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POLICY PAPER

FISCAL RULE OPTIONS FOR PETROLEUM REVENUE MANAGEMENT IN UGANDA

EXECUTIVE SUMMARY

Revenue Watch Institute

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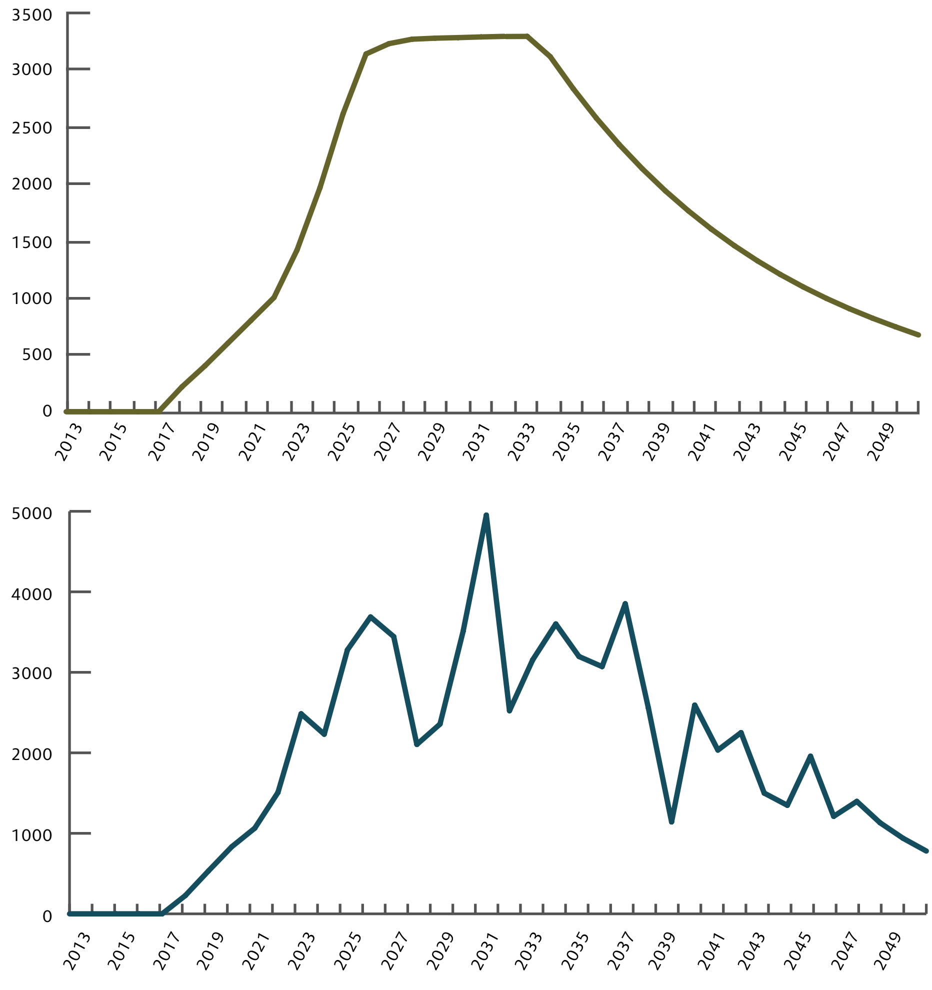
Based on projections made by the Revenue Watch Institute (RWI)—using Ministry of Energy and Mineral Development, Tullow Oil and IMF data—at peak production (from 2025-2035) the Government of Uganda may collect up to 3.3 billion USD annually. If it materializes, this revenue can catalyze economic growth through public investments in infrastructure, education and other social services. However, due to volatile oil prices and the nature of the oil industry, the true amount collected in any given year is subject to wide variation and is generally unpredictable. Furthermore, as international experience has shown, mechanisms to shield public expenditure from unexpected drops in oil revenue and protect these revenues from mismanagement are necessary if Uganda is to fully benefit from oil production.

FIGURES 1 AND 2

PROJECTED REAL GOVERNMENT OIL REVENUES (2013 US$ MILLIONS PER YEAR) BASED ON A LONG-TERM REAL INTERNATIONAL BENCHMARK PRICE OF $75 PER BARREL (SMOOTH AND VOLATILE REVENUE SCENARIOS)



Sources: IMF WEO database, Article IV Uganda report (2013) and RWI projections

For this reason, we recommend that Uganda enshrines in legislation a clear fiscal rule—a multiyear numerical constraint on government finances—to govern oil revenue expenditure, as well as the institutions and oversight bodies that will be responsible for implementing the rule. Fiscal rules in Chile or Norway have proven decisive in helping these countries manage their oil revenues well, which should serve as a key lesson for Uganda.

Such commitments would be consistent with the National Oil and Gas Policy and the Ministry of Finance, Planning and Economic Development's Oil and Gas Revenue Management Policy, which identified several priorities for revenue management, including reducing the impact of oil revenue volatility; limiting spending growth in line with absorptive capacity constraints; saving for the benefit of future generations; and investing rather than consuming oil revenues.

