

# Local Content Initiatives: Enhancing the Subnational Benefits of the Oil, Gas and Mining Sectors

Ana Maria Esteves, Bruce Coyne and Ana Moreno

## SUMMARY

Resource-rich regions usually expect and strive for local economies to benefit from oil, gas and mineral projects. Unfortunately, that is not always the case. These regions do not always know how to take advantage of extractive activities to create sustainable economic development, be it creating jobs and developing local businesses or building skills and improving technologies. Local content is the processes of building such economic capital at the national and subnational level, and meeting set public policy objectives.

National and regional governments need to consider a broader range of fiscal and economic policy issues to fully embrace the opportunities the oil, gas and mining sectors can offer. When considering these options, governments sometimes make trade-offs to maximize the benefits for their countries. Trade-offs made during negotiations between companies and governments may include the level and type of tax concessions offered to companies, the level of royalties companies need to pay, and targets such as the level of local content and social investment commitments sought. These trade-offs are typically specific to project, country and, in some cases, region. Governments also consider how the money flows from the national to the subnational level and the role different levels of government play in securing local benefits. Ultimately, the driver of policy choices is a country's unique and complex web of social, economic and political issues.

Several national governments have passed local content rules and legislation requiring and incentivizing extractive firms to use local products, businesses, resources and workers. Producing regions sometimes include local content as part of production-sharing agreements. For example, the 30-year production-sharing contract between Indonesia's oil company Pertamina and ExxonMobil requires that each company share 45 percent interest in the block, with 10 percent devoted to the local governments in the district of Bojonegoro. The contract is subject to Bojonegoro's regulations for local content.

Many companies also have implemented their own local content policies. While some have been effective at developing local businesses and capacity, others have created new channels of corruption or failed in their objectives. They also failed to understand and achieve the proper balance between immediate tangible benefits and long-term economic development.

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This paper offers guidance on designing and implementing local content initiatives in the oil, gas and mining sectors to ensure economic sustainability within producing regions. It aims to answer the question of how national and subnational governments, industry and civil society can maximize local benefits through partnerships among governments, companies and civil society organizations (CSOs). Governments should set clear targets based on which companies should make commitments and publish transparent reports on results. CSOs can then analyze the results and monitor progress of local content initiatives.

## LOCAL CONTENT: DEFINITIONS AND SCOPE

Local content policies aim at extending or expanding the benefits of oil, gas and mining activities for the national economy. These policies attempt to give local stakeholders access to economic opportunities, whether they are related to employment, participation in supply chains or the provision of other related support services. These policies can be further strengthened through mechanisms such as targets for local employees or suppliers, preference schemes for local businesses, industry or human capital development support from the government, or giving local businesses greater access to finance.

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Throughout this paper, the term “subnational” is used to refer to those host communities or regions that are adjacent to or directly impacted by a company’s activities. Under this definition, the area could be the province or state where the project is located, or it can cover multiple local government areas. A company operating across multiple subnational governments will need to consider something more complex than merely an aggregation of boundaries. Calculations to monitor performance on local content may also become more complex as a result, adding to the difficulty in managing a project that cuts across multiple administrative units. The following section explains some of the issues related to definitions.

### Definition of local content

The issue of what constitutes local content in a workforce or supply chain is the subject of different interpretations. For instance, with regard to local procurement, in some usages the term is equated with locally owned, whereas at the other extreme, it is sometimes used simply to describe any business that maintains a permanent operational office within a given area. Local content also has been defined in terms of the value contributed to the national economy through purchase of national goods and services.<sup>1</sup> “Local value-added” is the wealth local companies create in transforming materials and services purchased from other countries into revenue-generating output. It is calculated as the value of the firm’s output minus the value of all foreign purchased inputs (including raw materials, energy, contractor services and rents). The International Petroleum Industry Environmental Conservation Association (IPIECA), the global oil and gas industry association for environmental and social issues, also refers to local content as the added value brought to a host nation (or region or locality) through workforce development (employment and training of local workforce), and investments in supplier development (developing and procuring supplies and services locally).<sup>2</sup>

1 Michael Warner, *Local Content Solutions: Participation of Domestic Industry in Procurement for Oil, Gas and Mining Projects* (Sheffield, England: Greenleaf Publishing, 2011).

2 *Local content strategy: A guidance document for the oil and gas industry* (London: International Petroleum Industry Conservation Association, 2011).

Some jurisdictions differentiate between local content and local participation; local content is defined as the quantum/percentage of locally produced materials, personnel, goods and services rendered to the oil, gas and mining industries. It can be measured in monetary terms. Local participation is the level of equity ownership local citizens hold. These definitions have led to the emergence of numerous definitions for a local company. For example, in different contexts, a company may be deemed local if it demonstrates any of the following characteristics:<sup>3</sup>

- Local registration: legal entity is registered under local law.
- Local ownership: a certain percentage (for example, 50 percent or more) of the company is owned by citizens of the country or by existing locally owned and registered entities.
- Local workforce: majority of the company's workforce, whether directly employed or on contract, are citizens of the country.
- Local value-added: a specified percentage of goods/services is produced within the country.
- Joint venture between a foreign and a local company: the local company owns a specified minimum percentage of a partnership with a foreign company.

The position of this paper is that ownership or site of registration are not in themselves the critical factor; rather, the key question is whether a business contributes to building economic capital at the national and subnational level and whether in doing so, public policy objectives are being met. (The following section provides examples of blind adherence to definitions of local that led to undesirable consequences.) Public policy objectives could include enhanced local industrial capacity, broad-based economic development and increased local employment. A company that maintains a local branch office that is simply a conduit for bringing in goods and services from outside the country may not realize the desired policy objective. On the other hand, a foreign-owned firm entering a joint venture, consortium or taking ownership positions in local firms could make an important contribution to local economic capital.

Local content policy objectives and hence understanding of what local content means depend on the context, including the time frame of the activity, the nature of the business opportunities that are generated, local capacity and the aspirations of communities and host governments. For example, Ugandan oil experts Mwakali and Byaruhanga define local content in terms of value addition in country, by Ugandans in the oil industry, by the use of local materials, services produced by citizens and Ugandan firms, and the use of facilities in the country.<sup>4</sup> To them, the ownership of the company performing the value-added activities is immaterial. They draw on comparisons with Norway and Malaysia, where local content has been high and has been defined as value added to the host country rather than in terms of ownership of the supplier. They conclude that in a globalized industry a local subsidiary of a multinational company can be just as effective in using domestic inputs and developing capacity and competence in

*The key question is whether a business contributes to building economic capital at the national and subnational level and whether in doing so, public policy objectives are being met.*

3 Anthony Paul and M. Pierre, *Developing Local and Regional Public and Civil Society Capacities to Make Extractive Industries Work for Development and Democracy* (New York: Revenue Watch Institute, 2010).

4 J. A. Mwakali and J.N.M. Byaruhanga, "Local Content in the Oil and Gas Industry: Implications for Uganda," in J.A. Mwakali and H.M. Alinaitwe (eds.), *Proceedings of the 2nd International Conference on Advances in Engineering and Technology*, Entebbe, Uganda, 31 January-1 February 2011 (Kampala: Macmillan Uganda Publishers, 2011): 517-522.

Uganda as a company in which Ugandans hold a majority of the shares.

As this paper outlines, in practice contemporary local content policies in oil, gas and mining activities vary widely in scope and level or type of regulation applied. In some cases, local content policies are designed for a clearly identified target group in spatial, industrial or social terms. In other cases, they are part of a strategy to fundamentally transform the local economy; in such cases, it is expected that new productive activities arising directly and indirectly from the activities will make sustainable contributions to employment and income generation in the long run. The level of complexity and uncertainty attached to different interventions varies with the number of stakeholders expected to benefit from the intervention; the initial state of the local economy relative to expected outcomes, and the alignment of local content interventions with other industrial and developmental policy interventions.

### Scope of local content at the subnational level

One approach to local content policies is to focus on the national level. Another approach (sometimes referred to as “local-local,” “localized” or “community” content) is to focus on the smallest administrative unit, or combination of units, where the natural resource extraction projects take place, be it the village, the town or the municipality. While it is true that these small units are the ones directly concerned with the productive usage made from the unit’s resources, this is merely the starting point of the true spatial extent of oil, gas and mining activity effects on an area. In particular, two spatial dimensions are important when placing the subnational context in a broader light.

The first spatial dimension is one of natural resource extraction activities. Although the actual extraction of resources is fixed in space, being entirely dependent on the actual location of the resource, a large part of the rest of the value chain activities is unattached and flexible. In fact, the actual extraction process, as a highly capital-intensive process, may not make use of local resources other than land, water and public infrastructure such as rail or port facilities. Oil, gas and mining companies operate in highly integrated global value chains, in which the local economies do not necessarily participate. This is partly explained by the existence of higher-scale economies in the production of inputs in other locations, high level of risk and uncertainty, and lack of specialized knowledge and capital in the local economy.

The second spatial dimension to consider is the distribution of economic activity within the country in question. Agglomerative forces make population and economic activity concentrated across space. New businesses are drawn to dense places because of the availability of inputs, services, specialized labor and customers. For instance, Bloch and Owusu report that most of the firms in Ghana that make up the mining inputs cluster are concentrated in the Accra metropolitan area and in the adjoining area of Tema, where they are in close proximity to the headquarters of the producing mining companies.<sup>5</sup> This implies that even activities taking place within the same country may get clustered in specific areas. Nava observed a similar phenomenon in Peru.<sup>6</sup> The implication of this is that because of the concentration of economic activity in selected places, the bulk of the creation of new businesses derived from oil, gas and mining links may bypass the local-local or even the regional economy entirely. For suppliers that could benefit from

5 Robin Bloch and George Owusu, “Linkages in Ghana’s Gold Mining Industry: Challenging the Enclave Thesis,” MMCP Discussion Paper 1 (Making the Most of Commodities Programme, 2011).

