NRGI Reader
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Natural Resource Governance Institute

Local Content

Strengthening the Local Economy and Workforce

KEY MESSAGES

- Local content is the value that an extraction project brings to the local, regional or national economy beyond the resource revenues.
- Countries can encourage local content through requirements and targets written in national laws and individual contracts.
- Producing strong local content results can be very difficult because of the technical requirements of the industry.
- Companies should have open and transparent procurement procedures to avoid the opportunity for corruption and cronyism.
- Governments wanting to improve local content need to understand associated costs and challenges such as potential loss in company profits resulting in reduced revenue, inflation and corruption.

"Extractive projects also have the potential to generate benefits for local communities through employment and the demand for goods and services."

— Natural Resource Charter, Precept 5

WHAT IS LOCAL CONTENT?

Many resource-rich countries make efforts to improve the local economy by leveraging linkages to extractive projects, beyond the revenues these generate. The value brought to the local, regional or national economy from an extraction project is referred to as the *local content.* A push toward local content strives to ensure that a company is hiring local labor and procuring local goods and services from the host country. This reader discusses how governments try to promote local content and some of the challenges they face in fostering lasting benefits.

HOW IS A LOCAL CONTENT POLICY IMPLEMENTED?

What qualifies as local content often varies from country to country. For example, some countries refer to *national content* to emphasize that the inputs can be from anywhere in the country, while others seek to promote inputs from the resource-rich region specifically. There are often additional questions about what qualifies as a local business—is it enough to have a certain percentage owned by nationals? Must it be registered in the country? What percentage of the workforce must be local? Some countries are very explicit about these mandates; others are not.

This reader is intended for use in conjunction with Precepts 5 and 10 of the Natural Resource Charter.

To encourage local content, countries often create requirements for extraction companies to include local labor, products or companies. Governments use a variety of tools to reach their goal of benefiting the local economy through the extraction project, including:

- **Quotas**, embedded in laws, regulations or contracts, are provisions to require companies to award a certain percentage of hires, contracts or equity ownership to local companies or professionals.
- **Training program requirements** or incentives, are aimed at requiring or encouraging foreign companies to build the skills of the domestic workforce.
- **Public education initiatives,** wherein the state opens training centers, establishes programs or organizes overseas scholarships to build a cadre of expertise in sectors with strategic links to oil and minerals.
- **Incentives for small business development**, including fostering better access to credit for small business owners or opening business incubation centers.
- **Processing and production of derivative products**, such as refining crude oil or smelting minerals, which can capture significant economic benefits if done domestically but also can be expensive and complicated to construct.

Local content requirements in a country can be implemented on a project-by-project basis through contracts or universally through national legislation. Countries vary on the level of specificity of local content requirements and whether they include provisions for employment, training or ownership. A few examples:

- The **Afghan Amu Daya Basin contract** requires that the "contractor agrees to as far as possible train and employ qualified Afghan nationals. . .and. . .will undertake the schooling and training. . . The contractor will require the contractors and subcontractors to do the same."
- **Timor-Leste's production sharing contract for Area A** stipulates that "the Contractors shall draw to the attention of suppliers based in Timor-Leste, in such a manner as the Ministry agrees, all opportunities for provision of good and services in petroleum operations."
- The **Ghana-Tullow agreement** provides that "in the acquisition of plant, equipment, services, and supplies. . . [the] contractor shall give preference to materials, services, and products produced in Ghana. . .if [they]. . .meet standards generally acceptable to international oil and gas companies. . ."
- The **Indonesian Bill on Mineral and Coal Mining of 2008** requires all companies to process and refine mining products in Indonesia.
- The **Nigerian Oil and Gas Content Development Act of 2010** has provisions to enhance local participation in all aspects of oil operations, including the following: 65 percent of divers in offshore energy projects must be Nigerian; 60 percent of steel ropes used in projects must be made locally; all contracts awarded in excess of $100 million must include a "labor clause," mandating the use of minimum percentage of Nigerian labor or the use of indigenous companies of a minimum size.

While some the provisions are very specific, they are often lax enough to allow the company the option of utilizing outside resources if labor or service needs cannot be met locally. This brings to bear the need for a government that wants to promote local content to foster an enabling environment for local labor forces and business to have the knowledge and skills to be active participants in the extractive economy. The freedom to deviate from the requirements when standards are not met also creates a challenge for monitoring a company's compliance with local content targets.

WHAT MAKES LOCAL CONTENT DIFFICULT

Extractive industries have an unusually high capital to labor ratio compared with other industries. This means that they hire fewer employees per investment dollar than most businesses. Though there may be very high expectations for the extraction site itself to employ many individuals, the nature of the business is such to have few employees.

