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A SURVEY OF THE LITERATURE ON LOCAL CONTENT POLICIES IN THE OIL AND GAS INDUSTRY IN EAST AFRICA

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SUMMARY

Although oil and gas exploration has been going on in East Africa for decades, until recently exploration activities grew more slowly compared to other regions in Africa. Today, there has been a series of oil and gas discoveries in several East African countries, including Kenya, Madagascar, Mozambique, Tanzania and Uganda. Debate is however mounting over what effect the new oil and gas discoveries would have on East Africa, given the trajectory of older oil-producing countries in Africa, particularly Angola, Nigeria and Sudan. The challenge for East Africa is, therefore, how to maximize the potential benefits from the resources to avoid the under-developmental path that these other countries followed.

There is general consensus that lack of specialized skills is a major obstacle to Africa's realization of its resource potentials. One instrument currently being adopted by most oil and gas resource-rich countries (both in and outside Africa) to deal with the skills problem and to enhance linkages between the oil and gas sector and other sectors of the economy is the formulation of local content policies (LCPs). Typically, LCPs require companies to give preferential treatment to nationals of the country in which they operate in matters of employment and in the procurement of goods and services. It is believed that this would result in technology transfer and facilitate the ability of the country to take charge of its own development. But LCPs come with certain tradeoffs: Their potential incompatibility with international trade agreements threatens their sustenance; they can create unrealistic expectations capable of discouraging investment; and they are easily prone to corruption.

However, there is a strong case for emerging oil and gas-producing East African countries to consider adopting the LCP. The nascent nature of the oil and gas industry in the region means that these countries would not have the technical and even managerial expertise to meet the demands of the industry. And training and education are essential for economic development. The LCP appears to be a potent tool to train

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local professionals. The question however is how to design the policy to reflect the particular needs and circumstances of each country.

East African countries may consider adopting a localist approach to LCP by giving special consideration to the localities where the oil and gas and exploitation takes place. This approach may help them to address wider socio-economic problems associated with oil and gas development. They may also consider adopting a regional approach, which would enable all the countries to pull their resources together to jointly address the skills problem facing the region and thereby help one another. Given the enormous oil and gas skills gap in the region, it may help East Africa to avoid the imposition of stringent local content targets on oil and gas companies operating in the region and, instead, adopt an incremental and compartmentalized approach that takes stock of what skills are available, in what compartments at any given time and set their local content targets accordingly. Promotion of linkage development is essential to enhance the contribution of the oil and gas industry to the macro economy. Linkage development can facilitate technology transfer and economic diversification. But even these measures will have only minimal positive impact if the potential for elite capture and corruption is not addressed through the injection of transparency and accountability measures into the LCP design and implementation.

INTRODUCTION

According to one news report, recent discoveries of oil and gas in East Africa has made the region the "new promised land", comparable to the 19th century gold rush in South Africa, where South African gold rose from zero to 23 per cent of global supply within just a decade.[1] The discoveries have been mostly in Tanzania, Mozambique, Uganda, Madagascar and Kenya, where significant progress towards commercial development has been made.[2] Although Kenya's progress is more modest – with signals that bigger finds are on the way – Kenya is expanding investments in its oil and gas resources[3] and already plays a pivotal role in the region as a transit route for oil products coming into and going out of the region.[4] Another news report has it that "[oil and gas] companies are waiting for [East African] policymakers to determine priorities and incentives before they can settle on investment plans."[5]

While the oil and gas discoveries put East African countries on the precipice of economic prosperity capable of bringing broad public welfare improvements to their citizens, there is cause for concern. The regions where the discoveries have been made in the respective countries fall mostly within the arid and semi-arid parts of the countries.[6] This means that oil extraction in these countries is very likely to generate severe environmental problems for the surrounding local communities. In addition, a vast majority of the identified oil fields are located in troubled regions and on territories under dispute within and between the countries.[7] Even in relatively peaceful Tanzania there are unsettled disputes between the Tanzanian mainland and Zanzibar "over hypothetical royalties" for the yet to be discovered oil within the islands.[8] In Kenya, most parts of the oil region have faced historical marginalization by successive governments.[9] The struggle over scarce land and water resources in Kenya is spreading into oil, as local communities are already contesting the location of oil wells.[10] In Madagascar – a country marked by protracted political instability, leading to suspension of international aid programs – local communities are poverty-

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1 Zeddy Sambu, Oil and gas discoveries make East Africa a rich hunting ground for global explorers, Business Daily, 31 December 2012, online: http://www.businessdailyafrica.com/Oil-and-gas-discoveries-in-East-Africa-/-/539552/1654946/-/vvmvcs/-/index.html.

2 U.S. Energy Information Administration, "Emerging East Africa Energy", 23 May 2013, 1, http://www.eia.gov/countries/analysisbriefs/East_Africa/eeae.pdf.

3 *Ibid*.

4 Energy Information Administration, "Emerging East Africa Energy", 11 June 2013, online: http://www.eoearth.org/view/article/229816/.

5 *The Africa Report*, "Oil and Gas: East Africa's Race to Get Ready", 1 October 2012, http://www.theafricareport.com/North-Africa/oil-and-gas-east-africas-race-to-get-ready.html.

6 Chrispine Odour et al, "The Political Economy of the Extractive Sector" in Miriam W Oiro Omolo & Germano Mwabu, eds, *A Primer to the Emerging Extractive Sector in Kenya: Resource Bliss, Dilemma or Curse* (Nairobi: Institute Of Economic Affairs, 2014) at 181.

7 DM Anderson & AJ Browne, "The Politics of Oil in East Africa" (2011) 5:2 Journal of East African Studies 395.

8 *Ibid*.

9 Odour et al (2014), *supra* note 6 at 181.

10 Luke Patey, "Kenya: An African Oil Upstart in Transition", Oxford Institute for Energy Studies Paper: WPM 53, October 2014, p. 23, online: http://www.oxfordenergy.org/wpcms/wp-content/uploads/2014/10/WPM-53.pdf.

stricken, unstable and highly marginalized.[11] In Uganda, it has been reported that since the oil discovery several wealthy Ugandans have been "scrambling to buy land" around the exploration area[12] and that exploration activities have already caused distortions in the customary land tenure system in the oil region, conflict, displacement and substantial migration into the region.[13] These have led some opposition politicians in Uganda to warn that the oil discovery could become "a curse" rather than a blessing "if it leads to more conflict in the country."[14] *The Economist* has therefore cautioned against the risk of "Dutch Disease" in East Africa.[15]

The challenge for East Africa is how to maximize the potential benefits from the resources to avoid the under-developmental path that was the trajectory of most other oil producing countries in Africa, such as Angola, Nigeria and Sudan. There is general consensus that lack of specialized expertise is a major obstacle to Africa's realization of its resource potential. According to the World Bank, "[s]ignificant skills shortages exist both in terms of numbers and quality," especially within the fields of science, technology, engineering and mathematics.[16] The Bank notes that evidence from eight African countries (Angola, Botswana, Gabon, Ghana, Nigeria, South Africa, Tanzania, and Zambia) as well as evidence from six economic sectors in Africa (copper, diamonds, gold, oil and gas, mining services and timber) indicates that "skills, and the institutions that affect firm- and sector-level capabilities, constitute the most important determinant of economic benefits."[17]

One of the instruments currently being adopted by most oil and gas resource-rich countries both in and outside Africa to deal with the skills problem and to enhance linkages between the oil and gas sector and the other sectors of the economy is the formulation of local content policies (LCPs). Defined as the requirement that "a given percentage of domestic value added or domestic components be embodied in a specified final product",[18] LCPs are undertaken to enable countries to maximize the gains of foreign direct investment (FDI) through the promotion of local participation in FDI and the use of local raw materials by investors.[19] It is believed that this would result in technology transfer and facilitate the ability of the country to take charge of its own development. A number of African

[11] Association IRESA, Madagascar: The New Eldorado for Mining and Oil Companies, Friends of the Earth France & Friends of the Earth Europe, November 2012, 3, online: http://www.amisdelaterre.org/IMG/pdf/madagascareldoradooilmining-foefrance.pdf.

[12] See "Uganda Announces Oil Discovery", IOL News, 9 October 2006, online: http://www.iol.co.za/news/africa/uganda-announces-oil-discovery-1.296822#.VXSgtM9VhBc.

[13] Uganda Land Alliance, "Land Grabbing and Its Effects on the Communities in the Oil-rich Albertine Region of Uganda: The Case of Hoima, Buliisa and Amuru", September 2011, 24–26, online: http://landgovernance.org/system/files/ULA%20Land%20Grabbing%20Study%202nd%20October%202011.pdf.