6 A.M. Nava, *Discussing Local Content: Lessons drawn and recommendations based on experiences in Peru and worldwide* (New York: Revenue Watch Institute, 2011).

supply chain links with oil, gas and mining companies, the only way to operate may be by locating in an already dense location, implying that the suppliers have to incur transportation costs, which are often prohibitive for small producers in a country with poor infrastructure.

These considerations do not imply that some local economies are unlikely to develop their own industries. Rather, it points to the fact that designing the most beneficial interventions at the subnational level cannot be done independently of other regional and national efforts. Doing so runs the risk of replicating or even contradicting other industry or related government policy undertakings, and may not achieve the necessary momentum that is required to create dynamic, sustainable industries. A narrow view of space can limit the options of subnational businesses to basic services, such as catering and cleaning, which could be sourced locally. While this approach can constitute a source of employment for locals, it does not constitute a source of dynamic gains, such as higher and sustained productivity growth from technology and knowledge transfer.

Firms can exploit their unique advantage of being close to the oil, gas or mining project site by being part of larger competitive undertakings happening at the regional and national levels, such as the creation of industrial parks and clusters, or building technological capacities and shaping governance for upgrading local businesses in global value chains.<sup>7</sup> With this perspective, the role of stakeholders at the subnational level is to work actively in the design of such projects to make sure they maximize the benefits of oil, gas and mining activities for the local population. Policymakers can stimulate economic development through local content at the subnational level by identifying key sectors with higher-than-average backward and forward links compared with other sectors in a subnational region, and the highest sectors in terms of oil, gas and mining industry multipliers. Local economies will grow more rapidly if those sectors are encouraged to grow and the oil, gas and mining companies are encouraged to focus their local content efforts with businesses in those sectors.<sup>8</sup>

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## CONTEMPORARY APPROACHES TO LOCAL CONTENT POLICY AND PRACTICE

This section provides an overview of various policies and practices currently adopted by governments and industry to realize the benefits of local content in the oil, gas and mining sectors. We also discuss some practical examples of government-led initiatives with voluntary industry participation as well as international legal and policy frameworks on indigenous peoples' rights.

There is a marked absence of analysis of the effectiveness of local content policies applied to date and of which type of regulation is more effective in what context. We summarize the literature that exists on the topic, which is dominated by case studies of good industry practice and discussions of potential pitfalls.

*There is a marked absence of analysis of the effectiveness of local content policies applied to date and of which type of regulation is more effective in what context.*

7 Judith Fessehaie, "Development and Knowledge Intensification in Industries Upstream of Zambia's Copper Mining Sector," MMCP Discussion Paper 3 (Making the Most of Commodities Programme, 2011).

8 A.M Esteves and G. Ivanova, "Using Social and Economic Impact Assessment to guide local supplier development initiatives" in C. Karlsson and M. Andersson (eds.) Handbook of Research Methods and Applications in Economic Geography (Cheltenham, England: Edward Elgar, forthcoming 2013).

## Local content in the context of total oil, gas and mining contributions to host nations and communities

Local content commitments essentially represent benefits that oil, gas and mining can bring to the local economy and host communities that are unrelated to tax or royalties. When designing policies, however, it is important to consider how local content fits within a larger group of policy instruments available to manage financial and nonfinancial benefits from extraction in a way that maximizes national and subnational benefits.

In broad, simple terms, governments have two sets of (complementary) instruments they can use to make sure oil, gas and mining extractions contribute to expanding the local industrial base.

*Royalty and tax revenue maximization: As oil, gas and mining industry profits become part of the government's tax base, tax revenues available to government are maximized. This is expected to provide the government additional revenue to invest in infrastructure and other initiatives that can support the development and expansion of the industrial base. This industrial economic activity adds broader value to the economy through employment, investment and additional tax revenue for the government. The benefits are intended to flow to other sectors of the economy and contribute to greater national prosperity. National governments also share some of the tax revenues with subnational governments, but these are usually a fraction of the revenues produced in the subnational areas.*

*Local content maximization: With this strategy, relatively higher priority is given to the employment of locals and locally based firms. The host government requires the share of local content to be greater than what would have resulted from the procurement of goods and services in an open market. The aim of imposing preferential measures, like allowing for a price premium for domestic suppliers when evaluating tenders, is to encourage local workforces and businesses to work with leading international oil, gas and mining firms and their large contractors, and benefit from training and transfer of technology.*

For companies, establishing specific local content requirements may have an impact on their cost structure and affect their profitability, therefore lessening the tax base for the government. This would happen if local available goods and services were not priced competitively when compared with the companies' traditional suppliers. For governments, a balance between the two strategies requires that industrial development be stimulated through local content requirements, while oil, gas and mining companies are taxed appropriately to provide the financial resources for the government to support industry development initiatives. The balance between the two strategies also requires taking into account the fact that while most fiscal instruments provide revenues at the national level, local content policies can assuage demands of subnational stakeholders such as local governments and communities and help companies secure their social license to operate. In seeking the balance, trade-offs are sometimes made with companies regarding royalties, taxes and their commitment to local content targets. Such trade-offs may include changing the mix and/or timing of royalties and taxes in exchange for the oil, gas and mining industries' financial support for developing the local private sector.

Issues of timing and confidentiality also influence local content outcomes. Tax and royalty negotiations usually are conducted well in advance of a company knowing what it can achieve in terms of local content. While some companies may have conducted an analysis of local supplier capability, the analysis is not exact, and supplier capability development is undertaken often over the course of the project. Further, tax and royalty negotiations between companies and governments are usually carried out in secret, and it is difficult to have citizens' input into negotiations in real time. While it is good

practice to have prior public consultations and to share the final outcomes with the citizens, this is rarely followed.

Additional considerations for a government seeking to find the right balance between revenue generation and local development are the ease and cost of implementation and monitoring. These costs may be difficult to quantify and therefore omitted from calculations. However, this does not diminish their importance. Local content policies are implemented often when revenues from oil, gas and mining firms can potentially destabilize the local economy, lead to arguably wasteful government spending, undermine local accountability and increase conflict over control of natural resources. Local governments may not have the requisite institutional capacity to manage volatile resource revenues and invest them productively to ensure long-term benefits. If policymakers do not anticipate how their policies can exacerbate these problems, the benefits from local content may be felt by only a fortunate few (also referred to as economic capture).<sup>9</sup>

Specific challenges affecting the success of local content policy strategies are volatility in commodity prices, long-term economic booms and busts, and unpredictability and uncertainty of resource revenues. Social costs or risks identified by the authors in conducting social impact assessments for oil, gas and mining projects include community dissatisfaction resulting from seeing only basic works being given to local people. Demand for local goods as a result of local content policies can result in inflationary effect over certain basic goods that make them unaffordable for the local population. Community perceptions that particular groups have been favored in the allocation of employment or business opportunities can hurt social cohesion and lead to disputes within groups. The development of an educated, skilled labor market can affect a sense of community because these workers may move to other locations for employment. Unethical behaviors can also lead to community discontent. Some examples include the following: local content interventions being closely aligned with public officials' or investors' other local businesses; targets resulting in selection of contractors unable to meet prequalification without falsifying capabilities; extorting fees to be part of a tender list; authorization of single/sole sourcing without appropriate governance arrangements; bid-rigging between contractors to increase prices; or bribing officials to provide certification.

The impact on the local economy is limited when goods supplied to oil, gas and mining companies are merely imported, repackaged and resold by local firms.<sup>10</sup> This represents an economic cost. Relatively high wages paid by companies with large resources can result in local people being drawn away from other businesses in the area. As a result of these losses, communities can find their already limited services sector shrinking even more. The loss to communities is compounded because they also may suffer a major loss in human capital because experienced retailers, administrators, nurses and teachers leave their professions to work in the oil, gas and mining sector.<sup>11</sup>

9 Andrew Bauer, Draft report: Subnational oil, gas and mineral revenue management (New York: Revenue Watch Institute, 2012).

10 A Framework for Dialogue on National Market Participation and Competitiveness (Geneva: World Business Council for Sustainable Development, 2012).

11 Jeffrey D. Sachs and Andrew M. Warner, "The curse of natural resources," *European Economic Review* 45, 4-6 (2001): 827-838; Frederik van der Ploeg, "Natural Resources: Curse or Blessing?" CESifo Working Paper No. 3125 (Munich: CESifo, 2010); Claudia Viale, Local level resource curse: The "Cholo Disease" in Peru (New York: Revenue Watch Institute, 2011).

Small and Medium-sized Enterprises (SMEs) whose sole or major client is an extractive company are vulnerable to that client's business cycles, and there may be little in the way of opportunities for diversification. This issue is compounded when the extractive project is in a remote location and is the only game in town, so to speak; underlying demand is set by a single source. Oil, gas and mining business cycles typically go from boom to bust over several years, and some cycles can last for decades. The competition for resources, such as water, electricity and land, can also reduce opportunities for local content. The resulting impacts on employment, income and investments in local businesses can have devastating effects on communities heavily dependent on the industry. Those in remote, inaccessible areas could be especially hurt.

Setting inappropriate targets for local content can encourage perverse behavior, presenting governance risks. One example of this is "fronting," in which companies are established with local ownership or a local address, but the decision-making and benefits are held by individuals who are not targeted beneficiaries of the local procurement policy.<sup>12</sup> Nepotism and corruption can be associated issues, as observed in Angola and Nigeria.<sup>13</sup>

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### **Local content policies adopted by governments**

Regulatory mechanisms available to ensure that local content provisions are implemented usually are specified in national local content legislation and regulations outlining local content requirements. Oil, gas and mining companies also can commit to certain local content requirements under the terms of individual concession, production-sharing or framework agreements with governments. The strength of regulatory mechanisms varies with the specified monetary and operational consequences for oil, gas and mining companies in the event of noncompliance. For instance, while Kazakhstan's local content law established a target of 50 percent "Kazakh content" and a potential termination of the subsoil use contract in case of noncompliance, Tanzania's local content regulations did not incorporate any mention of targets and penalties.

