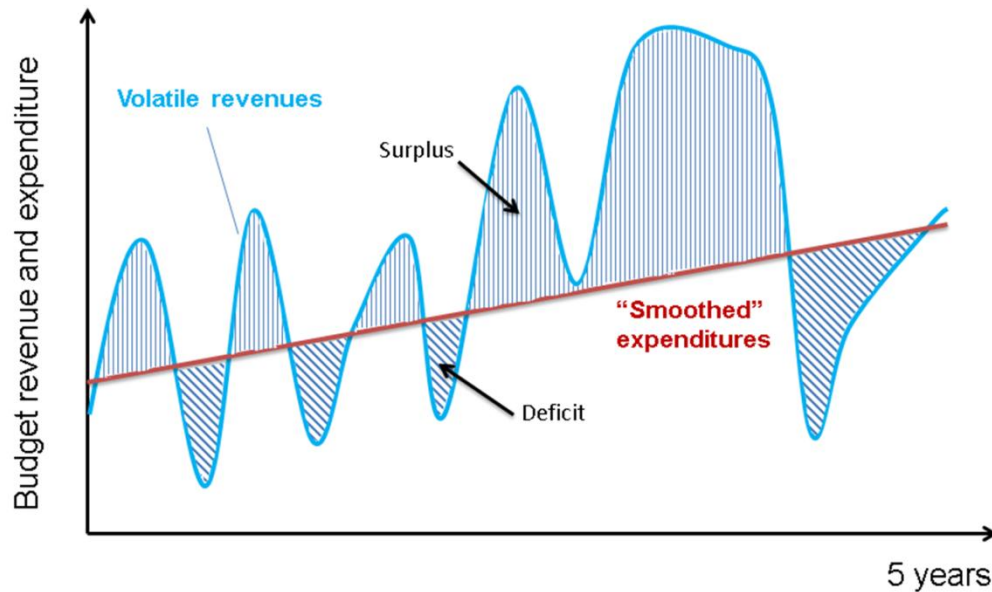
Oil revenues are volatile and unpredictable. In 2008, oil prices crashed from \$140 to \$40 in about six months. This volatility makes it difficult to develop a credible budget and sustainable public expenditure plan, resulting in 'pro-cyclical' fiscal policy, i.e. expenditures rising significantly when oil revenues increase and falling when oil revenues fall. One common consequence is wasteful spending when revenues rise and painful government spending cuts when revenues drop. Additionally, when spending increases too quickly, the bureaucracy finds it difficult to adjust, leading to poorly conceived, designed and executed projects. Private businesses are also affected, expanding when government expenditures are high, and suffering when the government cuts spending sharply and demand drops. In this way government expenditure volatility can lead to bankruptcies in the wider economy. **Revenue volatility is a fundamental challenge for oil revenue management.**

Even at peak production of 125,000-210,000 barrels per day, Uganda will be a small oil producer, on par with Chad, Ghana, Gabon, and Turkmenistan but much smaller than Angola, Ecuador or South Sudan. That said, the impact on the budget could be significant, especially in the 2020s. Depending on oil prices and whether new oil fields come on line, oil revenues accruing to the government budget could top \$3.5 billion per year around 2022 and could last 20-25 years. However they could just as easily be less than \$500 million in the same year if prices drop, production rates slow down or the Ugandan national oil company absorbs significant oil revenues, as in Nigeria. This uncertainty will undoubtedly cause significant challenges for budgeting in Uganda.

i. Rules for short- and medium-term expenditure smoothing

At present, the public finance bill does not include any provision to manage short- to medium-term revenue volatility. Section 56 states that the split of oil revenues between the consolidated fund and the PIR will be guided by a separate Appropriation Act. The discretion given to the Minister and parliament year-to-year carries significant risks for Uganda, namely that spending will increase dramatically when revenues rise and there will be painful cuts when revenues fall. In many countries, this type of discretion has led to spending on large unproductive infrastructure projects when money is flowing freely, such as dams, airports and steel factories. When oil revenues dry up, the end product is often unmaintained or inoperative infrastructure. An illustration of expenditure volatility versus smoothed expenditure is provided in Figure 1.

Figure 1: Medium-term expenditure smoothing



Most successful oil-rich countries have addressed this problem by either establishing an ‘expenditure smoothing’ fiscal rule (e.g. a maximum of X percent of oil wealth may be transferred in any given year from the fund to the budget; a maximum of Y percent of average oil production from 2012-2017 can be transferred to the budget) or creating a stabilization fund. Countries without a formal stabilization mechanism have not fared as well. Table 2 provides examples of natural resource-rich countries’ strategies for dealing with revenue volatility.

