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Chairperson; Parliamentary Ad-Hoc Committee
On the regularization of the oil sector.
Parliament House
P.O. Box 7178
Kampala.

Submission by the Bank of Uganda to the Parliamentary Ad Hoc Committee on the Regularization of the Oil Sector and other matters incident there-to.

This document, submitted by the Bank of Uganda to the Parliamentary Ad Hoc Committee on the Regularization of the Oil Sector and other matters incident there-to, is arranged as follows:

1. **The Oil and Gas Sector Revenue Issues in Relation to Macroeconomic Management**

2. **The Oil Revenue Accounts in Bank of Uganda**

3. **Total Revenue Generated from the Oil Sector so far**

4. The transmission mechanism of funds accruing to the oil sector

The document discusses the macroeconomic challenges which oil production will entail (section 1), provides details of the different Government accounts in the Bank of Uganda (BOU) on which oil revenues have been deposited (section 2), sets out the details on all of the revenues related to oil which have been deposited with the Bank of Uganda and the accounts on which they were deposited (section 3), and discusses the modalities through which oil related funds will be transmitted to the budget and the economy (section 4).

The specific allegation that oil revenues were removed from the BOU for a period of 14 days is addressed in section 3. The allegation is false. In summary, the following transactions took place. Capital Gains Tax and Stamp Duty from oil companies totalling US$449.4 million was deposited on a URA Tax Collection Account in the BOU in three separate transactions which took place in August 2010 and April 2011. After being deposited on the URA Tax Collection Account these funds remained on that account until the 7th July 2011, when the entire amount was transferred to the Government Oil Revenue Account in the BOU, upon instructions from the Accountant General. Two weeks later, on the 21st July 2011, following discussions with H.E. The President and the Hon. Minister of Finance, Planning and Economic Development, the US$ 449.4 million was sold to the BOU and the Shilling equivalent – Ushs 1,162 billion – was credited to a Shilling denominated dedicated Government account in the BOU. The full amount of these funds remains on this dedicated account.

All of the accounts on which the Capital Gains Tax and Stamp Duty have been, or are currently, held are components of the Uganda Consolidated Fund in the BOU. At no time since these revenues were initially paid by the oil companies have they ever been removed from the Uganda Consolidated Fund in the BOU.

The BOU was also requested to verify and confirm that the amount of `oil related revenue as submitted by the Ministry of Energy & Mineral Development (MOEMD) to Parliament was banked at Bank of Uganda. MOEMD maintains a non tax revenue (NTR) account at Bank of Uganda where all monies received including oil related revenue are reflected. We have to the extent possible extracted from the NTR account the oil related revenue to ascertain that it is in agreement with the schedule as presented by MOEMD.

While the responsibility of reconciliation lies with MOEMD, we have retrieved as many records as we could within the given time. There is a difference which is yet to be reconciled by MOEMD whom we are touch with to complete the exercise within the shortest time possible.

1. The Oil and Gas Sector Revenue Issues in Relation to Macroeconomic Management

The Bank of Uganda has contributed to the draft Oil and Gas Revenue Management Policy which is being prepared by the Ministry of Finance, Planning and Economic Development (MFPED) and which will shortly be submitted to the Cabinet.

The main macroeconomic management issues related to oil and gas revenues are the following:

1.1 The sustainability of Government spending out of oil and gas revenues

Oil and gas are finite resources and hence revenues from oil and gas represent temporary rather than permanent income flows for Government. The Government revenue accruing from oil and gas will allow Government expenditure to increase. However, this increase must take place in a sustainable manner, bearing in mind the temporary nature of the oil revenues. It will be optimal to save a substantial share of the oil and gas revenues to allow the increased

Government expenditures to be smoothed out over a much longer period than the relatively short time period in which oil and gas will be produced in Uganda.

Since global oil prices are very volatile, how much oil and gas revenue will actually accrue to Government is highly uncertain. This uncertainty implies that Government must be very cautious about increasing expenditures to avoid the danger that future oil revenues turn out to be lower than expected and are insufficient to fund the increased expenditures, leaving Government with a much larger fiscal deficit which must be financed through borrowing.