RWI stress tested a number of possible fiscal rules on a model of the Ugandan economy to see which rule would meet the government's objectives and would work best in the Ugandan context.

Implications of a system with no fiscal rule and four possible rules

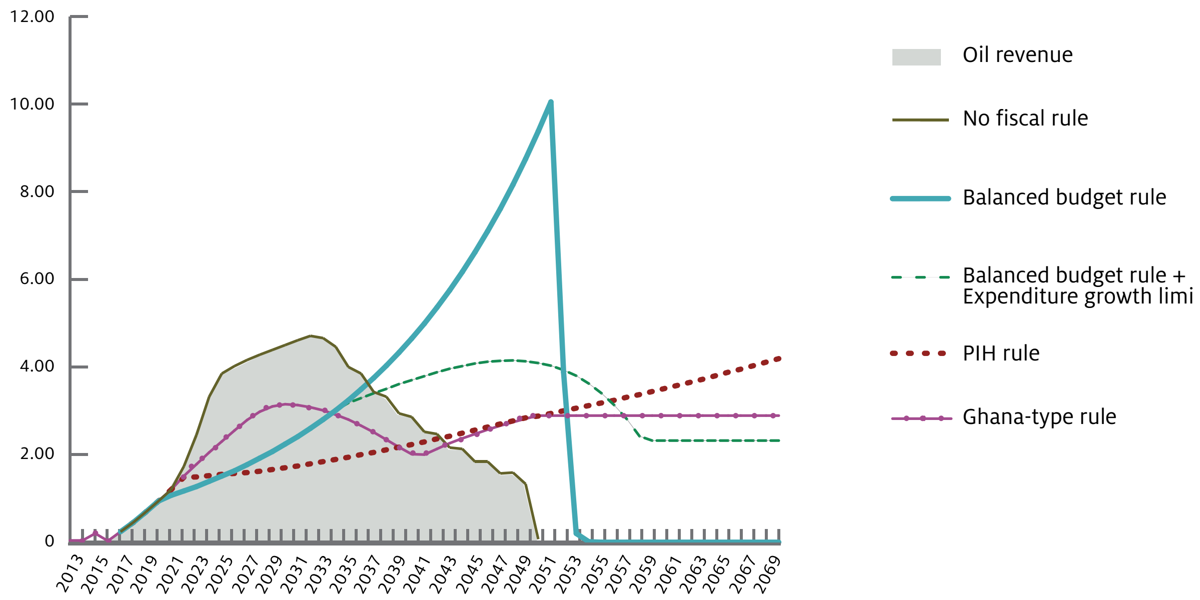
The five scenarios presented are:

- No rule: All oil revenues spent in any given year (This is the worst-case scenario, should Uganda decide not to apply a fiscal rule in the Public Finance Bill or the Charter of Fiscal Responsibility).
- Ghana-type rule: 70 percent of an 11-year average of oil revenues is spent and the rest is saved
- Permanent Income Hypothesis (PIH) rule: Oil revenue spending is limited to three percent of petroleum wealth
- Balanced budget rule: The budget deficit may not exceed three percent of the non-oil GDP
- Balanced budget combined with expenditure growth rule: The budget deficit may not exceed three percent of the non-oil GDP and current primary expenditures may not grow by more than seven percent per year

The results are presented in **Figure 3** and in our detailed policy paper. Based on our analysis, we recommend that the government of Uganda implement a fiscal rule that smooths expenditures to mitigate the negative effects of oil revenue volatility, with some frontloading of spending in the early portion of the production lifecycle if absorptive capacity allows it. Such a system would save revenues for the benefit of future generations, improve the quality of public spending, and improve macroeconomic stability, a prerequisite for strong, sustainable and balanced growth. At the same time, the front-loading feature would help the government respond to political demands for immediate and visible benefits while binding spending at an appropriate level and effectively stabilizing public expenditures in response to highly volatile oil prices.

FIGURE 3

OIL REVENUE EXPENDITURES UNDER DIFFERENT SCENARIOS (IN CURRENT USD BILLION, 2013-2070)



Sources: IMF WEO database, Article IV Uganda report (2013) and RWI projections

To be effective and for the rule to be followed, Uganda will need to introduce enhanced transparency and oversight measures. These could be complemented by reforms to improve the quality and delivery of public projects, as the rule does in itself does not improve absorptive capacity. Therefore we recommend the following:

- The creation of an independent oversight body in charge of monitoring oil revenue management
- Published, independent external audits of any Petroleum Fund
- Parliamentary review and approval of withdrawals from the Petroleum Fund according to a fiscal rule
- Easy public availability of all information regarding the deposits and withdrawals from the Petroleum Fund, the management of the fund, fund investments, and the implementation of the Revenue Management Policy
- Linking oil revenues to a detailed public investment plan in line with Uganda's National Development Plan

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