

Boosting the benefits from extractive industries through local content policies

The adoption of Local Content (LC) policies is one of the best known strategies for diversifying production and maximising the benefits from the extractive sector in countries that are rich in natural resources. Strategies include mechanisms such as job creation and technology transfer.

However, evidence shows that the best results come from those strategies which focus on strengthening the industrial base and on creating the conditions for national industries to provide services. These compare favourably with strategies focused on short-term proposals such as job creation. In addition, the existence of a favorable business environment and well-designed legal frameworks are key elements in boosting local content.

Extractive industries are important in most Latin American economies. Because of this, decision makers have focused efforts both on increasing revenues from the extractive sector and on transferring these benefits to other sectors of the economy. Local content (LC) policies have become a viable strategy for governments to achieve these goals.

Local Content strategies may vary between countries but generally include interventions aimed at:

- Job creation in the areas of influence of the extractive projects
- Capacity building and technology transfer, and the
- Participation of national industries throughout the extractive industry's value chain.

The regional research paper "[Local Content Frameworks in Latin American Oil and Gas Sector: Lessons from Ecuador and Colombia](#)" authored by Grupo FARO, analyses and compares the Local Content policies and practices of six oil and gas producing countries, as well as the development results that these policies have achieved. The research identifies those strategies that have led to the best results, and the underlying conditions that have led to success. The study presents different scenarios and considerations for decision makers interested in including Local Content measures to boost the extractive sectors in their countries.

Methodology

Due to the lack of existing literature on the legal frameworks designed by oil and gas producing countries in Latin America aimed at boosting Local Content, the first phase of the research involved a thorough analysis of the legal framework (policies, laws, regulations, decrees, etc.) regulating the oil and gas sectors in six countries Brazil, Bolivia, Colombia, Ecuador, Mexico and Venezuela.

Once the data on from these legal frameworks was mapped, they were **analysed to estimate the 'specificity'** of Local Content policies (and scored from 0 to 1.5).

Local content refers to the strategies that governments can adopt to enhance the benefits generated by extractive industries both at national and local level. Countries may include local content provisions within their legal frameworks to encourage hiring local workers rather than foreigners, or encourage oil companies to acquire or contract goods and services from national or local companies.

Local Content Strategies

Employment Local or National:

This strategy seeks to increase local or national employment in areas of influence of extractive projects.

Capacity building:

The goal is to increase knowledge and technology transfer from international staff to national staff, thus strengthening human capital.

National Industry Participation:

This seeks to increase the participation of domestic industry throughout the oil and gas value chain.

The scoring was based on (a) whether the articles and provisions for local content were contained in general legal frameworks (e.g. in labour laws, or in public procurement, etc.) or they were sector-specific (e.g. in hydrocarbon laws) (b) whether indicators to measure Local Content were present within the legal frameworks, and (c) whether mechanisms to monitor and implement Local Content were present within legal frameworks.

In order to **determine the effectiveness of these legal frameworks**, Local Content results were assessed for the six countries (and scored from 0 to 1.5), based on:

(a) *The information presented by national and private oil companies:* specific indicators assessed for this category are the percentage of local employees, the investment in capacity building per company employee and the value of contracts awarded to national and local service companies.

(b) *Contracts signed between the companies and the government:* this variable was assessed by examining the extent of Local Content contents in contacts signed with private companies - the extent to which these contracts reflect the national legislation on Local Content, and whether they include Local Content implementation and monitoring mechanisms, to measure and evaluate Local Content.

(c) *Secondary sources of information (reports, press releases, etc.) :* such as press releases and national reports among others, in order to determine(1) whether there is a debate in the country about the importance of Local Content and its implementation 2) whether there is evidence supporting the data reported by public and private oil and gas companies, and (3) whether there are press releases and articles on business practices related to Local Content.

For further information on the methodology, see: <http://ella.practicalaction.org/ella-knowledge/?thema=all&category=knowledge-research>.

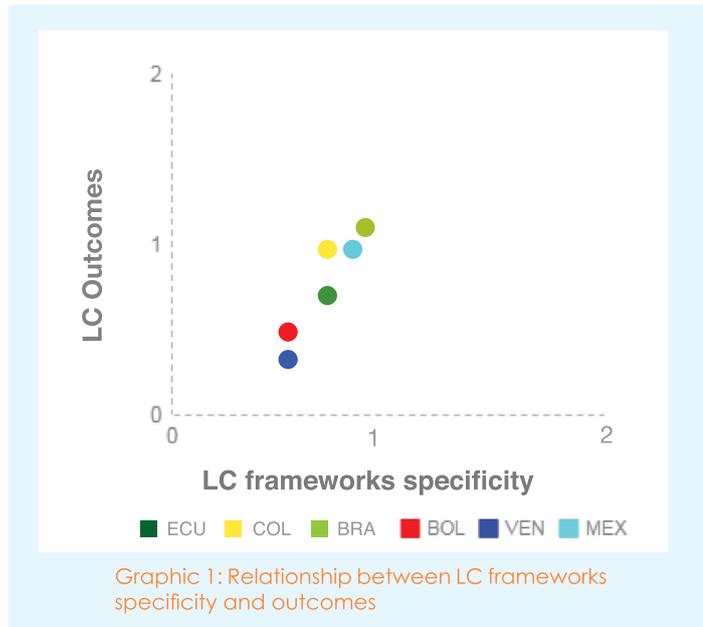
With these estimates, the research analysed the relationship between the specificity of Local Content frameworks and the outcomes from these Local Content policies. To strengthen the evidence and complement the findings, a case study of Ecuador and Colombia was also conducted.