[14] See "Uganda Announces Oil Discovery" (2006), *supra* note 12.

[15] *The Economist*, "Making the Most of a Good Situation", 7 February 2013, http://www.economist.com/blogs/baobab/2013/02/gas-discoveries-east-africa.

[16] World Bank, "Human Capital for the Oil, Gas and Minerals Industries", Science, Technology, and Skills for Africa's Development, March 2014, 1, online: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2014/03/05/000442464_20140305151740/Rendered/PDF/857140BRI0WB0H00Box382147B00PUBLIC0.pdf.

[17] *Ibid* at 2.

[18] Gene M Grossman, "The Theory of Domestic Content Protection and Content Preference" (1981) 96:4 Quarterly Journal of Economics 583.

[19] Silvano Tordo *et al*, *Local Content Policies in the Oil and Gas Sector*, World Bank Study (Washington, DC: World Bank, 2013) at 120.

countries, most notably Angola, Nigeria and Ghana, have adopted the LCP. In East Africa, Tanzania is probably the only country that has LCP legislation already in place, which is contained in its *Petroleum Act, 2015*, signed into law on August 4, 2015. Kenya's ongoing review of its petroleum legislation includes regulations to promote local content (the Petroleum Exploration, Development and Production (Local Content) Regulations, 2014). It is expected that other emerging East African oil and gas countries will follow suit in the foreseeable future and that they will look to other oil and gas-rich countries where the LCP is already in place for possible lessons. They may do so without delay, given that Ghana's delay in adopting its own LCP for three years after its oil discovery caused it to lose significant opportunities during the development phase of its Jubilee project.[20]

This paper is intended to outline and analyze policy perspectives and options that East African countries may consider in order to maximize the potential gains of the LCP. In addition to this introduction the paper is organized in three parts. The first part explains in detail the meaning of LCP and analyzes its pros and cons. The second part analyzes various options that East African countries may consider when formulating their LCP while the third part summarizes and concludes the discussion.

THE LOCAL CONTENT POLICY: ESSENCE AND TRADEOFFS

Meaning of LCPs

As noted above, LCPs are a requirement that "a given percentage of domestic value added or domestic components be embodied in a specified final product."[21] They are regarded as a form of productive development policies whose goal is to "strengthen the productive structure of a particular national economy".[22] They are designed to increase local participation in foreign direct investment by directing the utilization of indigenous companies in goods and services procurement, the employment of locals and the use of local raw materials by investors. Other measures include tariffs, taxes, pricing, licencing and concession systems that are skewed in favour of local industries or aimed at facilitating the creation of local content by investors as well as local firm reservations for certain inputs and services.[23] In practice, they require firms, particularly multinational firms operating within a country's territory, to give "first consideration" or "deliberate preference" to the country's nationals in matters of employment and training and in the procurement of goods and services. The requirements are either embedded in contractual agreements between governments and companies or enacted legislatively. In some cases, they are established in bidding rules as a precondition for winning contracts or embedded more indirectly in

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20 Kenya Civil Society Platform for Oil and Gas, "Setting the Agenda for the Development of Kenya's Oil and Gas Resources – The Perspectives of Civil Society", July 2014, 38, online: http://kcspog.org/wp-content/uploads/2014/08/KCSPOG_Agenda_Setting_Report.pdf.

21 Grossman (1981), *supra* note 18 at 583.

22 Alberto Melo & Andrés Rodríguez-Clare, "Productive Development Policies and Supporting Institutions in Latin America and the Caribbean", Inter-American Development Bank Research Department Competitive Studies Series Working Paper C-106, February 2006, p. 5, available at: http://www.iadb.org/res/publications/pubfiles/pubc-106.pdf.

23 Cathleen Cimino, Gary Clyde Hufbauer & Jeffrey J Schott, "A Proposed Code to Discipline Local Content Requirements", Peterson Institute for International Economics Policy Brief No PB14–6, February 2014, p. 1, online: http://www.iie.com/publications/pb/pb14-6.pdf.

regulation and tax regimes through provision of incentives to local industries or to other companies that support local participation.[24]

Arguments in Favour of the Use of LCPs

There are several arguments in favour of LCPs. They can help to correct market failures,[25] which arise "when there is a distortion that keeps the market from allocating resources efficiently and adjusting to a steady state", with the result that "domestic industries cannot gain the necessary technology and capacity to compete on the open market without outside intervention and protection."[26] The market fails from a domestic perspective, because the lack of domestic skills to serve the needs of the industry results in inefficient allocation of resources in the market. By requiring companies to invest in the development of particular local skills, LCPs can help to correct this market failure because such requirements help to ensure that skills are available to meet the demands of the market. Besides, there is an inherent good in a country developing its own technical skills to meet the demands of its industries. It enhances entrepreneurship and can contribute to poverty reduction.

LCPs can help domestic firms in developing countries integrate themselves into global economic networks. This is confirmed by studies which show that in the 1990s, both local "productivity-enhancing entrepreneurship" and state support to local development helped East Asian firms to achieve significant positions in global economic networks.[27] It has also been argued that LCPs can contribute to the productivity and competitiveness of domestic firms through knowledge transfers that take place from foreign firms to domestic firms.[28] Other proponents observe that most advanced economies utilized industrial policies similar to LCPs to boost their domestic economy while in the early stages of their industrial development.[29] After reviewing how countries like China, Chile and even the United States benefited from industrial policy (which later came into serious disfavour), Rodrik concludes that "developing new industries often requires a nudge from government. The nudge can take the form of subsidies, loans, infrastructure, and other kinds of support. But scratch the surface of any new successful industry anywhere, and more likely than not you will find government assistance lurking beneath."[30] This view is shared by many leading economists,

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24 Stanislaw Lec, "The Petroleum Sector Value Chain" in Silvana Tordo, Brandon S Tracy & Noora Arfa (eds.), "National Oil Companies and Value Chain", World Bank Working Paper No 218, 2011, pp. 8–9, available at: http://siteresources.worldbank.org/INTOGMC/Resources/9780821388310.pdf.

25 Tordo *et al* (2013), *supra* note 19 at pp. 24–25.

26 Alisa DiCaprio & Kevin P Gallagher, "The WTO and the Shrinking of Development Space: How Big is the Bite" (2006) 75 The Journal of World Investment & Trade 783.

27 Gary Gereffi, "Global Production Systems and Third World Development" in Barbara Stallings (ed.), *Global Change, Regional Responses* (Cambridge: Cambridge University Press, 1995) at 142.

28 See Oliver Morrissey, "FDI in Sub-Saharan Africa: Few Linkages, Fewer Spillovers" (2012) 24:1 European Journal of Development Research 26–31.

29 Lindsay Whitfield et al, *The Politics of African Industrial Policy: A Comparative Perspective* (Cambridge: Cambridge University Press, 2015).

30 Dani Rodrik, "The Return of Industrial Policy," *Policy Innovations* (April 13, 2010), online: http://www.policyinnovations.org/ideas/innovations/data/000165.

such as Chang, who believes that developed countries should not "kick away the ladder" with which they had used to climb to the top of economic development.[31]

Arguments against the Use of LCPs

One of the most frequently cited argument against the use of LCPs is their potential incompatibility with international trade measures applicable to members of the World Trade Organization (WTO). Particular mention is made of the agreement on Trade-Related Investment Measures, the General Agreement on Tariff and Trade, and the Agreement on Subsidies and Countervailing Measures (ASCM), all of which endorse the "national treatment" principle, which obliges member countries to treat one another as they would their own nationals. However, there are some limited exceptions for least developed and developing countries in the application of this rule. With regard to the ASCM, for example, domestic subsidies violate WTO rules only when they adversely affect the domestic commerce of another WTO member state.[32] Few domestic subsidies meet this threshold, based in part, on the difficulty, for the complaining party, of showing evidence of "adverse effects" as well as on the fact that the definition of subsidy under the rules is narrow.[33] This has led some scholars to suggest that countries should instead of using traditional LCP programs, make use of subsidies to support their domestic firms "on a time-limited basis."[34] Rodrik has argued that even though LCPs breach international trade and investment principles, they are an essential part of the "policy space" that developing countries ought to be allowed to pursue their economic development goals.[35] This view is echoed by another commentator who notes that "fair trade" in the sense of a "level playing field" does not necessarily mean applying the same set of trade rules and conditions to every nation, but also means recognizing that some countries are so disadvantaged that they need "reasonable accommodation" under the international trade system.[36] An analogy to this is the adoption of differential income tax rates according to levels of individual income in most developed countries, which is not necessarily regarded as "unfair" because it is justified by the principle of "reasonable accommodation" for the poor rather than condemned as "unjustifiable discrimination" against the rich.[37] Fortunately for developing countries, however, the WTO rules impeding the application LCPs are rarely enforced.[38]

In addition, LCPs are said to be a poor instrument for addressing the inadequate contribution of the extractive sector to local economic development, for it creates

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31 Ha-Joon Chang, *Kicking Away the Ladder – Development Strategy in Historical Perspective* (London: Anthem Press, 2002).

