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Foreign investments in Uganda's oil sector: linkages and issues for the local economy

Anne Mette Kjær

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INTRODUCTION

The Ugandan economy resembles many other economies in sub-Saharan Africa in that it has a large subsistence sector, relies on a few primary commodities for export and depends on aid to finance its public services. Oil and minerals have so far not been important to the economy. However, this might change as an estimated 3.5 billion barrel oil reservoir has been discovered in Uganda's Western and Northwestern Albertine Graben. Minerals have also been found and are being sold off as concessions. If oil revenues start to be mobilized as currently planned (2016-17), significant changes in not only government finance but also in the governments' relationships with donors and in state–society relations are likely to occur. The consequences for local communities and the environment are also likely to be significant.

Even though it has not started to be pumped yet, oil has been subject to intense debate in the Ugandan media and parliament. Many issues have been debated involving transparency with regard to the Production Sharing Agreements between the government and oil companies; the use of future oil revenues and the potential establishment of a Petroleum Fund; the potential environmental impacts; security issues in the oil exploration areas; the resettlement of affected citizens; and the extent to which local firms and contractors can benefit from Foreign Direct Investments (FDI). This paper focuses on the latter and explores how the Ugandan economy and local firms may benefit from FDI in oil and what donors might do to increase the potential benefits. More specifically we ask (i) what is the extent of linkages and the Ugandan capacity to create them, (ii) what are the political and economic factors that influence whether or not linkages can be created and iii) what are donors doing to support linkage formation?

We argue that the Ugandan economy is not well-equipped in terms of technological capabilities to make the most out of FDI in extractives. This is because the extent of the transformation of the economy is still limited due to a number of factors, but especially important is the nature of the political settlement. It is not possible to understand the constraints on and challenges to linkage formation without grasping the structure and nature of Uganda's current political settlement. Given the degree of fragmentation of the ruling coalition and the fact that the costs of staying in power have increased, the prospects for implementing initiatives to promote linkage creation and promote technological capabilities in the Ugandan economy are not optimal.

In order to address these questions, we first assess the extent of linkage creation from oil exploration. We then outline the extent of structural transformation of the Ugandan economy and how it is related to Uganda's political settlement. I describe the political settlement in order to be able to assess the likelihood that current legislation with regard to oil and the Ugandan economy will be implemented. I am relying on two main sources of information here. One is already existing material, including some of the author's own previous research on Uganda and reports available online. The other main source is material collected during the author's visit to Uganda in June 2013, which included interviews with key informants and experts, namely government officials, company representatives (main oil companies and sub-contractors) and donor representatives (World Bank, Norway, Irish Aid, Danida).

Table 1. Sectoral composition of FDI inflows into Uganda (USmill$)

	2008	2009	2010	2011
TOTAL (mill US$)	1,292	1,156	595	405
Transport, storage and communications	525	59	25	7
Unspecified secondary	279	620	195	67
Business activities	276	200	97	145
Wholesale and retail trade	85	15	9	11
Mining and quarrying	60	7	100	5
Agriculture and Hunting	48	76	110	79
Construction	9	42	43	21
Electricity, gas and Water	7	90	12.5	71
Community, social, and personal services	0.6	48	4	1

Source: International Trade Centre, 2013 at http://www.intracen.org/

FDI IN OIL IN UGANDA

FDI into Uganda grew over the 1990s, facilitated by a liberalized economic regime and stabilized political conditions. Foreign direct investment grew from near zero in 1990 to about 3.25 percent of GDP in 2006, accounting for a fifth of total capital accumulation in Uganda (Rasiah and Tamale 2004; MIGA 2007). FDI in manufacture went mainly into beverage- and food-processing involving, for example, the Coca Cola and Pepsi companies. The service sector has also been the recipient of FDI, especially telecommunications and banks. FDI reached about 5 percent in 2008 and then dropped somewhat, probably because of the global financial crisis (RoU, 2010).

As Table 1 shows, the mining sector, particularly the oil and gas sector, did not take up large shares of total investments in 2008-2011. However, investments are on the increase (RoU, 2011). Most recently, FDIs rose 93 percent in 2012 compared to 2011 (UNCTAD, 2013: 74), primarily because of the petroleum sector. Mining of various metals occurs, but to a limited extent (Uganda Investment Authority, 2013). British Tullow oil, which has been responsible for most exploration activities, has in all invested about 1 billion US dollars.[1] In all, investments in oil-sector exploration are estimated to have amounted to around 1.7 billion US dollars since exploration started in 1998.[2] In addition, recently the Chinese national offshore company CNOOC has become the first company to enter into a production agreement with the Ugandan government for the so-called Kingfisher field in

[1] World Bank source in Ch. 2 says an estimated 2 billion from Tullow, but our interviews confirmed 1 billion.

[2] *Wall Street Journal* 2013, March 25, "Investments in Oil exploration hits 1.7 bill".

Western Uganda.[3] The size of the investment is estimated at 2 billion dollars. Further, the government plans to have a refinery built in the Western region, the investment estimated to be 2.5 billion dollars.[4]

These increases in oil investments are considered to be a potential game changer in Uganda. So, although mining and quarrying (including oil) still make up only 0.3 percent of Ugandan GDP (Rou, 2013), the sector is considered to have potential (Background to the Budget, 2013). Even if oil is not being pumped, some revenues have already flowed into government coffers in the form of one-off capital gains taxes, stamp duties and the like. The exact amount is not known, but a recent estimate says that the Ugandan government will have received about 1 billion US dollars in revenues by the time production starts.[5]

The three companies operating in Uganda – British Tullow, French Total and CNNOC – have explored 88 drillings and found oil in 76 of them. The exact size of Uganda's oil reserves has yet to be finally determined, but in September 2012, the Ugandan government officially adjusted the estimated number of barrels upwards from 2 billion to 3.5 billion barrels (Global Witness, 2010; Reuters, 2012). It is also not known how much of that estimate will be recoverable. However, estimates are for about 150,000 to 200,000 thousand barrels a day during peak production, which it is thought will last for about twenty years and start in about 2016. This would place Uganda among the middle – African oil producers such as Gabon, the Democratic republic of Congo or Chad (Shepherd, 2013).