As with contemporary definitions of local content, the scope and regulatory mechanisms available vary across countries. Members of the World Trade Organization (WTO)<sup>14</sup> are bound technically by the national treatment obligation (NTO) clause under which foreign companies cannot be forced to buy from local suppliers or hire local service suppliers if a better alternative in terms of price or quality exists abroad.

In line with this obligation, some country-level provisions do not specify any type of sanction for noncompliance, but instead only suggest that oil, gas and mining companies give preferential treatment to local suppliers and workers. When noncompliance arises, these provisions ultimately can rely only on moral suasion. An example of such policy design can be found in the 2010 Local Content and Participation Policy Framework (LCPPF) in petroleum activities of Ghana. The LCPPF mandates that "all operators in the oil and gas industry are to be required to procure, as far as practicable, goods and services produced by or provided in Ghana in preference to foreign goods and services. Operators shall engage in

12 Ana Maria Esteves and Mary-Anne Barclay, "Enhancing the benefits of local content: integrating social and economic impact assessment into procurement strategies," *Impact Assessment and Project Appraisal* 29, 3 (2011): 205-215.

13 Mwakali and Byaruhanga, 517-522.

14 The most current list of members can be found at <http://www.wto.org/english/thewtoe/whatise/tife/org6e.htm>.



local procurement of goods and services which are competitive in terms of price quality and timely availability.” These principles are in line with the NTO clause, which excludes the possibility of increasing procurement and employment opportunities through regulatory tools without incurring possible sanctions.

### Legislation specifying minimum local content targets

Table 1 lists existing local content legislations in different countries. Currently, 31 countries that are WTO members and are also considered least developed countries (LDCs) can introduce measures that deviate from the NTO clause for a defined period of time on the grounds of their “individual development, financial or trade needs, or their administrative and institutional capabilities.”<sup>15</sup> Out of this group, only Angola has introduced explicit local content requirements.

In countries with small or weak industrial bases and few skilled workers, it is difficult to achieve short-term local content objectives, whether legislated or not. There are at least two main reasons why most LDCs have not enacted local content regulations: the very prominent mismatch between international companies’ requirements and local suppliers’ capabilities, and the limited capacity that LDCs have in introducing, implementing and regulating legislation. It is often the case that the majority of the inputs and services required by the oil, gas and mining companies’ global supply chains are sourced abroad through imports or expatriate labor. LDCs have very limited bargaining power and more limited access to good practices to make informed policy decisions and negotiate with companies.

Currently the group of countries that has translated local content requirements into national legislation is small; it includes Angola, Equatorial Guinea, Indonesia, Kazakhstan, Nigeria, Russia, South Africa and Zimbabwe (Table 1). Some countries in the group are non-LDC WTO members that have deviated from the NTO clause by translating local content policies into legislation and regulations (e.g. Indonesia and Nigeria),<sup>16</sup> while others (e.g. Kazakhstan) are not WTO members.

As shown in Table 1, existing local content legislations greatly vary in their scope and targets. For instance, while Angola’s legislation is limited to establishing a 10 percent preferencing margin for local suppliers and does not establish overall targets for Angolan content, Kazakhstan’s subsoil law establishes a target of 50 percent local procurement from Kazakh suppliers by 2012. While some legislation is specific for certain sectors (e.g., Russia), or for a specific component of the mining value chain (e.g., Indonesia), others are meant to benefit specific groups (e.g. South Africa and Zimbabwe).

15 Under the modification of the agreement of Trade Related Investment Measures (TRIMs) by Annexure F on Special and Differential treatment of the Doha Work Programme Ministerial Document (2005).

16 Since they are deviating from the WTO clause, these countries could be challenged by other members.

Table 1. Local content legislations in different countries

Country	Legislation	Description of relevant articles
Indonesia	New mining law in December 2008, replacing a contract of work system with a system of licensing. Law No. 4/2009. Source: Original Legislation, Christian Teo & Associates (2009)	<p>Under Articles 95–112 and 128-133, companies are obliged to process and refine mining products in Indonesia, and the extent of the required local processing and refining are to be specified in the implementing regulations.</p> <p>Additionally, companies must give priority to the utilization of local employees and domestic goods and services in accordance with the prevailing laws and regulations. To conduct operational production activities, companies must allow local entrepreneurs to participate in accordance with the prevailing laws and regulations.</p> <p>Regarding ownership, the law establishes that after five years of production, “Companies must divest part of [their] s foreign shareholding (if any) to the Government, Regional Government, State Owned Business Entity (Badan Usaha Milik Negara or BUMN), Regional Owned Business Entity (Badan Usaha Milik Daerah or BUMD) or (iii) Private Owned Business Entity (Badan Usaha Milik Swasta or BUMS). It is not clear, however, what amount of foreign shareholding must be divested. Rather, the New Mining Law simply provides that this issue will be dealt with in a subsequent Government Regulation (Peraturan Pemerintah).”</p>
Kazakhstan	New Law on Subsoil and Subsoil Use 2010. Source: Original Legislation/ World Bank (2012)/ Grata Law Firm (2012)	<p>Under this new law, if a subsoil user wants to buy certain equipment or hire a subcontractor for drilling, processing or other subsoil-related activities, he or she is obliged to follow the procurement rules approved by the state. These rules include long-term procurement plans from major operators and specific local content requirements defined in terms of percentages of Kazakh content. Kazakhstan has established a target of 50 percent local procurement from Kazakh suppliers by 2012.</p> <p>Kazakh content refers to use and development of local production and labor force, as well as technology transfer. Such development is ensured through creating legal mechanisms obliging subsoil users to use local goods, works and services in their operations, as well as to increase the proportion of local employees among their staff and their contractors’ staffs.</p> <p>Under Article 70.6 (Purchase of Goods, Works and Services [GWS] for Oil Operations) of the law, “A subsoil user’s expenditures for purchasing GWS made in violation of the Procurement Rules or on the basis of the tender held outside Kazakhstan shall be excluded by the competent authority for the costs, accounted as performance by the subsoil user of its contractual obligations.” If this exclusion causes the failure to perform contractual obligations of the subsoil user that automatically entails the risk of early termination of the subsoil use contract by the competent authority.</p> <p>Subsoil users under the obligation of meeting a certain percentage of Kazakh content can procure goods with a CT-KZ certificate, which is issued by the Technical Regulation and Metrology Committee to Kazakh manufacturers of goods for a period of one year. The draft subsoil law also would require U.S. companies to enter into a joint venture with KazMunayGas, the national oil company, which would own a minimum 51 percent share in all new exploration and production contracts.</p>
Nigeria	Nigerian Oil and Gas Industry Content Development Bill, 2003. Source: Original Legislation/ Menas Local Content Online	<p>The Nigerian Oil and Gas Industry Content Development Act of 2010 has provisions to enhance local participation in all aspects of oil operations. These include specifying minimum amounts of local materials and personnel used by oil and gas operators in the country. For example, the law stipulates that 65 percent of divers in energy projects must be Nigerian, and 60 percent of steel ropes must be made locally. Additionally, the Nigerian Content Division (government division empowered to work with industry stakeholders to develop local strategies and ensure compliance) Bill, Section 9, requires all contracts awarded in excess of \$100 million to include a “labor clause” mandating the use of a minimum percentage of Nigerian labor or the use of indigenous companies of a minimum size.</p>

At the subnational level, there are a few recent examples of legislation specifying explicit local content requirements on sourcing local goods and services and/or setting a percentage of local participation or training workers in communities affected by oil, gas and mining companies. One example is the Regulation of Regents Number 48/2011 on local content for the oil and gas industry in the district of Bojonegoro, Indonesia. In particular, Article 7, Chapter III, establishes the ways in which operators will facilitate the involvement of and/or empower local content, including the mandates to create supporting partnerships between public local enterprises and local entrepreneurs by providing a space for “local enterprises/local entrepreneurs to partner with large firms with the appropriate competencies to strengthen capital/competence/capability transfer,” and also by providing a space for “more advance local enterprises/local entrepreneurs to be able to partner with other local entrepreneurs who hosted the project activities.” However, this legislation does not specify what is understood by “providing a space,” what the reach of such clause is, or how the objective will be measured and monitored.

In the case of labor, the legislation mandates the centralization of the recruitment process in Bojonegoro district, the possibility for locals to access opportunities for apprenticeship training, and the mandate to carry out the recruitment process by “giving a rational proportion for local labor through a competitive selection system.” It requires contractors to “provide a database on the availability of local labor in accordance with the needed qualification.” The legislation does not set specific targets for number of locals to be trained or hired, the time frame of the objective, and the potential sanctions to operators in case of noncompliance. Only in the category of unskilled work does the legislation mention an explicit target of 100 percent for local labor; districts and villages in the project area should be prioritized when hiring unskilled labor. Furthermore, in Chapter IV, the mandate to provide information about potential opportunities for the local community in a transparent manner is included, but how this should be carried out is not mentioned explicitly. The legislation makes the requirement to “offer each package of work to be performed by local contractor” conditional on the local availability of the adequate suppliers by stating that this is to be done “if the work could be carried out by local entities.”

In designing policy, it is important to note that while legislation with precisely defined scopes and goals can be, in theory, more powerful in terms of enforcement, it may also prove to be too rigid in the face of changing competitive circumstances. Legislation that does not reflect local realities can be counterproductive, as it may lead to economic inefficiency and increased corruption.