32 Cimino, Hufbauer & Schott (2014), *supra* note 23, p. 3.

33 Chilenye Nwapi, "Defining the 'Local' in Local Content Requirements in the Oil and Gas and Mining Sectors in Developing Countries" (2015) 8:1 Law & Development Review 194–195.

34 Cimino, Hufbauer & Schott (2014), *supra* note 23, p. 3.

35 Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions and Economic Growth* (Princeton, NJ: Princeton University Press, 2007).

36 YS Lee, *Reclaiming Development in the World Trade System*, 2nd ed (forthcoming) (Cambride: Cambridge University Press, 2016) at 462–463.

37 *Ibid* at 463.

38 Cimino, Hufbauer & Schott (2014), *supra* note 23, p. 1.

distortions, inefficiency and corruption.[39] As one commentator has noted, however, these arguments are generalizations. Inefficiency, for instance, may be as a result of "technological strangeness" – i.e., "the ability of the rest of the economy to develop service capacity through backward linkages and the speed at which such capacity can be created."[40] Moreover, these problems can be dealt with through a well-designed local content framework that takes into account the socio-political and economic climate in which it is to be applied. Corruption, for instance, can be addressed through the integration of transparency measures into the policy and the avoidance of setting corruption-inducing unrealistic targets for companies.

Other arguments abound. For instance, it is believed that imposing quantitative conditions on companies regarding the hiring of locals when the existing local labour lacks the skills to carry out the desired task would not only discourage investment,[41] but also could put undue pressure on companies. As one industry perspective puts it,

> the issue is probably not just one of numbers of Nigerian employees or even of the proportion of Nigerians in senior technical or managerial positions. The real fuel for the controversies around the employment of Nigerians is most likely the fact that as more Nigerians are employed and progress to senior positions, they inevitably seek more opportunities for advancement and therefore the pressure to provide even more opportunities for Nigerians continues to increase. The push for the employment of more Nigerians thus feeds on itself.[42]

The problem of unrealistic expectations can, however, be addressed by a clear definition of what constitutes local content, and, even more importantly, by a country's recognition and acknowledgment of its skills level and a compartmentalized and incremental approach to local content target setting, rather than stipulating stringent targets that are more likely to create corruption instead of helping to grow the economy. That is to say, occupations with high local skills availability can be assigned higher targets than occupations with lower local skills availability. And as more local skills are trained, the level of local content required can be increased gradually and correspondingly. This would however require a comprehensive, occupation by occupation skills survey of the country and the relevant sectors to determine where local skills are available and where they are scarce. It may be assumed that where needed skills are locally available it would be unnecessary to adopt an LCP because firms would find it in their interest to recruit locally as a cost-saving measure. Experience has shown, however, that this is not necessarily the case, especially with Chinese companies, which prefer to bring in their own staff and insist on being allowed to do so in their investment negotiations in Africa.

There is a strong case for emerging East African oil and gas producing countries to adopt the LCP. The nascent nature of the oil and gas industry in the region means that these countries would not have the technical and even managerial expertise to meet

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39 Lec (2011), *supra* note 24 at 9.

40 *Ibid* at 9–10.

41 J Emeka Nwaokoro, "Signed, Sealed but Will it Deliver? Nigeria's Local Content Bill and Cross-Sectoral Growth" (2011) 4:1 Journal of World Energy Law and Business 56.

42 Ike Oguine, "Nigerian Content in the Nigerian Petroleum Industry: Legal and Policy Issues" (2011) 29 J Energy & Nat Resources L 409.

the demands of the industry. Mozambique, for instance, is characterized by lack of economic diversification, weak institutional capacity, high financing costs, a poorly qualified workforce and deficient infrastructure development.[43] Domestic skills shortage in Mozambique is described as "crippling", occasioned by "poor quality education, insufficient access to education and inadequate linkages between existing curricula and market demands."[44] A recent World Bank study notes that as the oil and gas industry is very new in Uganda, skills required by the industry are "quite low" in that country.[45] This, arguably, is also the case in Madagascar and, even if to a lesser degree, in Kenya and Tanzania due to their relatively more developed economies.

Studies have shown that training and education are essential for economic development. Between 1955 and 1961, for example, 225 personnel from the departments of medicine, engineering, and agriculture of South Korea's Seoul National University received training and education at the University of Minnesota under a program designed by the U.S. government to support South Korea. The professionals returned to South Korea at the end of their training and contributed to the economic development of South Korea in their respective areas.[46] Even though this program was not designed in the context of a local content strategy, it clearly indicates the importance of training in economic development. LCPs appear to be a potent tool for training local professionals. The question, however, is how to design the LCP to best reflect the economic development challenges of the adopting country. The analyses that follow examine some of the issues that East African countries should consider when adopting the LCP.

OPTIONS AND PERSPECTIVES FOR THE FORMULATION OF LCPS

There are several options for East African countries. They may choose to adopt a national entrepreneurial development approach – the conventional approach – which focuses on enhancing the participation of a country's "nationals" in the industry. They may choose to adopt a "localist" approach – being advocated by some scholars – which recognizes that the communities where the oil and gas resource projects are carried out bear the most brunt of the activities, by giving special consideration to such communities to alleviate their condition and minimize the potential of oil and gas development to generate conflicts. It has also been suggested that countries may choose to adopt a regional integration approach that is aimed at boosting regional rather than merely national competitiveness. What shape such an approach may take has scarcely been discussed. Countries may also choose to focus on training and education of local workforce. They may choose to focus on local procurement of goods and services to increase the participation of the national industry on a competitive

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43 African Development Bank Group, "Republic of Mozambique: Country Strategy Paper 2011–2015", August 2011, pp. iv and 9, online: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/Mozambique%20-%202011-15%20CSP.pdf.

44 Aditi Lalbahadur, "A Regional Approach to National Development Priorities in Mozambique?" 8 April 2013, http://www.thetradebeat.com/opinion-analysis/a-regional-approach-to-national-development-priorities-in-mozambique.

45 World Bank, "Leveraging Oil and Gas Industry for the Development of a Competitive Private Sector in Uganda", Report No: ACS12528, 25 May 2015, 8, online: http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2015/04/20/000442464_20150420122912/Rendered/PDF/ACS125280REVIS0itive0Private0Sector.pdf.

46 Chilenye Nwapi & YS Lee, "Trade and Development in Africa" in YS Lee, *Reclaiming Development in the World Trade System*, 2nd ed (forthcoming) (Cambridge: Cambridge University Press, 2016) at 390, footnote 1797.

basis. Or they may choose to focus on a broader goal of how to use the policy to enhance economic diversification (by promoting linkages to other sectors) to reduce economic dependency on the petroleum sector. These policy focuses are not mutually exclusive, and most countries have in fact adopted a broad approach that encompasses all of these. With each policy focus, however, there are inherent tradeoffs. The challenge for East African countries is to strike a balance between the clusters of stakeholders in the oil and gas sector and to prioritize their needs to meet legitimate citizen expectations.

A. The Definition of "Local"

Most local content laws do not define explicitly the term "local" in local content. What local means can only be deciphered in their definitions of local content. Under section 106 of the *Nigerian Oil and Gas Industry Content Development Act, 2010*, for instance, the Nigerian content is defined as "the quantum of composite value added to or created in the Nigerian economy by a systematic development of capacity and capabilities through the deliberate utilization of Nigerian human, material resources and services in the Nigerian oil and gas industry". In Ghana, Regulation 49 of the *Petroleum (Local Content and Local Participation) Regulations, 2013* defines local content as "the quantum or percentage of locally produced materials, personnel, financing, goods and services rendered in the petroleum industry value chain and which can be measured in monetary terms". Whereas in the case of Nigeria, there is explicit reference to "Nigerian economy" and Nigerian human and material resources and services, the Ghanaian Regulation speaks about "locally produced materials …" Thus, while one can easily assume that "local" in the Nigerian case is equivalent to "national", there is some ambiguity in the Ghanaian model regarding whether local refers to "national" or to the region or locality within Ghana where the goods and services are produced. However, this ambiguity may be resolved by looking at some other provisions of the Regulation. For instance, Regulation 9 requires a company's local content plan to contain detailed provisions that guarantee that "qualified Ghanaians are given first consideration" in matters of employment and that "adequate provision is made for the training of Ghanaians on the job". This suggests that "local" is equivalent to national rather than the subnational locality or region where the oil and gas activities take place. This also represents the position in most other countries, including Angola, Equatorial Guinea, and Indonesia.