There are a number of challenges to be met before production starts. Ugandan oil is not easy to recover, refine, and transport because of its very greasy nature and the fact that it is contained in low-pressure reservoirs (World Bank, 2010). A combined refinery in Uganda and pipeline through Kenya to the shore has finally been agreed both between those countries' governments and between the Ugandan government and the oil companies, but there is still a long way to go before production can begin.

When the pumping of oil begins, this will raise government revenues by about 1.5 to 2 billion dollars annually (Shepherd, 2013; World Bank, 2010), an amount which equals the size of total ODA to Uganda in 2010. That year, Uganda's total government revenue including grants was about 4.3 billion US dollars, of which grants and loans made up about 1 billion (RoU, 2013). Future oil revenues therefore have the potential to remove Uganda's dependence on foreign aid, at least during the period of peak production.

HOW WELL DO FOREIGN INVESTMENTS LINK UP?

Since oil pumping has not yet started, it is still too early to assess how and whether the local economy has benefitted from FDI in the petroleum sector. However, it is possible to explore the extent of linkages created in the exploration phase and assess whether local companies have been able to benefit from that.

FDI linkages in natural resources may be vertical or horizontal. Horizontal linkages are

[3] PennEnergy.com, October 1, 2013 "CNOOC first to invest in Uganda Oil".

[4] *Reuters*, Wednesday October 9, 2013. Sarah Young, Elias Biryabarema, "Uganda says many firms interested in 2.5 billion refinery project".

[5] "How much has Uganda earned from oil so far". *OilInUganda Newsletter*, Issue 6, August, 2013. Available at www.oilinuganda.org

linkages between foreign investors and other extractive companies in the same industry, involving, for example, technology agreements with local or international natural resource firms or joint venture collaborations with local companies. Vertical linkages are linkages between the extractive companies and companies that are not engaged in oil extraction. They may be either backward or forward. Backward linkages are collaborations with suppliers of equipment, raw materials or semi-manufactured components. They may also occur with providers of services such as security services, transport and logistics services, maintenance services or engineering services. Forward linkages are those with processing firms, exporters, handlers, distributors etc.

In Uganda, there are no horizontal linkages at the level of the main oil exploration and production companies (Total, CNOOC and Tullow) simply because no Ugandan company at that level exists. However some international sub-contractors have entered into a limited number of joint ventures with Ugandan companies. For example, one company visited was a local Ugandan company (Mineral Services ltd) which had existed since the 1990s when oil exploration started and was providing services and logistics for exploration companies. In 2011, Mineral Services Ltd joined up with Norsea Group, a Norwegian company also engaged with logistics.

There are no accessible figures of the number of such joint ventures in the sub-contracting industry, but according to the Ugandan Chamber of Mines, most of the major sub-contractors are foreign companies.[6] All interviewees, regardless of whether they were government representatives or multinational or local company representatives, were unanimous in arguing that there was a lack of local capacity in Uganda and that it would be very difficult to implement the specific policy requirements of local content. Such specific requirements could be a rule of a fifty percent local equity, an issue which had been raised in parliament and debated but not enacted. So, the extent of horizontal linkages, based on the interviews and a perusal of documents, is rather limited.

With regard to vertical linkages, there are a number of local companies in the supply chain of the multinationals. As already mentioned, there are some Ugandan companies in the form of joint ventures with multinationals who supply logistics, security and other services directly to the oil companies. However, not many Ugandan companies have the capacity to deliver very specialized services, and the MNCs feel that local suppliers can rarely meet the very high standards they require (Interviews; RoU2011b). Hence, we need to go further down the chain in order to find entirely Ugandan companies, such as security, catering or transport companies etc. However, in these cases too there may be an issue of a lack of capacity and of the ability to live up to certain standards, which means that the oil companies would prefer an international sub-contractor to coordinate many of the services they need.[7] That sub-contractor may in turn be able to use or cooperate with Ugandan suppliers. The most important sub-contractor is Halliburton, a big international oilfield service provider that works for Total and Tullow. Halliburton has contracts with the firm Hima Cement (but which is owned by a French

[6] Interview, June, 2013.

[7] In order to uncover the exact level and quality of local supply, Total had initiated an "Industrial Baseline Survey". This survey was expected to document a significant gap between what was demanded by the oil companies and what Uganda was able to supply.

company) for deliveries.[8] It has about forty local staff. One of the worlds' largest oilfield services suppliers, Baker Hughes, also operates in Uganda and employs about fifty Ugandans, some of them engineers or technicians, for whom training is provided. Schlumberger, the world's largest oilfield service provider, also operates in Uganda. In cooperation with the Ministry for Minerals and Energy development and Makerere University, it supports the university's geosciences programs. Tullow Oil has reported a total of 550 Ugandan suppliers of goods and services to its operations (RoU, 2011b: 19).

The number of Ugandan jobs created as a result of foreign investments in the petroleum sector is limited. Although estimates vary significantly depending on the source, there appears to be a consensus that at peak production, 10-15,000 jobs could be created if all jobs along the oil value chain are included. It should be born in mind that most of these are temporary jobs that will disappear once a refinery has been built or the oil recovered. One estimate says there will be about 1700 permanent jobs in the oil sector (RoU 2011b). By comparison, the big sugar factory in Uganda (owned by the Madhvani group) employs several thousand people with much smaller investments than the oil investments.[9] The biggest dairy company in Uganda, Sameer Agriculture and Livestock Ltd, employs 515 staff and buys milk from a large number of outgrowers. This reflects the fact that oil is not a very labor-intensive sector and suggests that oil revenues would have to be invested in productivity enhancement in the Ugandan economy in general in order to have a really significant impact on job creation.

[8] Interview, Total, June, 2013; www.oilinuganda.org.

[9] Madhvani's sugar factory, the Kakira sugar works, employs 7,500 permanent workers, another 4,500 contract workers, and about 8,500 outgrowers, according to *The New African,* "Kakira: Uganda's King of Sugar", October 2nd, 2012.