Table 2: Country approaches to oil or mineral revenue volatility

Countries with one fund and an “expenditure smoothing” fiscal rule	Countries with a stabilization fund	Countries without a formal stabilization mechanism
<ul style="list-style-type: none"> • Azerbaijan • Bahrain • Kazakhstan • Norway • Timor-Leste • Wyoming (United States) 	<ul style="list-style-type: none"> • Chile • Ghana • Kuwait • Mexico • Nigeria (established in 2011) • Trinidad and Tobago 	<ul style="list-style-type: none"> • Angola • Libya • Venezuela

Rules-based fiscal policy is generally associated with better fiscal performance. It can be extremely useful for maintaining fiscal discipline and binding governments to medium-term objectives. Two options for creating a rules-based mechanism to address oil revenue volatility and smooth expenditures are presented in the **Appendix**. Figure 4 describes an approach using one fund; Figure 5 describes a two fund scenario. Either could be easily incorporated into the current draft bill.

Revenue volatility can be addressed equally well under a one fund or two fund system. That said, there are pros and cons for each approach. The advantage of establishing a single fund is simpler accounting – money cannot be shifted from fund to fund to circumvent fiscal rules – and therefore oversight is easier. An advantage of establishing two funds is that the objectives of saving are made clearer to the public and to policymakers, thereby making saving some petroleum revenues easier to justify politically. As well, having two funds can make fund investment management more straightforward; the stabilization fund is invested in more liquid and less-risky assets while savings fund is invested for the longer-term with an eye to achieving a higher return.

Regardless of the option chosen, the government is required to estimate oil revenues for the following year in order to determine how much oil revenue to budget for and how much is set aside for savings or stabilization purposes. Section 60 (a) of the petroleum revenue management chapter states that the Minister should table in parliament estimated petroleum revenues for the next financial year based on oil production and price estimates. However the bill does not clarify that allocation to the budget should be based on this estimate. Nor does it specify what happens when actual revenues are higher or lower than the estimate made in September of the previous year.

Decisions around oil prices are subject to politicization: A high oil price allows for more money entering the budget; a low oil price demands more saving. An objective oil price – based on an average of past prices and future price projections or on the International Energy Agency’s World Energy Outlook reference price projections – would minimize the government’s discretion.

ii. A fiscal rule for long-term saving

Making oil revenues available for spending may help the government make the much needed domestic investment to transform the economy. Effective public investments can stimulate other economic sectors that over time can compensate for the decline in oil revenues. On the other hand, oil revenues can be saved, invested in foreign assets, and gain interest over time so that, once oil runs out, the country still benefits from the revenues. Saving can also help prevent dependence on oil revenues, reduce real exchange rate appreciation and give government time to improve its capacity to quickly deliver on high-quality

infrastructure investments. The ratio between spending and saving should be a function of: Current spending needs, the size and lifespan of oil fields, expected return on foreign investment, public debt level and Uganda's 'absorptive capacity', the ability of the government to turn a large revenue windfall into concrete domestic investments in health, education, infrastructure and other government projects.

The current draft states that the Petroleum Investment Reserve (PIR) is meant for "investment to support future generations", meaning that a certain percentage of oil revenues should be saved and invested outside the country and used after Uganda runs out of oil. The Ugandan government can make deposits to the PIR during oil production and make withdrawals when oil revenues are depleted. However the bill does not include any rules that ensure that the fund is used for the stated purpose.

In any given year a decision has to be made on the percentage of oil revenues that will be spent versus the percentage that will be saved. The draft public finance bill does not provide any indication of these amounts. Just the opposite, Section 56 states that the split of oil revenues between the consolidated fund and the PIR is guided by a separate Appropriation Act. The discretion given to the Minister and parliament year-to-year is likely to lead to short-termism and pro-cyclical fiscal policy. A flexible rule on how much to spend and how much to save is a key public policy decision that should be specified in legislation. This would help bring a long-term perspective to policymaking and discourage arbitrary year-to-year changes in spending and saving of oil revenues.

iii. Fund governance and investment rules

Sections 62-72 outline the management of the PIR by the Minister of Finance and the Bank of Uganda. One of the strengths is that these funds are held separately from other Bank reserves, thereby preventing a mixing of fiscal and monetary policy that threatens central bank independence. They also provide a strong degree of transparency and some guidelines for investment. However the rules governing fund investments are overridden by exceptions (e.g. Section 62(3c) allows the Minister to designate any investment as a "qualifying instrument"), allowing near total discretion by the Minister of Finance. The lack of oversight by parliament or an independent body leaves open the possibility of abuse by officials and mismanagement of the nation's oil revenues.

Strong investment rules can make the difference between a country leaving an endowment for generations to come and losing oil revenues forever. Some countries, like Azerbaijan, Chile and Timor-Leste, have invested natural resource revenues in low risk, relatively safe assets like US government bonds, to guarantee the inheritance of their children. Others, like Norway and Australia, have adopted higher risk / higher return approaches, losing a lot of money in poor years but gaining significantly when markets have recovered.

However in each of these cases, the investment rules are clearly specified in legislation or regulation. The consequence of a lack of rules was evident in Libya where millions of dollars were spent on management fees and the leader's pet projects, only to have the oil funds lose billions. If a significant fraction of petroleum revenues are deposited into a saving fund, it is important that these funds be invested in the long-term interest of Ugandans.

