



Implications of Local Content Policies in Developing East Africa's Natural Resources

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About KAPSARC

The King Abdullah Petroleum Studies and Research Center (KAPSARC) is an independent, non-profit research institution dedicated to researching energy economics, policy, technology, and the environment across all types of energy. KAPSARC's mandate is to advance the understanding of energy challenges and opportunities facing the world today and tomorrow, through unbiased, independent, and high-caliber research for the benefit of society. KAPSARC is located in Riyadh, Saudi Arabia.

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Key Points

Developing local content policies requires first a definition of what constitutes 'local' and 'content'. The politically workable answers are typically different in Eastern Africa than other parts of the world – local context is important. There is no single template that can be transported from one country and adopted in another. However, two inferences that may have more general application are:

- developing specific, stand-alone regulations for local content realizes higher levels of indigenization than trying to incorporate policies into existing general employment and procurement regulations; and
- countries whose local content policies encourage cooperation between foreign and domestic firms realize their targets faster than countries that emphasize control and ownership.

Uganda and Mozambique appear to be following very different paths in developing local content policies – perhaps a reflection of the differing scales and timeframes of their resource development – and only time will tell which will prove the more successful.

Summary for Policymakers

Creating local content in the petroleum sector has become a political and social imperative for those countries in Eastern Africa that are soon to become oil and gas producers. However, the complex social and economic make-up of these countries makes local content a controversial issue for which to legislate. This is further complicated by the countries in this area having no industrial base to develop their petroleum sector and needing to rely on the expertise of foreign energy and service companies to develop and produce these resources. Policies that balance both the social and corporate benefits that can arise out of local content appear more likely to create sustainable investments in resource development.

There is no 'template' for creating local content in the petroleum sector; each country will need to develop its own unique local content regime, though this process can nonetheless benefit from lessons learned elsewhere. The definition of 'locality' and what constitutes 'content' are complex issues in Eastern Africa. A regulatory framework that does not recognize these nuances is unlikely to achieve the stakeholder buy-in necessary to generate a long-term social license to operate.

Local content policy making benefits from a consultative, even negotiated, process rather than a prescriptive approach that is not grounded in realistic expectations. It is never too early to begin setting stakeholder expectations, because once formed, they are hard to change.

Developing specific, stand-alone regulations for local content generally realizes higher levels of localization than trying to incorporate policies into existing general employment and procurement regulations. In addition, countries with local content policies that encourage cooperation between foreign and domestic firms realize their targets faster than countries that emphasize control and ownership.

Background to the Workshop

Several countries in Eastern Africa are expecting to receive significant revenues from their recently discovered hydrocarbon resources. Responsibly developing and producing these resources to promote inclusive economic development is the greatest challenge for energy sector policymakers. This is especially difficult because these countries have no relevant industrial base and will have to rely on international energy and service companies to develop these resources.

Though hydrocarbon resources are newly discovered in Eastern Africa, many of these countries have a long history of dissatisfaction and controversy



surrounding mineral resources. The widely held belief is that African countries missed their opportunity to develop local industry around mineral resources and that foreign companies extracted the minerals without creating a value chain in the countries concerned. Consequently policymakers charged with developing hydrocarbon resources in their countries intend to 'get it right' this time. In practice, this means that they are focused on establishing a value chain for hydrocarbon development in their countries from the start and are considering policy and regulatory instruments to encourage international firms to develop local industry. These instruments—generally referred to as local content or national content policies—dominate current political and economic discussions about hydrocarbon development in Eastern Africa.

KAPSARC hosted a workshop on January 19-20, 2015, in Maputo, Mozambique, to discuss the implications of local content policies in developing Eastern Africa's natural resources. This workshop brought together policymakers from Uganda, Mozambique, Kenya and Tanzania who are charged with creating the policies, regulations and legislation for local content in hydrocarbon industries. They were joined by KAPSARC's research partners, representatives from leading economic think tanks in Eastern Africa and international experts working on issues of local content and indigenization of industry. The research partners are:

- Uganda – Economic Policy Research Center (EPRC);
- Tanzania – Economic and Social Research Foundation (ESRF);
- Kenya – Kenya Institute for Public Policy Analysis (KIPPR); and
- Mozambique – Centro de Estudos Económicos e de Gestão (CEEG).