### **Regulation requiring companies to produce local content plans**

There is more ample evidence on tightening of approval and regulatory processes to require extractive companies to produce local content plans that include enterprises and workforce participation in oil, gas and mining areas and that are aligned with regional economic development plans. Some examples from South Africa, Indonesia, Philippines and Australia are summarized in Table 2. These plans often include a subnational dimension because they require oil, gas and mining companies to specify impacts and benefits for local communities. For instance, in the Philippines, the law requires mining companies to draw a social development management plan that describes “the programs, projects and activities that would be undertaken by the mining operator to promote the general welfare of the inhabitants of the barangays [districts] where the mining area is located as well as neighboring barangays.”

*Legislation that does not reflect local realities can be counterproductive, as it may lead to economic inefficiency and increased corruption.*

As with monitoring environmental and social performance, monitoring local content plans require a high degree of government capacity. A specific issue is the cost versus benefit of additional monitoring that compounds already budget-constrained monitoring environments. Developing systems and capacities for verification would need to be weighed against the resources required to build the capacity of suppliers.

Table 2. Examples of sharpening of approval and regulatory processes

Country	Policy/regulation	Specific requirement
South Africa	Mineral and Petroleum Resources Development Regulation, Chapter 2, Part 2: Social and Labor Plan	<p>The contents of a social and labor plan must include, among others, the employment equity statistics and the mine's plan to achieve the requirement that 10 percent of the employees must be women, and 40 percent of management must be historically disadvantaged South Africans (HDSAs) within five years from the granting of the right or the conversion of the old order right.</p> <p>A local economic development program must include the procurement progression plan and its implementation for HDSA companies in terms of capital goods, services and consumables, and the breakdown of the procurement</p>
Indonesia	Article 74 of the Law on Limited Liability Companies (2007)	Companies doing business in the field of and/or in relation to natural resources must put into practice environmental and social responsibility (ESR) plans, and that ESR "constitutes an obligation of the Company which shall be budgeted for and calculated as a cost of the Company performance of which shall be with due attention to decency and fairness." Furthermore, Article 66 stipulates that annual reports must contain at least a report on ESR implementation.
Philippines	<p>Amendments to Sections 134-136 of Department of Environment and Natural Resources Administrative Order No. 96-40, the Revised Implementing Rules and Regulations of Republic Act No. 7942, otherwise known as the Philippine Mining Act of 1995</p>	<p>A social development management plan (SDMP) is a comprehensive five-year plan that all mining operators must prepare. The SDMP begins with the commencement of mining production and would be in place as long as the mining operation exists.</p> <p>The SDMP describes the programs, projects and activities that the operator would undertake to promote the general welfare of the inhabitants of the barangays where the mining area is located as well as neighboring ones. The law stipulates that foreign companies shall, at their own expense, "give preference to qualified Filipino citizens in the hiring of personnel for its mining operation, the majority of which shall originate according to priority from the host and neighboring" and that companies shall "give its firm commitment to skills re-formation and entrepreneurship development for people in the mining communities as an integral part of the mine decommissioning process."</p> <p>Activities recognized under Philippine law, and which form part of an SDMP, include:</p> <ul style="list-style-type: none"> <li>• Human resource development and institutional building programs in the local community</li> <li>• Enterprise development activities that support income generation</li> <li>• Assistance for infrastructure development and support services in the community</li> </ul>
	Sustainable Resource Communities Policy: Guideline to preparing a social impact management plan	"After assessing the project's social impacts, the project proponent is required to prepare a social impact management plan. Among the social impacts, other issues the plan addresses are: stakeholder engagement, workforce (training and employment), worker accommodation and housing, local industry participation, health and community services. The plan should be developed in consultation with government and community stakeholders."

### **Initiatives that give preference to locals without specifying targets**

Some countries bound by the NTO clause have adopted a significant number of local content policies within the parameters established by international trade and investment agreements. These policies aim at directly increasing the participation of local workers and suppliers without establishing legally binding national local content legislation and regulations. Enforcement in these cases relies on mechanisms with different degrees of power that range from specific commitments in production-sharing agreements to general agreements on the need to support local content that do not impose any sort of restrictions on oil, gas and mining companies.

Unlike other types of interventions, initiative for these types of policies can come not only from national, regional or local governments, but also from oil, gas and mining companies, local and regional organizations, NGOs and other types of CSOs at the community level. The need for such policies arises in the following situations: the companies have limited knowledge of local capabilities; local agents have limited access to procurement and employment opportunities in the companies; or the government is uncertain of the benefits of stronger policy actions, including legislation.

Examples of these types of initiatives include: national and subnational governments ensuring “full, fair and reasonable” access to opportunities for local suppliers (like the Australian Industry Participation National Framework set by the Australian national government);<sup>17</sup> local government agencies compiling a list of capable local suppliers (the supplier registry system developed by the Industrial Association of Antofagasta and mining companies in Chile is a good example of this);<sup>18</sup> oil, gas and mining companies identifying and informing the public about business opportunities for local companies at the project phase (for example the ExxonMobil Local Content Plan in Papua New Guinea);<sup>19</sup> and local government agencies or oil, gas and mining companies encouraging the implementing of certification systems for local suppliers by (like in The Atacama mining cluster, Chile.)<sup>20</sup> A particularly relevant policy for local SMEs is the requirement to unbundle contracts. This involves breaking packages of work or supply agreements into smaller parcels that targeted businesses are capable of fulfilling.<sup>21</sup> In Canada, these are established in participation agreements between local affected aboriginal communities and mining companies.

The advantages of these types of initiatives are that they can be readily implemented because they do not depend on enacting regulatory tools, and they can be flexible to the needs of the local economy and the companies. Their main disadvantages are that their effectiveness depends on the existence of a pool of competitive potential local suppliers and that compliance cannot be enforced legally.

### **Regulations to communicate opportunities to communities**

Reporting requirements serve to encourage oil, gas and mining companies to increase visibility and access to opportunities in resource-affected communities. For instance, South Africa’s Mineral and Petroleum Resources Development Regulation (Chapter

17 Go to <http://www.innovation.gov.au/INDUSTRY/AUSTRALIANINDUSTRYPARTICIPATION/Pages/AustralianIndustryParticipationNationalFramework.aspx>.

18 Go to <http://www.aia.cl/>.

19 Go to <http://www.pnglng.com/commitment/local.htm>

20 Go to <http://www.corproa.cl/>.

21 “Briefing Note: Maximising the contributions of local enterprises to the supply chain of oil, gas & mining projects in low income countries,” Engineers Against Poverty, [http://www.engineersagainstopoverty.org/db/\\_documents/EAP\\_Briefing\\_Note\\_\\_Local\\_Enterprise\\_Participation.pdf](http://www.engineersagainstopoverty.org/db/_documents/EAP_Briefing_Note__Local_Enterprise_Participation.pdf).

2, Part 2) requires all oil, gas and mining companies to submit an annual plan to the regional manager, who is a member of the Regional Mining Development and Environment Committee (RMDEC). RMDECs exist under the Mineral and Petroleum Resources Development Act, and membership comprises relevant government departments or organs of the state at national, provincial and local levels. The human resources development plan not only requires identifying, but also reporting on the number and education levels of the employees and the number of vacancies that the mining operation has been unable to fill for more than 12 months despite concerted efforts to recruit suitable candidates. Additionally, companies must submit a report on the implementation of a career progression plan, a mentorship plan and an internship and scholarship plan in line with the skills development plan and the needs for the specified groups of workers.

Mandated community engagement processes in Papua New Guinea, Australia, Peru, Indonesia, Philippines and Bolivia also serve to provide information on opportunities. In Papua New Guinea, Section 3 of the 1992 Mining Act requires the formation of development forums, a process of negotiation among national, provincial and local governments, affected landowners and project developers before a special mining lease can be issued. The outcomes of these negotiations typically are agreements among national government, provincial government and landowners, and mine development contracts between the national government and the mining firm.

Requirements to include benefit sharing or other community development initiatives also have been included in some countries' mining regulations. However, legislative requirements of this nature are still comparatively rare. Countries with strong policy and regulatory approaches include Chile, Papua New Guinea and South Africa. In addition, Egypt, Eritrea, Guinea, Mozambique, Nigeria, Sierra Leone and Yemen have introduced some form of mandated community engagement recently. It is understood that the Democratic Republic of Congo, Ghana, Namibia and Tanzania are increasingly seeking to entrench community development initiatives within their policy frameworks.<sup>22</sup> Community development obligations are relevant to local content because they tend to support enterprise development, skills development programs and other social and physical infrastructure that contribute to a healthy local economy.

### **Legislation to build local enterprise and workforce capacity for local content participation**

Given that policies aimed at increasing access to opportunities have only a limited impact on the size of the local supply of goods, services and labor, some countries have adopted complementary policies aimed at increasing the size of the local supply and workforce. Examples of this type of policy include those aimed at increasing local participation via specific requirements to transfer know-how and skills related to oil, gas and mining operations to local enterprises and workers, and the requirement to train the local labor force.

A related strategy is the requirement to form joint ventures with local public or private companies to ensure in a more direct way that foreign companies transfer knowledge and technology to local companies. In countries where the state is an active economic player, such as China and Brazil, this policy has been accompanied with an increasing

22 Community Development Agreement Frameworks—from Practical Experience and Technical Studies (draft) (Washington, DC: World Bank, 2010).

share of public ownership of oil, gas and mining-related industries.<sup>23</sup> These initiatives also can come from the companies themselves and nongovernmental organizations when they design and support programs for private sector development. (Examples of this include The Small Business Initiative, Anglo Zimele by Anglo American in South Africa, Chile and Brazil;<sup>24</sup> and Newmont's business link programs with the International Finance Corp. in Peru and Ghana.)<sup>25</sup>

The impact of this type of policy on the local supply depends on the timely coordination of complementary industrial, educational, technological and local content policies. For instance, if there are no significant educational investments in relevant areas, it would be difficult to identify and train suitable local workers. Furthermore, the local supply needs to be sustainable and ideally internationally competitive in terms of quality, value and scalability. Even after coordinated efforts have been made and significant revenue has been invested, the local industry can remain uncompetitive.