In sum, only a few international sub-contractors have entered into joint ventures with Ugandan companies. The rest hire Ugandans to a large extent, and Total, Tullow and CNOOC are estimated to have recruited at least sixty percent of their staff locally. However, the higher the level of specialization and skill required, the smaller the proportion that is Ugandan. There is clearly a great potential for Uganda in terms of educating and training its labor force, but also in benefiting more indirectly from the presence of oil companies by investing in production with the revenue generated from oil. This potential is far from being fulfilled, and although oil is not yet being pumped, there are clear indicators that Uganda's economy is ill equipped to benefit from the investments in its oil. A recent report commissioned by Uganda's Petroleum Department estimates – although it emphasizes that its figures are uncertain – the share of investment retained in Uganda of the total foreign investments to be 14 percent (RoU, 2011b).

FACTORS INFLUENCING AND EXPLAINING LINKAGE FORMATION IN UGANDA

1) The structure of the Ugandan economy: equipped for linkage creation?

One factor in explaining why Uganda's economy is ill equipped to benefit from building linkages to the oil industry is the structure of the country's economy, which remains dominated by subsistence agriculture. When the National Resistance Movement (NRM) and its leader, Yoweri Museveni, came to power, they had an explicit agenda of industrializing the economy (Kjær and Muhumuza, 2009),

improving infrastructure and increasing production and productivity. Indeed, throughout the last two decades, Uganda has enjoyed a period of sustained economic growth, reaching seven percent annually between 1990 and 2006 (Piron and Norton, 2004; Kjær and Muhumuza, 2009). This has been made possible because the country now has a stable ruling coalition, macro-economic stability, low inflation (until recently) and relative peace. Poverty declined from 56 percent in 1991 to 25 percent in 2010 (World Bank indicators).

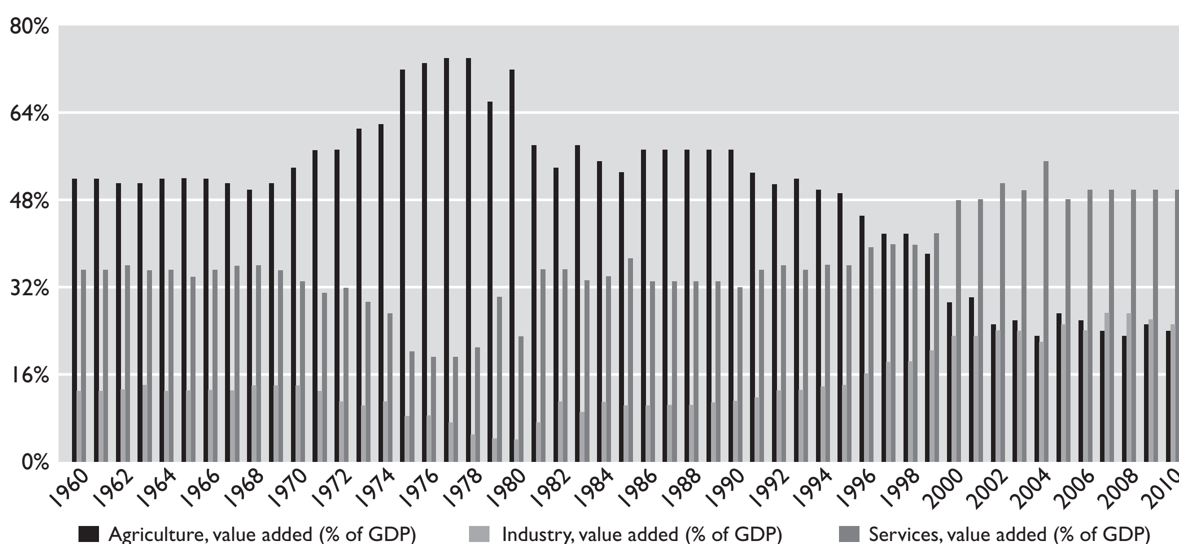
However, there has been limited structural transformation in terms of a shift from agricultural to industrial activities, increases in agricultural productivity, productivity in agro-business and manufacture, or the use of more developed technologies. 'Structural transformation' in poor countries can be defined as 'the shift of resources and labor from low- to high-productivity industries' (Justin Lin, 2012: 298). This involves at least three processes: 1) industrialization (in particular manufacturing); 2) technological upgrading and innovation across sectors of the economy, which are essential ingredients for long-run productivity growth; and 3) is economic diversification, which protects countries from vulnerability to shocks and reflects the pace at which less developed countries can reallocate their resources to take advantage of emerging opportunities.

It will take a local economy with some degree of technological development to benefit from investments in the extractive industry, because otherwise the gap between what foreign investors need and what the local economy is able to deliver will be too great.

Figure 1 shows that the share of agriculture in GDP has declined, while the shares of services and industry have increased since 1980. The share of agriculture in GDP declined from about 50 percent in 1980 to about 18 percent in 2010 (World Bank Indicators, 2012).

But this shift is not necessarily an indicator of structural transformation of the economy. In order for structural transformation to take place, productivity needs to increase in agriculture as well as industry. One indi-

Figure 1. The sectoral composition of Uganda's GDP, 1960-2010



Source: World Development Indicators online databank, 2011.

cator of rising productivity in agriculture is that less labor is producing increased outputs. However, the share of the population employed in the agricultural sector has not decreased substantially, being seventy percent of the labor force in 2007. There are no accurate data on agricultural production, but according to the Uganda Bureau of Statistics, growth in agricultural output declined in the 2000s from 7.9 percent in 2000/01 to 0.9 percent in 2010/11. Average yields for the eight major crops, namely matoke, cotton, rice, coffee, maize, beans, groundnuts and potatoes, are estimated to have declined between 1999 and 2006 (RoU, 2009). The potential for improving productivity in agriculture is huge. For example, it is thought that only 1 percent of farmers use fertilizer. In the post-harvest situation, farmers face enormous challenges when it comes to marketing their produce. There is a general consensus that the potential in the agriculture sector remains unfulfilled due to structural impediments that have not been addressed, especially research and extension, rural infrastructure, limited access to land and conflicts over land.

