Can we talk?

EAST AFRICA / **East Africa's new oil producers could maximise the industry's potential by working together, but that's easier said than done** / Luke Patey

It was not long ago that East Africa was the shining frontier of the continent's oil scene. Uganda sparked the rush after wildcatters ventured deep inland and made Africa's largest onshore discoveries in decades in 2006. The successful run continued with new oilfields discovered in Kenya's north-western Turkana region in 2012.

At the time, with crude prices averaging almost $112 per barrel, hopes grew that the fresh oil discoveries could be linked up with a new regional pipeline network stretching from producing oilfields in neighbouring South Sudan across East Africa and then to the coast.

Yet, a little over a decade after the first new large oil finds were made in East Africa, little has been done to construct a regional pipeline and Uganda and Kenya's oil remains trapped far from international markets. Discovering the oil was just the first hurdle. Monetising these new resources is proving to be far more difficult.

Domestic political and security risks have hindered oil industry development and the steep drop in crude prices from late 2014 have also slowed progress. But central to the long delay is an emerging challenge in the African oil and gas industry: regional risk. The influence of regional politics in determining progress and setback in individual oil industries has never been so consequential on the continent.

This is not to suggest that political instability and insecurity should be disregarded when considering the challenges facing new production in East Africa. In Uganda—at the heart of the region's oil prospects, where government estimates point to an estimated 6.5bn barrels of oil in place, a strong consensus has now formed to develop an export pipeline by the early 2020s. But it took years for President Yoweri Museveni to back down from his idea of meeting East Africa's petroleum needs through a large-scale Ugandan oil refinery—widely regarded as an uneconomic proposition. A smaller-scale refinery option has now been accepted instead.

A series of drawn out capital gains tax disputes in Ugandan and London courts have also caused problems. The January 2017 announcement of Tullow's $900m farm-down to Total, with fellow joint venture partner CNOOC invoking its pre-emptive rights to buy up part of the interest, will test whether this point of friction still exists.

Finally, Museveni's hard bargaining with international oil companies in production license negotiations has provided Uganda with financial terms strongly in the government's favour. But, arguably, it has delayed first oil by several years.

In Kenya, despite the fall in global oil prices slowing exploration work, marginal exploration gains have been made. Estimates of recoverable oil resources in the South Lokichar Basin, where the largest oil reserves have been discovered, have risen to 750m barrels, according to operator Tullow. Maersk Oil and Gas has also entered Kenya's main joint venture, alongside Tullow and Africa Oil, marking the attractiveness of low-cost, onshore oil in Africa.

But an unhealthy relationship between local and national politicians in Kenya should not be overlooked as an impediment to future production. The now oil-rich Turkana region has for decades been neglected by Nairobi and local political representatives are wrestling to control new resources brought in by oil development. This led to a suspension of oil operations for several weeks in 2013, and very likely may do so again in the future.

President Uhuru Kenyatta's insistence on moving forward with an early oil production scheme—an unprofitable-looking venture to take 2,000 barrels a day from Turkana to Mombasa by truck and rail—is an effort to demonstrate progress in the oil industry before his re-election bid this summer. But the move may backfire. As the oil is seen leaving Turkana, grievances among local communities over a lack of jobs and development could grow further.

In South Sudan, the outbreak of civil war in late 2014 quietened talk of tying in current and potential future oil production to a new East African pipeline. Since its separation from Sudan in July 2011, South Sudan's oil industry has been severely undermined by political intervention and armed conflict. Oil production reached up to 350,000 b/d around the time of independence, but has declined to around 130,000 b/d in early 2017, according to government officials—having been still lower during some periods of unrest.

A decade after the first new large oil finds were made in East Africa, little has been done to construct a regional pipeline

The government has ambitious plans to more than double the current production rate, but the ability to boost output depends on more than internal stability. The impact of the civil war on the oil industry has overshadowed the fact that South Sudan inherited an ageing oil industry from Sudan. Without investments in enhanced oil recovery or significant new discoveries, output from South Sudan's oilfields could decline rather than rise.

The best prospects for new oil in South Sudan are in Jonglei state. But the large, isolated and unstable region is hardly a desirable destination for low-cost, risk-free oil exploration. France's Total has been flirting with exploring for oil in Jonglei for decades without reaching agreement. The company has recently been in fresh talks with the South Sudan government, alongside partners Tullow Oil and the Kuwait Foreign Petroleum Exploration Company (KUFPEC), but in April, these negotiations broke down.