This workshop, KAPSARC's second in a series focused on natural resource-driven development, explored topics that included:

1. Defining what constitutes local content;
2. Policy approaches for creating local content; and
3. Implications of local content policies for upstream oil and gas.

This workshop briefing summarizes the issues and considers possible implications of these policies on businesses in Eastern Africa's upstream oil and gas sector.

Defining Local Content in Eastern Africa

Local content is generally recognized as a policy instrument of national governments, intended to ensure that goods and services required at each stage of the oil and gas value chain are supplied locally. Eastern African countries such as Uganda, Tanzania and Mozambique lack an industrial base and view local content policies as an immediate way to increase the percentage of local employees working in a new industrial sector. Eventually the goal of these policies is to compel international energy firms and service companies to actively engage the local workforce and firms, facilitating the transfer of valuable skills and knowledge to the benefit of local communities.

The concept of locality is complex in Eastern Africa, and policymakers have to draft local content policies that address the concerns of varied constituencies, each claiming primary 'locality'. Hydrocarbon resources are never uniformly distributed across a country. In fact, they are usually situated within a small cluster of communities. These communities, made up of a small number of culturally distinct tribes or kingdoms, often claim that they should



receive preference under any local content policy enacted by the state. These claims notwithstanding, most countries in Eastern Africa have defined locality more broadly, referring to all citizens of the sovereign state. There is less consensus, however, about what constitutes an enterprise that can meet the regulatory definitions of a local business.

The concept of 'content' within the oil and gas value chain is also complex in Eastern Africa. While human capital and supplies are well understood and easily prescribed in policies and regulations, is there a practicable limit to this? Should local content extend to project finance, equity participation, technology and engineering systems, etc? Countries in Eastern Africa often look to Nigeria with much admiration for the depth and breadth of local content in its energy sector, governed by a robust local content regime that sets out minimum requirements for nearly every stage of the oil and gas value chain.

Local content in Nigeria was actually created by the oil and gas professionals...and then the politicians got involved.

Uganda and Tanzania have addressed these issues through the existing legal framework and national policies for local content issued by their energy and mineral resources ministries. Neither Kenya nor Mozambique has released a national content policy that addresses these definitional issues for their petroleum sector.

Approaches to Creating Local Content Policies in Eastern Africa

There is general agreement that local content policies should be unique and specific to the development needs and national aims of each

country. Consider the very different circumstances of Uganda and Mozambique.

- Uganda has a national aim of becoming an upper middle income country by 2040, commercially viable petroleum reserves and a production profile of approximately 30 years, based on current appraisals of discovered reserves. The country has completed its initial exploration phase and could commence oil production in the next two years.
- Mozambique has a national development plan to become a middle income country by 2025, commercially viable petroleum reserves that could make it the fourth largest LNG producer in the world and a production profile that can easily exceed 50 years. It is still in the exploration phase, may see substantial further reserve growth and could expect production to begin in 2021 or later.

Both countries have made local content in the energy sector a political imperative but have taken very different approaches to creating local content policies. Uganda has an established legal framework in place for its petroleum sector that has been created through extensive consultative process between the ministry, civil society, and legislature. Local content provisions have been included in petroleum legislation, policies and in the model production-sharing agreement and a specific local content policy has been drafted for the petroleum sector. Mozambique does not have a specific national content policy and regulatory framework, but instead has identified several themes across other national legislation that focus on employment, procurement, fiscal and corporate social responsibility. The newly installed government in Mozambique has declared local content in the petroleum sector to be a major priority and the country has forgone a consultative policy approach in favor of directly writing a local content law.