The share of services in GDP rose from 34 percent in 1980 to about 50 percent in 2010.[10] This was driven by government services, which were in turn primarily financed by foreign aid. Private services such as telecommunications, banking, tourism/hotels and services in the informal sector provided by microenterprises also grew. The service sector, however, is characterized by low productivity and underemployment and thus cannot absorb all of the labor moving out of agriculture. Hence, in terms of its capacity to absorb labour, the service sector may in a sense be overblown (Badiane, 2010).

The share of industry in GDP rose from about 14 percent in 1980 to about 25 per-cent in 2010.[11] However, most of this growth was in construction and not in manufacturing. Construction takes up half of the value added within the industry category and manufacturing a third. The rest is water and electricity supply. Oil and mining still only take up 0.3 percent of value added (RoU, 2013).

Manufacturing has grown, but from a very low level and in 2010 reached only 8.3 percent of GDP, which was less than the 8.45 percent of GDP it was just before independence (World Development Indicators databank). The manufacturing sector is overwhelmingly characterized by informal small enterprises with fewer than five employees.

Uganda's exports are not very diversified. Coffee remains the main foreign exchange earner, accounting for about 21 percent of exports in 2010. Other traditional export sectors include tea, cotton and tobacco, but by the 2000s none of them were really doing well. Cotton does not constitute a significant share of export earnings and never really recovered after its collapse in the 1970s. Tobacco production is negligible. Tea, like coffee, has limited potential for further expansion due to land scarcity and population growth. Several non-traditional agricultural exports emerged after the end of the civil war, such as horticulture, floriculture and fisheries, but only the fisheries sector registered relative success.[12]

[10] 50 percent in WDI, 46.2 percent in the most recent Background to the Budget.

[11] 25.3 percent in the most recent Background to the Budget.

[12] See Kjær and Katusiimeh, 2012; and Whitfield et Al. (forthcoming, Ch. 3).

All in all, therefore, there has been little structural transformation of Uganda's economy, which hence remains ill equipped in terms of its technological capacity to benefit from the incoming investments in oil extraction. One important reason why the process of structural transformation has been so slow is the nature of Uganda's political settlement, which has made it difficult to introduce an effective industrial policy to promote economic transformation.

2) The political settlement

In the context of a fragmented ruling coalition, where the short-term political imperatives of staying in power are more expedient than longer term investments in national development, industrial policy, including oil-specific policies, are difficult to implement (Booth and Therkildsen, 2012; Whitfield and Therkildsen, 2011). The term 'political settlement' refers to the set of institutions and power relations that characterize the social order in a particular country.[13] The ruling coalition within a political settlement is more narrowly defined as the ruling elite, as well as the groups and individuals behind the rise of the ruling elites to power and/or those groups or individuals who give the ruling elite their support, typically in exchange for benefits (Whitfield, Therkildsen, Buur and Kjær, 2013). These groups and individuals keep the ruling elite in power by organizing political support. We turn now to describing the ruling coalition in Uganda, since next we need to understand the policy and institutional framework affecting linkages, and then the influence of the multinationals and donors.

[13] Khan, 2010.

INDUSTRIAL POLICY IN THE CONTEXT OF THE NRM RULING COALITION

The NRM government states explicitly in its National Development Plan that it wants to make the most out of Uganda's oil to promote national development. However, 'political will' as stated in plans is one thing, the ability to implement the plan another. A growing body of literature has tried to open up the black box that is called 'political will' to understand better the political incentives of ruling elites in promoting developmental policies.[14] Such incentives may derive from resource scarcity or external threats. However, these explanations focus more on explaining differences between countries than differences between different productive sector policies. Here, political settlement analysis is helpful.[15] The distribution of power in a country-specific political settlement shapes how ruling elites act and the policies they pursue. Thus, ruling elites cannot just decide to implement certain policies. If the settlement is constituted in such a way that it is destabilized if a certain initiative is implemented, then even an expressed 'political will' to implement it becomes hollow. Policy initiatives may face political resistance to the implementation and operation of particular institutions.[16] The greater the resistance from powerful groups, the more politically costly it may be to implement a certain policy.

[14] Atul Kohli. *State-directed development: political power and industrialization in the global periphery*, Cambridge: 2004; Doner, Ritchie and Slater: "Systemic Vulnerability and the origins of developmental states: northeast and southeast Asia in comparative perspective", *International Organization*, Vol. 59: 327-361, 2005.

[15] Whitfield, Lindsay, Ole Therkildsen, Lars Buur, and Anne Mette Kjaer (2013). *The Politics of Production*, unpublished manuscript.

[16] Khan, 2010: 36.

Uganda's constitution provides for a multi-party system with regular elections but the presidency has no term limits. The current president, Yoweri Museveni, has been in power since he and his National Resistance Army won a civil war in 1986. Although many of the army officers, then as now, were from Museveni's region in the southwest of the country, the government was relatively broad-based in 1986, accommodating former enemies as well as representatives of many different regions of the country.

The ruling coalition in the new millennium, however, is much more narrowly based than in the early years of NRM rule, with a considerable overrepresentation of south-westerners. Key government and army positions are held by people from Museveni's region (Lindemann, 2011). In addition, it is becoming increasingly difficult for the ruling elite to hold its coalition together because various opposing factions have grown stronger. Many factions from the central kingdom, Buganda, have left the coalition, but so have some factions and individuals from Museveni's own region. In addition, a combination of decentralization and the introduction of elections has strengthened the power of lower level factions of the ruling coalition, in particular local movement chairmen and local council chairmen.