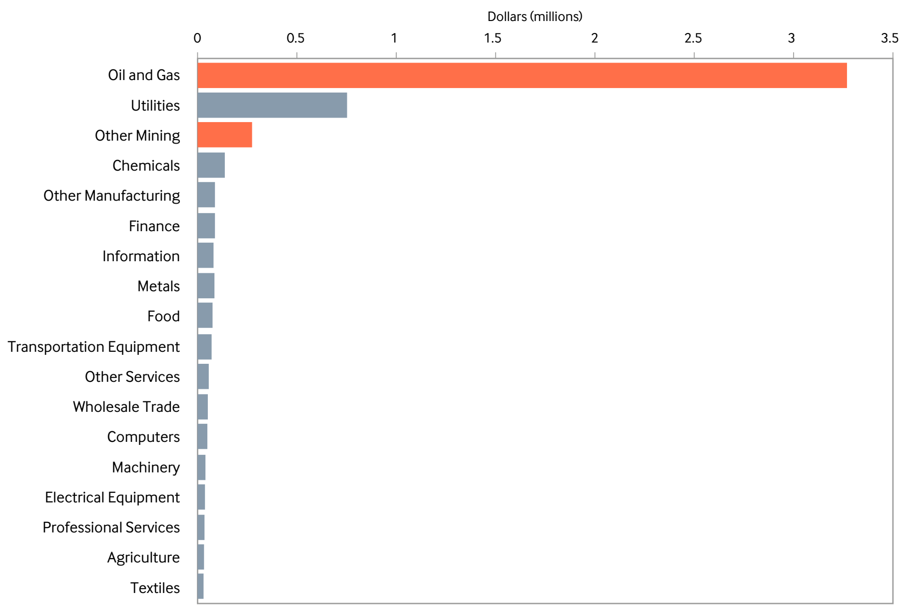

Figure 1. Capital-to-labor ratios in major industries (amount of money invested per employee by US businesses operating overseas)

Source: Ross, Michael, *The Oil Curse* (Princeton UP, 2012).

Further, the requirements for many of the extraction jobs and related services are extremely technical. For example, Tanzania has some experienced welders. However, when BG, British multinational oil and gas company, was looking for welders to help with the construction of its large offshore gas platform, it found few who could weld the specific types of piping necessary for the job. Existing welders require advanced training to be able to meet the needs of the company.

Even nontechnical jobs such as food production require a level of capacity that may not exist in the community. When there are farms near the extraction site, for example, it may seem reasonable to expect that the company could order food from the farmers. From the extractive company's perspective, however, it needs to be able to order food that is predictably at a high level of quality. Local farmers may need support to bring their farms to the capacity to meet the quality and quantity requirements for the company to use their produce. Near the Vale mine in Tete, Mozambique, nonprofit organizations have organized groups of farmers to provide chickens and other produce to the mine's cafeteria. While this step has helped small farmers interact with the mine, the local price for chicken has skyrocketed, and the mine still purchases much of its food from outside the country.

Generally, countries face a question about the benefit or sustainability of investing in local content. Because extractive resources are finite, it can be detrimental to create more economic focus on the extractive industries. Proponents of economic diversification suggest using local content provisions to develop a workforce with transferable skills.

Opening the door for corruption?

One challenge with local content is that it can open the door for corruption and elite capture of an industry. For example, in Nigeria, requirements to partner with local companies resulted in corrupt schemes wherein political elites created shell companies to profit from the law. Similarly, many suspect that the motivation for the national smelting requirement in the 2008 Indonesia mineral law stemmed from politicians seeking financial benefit for their smelting plants. Countries can mitigate the potential of corruption in local content by requiring transparent procurement processes and making information easily available to oversight actors, such as civil society and parliamentarians. Compliance with requirements to disclose the beneficial owners of extractive companies and subcontractors, such as those being piloted under the Extractive Industries Transparency Initiative, will also help reduce corruption and elite capture of local content opportunities.

QUESTIONS TO ASK

- What kind of local benefits could be offered by the extractive industry in my country?
- What kind of local benefits *are* being offered by the extractive industry?
  - Is there a local content maximization strategy in place? That is, is a relatively higher priority being given to the employment of locals and locally based firms?
  - Would such a strategy be appropriate?
- Are there mechanisms in place to track progress in meeting local content targets?

ADDITIONAL RESOURCES

Estevez, A. M., et al., *Local Content Initiatives: Enhancing the subnational benefits of the oil, gas and mining sectors* (RWI, 2013), available at: http://www.resourcegovernance.org/sites/default/files/RWI_Sub_Enhance_Benefits_EN_20131118.pdf.

Tordo, Silvana et al., *Local Content Policies in the Oil and Gas Sector* (World Bank, 2013), available at: http://books.google.co.uk/books?id=tX4xAAAAQBAJ&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.