The examples of Uganda and Mozambique illustrate different paths that countries can take to create local content policies. Mozambique is choosing the ‘prescriptive’ path, characterized by strong state leadership dictating, through specific legislation, how local content will be created in the petroleum sector. Once the legislation is passed, current investors in Mozambique’s petroleum sector will have to comply with it, which could lead to strained relations and pressure on corporate returns. Uganda has chosen the ‘negotiated’ path, characterized by a consultative process incorporating stakeholders and supported by studies and best practices. Investors are often viewed as partners in the petroleum sector and the process of writing policies, regulations and legislation is inclusive. These negotiated paths can sometimes lead to uncertain outcomes with regard to the pace at which volume of local content is created. The third path, not currently practiced in Eastern

Africa but often advocated by international trade experts and economists, is the ‘market’ path that essentially minimizes local content requirements in favor of letting markets decide how petroleum sectors develop. This path is generally incompatible with the politics of Eastern Africa and would likely undermine the social license to operate in these countries. However, it has been used in Tunisia with considerable success.

Returning to the observation that local content policies are best tailored uniquely to the development needs and national aims of a country, a hybrid approach incorporating elements of each of these paths may yield benefits. It is important to note, however, that the ease of administering local content policies changes with the complexity of the approach chosen. Figure 1 presents some common measures used to administer local content policies.

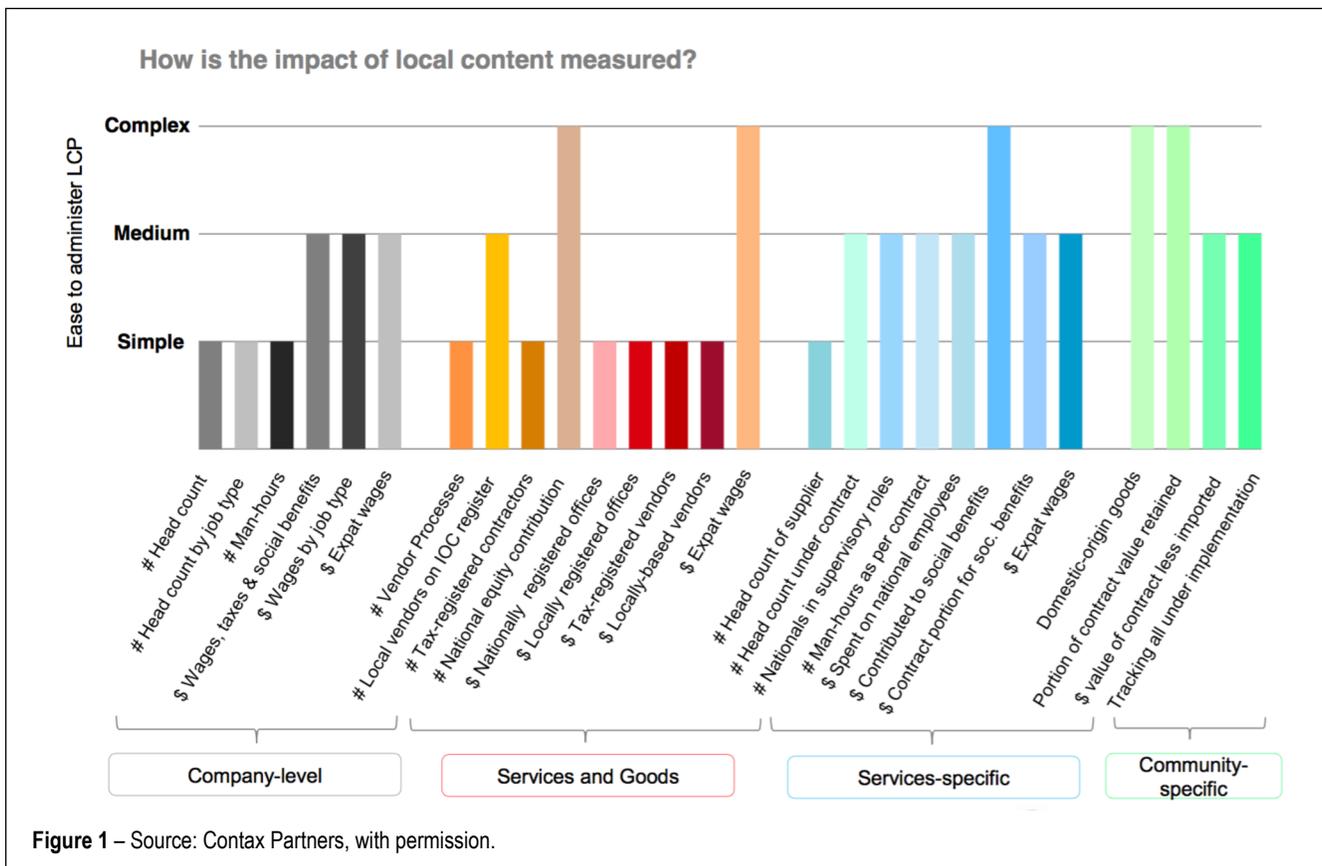


Figure 1 – Source: Contax Partners, with permission.