Increased fragmentation of the ruling coalition means, among other things, that key positions have to be given to politically important elites (Kjær and Katusiimeh, 2012; Golooba-Mutebi and Hickey, 2013). The costs of holding the ruling coalition together have increased, and this has led to increased political corruption, a phenomenon Joel Barkan (2011) has called 'inflationary patronage'. Increased corruption has in turn led development partners to cut budget support on several occasions, most recently in November 2012 after a major scandal in which funds for reconstruction in northern Uganda were misused in the Prime Minister's Office. Although the misappropriated funds have been repaid, the individuals involved have yet to be prosecuted.[17]

At the same time, domestic revenue collection has not improved significantly, although the most recent need to repay funds to donors has made the authorities look for new sources of domestic revenues. Hence, the ruling elite finds itself in a situation in which more funding is needed and alternative sources have to be found. New donors, such as China, which are less concerned with governance issues, constitute one such alternative source of funding. In 2012 China Exim Bank gave a 350 million dollar loan for a new road between Entebbe and Kampala, and in 2013 China announced its commitment to a 9.8 million dollar loan for the Ugandan government.[18]

Another alternative source of income is oil. Although Uganda is not yet pumping oil, revenue to an estimated amount of up to 1 billion US dollars will be collected from the licenses for exploration that Uganda issues, in addition to capital grant taxes etc. (RoU, 2013). Like the Chinese funds, oil revenues will come with no political conditionalities attached. Because the present ruling coalition appears to be concentrating increasingly on immediate, short-term political survival rather than long-term national development, considerable concerns have already been expressed in the media and among key observers and civil society organizations regarding the use of oil revenues. The fact that the

[17] See e.g. *The Independent*, "Better Financial Controls". Friday, July 19th 2013.

[18] *Oxford Analytica*, "Uganda President eyes greater control over the economy", April 23, 2013.

much debated Production Sharing Agreements between the government and the oil MNCs were not publicly available was also criticized.[19]

Independent observers have argued that the important big licenses are mainly negotiated personally by the president and that the revenue thus serves to strengthen the top ruling elite. This has led Roger Tangri and Andrew Mwenda to argue that 'aspects of the oil industry had been quietly distributed to friends, family and in-laws of Museveni's inner circle' (Tangri and Mwenda, 2013: 171).

In 2010 a group of young Movement and independent parliamentarians refused to pass legislation on oil because of the lack of transparency involved. They also refused to approve the appointments of ministers who had allegedly received bribes from oil companies (Tangri and Mwenda, 2013). The fact that the president was able to enforce party discipline and finally pass it testifies to the fact that the ruling elite has managed to bolster its position, but the protests show that the ruling coalition is not as cohesive as it once was. Internal wrangles within the army are also appearing, most recently with key army elites openly criticizing the favoritism shown to the presidents' son in the army. Even though the ruling elite has cemented its power, the fragmented nature of the ruling coalition makes it easier for 'rebel factions' within the ruling party and opposition FDC members to strengthen their positions.

[19] There have already been issues between the Ugandan government and companies, most notably, an issue around taxation of the sale of Heritage Oil to Tullow and a capital gains tax of 313 million US dollars that Heritage did not pay to the government. Tullow paid the tax in order to be able to continue its operations and then sued Heritage, a case Tullow recently won. See *Uganda Chamber of Mines and Petroleum* Issue 8, May-July, 2013; and *the Telegraph*: "Tullow wins 313 mill from Heritage in Ugandan tax dispute", June 14, 2013.

The increasing fragmentation and 'inflationary patronage' have both indirect and direct implications for the extent to which local linkages with the oil economy can be nurtured. Indirectly, implementing industrial policy to promote production and build capacity for linkage formation meets a larger number of obstacles and resistance when important groups have to be accommodated. Productive sectors are in general only promoted if they are important to the ruling coalition (Kjær and Katusiimeh, 2012; Whitfield et Al. forthcoming). Therefore, industrial policy has been implemented only to a very limited extent. The fragmentation and inflationary patronage makes the ruling coalition more prone to using oil funds for political or private purposes. Already, parliament has formed a committee to scrutinize money paid as signature bonuses, capital gains taxes etc. During parliamentary debates it was stated that some 'aspects of the oil industry had been quietly distributed to friends, family and in-laws of Museveni's inner circle' (Tangri and Mwenda, 2013: 171).

In a more direct way, building local capacity to benefit from oil is also affected by the fragmented nature of the ruling coalition. Key positions are held by people who are politically loyal and hence can use their contacts to obtain funding for the ruling coalition. This can be true in terms of who wins contracts, who gets to lead oil training institutes or who knows in advance which land will be expropriated when and how to benefit from it.

POLICIES AND INSTITUTIONS

It is in the political and economic context of a fragmented ruling coalition and competing factions that policies affecting the oil sector and linkage formation are to be un-

derstood. We address first the general policy framework, and then the specific policies affecting linkages. The government's overall framework for Uganda's economic policy is Vision 2040 (RoU, 2011), which states as its aim 'a transformed Ugandan society from a peasant to a modern and prosperous country within thirty years' (p. 3). This involves reaching a per capita income of 9,500 US dollars by 2040, and the theme of the vision is to accelerate Uganda's socioeconomic transformation. This focus is in theory well aligned with strengthening local capacity to link up to the oil economy, and the Vision lists oil as one of the main opportunities in the future to generate revenues that can be reinvested in strategic sectors of the economy to promote structural transformation (p. 26).

In order to reach the aims of the Vision, five-year development plans are drawn up, the first National Development Plan being drafted in 2010 (RoU, 2010). In the Plan, a strategy is laid out to address key constraints in transforming the economy. A mixed economy approach is adopted, key priority areas being human resource development, infrastructure development, the promotion of science, technology and innovation, and facilitating availability and access to critical production inputs. The Strategy also talks about targeted initiatives to promote industry and the development of technological capabilities in Uganda. 'The plan is to maximize future revenues from the oil industry and utilize them for high return public investments in the longer term' (p. 54). These are all factors that would ideally promote local linkage formation. However, the question is whether the plans are implementable (Shepherd, 2013).