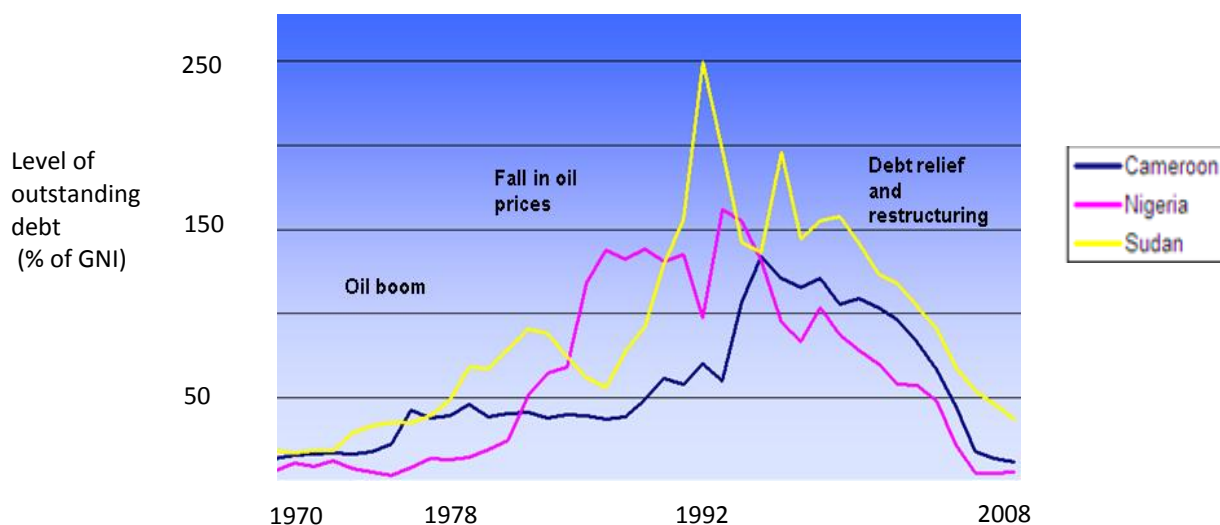
iv. Use of oil as collateral on public debt

Paradoxically, oil-rich countries have a tendency to build up debt at the exact moment they are collecting their windfall revenues. The reason is simple: When commercial discoveries are made, creditors are willing to offer loans to oil-rich countries at lower interest rates and better terms using oil revenues as collateral. These loans can be irresistible to governments, even if, in the short- to medium-term, they exacerbate boom-bust cycles and, in the long-run, can lead to debt crises.

Limiting the use of oil revenues as collateral for loans can help to smooth long-term expenditure and avoid excessive debt and related adverse economic effects. Prudent debt management, combined with revenue rules, can help to avoid a situation in which the country has difficulty repaying these loans once oil revenues decline and interest rates start going up. In these periods, as Figure 2 illustrates, outstanding debt can spiral out of control. Cameroon, Sudan and Nigeria are examples of where high oil prices were treated as permanent, leading to a lack of prudent debt management and, eventually, debt crises.

The current version of the PRM chapter already includes strong provisions prohibiting the collateralization of oil revenues in the petroleum fund. Section 58 stipulates the rules with regard to borrowing from the petroleum fund and the prohibition on using the fund to secure loans. Section 58 could be further strengthened by making explicit that money flowing to the annual budget and the PIR can also not be collateralized.

Figure 2: Development of external debt in Cameroon, Nigeria and Sudan



Recommendations

- i. *Rules for short- and medium-term expenditure smoothing*
 - The public finance bill should contain clear provisions for stabilizing oil revenues using a long-term revenue forecast and a fiscal rule. Two options are:
 - i. All oil revenues are deposited into a single fund (*Appendix Figure 4*): A fiscal rule is used to determine how much revenue enters the budget, thereby “smoothing” expenditures. The rule would also determine how much is saved and spent.
 - ii. Revenues are separated into three buckets (*Appendix Figure 5*): The Petroleum Investment Reserve (PIR), a Uganda Stabilization Fund, and an Annual Budget Funding Amount

Addressing oil revenue volatility and smoothing expenditures

Key Recommendations

1. Introduce a mechanism to stabilize oil revenues entering the annual budget by means of a fiscal rule or the creation of a stabilization fund
2. Introduce a fiscal rule determining annual allocations into the Petroleum Investment Reserve (PIR)
3. Designate an objective oil price to be used in oil revenue forecasts
4. Prohibit the Minister of Finance from defining a 'qualifying instruments' arbitrarily
5. Strengthen investment rules, such as setting a minimum percentage to be invested in low risk assets and introducing independent oversight of PIR investments
6. Explicitly prohibit the use of the PIR to be used as collateral on public debt

(ABFA) are established. A fiscal rule determines how much goes to the budget (the ABFA) and the remaining goes to the PIR. If there is a shortfall in the projected ABFA, the government may dip into the Uganda Stabilization Fund. If there is more revenue than was predicted for the ABFA, the surplus goes into the Uganda Stabilization Fund.

