



CRAFTING AN OIL REVENUE-SHARING MECHANISM FOR UGANDA

A Comparative Analysis



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LIST OF ACRONYMS

ABR	Aboriginals Benefit Reserve (in Australia)
ACODE	Advocates Coalition for Development and Environment
APF	Alaska Permanent Fund
CBD	Convention on Biological Diversity
CPR	Canadian Pacific Railway Company
CSOs	Civil Society Organisation
DP	Directorate of Petroleum
DRC	Democratic Republic of Congo
EITI	Extractive Industries Transparency Initiative
EPS	Early Production System
FOCs	Foreign Oil Companies
GAVI	Global Alliance for Vaccines and Immunization
GDP	Gross Domestic Product
GoU	Government of Uganda
ICCPR	International Covenant on Civil and Political Rights
ICESCR	International Covenant on Economic, Social and Cultural Rights
ILO	International Labour Organization
IMF	International Monetary Fund
LCs	Local Councils
MBICT	Mgahinga and Bwindi Impenetrable Conservation Trust
MDF	Mineral Development Fund (in Ghana)
MEMD	Ministry of Energy and Minerals Development
MEND	Movement for the Emancipation of the Niger Delta
MOSOP	Movement for the Survival of Ogoni People
NAPE	National Association of Professional Environmentalists
NATOIL	Ugandan National Oil Company
NDP	National Development Plan (in Botswana)
NGOs	Non Governmental Organisation
NIEO	New International Economic Order
NOC	National Oil Company
NOGP	National Oil and Gas Policy
NRO	Net Revenue from Oil
NURP	Northern Uganda Reconstruction Programme
NUSAF	Northern Uganda Social Action Fund
OMPADEC	Oil Mineral Producing Area Development Commission
OPEC	Organization of the Petroleum Exporting Countries
PAU	Petroleum Authority of Uganda
PEPA	Petroleum (Exploration and Production) Act of 1985

PEPD	Petroleum Exploration and Production Department
PRMP	Petroleum Revenue Management Program
PSAs	Production Sharing Agreements
RSP	Revenue Sharing Programme
SOFAR	State Oil Fund of Azerbaijan
TNCs	Transnational Corporations
UPAF	Uganda Poverty Action Fund
USA	United States of America
USD	United States Dollars
UWA	Uganda Wild Life Authority
PMA	Programme for Modernization of Agriculture
PSC	Public Service Commission
RDS	Rural Development Strategy
SWAPs	Sector Wide Approaches
UBOS	Uganda Bureau of Statistics
UCDA	Uganda Coffee Development Authority
UCDO	Uganda Cotton Development Organization
UNFEE	Uganda National Farmers' Federation

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This policy research paper is a product of ACODE's efforts aimed at influencing the Government of Uganda to formulate an open, transparent, accountable and equitable oil revenue-sharing mechanism for Uganda. While we appreciate that Uganda is fortunate to be in possession of commercial oil reserves, experience of oil producing countries teaches us that depending on how this resource is managed, it can either be a blessing or curse. We also appreciate President Museveni's pledge that government will not squander the wealth generated from oil resources on the purchase of perfumes and wines, but would invest it in infrastructure development and other strategic investments to create lasting wealth for the present and future generations. This pledge is commendable and comforting. However, without a robust legal, policy and administrative framework to translate the political commitments into reality, the country may not benefit from its oil asset which is a non-renewable resource. This paper calls upon government to speedily establish a revenue sharing mechanism ahead of oil drilling. The paper puts forward a strong case for a transparent and equitable revenue-sharing mechanism including the fact that such a mechanism would become a conflict management tool to avoid conflicts associated with oil resources, escaping the "Dutch Disease," endemic corruption and democratic stagnation that are always associated with oil rich developing countries. The paper examines lessons and experiences that Uganda could learn from in anticipation for oil revenue to be reaped after commercial production takes off.

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Advocates Coalition for Development and Environment

1

INTRODUCTION

At the height of the oil boom in the 1970's, a Nigerian military head of state allegedly boasted that money was no longer the country's problem, but how to spend it. This statement, whose veracity is shrouded in the realm of conjecture, nonetheless aptly captures the euphoria and sense of boundless wealth and power that petrodollars bestowed upon the Nigerian ruling class that had won a gruelling 30-month civil war in 1970. The Nigerian civil war, which was ostensibly fought to preserve the unity of the nation-state, was also partly provoked by the struggle between the political elite of the secessionist Biafra (Eastern region) and the rest of Nigeria (Northern, Western and Midwestern regions), over the control of the oil resources of the Niger Delta.¹

The discovery of commercial oil deposits in Uganda makes the country strategically important not only in the Great Lakes Region but also in international affairs. As one of the leading oil producers, Uganda will be expected to join the Organization of the Petroleum Exporting Countries (OPEC) which would make it a key player in international politics. OPEC members include; Algeria, Angola, Ecuador, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, United Arab Emirates and Venezuela.² As Uganda prepares to start drilling and refining petroleum, one looming question is how the country will manage oil revenues and the challenges associated with oil-producing countries in a manner that promotes equity, sustainable development and political stability.

Several oil companies including Tallow Oil, Heritage Oil, and Hardman Resources Ltd are involved in oil prospecting in Uganda. The officials in the Ministry of Energy and Mineral Development have indicated that the three fields in western Uganda where oil has been discovered contain between 100 and 300 million barrels with 30 million barrels ready for extraction at just over 12,000 barrels a day would last for 20 years. According to Dozith Abainomugisha, a senior geologist in the Petroleum Exploration Department; out of the 34 wells that have been drilled only two of them were dry. He also revealed that the total oil reserve potential for Uganda might reach six billion barrels which would put Uganda in the category of Sudan (6.4 billion); above Gabon (2 billion); Chad (1.8 billion) and Equatorial Guinea (1.1 billion)³. Commenting on oil discoveries, the Hardman's Chief Executive

1 Obi, C. I. (2004) Nigeria: The Oil State and the Crisis of Nation-building in Africa, in, Nation-Building: A Key Concept for Peaceful Conflict Transformation, London, Pluto Press, p. 111.

2 Wikipedia. Available on the Website at: <http://en.wikipedia.org/wiki/OPEC>. Accessed on 31/5/2010

3 Kasita, I. & Els de Temmerman (2009) Ngaffa 11 Oil Exploration Site at the Shores of Lake Victoria in Hoima District, The New Vision Newspaper, 29 August. This is available on the Website: <http://www.newvision.co.ug/D/8/12/692645>. Accessed on 31/5/2010.

Officer said the great news is the fact that flow tests from all the zones have exceeded the expectations of productivity⁴ .

While the discovery of commercial quantities of oil has been received with great hope due to anticipated economic fortunes likely to be generated from oil exploitation, it has also caused anxiety about how the accruing revenues will be shared. Furthermore, there is fear that if the revenues from oil are not well governed through a transparent and accountable system that ensures equity in sharing; the resource could turn out to be Uganda's curse rather than a blessing.⁵ Civil Society Organizations, oil-producing districts and traditional institutions in Uganda's oil-producing areas cite the experiences of oil-producing countries like Nigeria, Chad and Angola that have experienced violent conflicts over oil resources. Consequently, they have voiced concerns about Uganda's unpreparedness, the secrecy surrounding the exploration process and lack of enabling legal, policy and institutional framework in place as some of the critical issues that may plunge the country into problems when oil starts flowing in 2009. These concerns and fears that have been raised by the various stakeholders include: the possibility of oil induced violent conflicts as evidenced by the skirmishes between Uganda and DRC forces on Lake Albert over Rukwanzi Island, corruption, poverty and stifling of democratic development that is currently evolving in Uganda.

The paper is organized into five sections. Section one presents the objective and rationale for the study. Section two presents the legal, policy and political basis for oil revenue sharing in Uganda. Section three examines the experiences of oil revenue management from other countries as well as experiences of sharing revenues from other national resources both within and outside Uganda. Section four presents proposals on oil sharing options procedures and requirements. This section also discusses why oil revenue sharing should be equitably shared in Uganda. Section five provides the overall conclusions on oil revenue sharing in Uganda and recommendation for the development of an Oil Revenue Sharing scheme for Uganda.

1.1 The Objective of the Study

The objective for carrying out this study was to generate alternative policy ideas to generate informed debate among government officials and other stakeholders in the oil sector and contribute to the development of appropriate revenue sharing mechanisms for Uganda. It is hoped that a sound, transparent and accountable oil governance regime would promote sustainable development in Uganda through equitable development, prudent revenue management, sound economic management and avoidance of economic distortions and conflicts associated to control and access to oil revenues.

1.2 Justification for Carrying out the Study

The discovery of commercially viable oil deposits in Uganda, estimated at six billion barrels by the end of December 2009, has generated intense interests and expectations from

4 See, Elias Biryabarema, "Oil levels now hit 10,000 barrel mark", Daily Monitor, July 5, 2006.

5 See, Grace Matsiko, "Oil rush: Airports, army barracks built", Daily Monitor, July 8, 2006.

government and stakeholders (local governments, central government, the Bunyoro – Kitara Kingdom, civil society organizations, the private sector and international development partners) of economic boom resulting from future revenue windfall from Oil and Gas. Indeed the National Oil and Gas Policy (2008) proposes measures, including revenue sharing to address this interest and expectations.

There is a general expectation that oil revenues will be invested in developing public infrastructure and programmes to eradicate poverty. However, to be able to address this expectation, there is urgent need for the country to develop and manage the oil sector in a prudent manner. In order to achieve this objective, it is imperative to have in place a relevant and effective policy and legal framework for regulating oil sector as well as institutional capacities for economic management. In addition, there is need for mechanisms and procedures for implementing provisions in the National Oil and Gas Policy (2008), including sharing of oil revenues.

Information on performance of oil producing and exporting African countries reveal a worrying picture of poverty and underdevelopment, generalized violence and insecurity and general misery amidst plenty of petrodollars. Examples of such a paradox is the Niger Delta in Nigeria and Chad where oil revenues have been mismanaged leading to these countries' failure to exploit the oil resources fortunes to meet the needs of their citizens and achieve sustainable development.

This research was carried out in response to the indications that the necessary legal and institutional frameworks for management of oil revenues in Uganda are behind schedule. According to information from Ministry of Energy and Minerals Development in 2009, oil production was expected to begin in 2010 and on this basis, the research was hinged on the realization that preparations for oil revenue sharing are either clandestinely going on or not being undertaken altogether.

More so, the research underpins the fact that oil in Uganda could turn out to become a curse rather a blessing, like it has become in Nigeria, Chad, Angola, among others oil countries in Africa because of slow and unsatisfactory pace of the country's preparedness to manage oil production processes. Whereas the Museveni Government has on several occasions attempted to respond to the fears among some sections of Ugandans that oil will not be a curse but a blessing; there is no basis to believe the government because of a general absence of serious efforts to prepare the country for the implications of the oil revenue windfall. President Museveni has for example observed that:

There is a lot of nonsense that 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 assure you that we don't approach that description even by a thousandth mile. The oil is a blessing for Uganda and money from it will be used for development.⁶

⁶ See, Uganda's President announces oil discovery after years of exploration, The Associated Press, October, 8, 2006.

While speaking at a national seminar on 'Managing Uganda's oil revenue' on 8th July 2008, President Museveni further noted that oil and gas revenues would be channelled to building the human resource capacity, developing physical infrastructure including roads, railways, and to industrialize the country. President Museveni further noted that,

*Oil revenues will not be used for consumption and importation of perfumes, wines, cars and paying salaries. We shall use it as an infinite resource to create infinite capacity for Ugandans. This is our core view in building long-term benefits from oil.*⁷

In spite of President Museveni's assurances, the oil exploration process has caused a lot of excitement especially among the wealthy Ugandans who rushed to buy large chunks of land in prospecting areas in Bunyoro sub-region causing ethnic tension and violence. For example the ongoing conflict in Bulisa district between the Bagungu cultivators and the Baraaro pastoralists revolves around contested ownership of land, control and access to resources close to oil exploration sites.⁸ More so, before long after Uganda had announced discovery of oil, Uganda and Democratic Republic of Congo (DRC) forces clashed on Rukwanzi Island situated on Lake Albert with each country claiming ownership of the island. These are some of the incidents that lend credibility to public fears that unless there is effective management of oil production processes and oil revenues, Uganda's oil resource may bring more problems to the country instead of the anticipated sustainable development.

Furthermore, in spite of President Museveni's pledge to ensure that the country's resources will bring lasting wealth, Government has until now refused to make public the Production Sharing Agreements (PSA) arguing that these are business documents that may jeopardize the prospecting companies' interests if made public. In the course of conducting research, what could be accessed were simply models of the PSAs⁹ which only display the framework without mentioning the actual and relevant sharing proportions. Indeed, in December 2009, GreenWatch, a national advocacy NGO sued the government of Uganda over non-disclosure of the PSA. The refusal to make PSA public is suspected by the civil society and other stakeholders as a ploy under which public officers could conclude corrupt deals beyond the scrutiny of the public, including inadequate provisions for revenue sharing as required by Oil and Gas Policy.

Most observers believe that having in place credible oil revenue sharing schemes is a key tool for ensuring that oil revenues can indeed stimulate sustainable development. For instance Norway and Botswana have been able to utilize benefits from their natural resources to develop their countries. Norway for example has earned the highest place on the United Nations Development Program's list of the best performers with proceeds from oil resources.¹⁰ What the Norway example demonstrates is that the underlying problems

7 See, The New Vision, Museveni Reveals National Oil Plan, Wednesday, July 9, 2008.

8 Interviews with Bagungu peasant farmers and Baraaro pastoralist farmers in 2008.

9 Model Production Sharing Agreement for Petroleum Exploration, Development and Production in the Republic of Uganda By and Between the Government of the Republic of Uganda and Company X, 2006 (availed to researchers by the Ministry of Energy and Mineral Development on 24th July 2007).

10 See, Newsedge (2010). Oil in a Week Norway's Model in Government Cooperation with Oil Companies. Available online at: <http://www.poten.com/NewsDetails.aspx?id=10519177>. Accessed on 1/8/2010

around petroleum are not inherent in the resource itself. What matters is to determine whether the poor will benefit over the long run from oil resources and how revenues are raised, what percentage remains inside the producing country, and how these revenues are utilized. Whether countries succeed in sowing their petroleum- which means turning their oil revenues into long-term benefits for their people ultimately depends on the quality of public policy, legal framework and public accountability. Simply stated, given the right policy and legal frameworks and public accountability petroleum revenues can be “black gold” rather than the excremental of the devil. The good examples of Norway and Botswana should give Uganda opportunity to develop robust systems for revenue sharing before oil production begins in 2010. Consequently, this paper attempts to generate ideas and proposals on oil revenue sharing for Uganda. It is anticipated that the contribution made by this study will result into development of a credible revenue sharing scheme that meets expectations for equitable sustainable development arising out of oil revenues.

2

THE BASIS FOR OIL REVENUE-SHARING IN UGANDA

The process of developing mechanisms for sharing oil revenues in Uganda must be anchored on the Uganda's legal, policy and political factors. It should also take into account the oil resources endowment, location of oil deposits, the oil exploration stages and anticipated oil production system. The following section presents a situational analysis of these key factors.