Local content approaches that follow the prescriptive path – i.e. that focus on company level and services and goods measures – are generally easier to administer than those that follow the negotiated path, focusing on services specific and community specific measures.

Passing laws is easier than developing policies and regulations, but policies should come first.

Insights from Local Content Approaches in Oil-Producing African Countries

A broader analysis of local content policies in Africa reveals some interesting trends. Major oil-producing countries such as Nigeria and Angola have opted to develop stand-alone legislation prescribing local content requirements for the petroleum sector. Other oil-producing countries such as Liberia, Egypt, Algeria and Tunisia have opted to incorporate local content policies into larger petroleum regulations. These local content regulations, whether stand-alone or incorporated into the larger body of policy, are drawn up to achieve one of three specific government objectives for the petroleum sector:

- *Control* – placing an emphasis on local ownership of enterprises participating in the value chain;
- *Participation* – advocating cooperation between foreign and local firms; and
- *Value* – maximizing the value of the resource to the country, rather than maximizing the overall value of the resource.

The administration of local content varies widely from country to country. Some countries have

created dedicated agencies, independent of the energy ministries or national oil companies, to oversee and adjudicate local content regulations. Other countries place the local content oversight function within the energy ministry or petroleum regulator.

The reported local content achievements in resource developing countries suggest that countries passing stand-alone regulations achieved higher local content in the petroleum sector than those that used regulations incorporated into the general policy corpus. Additionally, local content regulations that stressed participation saw local content achieved faster than regulations that focused on control or value. Finally, countries that opted for specialized bodies to administer local content regulations were more successful in enforcement of local content regulations than those countries where the oversight function fell within the energy or petroleum ministry.

Local content that is competitive will be endorsed, not enforced.

Conclusions

Kenya, Mozambique, Tanzania and Uganda are preparing to join the ranks of significant oil and gas-producing nations in the next five to seven years. A legacy of unrealized prosperity from mineral resources and the promise of tens of thousands of new jobs in a new industrial sector have created a new ‘resource populism’ in these countries that makes local content a political imperative. It is no longer a question of whether to require local content in the petroleum sector, but of placing more emphasis on how to create local content in a way that maximizes social and corporate benefits.



Local content policies designed as an extension of national development visions and tailored to the recoverable resources of each country appear more appropriate than simply adapting the ‘Norwegian-model’ local content policy templates. Consultative approaches may lead to more effective local content development, depending on how well framed the consultation is and whether the stakeholders have benefited from information symmetry on the range of issues.

In some countries this extended consultative process can lead to stand-alone local content regulations that are less likely to be confused by competing political imperatives than if they are incorporated into more general policy measures within a ministry of energy.

Next Steps for KAPSARC

KAPSARC is examining the efficacy of local content policies in the petroleum sector. This research project will assess local content policies being considered in Eastern Africa.

Our approach involves:

- Estimating plausible development and production scenarios for oil/gas resources to understand the direct and indirect manpower and supply requirements for each country;
- Surveying the enterprises that are most likely to participate in the oil and gas industry in each country and systematically assessing their capacity, through structured interviews and survey instruments administered by our research partners; and
- Assessing the impacts of local content policies using a macroeconomic model that incorporates economic costs, local content requirements and fiscal terms of a petroleum sector into a calibrated model of the economy of each country.

KAPSARC’s next workshop on this project will be held in Dar es Salaam and will consider the expectations of stakeholders in Eastern Africa’s oil and gas.