At the subnational level, countries such as, India, Kazakhstan, Papua New Guinea, Peru, Philippines and South Africa have mandated spending on enterprise and skills development as part of social funds that companies are required to set up. In the Philippines, the law requires companies to not only produce development plans for the host and neighboring communities, but also to contribute to “self-sustaining income generating activities, such as but not limited to, reforestation and production of goods and services needed by the mine and the community.”<sup>26</sup> Companies also are expected to finance the training of Filipino workers should local skilled workers not be available. In addition, mining companies are required to implement a social development and management program that allocates 1 percent of the direct mining and milling costs for community development.

### **Government-led initiatives with voluntary industry participation**

There are also examples of nonmandated, voluntary approaches to subnational government and company collaborations to increase visibility and access to opportunities. One of them is C-Res, in Queensland, Australia, a subsidiary of the Mackay Whitsunday Regional Economic Development Corp. (REDC). This entity was established to deliver BHP Billiton Mitsubishi Alliance's (BMA's) local buying program. The program aims to provide opportunities for small businesses with fewer than 25 full-time employees to competitively supply goods and services to BMA in townships throughout the Bowen Basin region. In addition to providing supply opportunities, the program—through the establishment of a community foundation—aims to deliver community and economic development programs to enhance and build local business and community capability. The foundation aims to enhance the economic viability of the wider community and region through programs targeting new business, existing business growth and employment programs.<sup>27</sup>

23 A new era is dawning: the raise of the hybrid national oil company (London: Deloitte Touche Tohmatsu, 2010).

24 Go to <http://www.angloamerican.com/development/social/socio-economic-development/enterprise-development>.

25 Go to [http://www1.ific.org/wps/wcm/connect/corp\\_ext\\_content/ific\\_external\\_corporate\\_site/ific+news](http://www1.ific.org/wps/wcm/connect/corp_ext_content/ific_external_corporate_site/ific+news).

26 Revised Implementing Rules and Regulations of Republic Act No. 7942, Philippines, Section 136, Development of Host and Neighboring Communities.

27 For more details, go to <http://c-res.com.au>.

Another interesting example is ePilbara, an online registry for the Pilbara region in Western Australia managed by the Pilbara Development Commission and supported by a number of oil, gas and mining companies and chambers of commerce and industry. To be listed in ePilbara, companies must meet the following criteria: have a Pilbara postal address, have employees permanently based in the Pilbara, and have the ability to provide products or services from the Pilbara location. The website also provides access to ProjectConnect, a service provided by Chamber of Commerce and Industry of Western Australia that links project developers and their major contractors with their own categorized electronic library of suppliers.<sup>28</sup> The companies use ePilbara to publish information on upcoming tenders and recipients of recent tenders.

### Agreements influencing increase in indigenous content

Advocated in the International Labour Organization (ILO) Convention 169 on Indigenous and Tribal Peoples<sup>29</sup> and the United Nations (UN) Declaration on the Rights of Indigenous Peoples,<sup>30</sup> free, prior and informed consent (FPIC) recognizes various fundamental rights of indigenous peoples. The FPIC concept has been adopted by the International Finance Corporation (IFC) and other international entities. There is evidence of the concept being applicable to other vulnerable groups affected by oil, gas and mining projects.<sup>31</sup> The output of such a process is typically an impact and benefit agreement or a community development agreement.<sup>32</sup> When indigenous communities have a right to negotiate with companies based on the principle of FPIC, agreements tend to include commitments to local indigenous content, training and enterprise development opportunities. Three examples are provided in Table 3.<sup>33</sup>

28 For more details, go to [www.epilbara.com.au](http://www.epilbara.com.au).

29 International Labour Organization, "C169 Indigenous and Tribal Peoples Convention, 1989," <http://www.ilo.org/ilolex/cgi-lex/convde.pl?C169>

30 United Nations (UN) Declaration on the Rights of Indigenous Peoples 2007, UN General Assembly Resolution 61/295, adopted September 13, 2007.

31 Christina Hill, Serena Lillywhite and Michael Simon, *Guide to Free Prior and Informed Consent* (Carlton: Oxfam Australia, 2010)

32 Ginger Gibson and Ciaran O'Faircheallaigh, *IBA Community Toolkit: Negotiation and Implementation of Impact and Benefit Agreements* (Ottawa: Walter & Duncan Gordon Foundation, 2010); International Council on Mining and Minerals, *Indigenous Peoples and Mining: Good Practice Guide* (London: International Council on Mining and Metals, 2010); Ciaran O'Faircheallaigh, "SIA and Indigenous social development," in Frank Vanclay and Ana M. Esteves (eds.), *New Directions in Social Impact Assessment: Conceptual and Methodological Advances* (Cheltenham, England: Edward Elgar, 2011), 138-153; Simon Nish and Sara Bice, "Community-based agreement making with land-connected peoples," in *New Directions in Social Impact Assessment: Conceptual and Methodological Advances*, 59-77.

33 Ana Maria Esteves, David Brereton, Daniel Samson and Mary-Anne Barclay, *Procuring from SMEs in local Communities: A Good Practice Guide for the Australian Mining, Oil and Gas Sectors* (Brisbane: Centre for Social Responsibility in Mining, Sustainable Minerals Institute, University of Queensland, 2010).



Table 3. Agreements between oil, gas and mining companies and indigenous people

Region	Parties to agreement	Description
Western Australia, Australia	Rio Tinto Argyle Diamond Mine, and traditional owners	Argyle’s policy for local aboriginal content is driven by its mine participation agreement with indigenous owners, and is supported by a management plan specifically dealing with business development and contracting. The principle underpinning the plan is Argyle’s commitment to increasing business opportunities connected with the mine’s operations for local businesses in general, and indigenous owner businesses and local aboriginal community businesses in particular. Argyle defines “local” in the agreement as the East Kimberley Region. The company is obliged under the agreement to notify the business development task force (comprising indigenous owners and company representatives) of its intent to let any contract worth over an agreed amount in a year. In addition, any request for tender over this amount requires the tenderer to demonstrate how it will involve indigenous owner businesses in the contract, how it will employ and/or train indigenous owners, and how it will provide benefits to traditional owners. All else being equal, Argyle commits to giving preference to tenderers that bring the greatest opportunities to indigenous owners.
Northwest Territories, Canada	Diavik Diamond Mines Inc., Rio Tinto and five neighboring aboriginal groups	The Benefits-Impacts Agreement was viewed as an important instrument of economic change for people who traditionally had been left out of the mainstream economy. With an agreement in hand, aboriginal people have been in a strengthened position to access banking finance and to negotiate. There are a number of specific scopes of work (contracts) that are embedded in participation agreements with aboriginal authorities within the Diavik sphere of influence. These contracts tend to be very large and are valid for the duration of the mine. In legal terms, they are “evergreened,” which means that, subject to performance, the aboriginal contractor will have the work as long as the mine is in production. While the scope may vary from time to time as a result of changing production conditions, aboriginal contractors that have evergreen contracts maintain the right to continue as an integrated part of the Diavik operation.
Gulf region of northern Queensland, Australia	Century Mine, Queensland Government and the four native groups of Waanyi, Mingginda, Gkuthaarn and Kukatj	Century is a signatory of the Gulf Communities Agreement (GCA), an agreement among Century, the Queensland government, and the four native groups of Waanyi, Mingginda, Gkuthaarn and Kukatj. One of the agreement’s aims is to promote economic development opportunities for the people of the lower gulf region. Tendering and awarding contracts as per the GCA is enabled through three phases: business identification, the tendering process and business assistance. Century Mine has a department that works with the groups and the company’s contracts department to identify viable businesses. Tenderers are first evaluated for their eligibility as a native GCA party, prior to the technical assessment. The mine’s GCA Department facilitates support to provide tenderers with information on business set-up requirements and ongoing business management (e.g. preparation of payroll, training, health, safety and environment procedures, and human resources policy).

### Trends in industry good practices

Within industry, there are evolving attitudes toward local content. In many instances, the initial motivation for investing in local content was a need to comply with formalized commitments, either to a host government, an investment partner such as the IFC or an indigenous community, or in pursuit of a social license to operate. Compliance was deemed necessary to secure access to resources. Case study research on local procurement among 23 companies by Esteves found that over the past five to eight years these companies became increasingly motivated by the desire to establish and maintain enduring partnerships with local suppliers for mutual benefit.<sup>34</sup> Table 4 provides examples from this case study of extractive companies engaging in a range of local procurement interventions that are designed to increase local business access to contract opportunities. Activities include the following: assigning higher preference weightings to local businesses in competitive bidding processes; sole-sourcing arrangements with local suppliers; price matching—allowing local suppliers to match the price of other suppliers; breaking large contracts into smaller ones (unbundling) to create opportunities for smaller local suppliers; requiring outside suppliers to subcontract locally or enter joint ventures with local suppliers; providing technical and management training and mentoring; and linking local businesses to other service providers and agencies that promote technological innovation and provide access to finance.