2.1 Background to Oil Exploration in Uganda

Oil in Uganda was discovered in 1930's around Butiaba escarpment. For some unknown reason, these discoveries were never pursued until the 1980s' (NAPE, 2009). However, since late 1980, seismic studies have been carried out revealing presence of oil in several locations. Through the ongoing exploration activities, it has been established that Uganda has commercially exploitable reserves of oil and gas in the Albertine Graben of the Albertine Rift. The Albertine Rift forms the northern part of the Western Rift Valley, stretching from the Uganda – Sudan border southwards to the north of Lake Edward extending to the Democratic Republic of Congo in the west, covering an area of 20,000 sq. km (Figure 1). More information on the history of oil and petroleum exploration in Uganda is described elsewhere.¹¹

11 Bainomugisha Arthur, Kivengere Hope, & Benson Tusasirwe. (2006). Escaping the Oil Curse and Making Poverty History: A Review of the Oil and Gas Policy and Legal Framework for Uganda: ACODE Policy Research Series no. 20, 2006, Kampala.

Figure 1: Location of oil deposits and exploration activities in western Uganda.

Source: Dominion Petroleum PLC

Since early 2000, Government of Uganda (GoU) entered Production Sharing Agreements (PSA's) with Dominion Uganda Ltd, Tullow Oil Plc, Heritage Oil and Gas Ltd and Neptune Petroleum (Uganda Limited) to carry out oil exploration in Uganda. According to the Ministry of Energy and Minerals Development (MEMD) Policy Statement 2008/9, there are 34 oil wells of which 32 wells encountered oil at subsurface with estimated volume of 2 billion barrels. By the end of 2008, only Tullow had declared oil reserves in Buhuka and Kaiso-Tonya area for Kingfisher, Nzizi, Waraga and Mputa oil fields and had by early 2008, designed an Early Production System (EPS) consisting of min-refinery and 50 Megawatts power plant. However, this EPS was suspended in mid 2008 in favour of an oil refinery in Uganda. By the time of issuing this report, ongoing preparations are geared towards construction of the oil refinery in Uganda.

As the oil industry moves towards production stage, the country is undergoing preparation for management of oil production processes and accruing revenues. It is expected that ongoing preparations to manage the oil industry among other things will entail building national capacity to develop and implement good policies and legislation, negotiate equitable agreements, engage public and beneficiary stakeholders, manage disputes, establish and operate fair and equitable modalities for sharing oil revenues. Unfortunately, the ongoing preparations and capacity building efforts reveal serious shortcomings which put the country at risk of being unprepared by the time of oil production.

With respect to governance, a National Oil and Gas Policy was approved in February 2008.¹² The policy recommends putting in place a legal framework for the regulating the oil sector. In September 2009, Cabinet approved principles for enactment of Petroleum Law for Uganda.¹³ The law has since been enacted giving more powers to the Minister of Energy and Mineral Development to make key decisions on revenue management. It is the thinking of this paper that oil revenue governance should be discussed in detail in a very transparent and participatory manner so that stakeholders know exactly what their share is and how it was arrived at. This would do away with suspicions and speculations that are normally associated with the oil revenue sharing and governance regimes generally. To this end, beyond the enactment of the act, government should allow further consultations championed by civil society to breakdown in detail the revenue sharing mechanism.

In early 2000, Government established the Petroleum (Exploration and Production Department (PEPD) in Ministry of Energy and Minerals Development to manage Oil sector in Uganda. Government Plans to establish a Directorate of Petroleum (DP), Petroleum Authority of Uganda (PAU) and National Oil Company (NOC) in future.¹⁴ Government is also proposing to set up a Petroleum Fund as one of the mechanisms for managing oil revenue in a prudent manner.¹⁵ While government plans and promises for managing and utilizing oil revenue seem impressive, they are not matched by full information disclosure of PSAs which up to now remain a secret. More so, government has not engaged public and stakeholders to develop oil revenues sharing schemes, yet it is a known fact that these schemes take a long time to be developed. Without agreed upon revenue-sharing mechanisms, it is unlikely that revenue-sharing will be handled effectively.

2.2 Implications of Oil on Social and Political Landscape in the Albertine Region

Oil production is likely to generate direct social benefits to the citizens such as local employment and infrastructure development to benefit approximately 6 million people. Likewise, it will generate costs in form of limited access to livelihood values and resources within the oil production areas, culture mix-up, changes in social fabric and loss of existence values to the oil resource in favour of central government and oil companies (NAPE, 2009). The need to balance these social costs and benefits calls for revenue sharing in order to maximize the benefits or avert the likely social costs.

Also, it is imperative to note that the negative socio-economic and political consequences that have been witnessed in most of Africa's oil-producing countries could be experienced in Uganda if an appropriate revenue and benefit sharing mechanism is not put in place and applied. Revenue gains from oil production are known to be a mixed blessing to a number of oil-producing countries hence the analogy of the "Dutch Disease or Resource Curse".¹⁶

¹² Government of Uganda (2008); The National Oil and Gas Policy for Uganda

¹³ NAPE (2009); A critical analysis of Oil development process in Uganda.

¹⁴ NAPE (2009); A critical analysis of Oil development process in Uganda

¹⁵ Government of Uganda (2008); The National Oil and Gas Policy for Uganda

¹⁶ Corden W Max. (1984). the booming sector and Dutch disease economies: a survey and consolidation: Oxford Economic papers, 36, 6, PP 359-80.

It is worth noting that although the Dutch Disease can be avoided, if necessary legal and policy framework is put into place to promote transparent and equity in revenue sharing.

2.3 Oil and Macro-economic Management

The confirmed amounts of oil deposits in Uganda when fully exploited will generate substantial revenues. It is not possible to establish how much will accrue to the country because the details in the PSAs have not yet been disclosed.¹⁷ However, the oil industry in Uganda is expected to inject a lot of revenues into the national economy and therefore the need to ensure that macro-economic policies and planning are strong to sustain the economy to avoid distortions attributed to oil as has been the case in other Africa oil producing countries. Uganda needs to put into place appropriate macro-economic policies for managing and integrating oil revenues into national economy and for assessment of the likely economic implications and mitigation measures. In addition, there is need for strong provisions in the Production Sharing Agreements that ensure fair play and sound commitments on the part of government and oil companies. Lastly, there is need for sound policy guidelines on oil revenue management including, an oil revenue sharing formula.

2.4 Emerging Issues in Relation to Revenue - Sharing

Based on the available information in respect to political, policy, management, public expectations and international cooperation issues that have emerged, it is important that they are elaborated upon. The subsequent section discusses the emerging issues.

2.4.1 Expectations of Economic Boom

Oil production is expected to generate increased revenue earning to Uganda. Most crucially oil resources are likely to play a leading role in influencing the national economy and fiscal policies and plans. Until oil revenues start to flow, the likely scope of influence cannot be accurately estimated. However what is certain is that oil revenues will influence development planning and financing at national and local governments levels. The oil revenues are also expected to influence collection and management of revenues from "other" national resources such as wildlife, forestry, water and minerals, among others. Ultimately, there is strong likelihood that oil revenues will influence government spending priorities and patterns.

2.4.2 Policy and Legal Requirements for Revenue - Sharing

The debate on oil revenue sharing draws its legitimacy from the following law and policies: (i) the Petroleum (Exploration and Production) Act 1985,¹⁸ ii) the Uganda Constitution (amended 2005),¹⁹ and (iii) the National Oil and Gas Policy for Uganda (2008).²⁰

17 Platform London (2009); Uganda's contracts – a bad deal made worse; Preliminary analysis of Uganda's Production Sharing Agreements by PLATFORM

18 Petroleum (Exploration and Production) Act (1985). Cap 150

19 Constitution of Republic of Uganda (Amended 2005)

20 National Oil and Gas Policy for Uganda (2008)

2.4.2.1 The Petroleum (Exploration and Production) Act (1985)

With respect to oil revenue sharing, the Petroleum (Exploration and Production) Act (1985) (PEPA) does not provide for formula how revenues accruing from Uganda's oil resources are going to be shared out amongst the various stakeholders. Instead, it provides that money from licensing and royalties, is payable directly to Government.²¹

It is worth noting that the PEPA is weak in the following ways:

- a) The PEPA does not have provisions for regulating natural gas exploitation. This omission puts the exploitation of this valuable resource entirely outside the law;
- b) Information sharing is perhaps overzealously restricted to Government.²² The efficient and honest utilization of oil and gas resources would be best ensured if information on the resources and revenues was shared with the public most especially the civil society organization.
- c) There are no measures (such as Fiscal Stabilizing Fund) to guard against oil supply or price shocks that would severely destabilize the economy;
- d) There are not enough solid plans to oversee mid-stream and down-stream oil activities such as refining and sales, beyond that needed to supply Uganda.
- e) Weak obligations to promote responsible regulation of this sector.

2.4.2.2 The Constitution of the Republic of Uganda (Amended in 2005)

The Constitution of Uganda (amended 2005) establishes the basic right of citizens to own land, which cannot be taken from them unless they have been, compensated.²³ At the same time, the Constitution provides that "the entire property in, and the control of, all . . . petroleum" are vested in Government on behalf of the Republic of Uganda,²⁴ and that Parliament has the right and responsibility to make laws regarding the exploitation of this valuable resource and sharing of royalties arising from its exploitation,²⁵ provided that it is done "taking into account" individual landowners', and 'local governments' and 'government's' interests.²⁶

Among the objectives of the Constitution (Amendment) Act 2005, is a provision to control minerals and petroleum in the country. Under the National objective and State policy of protection of natural resources (Section XIII), it is provided that the State shall protect important natural resources, including land, water, wetlands, minerals, oil, forests, wildlife

21 Section 46-50 of the PEPA. Cap 150

22 Section 59.1 of PEPA. Cap 150

23 Article 26.2 of the Constitution of Republic of Uganda

24 Article 244.1 of the Constitution of Republic of Uganda

25 Article 244.2 of the Constitution of Republic of Uganda

26 Article 244.3 of the Constitution of Republic of Uganda

fauna and flora on behalf of the people of Uganda. By implication, revenue from oil production is for the benefit of all Ugandans, in a balanced and equitable development. Under Section XII,²⁷ the State is supposed “. . . to adopt an integrated and coordinated planning approach . . . take necessary measures to bring about balanced development of the different areas of Uganda and between the rural and the urban areas . . . take special measures in favour of development of the least developed areas”. The aforementioned provisions of the Constitution do explicitly provide nation wide sharing of revenues for all national resources specified in Section III.

2.4.2.3 National Oil and Gas Policy (2008)

The policy for sharing oil revenues in Uganda is enshrined in the National Oil and Gas Policy (2008) for Uganda. The foundations for oil revenue sharing is entrenched in the following policy guiding principles: (i) using the finite resources to create lasting benefits to society, (ii) efficient resource management, (iii) competitiveness and productivity, (iv) protecting the environment and conservation of biodiversity, (v) capacity and institutional building and (vi) transparency and accountability.

Specifically, the National Oil and Gas Policy²⁸ addresses the issues of oil revenue sharing by noting that “the interests of local communities . . . shall be taken into account by . . . sharing of royalties.” However, it only does so in line with the rules that are yet to be established by Parliament as required by the Constitution. Therefore, these policy intentions remain ineffective until the Parliament puts in place the required rules.

2.4.3 Legal Basis for Sharing Oil Revenue

The claims for sharing oil revenues have been analysed from the legal point of view in order to assess their legitimacy. The Petroleum (Exploration and Production) Act 1985 provides for ownership rights over property and land, but not petroleum that may be found under such property or land. Under Section 39.1 the owner or lawful occupier of any land with petroleum reserves the rights to use the surface only to the extent that it does not interfere with exploration and production activities. The developer, meanwhile, can erect the necessary structures either with the landowner’s permission, or, “if the consent is unreasonably withheld,” with permission from Government (Section 39.2). There are no absolute restrictions on oil production except a request that the licensed rights be used “reasonably” and with minimized harm to the surface land (Section 39.3). However, according to Section 40.1, the license holder may be required to either purchase the land at an agreed upon cost (or one set by arbitration) (Section 40.1), or to pay “fair and reasonable compensation” for any damage to the land. The final result of this law is that the landowner’s land rights are essentially protected by both the graciousness of the license holder, and the fairness of Government. So long as either of these protections remains active, the landowner is fairly protected – but without either, he/she can be stripped of his property rights. This law on ownership rights does not extend to include petroleum and

27 Subsection [sub-sections i, ii & iii] of Section XII of the Constitution of republic of Uganda

28 Section 5.1.6 of the National Oil and Gas Policy

therefore, other than for compensation or purchase of ownership rights, the land owners have no legitimacy for seeking to share oil revenues.

2.4.4 The Basis for Revenue - Sharing Claims by Cultural Institutions and Local Governments

Views from people associated with the Bunyoro – Kitara Kingdom (cultural institution), local government and political leadership within the districts across the Albertine rift reflect a high level of attachment to the oil resource.²⁹ The pre - independence relationship between the then Bunyoro – Kitara Kingdom and the British colonial government is deemed by people of Bunyoro to have been politically unjust to the kingdom. It is against this background, that views expressed on revenue sharing reflect the historical grievances and agitation for fair share of the oil revenues with Central government. Equally, local governments under whose jurisdiction oil exploration is occurring have pecuniary interest in sharing the oil revenue. In fact, they anticipate that the regional tier system of district governments in the region could provide them an opportunity to organize as a “bloc” to gain from the windfalls from commercial oil production.

According to Article 246 (3) (a) of the Constitution, the institution of a traditional leader or a cultural leader is enjoined to hold assets or properties in trust for itself and the people concerned. This provision does not give the kingdom rights to the oil revenues as Art. 244.1 of the Constitution bestows ownership and control of natural resources to the State. On this basis, there is no legal basis for oil revenue sharing by districts.

2.4.5 Likely Conflicts over Revenue - Sharing

Conflicts in many developing countries have been associated with the fortune of substantial natural resource endowments. In Africa, the discovery of oil has led to conflicts, poverty, and secessionist tendencies.³⁰ Most of the conflicts are known to result from struggles by different actors attempting to gain control of the accruing revenues.³¹ Natural resource wealth may also breed conflict since it promotes bad governance especially where it is captured by political elites to perpetuate themselves into power. Though such wealth may not be the original cause of conflicts, oil wealth may combine with other grievances to prolong and protract civil wars and human suffering.³²

Given the sensitivity of oil revenues and their positive coloration with conflicts, it is important to identify potential sources of conflicts.

²⁹ Views were collected from among others Hon. Beatrice Byenkya, James Rwebembera, Jalia Bintu, Beatrice Mpairwe, Stephen Birahwa and Mable Bakaine; the Principal Private Secretary to the Omukama of Bunyoro; District Chairperson, Hoima District, and the Mayor - Hoima Town Council during a Workshop on: Strengthening Government Opposition Relations and Environmental Governance in Uganda, held at Kolping Hotel, Hoima, August 7-8, 2008.

³⁰ See, Prof. E.M.R. Kiremire, “Where Uganda stands as an African oil country” *Daily Monitor*, Wednesday, August 15, 2007, Pg 12

³¹ See, Paul Collier, & Anke Hoeffler. (2005). Resource Rents, Governance, and Conflict *Journal of Conflict Resolution*, 49(4), 625-633

³² See, Humphreys & Macartan (2005). Natural Resources, Conflict and Conflict resolution: Uncovering the Mechanisms; *Journal of Conflict Resolution*, Issue 4, Vol. 49

2.4.5.1 National Level Conflicts

The likely causes of the conflicts at national level are likely to arise out of the desire to manage or fulfill public expectations for economic and social transformation. As indicated in section 2.3, the levels of expectations for economic and social benefits are rather high and failure to meet these expectations might be source of conflicts. On the political front, the ongoing debates between the Central Government and the Bunyoro – Kitara Kingdom on one hand and oil districts on the other, regarding the issue of revenue sharing and payment of royalties to the Kingdom pose a likely source of political conflict between central government and these entities. Another likely source of conflicts is if the current ruling party in Uganda positions itself to exploit oil resources and use revenues to suppress political dissent. Experience from other African oil producing shows that the ruling political elites have used oil revenue to suppress political opposition and entrench themselves into power.

