

AFRICA RISK CONSULTING**Country briefing – Uganda****6 September 2014**

1 Summary

Tullow Oil Plc publicly denies media reports that it is planning to divest from Uganda. The government will hold a competitive oil and gas licensing round in late October or early November. Uganda rises seven places on the World Economic Forum's (WEF) annual 2014 – 2015 Global Competitiveness Index (GCI) to 122 out of 144 countries. The WEF is critical of Uganda's infrastructure and higher education. The survey shows corruption and access to financing as obstacles to conducting business in Uganda. Fitch affirms Uganda's long term foreign and local currency issuer default ratings at B with a positive outlook. In South Sudan, the Sudan People's Liberation Movement/Army in Opposition (SPLM/AIO) reverses its previous position of demanding Uganda's military withdrawal as part of any ceasefire agreement.

1.1 Uncertainty about Tullow's future as government prepares licensing round

Tullow Oil Plc has publicly denied media reports that it is planning to withdraw from Uganda, but an industry source says a farm out agreement is a possibility.¹ **Tullow Uganda Operations Pty Ltd** and **Tullow Uganda Ltd** general manager **Jimmy Mugerwa** on 28 August denied popular and media reports that Tullow is considering selling its Ugandan assets.² Tullow has also privately denied and “forcefully” sought to quell the rumours of a planned departure.³ It is possible that Tullow is using the proposed withdrawal as a strategy to pressure the government to accelerate the issue of its long-awaited production licence. Tullow is currently expected to get its production licence before the end of 2014. Any threat to leave may also be connected to a possible appeal against the \$407m capital gains tax ruling (see *ARC Uganda July 2014 Briefing*).

1 Source, oil analyst, Kampala

2 Daily Monitor, 28 Aug 2014.

3 Source, oil analyst, Kampala

Media reports of its withdrawal from Uganda may prove accurate if Tullow seeks to focus its resources and activities in **Kenya**.⁴ *“Tullow sees Kenya as more profitable... If the right buyer comes in, Tullow will sell up in Uganda.”*⁵ In June Tullow and partner **Africa Oil** announced a discovery of high quality oil at the **Ngamia-2** well in **Turkana** in Kenya and that they are looking to bring in third parties to develop **Block 13T** and **Block 10BB**.⁶ Job losses at Tullow’s operations in Uganda are evidence that Tullow is beginning to minimise its presence in Uganda:

*“Tullow has been laying off workers in Uganda for months. They’re doing it in batches so no one is really paying much attention but Tullow has reduced its workforce by approximately 50%. Tullow claims that these are only technical staff not currently needed but it is much broader than that and suggests to me they’re disengaging slowly.”*⁷

The energy ministry would be amenable to Tullow withdrawing from Uganda despite its role in developing the **Albertine Graben** deposits and being a potential partner in the **East Africa** regional oil pipeline:⁸

*“The energy ministry would wish them all the best and wave ‘goodbye’. It really wouldn’t see it as a blow. Energy ministry officials are arrogant and tell me that they are looking to bring in bigger companies than Tullow. But should they go, the energy ministry wouldn’t bring in anyone new. They would look to **ENI S.p.A** or **China National Offshore Oil Corp** to up their acreage. If the terms are agreeable, I am convinced that Tullow will go.”*⁹

Rather than a complete withdrawal, Tullow is more likely to agree to a farm out agreement with another exploration and production company.

*“Tullow has invested a lot and I imagine they will retain a stake and keep at least a small presence in Uganda. They’re continuing to invest millions in corporate social responsibility programmes which suggests they see some future in Uganda.”*¹⁰

There is unlikely to be any significant development before the government holds an open competitive oil exploration licensing round either at the end of October or early November.¹¹ The government

⁴ Source, oil analyst, Kampala

⁵ Source, oil analyst, Kampala

⁶ Daily Oil Bulletin, 24 Jun 2014.