Kenya's draft local content regulation adopts a definition of local content similar to the definitions adopted in Nigeria and Ghana and equally does not contain any definition of local. It is in fact worth noting that during discussions on the Petroleum Exploration and Production Act, the Kenyan government adopted the term "national content" instead of "local content" because, according to it, "'Local' may be misconstrued to mean particular communities where oil and gas operations are being conducted.'"[47] A recent study of LCPs in Ghana shows this concern to be accurate. According to the study,

> it was obvious that about 95% of the local communities either misunderstand or misapply the concept of local content. Instead, they understand local content and local

[47] See Ministry Reviews the Petroleum (Exploration and Production) Act Cap 308, online: http://ices.or.ke/ministry-reviews-the-petroleum-exploration-and-production-act-cap-308/?print=print.

participation to mean, the considerations for offering employment, award of service contracts, allocation of CSR programmes and the award of scholarships *inter alia* should be offered first and foremost to the indigenes of the Western Region before any other Ghanaian.[48]

However, the draft Kenyan bill as well as the draft local content regulation that was finally prepared abandoned the term national content in favour of local content. While section 2 of the draft regulation defines local content as "the use of Kenyan local expertise, goods and services, people, businesses and financing for the systematic development of national capacity and capabilities for the enhancement of the Kenyan economy", however, section 85 of the petroleum bill requires that "first consideration be given to services provided within the *county* and goods manufactured in the *country*" (italics mine). Provisions relating to employment and training are in relation to "Kenyans".

An initial draft of Tanzania's oil and gas industry LCP similarly adopts a national approach to an understanding of "local". The document contains an explicit definition of local as "[t]he Tanzania Mainland and its people".[49] It defines local content as "[t]he added value brought to the country in the activities of the oil and gas industry in the United Republic of Tanzania through the participation and development of local Tanzanians and local businesses through national labour, technology, goods, services, capital and research capability."[50] At another point the document defines local content as "the added value brought to a host nation (*and regional and local areas in that country*) through the activities of the oil and gas industry."[51] The reference to "regional and local areas" is a remarkable departure from the position in other countries and represents specific recognition that the localities or regions where oil and gas resources are extracted deserve special recognition in the implementation of LCPs. In addition, the document recognizes the need to develop "local local content",[52] the essence being to give oil and gas companies the "social licence to operate" and to contribute to the growth of local communities to achieve a "mutually beneficial and sustainable" business environment.[53] However, it does not require any special preference for the extractive localities or regions over other Tanzanians, but only encourages companies to, "as far as possible", procure their workforce, materials and services from the communities in which they operate.[54] In the final LCP legislation that was passed by the Tanzanian Parliament, however, the idea of "local local content" was abandoned.

The idea of "local local content" is consistent with what Warner has termed "community content", i.e., "the interface of community investment programmes with local content", which consists of "the strategic deployment of local participation and local capability

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48 Evangelia Fragouli & Aiden Yengbalang Danyi, "Promoting Local Acceptability of International Oil Companies (IOCS) Through Corporate Social Responsibility (CSR): The Case of Tullow Oil in Ghana" (2015) 1:1 Financial Risk & Management Reviews 45.

49 See "Draft Local Content Policy of Tanzania for the Oil and Gas Industry", April 2014, p. iii, online: http://www.tanpetstate.org/wp-content/uploads/2014/12/Local-Content-Policy-2014-Draft.pdf.

50 *Ibid* at iii (italics mine for emphasis).

51 *Ibid* at 7.

52 *Ibid* at 25.

53 *Ibid*.

54 *Ibid* at 25–26.

development opportunities arising from an oil or gas project, specifically directed to strengthen the sustainability, relevance and political visibility of community investment programmes."[55] To Warner "community content is about realising a competitive advantage for the oil company in the eyes of both the local population and the country's guardians of economic policy."[56] The distinction between community content and local content programs is that whereas the former is a "merit good" directed at supporting those adversely affected by extractive resource projects, local content programs represent "public good[s]" although from a global perspective they may also be regarded as merit goods in that they give privilege to nationals and firms from within the country as against other nationals and firms.[57]

Warner suggests that community content should be pursued as a separate policy from local content. This is because community content would present some unique challenges. For instance, opportunities for employment provision at the community level would be severely hampered by the greater lack of available skills at the community level when compared to available skills at the national level.[58] Therefore achieving community content would require strategically building the skills capability of local communities to enable them to capture the opportunities created by oil and gas resource projects.[59] One writer has argued that this model, though "progressive", may face implementation difficulties because it would involve "considerable undertakings" by oil and gas companies to provide sustained assistance to local firms to improve their capabilities and to provide financial support such as "venture capital, credit guarantees and short-term loans to local suppliers and contractors".[60] The writer appears to assume that the building of local capacities is the sole responsibility of the companies. However, there is a considerable role for the government, such as the establishment and strengthening of educational centres and institutions where relevant skills are taught. Moreover, the provision of financial credits to local suppliers would be the responsibility of financial institutions, supported by the government, and not that of oil and gas companies. However, pursuing a separate community content policy does not necessarily mean pursuing it independently of LCPs. Rather, it can be embedded into an LCP framework by giving specific recognition to the communities surrounding the resource extraction in matters of employment and in the procurement of goods and services.

A clear definition of local in LCPs is important, especially in African countries where relationships between extractive companies and their host communities as well as between extractive communities and their governments are very fragile due to struggles over land and due to the adverse impact of resource extraction on surrounding communities and the absence of strong regulatory structures. An LCP designed to give special recognition to the

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55 Michael Warner, "Community Content: The Interface of Community Investment Programmes with Local Content Practices in the Oil and Gas Development Sector", Policy Brief Note 9, 2007, p. 5, online: http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/2087.pdf.

56 *Ibid*.

57 *Ibid*.

58 *Ibid*.

59 *Ibid* at 8.

60 See Ugwushi Bellema Ihua, "Local Content Policy and SMEs Sector Promotion: The Nigerian Oil Industry Experience" (2010) 5:5 International Journal of Business Management 6.

communities or subnational regions where the resource extraction takes place may provide a mechanism for addressing this fragility. As the World Bank has noted in connection with the extractive industry in Africa, "[l]ocal employment is consistently the top concern of communities located near extraction projects, and often a central issue behind disputes, grievance and conflict. More local jobs result in more support for projects."[61] This is supported by "a growing body of evidence that demonstrates that deliberate community action can and does influence the local economy and is capable of improving the quality of life for local residents".[62] It is particularly supported by subnational economic development theory, which calls for a regional or local approach to development,[63] as well as by subnational competitiveness theory, which views subnational growth as "a generative process" and national growth as "an aggregate" of subnational growth and calls on national policymakers to focus on enhancing subnational growth, as this would engender national growth eventually.[64]

In addition, community content can help improve company-community relations, enabling companies to obtain the social licence to operate.[65] Given the negative impacts of oil and gas development on surrounding communities, local community content can help to compensate the afflicted communities through job creation and value addition in the communities.[66] It has been observed that community displeasure over lucrative oil and gas jobs being handed to outsiders, with only menial jobs going to the communities, poses a significant threat to the success of oil and gas projects.[67] Community content can also help governments in conflict-prone countries or those emerging from conflict to achieve "political harmony" through its potential to address some of the equity issues that all too often lead to resource conflicts.[68] The continuing conflict in Nigeria's Niger Delta has been attributed to lack of proper management of local community expectations.[69] The United Nations Conference on Trade and Development has found that "community relations issues are a significant obstacle to the implementation of a speedy, strife-free local content development in the oil and gas industry in Nigeria."[70] Writing from his experience of the

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61 World Bank, "Human Capital for the Oil Industry" (2014), *supra* note 16 at 4.

62 S Markey *et al*, *Second Growth: Community Economic Development in Rural British Columbia*, (Vancouver: University of British Columbia Press, 2005) at xiii.

63 Nwapi, "Defining the 'Local'" (2015), *supra* note 33 at 187–216.

64 Suahasil Nazara, Michael Sonis & Geoffrey JD Hewings, "Interregional Competition and Complementarity in Indonesia", Discussion Paper 01-T-02, The Regional Economic Applications Laboratory, March 2000, p. 3, available at: http://www.real.illinois.edu/d-paper/01/01-t-2.pdf.

65 Ana Maria Esteves & Mary-Anne Barclay, "Enhancing the Benefits of Local Content: Integrating Social and Economic Impact Assessment into Procurement Strategies" (2011) 29:3 Impact Assessment and Project Appraisal 205.