2.4.5.2 Local Government Level Conflicts

The mandate of Local Governments over national resources such Oil is spelt out in relevant policies and legislation (Section 2.4.2). However, because of the uniqueness of oil resource, it would seem that there are interests to either misinterpret the legal mandates or ignore them altogether in order to pursue selfish demands for greater control over oil resources by Local authorities. This is a likely source of legal and policy conflict that could degenerate into violent conflict.

In addition, two of the oil districts fall under Bunyoro – Kitara Kingdom. Whereas the laws regulating functioning of kingdoms are clearly spelt out, there are demands and positions expressed by the Bunyoro – Kitara kingdom which have potential for causing conflicts if they are not satisfactory met or if the kingdom does not rescind them. These demands and positions include the following, tenure of land/natural resources (including Oil), enhanced participation in decision making regarding oil investments and revenue management, payment of oil royalties to the kingdom and employment of local people.

2.4.5.3 Community Level Conflicts

The likely conflicts will revolve around the tenure of land and resources which will be affected by oil activities, benefit or revenue sharing and participation in oil industry e.g., employment, among others. Much as these are likely to be conflicts emanating from communities, the community is highly susceptible to manipulation by external forces which could lead to conflict.

2.4.5.4 Policy and Legal Related Conflicts

At Legal and Policy front, the National Oil and Gas Policy (2008) and upcoming Petroleum Law ought to be in harmony with sectoral policies of benefit sharing currently applied under the Wildlife and Forestry policies in order to avert what could turn out to be policy related conflicts. Already, the process of exploration in Murchison Falls National Park is

inconsistent with the Wildlife Policy which does not permit extractive use of resources within the national park. Unless the Wildlife Policy is amended, the conflict is real.

In addition, the National Oil and Gas Policy (2008) and upcoming petroleum law ought to be in harmony with the International Law (regarding international water, internationally recognized resources such as Murchison Bay Ramsar Site, biodiversity conservation, human rights), among others. These are important instruments that the Government of Uganda should avoid infringing upon in order to avoid conflict at this level.

Lastly, policy level conflicts are likely to arise if the expected policy reforms are not carried out as per laid down procedures, especially, the aspect of public participation. The Government formulated an "Oil and Gas Policy" which was not subjected to wide public participation as is normally required in policy formulation.³³ The process of making the policy was limited to selected stakeholders, especially to the communities where oil prospecting is going on. This process is seen to be inconsistent with the established procedures for policy formulation in Uganda.

By and large oil in Uganda, like in several other countries in Africa, is likely to attract different forms of conflicts. This requires investment in building capacity for conflicts management which encompasses ensuring that there is openness and accountability in government dealings and establishment of a permanent dispute resolution mechanism to handle conflicts when they arise. A Conflict Management Strategy is strongly recommended and efforts to develop this strategy should be encouraged at the earliest opportunity.

2.4.6 Politics and oil Revenue - Sharing

While natural resource revenues are potentially detrimental if not properly managed, they are potentially beneficial to society. Revenues can be used to reduce poverty and to initiate sustainable economies as the case has been for Norway and Botswana. The failure to put in place and maintain effective, transparent and vibrant oil governance systems has had horrific effects in almost all oil-producing developing countries notably; Nigeria, Gabon, Angola, Indonesia, Sudan and Chad are examples of oil producing countries that are experiencing oil related problems. To a larger extent, political power in oil states is highly personalised which produces a political system that is characterised by authoritarianism, distrust, instability and the use of coercive state power to keep any competition or opposition in check. While this is obvious in the oil states of North Africa, the Middle East and the Gulf, the situation in Sub-Saharan Africa particularly in Nigeria and Sudan is more complex and appalling.

In Uganda, the National Oil and Gas Policy (2008) specifies roles and responsibilities of different administrative institutions. The Ministry of Minerals and Energy Development is responsible for oil and gas exploration in the country. The main roles of the ministry are policy making and implementation, regulation of the sub-sector and managing the commercial business prospects. The policy provides for establishment of a National Petroleum Authority of Uganda (NPAU) to regulate the different actors in the sub-sector. The Authority is supposed to among other things, play the role of monitoring and regulating

³³ The New Vision, Hoima Wants Migereko To Explain Oil Revenue Sharing, Sunday, 13th May, 2007.

petroleum operations including reserve estimation and measurement of the produced oil and gas, monitoring expenditure on licences, proposing and implementing regulations, assessing plans for field development, managing petroleum data, contributing to national (budgetary) planning and control and ensuring health, safety and environmental standards in oil and gas operations. The membership of NPAU is however not clear. It is important that different stakeholders, notably civil society get representation on NPAU.

According to the NOGP, the state will establish Uganda National Oil Company (NATOIL) to handle the commercial interests associated with oil and gas production. NATOIL is supposed to participate in licensing and marketing of the country's oil and gas and managing the oil/gas revenue share accruing to the state. Much as actual commercial oil production is yet to start, NATOIL should be initiated early enough to prepare for capacity building. Capacity must be built in preparation for the following upcoming roles; (i) managing the business aspects of oil production, and (ii) developing an in-depth expertise in the oil and gas industry.

2.4.7 Lessons from other National Resources Revenues

The sharing of oil revenues bears serious implications to ongoing revenue sharing programmes in the wildlife and mining sectors in Uganda in the following ways.

a) Wildlife

The Revenue Sharing Programme (RSP)³⁴ for income accruals from wildlife conservation (revenue from gate fees) with the neighbouring local communities was adopted as a government policy in 1994 and was subsequently supported by provisions in the Uganda Wildlife Act (cap. 200). The policy guidelines stipulate that up to 20% of all the gate collections should be remitted to the RSP through the district authorities.³⁵ This scheme is operational within Murchison Falls National Parks and surrounding Wildlife Reserves. It is imperative that the development of the oil revenue sharing scheme takes into account this scheme under wildlife since some of the oil production takes place within Murchison Falls National Park.

b) Mining

According to Article 244 (2) (b) of the Constitution of Uganda and Section 98 (2) of the Mining Act, 2003, and the Mineral Policy for Uganda, 2000,³⁶ royalties from exploitation of minerals are shared by the Government, Local Governments and owners or lawful occupiers of land subject to mineral rights as specified in the Second Schedule to the Act. According to the Second Schedule percentages designated for Government, Local Governments and

34 See the First National Report on the Conservation of Biodiversity in Uganda, available at <http://www.cbd.int/doc/world/ug/ug-nr-01-en.pdf> (Accessed 27.7.2008); See also Godber Tumushabe and Eunice Musiime, *Living on the Margins of Life: The Plight of the Batwa Communities of South Western Uganda*, ACODE Policy Research Series, No. 17, 2006, Pp.18, 20-23.

35 See Section 69 (4).

36 Visit: <http://www.energyandminerals.go.ug/minpo100.pdf>. The strategy of the policy is to ensure that the country's mineral wealth supports sustainable national growth and development.

Owners or lawful occupiers of land are 80%, 17% and 3% respectively.

In Kasese District, for example, royalties accrue from a number of mining operations carried out by among others: Hima Cement Limited, Muhokya Lime Works, and Kasese Cobalt Company Limited. The Local Government acknowledges having received a share of royalties for each of the past two financial years i.e. 2006/2007 and 2007/2008. There is no sharing of royalties with lower local governments.³⁷ This is attributed in part, to lack of transparency on the part of the district. It is noted that the district leadership led by the Chairperson and the Chief Administrative Officer make spending decisions.³⁸ This shortcoming is compounded by the fact that the Mining Act is silent on the issue.

Although, oil resources are not covered by the Mining Act, the example of Kasese district and mining royalties sets a good precedent for oil revenue sharing. It will require convincing reasons why the oil districts should not be treated in a manner similar to that of Kasese district.

2.5 Priority Issues for Consideration under Proposed Oil Revenue - Sharing

From the above analysis, the following are the priority issues of concern when developing an Oil Revenue Sharing Mechanism for Uganda.

- a) Putting in place an enabling policy and legal framework that addresses potential causes of conflicts;
- b) Developing conflict management strategies and building capacity to manage conflicts;
- c) Popularising legitimacy for oil revenue sharing claims;
- d) Developing the oil revenue sharing formula or options for revenue sharing;
- e) Facilitating the process for negotiating revenue sharing;
- f) Capacity building for negotiating and implementing revenue sharing;
- g) Access or provision of information in government hands, especially the PSAs; and
- h) Developing oil revenue management system, including essential fiscal policies, planning tools and institutional capacities.

These priority actions require a government led collaborative effort. However, this paper seeks to make a contribution at this stage by way of providing the analysis and proposals on potential revenue sharing options and their development process.

³⁷ Interview with Mr. Sylvester Kabale, Senior Finance Officer, Kasese District (23.6.08)

³⁸ Interview with Mr. Augustine Kooli, Wetlands Officer (and acting District Environment Officer), Kasese District (23.6.08)

3

EXPERIENCES OF OIL REVENUE MANAGEMENT

The research analyses the various oil revenue schemes and practices from several countries and presents the examples in subsequent sections. The aim for this analysis is to distil lessons that inform Uganda's efforts to develop her own oil revenue sharing arrangements. The analysed experiences are unique to their countries. However, these experiences offer useful hints that could inform the development of Uganda's revenue sharing mechanism.

3.1 International Policy on Oil Resources

Governments worldwide have increasingly asserted their desire for ownership and control over natural resource developments in their countries, especially, Oil resources. Such ownership and control is seen as an integral part of the New International Economic Order (NIEO), a system whose outlines at least have been sketched in numerous international fora.³⁹ This has led developing countries to attempt to nationalize oil resources as shown in the *Anglo-Iranian Oil Company Case (United Kingdom v. Iran)*.⁴⁰ The right of all states to permanent sovereignty over their natural resources, including the right to nationalize or otherwise expropriate those resources was asserted in that landmark case.

Contemporary international law reflects international consensus that States have, in accordance with the Charter of the United Nations and the principles of international law, the sovereign right to exploit their own resources pursuant to their own environmental policies and the responsibility to ensure that activities, within their jurisdiction or control, do not cause damage to the environment of other states or of areas beyond the limits of national jurisdiction. This principle of international customary law also restates the time honoured principles of state responsibility for damage, including environmental damage to other States and State sovereignty. The existing rules of international law favour the sovereignty of States over their natural resources.⁴¹ Thus, the issue of ownership of natural resources has been addressed by international law. This right has been asserted by many

39 See General Assembly Resolutions 3201 (S-VI) and 3202 (S-VI) of 1st May 1974 and 3362 (S-VII) of 16th September 1975 contain the basic summary of the goals of NIEO. See generally Mohammed Bedjaoui (1979), *Towards a New International Economic Order: New Challenges to International Law*: Paris, UNESCO.

40 [1952] I.C.J. Rep. 4

41 See generally Robert Wabunoha: "Introduction to the Convention on Biological Diversity: the Question of National Sovereignty and the Key Concepts and Requirements of Article 15" a paper presented at the proceedings of the National Workshop on Access to Genetic resources and Benefit Sharing in Uganda; February 16-17, 1998, Fairway Hotel, Kampala

international instruments namely; the United Nations General Assembly's Resolution on the Permanent Sovereignty over Natural Resources passed on 14 December 1962, the 1972 Stockholm Declaration,⁴² the 1992 Convention on Biological Diversity (CBD),⁴³ the United Nations Covenants of Human Rights (International Covenant on Economic, Social and Cultural Rights (ICESCR) and International Covenant on Civil and Political Rights (ICCPR) adopted by the General Assembly in 1966⁴⁴ and the African [Banjul] Charter on Human and Peoples' Rights.⁴⁵

3.2 Defining Ownership of Oil Resources

The provision for ownership provided for under the International law has been variously applied by countries when defining ownership of oil resources. Oil revenue sharing can be best pursued when the ownership of the resource and accruing revenues is properly defined and agreed upon. Presently, oil resources are owned in different ways across several countries. Oil-producing countries utilize various arrangements for determining ownership of oil and the attendant rights to extract and develop these resources. The common arrangements for determining oil ownership fall under four categories: national, regional, shared and private ownership.⁴⁶

3.2.1 National Ownership of Oil Resources

Under this arrangement, ownership and control of oil resources is vested in the national government. This type of ownership is constitutionally provided for in Russia, Norway, Venezuela, and Indonesia and in most of Middle Eastern and African oil-producing countries.⁴⁷ Oil-producing countries using this category of ownership are known to have highly centralized governments as exemplified by most of the monarchical Gulf States, Egypt and Iran. Others like Indonesia, Russia and Venezuela are republican governments that are often democratically weak; non-democratic countries like Chad; de facto military dictatorships like Libya or marked by civil unrest like Angola. National ownership may reduce the potential for sectarian or ethnic conflict.⁴⁸ However, sovereign ownership may also potentially create friction between central and regional governments over revenue, geographic boundaries and/or regional wealth disparities.

3.2.2 Regional Ownership of Oil Resources

This arrangement arises in states practicing federal or decentralized form of governments (e.g., U.S.A/Alaska and United Arab Emirates) whereby ownership and control of oil

42 See Principle 2

43 See Articles 3 and 15

44 See Article 1(2) of both instruments.

45 See Article 21

46 Yoonie Kim, Alexandros Aldous, Jason Crosby, Kate Ellis, Ethan Ostroff, & Valbona Sherifi. (September, 2004). A Primer On The Equitable Distribution Of Oil For Iraq: Legal Memorandum: Public International Law & Policy Group. www.publicinternationallaw.org.

47 Ibid

48 Roy Bahl, & Bayar Tumennasan, May 1-3, 2002, Natural resource wealth is not evenly distributed within countries, and those regions that house this natural resource are likely to clamour for a more larger and dedicated share of the returns. Debate over the sharing of natural resource wealth can seriously harm national unity.

resources is vested in the government of the region where the resources are located. This is because it fulfils the goal of enabling regional entities to retain a high level of autonomy from the central government. However, regional ownership may increase the risk of conflict between oil-rich and non-oil producing regions of a country.

3.2.3 Shared Ownership

The shared ownership category is when ownership and control of oil resources is vested in the national and regional governments as exemplified by Canada. Each province owns and administers natural resources within its borders while the federal government owns and exploits oil resources on federal lands. This approach permits resource-rich regions to maintain direct control over their resources. Local administrators of the resources are directly accountable to the citizens of the region rather than the federal government. Shared ownership provides a compromise between those who desire regional ownership and those who desire national ownership. One drawback may be the difficulty in deciding how to divide ownership between the entities to the satisfaction of all.