- An objective price – such as an average of past and future prices or an IEA reference price – as well as a formula for oil revenue estimations should be included in the public finance bill to improve budgeting and fiscal rule determination.
- The bill should include strong deposit rules (e.g. all oil revenues not allocated to the budget or for budget stabilization purposes must be deposited in the PIR) and strong withdrawal rules (e.g. funds can only be withdrawn once large-scale oil production has ceased).
- If withdrawals can also be made in case of exceptional circumstances, these circumstances should be clear and specified in legislation.

ii. A fiscal rule for long-term saving

- The public finance bill should include a fiscal rule determining the percentage of petroleum revenues available for spending and the amount to be saved. An example of such a rule is setting a maximum percentage of petroleum wealth or revenues that can be transferred to the budget. Alternatively, a minimum percentage of petroleum wealth or revenues could be allocated to the PIR.
- The saving-spending ratio could be subject to revisions on certain conditions, such as a recommendation by parliament or an independent advisory group.

iii. Fund governance and investment rules

- Having detailed regulations on the investment rules and what constitutes 'qualifying instruments' can help to avoid financial mismanagement. Ministerial discretion to define a qualifying instrument arbitrarily should be eliminated.
- Parliament may wish to consider an investment rule similar to that found in Timor-Leste which states that a minimum percentage of oil funds will be invested in low-risk assets, subject to review every few years.
- A rule preventing any single manager from managing more than a certain percentage of the PIR (e.g. 10 percent) would help prevent corruption and would spread the risk of mismanagement.

iv. Use of oil as collateral on public debt

- Section 58 could be further strengthened by making explicit that the PIR cannot be collateralized.

2. Ensure proceeds from oil revenues are invested for growth and development

- i. *Link spending from oil revenues to domestic investments as outlined in a long-term development and economic diversification plan*

If petroleum revenues are invested in priority sectors of the economy, these sectors can grow and, in the long-run, compensate for the decline in oil revenues. However, if oil revenues are not invested wisely, it can fuel domestic inflation or cause an appreciation of the exchange rate without raising the competitiveness of other export sectors. Combined, these effects can actually cause productive human and capital resources to shift out of export sectors like agriculture and manufacturing, harming these industries.

For oil to make a long-standing contribution to people's lives, revenues need to be invested well and in sectors with strong growth potential. Some of the most successful oil-rich countries – Malaysia, Indonesia and Norway – have used their natural resource revenues for investments in education and infrastructure. Investments in education and infrastructure have the benefit of supporting non-oil business development and the broader economy, making it less vulnerable to shocks in oil prices and production. Moreover, reducing capital expenditure when oil revenues start to decline is politically less difficult than reducing recurrent expenditure.

One strategy for promoting the use of oil revenues for broad-based benefits is to explicitly link them to financing a long term development and economic diversification plan. If the law stipulates that investments should be made in line with such a medium to long-term national development plan, like Uganda's NDP, it can help to avoid a situation whereby national investment priorities change with political whims.

The National Oil and Gas Policy (2003) provides some guidance. It states that: "Revenues accruing from oil and gas resources shall not be used for consumer purposes, but for durable investments like infrastructural development and other activities which will contribute to lowering the cost of doing business in the country". The public finance bill can provide the right set of rules to enforce this policy.

Currently the PRM chapter in the public finance bill does not offer guidance on how the money that flows to the budget should be used. It does not make explicit that oil revenues should be used for capital investments, nor does it link the investment priorities to long term national development plans.

- ii. Set clear rules on retention of revenues by the National Oil Company to balance the investment need in the oil and gas sector and other sectors of the economy*

The National Oil Company of Uganda, NATOIL, will play a key role in the oil and gas industry of Uganda. A significant fraction of petroleum revenues—particularly from the government’s share under production sharing agreements—is likely to be channeled from the international operators via the NATOIL to the government. Regulating this flow of funds is important to avoid financial mismanagement and balance the investment need in the oil and gas sector and other sectors of the economy.

The mechanism for fiscal transfers between NATOIL and the state should be part of the public debate on how oil revenues are invested. Oil producing countries have handled the fiscal relationship between national oil companies in different ways. In countries such as Mexico the national legislature must approve the company’s budget every year, and the company is not permitted to retain any other revenues. Such a structure subjects the company’s budget to debate in parliament as part of the regular budget procedures, enabling the government to yield more control over the company’s expenditure decisions and reduces the risk that inappropriately high portions of oil revenues will be diverted to the company. The major drawback of such an approach is that the company can become cash constrained and unable to execute its mandate effectively.

In other countries the national oil company is allowed to retain a share of revenues up to some capped percentage, which is either set in legislation or is fixed at several-year intervals but is not subject to annual budgetary votes. This set-up limits what the company is able to retain but gives the company more control over its annual budgets. In establishing such a system, the government would need to set the limitation carefully, in line with estimated oil revenues and the company’s medium-term investment program, to ensure that it is appropriate for the priorities for developing the company and does not excessively reduce the amount available for the budget or any revenue management fund.