66 Rabiu Ado, "Local Content Policy and the WTO Rules on Trade-Related Investment Measures (TRIMS): The Pros and Cons" (2013) 2:1 International Journal of Business and Management Studies142.

67 Ana Maria Esteves, Bruce Coyne & Ana Moreno, "Local Content Initiatives: Enhancing the Subnational Benefits of the Oil, Gas and Mining Sectors", Revenue Watch Institute (RWI) Briefing, July 2013, p. 6, online: RWI, http://www.resourcegovernance.org/sites/default/files/RWI_Sub_Enhance_Benefits_EN_20131118.pdf.

68 Ado (2013), *supra* note 66, p. 142.

69 U Idemudia & UE Ite, "Demystifying the Niger Delta Conflict: Towards an Integrated Explanation" (2006) 33:109 Review of African Political Economy 391–406.

70 United Nations Conference on Trade and Development (UNCTAD), *UNCTAD/CALAG African Oil And Gas Services Sector Survey*, *Volume 1 – Nigeria: Creating Local Linkages By Empowering Indigenous Entrepreneurs*, UNCTAD, Geneva, 2006, 79, online: http://commodities.open.ac.uk/8025750500453F86/%28httpAssets%29/4BFA672B2FFEF5AA8025782B003DA71C/$file/UNCTAD%20_%20Oil.pdf.

social tensions in the oil-bearing Niger Delta region of Nigeria, a former General Counsel of Chevron Nigeria has described as "a serious shortcoming" the absence of community content requirement in Nigeria's local content legislation.[71] Countries can also use LCPs to "re-direct the rents arising from economic undertakings … away from foreign investors and towards specific groups, firms or regions in the host country",[72] thus directing some of the benefits also away from the national government. Such redistribution can serve "to ensure that the profits and employment from natural resource extraction are felt directly in the communities where the extraction is done".[73] Recognition of community content in LCP frameworks can serve as an effective tool for such redistribution.

Fragouli and Danyi have argued that local communities in Ghana who view local content from a localist perspective do not agree that that oil and gas resources are found on their territory does not give them ownership rights over them, as stipulated by the Ghanaian constitution, which gives ownership of the resources to all Ghanaians. They argue further that these communities also do not agree that the goal of the LCP is to promote engagement of the capacities and businesses of all Ghanaians in the oil and gas value chain without regard to ethnic or regional origin or proximity to the resources. In order to manage local perceptions and expectations over the LCP, the scholars recommend that the Ghanaian government and civil society should engage in educating the communities about the meaning of local content.[74] Since oil and gas resources are not subject to private ownership in the emerging East African countries, these arguments apply with equal force to East Africa.

The above view ignores the exceptional hardship that local communities within the proximity of the resources suffer due to such proximity. The approach Fragouli and Danyi recommend would lead to exclusion rather than inclusion of local communities in the oil and gas value chain. Relations with local oil and gas communities do not call for government posturing and insistence on strict legal and constitutional rights. To be clear, community content does not mean precluding other nationals within the country from consideration in the distribution of the benefits of LCPs. Rather, community content is better regarded as a sub-component of an LCP, requiring, for instance, that first consideration be given to resource-bearing communities before other nationals in matters of employment and procurement of goods and services, or requiring a certain percentage of these to be allocated to the communities where those communities meet needed specifications and where they do not, a requirement that deliberate effort be made to build their capacity to meet those specifications.

There is a strong case for East African countries to consider a localist approach to LCP. Like other regions in Africa, East Africa is characterized by a huge sense of ethnic identity among each country's nationals. That is to say, East Africans are more likely to identify themselves by their ethnic origin than by their nationality. Uganda presents the most

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71 Oguine (2011), *supra* note 42 at 428.

72 WTI Advisors, "Local Content Requirements and the Green Economy", paper presented at the Ad Hoc Expert Group Meeting on Domestic Requirements and Support Measures in Green Sectors: Economic and Environmental Effectiveness and Implications for Trade, 13–14 June 2013 Salle XXI, Palais des Nations Geneva, p. 10, online: http://unctad.org/meetings/en/Contribution/DITC_TED_13062013_Study_WTI.pdf.

73 *Ibid*.

74 Fragouli & Danyi (2015), *supra* note 48 at 48.

extreme form of this, having the highest index of ethnic fractionalization in the world.[75] In Tanzania, there is additional significant tension between black Africans (who dominate political power) and Asian and Arab Tanzanians (who dominate the business sector).[76] This foretells how the local communities around the resources in East Africa, particularly in Uganda, are likely to vent their grievances should the extraction impact negatively on them.[77] The risk of a head-on collision between the East African governments and/or the oil companies operating there, on the one hand, and the local communities on the other is thus readily apparent.

Notwithstanding the above argument, the localist strategy may come with some tradeoffs. But the tradeoffs are not insurmountable and the advantages of the strategy may outweigh the consequences of the tradeoffs. For instance, the localist strategy may not promote supplier diversification and may not offer adequate opportunities to the country's best, in terms of technical and managerial expertise, to participate in the development of the oil and gas sector in the country. However, the benefits of maintaining social stability in the resource-bearing region and, more broadly, national unity that such a strategy would bring about may be more important for national economic development than the loss to be occasioned by these tradeoffs.

B. Use of Mandatory Targets

A major problem with LCPs is that local skills availability frequently lags behind industry needs. Many oil and gas companies have used this as an excuse for not meeting local content directives. Oguine has, for instance, pointed out as follows:

> The challenge here is determining the extent to which opportunities can reasonably be provided to Nigerian companies to supply goods and services to the petroleum industry, even when they do not necessarily offer the best value, so that they can develop their capacities. A regulatory body needs to distinguish between capacity that is available but currently limited and that can be enhanced, and capacity that is simply not available or so limited that to insist on its use will cause significant economic loss to the operators in the petroleum industry and the nation.[78]

Civil society organizations have found that in Ghana oil and gas companies have difficulties finding local staff with the requisite education and skills to fill available positions, and that in Nigeria company ownership requirements imposed under the Nigerian content law have fostered the formation of hollow companies by local entrepreneurs who front for foreign companies that have the capabilities to execute oil and gas projects.[79] Industry stakeholders in Nigeria have argued that about 70 per cent of the contracts awarded to Nigerian companies are executed overseas, thereby defeating the goal of developing in-country

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75 Alberto Alesina et al, "Fractionalization", Harvard Institute of Economic Research Discussion Paper No 1959, 2002, p. 8, online: http://dash.harvard.edu/bitstream/handle/1/4553003/alesinassrn_fractionalization.pdf?sequence=2

76 David Booth et al, "East African Prospects: An update on the political economy of Kenya, Rwanda, Tanzania and Uganda", ODI Report, May 2014, p. 35, online: http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/8945.pdf.

77 Odour et al (2014), *supra* note 6 at 192–193.

78 Oguine (2011), *supra* note 42 at 418.

79 See Kenya Civil Society, (2014), *supra* note 20 at 40.

capacity.[80] The same has also been pointed out with respect to Angola.[81] Imposing stringent conditions regarding the use of local labour and local procurement may therefore not achieve the best outcome. Specifically, it may not be the best way to address the capacity problem as it incorrectly assumes that the requisite skills are available. It has accordingly been argued that local content works best to create value where the necessary technical and vocational skills are available.[82] A better approach for an emerging oil and gas country would therefore be to focus first and foremost on local skills development by developing skills training programs for young people in relevant areas so as to catch up with the needs of the industry. Such development of local skills can be facilitated through the LCP by requiring firms to invest in local skills training to complement efforts by the government to establish relevant skills training institutions for its nationals.

Ghana presents a pertinent example of a new oil and gas producing country that has shown strong commitment to skills development that East African countries can learn from. The skills shortage in Ghana was described as "contribut[ing] to a workforce structure shaped like a steep Egyptian pyramid or the Eiffel Tower", the base of which comprised of unskilled workers employed in activities that required little technology.[83] In 2013, Tullow Oil led the Jubilee Partners to set up a $15 million state-of-the-art training centre at the Takoradi Polytechnic, Ghana. This is a public-private initiative aimed at addressing the skills gap in technical and vocational education in the oil and gas industry.[84] The initiative is further supported by an education foundation established by the Ghana National Petroleum Corporation and the World Bank provided further support with a $4.7 million fund to support training in relevant engineering fields.[85] In Kenya, it must be noted however, Tullow has, in collaboration with Africa Oil Corporation, established a polytechnic in Lodwar to provide oil and gas training to Kenyans.[86]

Rather than setting stringent targets, an incremental approach to promoting local content over time may ensure greater benefits. As a country continues to invest in training of local professionals, the level of local content required of companies can be increased gradually, in proportion to a reasonably projected increase in the availability of qualified local professionals and firms to take up the opportunities.

