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Oil in Uganda:
Hard bargaining and complex politics in East Africa

Executive Summary

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From 2006 onward, a series of oil discoveries put Uganda on the global energy map. These were the largest onshore oil finds in sub-Saharan Africa in over two decades, and part of an oil and gas surge in East Africa and a wider energy boom on the continent. But almost immediately after the discovery of oil, a series of regulatory disputes between the Ugandan government and international oil companies delayed development and production. Uganda's first oil exports are now not expected until 2020 at the earliest.

Uganda's oil sector

Finding oil marked a successful end to over a century of on-and-off-again exploration for Uganda. The international oil price upturn over the past decade was instrumental in unlocking Uganda's oil resources by enticing international oil companies to prospect inland despite operational and security challenges. After passing the commercial threshold of oil discoveries in 2009, the industry shifted from small-sized 'wildcatter' exploration companies and oil independents to include large-sized oil majors keen on development and production.

By 2014, the Ugandan government estimated that there was 6.5 billion barrels of oil in place, but recoverable oil is estimated to be between 1.8 and 2.2 billion barrels. Oil production is expected to reach heights of between 200,000 and 250,000 bpd based on current discoveries. This places Uganda in the position to be a mid-level African producer, comparable with present day levels in Equatorial Guinea and Gabon.

Oil will only flow from Uganda to international markets with the construction of a regional pipeline. A route to the Kenyan coast has long been argued to be the most economically feasible, particularly after Kenya's discovery of oil in 2012, but a route through Tanzania may offer an alternative. In any case, the infrastructure and regional regulatory challenges are immense and investors may be cautious in the current lower oil price environment. Uganda also needs to settle regulatory issues in its own borders before regional cooperation can take shape.

Regulatory environment

Shortly after Uganda passed the commercial threshold for oil discoveries, a series of regulatory disputes between the Ugandan government and international oil companies delayed the industry's development. The regulatory issues came in three waves. First, President Museveni said he would prohibit oil exports, and instead, a large refinery would be built to process all of Uganda's oil in order to service the region. This was quickly followed by a number of capital gains tax disputes with international oil companies. Finally, long negotiations between the Ugandan government and international oil companies on terms for production licenses constrained the industry from moving forward. These regulatory disputes have arguably delayed first oil production by several years.

But hard bargaining from the Ugandan government on infrastructure, tax, and contract demands should not be overly conflated with unwarranted political intervention. Uganda possesses strong technical and bureaucratic capacity to negotiate with international oil companies and direct involvement from President Museveni to advance their position. It is not uncommon for oil producers around the world to change policies and laws governing the oil sector, particularly during a period of high international oil prices. While in Uganda these disputes came during the exploration phase of the industry's life cycle, they should not be taken out of this wider context.

At the same time, the delay in industry progress cannot be solely attributed to the Ugandan government's hard bargaining. International oil companies seek better contractual terms when the pricing environment upsets their previous valuations. The regulatory demands from the Ugandan government were also not too harsh. If they were, international oil companies would have abandoned the country. They did not. Sunk-capital and the promise of revenues from future production kept the companies from leaving. As a result, Uganda continues to command one of the most impressive consortiums in Africa, which includes Tullow Oil, a British oil independent with a strong track record for frontier success; Total, a French oil major with nearly unparalleled technical expertise and operational experience; and CNOOC, a Chinese state oil giant with sizable capital.

While no company entering Uganda in the future should neglect this history for regulatory battles between the government and investors, most of the disputes have been resolved. The government has accepted the construction of an export pipeline and answered questions over the size of a potential refinery, lengthy tax disputes have been settled, and production licenses could be finalized by the end of 2015 or early 2016. Lower international oil prices will also sap the last of Uganda's regulatory bravado.

In any case, Uganda did not miss much of the upturn in international oil prices. As a landlocked country with little supporting infrastructure and no regional agreement on an export pipeline, it would have taken a long time to produce oil even in an ideal scenario with few political and regulatory delays. After passing the commercial threshold of oil resources in 2009, it would take at least five to seven years to develop an export pipeline and for production to rise to high levels.

Politics

Is the relationship between Uganda and international oil companies reconcilable or bound for further turmoil? National and regional politics will answer this question in time. The regulatory environment in Uganda has been difficult to discern from its politics. The centralizing authority of President Museveni in recent years helps to explain the government's hard position on regulatory issues. The obscure control over the oil industry by Museveni and a small circle of Ugandan officials and international advisors has played a divisive role across government and society. This lack of transparency in the oil industry has led parliament to demand greater oversight. As such, Museveni's growing tendency to micromanage presents a concerning political risk for international oil companies. A quasi-authoritarian leader in a dysfunctional democracy could very well lead to further delays in the industry's development. An unpredictability remains for the oil industry in this hybrid governing system.

The overlap between politics and regulatory disputes in Uganda has also been associated with corruption. Capital gains tax disputes were regarded as a means for the ruling National Resistance Movement to tap new sources of campaign financing for national elections. Political intervention could widen as the industry heads towards the infrastructure-heavy development stage. The onset of production could also very well spark new legal and publicity battles within and without government, which slow industry progress and efficiency.

The inevitable process of political succession in Uganda is widely seen as a significant political risk. But a future leader, anointed by the longstanding president to lead the National Resistance Movement or coming to power from the political opposition, is unlikely to forward major policy changes for the oil industry. In the short and medium term, Museveni is likely to stay in power. He intends to run for president again in 2016 and will very likely win the election, but may be approaching his final term as Uganda's leader. Nonetheless, the Museveni government has negotiated very strong production sharing agreements with international oil companies that a new leader would be at pains to improve beyond underdeveloped areas on social and environment matters.

One of the largest political-regulatory risks still facing the oil industry is the development of a regional pipeline. Regional politics are central to the monetization of Uganda's oil industry. If Uganda and Kenya wish to see oil by the end of the decade, President Museveni and President Uhuru Kenyatta must compromise on domestic political goals to establish regional regulatory measures, such as financing and security for the pipeline, that allow its construction and stable operation. Alternatively, a route through Tanzania is emerging as a possibility for Uganda in a complicated game of regional politics.

Social concerns and insecurity

There is a dearth of responsibility in Uganda for the demands of local communities in oil areas. The central government is largely unwilling to find long-term solutions for social issues, and the capacity of local government is weak across the district, country, and sub-county levels. International oil companies and their contractors, working day to day in local areas, are on the frontline of social protest against the oil industry, leading to costly operational stoppages and a persistent, and difficult to retract, negative relationship with local communities.

Apart from generating petrodollars for the Ugandan government, the developmental impact of the oil industry is limited. Sub-national oil revenue sharing from the central government to both district level and cultural institutions will also be relatively small. Social investment can still have an impact, but communities in Uganda have generally not been heavily consulted on service provision, and corporate responsibility projects have not been aligned with central or district development plans. Social investments also do not counterbalance the negative consequences the industry can have on livelihoods. Oil infrastructure plans will continue to displace thousands.

The increase in army personnel and police in the Lake Albert region may only serve to enflame the social grievances of local populations towards the oil industry. The militarization of the region by the Uganda People's Defence Force (UPDF) and personalization of security by Museveni should caution rather than comfort oil companies. Although President Museveni has successfully quelled multiple insurgencies in Uganda over his tenure in office, and the UPDF remains strong, multiple sources of regional instability from eastern Democratic Republic of Congo (DRC) and farther afield due to Uganda's military presence in Somalia, could threaten the onshore oilfields.

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