In either case, the choice whether oil revenues are used for investments in the oil and gas sector or other priority areas of the economy should be a central element on the debate on petroleum revenue management. The current version of the PRM chapter does not include provisions covering the financial flows between NATOIL and the state. It is critical that this relationship be clarified.

Recommendations

i. Link spending from oil revenues to domestic investments

- The public finance bill could include a provision calling for investments from oil revenues to be guided by the National Development Plan (NDP)⁵ and the National Vision Framework. The NDP is a 5-year plan which stipulates the medium term strategic direction. The National Vision Framework is a long term (30 year) development plan.
- The bill could introduce an agency or oversight body with the task of ensuring that oil funds are being used to finance the NDP.

Investing the proceeds from oil for growth and sustainable development:

Key Recommendations

1. Explicitly link oil revenues to physical and human capital investments as outlined in the NDP
2. Introduce a system governing the procedures for financing NATOIL, any revenue NATOIL is allowed to retain and the amount to be paid to the government as a dividend

ii. Clear rules on dividends from NATOIL

- The public finance bill can lay out the rules for retention of revenues by NATOIL and other state-NATOIL financing arrangement. An example of such rules can be drawn from the Ghanaian PRM Act⁶ which states that “[oil revenues] ceded to the national oil company cannot exceed fifty-five percent of carried and participating interest after deducting the equity financing cost”. The Ghanaian system has pros and cons, but will give Ugandan authorities an idea of how a country facing similar challenges (albeit with an existing National Oil Company) has decided to address this issue.

3. Strengthen oversight and transparency rules to promote accountability in oil revenue management

The difference between success and failure in the implementation of fiscal rules is oversight. Many countries have failed to benefit from these rules, not because they did not have the right ones, but because they were not followed. For example, Argentina has a rule limiting debt and another limiting expenditure growth but the Argentine Congress has repeatedly granted "emergency superpowers" to the president, leading to suspension of the rules.

⁵ Uganda National Development Plan (NDP) at <http://www.npa.ug/docs/finalndp.pdf>

⁶ Petroleum Revenue Management Act, April 2011 (Act 815), section 7 (3)

Adequate oversight requires access to enough reliable information that oversight bodies, like parliament, can do their jobs effectively. This necessitates a strong degree of transparency of contracts (production sharing agreements), oil revenue flows, oil fund investments, revenue sharing flows, and national oil company operations.

Transparency of oil contracts can help to ensure accountability in the licensing process, because all parties in that process know that the resulting contracts will be subject to public scrutiny. Moreover, contract transparency enables citizens to verify whether a fair deal has been struck between the government and the operators, by comparing these contracts to comparable deals in other countries. Lack of contract transparency has been in the frontline of the public debate on the petroleum sector in Uganda. Making (future) contract available can reduce distrust of government and international operators. The RWI-Skadden commentary on the E&P bill (Bill No.1)⁷ also makes a strong claim for contract transparency.

i. Transparency

The current version of the public finance bill includes some strong transparency provisions. Section 60 (b) stipulates that the minister shall publish semiannual and annual audited financial statements of the petroleum fund. This statement should indicate, among others, actual in- and outflows of the petroleum fund, volumes and values of the petroleum produced and the source of petroleum revenue. This information should also be published in newspapers. Section 69 dictates that The Bank of Uganda has to publish bi-annually the financial performance and activities of the fund. These publications must be available on the bank website. The annual plan (forward looking) and annual report (backward looking) of the Petroleum Investment Reserve has, according to section 70 & 71, to be made available to parliament and the wider public on set dates. Section 72 requires a bi-annual external audit of The Petroleum fund. The results of this audit will be represented to parliament on set dates.

i. Oversight mechanisms

Having checks and balances in the petroleum revenue management system can help to avoid mismanagement and corruption. Various oversight mechanisms are introduced in the current version of the public finance bill. Sections 56 and 57 state that moneys withdrawn from the petroleum fund and transfers to the Consolidated Fund should be approved by parliament (with an Appropriation Act). The same sections state that the Appropriation Act should be accompanied with a warrant from the Auditor General. Section 60 requires the Minister to table financial statements of the Petroleum Funds before parliament. Section 65

⁷ Comments on Uganda Petroleum (Exploration, Development and Production) Bill, 2012 (Bill No. 1), March 2012

calls for the establishment of an Investment Advisory Committee (IAC). The IAC shall advise the Minister on the investments made from the PIR.

Recommendations

i. Transparency

- The transparency provisions could be further strengthened by requiring that the government publish petroleum receipts, similar to the standard employed by the Extractive Industries Transparency Initiative (EITI). This would be consistent with the National Oil and Gas policy of 2003 that committed to the implementation of EITI. The public finance bill could also describe the form of dissemination (e.g. publish online; radio dissemination).
- Government should also make in-kind oil receipts transparent, including infrastructure projects paid for using oil revenues or provided by oil companies.
- The obligation to make contracts (PSA's) publicly available should be part of the E&P bill or PRM chapter.
- Transparency of the Petroleum Investments Reserve can be improved by requiring disaggregated disclosure of investments.
- Section 60 can be strengthened by requiring that the report of the Auditor General on the Petroleum Fund is submitted to parliament and made public online.
- The bill should set strict reporting requirements for NATOIL, ensuring its reporting standards are on par with publicly listed international oil companies.

