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Is East Africa ready for a Sovereign wealth fund for their natural resources?

Over the last decade the global oil and gas industry has witnessed considerable changes from the dynamic pricing and investment cycles to emergence of relatively unknown or frontier countries announcing significant hydrocarbon discoveries. Kenya, Uganda and Tanzania are among the new frontier economies in the oil and gas industry.

These EAC countries have introduced laws to manage oil and gas resources for the benefit of all stakeholders. Kenya, for instance, introduced a petroleum act last year; the Act stipulates that 75% of the profit from commercial oil and gas produced is retained by the national government, with the county governments hosting the deposits receiving 20% and local community receiving 5%.

This is a departure from an earlier version of the petroleum bill which had 5% of oil royalties going to sovereign fund incorporated.

Tanzania, with an estimate of more than 55 cubic trillion of natural gas, also revised its petroleum act in November 2015; a major step towards Tanzania's fiscal and economic stability, with the hope that the natural resources would promote social and economic progress for Tanzanians.

Natural resources, including oil and gas, are dire. They slowly run off over time and consequently a slow clock of resource depletion is inevitable. So what is the most rational approach for East African governments, particularly Kenya, Uganda and Tanzania?

The region has an opportunity to learn from some of the best and worst models in the world and explore and adopt what works for East Africa. It is therefore the responsibility of the political and policy makers to prime up the hydro carbon sector as a driver for wealth creation and regional integration.

Can the Norwegian model work for East Africa?

The Norwegian model is the most influential model used and talked about worldwide as far as natural resources are concerned. Norway is the most successful resources management county in the world today, and has a sovereign wealth fund to manage their natural resources. So why is it not prudent for East African countries to copy this model of what to do with accumulated savings from their own natural resources? Why does it make economic sense for Norway to have a sovereign wealth fund but not East African countries?

The answer lies in the economic structures of these two countries. The basic economics for these countries are different. Norway has a much higher invested capital stock to labour force ratio than any other country in the world. It is also the most capital-rich country in the world, and so by adding to Norwegian capital stock will not be very productive. It makes much more sense for Norway to buy more capital stocks in foreign countries such as Brazil or China which is what they are doing with their sovereign wealth fund. When a country has sufficient capital stocks domestically, additional stocks don't yield much return and therefore it makes more economic sense to buy capital assets in foreign countries since the return on those assets is higher and more productive.

On the other hand, East African countries are on the extreme end, with totally different economic fundamentals. Not only do they have an underdeveloped manufacturing and agricultural sector, they also have less capital accumulation to labour force ratio than almost any other part of the world, and so what makes economic sense for these countries is to use the savings from the natural resource proceeds to build capital stocks rather than a sovereign wealth fund.

It is therefore prudent for these governments to adopt policies that focus on building the capacity to invest in capital stocks, a phenomena that is referred to as capital accumulation in economics which is what I call investing in investment. By doing this, governments will respect their obligation to the future as far as natural resources are concerned.

Capital stock involves the act of investment itself, a set of infrastructure developments, roads, rail networks, airports, public hospitals etc. It involves reducing consumption levels. I would rather these governments adopt a sovereign development fund and embark on capital accumulation processes. Until you build this capacity to investing in resources, the curse phenomena will persist, and so the decision that informed the revision of the petroleum bill in 2015 was well thought for.

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