⁷ Source, oil analyst, Kampala

⁸ Source, oil analyst, Kampala

⁹ Source, oil analyst, Kampala

¹⁰ Source, oil analyst, Kampala



imposed a moratorium on oil licensing in 2007 – before exploration confirmed commercial reserves – to allow it to develop and implement an effective legislative and regulatory framework. On 30 August petroleum exploration commissioner **Ernest Rubondo** said that Uganda had revised upwards its oil and gas resource deposits from 3.5 to 6.5 billion barrels.¹² However, Rubondo confirmed that levels of recoverable oil only increased marginally from 1.2 to 1.4 billion barrels.¹³

Although no action has followed previous reports that the government was about to launch a licensing round, it is more likely that it will happen this time. In August parliament appointed boards for the **National Petroleum Authority (NPA)** and **National Oil Company (NOC)** (see *ARC Uganda August 2014 Briefing*). The provisions of the **2012 Upstream Act** also end in December and the government wants to complete the licensing round before then.¹⁴ The ruling **National Resistance Movement (NRM)** also hopes for a capital injection before campaigning for the 2016 elections begins in earnest.¹⁵

1.2 Uganda moves up the Global Competitiveness Index

Uganda rose seven places on the **World Economic Forum's (WEF)** annual **2014 – 2015 Global Competitiveness Index (GCI)** to 122 out of 144 countries. The GCI is based on an analysis of 12 pillars of competitiveness.¹⁶ Despite its rise up the rankings, Uganda came ahead of only **Burundi** (139) within the **East African Community**. The WEF ranked **Rwanda** (62), **Kenya** (90), and **Tanzania** (121) as more competitive than Uganda. Despite the rise up the GCI, Uganda's position has remained mainly static over the past five years:

Year	Ranking
2013 – 2014	129 (out of 148)
2012 – 2013	123 (out of 144)
2011 – 2012	121 (out of 142)
2010 – 2011	118 (out of 139)

11 Source, oil analyst, Kampala

12 Energy Monitor Worldwide, 2 Sept 2014.

13 Energy Monitor Worldwide, 2 Sept 2014.

14 Source, oil analyst, Kampala

15 Source, oil analyst, Kampala

16 Institutions, infrastructure, macroeconomic environment; health and primary education; higher education and training, goods market efficiency, financial market development, technological readiness, market size, business sophistication and innovation.

The WEF was especially critical of Uganda's infrastructure and the quality of its higher education, ranking both 129 out of 144. The GCI also surveys those conducting business in Uganda, with 11.5% citing inadequate infrastructure as the biggest impediment. The government has prioritised improving infrastructure, committing 17.8% of the 2014 – 2015 budget to the sector. However, progress has been slow with corruption and a weak private sector inflating costs and impeding the implementation of projects.¹⁷ Delays to infrastructure development mean that power supply remains a major obstacle to investment with the electricity network requiring renovation and expansion (see *ARC Uganda April 2014 Briefing*). In August, electricity distributor **Umeme Ltd** reported a 19% decrease in first half profits citing foreign exchange losses and the cost of installing new transmission wires and transformers in order to cut power losses.¹⁸ Increased government investment on capital intensive infrastructure projects has limited sources of financing for the private sector. Access to financing is a concern for businesses with 14.0% claiming it is the largest obstacle to conducting business (see *ARC Uganda April 2014 Briefing*). The criticism of Uganda's higher education is especially concerning for the nascent oil sector which requires educated engineers and plant operators as well as Ugandan companies able to provide technical services.¹⁹

According to the WEF survey the largest obstacle to conducting business in Uganda is corruption. The GCI survey of those conducting business in Uganda showed this was true for 22.5% of businesses. Despite the 2009 **Anti-Corruption Act**, pervasive corruption is a widely acknowledged problem in Uganda. After international donors suspended support in 2012 amid allegations of corruption in the prime minister's office, Ugandans "*shrugged their shoulders. There was no real shock, people just assumed that the system was corrupt and now they knew.*"²⁰ The level of corruption is significant as it encourages a culture of distrust: business owners assume their competitors and rivals are paying bribes and that they must therefore do the same to level the playing field. Key anti-corruption legislation including the **Anti-Counterfeiting Bill**, the **Proceeds of Corruption Assets Recovery Bill** and the **Public Finance Management Bill** remain at various stage of passage in parliament. There is, however, a lack of political will to systematically address corruption. In August, local media reported that parliament has acted on only 10 of 40 reports that the auditor general has submitted, alleging corruption by government officials.²¹

¹⁷ Source, economist, Kampala

¹⁸ Bloomberg, 18 Aug 2014.

¹⁹ Source, journalist, Nairobi

²⁰ Source, Ugandan businessman

²¹ The Independent, 18 Aug 2014.