It is also imperative for Government to avoid using the prospect of future oil revenues to incur excessive increases in public debt, in order to front load the increase in expenditures, because actual future oil revenues may not be large enough to enable Government to service its debt.

1.2 Avoiding volatility in Government expenditures

As noted above, oil revenues are volatile, because of swings in world market prices and, in some cases, volatility in the volumes of domestic oil production. The volatility of oil revenues will be very damaging for macroeconomic stability if revenues are closely correlated with Government expenditures, because this would mean that Government expenditures themselves would become very volatile. Expenditure volatility would lead to large swings in aggregate demand in the economy which in turn would impart instability to prices and output.

The volatility in oil and gas revenues cannot be avoided but it is possible to avoid the adverse impact on macroeconomic stability by de-linking Government spending from oil revenues intertemporally (i.e. in each individual time period). This can be achieved by establishing a fiscal rule which determines the size of the fiscal deficit independently of short term oil revenues but on a sustainable long term basis. An example of such a rule is a non oil fiscal deficit rule. In effect, the Government should aim to have a reasonably smooth path of expenditures, relative to non oil revenues (e.g. VAT, personal income tax). During periods of large oil revenue inflows, the budget would accrue surpluses, while deficits would be incurred during periods in which oil revenues are unusually low. However it is crucially important that the fiscal rule followed by Government is consistent with a sustainable path of expenditures and public borrowing over the long term.

1.3 Minimising the dangers of Dutch disease

The spending in the domestic economy of large oil and gas revenues boosts domestic demand for non traded goods (goods which cannot be imported or exported). The increased demand for non traded goods raises their prices, relative to those of traded goods (goods which can be exported or imported). This shift in the relative prices of non traded and traded goods is a real exchange rate appreciation. A real exchange rate appreciation has potentially damaging consequences for the economy, because it renders traded goods production less competitive. The traded goods sectors of the economy are likely to shrink as a result, while in contrast the non traded goods sectors (e.g. construction, transport, and other services) expand. This phenomenon is called “Dutch disease”.

Dutch disease is potentially harmful for two reasons. First, many of the traded goods sectors which contract as a result of the real exchange rate appreciation are labour intensive (e.g. export agriculture). The labour shed as these sectors contract may not have the skills to find employment in non traded goods sectors, with the result that unemployment will rise and poverty will increase. Secondly, traded goods industries often provide a more dynamic engine of growth than non traded goods industries, because the former are exposed to greater competition on world markets compared to non traded goods industries which only face competition in the domestic market. Hence the contraction of the non oil traded goods industries may lead to lower long term economic growth, even though oil production itself will provide a temporary boost to economic growth.

A degree of real exchange rate appreciation is unavoidable if Uganda is to exploit its reserves of hydrocarbons. However, Government can reduce the magnitude of real exchange rate appreciation by moderating the increase in its own expenditures. The slower the rate of increase in Government expenditure, and the longer the time period over which Government spending of oil revenues is spread out, the less damaging will be the appreciation of the real exchange rate.

1.4 Public Financial Management

The management and spending of oil revenues should follow sound principles of public financial management, to ensure accountability and value for money. In particular, all expenditures incurred by Government out of oil revenues should be implemented through the normal Government of Uganda budgetary procedures. The expenditures should be appropriated by Parliament in the annual budget. In addition the revenue required to fund these expenditures should first be transferred into the Consolidated Fund in the Bank of Uganda (even if they are initially held in a Petroleum Fund) and then released to the applicable spending agency, with the expenditures recorded in the Integrated Financial Management Information System (IFMIS). The rules and regulations governing oil revenue management should be stated explicitly in legislation. Accordingly the Public Finance and Accountability Act (PFAA) requires amendment to incorporate oil revenue management issues. The MFPED is currently leading an exercise to prepare draft amendments to the PFAA to which the BOU is contributing.

2. The Oil Revenue Accounts in Bank of Uganda

a) The BOU maintains four categories of Oil Revenue related accounts namely:

   (i) Uganda Revenue Authority – Tax Collection (USD);

   (ii) Government of Uganda – Oil Revenue account (USD);

   (iii) Government of Uganda - Oil Revenue (UGX); and

   (iv) The Ministry of Energy and Mineral Development (MOEMD) Non Tax Revenue (NTR) which holds non-tax related oil revenue (UGX) alongside other non tax revenues as explained in (b) below.

b) MOEMD operates a Non Tax Revenue (NTR) account which is used to bank NTR collections and receipts such as mineral royalties, surface rentals and training fees from mineral exploration companies. The MOEMD also collects revenues from sale of old items and any other revenue due to the Ministry.