3.2.4 Private Ownership

In most countries, governments have nationalized subsurface hydrocarbons, and there is no private or 'freehold' ownership of oil and gas. Only in the United States is most subsurface oil and gas owned by individual 'freehold owners' or 'freeholders'. Canada is unique in a way that the vast majority of known oil and gas reserves are owned by the provinces. However, there is still some private ownership. In Alberta for instance, the oil and gas approximately 10% of the Province is privately-owned. However, most of these freehold mineral interests are held by Encana Corporation ("Encana") which succeeded the Canadian Pacific Railway Company (CPR) and individuals who inherited or purchased farm lands from Alberta's original settlers own the oil and gas beneath approximately 4% of Alberta.⁴⁹

3.3 Examples of Oil Revenue - Sharing Mechanisms

Due to the capital intensive nature of the oil industry and the domination of production and consumption of oil by vertically integrated oil multinationals in developed countries, oil-rich developing countries have often been reduced to rent collectors and distributors. In such a scenario, those who directly control the state control the oil and political power is always concentrated in their hands. The lucrative profits associated with oil create a feeling among individuals and the public of 'getting out of poverty quickly and easily'. Those who gain access to the petrodollars tend to do anything within their means to maintain the control of oil resources and revenue. It is such tendencies that have eventually escalated into civil strife in the oil states of Angola, Sierra Leone and Sudan. The oil craziness generates conflict between oil producing states and regions if accruing revenues are not equitably distributed. Furthermore, wealth associated with oil is known to breed bad governance and corruption

⁴⁹ See Freehold Owners Association, "The plight of freehold ownership in Canada", Visit: <http://www.fhoa.ca/history.htm>, see also Freehold Owners Association "privately held subsurface hydrocarbons", visit: <http://www.fhoa.ca/oilgas.htm>

in most oil-rich developing countries. Unfortunately, bad governance and corruption cause inequality, poverty and political exclusion which contribute to conflict, particularly along ethnic or regional identities.

Other than ownership, the other question facing any oil-producing country is how to use oil wealth. One of the issues likely to arise in Uganda after embarking on commercial production of oil will be allocation of accruing revenues. Several key distributional principles to consider in designing an oil-revenue allocation system are derivation, population, basic needs, and unique historical circumstances. Other important considerations are national and local economic stability, funding for infrastructure, modernization, healthcare, education and security.

The following section presents some of the common forms of oil revenue sharing mechanisms worldwide.

3.3.1 Full Centralisation of Oil Revenues

Under full centralization mechanism, the proceeds from the extraction and production of oil resources are included in the general revenue of the central government. The full centralization model is common in many unitary states since the central government can easily absorb oil-revenue fluctuations because of more diverse tax bases uncorrelated with oil. Coupled with the ability to borrow, central governments can potentially reduce inter-regional disparities because of its better position to establish horizontal equalization mechanisms. This model has been applied in countries such as Algeria, Azerbaijan, Indonesia (until 2000), Iran, Iraq, Kuwait, Libya, Norway, Oman, Qatar, Saudi Arabia, and Yemen.⁵⁰ In these countries, efforts have been made to address the oil revenue windfall problem. They have established stabilization funds with a view to smoothen revenues and expenditures over time.⁵¹ The following examples of Norway and Chad show how this mechanism has been applied.

3.3.1.1 The Norwegian Petroleum Fund

The Norwegian experience with oil production is held as a “best practice” in natural resource revenue management.⁵² It is hailed as a good example of well-governed central budgeting and saving for the future with a high yielding investment strategy. The infusion of oil revenues in the country has helped to fund the expansion of Norway’s welfare system. Directly, the revenues have sustained Norway’s strong growth in public sector employment and social security while indirectly, they have helped to avoid accumulation of public debts

and the attendant large interest payment obligations that burdens most other nations.

50 See Ehtisham Ahmad and Eric Mottu (2002): “Oil revenue assignments: country experiences and issues” IMF Working Paper No. 02/203, Pg 7

51 Azerbaijan has established the State Oil Fund of Azerbaijan (SOFAR); Kazakhstan the Kazakhstan National Oil Fund, Norway the Pension Fund (formerly the Petroleum fund) and Kuwait the Reserve Fund

52 See, Bantekas Ilias. (2005). Natural Resource Revenue Sharing Schemes (Trust Funds) in International Law. Netherlands International Law Review, LII, 31-56; Jonas Hjort. (2006). Citizen funds and Dutch Disease in developing countries. Resources Policy, 31, 183-191.

The Norwegian Parliament “the Storting” founded the multistakeholder fund, ‘The Petroleum Fund’ in 1990. Oil revenues are accumulated there through a system of royalties, taxes, and state-owned production and they flow into the central government budget. All fiscal decisions are made through the central budgeting process and any budget surplus flows into the fund. The goal of the Petroleum Fund is to provide a reserve for continued expenditures over the long term given the prediction that the North Sea oil deposits will be depleted within the next four decades or so. All resources coming into the oil fund are reported to parliament which must authorize any transfers from the fund to the budget. All spending is done from the regular budget.

The responsibility of managing the Petroleum Fund which technically lies with the Ministry of Finance was delegated to the central bank, ‘Norges Bank’ for day-to-day matters. The Ministry only issues guidelines for investment of the fund’s capital. As a small and open economy, Norway has chosen to invest the funds’ assets exclusively in foreign bonds and equity. This strategy reflects the main goal of income generation and risk diversification. Recently, guidelines for ethical investing have also been developed. Reporting is transparent, publicity available and oversight is strong.

Beneficiaries of Norway’s resource revenue management are the Norwegian society as a whole, through a sustainable expansion of the government budget. In recent years, petroleum-related revenues have covered one quarter of the budget, allowing current residents to benefit from great public services relative to their tax burden. Good management of these public investments has also helped foster strong economic growth.

The petroleum fund is structured to benefit future citizens whereby; three quarters of current revenues is saved and invested to provide for continued government revenues after resource rents diminish. None of the funds are earmarked for particular projects or benefit sharing. The Norwegian case is a good example of how strong and well governed institutions can manage natural resource assets for the greater good, without need for specific earmarking. Transparency and accountability are fundamental to the Norwegian success.

3.3.1.2 The Chad Petroleum Revenue Management Programme

Chad ranks as one of the poorest and least developed countries in the world. The Chad-Cameroon Pipeline project offered Chad a promise for funding critical efforts to reduce poverty. The Chad-Cameroon Petroleum Development Pipeline Project may be one of the few examples of conditionality in a natural resource development project. The World Bank Group partially financed the project and, in collaboration with the Chad government, structured unprecedented safeguards. IMF and World Bank have placed oversight conditions on resource revenue flows in exchange for their assistance in funding the government’s portion of the project, which seeks to develop oil fields of Kome, Miandoum and Bolobo in southern Chad for export via a new pipeline to Cameroon’s Atlantic coast.⁵³

⁵³ Visit: www.esso Chad.com. The money covered by the monitoring arrangements includes both the Chadian government’s share of oil production and taxes paid by foreign oil companies on their shares. However, bonuses paid by the international companies were not originally included. This exception caused some difficulties for the

The Petroleum Revenue Management Program (PRMP) or The Law on the Management of Oil Revenue, developed with World Bank assistance and passed by the Chadian Parliament in 1998, provides for oversight of the collection and use of oil revenues. The structure of the PRMP, in its policy and management strategies, reflects some of the more recent thoughts on how to design a program for managing and distributing resource revenues in a developing country.

By law, the government must allocate oil revenues according to specific shares. An offshore audited escrow account holds royalties and dividends and disburses them to agreed upon special accounts.⁵⁴

The Future Generations Fund receives 10% of the revenues to invest for the future. Special Petroleum Revenue Accounts, which are Treasury accounts held in one or two private commercial banks in Chad, receive the other 90% for poverty alleviation. Of this amount.

- a) 80% goes to priority sectors;- incremental projects targeting poverty reduction and development, including health, education, rural development, vital infrastructure, and environmental projects;
- b) 15% is directed to the general budget for the first five years for pressing operational needs, after which it is intended to contribute to the priority sectors; and
- c) Special attention was given to the concerns of local populations in the Doba producing region. A visible or largely symbolic 5% of the revenues were earmarked to help residents increase local capacity, enhance regional economic development; and encourage local participation in the development process.⁵⁵

Several issues influence these allocations. First, the development priorities dominate, reflecting the dire poverty in Chad. An important question is whether Chad can effectively absorb and put to productive use such a large share of the oil revenues. Second, the share to government is significant but limited, apparently in an attempt to balance general government needs with governance challenges. Thirdly, only a small share is dedicated to communities affected by the petroleum activities because the resource is considered primarily a national asset rather than local property.

The offshore accounts are subject to audit controls that have been codified into law. The agreement is monitored by a control group that includes representatives of a Chadian NGO, a trade union, members of Parliament and the Supreme Court, as well as civil servants from relevant government departments.

project's image when it was revealed that the government used some \$4.5m of its \$25m signing bonus to purchase weapons. This accelerated the establishment of the oversight committee which originally had not been expected to be in operation until 2004 when the first royalties and taxes were expected to begin accruing to the government. See Philip Swanson, Mai Oldgard, and Leiv Lunde, "Who gets the money? Reporting resource revenues" in Ian Bannon & Paul Collier (Eds) (2003): *Natural Resources and Conflict: Options and Actions*, Washington, D.C, The World Bank, Pg 89.

54 See Articles 3, 7,8 and 9 of the Revenue Management Plan, Law No. 001/PR/99

55 The principles and mechanisms for allocation of 5% of revenues to the oil-producing region are undefined. This is particularly problematic since one of the main causes of Chad's civil strife is rooted in the rivalry between the Muslim North and the predominantly Christian South, where the oil originates.

3.3.2. Full Decentralisation of Oil Revenues

This is an approach where there is regional control and taxation of oil resources. The regions control and decide on the revenue-sharing arrangements. The main advantage of this approach is that if there is distrust of the centre, the regional government will be reluctant to release sufficient revenue to the central government. Similarly, the central government will be reluctant to provide grants for regional expenditure. This model has been applied in United Arab Emirates only.

Each of the emirates has full ownership and control over its oil resources. Revenue from these resources accrues to the emirate governments in the form of royalties, company profit transfers, and income tax receipts. The emirates then implement an upward revenue sharing arrangement by making cash or in kind contributions to finance the federal government. Cash contributions are negotiated annually between each emirate and the federal government. Thus, there is considerable smoothing between high-price and low-price years, providing the federal government with a relatively stable source of revenue despite oil price fluctuations.

3.3.3 Definite oil Revenue - Sharing

In some countries the derivation principle is applied i.e. each sub-national government's share is related to the revenues originating from its territory. Others apply other criteria such as population, needs, or tax capacity. Arrangements that are rather decentralizing provide relatively large amounts of revenues to sub-national jurisdictions while those that are rather centralizing provide small amounts.

3.3.4 Limited Revenue Sharing

This approach is practiced in Mexico where oil revenues represent a significant proportion of revenue for the public Sector and sub-national governments. While oil revenues accrue to the central government, a small part is shared with sub-national governments based on a transparent formula. Lower local governments receive 20% of so-called ordinary oil extraction rights which is incorporated into a general fund that is distributed to states based on a fixed formula taking into account their characteristics. They also get 3.17% of the additional oil extraction rights which is earmarked for municipalities that are located in oil-producing regions or where oil is shipped abroad, to compensate for environmental damage.

3.3.5 Extensive Revenue Sharing

This approach is practiced in Nigeria. Generally, 73% of government revenue in Nigeria is oil-based. As is often the case in African countries, most fiscal revenue in Nigeria is collected by or on behalf of the national government. Revenue sharing and management has sparked off constitutional, political and legal controversies and sometimes violent clashes in the

country. Oil producing states in the Niger Delta region have continued to protest about the inadequacy of shares allocated to them from oil produced from the region. They have pressed for more control of the oil resources in their area as well as the application of the derivation principle as a formula for sharing revenues since it favours their interests.⁵⁶

Three layers of government, namely the federal, the state and local governments make up the system of government in Nigeria. Allocation of revenue between the Federal and State governments as well as the local government councils is provided for in the Nigerian constitution. The constitution vests control and collection of oil revenue in the federal government. A common pool of financial resources, called the Federation Account, is created under section 162 (1) of the 1999 Constitution into which is paid all monies to be distributed among Federal, State and Local Government Councils in each state on such terms and in such manner as prescribed by Parliament. Any approved formula is required to reflect the principle of derivation as being not less than 13% of the revenue accruing to the Federation Account directly from any natural resources.⁵⁷

From the Federation Account, deductions called 'first charges'⁵⁸ are made, including 13% dedicated to sharing on the derivation basis. What remains is then distributed among various levels of government in accordance with a single formula.

- a) The Federal Government receives 48.5%.
- b) 24% is remitted to the State Government Joint Account to be shared among states on the basis of equality (40%), population (30%) and social development (10%), land mass and terrain (10%), and internal revenue effort (10%);
- c) 20% goes to the Local Government Joint Account and is shared based on the above criteria; and
- d) 7.5% accrues to special funds: Fiscal Capital Territory 1.0%, Ecological Fund 2%, Oil Mineral Producing Area Development Commission (OMPADEC) 3%, Derivation 1%, and Stabilization 0.5%.

More revenues are channelled to states through the federal grants' system which are of a general character aimed at augmenting resources of those states that find themselves in financial difficulties due to natural disasters or simply to correct the disparity in services to

the people of different states. The weight that should be given to the location of a resource has been a source of much controversy in the context of the allocation of petroleum revenue.

States in the Niger Delta often complain that they have not received a fair share of petroleum revenue even though they bear most of the adverse environmental and social consequences of the operations. One of their complaints is that the federal government often interprets

56 See generally Hon. John Udeh, "Paper on petroleum revenue management: the Nigerian perspective" presented at a workshop on petroleum revenue management, Washington, DC, October 23-24, 2002.

57 See Section 162 (2) of the 1999 Constitution of the Federal Republic of Nigeria

58 First Charges comprise mainly of the government's share of the production cost of oil ('cash calls') and priority projects of the national oil company, external debt service, and 13% allocated to oil producing states. In Ehtisham Ahmad, & Eric Mottu. (November, 2002). Oil-Revenue Assignments: Country Experiences and Issues: IMF Working Paper. WP/02/203. International Monetary Fund. Page 17.

the constitutional provision, which requires the allocation of at least 13% of petroleum revenue to the state from which it is derived, in a manner that gives insufficient weight to the derivation component of the current formula. The issue has turned on whether petroleum produced offshore can be said to be derived from the state whose land abuts the production area. The federal government has taken the position that the offshore areas of Nigeria are not part of any state. This position was upheld by the Supreme Court of Nigeria.⁵⁹ However, legislation was subsequently passed (Abolition of Dichotomy in the Application of Principle of Derivation) Act, 2004 to make the onshore/offshore distinction immaterial for the purposes of revenue allocation.⁶⁰

A Revenue Mobilization Allocation and Fiscal Commission were set up to monitor the accruals to and disbursement of revenues from the Federal Account, as well as review from time to time the revenue allocation formula and principles in operation to ensure conformity with changing realities. It also advises the federal and state governments on fiscal efficiency and methods by which revenues can be increased.

3.3.6 Special/Negotiated and Ad hoc Revenue - Sharing Arrangements

This approach is practiced in Indonesia. In Indonesia oil resources used to be owned by the unitary state. Oil revenues were fully centralized and were thus not subject to any revenue sharing arrangement with provincial and district-level governments until 2000. Implementation of decentralization laws in the country from 2001 transferred substantial expenditure obligations to the provinces and districts. Beginning 2001, a revenue sharing arrangement was instituted for on-shore oil and gas revenue whereby 15% of oil revenue and 30% of gas revenue were to be transferred to the originating provinces, districts and adjacent districts. It is estimated that regional disparities will result since sources of oil and gas are concentrated in a small number of provinces and districts.⁶¹ Thus the need for an equalization transfer system still remains.