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80 Whitehall Capital Partners Limited, "PIB and Nigerian Local Content", 2012, p. 9, online: http://www.whcpt.com/Pib-Nigerian-Local-Content.pdf.

81 Zeferino Teka, "Linkages to Manufacturing in the Resource Sector: The Case of the Angolan Oil and Gas Industry" (2012) 37 Resources Policy 466.

82 Chinyere Shirley Ayonmike & Benjamin Chukwumaijem Okeke, "The Nigerian Local Content Act and Its Implications on Technical and Vocational Education and Training (TVET) and the Nation's Economy" (2015) 3:1 International Journal of Education Learning & Development 30.

83 Kwamina Panford, "An Exploratory Survey of Petroleum Skills and Training in Ghana" (2014) 60:3 Africa Today 62.

84 See Jim Playfoot & Phil Andrews, "Education and Training for the Oil and Gas Industry: Case Studies in Partnership and Collaboration – Case Study 5 – Takoradi Polytechnic and the Ghanaian Energy Industry: An Education/Industry Partnership to Build an Energy Workforce for Ghana" (San Diego: Elsevier Inc, 2014) 59–70.

85 Panford (2014), *supra* note 83 at 60.

86 Kenya Civil Society (2014), *supra* note 20 at 40.

C. Promoting Project Linkages

There is a noticeable assumption in the design and even more in the implementation of most LCPs in developing countries that the capture of economic benefits from the presence of foreign investors can come merely through employment generation and the participation of local firms.[87] As studies have shown, however, despite an observable increase in the number of Nigerians in managerial and professional positions in oil and gas companies in Nigeria, evidence of technology transfer is minimal.[88] Inadequate attention is paid to the potential benefits that could come from project linkage or what has been termed "'off-project' strategies".[89] Off-project strategies is the involvement of companies in "local content capability development outside of a particular employment, supplier or sub-contractor contract, such as through community investment programmes".[90]

Morrisey identifies three basic types of linkages: (1) those relating to employment, (2) those relating to demand for inputs from local suppliers, and (3) those relating to supply of inputs to local producers.[91] Regarding employment, linkages occur through the provision of training that firms provide to their workers, as such training can benefit local firms if the workers later move to work for local firms.[92] Labor turnover is thus regarded as a significant factor in linkage development between the oil sector and the non-oil sectors. In Sub-Saharan Africa, however, due to limited labour mobility and the fact that foreign firms tend to provide firm-specific training because they bear the costs of training, linkages through employment are limited.[93] It has however been reported that in Nigeria, 56.5 per cent of oil companies are aware of their former employees who developed expertise while working with them but who later moved to other sectors.[94] On the other hand, inputs from local suppliers carry linkage potentials because in the effort to meet the demands of foreign firms, local firms improve their production standards and practices. Similarly, when foreign firms supply inputs to local producers, some technology is implanted in it that benefits local producers.[95]

Promotion of project linkage is critical to the economic diversification of the local economy. As the International Monetary Fund has pointed out, albeit with reference to São Tomé and Príncipe, the development of specific activities in the oil sector cannot be undertaken without reference to other sectors.[96] The link between the oil sector and the non-oil sectors,

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87 Warner (2007), *supra* note 59 at 2.

88 Jean Balouga, "Nigerian Local Content: Challenges and Prospects", International Association for Energy Economics Newsletter, Third Quarter, 2012, 24, online: www.iaee.org/en/publications/newsletterdl.aspx?id=176.

89 Warner (2007), *supra* note 59 at 2.

90 *Ibid* at 3.

91 Morrissey (2012), *supra* note 28 at 27.

92 *Ibid* at 28.

93 *Ibid*.

94 Adeolu O Adewuyi & T Ademola Oyejide, "Determinants of Backward Linkages of Oil and Gas Industry in the Nigerian Economy" (2012) 37 Resources Policy 456.

95 *Ibid*.

96 Ulrich Klueh *et al*, "Inter-sectoral Linkages and Local Content in Extractive Industries and Beyond – The Case of São Tomé and Príncipe", IMF Working Paper, WP/07/213, September 2007, p. 24, online: http://www.imf.org/external/pubs/ft/wp/2007/wp07213.pdf.

such as agriculture, tourism and finance, may be viewed as symbiotic.[97] Some economic activities outside the oil sector can provide inputs to the growth of the oil industry. For instance, the provision of decent housing and other services to oil company employees constitutes an input into the oil sector. At the same time, and perhaps more importantly, it can result in the emergence of a robust tourism industry in the region of the country where the oil facilities are located. Also, revenues from oil can be used "to carry out well-targeted productivity enhancing investments" in other sectors.[98] There is therefore very strong potential for the emergence of the oil and gas industry in East Africa to boost the non-oil sectors and for these other sectors to in turn boost the oil and gas industry. LCPs can contribute to enhancing the positive aspects of this symbiotic relationship when informed by this principle of sectoral interconnectedness and targeted at programs that carry the entire economy along at the same time.

Project or sectoral linkages do not occur unconditionally. "The industrial policy environment matters."[99] In their investigation of the factors which influence linkage development between foreign firms and domestic firms in Sub-Saharan Africa, Amendolagine *et al* find that "[f]oreign firms with a local partner and those with a final market orientation" interact more closely with local firms and so have a higher potential to contribute to linkage development.[100] They also find that local linkages are higher when the local management of the foreign plants enjoys a high degree of decisional independence from the headquarters of the parent company.[101] Their research demonstrates that foreign firms with technological knowhow too advanced for the domestic economy do not have high linkage potentials since their interactions with domestic firms would be minimal and superficial. Another interesting finding of their research is that Chinese companies have low linkage potentials in Sub-Saharan Africa and that this may be due to language and cultural barriers. Other factors that influence linkage development include a reliable legal system, a functioning institutional setting and public private partnerships.[102]

In addition, whether linkages will deliver benefits depends on whether they result in spillovers, defined as the occurrence of knowledge transfer to, or learning by, local firms. Thus, linkages may occur without or with limited spillovers, either because foreign firms do not support knowledge transfer by withholding pertinent information, or because local firms are unable to learn from what is transferred due to limited capacity to attract able workers.[103] Research has found that spillover effects occur when the ownership of investment projects is shared between domestic and foreign firms, for in such cases foreign firms are more likely to source their suppliers locally and so would be more willing to share their technology since this can improve the performance of their suppliers, whereas wholly

97 *Ibid*.

98 *Ibid*.

99 Morrissey (2012), *supra* note 28 at 27.

100 Vito Amendolagine et al, "FDI and Local Linkages in Developing Countries: Evidence from Sub-Saharan Africa" (2013) 50 World Development 42.

101 *Ibid*.

102 *Ibid*.

103 Morrissey (2012), *supra* note 28 at 27–28.

owned affiliates would tend to import their inputs.[104] Compared to the manufacturing and telecommunication industries, there are fewer linkage benefits in the extractive sector in Africa because extractive sector linkages in Africa are seldom accompanied by spillovers, as the sector provides mostly basic employment with little learning and knowledge transfer.[105] As Morrissey concludes,

> a proper understanding of the failure of FDI to truly benefit sub-Saharan African economies lies in exploring the failure to develop a coherent industrial policy. Without such a policy, they are unable to identify the important linkages to promote through FDI, and even less able to provide the incentives and capabilities for spillovers to occur. More fundamentally, meaningful spillovers imply learning – knowledge transfer occurs and the beneficiaries are able to apply this knowledge. The search for spillovers should be a search for learning.[106]

These findings point to the way industrial policy should be formulated to play a pivotal role in shaping linkages. A country that seeks to promote linkages must be strategic and systematic in the kind of firms it wishes to attract and in the nature of the conditions it imposes on such firms before they can operate. Inter-sector knowledge transferability must be written into local content legislation. Provisions that require firms to invest in local skills training can as well as those that require firms to procure their goods and services locally help in achieving this.

East African countries must therefore strengthen the environment for linkage development. This requires promoting the growth and capacity development of institutions and organizations that help to build the socio-economic assets and infrastructure on which industries depend.[107] These institutions and organizations include: Educational institutions and vocational training institutes, credit providing institutions, cooperatives and other small business associations, entrepreneurship organizations, and relevant government agencies and departments such as company registries and tax offices.[108] The capacity development of government institutions is particularly important, for in matters relating to business licencing and regulatory enforcement, for instance, inefficiency can slow down linkage development by delaying project approvals which in turn can lead to corruption and discourage competition. Like most other regions in Africa, East Africa has fared poorly in this regard. This is apparent in the World Bank's *Ease of Doing Business 2015* report[109] as shown in the table below of the emerging oil producing countries in East Africa under consideration.