Indeed, so far, industrial policy to promote local capacity or promote the transformation of the economy has been either lacking or inadequately implemented (Kjær and Katusiimeh, 2012; Whitfield et al., forthcoming). This not only goes for initiatives targeted at certain sectors, but also policies to provide public goods. Infrastructure remains highly inadequate, power supply is not reliable, and agricultural extension advice covers an estimated fifteen percent of farmers only. Previous government initiatives to promote industrialization, such as the 2001 Strategic Export Initiative, government support for the textile industry or the Plan for Modernization of Agriculture launched in 2000, have had meager results (Kjær and Muhumuza, 2009; Kjær and Joughin 2012). In addition, the previous national strategies, such as the Poverty Eradication Action Plan, did not achieve what they set out to do. Although poverty was reduced in the PEAP period, this was as much due to a peace dividend after 1986, a growth in services driven partly by aid and remittances as it had to do with successful strategies (Kjær and Muhumuza, 2010), and it had little to do with a genuine transformation of the economy (Selassie, 2008).

One precondition for increasing productivity is clearly access to land. But land conflicts are becoming more frequent, and they are a potential threat to investors. There is a perception of that there is little security of tenure. Although the government tries to help investors through a one-stop shop in the Uganda Investment Authority, in reality investment is not easy and there are lots of bureaucratic obstacles. Recently, politicians, including a minister of state for land, have been helping squatters who had already been compensated by investors reclaiming the land they sold. This may set a bad example and deter future investment. Along the same lines, Movement party elites have been known to benefit from their knowledge about land that will be expropriated. They are able to buy the land rather cheaply from the inhabitants and

then be the ones to receive compensation once the land is appropriated by the government for infrastructure, electricity or use in relation to the oil and gas sector.

In sum, lack of implementation of legislation regarding development plans and land has much to do with a general political economy environment characterized by a fragmented ruling coalition and a ruling elite intent on staying in power. According to 'doing business surveys', the main threat to investments is said to be corruption and weak institutions.[20] However, this cannot by itself explain the lack of industrial policy. China, for example, also scores poorly in doing business surveys and has still managed to promote local industries. Some types of rent-seeking and rent provision to selected industries may even be important in creating linkages (Buur, Therkildsen, Hansen and Kjær, 2013). Thus, the lack of industrial policy may be explained by the fact that the need to hold the ruling coalition together necessitates a form of decentralized rent management that is not conducive to implementing policies that could promote linkage formation.

The National Oil and Gas policy of 2008 sets the framework for *oil-specific policies*. In line with the overall Vision 2040, the goal is to use Uganda's oil resources to bring down poverty and promote the country's socioeconomic transformation. Some of the sub-objectives of this overall goal were to ensure national participation in oil and gas activities and to enhance national skills. To implement the policy, there are different acts.

For revenue collection and management, for instance, an 'Oil and Gas Revenue Management Policy' was adopted in February 2012, which stipulates how oil will be taxed and how the revenues will go into a Petroleum Fund. There has been a debate about the ability of the Ugandan government to assess whether the industry is taxed correctly, and whether the Uganda Revenue Authority possesses the capacity to tax the industry. However, this is clearly an area that is being prioritized by the government, and considerable technical advice is being received, particularly from Norway.

The most relevant bill for local content is the Petroleum Exploration, Development and Production Act(2012).[21] In this Act, there are no provisions for mandatory linkages or indications of certain percentages of local content. However, a number of requirements are listed. For example, applicants for a license under the bill need to come up with plans for local employment and training, as well as proposals for the procurement of goods and services in Uganda (RoU, 2012: 20). Article 52 says that the licensee shall give priority to Ugandans in the provision of goods and services and to purchasing local products (ibid.: 49-50). It also stipulates that the licensee shall give an annual report on its achievement with regard to using local products and services. There are similar articles on the training and employment of Ugandans that require licensees to have training and recruitment programs for Ugandans.

The legal framework for local content is more or less in place. With regard to the ability to implement, there is no doubt that institutional capacity on the Ministry level is high. Since oil is now a key strategic sector for the ruling elite, developing an efficient oil agency has been given a high priority politically. The Petroleum Exploration and Pro-

[20] Uganda's rankings in "Ease of doing Business" surveys have not really improved, the overall ranking being 120 (compared to, e.g., Tanzania's 126).

[21] Available at the Ministry of Energy's petroleum departments website: http://www.petroleum.go.ug/

duction Department within the Ministry of Energy and Minerals has received plenty of resources and advice over the last decade and has built up considerable technical capacity. As a recent evaluation of Norwegian support for the PEPD concluded, it is today a 'competent institution with a number of highly experienced and focused directors and staff'. This is clearly the impression one receives from the website, which is well run. Thus a politically endorsed and capable agency is an important precondition in encouraging local linkages. However, at any level of implementation, political interventions in contracting and licensing processes could be an issue. We know from other sectors, such as highly capable teams in the Ministry of Finance or Bank of Uganda or the previously well-functioning secretariat for agricultural extension reform, that political pressure to change policy direction or political interference in implementation can be so strong that it cannot be overlooked (Kjær and Joughin, 2012). Additionally, for local content policies to succeed, other focus areas of Vision 2040 to strengthen infrastructure and the economy generally need to work too.

Implementing provisions for educating a skilled Ugandan labor force in the oil and gas sector is proving harder than initially contemplated. The Uganda Petroleum Institute in Kigumba was set up to provide training in 2010. The Institute offers a diploma in technical skills related to oil and gas, and there is a six-month training trip to Trinidad and Tobago. However, of the first class of 28 students who entered the program in 2010, only two graduates have a job in 2013. The Institute has been criticized for not giving its students skills on a level that is needed and for the fact that its graduates need further training abroad. There is another industrial training institute, Nakawa, which has been supported by the Japanese, but it still lacks specific expertise in oil. Three universities in Uganda have programs in the country, and Makerere University has recently added a Master's degree to its Bachelor's program in oil engineering. However, many Ugandans prefer to go to universities abroad to acquire oil-related technical skills. Those who do so are those who can afford it, which often means that they or their relatives have an important position in the government.[22]

There has been a fierce debate on the use of oil revenues. Based on experience with previous cases of misuse of public funds, the public has a reason to be skeptical. For instance, a recent civil society report on transparency in the oil sector lists eleven major corruption scandals during the last twelve years in order to justify its concern with the use of oil revenues (Global Witness, 2010). Another issue affecting local content has been to define the powers of the Minister for Energy, and especially whether the Minister or a semi-autonomous petroleum agency should have the power to grant licenses to oil procurement companies and their sub-contractors. The draft bill reflected the opinions of many MPs and NGOS and granted the authority to the agency, in the hope that it would be less subject to direct political influence. However, in the final version of the bill drawn up in 2012, the Minister is granted the authority. This has been criticized by civil-society actors and parliamentarians as well as by the oil MNCs because they fear that they will not be allowed to contract with the best companies but rather with those that are somehow preferred politically. Another huge issue of contention between the oil companies and the government

[22] Interviews; see also "Kigumba graduated unfulfilled dreams" in *The Uganda Chamber of Mines and Petroleum*, May-June 2013.

has been whether to build a refinery or not. While the government preferred a refinery, the oil companies preferred only to invest in a pipeline to export the crude oil. A feasibility study had recommended a refinery of some capacity, but its recommendations were questioned by the oil companies.