Transparency and oversight:

Key Recommendations

1. Include mandatory reporting of payments from oil companies, disaggregated and in an easy-to-use online format
2. Transparency of in-kind oil receipts
3. Disaggregated disclosure of investments
4. Set reporting requirements for NATOIL
5. Specify role and mandate of parliament
6. Strengthen independence of the Investment Advisory Committee
7. Specify independence of audits to international standards
8. Establish a formal public oversight body representing major stakeholders in society

ii. Oversight mechanisms

- Oversight can be strengthened by specifying the role of the parliament. For instance, parliament should be able to call on officials involved in the management of petroleum revenues before parliament for public hearings.

- In the current version the Minister has discretion in appointing and removing members of the Investment Advisory Committee (IAC). The independence of the IAC can be strengthened by stating that a member of the IAC can only be replaced within his or her term for certain predefined causes.
- Having an official public oversight body representing major stakeholders in society can put further scrutiny on PRM and the implementation of the PRM chapter in the Public Finance Bill. This public oversight body can also be mandated to have public hearings and consult with the wider public on concerns with regard to the management of petroleum revenues. Ghana established such an oversight body when adopting their PRM legislation in April 2011. See Box 1 for further details.

Box 1: Ghana's Public Interest and Accountability Committee (PIAC)⁸

In 2007 commercial quantities of oil were found off the coast of Ghana. Oil started flowing in December 2010. With proven reserves of 500 million barrels and estimated peak production of 120,000 barrels per day, Ghana is a minor oil producing country. In April 2011, the Parliament adopted the 'Petroleum Revenue Management Act' (PRMA) to regulate management of money earned in Ghana's new oil production sector. The law commits the nation to saving a minimum of 30 percent of its oil revenues in "Heritage and Stabilization" funds that will both protect the economy against oil price volatility and put aside earnings from this finite resource for future generations. Under the bill, the remainder of oil revenues will be invested in productive sectors of the Ghanaian economy. The PRMA establishes rigorous rules for reporting on oil fund assets and investments and creates an independent regulatory body, the multi-stakeholder Public Interest and Accountability Committee (PIAC), to monitor compliance with the law.

The objectives of the PIAC are threefold. Firstly, "monitor and evaluate compliance of this act [PRMA] by government and other relevant institutions". Secondly, "provide a space and platform for public debate [...] on whether the use of [oil] revenues conforms to development priorities ". Thirdly, "provide an independent assessment on the management and use of petroleum revenues". The role of the PIAC is advisory and has no formal powers to force government to alter its spending policies. Potentially they do have significant leverage with government because the committee consists of 13 high standing members of Ghanaian society with a sizable public backing. Represented in the committee are: religious, traditional and professional bodies, civil society and community based groups, trade unions and the Ghana Extractives Industries Transparency Initiative. The committee will publish bi-annual reports on the performance of government and concerns in society.

⁸ Source: Heuty⁸, January 2012: The Role of Transparency and Civil Society in Managing Commodities for Inclusive Growth and Development

4. **Establish a widely acceptable rules-based and transparent revenue sharing scheme**

The 1995 Constitution of Uganda states that the Government may regulate the use of land as it wishes. That said, it also says that land belongs to the citizens of Uganda and that “minerals and mineral ores shall be exploited taking into account the interests of the individual land owners, local governments and the Government.” There is no specific reference to petroleum in the Constitution.

Regardless of whether there is a legal obligation to share oil revenues, most oil-rich countries, including Colombia, Ecuador, Indonesia, Mexico, Nigeria, and Russia, have specific oil revenue sharing schemes. Revenue sharing can mitigate threats of conflict or appease demands for local ownership. However it can also exacerbate inequality and conflict. For example, in 1997 the five richest regions in Russia, accounting for only 5.5 percent of the population, collected 53 percent of all sub-national government revenues from natural resources.⁹ In the most extreme cases, conflicting claims over oil revenues have led to political fragmentation and conflict. Conflicts in Iraq, Sudan / South Sudan and Nigeria are cases in point.

Several strategies are available to avoid these pitfalls. Governments can use an objective formula based on needs (e.g. population; poverty) or revenue-generating capacity. In parallel, it is important to ensure that the revenue sharing formula and revenue flows are transparent and made available to all stakeholders. With the important role for Kingdoms and the already fierce debate on revenue sharing, this is especially relevant in Uganda. Finally, it is essential that there be consensus among stakeholder to avoid conflict and manage expectations.