The negotiated revenue sharing arrangement has been applied in Indonesia, where two provinces, Aceh and West Papua, have negotiated a special revenue sharing agreement with the central government which recognizes their relevant differences. Under this arrangement, regions or districts negotiate with the central government in accordance with the principle of fairness and equity, and on mutually agreed terms for a share of the oil revenues. Where necessary stakeholders on an ad hoc basis can meet and solve

outstanding and emergent issues. Agreements reached recognize relevant differences of the stakeholders. While this along with the fact that the negotiation is bilateral and may be easier to bring to closure may be cited as merits, this arrangement also has a number of drawbacks. First, special negotiations never end. The agreements may lapse and need to be renegotiated after some time. There may also be a tendency to renegotiate on a regular basis. Thus, it is not easy to gain certainty in the sharing of revenues by either the central

59 See the case of Attorney-General of the Federation versus Attorney-General of Abia State (No.2), Nigeria Supreme Court (2002) 6 Nigerian Weekly Law Reports page 542.

60 See Economic Commission for Africa "Improving Public Participation in the Sustainable Development of Mineral Resources in Africa" Addis Ababa, Ethiopia, 2004, PP. 21-25

61 See Ehtisham Ahmad and Eric Mottu Op. Cit. Pg 13

government or the recipient local government.

Second, special negotiations open the door for imitations. Other local governments may seek also to be accommodated in a similar way and soon all of them become special in terms of their expected revenues. Third, where there is no uniform policy for all local governments, every new agreement creates a new precedent for subsequent negotiations whereby the next local government will ask for as much as the one before.

3.3.7 Sharing on Basis of Taxation

This formula has largely been applied in North American States of USA and Canada where tax bases are assigned instead of sharing oil revenue collected centrally. Tax bases can exclusively be assigned to one level of government (separation of taxes) or shared between levels (overlapping tax bases). Thus, overlapping tax bases refer to nationwide tax bases, but total tax rates are under the control of sub-national government control. In this case, the same tax base, for example personal income would be used by both central and sub-national governments as the base of their own taxation, which may have different tax rates and schedules.

3.3.8 Delegated or Assigned Formula

In the United States, resource revenue bases are assigned to the states, which are sovereign and own the resources, except on federally owned land, but with an arrangement to share the income tax base. Thus the state of Alaska levies a property tax, a severance tax, royalties, a production tax surcharge for hazardous spill, and a corporate income tax on oil production-related activities. The state is fully, accountable for the fiscal policy choices related to oil revenues and their possible uses for spending or savings.

3.3.9 Direct Distributions to Citizens

3.3.9.1 The Case of Alaska

Following a constitutional amendment that mandated earmarking of revenue, the state has created the Alaska Permanent Fund (APF), among other funds, to save part of the oil revenues for future generations. The APF comprises of the principal and earning reserves. Revenue from the fund is distributed for two purposes: (1) annual dividend payment and (2) "inflation proofing." The principal of the fund remains to benefit future generations, while cash dividends on the principal are paid out annually to all Alaskan residents.

Alaska uses the APF strictly for savings and income, while some current revenues are used for economic development goals. Alaska residents benefit directly from the fund, since the primary use of the income is to pay dividends to every citizen in the state. The dividend in 2004 was \$920.⁶² As a share of total oil revenues, however, less than one eighth is dedicated toward benefit sharing in the stricter sense. Since much of the APF is dedicated to

⁶² <http://www.apfc.org/alaska/dividendprgm.cfm>

citizen dividends, government revenues remain subject to oil price volatility and production variability. The APF is managed by the APF Corporation and oversight is provided by a Board of Trustees, the Alaskan state legislature and the public.⁶³

Under this arrangement, monetary benefits realized from the exploitation of hydrocarbons are distributed directly to the citizens. This is a very uncommon system. It has been used in Alaska where the Permanent Fund receives 25% of oil revenues, and pays out dividends that are evenly distributed in cash to all Alaska residents. The beneficial economic and distributive effect of direct distributions is that it may put purchasing power directly in the hands of the poorest of the poor.

The main objections to this arrangement are political. These relate with how to overcome opposition from existing vested interests. Those against it argue that people cannot be trusted with money and will squander it, creating detrimental macro-economic distortions. In light of cases of misappropriation of public funds in many developing countries, one may pose the question: who is better at managing and spending money; the people or a weak corrupt state?

Even where there have been large needs for infrastructure developments and social spending, some governments have considered distributing part of the resource revenues directly to citizens, as a way of achieving equitable distribution of benefits and obtaining popular policy support. However, doing so requires a means of identifying all citizens and an economy-wide mechanism for distributing cash benefits (such as banks).

There are good reasons both for and against direct distributions. Nevertheless, the distribution of windfall revenues to citizens, may not meet social objectives as it rests on the assumption that individual private citizens can save money or make investment decisions better than corrupt government bureaucrats.⁶⁴ This may not necessarily be the case.

3.3.9.2 The Case of Libya

Libya has the third highest GDP per capita in Africa. This is largely due to her large petroleum reserves and a small population.⁶⁵ The ruling class in Libya maintains a monopoly on the

distribution of oil revenues. Oil revenue has been used to bankroll spectacular developments. Huge sums of money are spent on eccentric schemes like the construction of a \$25 billion "Great Man-made River Project" across the Sahara. Billions of petrodollars have gone to finance the causes of liberation and Islam throughout the world. The government has distributed oil revenues to influence tribal leaders and placate those who question political

63 Carolyn Fischer. (May, 2007). *International Experience with Benefit-Sharing Instruments for Extractive Resources: Resources for the Future*, 1616 P Street NW, Washington, DC 20036. Available at: <http://www.rff.org/Publications/Pages/PublicationDetails.aspx?PublicationID=9576>

64 See Collier, P. and Gunning, J. W., 1996, "Policy towards commodity Shocks in Developing Countries," IMF, Working Paper, WP/96/84, Washington D.C.; and Sala-i-Martin, X. and Subramanian, A., 2003, "Addressing the Natural Resource Curse: An Illustration from Nigeria," IMF Working Paper, WP/03/139.

65 See Annual Statistical Bulletin, (2004), "World proven crude oil reserves by country, 1980-2004", O.P.E.C., Accessed July 20 2006 ; World Economic Outlook Database, (April, 2006), "Report for Selected Countries and Subjects", International Monetary Fund, Accessed July 15 2006

concepts of the ruling class.⁶⁶

Libya embraced a direct distribution policy of oil revenues to its citizens. The National Oil Company is in-charge of the oil policy, and reports directly to the General People's Committee. According to Reuters, the Libyan leader is quoted to have said that "all citizens have the right to benefit from the oil funds. They should take the money and do whatever they want with it . . . citizens will get part of the oil revenue directly. They do not need intermediaries."⁶⁷

3.4 Examples of Sharing Non-Oil Revenues

The following section presents two scenarios of revenue-sharing mechanisms within and outside Uganda relating to wildlife and mining sub-sectors, respectively.

3.4.1 Non-oil Revenue-Sharing Experience in Uganda

3.4.1.1 The Revenue Sharing Program in the Wildlife Sector

The Revenue Sharing Program (RSP)⁶⁸ for income accruals from wildlife utilization (revenue from tourism, concessions and franchise fees) with the neighbouring local communities was adopted in the 1994 Wildlife Policy and was subsequently legally backed by provisions in the Uganda Wildlife Act.⁶⁹ Originally, 12% of all the revenue from Parks (including gorilla tracking fees) was set aside for the RSP of which 8% was shared with the local communities, 2% with the district authorities and 2% went to the National RSP Consolidated Fund for other parks. In 1996, new policy guidelines were passed by parliament stipulating that 20% of all the gate collections should be remitted to the RSP through the district authorities.⁷⁰

3.4.1.2 The Revenue Sharing Program in the Mining Sub-sector

Uganda has embraced⁷¹ revenue sharing in the mining sector. Minerals belong to the

State and mining companies are required to pay royalties. According to Article 244 (2) (b) of the Constitution of the Republic of Uganda and Section 98 (2) of the Mining Act, 2003, and the Mineral Policy for Uganda, 2000,⁷² royalties from exploitation of minerals are paid

66 See Craig R. Black "Deterring Libya: The Strategic Culture of Muammar Qaddafi" available at <http://www.au.af.mil/au/awc/awcgate/cpc-pubs/black.pdf> (Accessed 27.7.2007)

67 See "Kadhafi: Ministries Abolished, Oil Revenues to be Distributed to Libyans" Knight Ridder/Tribune Business News, Monday, March 03, 2008: ___ "Libya abolishes government (again)", *The Estimate*, Vol. XII No.5, March 10, 2000. Available at: <http://www.theestimate.com/public/03102000a.html>. (Accessed 30.7.2008.)

68 See the First National Report on the Conservation of Biodiversity in Uganda, available at <http://www.cbd.int/doc/world/ug/ug-nr-01-en.pdf> (Accessed 27.7.2008); See also Godber Tumushabe and Eunice Musiime, *Living on the Margins of Life: The Plight of the Batwa Communities of South Western Uganda*, ACODE Policy Research Series, No. 17, 2006, Pp.18, 20-23.

69 See Section 69 (4).

70 See Section 69 (4).

71 Section 100 of the Mining Act 2003 (minerals obtained in the course of prospecting & exploration shall be subject to payment of royalties based on prevailing market price and at such rates as shall be prescribed).

72 Visit: <http://www.energyandminerals.go.ug/minpo100.pdf>. The strategy of the policy is to ensure that the country's mineral wealth supports sustainable national growth and development.

directly to Central Government and then shared by the Government, Local Governments and owners or lawful occupiers of land subject to mineral rights as specified in the Second Schedule to the Mining Act, in ratios of 80%, 17% and 3% respectively.

In Kasese District, for example, royalties accrue from a number of mining operations carried out by among others: Hima Cement Limited, Muhokya Lime Works, and Kasese Cobalt Company Limited. The Local Government acknowledges having received a share of royalties for each of the past two financial years i.e. 2006/2007 and 2007/2008, albeit delays in disbursements from Central government.

3.4.2 Non-oil Revenue-Sharing Experience from outside Uganda

3.4.2.1 The case of National Development Plan in Botswana

The sharing of diamond-revenues in Botswana is held as an example of a “best practice” in a developing country.⁷³ Botswana is known to have been able to avoid the resource curse by pursuing far-sighted fiscal policies. Though not endowed with oil, the discovery and subsequent production of diamond in 1960’s has dominated the mining sector.

The primary mechanism of Botswana’s revenue management is not explicit saving funds or an allocation scheme, but rather a solid approach to budgeting using a viable National Development Plan (NDP). The rationale behind instituting this planning process was to stabilize government spending so that it would not add to volatility in the economy and to prioritise spending. In part, the process was carried over from donor requirements of earlier years when much of budget financing was by donor agencies.

In partnership with the World Bank, Botswana developed an investment strategy in 1980’s. The World Bank engaged commercial fund managers with performance benchmarks and an expertise was built within the central bank which began to manage the reserves internally. The planning process serves not only to impose fiscal discipline but also to articulate clear policy goals. Its four main objectives are; (i) to accumulate international reserves and earmark budget surplus for stability spending in leaner years, (ii) to manage foreign exchange reserves, liquidity in the economy, and the exchange rate to avoid real appreciation, (iii) to expand essential public services and infrastructure, including electricity, water, roads, government buildings, police, courts, broad based primary health care and education and (iv) to provide credit to state owned enterprise, enabling them to make commercial loans.

To generate government income from mining operations, Botswana has kept its royalty rate at an internationally modest level so as not to discourage production, and mandates that it receives free of charge.⁷⁴ This enables the govern–ment to reap significant profits

⁷³ See, Sarraf Maria, & Moortaza Jiwajji. (2001). “Beating the Resource Curse: The Case of Botswana”. Environment Department Working Paper 83. Environmental Economics Series: Washington, DC: World Bank Group.

⁷⁴ See, Carolyn Fischer. (May, 2007), Op Cit

without relying on an income tax system. Rents are further enhanced by exercising market power in conjunction with Central Selling Organisation for diamonds. In addition, the accumulated foreign exchange reserves generate significant investment income. Botswana has also incorporated environmental protection into its mining policy. As part of concession agreements, mining companies were made responsible for implementing specified environmental protective measures. Mining revenues in Botswana have been leveraged for broad-based growth through expanded government services. Consequently, benefits have not been earmarked to specific recipients, but rather accrue to citizens more generally, as determined by the central budgeting process.

3.4.2.2 The case of the Mineral Development Fund in Ghana

In Ghana, the Mineral Development Fund (MDF), which has been in existence since 1993, provides the mechanism through which portions of royalties paid to the central government are distributed to mining communities. Under the MDF, 9% of royalties paid by a mining project goes to the local community to be shared between the District Assembly (the local political administrative unit) and the local traditional authorities. The MDF also provides for monies to be made available, on application, for use in addressing some specific problems, which may be shown to result from mining activities. In addition, under a general national revenue-sharing scheme (the District assemblies Common Fund), all District Assemblies in the country (including those in mining communities) get a share (determined by a complex formula) out of five per cent (5%) of all revenues collected by the central government. Thus further monies from mining go back to the mining communities.⁷⁵

3.5 Conclusions on Experiences and Lessons for Uganda

As Uganda prepares to join the club of Oil Producing and Exporting Countries (OPEC), she faces challenges concerned mainly with oil revenue management and sharing. Whatever approach Uganda takes in designing a formula for allocation of her oil revenue, the following key considerations should be taken into account: (i) a coherent energy policy; (ii) distributional principles; (iii) compensation to producing areas for costs of production; (iv) national and regional/local economic stability; and (v) expenditure responsibility.

In a developing country like Uganda, government may find the temptation to spend the 'oil-windfall' irresistible, especially during the periods of high prices because of low income levels and substantial development needs.

As Uganda prepares to embark on commercial production of oil, it is important to appreciate that;

- a) Broadening revenue base for the country: the need to develop a significant non-oil revenue base to minimize the variations in total revenues: – the income from oil may not be substantial enough to shoulder the economy by itself. The challenge is to dare other sectors of the economy to get in a full production mode. A lot needs to be

⁷⁵ See Economic Commission for Africa Op. Cit. 2004

done to sustain those sectors buoyant.

- b) Managing price volatility: there are problems of price volatility with oil-revenues; Some countries have sought to deal with these through establishment of a stabilisation funds to smoothen revenues and expenditures overtime. One disadvantage with this system is the possibility of establishing a parallel budget system, often with less oversight than the regular budget. This is common in developing countries. Norway's responses to the potential difficulty are noteworthy; (i) all resources coming to the oil fund are reported to parliament, (ii) parliament must authorize any transfers from the fund to the budget, (iii) all spending is done from the regular budget
- c) Saving for the future: the finite (exhaustible) duration of oil extraction has to be addressed by setting up a savings fund: - the 'future generations' fund'. Spending on such funds should be expressly curtailed. If the government wants to spend a penny from the fund, it must be allowed by parliament.
- d) Developing sharing formula and mechanisms: mechanisms for allocating Oil revenues should be developed at the earliest opportunity, in any case before the Oil production begins. Since oil resources in Uganda are nationally owned, a revenue-sharing agreement ensuring equitable benefit to the oil and non oil-producing regions should be negotiated.
- e) Consulting with local stakeholders: It is imperative to note that serious conflicts can arise when local stakeholders; — notwithstanding whether they have legal tenure over the land or not — are adversely affected by oil production activities. A clear process has to be put in place for consulting stakeholders, incorporating their views into decisions about oil exploitation and production, and negotiating some form of compensating them. The development forums of Papua New Guinea are one good example.
- f) Assessing institutional capacity: The success of oil wealth management depends on good governance. A critical issue is about institutions that are best placed to provide services, be they central government or district based. Options for improving capacity at all levels should be explored and capacity gaps addressed.
- g) Offering benefits in a productive form: - to be of benefit in a developing society like Uganda, oil revenues should be allocated to providing critical public infrastructure and productive services like; transport, water and sanitation, health, education, etc, determined through a well-structured process. Cash transfers are likely to be spent on non-productive consumption although they may alleviate current poverty if distributed broadly. In such a case, investing in improving capacity of governance and saving oil wealth until it can be put to better use; — either through a future generations fund or even by leaving it in the ground may be the best course of action.
- h) Formalizing management structures and priorities: - drawing from the example of Botswana, a process for identifying priorities and planning expenditures can also be implemented within a governing institution. A formal structure with a clear mandate should be put in place to prioritize and plan spending, be it through a trust fund board or government institution or both.