   It is this account that received Oil related revenue from Dominion Petroleum Ltd, Heritage Oil, and Gas (U) Ltd; Neptune Petroleum and Tullow Uganda.

3.0 Total Revenue Generated from the Oil Sector so far

BOU has so far received a total US$449,425,000 (before bank charges) in Capital Gains Tax and the related stamp duty. The BOU has also received non-tax related oil revenue as banked by MOEMD and SWIFT transfers amounting to US$4,000,456.67 (UShs7,633,351,758); this figure is extracted from the account statement but is yet to be fully reconciled with the MOEMD position (***Appendix 5***). Details of both the Capital Gains Tax and oil related NTR are provided below;

(a) Oil Capital Gains Tax Revenue and Stamp duty

(i) On 4 August 2010, US$121,477,500.00 capital gains tax was credited to URA's Tax Collection Account No.003410158400000 (which is a URA holding account in the BOU) from Heritage Oil and Gas Ltd (***Appendix 1***).

(ii) On 07 April 2011, US$313,447,500.00 capital gains tax was credited to the same URA Tax Collection Account No.003410158400000 (from which BOU debited US$20 for administration costs) from Tullow Oil Plc (***Appendix 1***).

(iii) On 11 April, 2011, US$14,500,000.00 stamp duty was credited to the same URA Tax Collection Account No.003410158400000 (from which BOU debited US$20 for administration costs) from Tullow Oil Plc (***Appendix 1***).

(iv) Therefore, the total accumulated Oil Capital Gains Tax Revenue plus Stamp Duty credited to the URA Tax Holding Account was US$449,424,960.00 as at 11 April 2011 (***Appendix 1***).

(v) On 6 July 2011, the Accountant General (Ministry of Finance, Planning and Economic Development) instructed BOU to transfer a total of US$449,424,960.00 from URA's Tax Collection Account No003410158400000 to Government of Uganda Oil Revenue USD Account No. 003300328400001 (***Appendix 2a***). The entries were effected on the following day, 7 July, 2011, leaving a nil balance on the URA Tax Collection

Account and a credit balance of US$449,424,960.00 on the Oil Revenue account, which is a dedicated and ring fenced account for oil receipts (***Appendix 2b***). Both accounts are part of the Government of Uganda Consolidated Fund (UCF) Account in the BOU. Consequently, the aggregate amount of oil related funds in the UCF did not change as a result of this transfer. All that happened was that the funds were transferred from one account to another within the UCF (***Appendix 1 & 2a***).

(vi) **Putting these funds in a dedicated Government Consolidated Fund Account allows separate reporting and transparency because it is easier to track any movements on that specific account. These funds are, therefore, reported separately and clearly in the financial statement showing the overall Government Position with BOU.**

(vii) On 21 July 2011, these funds amounting to US$449,424,960.00 were bought by BOU. The shilling equivalent of US$449,424,960.00 amounted to UG.Shs.1,161,736,556,120.00. This amount in Shillings was credited to the Shilling Government Consolidated Account No.00330032800004 which is part of the Government Consolidated Fund Account while the US Dollar equivalent was transferred to the BOU foreign reserves.

b) Oil Related Non Tax Revenue received through MOEMD

The BOU was also requested to verify and confirm that the amount of USD 4,415,129 in oil related revenue as submitted by the MOEMD to Parliament was banked at Bank of Uganda. MOEMD maintains an NTR account at Bank of Uganda where all monies received including oil related revenue are reflected. We have to the extent possible extracted from the NTR account the oil related revenue to ascertain that it is in agreement with the schedule as presented by MOEMD.(Appendix 5)

While the responsibility of reconciliation lies with MOEMD, we have retrieved as many records as we could within the given time. There is a difference which is yet to be reconciled by MOEMD whom we are touch with to complete the exercise within the shortest time possible.