About the workshop

In January 2015, KAPSARC convened its second East Africa workshop from the series of workshops focusing on local content and macroeconomics impacts of natural resource developments. The two-day workshop, attended by over thirty international and local experts, took place in Maputo. Discussions were conducted under the Chatham House Rule of capturing the discussion on a non-attribution basis. Participants included:

Hisham Akhonbay – Collaboration Specialist, KAPSARC

Julien Bandiaky – Senior Macroeconomist, African Development Bank

Ann-Marie Carbery – Director Business Advisory, Contax Partners

Cathleen Cimino – Research Associate, Peterson Institute for International Economics

Ann-Sophie Corbeau – Research Fellow, KAPSARC

António Cruz – Director, Centro de Estudos Economicos e Gestao (CEEG)

Harrison Declan – Solicitor, Hybrid Solicitors

Filippo Fantechi – CEO, Contax Partners

Hipolito Hamela – Head of Research Department, CTA – Confederation of Business Associations of Mozambique

Fatuma Hassan – Director, National Oil Company of Kenya

David Hobbs – Head of Research, KAPSARC

Wumi Iledare – President of the International Association of Energy Economics, University of Port Harcourt

Christine Jojarth – Lecturer, Stanford University

Ibrahim Kasirye – Deputy Director, Economic Policy Research Center

Dickson Khainga – Programmes Co-ordinator, Kenya Institute for Public Policy Research and Analysis (KIPPRA)

Sheila Khama – Director, African Natural Resources Center, AfDB

Joseph Kieyah – Principal Analyst, Kenya Institute for Public Policy Research and Analysis (KIPPRA)

Bohela Lunogelo – Executive Director, Economic and Social Research Foundation

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Mary M'Mukindia – Oil & Gas Consultant, Board Resourcing Ltd.

Betty Namubiru – National Content Development and Capacity Building Officer, Ministry of Energy and Mineral Development

Marcelo Neuman – Research Professor, Universidad Nacional General Sarmiento, Instituto de industria

Nhabinde – Director, National Directorate for Studies and Policy Analysis (DNEAP), Ministry of Planning and Development, Government of Mozambique

Fernando Nhantumbo – National Content Manager, Anadarko Mozambique

Luca Roffarello – Trade Policy Specialist, United Nations Development Program

Ernest Rubondo – Commissioner, Petroleum Exploration and Production Department, Ministry of Energy and Mineral Development

Godfrey Simbeye – Executive Director, Tanzania Private Sector Foundation

Sarah Ssewanyana – Executive Director, Economic Policy Research Center

Ronaldo Toledo – Head of Investment Banking, Standard Bank, Mozambique

Roger Tissot – Research Fellow, KAPSARC

Gituro Wainaina – Director Social and Political Pillars, Kenya Vision 2030 Delivery Secretariat

Akil Zaimi – Research Fellow, KAPSARC



Notes



Notes

About the team



Anne-Sophie Corbeau is a Research Fellow specializing in gas markets; she holds two MSc in energy engineering and economics from Centrale Paris and University of Stuttgart.



Artem Malov is a Senior Research Associate specializing in facilities and cost engineering. He holds a MSc in reservoir engineering.



Tilak Doshi is a Senior Research Fellow specializing in oil and gas markets. He holds a PhD in economics from the University of Hawaii / East-West Centre, USA.



Baltasar Manzano is a Visiting Research Fellow in the East Africa project at KAPSARC. He holds a PhD in economics.



Fakhri Hasanov PhD is a Visiting Research Fellow working on East Africa. He is the director of the Center for Socio-Economic Research at Qafqaz University.



Marcelo Neuman is a Visiting Researcher collaborating with KAPSARC's Local Content Project in East Africa. He is an Associate Professor and researcher at the University of Sarmiento in Argentina.



Fred Joutz is a Senior Research fellow His research focuses on energy macroeconomic modeling. He holds a PhD in Economics from the University of Washington.



Roger Tissot is a Research Fellow specializing in local content. He holds MA Economics and MBA; worked in Business Development and as advisor to government petroleum authorities.



Daniel Mabrey PhD is a Research Fellow in the Policy and Decision Sciences program. He is project lead on research efforts in East Africa.



Akil Zaimi is a Senior Research Fellow and was an upstream petroleum economist for 30 years where he advised governments and companies on investments, fiscal terms, and financing.