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[104] Beata Smarzynska Javorcik, "Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In Search of Spillovers through Backward Linkages" (2004) 94:3 American Economic Review 609.

[105] Morrissey (2012), *supra* note 28 at 28 and 29.

[106] *Ibid* at 31.

[107] Ben Jenkins *et al*, "Business Linkages: Lessons, Opportunities, and Challenges", International Finance Corporation, International Business Leaders Forum, and the Kennedy School of Government, Harvard University, 2007, p. 10, online: http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_16_BUSINESS%20LINKAGESFINAL.pdf.

[108] *Ibid*.

[109] World Bank Group, *Doing Business 2015: Going Beyond Efficiency*, 12th edition (Washington, DC: World Bank, 2014) p. 195, online: http://www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Full-Report.pdf.

EASE OF DOING BUSINESS IN EAST AFRICA

	Kenya	Madagascar	Mozambique	Tanzania	Uganda
Overall Rank out of **189**	**136**	**163**	**127**	**131**	**150**
Starting a Business	143	37	107	124	166
Dealing with Construction Permits	95	177	84	169	163
Getting Electricity	151	189	164	87	184
Registering Property	136	153	101	123	125
Getting Credit	116	180	131	151	131
Protecting Minority Investors	122	87	94	141	110
Paying Taxes	102	65	123	148	104
Crossborder Trading	153	109	129	137	161
Enforcing Contracts	137	146	164	45	80
Resolving Insolvency	134	129	107	105	98

Derived from World Bank Ease of Doing Business 2015 Report.

Given the above outlook, the challenge for East Africa is to enhance the capacity of the relevant institutions to remove needless bottlenecks. This requires a clear policy focus. In a study of backward linkages in the mineral sector in Tanzania, Mjimba finds that policy – understood as a "plan to guide action towards concerted goals and/or objectives" – is the main driver of linkages and that the main public policy problem in Tanzania is the failure of governments to align sectoral policy with macro policy as well as failure to implement already formulated policy.[110] The scarcity of basic social infrastructure such as roads, water supply and telecommunication in Tanzania limits the development of linkages between the extractive sector and the rest of the economy.[111] This speaks to the need for appropriate policy formulation by East African countries to enhance the development of linkages between the oil and gas sector and the macro economy.

D. A Regional Approach

A critical challenge for African countries is how to design the LCP to reflect their peculiar development needs. It has been suggested that due to the acute shortage of specialized extractive sector skills in most African countries, acting individually, African countries cannot achieve much with the policy and that a regional approach would be more effective. Lalbahadur for instance argues that while the promotion of technology and skills transfer is one way to address the skills crisis in Africa, another possible way is "a more strongly focused African strategy."[112] She suggests that a more liberal foreign labour would benefit a country like Mozambique that has an acute skills shortage, but that this calls for reconsideration by the Mozambican government on how it can enhance its development by

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[110] Vuyo Mjimba, "The Nature and Determinants of Linkages in Emerging Minerals Commodity Sectors: A Case Study of Gold Mining in Tanzania", MMCP Discussion Paper No 7, University of Cape Town and Open University, March 2011, pp. 43–44, online: http://www.cssr.uct.ac.za/sites/cssr.uct.ac.za/files/pubs/MMCP%20Paper%207_0.pdf.

[111] *Ibid*.

[112] Aditi Lalbahadur, "A Regional Approach to National Development Priorities in Mozambique?", 20 March 2013, South African Institute of International Affairs, online: http://www.saiia.org.za/opinion-analysis/a-regional-approach-to-national-development-priorities-in-mozambique.

"linking its foreign investment and socio-economic development strategies more closely with that of its region."[113] The Oxford Institute for Energy Studies believes that "Kenya's role as a regional hub for East African crude oil and petroleum products may be more significant than its potential position as an oil and gas producer."[114] This belief stems from the fact that Kenya's oil reserves are estimated at about 600 million barrels, suggesting that even if new discoveries are made, Kenya may still remain a small oil producer.[115] It may therefore make economic sense for Kenya to share oil facilities, such as pipelines, with its neighbours. Such cooperation would open opportunities for a regional local content development.

While the idea of regional integration has been extensively discussed in the literature, a local content dimension to it peered through only very recently. The rationale behind it is that the comparative advantages that each country enjoys can be strategically mobilized to meet the supply needs of the regional extractive industry (White, 2012). It has been argued that while the idea behind LCPs is to promote local participation in FDI, restrictions to employment of foreign labour may hurt a country's economic growth by restricting the crossborder exchange of information and technology transfer and denying local professionals learning opportunities that the presence of foreign professionals provides.[116]

However, unlike regional cooperative mechanisms on other issues, it is not yet clear what form a regional approach to LCPs can or should take. What should be the guiding principles informing such a framework? What type of implementation structures would be effective? Given how difficult it has been for public and private actors to work together within a given country under most LCP frameworks, achieving the level of public-private partnership required for a regional content development must be challenging. The strikingly varied levels of technological and human capacity among African countries may cause low capacity countries to fear that relatively high capacity countries may take an opportunistic approach to the policy to capture the employment benefits that otherwise would have gone to their own nationals. The recent xenophobic attacks in South Africa suggest that a regional content approach may meet local opposition in some countries, especially in areas of employment. A detailed analysis of these issues requires a separate study, but some preliminary thoughts can be penned here.

A regional approach to LCPs may take the form of regional governments providing a framework for the development and inter-country transfer of specialized skills. The 1997 Southern African Development Commission Protocol on Education and Training could be utilized to provide highly-skilled training to Southern African professionals in the extractive industry. The East African Community could model such an initiative for East African countries. A country would be better positioned to draw on resources from its immediate neighbours than from more remote countries. That is why sub-regional frameworks might be more effective than an African-wide framework. However, an African-wide framework can serve as a continental coordinating mechanism to support sub-regional frameworks by linking the sub-regions together and creating opportunities

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113 *Ibid*.

114 Patey (2014), *supra* note 10 at 14.

115 *Ibid*.

116 *Ibid*.

for cross-pollination of resources. The Economic Commission for Africa appears to be developing such a framework through the launching of the African Mineral Skills Initiative (AMSI) in 2012 to reduce the skills shortage in African mining.[117] Part of AMSI's strategy is to create regional centres of specialization that offer education and training programmes in critical and specialized mineral-relevant skills that African countries can draw on.[118] However, this initiative can be broadened to include the oil and gas sector as well and can be used to provide a foundation upon which an African regional content framework for the extractive sector as a whole can be built.

In May 2015, the African Development Bank published a draft strategy for the African Natural Resources Centre established by the Bank in 2013 to deliver capacity building programs to regional member countries of the Bank.[119] Under the strategy, the Center's activities would span seven renewable and non-renewable economic sectors: Water, forestry, fishery, land, oil, gas and minerals and would focus on addressing a range of policy, legal and institutional capacity challenges facing African countries in these sectors.[120]

For a regional extractive sector LCP framework to be effective, however, it must include mechanisms to promote interaction among companies, professional associations and policy-makers in the extractive sector and to facilitate regional mobility of labour. It may also take the form of technical partnerships among East African countries to promote the exchange of technical experts in the oil and gas sector. Countries would therefore be required to adopt more liberal foreign labour laws and policies that address bureaucratic bottlenecks in the processing of work permits.

In addition, an effective regional content arrangement ought to be based on a number of key principles, perhaps most importantly, relevance, accessibility and equity. Relevance means that the framework must enable each country to draw only skills that are relevant to its skills priorities. To achieve this, any regional specialized training centres established must be informed by an empirical survey of the types of skills needed in all the participating countries. Accessibility speaks to the ease of mobility of labour across the region. This imposes a burden on participating countries to remove unnecessary bureaucratic bottlenecks that make employment of foreign workers difficult. Equity means that the framework must be designed to guard against the domination of weaker countries by stronger countries. For instance, admission to established specialized training institutions must be evenly distributed among nationals of the participating countries, taking into account, however, the skills priorities of each of the countries. In addition, benchmarks must be established for assessing the effectiveness of the arrangement over time, to ascertain where and what types of improvements are needed.

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[117] United Nations Economic Commission for Africa, "Mineral Skills Initiative to support Africa's Mining Vision", ECA Press Release 175/2012, online: http://www1.uneca.org/ArticleDetail/tabid/3018/ArticleId/2203/Mineral-Skills-Initiative-to-support-Africas-Mining-Vision.aspx.

[118] United Nations Economic Commission for Africa, "Concept Note: African Mineral Skills Initiative Pre-ADF VIII Event", 22 October 2012, online: http://www1.uneca.org/Portals/adfviii/Documents/Pre-ADF/Pre-ADFVIIIConceptNote_AfricanMineralsSkillsInitiative.pdf.