Section 73 and schedule 6 of the public finance bill call for 7 percent of one particular revenue flow, royalties, to be allocated to local governments. The lack of transparency about the fiscal terms of the oil contracts makes it difficult to determine whether royalties will form a significant portion of all oil revenues. However royalties are just one revenue stream and are typically not as large as profit oil, corporate income taxes, withholding taxes and other types of revenue combined. For example, the Gabon 2006 EITI report shows royalties were about 28% of total oil revenue, corporate income tax constituted a similar share, profit oil was 39%, and the dividend from state equity was 5.8%. If it becomes evident that the vast majority of revenues are accruing to the national government without consultation with local governments, the formula may prove unsustainable.

⁹ Jorge Martinez-Vazquez & Jameson Boex, 2000. "[Budgeting and Fiscal Management in Transitional Economies](#)," [International Studies Program Working Paper Series, GSU](#) Paper 6, International Studies Program, Andrew Young School of Policy Studies, Georgia State University

Section 73 (1) refers to the 7 percent going to “petroleum exploration and production areas of Uganda”. The lack of definition may cause conflict over which local government is a petroleum exploration and production area. Is an ‘area’ defined by location of the wells or the oil fields? If the latter, if 90 percent of the field is located under Local Government G1 and 10 percent under Local Government G2, can they claim equal shares of oil revenue?

As well, there is no requirement to publish revenue projections or project-by-project revenues, information necessary for planning local budgets.

Sections 73 (8) and 73 (9) state that the Minister will hold revenues in excess of 100 percent of non-oil revenues of a local government and that they will be used for stabilizing fluctuations in non-oil revenue. This rule is vague and could lead to conflict between levels of government, as witnessed in Indonesia.

Recommendations

- The revenue sharing provisions in the bill can be strengthened by laying out the detailed rules determining revenue sharing. These rules should be designed in a manner that will lead predicable transfers to sub national entities.
- High levels of transparency, driven by transparency provisions specific to the revenue sharing regime can increase trust in the system and support of all parties involved. To arrive at such a system it may be useful to have a thorough discussion with local governments and Kingdoms on the revenue sharing system and to carry out a study on what the consequences will of different systems be for all parties involved. To avoid conflict, consensus should be reached on the revenue sharing regime among all stakeholders before it is being put into law.
- To avoid misunderstanding the provision brought forward in section 73, a “petroleum exploration and production area” should be defined, the use of “excess” revenues should be clarified and all relevant information related to revenue flows from the central government to local governments should be published.

<p>Revenue Sharing:</p> <p>Key Recommendations</p> <ol style="list-style-type: none"> 1. Commission a study on the impacts of the proposed revenue sharing system on local governments 2. Undergo a consultation with sub-national jurisdictions, including local governments and kingdoms 3. Clarify the revenue sharing formula (e.g. define petroleum production area; population index) 4. Publish all revenue flows to sub-national jurisdictions as well as estimates for future years
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Concluding remarks

The purpose of this commentary is to facilitate public debate on Petroleum Revenue Management and related legislation. Ghana experienced a long legislative debate prior to passage of the Petroleum Revenue Management Act (2011). The result was significant national and international support for the legislation and increased trust in the Ghanaian government. Having more extensive public consultation on PRM legislation can improve the outcomes and lead to more public support and trust in government's effort to manage the oil revenues for the benefit of the Ugandan People.