- i) Considering the scope of the revenue stream: the larger the revenue from oil production to an economy, the more important it is to follow proper macro-economic policies and micro level allocation issues. The extraction horizon is equally important. If oil revenues are expected to flow consistently over a long period, it may be less necessary to save for the future but more prudent to think of stabilization. However, if revenues from the sector are likely to boom and taper off within a shorter time horizon; - particularly before broader economic development is achieved — it is important to save more substantial amounts to ensure future financing for continued public expenditure.
- j) Assessing environmental impacts: the potential environmental impacts of oil extraction projects in Uganda should be assessed for several reasons; (i) to decide whether the benefits of oil production exceed its costs, (ii) to identify the needs of local stakeholders who will be affected and determine their compensation, and (iii) to design regulatory strategies for mitigation and enforcement. Those strategies can also incorporate revenue-raising market mechanisms like environmental taxes to ensure that the costs of environmental damage are internalized. A liability fund, which earmarks those revenues, can ensure that funds are available to cover any excess cleanup costs or health costs that might fall to the government. These mechanisms should be of particular importance where valuable biodiversity and renewable resources are located in oil-producing areas, which is the case in Uganda.
- k) Nurturing and nourishing a fiscal consolidation plan: This involves forecasting and planning for the future when the oil resources are depleted. It involves planning for a time without earnings from oil which requires diversifying the economy by investing in other long term assets and building the capacity that enables proper adjustment to the depletion of such a resource. To avoid the many pitfalls that have fuelled the 'Dutch Disease' syndrome in many developing countries, certain principles for oil revenue management have been suggested.⁷⁶ These include;
 - I. Pursuance of high rates of return from natural resource endowments.
 - II. Investment in human capital and critical public infrastructure.
 - III. Accumulation of surpluses and avoiding large-scale debts as well as control of exchange rate appreciation when applicable.
 - IV. Creation of a stabilization fund to cope with commodity-price volatility.
 - V. Promotion of transparency and good fiscal practices.
 - VI. Ensuring fair distribution of wealth to affected communities.
 - VII. Avoiding corruption and preventing misuse of funds.

⁷⁶ Sarraf Maria, & Moortaza Jiwani. (2001). Op cit.

4

PROPOSALS FOR OIL REVENUE SHARING FOR UGANDA

The following section provides proposals for revenue sharing. These proposals are based on the legal provisions for revenue sharing (Section 4.4) and the fact that substantial revenues will be accruing to government in form of royalties, taxes, and proceeds from profits.

4.1 Definition of Revenue - Sharing for Uganda

This study proposes the following definition: *investment of incomes accruing from oil revenue based on negotiated proportions between government and legitimate beneficiary entities*. All forms of Oil revenues to government shall constitute the "Revenue" to be shared between government and beneficiaries.

4.2 The Principles for Oil Revenue - Sharing in Uganda

The key principle for an oil revenue sharing mechanism is proper definition of the system for the allocation of investments by oil companies and government from oil/gas-related incomes which accrue in form of taxes, fees, royalties, profits and other transfers to host governments. In the case of Uganda, this principle ought to define equity, heritage issues, ethical consideration and sustainable development. It should also define aspects of economic rent, cost re-imburement and international obligations as elaborated in the following sections.

A transparent revenue sharing mechanism for Uganda would enable government to achieve socio-economic transformation of the country in strategic sectors such as health, education and infrastructure. On the other hand, failure on the part of government to establish a robust transparent revenue sharing mechanism could result into the Dutch Disease- stagnation in technological innovation, decline in agricultural and industrial sector, run away corruption and democratic failure, violent conflicts and underdevelopment. Fortunately for Uganda, oil has not yet started flowing and therefore, there is time to establish a revenue sharing mechanism that can usher in lasting wealth and prosperity.

4.2.1 Securing Equitable Development

Natural resource development projects are usually situated in poorer regions. Exploiting untapped resources present an opportunity for the regions to experience development

through opportunities created by the projects such as road infrastructure built to facilitate production. Development of road infrastructure would improve agricultural production by facilitating access to markets. Such an approach also addresses the risk of leakage of redistributed benefits away from project-affected communities. This risk is high in poorer regions lacking in infrastructure, industry, public and commercial services as well as local institutional capacity.

4.2.2 Addressing Heritage Attachment

The heritage argument holds that an oil producing region and her people have a heritage in the form of the natural resources.⁷⁷ It is important to appreciate that there are genuine arguments for giving local governments a share of oil revenue. Other than oil being a natural resource endowment of a region where it is found, it is unfortunately exhaustible. Whilst entitlements from the exhaustible resource such as oil may appear bountiful and exorbitant to casual observers, it should be seen by residents of the oil region, as payment for selling their heritage.⁷⁸

4.2.3 Addressing Ethical Considerations

Ethical considerations justify that part of the revenues be channelled to project-affected populations. The communities in the oil producing regions are always at the receiving end of the negative effects of oil exploitation notably environmental degradation through pollution of water and air.⁷⁹ Thus it would appear to be a basic principle of social justice that development projects should not come at the expense of the poor and that people directly affected by a project should benefit most. Available literature on oil resources especially among the oil producing and exporting countries like the Oriente in Ecuador and Niger Delta in Nigeria indicates that the affected communities have risen in arms against the resource development. Organizations such as the Movement for the Survival of Ogoni People (MOSOP) and Movement for the Emancipation of the Niger Delta (MEND) have been formed in Nigeria whose members are said to be involved in violent activities with disastrous results.⁸⁰

4.2.4 Application of the “Theory of Economic Rent”

“Economic rent” (sometimes referred to as Economic bounty) is the maximum economic surplus that can be extracted from oil resources while the oil industry continues to operate efficiently.⁸¹ Natural resource developers do not “earn” rent as they do with normal profits

77 In the case of Abdikadir Sheikh Hassan & 4 Ors vs: Kenya Wildlife Service HCCC No 2059 of 1996 the court in finding that the applicants were entitled to maintain the suit found that the respondent was trying to deplete through translocation the applicant’s heritage of fruits of the land of which they were entitled to through the County Council Trust.

78 McLure put it nicely thus: “Sub-national governments have argued strongly that they may have the right to tax natural resources located within their boundaries, to convert resource wealth (their ‘heritage’) into financial capital – to turn “oil in the ground into money in the bank” (McLure Jr & Charles E, 1994).

79 See Daily Monitor, Tuesday, June 10, 2008, Pg 12.

80 “Nigerian Troops repossess oil facility”, The New Vision, Friday, June 22, 2007, Pg 35.

81 For example, a film star might earn a fee many times the salary of a less well known actor. The difference in salary is the economic rent accruing to the star. Similarly, the Organization of the Petroleum Exporting “ Countries (OPEC) is a cartel that keeps oil supplies artificially low compared with potential world production, raising the price of oil. The additional cost to consumers is economic rent. Seeking economic rents by creating artificial limitations is a booming

(i.e. return to capital and entrepreneurship), rather, rent is a windfall created by the bounty of nature.⁸²

Indeed, the exploitation of natural resources, including oil resources can generate a significant economic rent as a surplus return over and above the value of the capital, labour, materials and other factors of production employed to exploit the oil resource. In this regards, sharing monetary benefits from projects implies the existence of an economic rent from project operations that goes to the owner of the project but that can also be distributed to other entities.

4.2.5 Application of “The Cost Reimbursement Theory”

It has been said that oil business is ‘dirty business’ since it imposes high social and infrastructural costs as well as likelihood of environmental pollution and degradation. This is evident in the Niger Delta in Nigeria⁸³ and the Oriente in Ecuador. Oil development requires the construction of infrastructure specific to oil production like drilling machinery and more general infrastructure like roads to deal with increased traffic and movement of heavy machinery. A large number of migrant workers may migrate to the region in search of jobs which may result in social intrusion that the region’s in-habitants may seek compensation for. A population explosion in the region resulting from an influx of jobseekers will stretch the available amenities thus imposing increased costs on the provision of education, security, and other services.

Therefore, through oil revenue sharing arrangements, costs such as those highlighted above are “offset” by the benefits arising from the shared revenues.

4.2.6 Addressing International Obligations

In recent years, issues of fair and equitable sharing of benefits arising from the utilization of natural resources have received a high global attention especially with regard to indigenous or project-affected communities. Generally, benefit sharing has emerged as an environmental as well as a human rights issue and is now expressly stipulated in both binding and non-binding international law instruments. For instance, Article 15 of

the International Labour Organisation (ILO) Convention Concerning Indigenous and Tribal Peoples in Independent Countries, (1989, No.169) requires that indigenous peoples concerned wherever possible participate in sharing the benefits of utilization of such natural resources. The norms and values enunciated in this international law obligation are binding on states having become jus cogens.

business and is particularly prevalent in oil economies.

82 Mitchell Rothman: “Measuring and Apportioning Rents from Hydroelectric Power Developments”, World Bank Discussion Paper. No. 419 of 2000.

83 See Bola Adewale: “An Overview of legal and political considerations of environmental issues in the Nigerian petroleum industry” *Rivista Giuridica Dell’Ambiente*, Vol. 10, 1996, Pp 531-541.

4.3 Sources of Revenues to Share – Production Sharing Agreements

Uganda's revenue from oil is committed through Production Sharing Agreements (PSAs). According to Keith Myers (2009) and standard application of PSA, the following shall constitute sources of oil revenue to Uganda: Royalty 5-12.5% (production rate related); Cost Recovery (Taxes) Cap 50%; Profit Oil Government Share 50-80% (production level related).

Uganda, like many other oil producing countries, entered PSA because governments most frequently choose not to be directly involved in the actual process of discovering, extracting, refining and marketing such commodities. This is due to relative inefficiency that a state enterprise would bring to such undertakings and lack of capital, skilled manpower and appropriate technology. Extensive co-operation with private companies is common in cases where governments are involved in the oil and gas sector, usually through state owned companies, such as a "National Oil Company" (NOC). The decision not to be directly involved in the oil and gas sector means that governments must find someone else to undertake the operational tasks of exploration, development of discoveries and production. The structure of the agreement that a country enters into with the oil companies determines the nature of benefits that will accrue to it, which can be subjected to a sharing mechanism.

Evolution of Oil Exploration and Production Agreements

Historically, Oil exploration and production have been done under a variety of contractual structures. In this regard, there are basically five types of agreements: traditional concessions, modern concessions, joint ventures, production-sharing agreements, and service agreements. These legal arrangements present an evolutionary sequence which has been dictated by the needs of the petroleum industry and the increasing interest of states participating in the production and marketing of petroleum. This evolutionary sequence, however, does not follow a uniform pattern. Older arrangements continue to co-exist with innovation. The historical evolution of these arrangements can be divided into the following periods;⁸⁴ (a) 1901-1957-the period of concession agreements; (b) 1957-1966 -the period of Joint venture agreements and production sharing agreements, and (c) 1966-to date - the period of the development of service contracts and direct participation of National Oil Companies in the exploration and production of petroleum resources.

Application of "Production Sharing Agreements"

Production sharing agreements for Uganda represent a development in the petroleum industry which recognizes the permanent sovereignty of states over their natural resources. Production-Sharing Agreements (PSAs) are among the most common types of contractual arrangements for petroleum exploration and development. A number of African countries such as Egypt have adopted the PSAs as their primary arrangement for the exploitation of their petroleum resources. In its most basic form,

⁸⁴ UNCTC: Main Features and Trend in Petroleum and Mining Agreements. A Technical Paper, United Nations, New York, 1983. (Doc. UN/ST/CTC/29) see pages 1-5.

a PSA has the following principal features: (i) Petroleum resources are vested in the state or in the NOC on behalf of the State, which, as the owner of mineral resources, engages a FOC as a contractor to provide technical and financial services for exploration and development operations. The principal agent of the state for the exploration and development of petroleum resources is the National Oil Company (NOC). The NOC then contracts out the exploration and production work to the oil TNCs. (ii) Oil Trans-national Companies (TNCs) carry out the day to day management of the resources. (iii) The Oil TNC bears the risk of exploration and the cost of development and production and receives a specified share of production as a reward. If no oil is found, the company receives no compensation. (vi) the foreign partner pays a royalty on gross production to the government. The remainder of the production is divided into "cost oil" and "profit oil". Cost oil goes to the TNC for recovery of costs of production and exploration. What is not recovered is carried forward to subsequent years. The remainder of the production, so called "profit oil", is then shared between government and FOC at a stipulated share (e.g. 65% for the government and 35% for the FOC). The ratio sometimes depends on the production levels that have been attained. (v) The contractor then has to pay income tax on its share of "profit oil". Over time, PSAs have changed substantially and today, they take many different forms. The main advantage of a production sharing agreement is that the host state does not contribute to the cost of exploration or production. At the same time, the state gets a role in controlling the petroleum operations. Like in the normal joint venture, production sharing also allows the state to receive revenues at the outset because it enables both operating and capital to be carried forward.

4.4 Proposals for Revenue - Sharing

The issue of ownership of oil and sharing of oil revenue poses a potentially divisive question, especially in developing countries. Globally, conversions of oil wealth to permanent wealth in most oil-rich countries often accompany any discussion about commercial oil production.

There is public debate in Uganda on how oil revenues should be managed and allocated. While Uganda has no prior experience in managing and allocating revenues accruing from exploitation of hydrocarbon resources, the country can greatly benefit from these early public debates of how good management of oil issues could create national prosperity. There are two sides of the debate favouring or not favouring oil revenue sharing, respectively. The debate in favour of the Oil Revenue Sharing draws their arguments from the legal and policy provisions (section 2.4.2).

The debate against oil revenue sharing advances an argument that Uganda's natural resource endowments are unevenly distributed, and therefore, should accruing revenues be shared among local governments purely on a derivation basis, gross inequities in the revenue-sharing system would occur.

More so, it is argued that current macro-economic planning and growth considerations dictate that revenues raised from natural resources should be kept by the central government.

It has been proposed⁸⁵ to integrate oil revenues into the Government budget - just like any other revenues – so as to ensure that Government expenditure takes into account the economy’s absorptive capacity and national development priorities. According to the Governor of Bank of Uganda, the regulatory framework within central government is the only one that can ensure macroeconomic stability, maintain low and stable inflation rates and avoid excessive appreciation of the domestic currency. It is known that unrestrained currency appreciation is harmful, particularly to the non-oil export sector. Accordingly, new oil-related foreign exchange revenue inflows would undoubtedly appreciate the Shilling in Uganda if not properly planned for.⁸⁶

4.4.1 Policy Considerations

The National Oil and Gas Policy (2008) provides for Oil revenue sharing. However, there is no reference to the mechanisms for sharing the oil revenues. This study proposes that the government in consultations with stakeholders in the oil sector should present to the Parliament policy proposals on sharing policy for enactment.

