**Policy brief**

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# Expanding and positioning Uganda's technical capabilities for the oil and gas industry

## In brief

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- By 2016, with about 40% of the total area with potential for petroleum reserves having been explored, commercially viable oil reserves had been discovered estimated at 6.5 billion barrels. First oil production is now expected to come on line in 2021.

- The development phase is expected to increase opportunities for domestic firms to engage in the oil and gas value chains, but there's a need to ensure meaningful implementation of appropriate local content policy and regulations.

- This note discusses the challenges and opportunities for raising local content in the oil and gas sector.

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## Introduction

Oil was first discovered in Uganda in 1877, but development has been erratic and greatly impacted by geopolitical events and government administration, resulting in exploration activities only starting in earnest in the 2000s and 2010s. By 2016, with about 40% of the total area with potential for petroleum reserves having been explored, commercially viable oil reserves had been discovered estimated at 6.5 billion barrels (Wolf and Potluri, 2018). First oil production is now expected to come on line in 2021.

In recent years, the government has developed a solid policy and legal framework to govern activities in the oil and gas sector. This included passing the Petroleum (Exploration, Development, Production) Act and the Petroleum (Refining, Conversion, Transmission, and Midstream Storage) Act in 2013, and establishing the Petroleum Authority of Uganda (PAU) as a regulatory body and the Uganda National Oil Company (UNOC) to manage the government's commercial interest in the sector (Wolf and Potluri, 2018). In 2015, the government passed the Public Finance Management Act, which includes provisions on the management of oil resources and established the Petroleum Revenue Fund, the Petroleum Revenue Investment Reserve, and the Charter for Fiscal Responsibility (Wolf and Potluri, 2018).

Local content policy and regulations have also been adopted to boost the participation of domestic firms in the oil and gas value chain and the employment of Ugandan nationals in the sector. Government's efforts to strengthen the policy and legal framework before signing production contracts with multinational companies (MNCs) was aimed at ensuring that oil exploitation can be done in a way that maximises benefits for Ugandans.

Activities in the oil and gas sector have now progressed from exploration into the development phase. The development phase is expected to increase opportunities for domestic firms to engage in the oil and gas value chains, including through providing accommodation and catering services, supplying pipeline equipment, and transportation and logistical services (Wolf and Potluri, 2018). However, to ensure that domestic firms can seize these opportunities, and Ugandan nationals secure employment in the sector, there's a need to ensure meaningful implementation of appropriate local content policy and regulations. There is notable time-sensitivity as opportunities for participation by domestic firms peak in the early years of oil and gas development, and then decline with time.

In this regard, presenters and participants at the Uganda National Budget Conference and Economic Growth Forum FY2019/20 discussed the challenges and opportunities for raising local content in the oil and gas sector. This session was chaired by Hon. Richard Kaijuka, former Minister of Energy and Chairman of the Board of Trustees of the Ugandan

Chamber of Mines and Petroleum (UCMP). The presenters for the session were Sarah Logan (IGC), Hon. Eng. Irene Muloni (Minister of Energy and Mineral Development), and Ernest Rubondo (Petroleum Authority of Uganda). The discussants were Prof. Elijah Mushemeza (Advocates Coalition for Development and Environment) and Jeff Baitwa (Managing Director, Threeways Shipping Services). Key points from this discussion are outlined below.

## Constraints to raising local content in the oil and gas sector and policy solutions

The Ugandan government has identified the exploitation of natural resources – oil, gas, and minerals – as a key driver of economic growth in coming years. Consequently, as reflected in the FY2019/20 Budget Strategy, it will continue to prioritise development of the supportive infrastructure needed for oil production and focus on the commercialisation of mineral deposits in the country. Specific attention is given to increasing the participation of domestic firms and Ugandan nationals in oil and gas sector activities and value chain.

Most of the constraints to raising local content relate to:

1. Low domestic firm capabilities to supply goods and services of the standard required by MNCs operating in this highly technical sector, and
2. Ugandan nationals lacking the skills and expertise required to secure employment in the sector.

An assessment of the capabilities of domestic firms demonstrated that, although there are a number of sectors and firms with direct or indirect linkages to Uganda's oil and gas sector, the productivity of domestic firms tends to be low. Furthermore, there are several sectors, including those reserved for domestic firms under local content policy, where domestic firm capabilities to supply the oil and gas sector to industry standards falls below or far below what is required, including in construction of roads and highways, freight transport by road, and cargo handling (Sen, 2018). However, it was also shown that, in some sectors, there is in fact a small fraction of domestic firms that are among the most productive firms in their sectors, based on data on sales or revenues earned per worker (Sen, 2018). These firms have the most notable potential to supply goods and services to MNCs, making them the ideal candidates for targeted supplier development initiatives. Raising domestic firm capabilities in some sectors, such as accommodation and catering, will also be easier than in other sectors, such as hazardous waste management.