[119] African Development Bank, African Natural Resources Centre (ANRC): Draft Strategy for 2015 – 2020, Draft version for online consultation, May 2015, online: http://www.afdb.org/fileadmin/uploads/afdb/Documents/Policy-Documents/Draft_African_Natural_Resources_Center_Strategy_for_2015_%E2%80%93_2020.pdf.

[120] *Ibid* at 3.

Lastly, a regional strategy does not necessarily mean an abandonment of any consideration of national or even community content. Rather, these could all be part of an integrated approach to local content. A regional approach enables neighboring countries facing similar challenges to pull their institutional resources together to enhance the local capacity of each country. In matters of employment, for instance, a country would still give priority to its nationals (or first priority to the communities where the resource development takes place, if a country adopts the community content) and then draw from the labour force of the participating countries to fill any remaining skills gap. The main emphasis of a regional strategy should therefore be on training and education.

E. Avoiding Elite Capture and Corruption Vulnerability

LCPs can be subject to capture. The Global Witness has found that following the passage of the Angolan and Nigerian local content laws, a number of indigenous companies in both countries have either been assigned shares in oil licences or been pre-qualified to bid for shares in such licences, even though the beneficial owners of the companies are a matter of top secret or are identical with some public officials.[121] The organization decries the "opacity" that has characterized the oil licencing process in both countries. It further observes that corruption associated with LCPs is "even more damaging than one-off payments for contracts because it means revenues can be stolen from the state continuously and in a way that is much more difficult for an audit to detect".[122] Corruption also damages a country's business reputation and puts foreign businesses at the risk of violating the extraterritorial antibribery laws of their home countries.[123]

Investigations have shown how Angolan elites and public officials are reaping huge benefits from Angola's LCP, which requires foreign companies to partner with indigenous companies when bidding for oil licences. There is increasing evidence that foreign oil companies are paying huge fees to Angolan public officials and economic elites to form "'front' companies" that frequently lack the technical and financial capacity to carry out oil operations.[124] Top members of the Angolan government control the ownership and shareholding structure of the Angolan partner companies.[125] Similarly, it has been argued that while lack of "linkage formation" and "low institutional capacity and governance" are significant problems hindering the potential of LCPs to generate real economic development in Africa, underlying these problems is elite capture:

> The real problem is that ruling elites have little incentive to support linkage development for domestic economic entrepreneurs if they are without much political

[121] Global Witness, "Rigged? The Scramble for Africa's Oil, Gas and Minerals: A Report by Global Witness", January 2012, p. 8, online: https://www.globalwitness.org/sites/default/files/library/RIGGED%20The%20Scramble%20for%20Africa%27s%20oil,%20gas%20and%20minerals%20.pdf.

[122] Global Witness, "Blueprint for Prosperity: How South Sudan's New Laws Hold the Key to a Transparent and Accountable Oil Sector", November 2012, p. 17, online: http://www.globalwitness.org/sites/default/files/library/Blueprint%20for%20Prosperity_LR_1.pdf.

[123] *Ibid*.

[124] Maria Lya Ramos, "Angola's Oil Industry Operations", Open Society Initiative for Southern Africa, 2012, p. 7, online: http://www.osisa.org/sites/default/files/angola_oil_english_final_less_photos.pdf.

[125] *Ibid*.

importance for the survival of the ruling elites. Instead, ruling elites protect and engage with domestic economic entrepreneurs who have already captured the local content markets, because this is where rents can be extracted from entrepreneurs in support of elite political survival strategies.[126]

If the promotion of linkage development through LCPs actually mattered to the ruling elite, they would ensure that institutional and governance capacity is strengthened and supported.[127]

The above view is confirmed by other studies which cite lack of a clear divide between the public and the private in most resource-rich developing countries as a major reason for elite capture of LCPs.[128] Many public officials have close ties with the economic elite and in several cases are the chief beneficiaries of LCPs. In their study of industrial policy (the progenitor of today's LCPs) in Nigeria, Ikpeze, Soludo and Elekwe identify "politicization of ethnicity", "distributive politics" and "special interests" as impediments to the realization of industrial policy in Nigeria.[129] The authors describe how these factors have combined to create opportunities for persons whose overriding goal is to acquire their (ethnic or personal) share of the "national cake instead of helping to bake it" to rise to positions of authority.[130] As a result, even well-conceptualized and well-designed policies fail at the implementation level because those responsible for their implementation are often indistinguishable from the economic actors.[131] These views find ample support in the theory of "regional favoritism" – a form of distributive politics and rents-seeking characterized by political leaders adopting mainly policies that favour their preferred regions – believed to be pervasive in Africa although common in other continents as well.[132]

East Africa therefore must guard against the risk of corruption undermining their ability to maximize the benefits of LCPs. To address the capture-corruption problem in LCPs, it would be necessary to impose public disclosure requirements on companies bidding for oil and gas contracts regarding their ownership and shareholding structure. Other mechanisms that can promote transparency include the streamlining of the oil bidding process to remove complex and unnecessary bottlenecks that make compliance with the requirements cumbersome and that promote opacity, and government publication of names of companies bidding for licences as well as their beneficial owners and shareholding structure.[133] In addition, there is need for caution in granting small local companies oil and gas exploration

126 Michael W Hansen et al, "The Political Economy of Local Content in African Extractives: lessons from Three African Countries", Paper presented at 46 Årsmøde i Dansk Selskab for Statskundskab, okt, 23 – 24, 2014, Vejle, Denmark, p. 3, online: http://openarchive.cbs.dk/bitstream/handle/10398/9014/Wendelboe%20Hansen.pdf?sequence=1.

127 *Ibid* at 4.

128 Maíra Martini, "Local Content Policies and Corruption in the Oil and Gas Industry" U4 Anti-Corruption Resource Centre, September 2014, p. 6, online: http://www.u4.no/publications/local-content-policies-and-corruption-in-the-oil-and-gas-industry/.

129 NI Ikpeze, CC Soludo & NN Elekwa, "Nigeria: The Political Economy of the Policy Process, Policy Choice and Implementation" in Chukwuma Soludo, O Ogbu, & H Chang, eds, *The Politics of Trade and Industrial Policy in Africa: Forced Consensus?* (Trenton, Africa World Press, 2004) 342–343.

130 *Ibid* at 342.

131 *Ibid* at 347.

132 See, e.g., Roland Hodler & Paul A Raschky, "Regional Favoritism" (2014) 129:2 The Quarterly Journal of Economics 996.

133 Chilenye Nwapi, "Corruption Vulnerabilities in Local Content Policies in the Extractive Sector: An Examination of the *Nigerian Oil and Gas Industry Content Development Act, 2010*" (2015) 46 Resources Policy 95.

rights, as such companies are unlikely to have the technical and financial capacity to carry out large-scale operations. Allowing such companies, after they have been granted exploration rights or other licences, to sell their interests to foreign companies with the competence to carry out the operations may defeat the goal of LCPs.

CONCLUSION

Increasing oil and gas finds in East Africa offer significant opportunities to East African countries to fast track economic development and ensure that public welfare improvements are delivered to their citizens. One approach to doing so that is increasingly being adopted by developing countries is the LCP. LCPs enable a country to capture the benefits of foreign direct investment by imposing conditions on foreign investors to ensure value addition in the country. The challenge for East Africa, however, is how to design the policy to reflect their unique economic development needs and local conditions. This paper has considered LCP options and perspectives that East African countries may consider. Two key options identified and discussed in this paper are a localist approach and a regional approach to the LCP. A localist approach may be utilized to address a number of other problems associated with extractive resource development that have historically impeded most African countries from fully realizing the potential benefits of their extractive resources. For instance, it can also be used to improve company-community relations. It can be used to partially compensate the local resource-bearing communities for the negative impacts of oil and gas development. On the other hand, a regional strategy can help East African countries to pull their resources together through, for instance, the establishment of joint technical and vocational training centres for the training of their oil and gas professionals in relevant skills. The paper also discusses and emphasizes the need for the promotion of linkage development through the LCP in East Africa and identifies some of the factors that can promote linkage development. The adoption of stringent local content targets that do not take into account the skills gap in the country may hurt rather than help the realization of the potential of the LCP to fast-track economic development in East Africa. To benefit optimally from the LCP, however, it is important for emerging oil and gas producers to inject transparency measures into the design and implementation of the policy to avoid or reduce the likelihood of elite capture of the benefits of the policy. Although the policy options discussed here are not exhaustive, it is hoped that the paper can serve as a useful policy guide to emerging oil-producing East African countries as they tread their way through the exploitation of their oil and gas resources to bring maximum benefit to their citizens.

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