The following sections provide potential oil revenues sharing options to choose from.

4.4.2 Revenues- Sharing Options

Oil revenues have two key characteristics that must be taken into account in designing any revenue sharing mechanism. First, oil revenues can never be permanent since the resource is non-renewable. This has an implication on intergenerational equity. There is thus a need for savings. Second, they will fluctuate over time due to market price and volume volatility.⁸⁷

Considering the distinctive role that oil has played in many countries, there are a number of policy options through which oil revenues could be distributed more equitably to prevent a dive towards ethnic and regional fragmentation. The options for developing a revenue-sharing framework in Uganda include:

4.4.2.1 Sharing Royalties

The System of governance in Uganda combined centralized and decentralized systems. To maintain the country’s bargaining position with oil companies, oil reserves should be centralized. This is because a central authority in control of the country’s oil reserves has the legal mandate, technical capacity, managerial and negotiating skills necessary for the exercise.

Should this option be pursued, it important to note that the Constitution of Uganda becomes a limiting factor in terms of revenue sharing. It enjoins parliament to enact laws regulating

⁸⁵ National Gas and Oil Policy 2008

⁸⁶ Prof. Tumusiime-Mutebile (Governor Bank of Uganda). (February 26th, 2008). Oil Economics and Petroleum Revenue Management. Paper presented at the A Seminar Discussion of the earlier Presentations, Imperial Resort Beach Hotel, Entebbe.

⁸⁷ See Ehtisham Ahmad and Eric Mottu (2002) Op. Cit at Pg 4

the sharing of royalties from mineral and petroleum exploitation.⁸⁸ Although there are many probable sources of oil revenues in the oil sub-sector, only royalties can be subjected to any sharing mechanism as the rest accrue to the government which budgets for them for the benefit of all citizens and the whole country. The Mining Act, 2003 is illustrative of this legal position. Going by this, it is anticipated that government will adopt the approach for distributing royalties from mining sector. However, the legal position regarding sharing of royalties in the mining sectors has not been free from criticism. The choice of the percentage to allocate is an issue yet to be revealed, and the final determination must be made by parliament. The final formula will have to take into account the share of the central government budget spent in or on the oil producing region.

4.4.2.2 Local Authorities Taxation of the Oil Sub-sector

Nationally, tax administration considerations require that basic methods of taxing the sub-sector that is Personal and Corporate income taxes, Value Added Tax, etc, should remain centralized. However, it may be possible to explore the possibility of the state allowing local authorities to directly tax oil companies on the property value, use of infrastructure or other basis. Such taxes are usually administered by the level of government responsible for maintaining that specific infrastructure and are set with the objective of maintaining an adequate level of funds for maintenance purposes.⁸⁹ Such taxes to be paid to local authorities would have to be defined in legislation, sometimes as a percentage of sales or net income. In the latter case, this mechanism is similar to revenue sharing.⁹⁰ Thus, another means of augmenting resources of the local governments is by reviewing the tax powers of the various tiers of government and ensuring optimum exploitation of internally generated revenue possibilities at the local government levels. This will enhance their revenue base to enable them execute their socio-economic programmes without complete dependence on the central government.

Avenues for raising revenue already exist in the Local Governments Act through which local governments can collect their own revenue i.e. through fees and charges as well as property taxes. However, this should be done within the general framework of allowable local government revenue-raising as stipulated in the Fifth Schedule to the Local Governments Act. Fees and levies should be general on all businesses, and should be aimed to recoup some of the cost of providing services.⁹¹ By invoking these provisions, Hoima District has included provisions for taxing the oil industry in the Hoima District Local Government Environment and Natural Resources Management Bill, 2008.

88 See Article 244 (2) (b)

89 See Prof. James M. Otto (March 2001): "Fiscal decentralization and mining" The World Bank Group Mining Department, Pg. 12.

90 This mechanism has been applied in: (i). The Glomma and Laagen River Basin in Norway where benefit sharing is through local taxes. (ii). The Itaipu Binational Project in Brazil and Paraguay where benefit sharing is through payment of royalties to national, regional and local authorities.

91 See Roy Bahl, "How should revenues from natural resources be shared in Indonesia?", May 2003. Visit: <http://isp-aysps.gsu.edu/papers/ipwp0214pdf> (Accessed 20.4.08) 19.

Thus, while local governments should generally not be allowed to tax the natural resources sector, political considerations may justify the case for such local government participation. Some of the taxes like; Royalty (Profit based type), Income profit based tax, Royalty (ad valorem type), Royalty (Unit type), Royalty tax collected nationally and % distributed, Licensing fees, Surface rental and land use fees, Stamp duty, Property tax (on book or assessed value), Surtaxes and User fees can be imposed at the level of central government but could as well be delegated to regional or local governments of the oil producing regions/districts.⁹²

4.4.2.3 Establish a Heritage Fund

While Article 244 enjoins parliament to enact laws on the sharing of royalties, there is no provision in the Constitution prohibiting the sharing of the other sources of oil revenue. Thus, in addition to royalties, Parliament may allocate certain portions of the other sources of oil revenues. Establishing a Heritage Fund for the identified stakeholders in Albertine Region to receive transfers of oil revenue is one option for doing this.⁹³ This move is constitutionally justified in light of Principle XII of the Constitution which enjoins the State to take necessary measures to bring about balanced development of the different areas of Uganda and between the rural and urban areas. The State is also enjoined to take special measures in favour of the development of least developed areas. As a precedent to this option, government recognizes that there is regional disparity in poverty levels due to historical factors and the 20 year-old war in northern Uganda has justified significant investment of resources in that region. Government introduced deliberate programmes to address these disparities, exemplified by the Northern Uganda Reconstruction Programme (NURP) I and II, Northern Uganda Social Action Fund (NUSAF) worth \$100m and more recently, the Peace, Recovery and Development Plan worth \$650m. This is over and above the budgetary allocation given to each district on per capita basis and further supported by equalization grants.⁹⁴

Considering that royalties are just a small portion of oil revenue, the Ugandan parliament could establish a Heritage Fund for the oil-producing districts. Payments into the funds could fluctuate with commodity prices without harming the provision of local government programmes and expenditures from the fund could be evened out over time. The Funds would be conservatively invested, the corpus would grow over time, and earnings would be earmarked for prescribed investments in regional development.

There are a number of successful Trust Funds established in Uganda from which lessons can be drawn notably; the Mgahinga and Bwindi Conservation Trust (MRICT) and the Uganda Poverty Action Fund (UPAF).⁹⁵

92 Source: Prof. James M. Otto (March 2001): "Fiscal decentralization and mining" The World Bank Group Mining Department, Pg. 8.

93 See Article 153 (2) (a)

94 See President Museveni's address to the 9th Africa Peer Review Mechanism Forum, The New Vision, Wednesday, July 16, 2008, pp 20-23 at 22.

95 Tumushabe, G. & Musiime, E. Op Cit. pp.14. See also the First National Report on the Conservation of Biodiversity in Uganda, available at <http://www.cbd.int/doc/world/ug/ug-nr-01-en.pdf> (Accessed 27.7.2008)

4.4.2.4 Establish Specialised Oil Trust Funds

A fairly new mechanism for oil revenue allocation and management in several oil producing countries has been to create oil trust funds. This is particularly attractive in the wake of the past high and volatile oil prices and new oil discoveries. Some objectives of oil trust funds have been to combat commodity price volatility, currency appreciation, inflation, and dependency on oil revenues. Other objectives have included a desire to pay for social and economic development, provide financial resources for future generations, and provide an incentive for prudent financial management by putting revenue away for later use. The oil trust funds can be classified into two basic categories: a) stabilization funds and b) intergenerational funds.

4.4.2.4.1 Stabilization Fund

This is a percentage of income that is set aside for national financial reserves and national emergencies. It may be used to stabilize a country's economy during particularly volatile periods. Stabilization funds have also been used to spur development in non-oil sectors of a country's economy.⁹⁶ A common feature of stabilisation funds is that they are managed by Central Banks on behalf of their respective governments.

Stabilization funds for government expenditures offer some stability to government budgets, as compared to using oil revenues directly. Most developing countries have employed stabilisation funds but with mixed success. Botswana is a good example of a country that exercises fiscal restraint, conducts multi-year budgeting, and uses the stabilisation fund to cope with sudden drops in diamond prices. Other examples of Stabilization Funds are as follows:

- a) The Government Petroleum Fund of Norway acts as a financial buffer to smoothen short-term variations in oil revenues and as a mechanism to cope with the likely long-term challenge of funding government expenditures if oil resources are exhausted.
- b) Kazakhstan has a stabilization fund, which aims at reducing the economy's susceptibility to unfavourable external factors and ensuring stable social and economic development.
- c) The Iranian stabilization fund aims to build up a reserve to balance future downturns in oil prices and to support Iran's industrial sector and non-oil exports.

One disadvantage of stabilization funds is that the government may treat them as slush funds. For example, in Azerbaijan, the government is reported to have used part of the oil fund to finance a commercial pipeline development, although the fund had been set aside specifically to benefit the non-oil sectors.

⁹⁶ Bantekas Ilias. (2005). *Op cit.*

4.4.2.4.2 Intergenerational Fund

An intergenerational fund saves a share of oil income for future generations. The purpose of such funds is to ensure that future generations reap benefits from oil production that preceded their existence. Under World Bank guidelines, Chad established an intergenerational fund. The Chadian Revenue Management Plan reserves 10% of oil revenues for the benefit of future generations. The funds are held in an offshore escrow account, audited by the World Bank.

The greatest challenge with any intergenerational fund is to ensure that it is preserved for future generations, particularly during a financial crisis or other significant emergency. For example, there has been pressure on the Alaskan legislature to open up its intergenerational fund to deal with the budgetary crisis gripping the state government.⁹⁷ Since the use of oil funds is a relatively new mechanism for revenue allocation and management, some key issues to scrutinize are; who manages, who audits and who decides disbursements. Some fundamental factors in the success of oil funds are; establishing clear goals on the objectives of the funds, transparency of operations, and fund management rules that guarantee accountability.

4.4.3 Procedures for developing the Proposals into Actions

4.4.3.1 Legal and Policy Procedures

As noted in section 2.4.2, there is need for establishing the required legal and policy framework for the chosen revenue sharing option and the sharing formula. The proposed framework should address the following, among others, initiation of the process for developing the oil revenue sharing mechanisms, including the formation of negotiating team and its mandate, the policy gaps and legal amendments.

4.4.3.2 Negotiating Oil Revenue - Sharing Mechanism

The process of developing the sharing mechanisms ought to be transparent and participatory. The government takes the lead in this process and should involve the oil companies and "legitimate" beneficiaries, include third party players such as NGOs/CSOs. It is recommended to publish the negotiation approach and methodology for the sake to being transparent. Where applicable, expertise in this field should be outsourced to facilitate the process.

4.4.3.3 Securing Binding Mechanisms

Oil revenue sharing agreements attract a high level of commitment and interest from parties involved. They also attract high interest from non-parties whose primary interest is fairness, equity, transparency and accountability. It is therefore essential to entrench measures for binding the parties and for monitoring compliance to the agreed terms and

⁹⁷ See, Yoonie Kim, Alexandros Aldous, Jason Crosby, Kate Ellis, Ethan Ostroff, & Valbona Sherifi. (September, 2004). Op cit

conditions. It is also recommended that the concluded agreements receive legal backing so that they (agreements) can be enforceable.

4.4.4 Procedural Requirements

4.4.4.1 Enlisting Stakeholder Participation

Stakeholder participation in decision making especially the private sector, civil society and local communities is an important factor in natural resource development projects. Ideally, oil resources in Uganda belong to Ugandans who should develop them for their good and for the good of future generations. It is important that Ugandans feel confident that they own these resources and are part of the process of commercially exploiting them and benefitting from the oil revenue in an equitable manner. They deserve to have a voice on how the revenue generated is disbursed. From the wildlife sub-sector experience in Uganda, public participation has been a key parameter of success. Thus, it is not enough that people acquire capabilities to contribute to the development process of the oil revenue sharing mechanisms, but they should decide on the type of development to benefit from the oil revenues. This is in line with Principle X of the Constitution of Uganda which recognizes the need for the State to involve the people in the formulation and implementation of development plans and programs which affect them.

Development of oil revenue sharing mechanisms is possible as long as the process of transparent engagement by local and non-local stakeholders is maintained to alleviate mutual distrust. If this is not done, disagreement on sharing mechanisms and formula can create conflicts and put the country on a path of disaster and instability. The Opposition in Uganda has already complained of not being involved in the planning for the management of the oil revenue.⁹⁸

4.4.4.2 Development of Effective Mechanism for Management of Oil Revenues

The system for ensuring compliance to the sharing formula (collecting and disbursing oil revenues) should be in place. Measures should be put in place for reporting, auditing and monitoring of oil-revenue proceeds. Effective safeguards need to be established to protect against corrupt practices. These measures are particularly important in Uganda because the country is perceived as having weak institutions. Legal, financial and administration/management institutions do not have deeply embedded procedures and capacity for ensuring regulatory oversight and transparency. The mismanagement of funds of the Northern Uganda Social Action Fund (NUSAF),⁹⁹ the Global Fund for HIV/AIDS, Malaria and Tuberculosis, and the Global Alliance for Vaccines and Immunization (GAVI) Fund attest to the fact that Uganda's record in managing large inflows of public funds is not impressive.

98 The leader of the official opposition was quoted as saying: "We, as the opposition, we are amused that a workshop is taking place without our representation...this is an important national planning function and our views need to be taken on board. We have been ignored as if we are not Ugandans being excluded from a national seminar on managing Uganda's expected oil revenue." See Milton Olupot, "Exclusion from oil meet angers Latigo", *The New Vision*, Friday July 11, 2008, Pg 5.

99 See Madinah Tebajjukira: "Shs 2.5 B NUSAF funds missing", *The New Vision*, Friday, July 11, 2008, Pg 1.

The government needs to strengthen control on Oil revenues and expenditure. The establishment of a mechanism for management of oil revenues should be informed by a process of public participation. It is recommended to establish a 'Petroleum Oversight Commission' composed of representatives of all stakeholders, including CSOs, as has been practice in Sao Tome¹⁰⁰ and Chad.¹⁰¹

4.4.4.3 Transparency and Accountability Concerning Oil Revenues

The National Oil and Gas Policy (2008) and the Petroleum Law (under consideration) should be strengthened on aspects of transparency, fairness, equity, accountability and respect for human rights. So far, the Government of Uganda has not been transparent in making public details of PSAs signed with oil exploration companies.¹⁰² One of the arguments in support for a transparent process of turning Uganda into an oil producing nation is to create institutional ownership. It is anticipated the oil revenue sharing agreements will be made public.

Transparency can allow concerned citizens and civil society organizations to shed light on unsound decision-making; disclose fraud, waste, and substandard practices, and press government officials to account for their actions. All stakeholders are likely to embrace a revenue sharing regime if the shares allocated to them are honoured and implemented in a fair, equitable and transparent manner. This can be done if there is verification of what the government has received. The first step toward fiscal accountability and transparency is making sure that oil revenues are included in the public budgetary process. Constitutional provisions assigning responsibility for the development and implementation of the national budget must make this explicit.

Accounting for revenues paid to governments from mining projects has become an important issue of governance. At the forefront of keeping this matter on the international agenda are the "Publish What You Pay" and "Publish What You Earn" Campaigns launched by a group of NGOs and the Extractive Industries Transparency Initiative (EITI) sponsored by the British government and now supported by a number of governments, multilateral agencies, companies and civil society groups.¹⁰³ Uganda should subscribe to these processes.