In capacity-constrained, small market contexts, such as Uganda, merely imposing mandatory local content requirements has not been an effective way to increase domestic firm participation in MNC value chains, as these requirements do not, by themselves, contribute to raising domestic firm capabilities. Indeed, such an approach has done little more than distort procurement, increasing production costs for MNCs (and governments where government procurement is concerned) and diminish domestic firm competitiveness by removing the need for innovation. Mandating local content requirements in sectors where domestic firms cannot adequately service the oil and gas sector risks exacerbating bottlenecks and will also impede firms' ability to continue to supply other sectors in the broader economy.

An established, market-oriented approach to raising domestic firm capabilities and skills of nationals has been the establishment of a Local Content Unit (LCU). As standards cannot be lowered in the oil and gas sector, it is necessary to raise the capabilities of domestic firms to reach industry standards. LCUs are tasked with building in-depth knowledge of the existing capabilities of domestic firms, the requirements of MNCs, and an understanding of what capabilities can be improved through a combination of business and technical training. LCUs should then develop and implement business and technical training programmes and 'Approved Vendor' certification schemes for selected domestic firms, as well as training programmes for nationals to develop transferable skills, such as welding. It is vital that the timing of these training programmes is aligned with the development schedule of oil and gas projects so that capabilities are developed ahead of when they are needed (Sutton, 2017). Training that comes too late will fail to assist domestic firms to participate in the oil and gas value chain.

The LCU could also play an important role in liaising with MNCs to develop processes that enable greater domestic firm participation, including designing appropriate tender processes for MNC bids and unbundling supply contracts to make it more likely that domestic firms can successful bid on and deliver contracts. For an LCU to executive its tasks effectively, it is essential that it has high caliber leadership to ensure that the LCU can negotiate with MNC executives on an equal footing (Sutton, 2017).

Importantly, a national supplier database should be developed to facilitate matching between MNCs and domestic firms. This national supplier database should list all domestic firms that have achieved 'Approved Vendor' certification and provide information on domestic firm performance/capabilities to guide MNC selection of local suppliers.

It was emphasised that local content should not be seen as an issue of ownership, but rather of adding value to the domestic economy. For example, a firm fully owned by Ugandan nationals could fail to add value to the domestic economy by, for example, hiring only foreign workers to assemble imported inputs. On the other hand, foreign-owned firms operating in Uganda could add substantial value to the domestic economy through employment of Ugandan nationals and use of locally available raw materials. Government should therefore avoid defining 'domestic' or 'local' firms (in the context of local content) in terms of ownership, but should instead focus on the value that firms, regardless of ownership, add to the domestic economy.

The Ugandan government is keeping detailed records of what money is being spent in the oil and gas sector and what proportion of money has been spent on local goods, services, and labour. It is estimated that 28-30% of money spent in the sector has gone to Ugandan firms, including in the accommodation, catering, surveying, and transport and logistics sectors. Seventy percent of the staff of MNCs are Ugandan, and Ugandan nationals hold many professional positions in these MNCs. A growing number of Ugandans have been trained with transferable skills, including 500 certified welders.

## Conclusion

The Ugandan government has recognised the need to raise domestic firm capabilities and the skills of Ugandan nationals to ensure that domestic participation in the value chains of oil and gas MNCs is possible. In this regard, supplier development initiatives have been established (based on requirements provided by MNCs) and an Industry Enhancement Centre created, although not yet operationalised. With construction activities anticipated to begin in late 2018, time is of the essence to operationalise the Industry Enhancement Centre and get training programmes underway to increase domestic firm capabilities. There is much potential to better target supplier development initiatives to domestic firms with the greatest potential of being able to raise their capabilities to supply MNCs in the oil and gas sector according to industry standards. These firms can be identified from VAT transaction data that reveals which firms are supplying the oil and gas sector, as well as firm productivity data on sales or revenues earned per worker, as demonstrated by Sen (2018).

A Local Content Fund has been formed to finance these efforts, with funding to be sourced from a fee to be levied on all sector contracts. Additionally, UNOC was established to participate directly in oil and gas development projects and to facilitate, among other things, knowledge and technology transfer. It is vital, however, that efforts and tasks are not scattered across a variety of entities, but rather centred in a single entity (a Local Content Unit) tasked with leading on local content efforts. Experience has shown, too, that local content efforts are most successful when first focused only on the oil and gas sector and, in time, rolled out across other sectors of the economy (Sutton, 2017). It is a mistake to attempt too broad an initial approach while the institutions tasked with local content are still building capacity and expertise.

Recently, an Industrial Baseline Survey undertook a detailed capabilities assessment to identify skills gaps and provide recommendations to address these skills gaps. It was noted that the survey findings have not yet been acted on by government, and that it would be valuable for government to do so. Government efforts to train Ugandan nationals with skills identified by the private sector as being needed but in short supply were also outlined.

In addition to providing domestic firms with the assistance outlined above, the need to address broader structural constraints in the economy cannot be overemphasised. Access to affordable credit ranks among the biggest constraints to domestic firm growth in Uganda and there is a need to explore ways to make financing available to domestic firms at affordable interest rates. Infrastructure, electricity, and other constraints will also need to be eased if domestic firms are to grow and become more productive.

## References


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