International tension

In addition to domestic political and security challenges within East African countries, regional relations have emerged as a complex risk facing the oil industry in recent years. If landlocked Uganda is ever going to monetise its oil resources, and begin to pay back its growing debt to finance large-scale infrastructure projects, it must negotiate a pipeline route through either neighbouring Tanzania or Kenya—Tanzania is currently favoured.

South Sudan may have attained its political freedom in 2011, but its economic independence is still limited by Sudan offering the only export pipeline routes for its oil production, the main source of revenue for the South Sudanese government.

Negotiations on pipeline routes between East African countries do not boil down to simply picking the most cost-efficient solution. Rather they are rooted in national politics and mistrust driven by longstanding regional rivalries. Uganda is both wary of over-dependence on Kenya as its main trade route to international markets, and the ability of the Kenyan government to ensure the speedy development, low cost tariffs, and security for an $5bn-plus pipeline heading through Kenya's restive north to a new port at Lamu.

For its part, the Kenyan government has so far been stubbornly unwilling to fully consider a central pipeline route to Mombasa, despite its cost and security advantages. Uganda's joint technical team with Total, Tullow, and CNOOC estimated a price range of between $4.4bn and $4.6bn for the central route.

While President Kenyatta suggests a pipeline from Turkana to Lamu will spur development in Kenya's marginalised northern region, dampening security concerns by providing economic opportunity, others fear the political elite of Nairobi and the central highlands are looking to further enrich themselves through land grabs in the region.

But, whatever the factors at play, President Museveni is now pushing forward with a route for Uganda's oil that heads through Tanzania, leaving Kenya to find its own solution.

Two pipelines, instead of one, would be a costly outcome for the region. The Kenyan government estimates losses of over $3bn each for Uganda and Kenya due to higher tariffs over the 25-year lifespan of the oilfields. Meanwhile, Uganda and Kenya have no guarantee that other options will be better than working together.

A Tanzania route is no easy fix for Uganda. At an estimated cost of $3.9bn, the 1,443km pipeline, running from Lake Albert down the western edge of Lake Victoria and crossing Tanzania to the port at Tanga has a more feasible timetable, fewer land acquisition constraints, and lower security risks. But Tanzania's offer of providing Uganda with a lower tariff than Kenya was prepared to negotiate must still be finalised in an intergovernmental agreement.

If Uganda took Kenya as a partner, the two upstream producers would share an interest in maintaining a low tariff, but Tanzania could be tempted to exploit its position as the only transit route for Uganda's oil to improve terms in the future. Dar es Salaam has already been trying to leverage its potential as a destination for Uganda's pipeline—and its own gas reserves—by angling to become a regional gas supply hub.

As for Kenya, the persistence of lower global oil prices means the country could do with expanding its hydrocarbons resource base, if financing its own pipeline is to be regarded as fruitful financial venture for investors.

In South Sudan, a deal was struck late last year with Sudan to extend the existing agreement to use its pipeline infrastructure until the end of 2019. While the inclusion of a sliding scale for transit fees will save South Sudan from running a loss on exporting oil when global prices are low, the political relationship between the two Sudans is anything but stable, as the short border war in 2012 demonstrated. Khartoum may attempt to extract new political and economic concessions from South Sudan when the current agreement expires.

Border disputes

Undefined and porous borders across Africa will also heighten regional risk for oil companies. Future oil production in Uganda will help unlock Central Africa's potential, but the Democratic Republic of Congo is already protesting Uganda's exploration on its Lake Albert border. In the Horn of Africa, Somalia disputes Kenya's push for maritime exploration in the Indian Ocean, and in West Africa, Ghana and Côte d'Ivoire are involved in a similar tussle in international courts.

The implementation of the international rulings on disputes between Nigeria and Cameroon, and the offshore joint development initiative of Nigeria and São Tomé and Príncipe, will be important precedents in solving border disagreements.

In East Africa and beyond, regional politics are set to become increasingly prominent in determining the success of new growth opportunities in Africa's frontier markets. **PE**

FIG 1: Stranded assets: Uganda and Kenya's oil remains trapped Source: *Petroleum Economist*

Luke Patey is senior research fellow at the Oxford Institute for Energy Studies.