Accountability requires oversight by all organs of the state: executive, legislature and judiciary. The media, civil society organizations and the general public has a role to play. Many agree that the use of oil revenues should always be subject to parliamentary oversight. In Uganda, Article 164 and 165 of the Constitution provide model parliamentary oversight provisions. However, allegations that monies have been withdrawn from the Consolidated Fund without parliamentary approval,¹⁰⁴ and that Members of Parliament received bribes to pass bills portray the institution's lack of credibility to adequately exercise

100 See Article 23 (2) (h) of the Petroleum Revenues Management Law, Law No. 8/2004

101 See Article 19 of the Revenue Management Plan, Law No. 001/PR/99

102 Elizabeth Palchik Allen, "Citizens to sue Uganda govt over oil contracts", *Daily Monitor*, Saturday, July 12, 2008, Pg 4.

103 Ian Gary, & Nikki Reisch. (February, 2005).Op cit.

104 See Beti Olive Kamywa-Turwomwe, "Uganda's problem is not lack of money but its management", *Daily Monitor*, June 16, 2008, Pg. 32; Beti Olive Kamywa-Turwomwe, " Why Museveni letter on corruption can't be taken seriously", *Daily Monitor*, Monday May 26, 2008, Pg 36

this oversight function.¹⁰⁵ Therefore, parliament should take immediate action to enhance its ability to serve a viable oversight role, including establishing a committee that has specific responsibility for oversight of oil revenue flows.

The establishment of a National Oil Fund can also go a long way towards promoting transparency for oil revenue sharing. The establishment of an oversight commission is crucial and should work under the auspices of the parliament. The commission should have the right to investigate disbursements under the National Oil Fund; have access to all relevant documents related to revenue management; and be able to suspend transfers from the Fund to beneficiaries should it find sufficient evidence of significant non-compliance with the Fund rules.

4.4.4.4 Capacity Building in the Oil Sector

An extensive training program needs to be devised in order to ensure that the country has the required capacity for managing the oil-revenues, and for negotiating and implementing oil revenue sharing agreements. Expertise to facilitate and train Ugandans on the development of Oil sharing agreements should be engaged as appropriate. There is need to identify and fund training of a cadre of experts and trainers to work within the Oil sector.

Immediate efforts should be aimed at strengthening institutions and building the capacity of the media, parliamentarians and NGOs so that they are equipped to prepare for, respond to and manage the forthcoming oil revenues, thereby preventing conflict. Strengthening journalists' capacity and independence is vital to ensuring transparency, accountability, respect for the rule of law and good governance.¹⁰⁶

Parliament, as a scrutinizing body, has much potential and is well positioned to hold government to account. It has a central role to play in drafting legislation and scrutinizing bills put forward by government, as well as overseeing the budget. Parliamentarians must increase their capacity to do this by undergoing training in oil and transparency issues and ways of reviewing and supervising state budgets and expenditure, drafting laws on oil and gas revenues, as well as the role of parliament in scrutinizing and monitoring resource flows in a democracy.

4.4.4.5 Dispute Management Mechanisms

Disputes are likely to arise under any revenue sharing mechanism. In most cases, disputes may not arise between the oil-producing country and oil companies but between the state

¹⁰⁵ See also Yasiin Mugerwa & Agnes Nandutu: "Museveni pushed me on \$1m CNN deal – PS", *Daily Monitor*, Tuesday January 29, 2008, Pg. 1; Yasiin Mugerwa & Sheila Naturinda, "MP drops Chogm bribe accusations", *Daily Monitor*, Thursday, July 10, 2005, Pg 5; Milton Olupot, "MP Otto withdraws graft allegations", *The New Vision*, Thursday July 10, 2008, Pg 5.

¹⁰⁶ Sarah Skorupski. (August, 2004). Sudan's Energy Sector: Implementing the Wealth-Sharing Agreement. AFRICA NOTES. Number 22. Africa Program Centre for Strategic and International Studies 1800 K Street, NW Washington, DC 20006. www.csis.org.

and its own people and institutions. Unless resolved to the satisfaction of all stakeholders, these conflicts may degenerate into conflicts that threaten national unity. A dispute or Conflict Management Strategy should be included as an integral component of revenue sharing mechanisms. Further, parties to the sharing mechanisms should be equipped with conflict management skills and tools.

4.4.4.6 Revenue Collection

Revenues must be collected first before they can be allocated. Effective and efficient oil revenue collection has two dimensions; a policy dimension and an administrative dimension. A proper design of the tax policy framework must be adopted in the case of oil revenue collection. A fair and efficient application of the tax system through appropriate administrative arrangements must also be guaranteed. The revenue sharing formula must be clearly calculated and determined. For instance, a clear designation of the oil-producing districts/regions has to be made in advance and the revenue due to each region determined. In Nigeria as an example, there is the 13% derivation policy and in Chad, 5% of oil revenue goes back to Doba oil-producing region. Otherwise, the potential for continued local grievances will remain high.

4.4.4.7 Political Will

With the right policies and institutions, resource abundance can be a blessing. The resource curse is not only preventable but also curable. Political will by governments and functional institutions with transparency and accountability are critical factors for preventing and curing resource curses. However, there is no consensus about the specific set of policies that could create appropriate political incentives for the development of transparent and accountable institutions. Thus, the planning, training and good intentions will get Uganda nowhere if leaders lack political will to demand that revenues from oil resources be used solely for the sustainable development of the country. The country must develop a transparent policy framework and establish institutional structures that will prevent anyone, no matter how powerful, from misusing these revenues.

4.5 Recommendation for Operationalizing Oil Revenue - Sharing

The following sections provide general recommendations on operationalizing views and suggestions on oil revenue sharing provided in this paper.

4.5.1 Legislation on Oil Revenue - Sharing

Currently, there is no specific legal and institutional framework in place for oil revenue management and sharing. Uganda must enact such a law. The law should be drafted by oil experts in the industry and would benefit from the experiences of other oil producing countries. This should be based on principles of good governance and should have clear objectives. For this purpose, the Cotonou Agreement between the European Communities

(EC) and African, Caribbean and Pacific countries of 2000 is instructive:

In the context of a political and institutional environment that upholds human rights, democratic principles and the rule of law, good governance is the transparent and accountable management of human, natural, economic and financial resources for the purposes of equitable and sustainable development. It entails clear decision-making procedures at the level of public authorities, transparent and accountable institutions, the primacy of law in the management and distribution of resources and capacity building for elaborating and implementing measures aiming in particular at preventing and combating corruption.¹⁰⁷

While parliament has the final say in legislative matters, opportunity should be availed to stakeholders (public, private sector and civil society) to actively participate in designing revenue sharing legislation. The first step for the consultation process is to establish a multi-stakeholder drafting committee, formed with representatives from government (parliamentarians and representatives from the oil-producing regions), civil society representatives, representatives of interest groups such as labour unions and the military, and the Inspectorate of Government to represent the interests of the public. This would ensure fairness of the process that establishes the national revenue management laws.

The law must among many other things provide for a Sharing formula that specifies:

- a) The requirement to publish and make public information on what the government receives¹⁰⁸ as well as the components of government revenues from which allocation is to be made: -whether from royalties, corporate taxes, dividends, or a combination of any of these;
- b) The proportions of revenues to be allocated;
- c) The groups or institutions within the community to benefit, and their respective shares. These could be central government,¹⁰⁹ Local governments, local communities,¹¹⁰ and the future generation of Ugandans;
- d) The guidelines on how to spend the oil revenue monies or the category of uses for the monies (preferably for community capital projects); and
- e) An institutional framework to decide on how the money will be spent.

Two approaches may be considered. Every country addresses some issues in its Constitution and others through legislation. Constitutions, which are typically difficult to change, aim to nail down the most basic principles that a nation values. Subsequent legislation provides the details about how those principles are to be exercised. Many questions on how the oil industry should be organized are better answered through legislation. However, certain

¹⁰⁷ See Article 9 of the Partnership Agreement between the Members of the African, Caribbean and Pacific Group of States of the one part, and the European Community and its Member States of the Other Part, signed on 23 June 2000.

¹⁰⁸ In Sao Tome and Principe Article 20 of the Revenue Management Law declares confidentiality clauses or other mechanisms included in oil contracts or in any other transaction instrument concerning any oil revenue or oil resource that prevent or attempt to prevent access to documents and information null and void and contrary to public policy.

¹⁰⁹ Of course, a portion of the revenue increase from commodity booms may go to good public investment projects; the right kind of public investments are indeed desirable and needed. In many countries, such investments involve over-ambitious projects that are abandoned halfway through when revenues decline.

¹¹⁰ Political statements made in the country indicate that these communities will be beneficiaries. See for example President Museveni's New Year's speech.

basic principles should be secured in a Constitution to provide the basis for protecting against later abuses.¹¹¹ Issues surrounding oil should be provided for in the Constitution to provide some constitutional safeguards to protect oil revenues and give constitutional recognition of host communities' and local governments' entitlements to benefits. Therefore, the first avenue is through a constitutional provision. Once drafted and agreed to at the national level, a law should be backed by the constitution. Any amendment to the law must then require a constitutional amendment. It is argued that inclusion of specific provisions for revenue sharing in favour of host communities and local governments in the Constitution places the issue so high on the national agenda that no government would not be able to ignore, neglect or side-step it. Giving the revenue management law constitutional status could be a strong deterrent to any unilateral attempt to change the law.

4.5.2 Learning from “Best Practice” Countries

The case for revenue-sharing arrangements in Norway and Botswana has been noted to provide models for best practices.¹¹² It is instructive for the Government of Uganda to learn from the experiences of the two countries (Section 3.5).

However, it is vital to proceed cautiously in applying these lessons to different circumstances. Some of these recommendations rely on three critical characteristics of the central government i.e. (i) having a clear ownership and authority to engage in resource development, (ii) being strong and effective in providing public goods and services, and (iii) being able to regulate and enforce environmental compliance without conflicts of interest.

4.5.3 Trust Funds

There should be established a fund for the future of Ugandans. Withdrawals from the fund should be expressly prohibited. Any violation of this should be severely punished. The Kuwaiti Reserve Fund for Future Generations can offer useful lessons. The experience with the Wildlife and Environment Funds indicates that it has not been easy to receive money once it has entered the Consolidated Fund. To ensure that the established Fund receives the allocated shares, they should be channelled directly from the Oil Fund, and the rest channelled to the Consolidated Fund to be budgeted for by Parliament.

4.5.4 Petroleum Agreements

The Petroleum (Exploration and Production) Act Cap 150 chooses one modality, 'Production Sharing Agreements' for managing oil production.¹¹³ This is a limitation. The Act should be amended to provide for other modalities. It may also be necessary to amend the constitution so that oil and gas resources are returned under the ambit of Parliament. These resources

¹¹¹ The Alaska state Constitution is often cited as an example of how Constitutional protections led to long-term benefits to citizens from the state's oil revenues. A Constitutional amendment, not a legislative act, created the Alaska Permanent Fund (APF). The APF secures future state income by receiving at least 25 percent of all the state's mineral-based royalty revenues. A separate organization, the Alaska Permanent Fund Corporation, manages the APF, operating under the oversight of an independent, publicly appointed board of trustees and the state legislature. The APF's Constitutional status protects it from the economic and political vagaries that might otherwise prematurely deplete the fund, as occurred in Venezuela and Mexico

¹¹² See, Carolyn Fischer. (May, 2007), Op Cit.

¹¹³ See Section 3

should be held in trust on behalf of the people of Uganda.

4.5.5 Taxation

Under the Production Sharing Agreements, oil companies are to pay a tax on their share of “profit oil”. Authority to impose taxes can only be exercised under a given law yet there is no equity in taxation.¹¹⁴ Currently, there is no law to provide for the specific needs of oil sector taxation. Such a law should be enacted to supplement the provisions of the Income Tax Act¹¹⁵ which are perceived as being grossly inadequate. In the oil sub-sector, the tax burden is much higher upstream than downstream. Oil companies, like other large businesses, with highly sophisticated legal advice use tax avoidance schemes. Thus, the law should introduce clear and efficient petroleum industry taxation provisions. Building capacity in tax administration, especially in large taxpayer departments, so that a core group of experts with sufficient understanding of the oil industry business is available is critical.

At the same time, Uganda needs to set up a Special Oil Revenue Office. A number of countries have set up such offices to increase the efficiency of revenue collection from large oil companies. This is a highly appropriate step to guarantee the necessary professional knowledge of the oil industry in the tax administration. Tax and customs administration have been identified as being among the most corrupt institutions in many developing countries. In Uganda this prompted the Judicial Commission of Inquiry into Corruption in the Uganda Revenue Authority – chaired by Justice Julia Sebutinde (June 2002 - February 2004).¹¹⁶ Thus, the proposed oil revenue office responsible for the collection of a major share of the total tax revenues of the country can easily become the most lucrative place for corruption. Anticorruption strategies specifically focusing on the revenue office need to be put in place. Oil revenue collection is a complicated process. Efforts should be made to build the capacity not only of the revenue collectors but also those exercising oversight roles in the country.

4.5.6 Public Information and Education Campaigns

Information on the oil and gas sector needs to be widely disseminated and frequent interactions between the Ministry of Energy and local constituents encouraged in order to waive off the myth and anxiety surrounding the oil discovery, its subsequent production and revenue sharing. An important step in ensuring sound revenue management and accountability is to publish independent audits of oil revenues.

4.5.7 Macro-economic Policies

To avoid the Nigerian “curse” or the “Dutch disease”, Uganda must adopt practices that guard macro-economic stability by for instance, maintaining low and stable inflation rates. A related component of macro-economic stability is the need to avoid excessive appreciation of the domestic currency.

¹¹⁴ See Article 152 (1) of the 1995 Constitution

¹¹⁵ Namibia enacted the Petroleum Taxation Act, 1991 (Act 3 of 1991)

¹¹⁶ See also Fortunate Ahimbisibwe “60 URA staff go on forced leave”, *The New Vision*, Monday July 7, 2006, Pg 1.

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CONCLUSION

Governance principles that apply to oil-production are very important in oil-rich developing countries. Sharing oil revenue may be a source of conflict and bad governance if it is mishandled. Ensuring that oil and gas production revenues provide economy-wide benefits, that a fair share accrues to districts or regions where oil and gas fields are located, and that there is general awareness of how oil revenues are used all potentially contribute to sustainable development.

A system of sharing oil revenues which is perceived as just, equitable and fair has the potential to ensure political stability. Care in planning expenditures is required; (i) to prevent volatility in resource prices and public spending and (ii) to provide some public saving when oil resource revenues exceed immediate spending needs.

Developing suitable legal and institutional frameworks for managing the sector is crucial. A lack of management capacity calls for creating simple, clear, and transparent legal and institutional arrangements. The complexity of contracts and resource payments to the government in the oil industry requires capacity building in the sector, to produce a full understanding of the oil flows and their likely development by both the government and the public at large. This effort helps in managing the population's expectations about the benefits and impacts on the sector. Transparency in the oil revenue stream flowing to the government is key in building trust. Uganda is a well endowed country and is politically on the course to democratic consolidation. Oil wealth if well governed could enhance democratization. On the other hand, if poorly governed, the oil boom could negatively reverse democratic gains and become a nightmare for the citizens. The proposed oil revenue sharing mechanism is underpinned by the desire to use oil to banish poverty, advance democratic governance and transform the country economically.

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