Table 4. Examples of oil, gas and mining local content activities

Company	Activities undertaken by oil, gas and mining companies
<b>Increasing the access of local businesses to opportunities</b>	
Total Indonesia, Indonesia	<ul style="list-style-type: none"> <li>Adapted the design of the oil and gas project to increase the opportunities for local content.</li> </ul>
Cameco, Saskatchewan, Canada	<ul style="list-style-type: none"> <li>Considered total contract cost rather than single point-in-time contract cost, ensuring procurement decisions take into account the cost-benefit over time of sourcing from a local firm instead of an international firm.</li> <li>Targeted for 35 percent of all goods and services to be sourced from northern-based, aboriginal-owned businesses.</li> <li>Conducted workshops to communicate upcoming contract opportunities within the business and to provide guidance on how to become a Cameco supplier.</li> </ul>
Newmont Boddington Gold, Western Australia	<ul style="list-style-type: none"> <li>Applied price preferences to local businesses during the final analysis of bids.</li> <li>A regional content preference is available to businesses located outside the prescribed areas that use goods, materials or services in contracts that are purchased from businesses located within the prescribed areas. All tenderers are required to show the actual cost of their local or regional content.</li> </ul>
Argyle Diamond Mine, Kimberley, Western Australia	<ul style="list-style-type: none"> <li>Made a number of adaptations to procurement systems to make these more accessible to local aboriginal people. They include: a paper-based expression of interest form, distributed through traditional owner organizations and the company; providing a consistent point of contact in the procurement department for each tenderer; allowing for tenders to be sent by e-mail or post; offering a longer notification period to traditional owner groups (beyond the three months specified in the agreement) about opportunities coming up to enable better preparation.</li> </ul>

34 Esteves, Brereton, Samson and Barclay.

OZ Minerals, South Australia	<ul style="list-style-type: none"> <li>Established a website on the Industry Capability Network (ICN) site, through which suppliers were invited to lodge an expression of interest for packages of work. The ICN undertook a first round of screening and the engineering, procurement, construction and management (EPCM) contractor followed with a short-listing process.</li> </ul>
<b>Developing strategic partnerships and agreements</b>	
Total Indonesia, Indonesia	<ul style="list-style-type: none"> <li>Sponsored the creation of the Indonesian Welding Society and facilitated a partnership with the French counterpart society.</li> </ul>
Rio Tinto Argyle Diamond Mine, Kimberley, Western Australia	<ul style="list-style-type: none"> <li>Argyle's policy for local aboriginal contracting is driven by its mine participation agreement with traditional owners, and is supported by a management plan specifically dealing with business development and contracting. Under the agreement and all else being equal, Argyle commits to giving preference to tenderers that bring the greatest opportunities to traditional owners.</li> <li>The company is obliged to notify the business development task force (comprising traditional owners and company representatives) of its intent to let any contract worth more than \$250,000 in a year, relating to the provision of goods or services to Argyle at the mine site. Any request for tender over this amount requires the tenderer to demonstrate how it will involve traditional owner businesses in the contract, how it will employ and/or train traditional owners, and how it will provide benefits to traditional owners.</li> </ul>
Ahafo Mine, Newmont Ghana Gold Ltd. (NGGL)	<ul style="list-style-type: none"> <li>NGGL entered into a partnership with the International Finance Corp. (IFC) to establish the Ahafo Linkages Program. The objectives are to increase income and employment opportunities in local communities by building the capacity of local enterprises that are directly or indirectly related to NGGL activities, and to improve the environment for business development.</li> <li>The IFC Linkages Program includes technical assistance programs that range between two and four years to optimize local procurement by strengthening local SMEs and entrepreneurs linked to IFC's investment clients or large multinational companies.</li> </ul>
ExxonMobil-owned Esso, Chad	<ul style="list-style-type: none"> <li>Partnered with the IFC to develop local suppliers for the Chad-Cameroon Oil Development and Pipeline Project. Before the supplier development program began, all possible procurement opportunities were segmented according to their level of difficulty and a star rating system for the SMEs was developed.</li> </ul>
<b>Actively engaging and supporting communities</b>	
Cameco, Saskatchewan, Canada	<ul style="list-style-type: none"> <li>Employed a business specialist to assist communities in establishing businesses and to access financial resources or a business partner.</li> </ul>
BHP Billiton Iron Ore, Pilbara, Western Australia	<ul style="list-style-type: none"> <li>The company makes itself aware of potential opportunities during engagement processes with traditional owners. This enables intervention at an earlier phase to assist people with establishing business structures and administration, rather than waiting for vendor pre-qualification processes to identify capacity needs.</li> </ul>
Rio Tinto Iron Ore, Pilbara, Western Australia	<ul style="list-style-type: none"> <li>In planning for a new project, the projects team works with the community team to identify opportunities for aboriginal businesses and ensure that they are invited to tender.</li> </ul>

<b>Identifying and classifying local productive capacity</b>	
Anglo Ferrous, Minas Gerais, Brazil	<ul style="list-style-type: none"> <li>• Profiled businesses located in affected communities and assessed their capability by drawing a random sample of 365 companies from the industrial, commercial and services sectors. The data collected were used to develop a business action plan in collaboration with local community leaders.</li> </ul>
Rio Tinto Iron Ore, Pilbara, Western Australia	<ul style="list-style-type: none"> <li>• Commissioned an independent inquiry to identify systemic blocks to aboriginal business procurement, and make recommendation to increase aboriginal involvement in the supply chain.</li> <li>• Implemented a system to track progress through joint reporting by the procurement and community relations divisions on aboriginal business spend, using a monthly reporting system. The metrics for this system inform management incentives and reward programs.</li> </ul>
<b>Directly supporting local business development</b>	
BHP Billiton Iron Ore, Pilbara, Western Australia	<ul style="list-style-type: none"> <li>• Provided assistance via an accounting firm that assists with governance, periodic audits and risk management, and provided access to a range of other consultants assisting with items like preparation of prospectuses.</li> </ul>
Anglo Zimele, South Africa	<ul style="list-style-type: none"> <li>• Anglo Zimele Development and Empowerment was established in 1989 to empower entrepreneurs in South Africa. It is made of three funds:</li> <li>• Anglo Khula Mining Fund, providing financing for local junior mining companies in the exploration and pre-feasibility phases until they are able to demonstrate a commercial return.</li> <li>• Small Business Start-Up Fund, which provides loans in the communities residing around the mining operation. Small business hubs provide training and mentoring in business skills.</li> <li>• Supply Chain Development Fund, which works with Anglo American's procurement departments to incorporate local SMEs into the supply chain. The fund provides loan and equity financing and technical assistance.</li> <li>• Capacity is built in four ways: training programs and/or on-the-job training; a technical mentor; assistance from business development officers in management, marketing, operational and financial aspects; and personal guidance and mentoring from Anglo Zimele staff.</li> </ul>
Rio Tinto Coal & Allied, Hunter Valley, New South Wales	<ul style="list-style-type: none"> <li>• Provided funding to the Hunter Region Business Enterprise Centre, which enabled it to employ two full-time business facilitators who provide free advice to small and medium businesses looking to start up or grow. The centre also provides support to local aboriginal communities.</li> </ul>

<p>Anglo Ferrous Brazil's Supplier Development Program</p>	<p>Established a supplier development program with the following elements:</p> <ul style="list-style-type: none"> <li>• Management training: entrepreneurial awareness; initiatives to improve education levels of managers; joint development (owner/family/employees) of a strategic company vision; business management courses; technical training courses in specific areas of work; financial management courses.</li> <li>• Business development and growth: programs to support higher education for employees, courses focusing on sales, production and administration, market research of local demand, financial disclosure, participation in trade fairs and events, and bulk purchasing incentives.</li> <li>• Improvements to unprofitable businesses: diagnostics of individual companies experiencing financial difficulties to evaluate profitability and potential market repositioning, and awareness of the potential to move into other market segments.</li> <li>• Creation of new enterprises: entrepreneurial awareness, promoting the establishment of new suppliers of raw materials, machines and equipment; campaigning to repatriate local residents who have been trained and are living or working elsewhere; attraction of young people to the region through study grants; attraction of company subsidiaries and suppliers; promotion among investors interested in expanding into, or creating new businesses in affected municipalities.</li> </ul>
<p>Mozlink, Mozambique</p>	<ul style="list-style-type: none"> <li>• Established a mentor's program to support local businesses in the technical and business categories. Technical mentors typically are employees of the lead company selected to volunteer to work with the SMEs, and address the Health, Safety, Environment and Community (HSEC) and Maintenance Capability and Quality Management categories. Business mentors are usually external business consultants contracted to carry out the task of mentoring SMEs in developing business skills, and address business management, finance, human resource management, marketing and tendering.</li> </ul>

## DESIGNING AND MONITORING EFFECTIVE LOCAL CONTENT INITIATIVES

The previous section demonstrates the existence of a wide range of policies and industry practices at different stages of implementation. In the absence of empirical data on the outcomes, conclusions cannot be drawn on their application to all local content settings. There are, however, some common themes that emerge through case study research, pointing to certain elements of success. For example, Neff draws on studies conducted in Norway, Brazil, Canada's Atlantic Provinces, and Trinidad and Tobago to propose that successful local content policies possess: (1) critical vocational training and SME support programs; (2) transparent and independent regulatory oversight; and (3) preference for local industry and workers that also sets standards for sustainable commercial success.<sup>35</sup> "In addition, joint ventures in which local staff work alongside those of the international oil companies have proven especially effective at transferring technology—the skills and operating practices of the oil industry—and business acumen. Government support for local companies in the form of research and development assistance, including the requirement that international companies engage in research in the host country, has been an important factor in building internationally competitive local companies as well as labor skills."<sup>36</sup>

35 Shirley Neff, "Memorandum on International Best Practice in Development of Local Content in the Energy Sector," <http://www.neiti.org.ng/sites/default/files/page/uploads/local-content-5-9-051.pdf>

36 Neff, 10.

Further conclusions can be drawn from the industry practice case studies Esteves conducted that led to recommendations for industry efforts to increase local content in the supply chain.<sup>37</sup> A proposed framework for an effective local procurement strategy was underpinned by four key principles: appropriate analysis and systems; procurement activities directed to contributing to a healthy local economic environment; local business participation supporting (instead of impeding) procurement practices; and the end goal being local businesses competing on an equal footing with other providers. The framework identified six umbrella activities that industry can undertake to put these principles into practice: develop a local procurement strategy; build internal capacity to deliver the strategy; identify opportunities; establish and manage contracts; grow local SME capacity; and monitor and evaluate the strategy.