INDUSTRY: MNCS AND LOCAL INFLUENCES ON LINKAGES

All MNCs and their international suppliers have programs to hire Ugandan labor and use Ugandan suppliers. According to the Ugandan government, seventy percent of Total and Tullow employees and sixty percent of CNOOC employees are Ugandan.[23] There are very few Ugandans, however, among the highly skilled employees.

The MNCs interviewed for this study (Tullow, Total, and Neptune) had all taken initiatives to support training. CNOOC had launched a scholarship program and sent Ugandan employees for training in China.[24] CNOOC, Total and Tullow were cooperating with each other in order to identify opportunities for them to support or collaborate with the Ugandan business sector. This section briefly gives examples of these programs and outlines the challenges to their implementation as the companies see them, as well as touching on how they are perceived in the public media.

The oil companies in Uganda seem very aware of the local context in which they are operating. They have Corporate Social Responsibility and community programs, and they are making an effort to go further than merely providing hand-outs such as buying books for schools or building a local health clinic. They are trying to initiate programs that have a more lasting impact in terms of local supply chain development. For example, Tullow is working with Irish Traidlinks to strengthen the local business environment in Hoima, in the oil-producing area.[25] They have set up an enterprise development center to help enable farmers to supply the oil sector with food. They are trying to think of areas where they can use local suppliers. For example, one company representative mentioned the possibility of buying special protective work clothing from Ugandan rather than foreign suppliers. This would, of course, mean that a local capacity to produce that type of special clothing should be built.

The companies interviewed have policies for local hiring, especially for casual labor. They go through strict procedures regarding how they announce openings, how people are supposed to apply and how the applications will be processed. This is to avoid accusations that some individuals have been favored over others.

Tullow had recently established a training program for oil technicians in cooperation with the Nakawa Vocational Training Institute, and several donors had given commitments to support it, but the initiative had been postponed due to the lack of agreement on a refinery. In general, the negotiations had delayed local content as well as other activities.

Local companies and private-sector organizations in Uganda have recently joined up

[23] *The Observer*, July 18th, 2013: "Ugandans await oil opportunities".

[24] *Daily Monitor*, December 7th, 2012: "CNOOC trains Ugandan employess in China".

[25] Traidlinks is a not-for-profit business-led organization that supports and promotes enterprise-building in Africa. Their program in Hoima is supported by Irish Aid.

for an initiative they call 'Skilling Uganda', a ten-year strategic plan for vocational training. It emphasizes the development of employable skills and also on-the-job learning. The oil and gas sector has representatives in the implementing task force.

Finally, Total has a scheme to link up with international NGOs to try to help the communities in which they operate. When the refinery is built in Hoima, about 7,000 local residents will be resettled, requiring information to be given to local communities about what will happen, a need Total recognizes. However, there is a limit to how much the companies feel they can do. It is the government that carries the main responsibility for carrying out the resettlement plan, including compensating those who are being resettled. For this purpose, the Ministry for Energy has hired a consultancy company, and the process of sensitizing residents and compensating them has started. There has been some controversy regarding the implementation of the resettlement plan; there are stories in the media about locals being intimidated by security officers or being forced to sign consent forms even when they have not received compensation.[26]

Generally, the oil companies express frustration that the government expects them to fund things, like education, that traditionally are the government's primary responsibility. They also feel the government expects them to employ its 60 new graduates from the Kigumba training institute even if these graduates still do not have adequate skills. The companies emphasize that they are not substitutes for the government and cannot pay for entire educational programs. In this sense, there is a mismatch between what the government expects of them and what they feel they are able to deliver.

In the public debate, views are aired about ruling elites pressurizing oil companies to favor them individually. There are public suspicions that those who receive support or are recruited are in some way politically connected. Some interviewees gave specific examples of well-connected individuals who had been hired by oil companies as a consequence of political pressure.

All in all, although the MNCs do have programs for local content and creating linkages, there are limits as to how much they feel they can do, given the gap between capacity in Uganda and the kind of provisions the companies need.

DONOR INFLUENCES ON LINKAGE FORMATION

The donor representatives interviewed for this study all had programs to help build up the Ugandan ability to benefit from oil investments. There was an expressed interest in focusing more on the issue. Many like-minded donors (e.g. the Irish, the British, Danida, Norway etc.) are also interested in pursuing the issue of transparency in oil management. The Ugandan government has not yet signed up for the Extractive Industries Transparency Initiative (EITI), but has pledged to do so and is allegedly waiting until all legal frameworks are in order. This section briefly gives examples of donor programs to support linkage formation, and then discusses the general relations between donors and the Ugandan government in the light of the oil sector.

