



The Macroeconomics and Development Issues of Oil Production in Uganda

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Introduction

How to transform developing countries' resource wealth into other assets to support sustained growth and development?



Opportunities with natural resources

Issues facing developing countries

- Low per capita incomes
- Scarcity of domestic capital
- Limited access to international capital markets

Natural resources provide opportunity to build

- Human capital
- Domestic public and private capital
- Foreign financial assets.



A key opportunity

Resource revenues are an opportunity to make progress on development goals, such as poverty reduction, infrastructure and growth.



Challenges: price volatility

- Complicates fiscal planning and leads to revenue volatility
- Spending cyclicalities and volatility, which is less effective and productive

**Requires fiscal rules to limit
pro-cyclicality of fiscal policy**

(e.g. non-resource primary balance target)



Challenges: exhaustibility

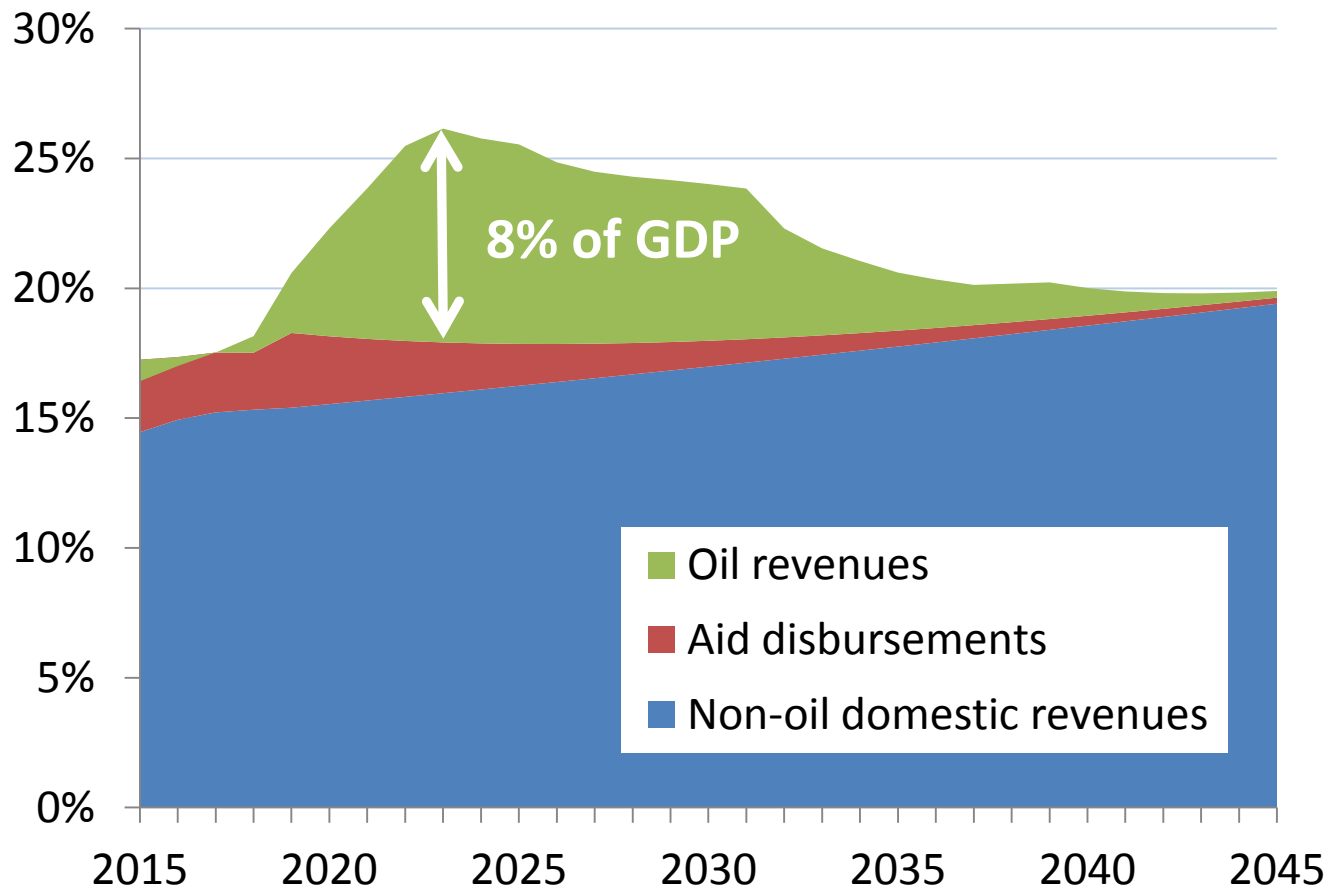
- Exhaustibility
 - Oil doesn't last forever
 - Sustainability and intergenerational equity
 - Requires smoothing government consumption over time
 - Insufficient saving can lead to a RER appreciation and hurt the non-revenue traded sector.