Partnerships among various stakeholders are critical for local content development. This section builds on this theme and makes specific recommendations for each partner's role in the design of local content policies.

Partnerships among governments, industry and CSOs are particularly evident in local supplier development programs, with a view, for example, to enable SMEs to access financing and skills development programs, technical mentoring and support for the development of business management skills.<sup>38</sup> Some programs focus heavily on institutional strengthening activities to encourage an enabling environment for SME development. Others have focused on helping women establish their own small businesses by providing them with access to legal, business and financial systems, thereby reducing the gender gap that prevents many women from participating in economic life.<sup>39</sup> Generally speaking, CSOs have not played a dominant role in these programs.

It is important to consider the drivers and obligations of each stakeholder in considering its potential contribution to policy design. The role of national government versus subnational government varies greatly in terms of local content policy development and practice. In most cases, national governments have far more discretion and capacity to make and implement laws than subnational governments. Their respective authority and capacity to pass laws, and establish and monitor agreements with oil, mining and gas companies can determine their contribution to local economic development outcomes. One role that both levels frequently have is to create a business-enabling environment, build human capital capacity, strengthen institutions and invest in industry development, as well as have constructive oversight of companies' local content plans.

For the purposes of this paper, it is assumed that companies are public or private entities (not government-owned or controlled). While the roles proposed could still apply

37 Esteves, Brereton, Samson and Barclay.

38 Deloitte, Partnerships for Small Enterprise Development (New York: UN Development Programme and Vienna: UN Industrial Development Organization, 2004); Beth Jenkins et al., Business Linkages: Lessons, opportunities, and challenges (Cambridge: IFC, International Business Leaders Forum, and the Kennedy School of Government, Harvard University, 2007); Jane Nelson, Building Linkages for Competitive and Responsible Entrepreneurship, (SO WHICH PLACE PUBLISHED IT – THE UN OR HARVARD? Cambridge: UN Industrial Development Organization: Harvard University, 2007); Lorraine Ruffing, Deepening Development through Business Linkage (New York and Geneva: UN, 2006); UN Conference on Trade and Development, World Investment Report 2001: Promoting Linkages (New York and Geneva: UN, 2001).

39 Overseas Development Institute, Levers & Pulleys: Extractive Industries and Local Economic Development: Incentivising Innovation by Lead Contractors through Contract Tendering. Briefing Note (London: Overseas Development Institute, 2005); Holly Wyse and Sokol Shtylla, The Role of the Extractive Sector in Expanding Business Opportunity. Corporate Social Responsibility Initiative No. 18 (Cambridge, MA: Kennedy School of Government, Harvard University, 2007).

to government-owned or controlled entities, the level of direct control and influence differs and may affect local content outcomes. Beyond the explicit licensing agreement associated with a given mining concession, the company needs to establish and maintain a social license to operate within the communities around the project site and beyond. Making sure that social and economic benefits flow to the local community is one important avenue for a company to pursue. Optimizing local content opportunities within its supply chain is practical and can be commercially attractive for the company.

Practical challenges, however, exist in achieving this goal. In a developing country context, the most common one is the lack of underlying industrial capacity in geography given area. Building local supply capacity is in the interest of all but needs to be a medium to long-term objective. A skills development and supplier development program should be designed with a longer time frame in mind. In the short term, the company has other important obligations in the operation of its mine that include meeting set standards in health, safety, social and environmental management. It must meet regulatory obligations to the government and contractual obligations and maximize financial returns for shareholders. Obligations for strict short-term targets for local content can threaten the foundations that make a mine or oil and gas project commercially viable.

CSOs are defined in this context as organized, independent (preferably politically nonaligned) groups that have an externally focused role in facilitating communication among the community, industry and government, conducting independent research and oversight, disseminating results and advocating for necessary change. This includes NGOs (international or national), industry bodies (business chambers) and the media. Many of the roles CSOs play require supplementary funding support, because typically their own operational budgets are meager.

An essential component for the success of local content policies is the monitoring of local content practices. There should be clear targets agreed upon by governments, companies and communities on the basis of which companies can make commitments and report on results. Interested parties could then evaluate and report on the progress of local content initiatives. In reality, however, the goal of monitoring these practices is plagued with obstacles, including vagueness and lack of uniformity in definitions and targets and lack of transparency in reporting results.

The Natural Resource Governance Institute offers some useful guidance for effective monitoring of the mining industry, which can inform the design of monitoring frameworks for an oil, gas or mining company's local content performance. Monitoring is referred to as encompassing four broad activities undertaken in collaboration with a range of stakeholders:<sup>40</sup>

- Reviewing laws and contracts to understand a company's obligations.
- Monitoring companies' activities to determine compliance with those obligations.
- Communicating information to address any areas of noncompliance.
- Enforcing laws and contracts when companies fail to comply.

Table 5 lists examples of local content policy design and monitoring that should be led by different stakeholders (government, companies and CSOs).

*There should be clear targets agreed upon by governments, companies and communities on the basis of which companies can make commitments and report on results. Interested parties could then evaluate and report on the progress of local content initiatives.*

40 Erin Smith and Peter Rosenblum, *Government and Citizen Oversight of Mining: Enforcing the Rules* (New York: Revenue Watch Institute, 2011), 40.

Table 5. Role of different stakeholders in designing and monitoring local content initiatives

<b>Government</b>	Develop short-, medium- and long-term national and subnational plans.	National and subnational governments need to develop robust plans that take into account the extractive cycle and the long-term vision of the region and country. Plans could include roads around resource-rich areas; technical vocational and educational training programs; finance programs for SMEs; and support for relevant CSOs (through, for example, capacity building on understanding and interpreting social impact statements, procurement plans, tendering processes and local business registration processes).
	Align local content plans with local and subnational development plans.	National and subnational governments granting exploration concessions and permits can exert influence over subnational local content programming decisions by requiring the local content management plan to be integrated with subnational development plans. This calls for different sectors and levels of government to share information and cooperate. For example, joint planning committees or working parties could be formed if a significant common goal is local content development in an area. Local content management plans should include specific targets that are measurable and publicly available, like planned level of local spending. Integrating the plans into permitting processes opens up the prospect for meaningful analysis, stakeholder participation and negotiation in identifying the future needs for sustainable economic development at the subnational level.
	Explore and establish different funding mechanisms.	National and subnational governments can explore different mechanisms to facilitate economic links and strengthen local capacity. One mechanism is to establish funds or trusts to return a portion of royalty income to communities, or enter into cofinancing arrangements with oil, gas and mining companies. For example a company funds the development of physical infrastructure, like a hospital, and the government funds recurrent costs (operations, staffing, and supplies). Governments can also impose lower royalties and taxes to encourage companies to increase levels of local content in a way that demonstrably contributes to sustainable development of the subnational economy and thus reduces the obligations on government to provide welfare support services. Governments also can negotiate innovative financing agreements with companies if their spending is linked to the development of a labor market they can draw from. For example, a straightforward case could be made for companies to invest in technical vocational training. Such negotiations require a shared understanding of the benefits, costs, risks and responsibilities related to local content development. This alignment of priorities will help governments and companies avoid “white elephant” projects, like building a school in an area with insufficient teachers or students.
	Set local content targets.	When legally able, national and subnational governments can establish local targets in conjunction with companies in an area. If not enshrined in law, a cooperative agreement that is publicly declared can act as a powerful tool in ensuring that companies maximize local content outcomes. As discussed earlier, several companies set voluntary targets that could be models for such cooperative agreements. For example Newmont Ghana tracks both geography and ownership of companies it contracts to through measures such as “foreign,” “locally registered/ internationally-owned,” “regional,” “national” and “local-local.” It is important to consider when setting direct spending targets that these are a weak measure of impact, and for this reason, a range of measures should be considered to track impact to communities and to the business.
	Simplify business processes.	National and subnational governments can simplify business processes to encourage establishment of local businesses. These could include establishing fast-tracked registration services for SMEs and establishing concessions on expensive business establishment processes, such as deferred, or waiving of, registration fees.
	Have clearly specified systems for monitoring company obligations.	Wherever a company’s obligations are defined, whether in legislation, regulations or company-specific contracts, it should be specified which government ministries will be responsible for verifying compliance with specific obligations.



<b>Government</b>	Have clearly defined legal obligations for companies and uniform frameworks for all oil, gas and mining projects.	Objective local requirements are easier for government and civil society to monitor and enforce. This requires clear, unambiguous definitions for local content and performance measures. Monitoring efforts are simplified by establishing a company’s obligations in law, rather than in individually negotiated contracts. When this is not possible, model contracts with a set of common requirements for local content development present another option for uniformity.
	Have oversight institutions with relevant capacities.	Parliaments and the judiciary can help enforce local content obligations in situations of noncompliance. For these mechanisms to be effective, government employees must be trained adequately.
<b>Oil, gas and mining companies</b>	Undertake a diagnostic of demand and supply capacities.	<p>Companies should undertake or fund a diagnostic study of local workforce and business capacity as part of their baseline study/context analysis. Conducting this analysis in partnership with governments and communities can be useful in informing appropriate roles for governments, companies, CSOs and other partners like development agencies.</p> <p>There are a number of frameworks available for such context analysis. Appendix 1 has some baseline indicators of human and economic capital that represent factors contributing to the success of local economic development.<sup>41</sup> The World Business Council for Sustainable Development has proposed a set of indicators that represent factors contributing to the success of local content in particular. These are described as drivers in the local economy that affect companies’ competitiveness. A distinction is made between drivers of competitiveness at the microeconomic and macroeconomic levels. Microeconomic drivers include human resources and management capabilities; technological capabilities; access to finance; access to procurement opportunities with large investing companies; local infrastructure (such as transport, energy and communications); and clusters and support structures (such as industry commissions and trade associations) to generate additional synergies and opportunities for local firms. Macroeconomic drivers include capital markets; regulatory environment; ease of compliance and certification with regulation; import and export regimes; investment incentives; national infrastructure; and workforce improvement through educational and training policies.<sup>42</sup></p>
	Develop a clear local content strategy.	<p>While the employment and expenditure associated with an oil, gas or mining project is substantial, it can’t be assumed that it can be localized. A structured, clear strategy is required to be sure that the local workforce and business community can participate in the opportunities either directly or indirectly. The strategy should include a local content component, and establish clear metrics and a reporting framework. This may require the company or its major contractors to deviate from their usual procurement practices by creating smaller supply packages; setting aside some opportunities for procurement solely for local businesses; offering local preferencing in which local firms are favored through a weighting in the procurement adjudication process; “forward financing” in which the company or a major contractor may make a down payment for goods and services from a local company so that business can buy inputs required to deliver the goods and services under the contract; or rapid payment terms, when the local business is paid faster than the standard payment terms offered to outside businesses for its goods or services (this might mean being paid in 7 days instead of the usual 30 or 60 days.)</p> <p>Companies should apply the same level of rigor that they apply to assess environmental, social and health impacts associated with the project to assess local procurement and employment opportunities. This is not observed in practice; the economic impact assessments that industry conducts primarily are used to communicate the revenues and profits associated with the project, rather than to inform local content strategy.</p>

41 Sean Markey et al., *Second growth: community economic development in rural British Columbia* (Vancouver: UBC Press, 2005), 146.