The gradual shift away from a focus on poverty directly to poverty reduction through

[26] See e.g. *The Observer:* "The Refinery: Residents want resettlement plan" May 1st, 2013; or wwwoilinuganda.org "Refinery residents unhappy with compensation process", July 27, 2013.

private-sector development means that there is a lot of general donor support to local industry and agriculture. Donors do support linkage formation in various ways. The World Bank, for example, has just launched an 'Albertine Region Sustainable Development project' (World Bank, 2013) providing vocational training and infrastructure for the oil region. Irish Aid supports Traidlinks, a private-sector organization involved in strengthening local food suppliers so they can supply the oil firms (interview at Traidlinks, June 2013). Both DfiD and the French have to take care that they are not associated with the interests of the oil companies, since Tullow is British and Total is French. Both support private-sector development and hence indirectly local supply chains and local capacity to link up to oil. The same is the case with Danida, which has also supported on-the-job training of a limited number of welders for the oil industry. Thus many donors are supporting local capacity indirectly through funds for loan guarantees and in other ways to develop agro-business etc. It is the impression, however, that these and other initiatives are ad hoc and that there is a clear lack of coordination and mutual information-sharing among external actors. There are isolated studies going on set in motion by different development partners, but little in terms of an overview of knowledge about the sector.

It is clear that the Ugandan government's relations with donors has changed significantly over the last two decades. Throughout the 1990s and into the new millennium, the government had a close and frequent dialogue with the World Bank, probably its closest development partner. Other development partners of significance in Uganda were the African Development Bank, DfiD, the EU and Danida, to mention a few, all of which had fairly good working relations with the government, with relatively easy access. After the introduction of Poverty Reduction Strategy Papers and the increasing emphasis on the harmonization and coordination of aid, development partners drafted a joint assistance strategy for Uganda in cooperation with the government to support implementation of the poverty eradication plan (World Bank, 2005).

Gradually, both coordination among donors and the latter's relations with the government have changed. Recent corruption scandals have compelled donors to react. There have been regular cuts in general budget support, although this has often been resumed after a while. Recently, the scandal mentioned earlier in the prime minister's office led many donors to suspend aid, and the EU ambassador to Uganda saw the scandal as a 'breach of trust' between Uganda and donors.[27]

The prospect of becoming less dependent on aid means that the government is apparently placing less emphasis on dialogue with the donors. The government very much appreciates the technical advice it receives from Norway, which has assisted, among other things, by sending experts from oil-specific branch agencies in Norway to help build up oil-related capacity in Uganda's government. This means that although Norway too suspended aid in the aftermath of the scandal in the prime minister's office, it has enjoyed easier access to the government. China is in a different category, because its presence in Uganda is visible as much through the national oil company CNOOC as through its role as a donor. Recently China has given Uganda grants to support infrastructure development, and it does not have governance-concerns as traditional donors do. Hence, while Uganda's

[27] *Reuters*, Tuesday December 4: "EU joins national donors in freezing aid to Uganda over graft".

relations with Western donors may have deteriorated, this is evidently not the case with regard to China.[28]

Perhaps because of their deteriorating relations with the Ugandan government, coordination among donors is not as apparent as it was at the time of the joint assistance strategy because such a joint strategy no longer exists. There is still a formal dialogue around support for the National Development Plan. Some donors have traditionally not coordinated much, such as USAid. It is unclear how the presence of oil will affect coordination. Some donors may feel it would be easier to enjoy direct access to the government, an access gained because of oil. China never coordinated much with other donors and now appears to have close relations with the Ugandan government primarily because of its oil investments.

There is a perception among other development partners that Norway has been able to nurture a good relationship with the government and thus does not need to interact with the other development partners. For its part, however, Norway expresses a desire to work more with other donors and especially to draw on their support with regard to governance issues.

One way in which oil findings have indirectly contributed to deteriorating relations between donors and the Ugandan government is through the role of CSOs as watchdogs over how the oil resource is managed. Development partners support civil society and the ability of civil society and parliament to hold the executive to account. This support also concerns the oil sector because CSOs have become more vocal in oil issues and have demanded to be heard in key issues such as the nature of production sharing agreements. They also vocally criticized the fact that the Minister of Energy, rather than an independent petroleum authority, was given powers to grant licenses in the oil sector. The multi-donor Democratic Governance Facility has supported many of these CSOs. The president apparently perceives this as an alliance against the government. This perception came out clearly in a recent speech to parliament in which he referred to the 'nefarious and mendacious campaign of the foreign interests, using NGOs and some Members of Parliament to try and cripple or disorient the development of the oil sector'.[29] Referring to a parliamentary forum on oil and gas supported by DGF and its criticism of the authority of the Minister, the president says that 'the malignment by internal saboteurs working on behalf of external parasitic interests must be stopped by legal, political and media actions by the NRM and Government leaders'. The speech is itself evidence to the deteriorating relations between the government and (many) donors.

CONCLUSION

There is much hope in Uganda about the wealth that will come from oil in the future. This paper set out to explore three questions: (i) what is the extent of linkages and the Ugandan capacity to create them, (ii) what are the political and economic factors influencing whether linkages can be created, and iii) what are donors doing to support linkage formation? The paper is based on a review

[28] On China's good relations with Uganda, see, for example, *Xinhuanet*, 18 September, 2013: "Chinese top legislator pledges closer ties with Uganda". See also Lee (2007).

[29] President Museveni's speech to Parliament, December 13, 2012.

of the secondary literature and supplemented by news articles and a number of interviews carried out in Uganda in the summer of 2013 . Although it is still early days to assess the impact of oil, the answers to these questions are sobering in the sense that there are only a few linkages. This reflects the basic fact that the technology gap between what investors need and what Ugandan suppliers can provide is very large. The legislation to address this is in place, but judging from history, not much in terms of industrial policy has been implemented. This again has much to do with the nature of Uganda's political settlement. Competing factions that are hard to please and keep within the ruling coalition impede the implementation of initiatives to promote the local economy and ultimately to push forward a process of economic transformation. Donors are trying to support linkage formation. They are also trying to put pressure on the Ugandan government to increase transparency in the management of oil resources. Due to an increased variety of sources of income, the Ugandan government has gained more autonomy and hence will use its own experiences to decide what works and what doesn't. This is basically a positive development because it means that domestic political actors and institutions rather than aid donors will decide which initiatives are taken and implemented. Hence, at a general level, donors can try to push for increased transparency regarding the use of oil revenues. At a more specific level regarding local content, donors can do no more than identify Ugandan policies and initiatives that have genuine political impetus and choose to support those rather than call for policies that may sound good on paper but have no real chance of being implemented.

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