The BOU has been analysing the oil related transactions on the MOEMD NTR account following the Parliamentary investigations concerning the same transactions. The accounts were operated as follows:-

(i) For Financial Years 2001/02 and 2002/03 non tax oil revenue was booked on Accounts No. 229.203227.1 and 229.203228. These accounts were closed in 2003 when the NTR account No.229.203229.1 was opened. With effect from 2003 one account was used until June 2010.

(ii) BOU implemented a new Banking System with effect from July 2010 to which all government accounts were transferred. Account No. 000170168000001 which is denominated in Uganda shillings was opened for the NTR by MOEMD.

c) **Operations**

(i) In July 2010, BOU went live on the new Bank of Uganda Banking System (BBS) where most of the accounting functions have been automated which minimize human intervention. In the old accounting system, the funds received would periodically be transferred to the Uganda Consolidated Fund Account (UCF a/c) manually by raising entries on paper vouchers.

(ii) With the introduction of the BBS, the transfers to the UCF a/c from the collection account are automatically effected without human intervention at the close of each business day. A control was instituted to minimise errors and delays in the processes. (**Sample statement is shown in *Appendix 8***)

(iii) <u>Oil related non tax revenue received from 2001 to date</u>

The BOU has, to the extent that this is possible, extracted oil related NTR from the global statement in order to compare it with the schedule submitted by MOEMD. The BOU records as extracted from the NTR account indicate that, as at the end of FY 2010/11, a total of US$4,000,454.67 had been received at BOU (***Appendix 5***). These receipts were transferred to the UCF a/c on various dates. It should be noted, however, that in FY 2002/03 and FY 2003/04, the non tax oil revenue received by BOU was Ushs 229,532,608 and Ushs.199,187,405 respectively (***Appendix 5***). The funds were translated at the respective end of year exchange rates (FY 2002/03 –USD/Ushs. 1,997.5 and FY 2003/04- USD/Ushs 1,788.49) to arrive at US$ 114,909.94 (FY 2002/03) and US$ 113,371.83 (FY 2003/04) for comparative purposes with MOEMD's schedule (***Appendix 6***).

d) BOU and MOEMD Classified document compared

(i) The BOU is unable to categorise comprehensively the non tax revenue collections according to the source (i.e. annual surface rental, training fees, signature bonus, permit fees, well data etc) because in most cases the funds were bundled up and banked as one whole sum without classifying the source. (***Appendix 7;a,b,c and d***) The categorisation of revenues by source can only be done competently by MOEMD.

(ii) According to our records retrieved so far, there is a discrepancy of US$414,674.33 between the MOEMD and BOU positions. MOEMD schedule for non tax revenue indicates US$4,415,129 as the total revenue received to date; MOEMD would be in the best position to reconcile the Bank statements with their internal records.

4. The transmission mechanism of funds accruing to the oil sector

Income generated from the future production of oil will be shared between the Government and the oil companies. Most of the income which accrues to oil companies will be transferred abroad, as payments for capital (servicing of foreign loans, purchase of capital equipment, repatriation of profit, etc). A relatively small amount of income will be spent locally, on the salaries of Ugandan workers and on some domestically procured supplies, such as building materials. However, the magnitude of local expenditures by the oil companies is unlikely to be large enough to have significant macroeconomic effects nationwide, although it will be important in specific localities (e.g. the oil producing regions).

The main transmission mechanism to the domestic economy of funds accruing to the oil sector will be via the Government budget. Government's annual spending out of oil revenues is likely to be of much greater magnitude than the expenditures incurred in the domestic economy by the oil companies.

The specific details of the mechanism for transferring oil revenues to the budget and the spending of these resources will be set out in the Oil and Gas Revenue Management Policy which is being drafted by the MFPED. However, the basic mechanism will probably involve the following:

1. Revenues will first be collected by URA and deposited in a Petroleum Fund.
2. The Petroleum Fund will be managed by the BOU.
3. An annual transfer will be made from the Petroleum Fund to the Uganda Consolidated Fund, which will be approved by Parliament as part of the annual budget.

4. Spending of oil revenues will occur through the normal budgetary processes, with resources drawn from the Consolidated Fund.
5. All expenditures will be appropriated by Parliament.

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GOVERNOR