Appendix: Options for Revenue Management Structure and Fiscal Rules

Figure 3: Current proposal

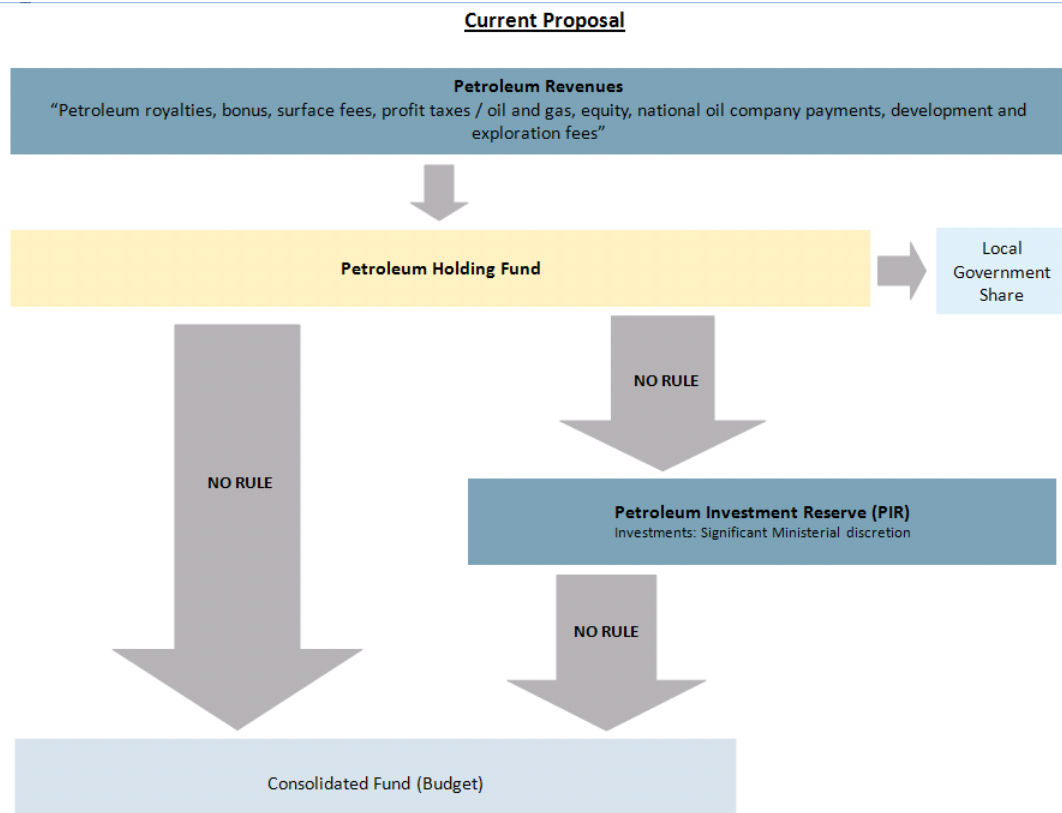


Figure 4: One Fund Option

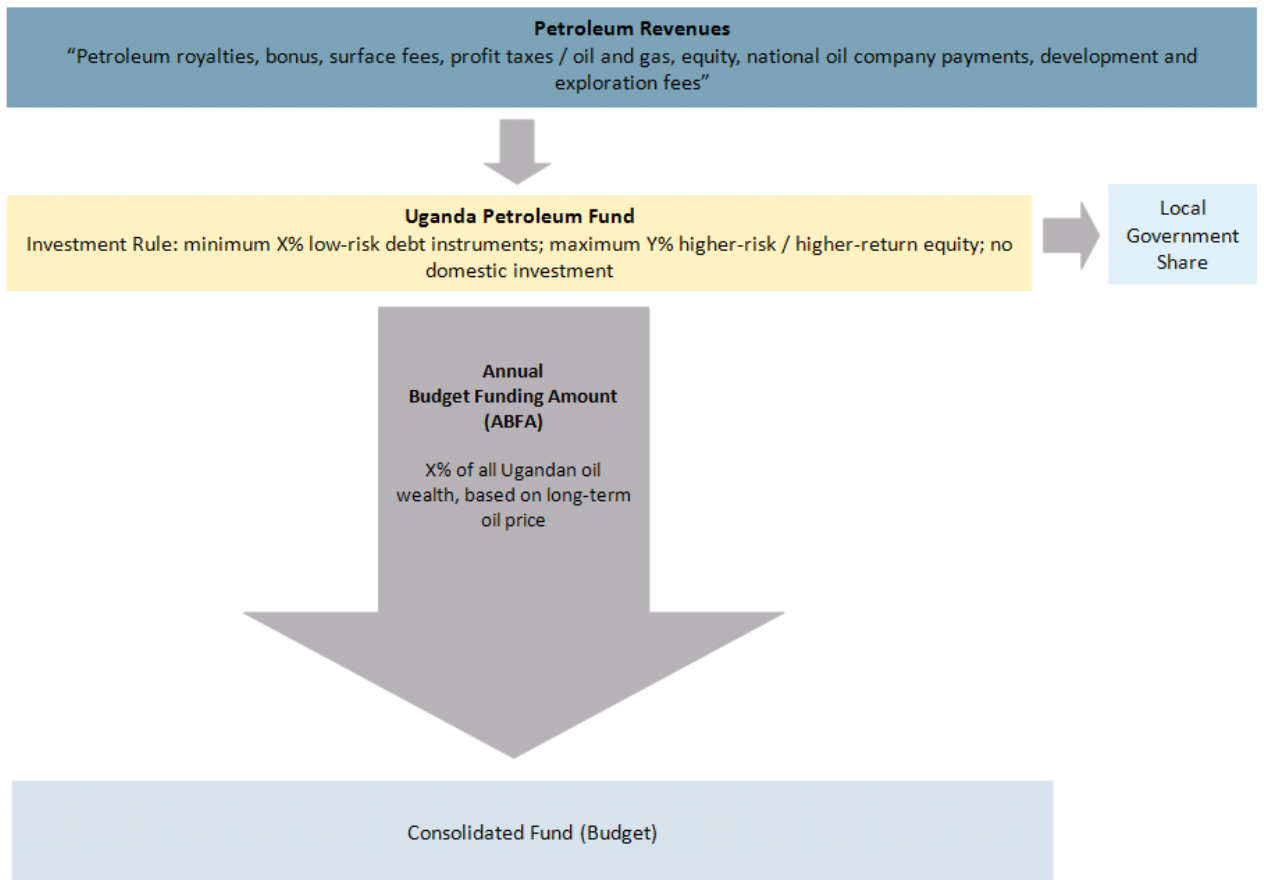


Figure 5: Two Fund Option