Oil in Uganda

- An important resource
 - 15 percent of GDP
 - 50 percent of revenue
- A volatile and uncertain resource
 - Volatile oil prices
 - Uncertain reserves and costs
- An exhaustible resource: lifespan \pm 30 years

Sources of revenue in Uganda





Fiscal Regimes for Natural Resources

- Regimes need to be country specific, but should rely on three broad instruments
 - Royalties
 - Corporate income taxes
 - Tax targeted on economic rent
- Ensure revenues arise from the start of production
- Enhance stability and credibility
- Minimize distortions



Government share: how much?

- In theory, can tax up to 100% of rents
 - Rent: revenues over all costs of production and normal return to capital
- But imperfect information leads to lower revenues to provide appropriate incentives for IOC
- Administration is vital
 - e.g. poorly designed international tax arrangements, can undermine revenue potential



Specific issues with natural resources

How to deal with price volatility and exhaustibility?

- Savings
- Domestic investment
- Consumption—preferably social outlays.

**How much to save, how much to invest and
how much to consume?**



Assessing fiscal sustainability

Frequently cited benchmark:

- Permanent Income Hypothesis (PIH)
 - Government consumption and wealth held constant over time
 - Present value of non-resource deficits should equal the present value of resource revenues

Useful benchmark, but could be optimal to tilt spending forward to benefit relatively poorer current generations.



Assessing fiscal sustainability

Fiscal Sustainability Framework (FSF)

- Allows for a sustained drawdown of financial assets to build human and physical capital to deliver an expected permanent gain in non-resource revenues
- Crucial to improve implementation capacity, cash management and budget processes before oil revenues start



Oil revenue fund

- Resource funds help deal with resource revenue volatility and save for future generations
- Enhance transparency
- Mitigate impacts on domestic liquidity and exchange rate.
- Fund flows should be fully integrated into the fiscal accounts and should not have independent spending authority.



Where to spend?

- Uganda needs to “invest in investing” by:
 - building capacity for public investment
 - building capacity for private investment
 - building capacity for reducing the unit cost of capital
- Importance of sound institutions to ensure transparent and efficient use of resource wealth.
- Countries with stronger economic and political institutions tend to have better macroeconomic and growth performance.



Invest in investing

- Capacity for public investment depends crucially on appraisal, selection, implementation and evaluation of investment projects
- Capacity for private investment depends on the business environment
 - Governance
 - Infrastructure
 - Fair rules of the game investors
 - Financial sector effectiveness



Invest in investing

- Reducing the cost of capital requires investing in
 - Infrastructure
 - Education and health to increase labor productivity
 - Reducing supply-side bottlenecks

Uganda should also seek to diversify its economy, notably by promoting investment and growth in the agriculture and tourism sectors



Transparency and expectations

- Population expectations of the benefits of oil
 - Requires comprehensive communication strategy that is fully transparent
- Some of the challenges include
 - increased pressures on the government to deliver on public services and account for oil revenues
 - resist temptation to borrow against future oil revenue
 - unrealistic expectations on wealth prospects shifting private consumption patterns
 - higher future growth could raise expectation of exchange rate appreciation and fuel asset price bubbles



Thank you