OVERVIEW

Why is local content relevant in the oil, gas, and mining sectors?

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1. Background

A number of established and nascent petroleum and mineral producing countries have adopted or are considering the adoption of policies aimed to obtain the greatest benefits for their economies from the extraction of these exhaustible resources. One important theme of such policies is the so-called local content created by the sector—the extent to which the output of the extractive industry sector generates further benefits to the economy beyond the direct contribution of its value-added, through its links to other sectors. Government intervention in the petroleum and mining sectors to support broad-based economic growth is hardly a new trend. But the extent and type of intervention has evolved over time from the restrictions on imports, and direct state intervention, to more complex policies aimed at creating *backward links* (that is, supplying input to the local economy through transfer of technology, the generation of value-added in domestic supply sectors, the creation of local employment opportunities, and increasing local ownership and control) and *forward links* (that is, processing the sector's output prior to export through, for example, the establishment of refineries, petrochemical industry, and the production of fertilizers).

While local content policies have the potential to stimulate broad-based economic development, their application in resource-rich countries has achieved mixed results. The industry is characterized by the use of specialized input, often at the high end of the technology spectrum, sourced through globally integrated supply chains. Consequently, supplier concentration in many industry-related sub-sectors is high, adding further barriers to the development of a local supply sector. Countries with a limited economy would naturally find it difficult to develop a local supply industry at the pace, size, and quality necessary to satisfy the demand from petroleum and mining projects. In these countries, a fast-growing petroleum and mining sector combined with too ambitious local content targets may exacerbate supply bottlenecks arising from increased local demand, negatively impacting employment and output trends in other sectors of the economy, creating inefficiencies, and in some cases even promote corruption. [1]

Although total spending on goods, services, and equipment usually constitutes a significant share of petroleum and mining projects costs, limited local supply chains have developed in petroleum and

[1] Local content in the Oil and Gas Sector, World Bank Studies, 2013; and Increasing Local Content by the Mining Industry in West Africa (World Bank, 2012)

mineral-rich developing countries.[2] Petroleum and mining operations often take place in remote locations away from domestic manufacturing centers and with limited access to infrastructure and electricity. Restrictive business conditions, such as difficulties in accessing finance, lack of relevant skills, and information asymmetry, typically constrain an efficient supply response from domestic entrepreneurs. As a consequence often, a very high share of the value of goods and services used in petroleum and mining projects are imported, and local content is limited to port handling, transport services and distributorships.[3]

The petroleum and mining industries are generally known for the relative high market concentration, and substantial investment in R&D to reduce costs, improve productivity, and secure technological advantages. Collaboration among petroleum and mining companies, their integrated service providers, and domestic suppliers is therefore critical to the development of a sustainable local industrial capacity. Countries experience shows that the agglomeration of activities can accelerate productivity and efficiency through knowledge spillovers, synergies, better coordination, and efficient access to public goods. Resource corridors, regional integration, geographic and sectoral clusters, and special economic zones have been used by governments to accelerate the development of competitive local enterprises.

In principle, local sourcing makes good business sense for the extractive industries. Petroleum and mining companies are facing rapid cost escalation and a shrinking pool of skilled labor at technical and managerial levels. Long logistics chains coupled with port and boundary issues are sources of delay and hence cost – import tariffs (or red tape associated with duty waivers) add to concerns. Local sourcing, provided it delivers goods and services reliably that meet requisite standards, would help to contain costs. Relationships with nearby suppliers can also help support the companies' social license to operate. Also, a better-educated workforce has a major impact on productivity and adaptability to new routines and technological change. Overall, by generating more tangible benefits than merely foreign exchange earnings and taxes, local sourcing demonstrates good corporate citizenship by oil, gas and mining companies.

Citizens of resource rich countries are also increasingly focusing on enhancing benefits from extractive industry investments. As such, the number one concern of civil society and communities in EI producing regions is employment, and the government's credibility often rides on its ability to create jobs. Although policies mainly refer to local content without specifying its location within the economy, it is common that the communities closest to—and possibly most affected by—petroleum and mining installations will also exert the most pressure for job creation and development of a domestic private sector. It is also common for companies to agree with the local communities on quotas for employment and skill training.[4] Even small gains in the share of local supplies to petroleum and mining projects often

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[2] For example, annual procurement of supplies by the oil, gas and mining sectors in Sub-Saharan Africa run to the tune of USD40 billion per annum and are on an upward path based on the investment pipeline.

[3] For example, a recent study in Zambia found that the supply of manufactures and services to the mining sector accounted for less than 5 percent of total annual industry spending after discounting the amount spent on power, cement and fuel supplies.

[4] Community Development Agreement Sourcebook (World Bank, 2012).

represent large opportunities for affected communities. In some cases, pressure from civil society may add to the complexity of designing efficient and sustainable local content policies.

Local content is a complex and rapidly evolving policy area. Policies and regulations differ widely among countries, and at times between oil/gas and mining in the same country. The use of LCPs raises a number of questions:

- What exactly is "local content"?
- What is the extent of local content in the petroleum and mining sectors?
- Is increasing local content good for development?
- What types of policies can be used to encourage an increase in local content and how do they differ among frontier, emerging, and mature markets?
- What are the costs and benefits of introducing such policies?
- How can the implementation of such policies be measured and monitored?
- What is the experience in assessing demand of extractive industries and locally available supply of goods, services, and skills?
- Can the development of regional clusters or resource corridors facilitate the investments in local suppliers and potential supplier sectors to the extractive sector?
- What is the role of vocational skill training and tertiary education in developing local content?
- What is the role of the private versus the public sector in promoting local content?
- What is the experience with Enterprise Development Centers?

The conference will address these themes.

2. *Conference Objectives*

Speakers and participants will share their knowledge and experience to generate common understanding of the potential benefits of local content policies and the conditions that lead to successful outcomes.

The conference will also create the foundation of a community of practice around this key topic to support continuous knowledge sharing. Participants will be invited to explore innovative solutions through which the World Bank may support the public and private sectors in their efforts towards efficient local diversification.

Participants: The two day conference will gather policy makers, industry associations, major international and national petroleum, mining and service companies, suppliers associations, practitioners, civil society representatives, and donors from over 50 petroleum and mining producing countries around the World.