1.3 Fitch corroborates WEF's praise for Uganda's economy

The WEF praised Uganda's macroeconomic environment, ranking it 96 out of 144. Ratings agency **Fitch** supported this analysis, affirming Uganda's long term foreign and local currency issuer default ratings at B with a positive outlook on 15 August.²² Fitch noted that Uganda's average annual growth of 5.5% over the past five years was greater than the B category median of 4.2%. It praised the government's sound macroeconomic policies but noted that growth of 4.7% in the 2013 – 2014 financial year was below expectations. Fitch cited weak credit growth, construction and financing delays at the **Karuma** and **Isimba** hydropower dams and the ongoing conflict in **South Sudan** (see below). The ratings agency said that it expects growth greater than 6% in 2015 on the back of accelerated infrastructure investment and renewed foreign investment in the oil sector. Fitch cautioned that per capita income remains low due in part to Uganda's high population growth of 3.2% and that the delays to Karuma and Isimba meant that Uganda would bear the budgetary impact of their \$2.3 billion construction in 2015 rather than 2014 as originally planned. Fitch warned of a budget deficit of 5% in 2014 and 7.2% in 2015. Longer term constraints on growth include low levels of infrastructure investment, a volatile relationship with donors, and a lack of capacity in revenue collection which has encouraged domestic borrowing. Government debt increased from 24.4% of GDP in 2010 to 35.5% in 2014 on the back of increased domestic and external borrowing. This will breach 40% of GDP by 2017, though this is still below the B median.

1.4 South Sudan opposition accepts presence of Ugandan troops

The **Sudan People's Liberation Movement/Army in Opposition (SPLM/AIO)** has said it will no longer demand the withdrawal of Ugandan troops from South Sudan as part of any ceasefire agreement.²³ The SPLM/AIO said it would accept the deployment of the **Uganda People's Defence Force (UPDF)** until the **Intergovernmental Authority on Development (IGAD)** can deploy regional peacekeepers. The SPLM/AIO had previously said that the withdrawal of the UPDF was a prerequisite for signing an implementation plan for the cessation of hostilities agreed in January. On 25 August, the IGAD said that the South Sudan government and the SPLM/AIO had signed a new ceasefire agreement and called on the parties to form a government of national unity within 45 days.²⁴ The SPLM/AIO's new stance will preclude any immediate Ugandan withdrawal and will also encourage president **Yoweri Museveni** (1986 – present) to continue to play an active diplomatic role in seeking an end to the fighting in South Sudan. Uganda fears that any rapid withdrawal may trigger the collapse of the

²² Reuters, 15 Aug 2014.

²³ Sudan Tribune, 22 Aug 2014.

²⁴ Sudan Tribune, 25 Aug 2014.

administration of president **Salva Kiir** (2011 – present). Museveni's brother **Caleb Akandwanaho Salim Saleh** led negotiations with an SPLM/AIO delegation led by deputy chairman **Alfred Lado Gore** in Kampala.²⁵ UPDF forces are stationed in **Bor (Jonglei State)** and **Central Equatoria State** in South Sudan. Bor remains a buffer zone between the SPLA in the south and the SPLM/AIO in the north.²⁶ The presence of UPDF forces in the states where clashes are fiercest therefore raises the possibility of Uganda getting drawn further into the conflict especially as the UPDF provides military air support to the **Juba** government.²⁷ The SPLM/AIO is increasingly attacking aircraft, with surface to air fire notably downing a **United Nations** MI-8 cargo helicopter over **Unity State** on 26 August 2014.

2 Implications

Although Tullow is unlikely to divest from Uganda entirely, a farm out agreement is a possibility. The licensing round will attract larger oil companies than Tullow and potentially international oil majors. The subsequent award of exploration licences will take place during the second half of 2015. Developments in the sector will slow as campaigning for the 2016 election takes precedence.

The GCI did not contain any surprises for investors. While the government has taken modest steps to encourage foreign direct investment, there are few tangible results hence Uganda's static position in the GCI rankings. Dilapidated infrastructure and corruption will continue to deter risk-averse investors while domestic debt will squeeze out the private sector. The commercial promise of Uganda's oil deposits will continue to encourage international oil companies. Fitch's ratings will further reassure investors, though their concerns about the impact of construction and financing delays at the Karuma and Isimba dams highlight the challenges facing the government in rehabilitating and extending Uganda's infrastructure.

Uganda may begin a withdrawal of UPDF forces when the IGAD mission deploys but will retain a security presence in South Sudan for the medium term. This may be either a unilateral force or one within the mandate of the IGAD force. If the security situation in South Sudan deteriorates, Uganda is likely to become further drawn in given its economic links and Museveni's desire to be a significant regional diplomatic and military state.

²⁵ Radio Tamazui, 21 Aug 2014.

²⁶ Source, INGO official, Upper Nile

²⁷ Source, journalist, Kampala