42 Riccardo Crescenzi and Andrés Rodríguez-Pose, “An ‘integrated’ framework for the comparative analysis of the territorial innovation dynamics of developed and emerging countries,” *Journal of Economic Surveys* 26, 3, (2012): 517-533.

<p><b>Oil, gas and mining companies</b></p>	<p>Produce regular, transparent, auditable reports.</p>	<p>Companies can develop and report on key performance indicators (KPIs) related to a local supplier development program. Indicators to monitor impact could include increase in number of local suppliers and increase in local spending as a proportion of total spending. KPIs should be updated on average every three years. This is to reflect the changing business drivers over the duration of the project, and the changing community context. Reports should be transparent and auditable by independent third parties prior to submission to government and open to requests for additional detail. Reports should be also regular and timely and based on internationally accepted reporting standards. For example, initiatives such as the Extractive Industries Transparency Initiative (EITI) require public disclosure of payments from oil, gas and mining companies to governments. Such initiatives could be extended to transparency in local content development.</p>
<p><b>CSOs</b></p>	<p>Advocate for resource-allocation and implementation of sound local content policies.</p>	<p>CSOs can advocate for better resource allocation to support the growth of local businesses and, more broadly, human resource development. They could undertake independent research to identify subnational needs, and advocate for specific government and company policies and practices to address those needs to ensure sustainable development.</p>
	<p>Create a space for multi-stakeholder local content planning.</p>	<p>CSOs can play a vital role in facilitating the collaborative development of initiatives to build local economic capital. They could raise awareness within the company and government of local supply capability and also gaps in capability that the company and governments may be able to strengthen. As part of their facilitation role, CSOs can be intermediaries for the government, companies and communities in disputes or conflicts.</p>
	<p>Oversee and monitor compliance by governments and raise concerns and advocate for suitable action in the case of noncompliance.</p>	<p>CSOs play a role in monitoring government and company strategies and plans related to local content. This can take the form of corporate–community partnerships that identify areas of concern to the community related to local content and jointly monitor the company’s efforts to address those concerns; government-trained community monitors; and independent monitoring by communities that report their findings to the company or government to address noncompliance. In instances of noncompliance with legislated local content commitments, anticorruption laws or human rights violations, CSOs can use the media to shape public opinion and make the company consider its reputation; raise concerns directly with the company through internal grievance mechanisms; influence government agencies and companies’ home countries responsible for enforcing the companies’ obligations to conduct independent investigations and sanction as appropriate.</p>

## CONCLUSION

While a number of countries are actively developing a range of local content policies, regulations and programs, a set of best practices has yet to emerge. Initiatives discussed in this paper offer examples of different design options that need to be considered carefully in the context of where they operate. The context in a given country may mean that elements that work in one country may not work in another. For instance, national or subnational legislations requiring specific targets to be met in areas with small or weak industrial bases and a limited number of skilled workers may lead to economic inefficiency and increased corruption. There is a clear need for more empirical research that answers questions of effectiveness of different local content policies and practices in different contexts; the factors contributing to success; how local content policy can support industry development in subnational regions; and how governments can maximize benefits for citizens through the right mix of fiscal arrangements and local content obligations.

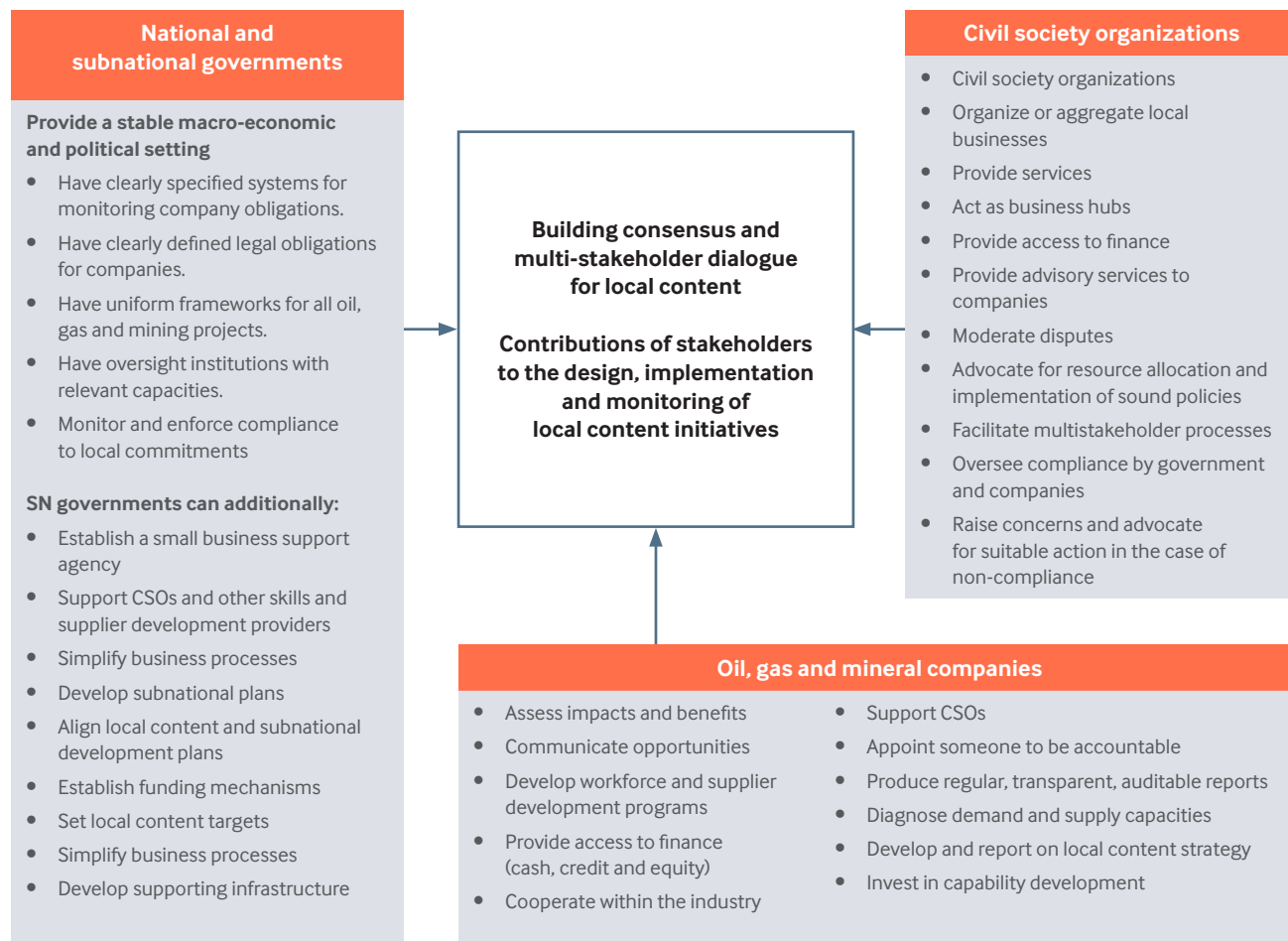
Some aspects of local content offer greater certainty. As a growing field of practice, there is a need to build capacity to support, monitor and influence local content development, whether among government, industry, CSOs or donors. The role of partnerships spanning the public and private sectors in the design, implementation and monitoring of such initiatives is an imperative. The figure on the following page lays out the role of key stakeholders in partnerships for transparent, accountable and effective local content initiatives. Depending on the context and capacities, national and subnational governments, industry and CSOs will have different roles in different stages of the initiative. Some of the key elements partnerships need to focus on include: active and informed citizen participation in local content planning, implementation and monitoring; transparency and accountability in contracts and bidding processes; and alignment of company activities with government plans.

Incorporating local content into EITI processes could address both varying local contexts and the need to engage different stakeholders in the consultative processes. Countries that implement EITI could choose to make local content disclosures part of their EITI reports in ways that address the dynamics in the applicable country. Over time, such disclosures from various countries could shed light on emerging best practices. To build partnerships, policymakers also could draw on lessons from EITI's innovative multi-stakeholder approach. Bringing all the relevant players together to discuss the goals and challenges of developing local content policies will likely be the necessary first step toward future progress on this issue.

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## Partnerships for transparent, effective and accountable local content initiatives



The Natural Resource Governance Institute, an independent, non-profit organization, helps people to realize the benefits of their countries' oil, gas and mineral wealth through applied research, and innovative approaches to capacity development, technical advice and advocacy.  
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