Specific legal frameworks lead to better results

Internationally several resource-rich countries have adopted or are designing Local Content policies. Norway and Brazil are successful examples showing how Local Content measures can strengthen and diversify the productive base of the country. For years, governments and international agencies such as the World Bank have led a series of efforts to document and improve Local Content practices of oil and gas producing countries, but what is the best approach to designing a Local Content policy?

The research evidence shows that countries in the region that have developed more specific Local Content regulatory frameworks are also the countries with better results.

Brazil and Mexico top the list of countries in the region, and their Local Content strategies are backed by specific local content policy frameworks and measurement mechanisms and institutions monitoring compliance with these measures. Bolivia and Venezuela are among the countries with the least specific Local Content frameworks.



Furthermore, these countries have no institutions to monitor their implementation, and the Local Content outcomes are generally weaker. Ecuador is located in the middle for the Latin America region as a whole: Local Content regulatory frameworks primarily focus on job creation, but monitoring and implementing measures face important challenges.

Graph 1 shows the relationship between the Local Content regulatory frameworks and the results achieved by the six countries.

“Countries that have developed more specific regulatory frameworks are also countries with better local content outcomes. Brazil and Mexico top of the list of countries in the Latin America region.”

How can Governments promote the adoption of Local Content strategies?

Additionally, research evidence shows that although more specific regulatory frameworks lead to better results, the specific focus of these frameworks is also important. The review of the Latin-American experience shows that there are two trends to the way countries design their policies:

Local content focused on job creation

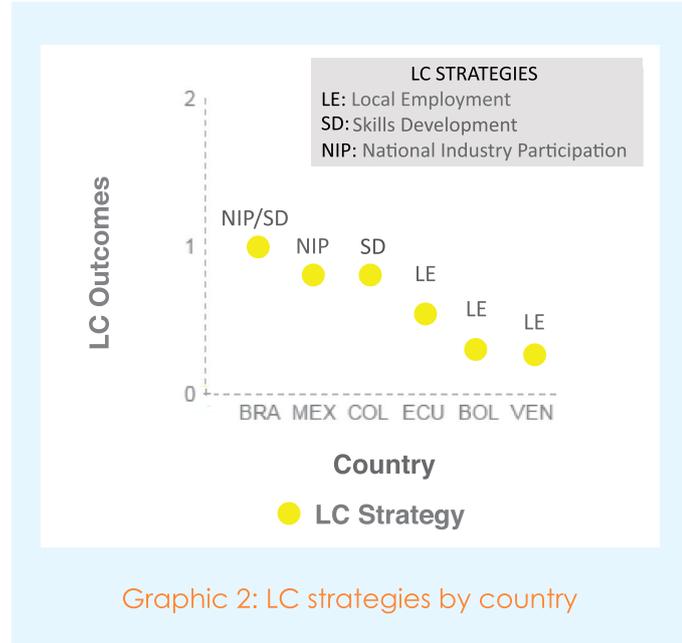
Among oil and gas producing countries in Latin America one trend is to focus on creating local jobs and setting up quotas or preferential measures to hire national or local employees. Although this Local Content strategy has a visible direct benefit in the short-term, it can also make a country or region more dependent on the extractive sector, and this can also exacerbate local work concentration in unskilled jobs. But the evidence shows that these countries have not been very effective in strengthening and diversifying the country's productive base, compared to those countries which have focused on technology transfer and on strengthening national industry. In Latin America, the countries giving greater priority to job creation include Bolivia, Ecuador and Venezuela.

Local content focused on strengthening domestic industry

A second group of countries, led by Brazil and Mexico, has placed the participation of their national industries in the extractive sectors in the centre of their Local Content strategies. Their strategies include quotas to ensure that oil companies acquire goods or hire services from domestic industries or ensure capacity building training programs for providers.

Although these strategies require a long-term vision and the participation of more actors, they are more likely to generate better Local Content results, as they prioritise national industry development through their countries' hydrocarbon industry, thus strengthening and diversifying the countries' productive basis. Participation leads to stronger local industry with prospects for further development in the future.

Graph 2 shows the dynamics of these two trends (job creation versus strengthening of national industries). In this regard, we see that countries



Graphic 2: LC strategies by country

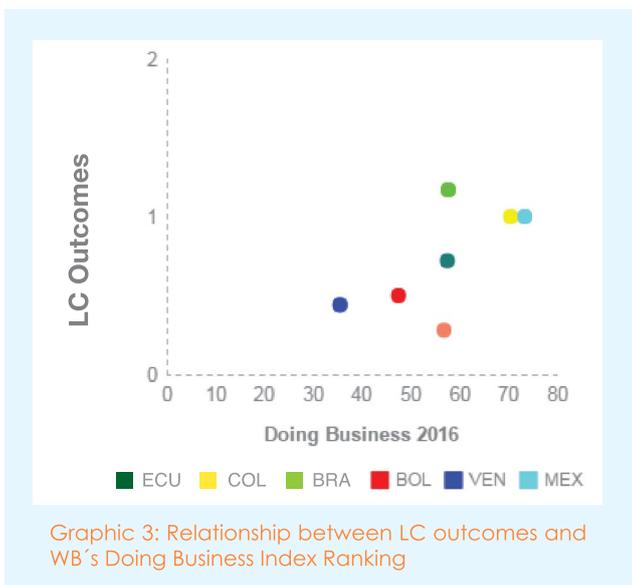
with better Local Content outcomes are Brazil and Mexico, whose strategies focus on the participation of domestic industry (PIN).

A favorable business environment contributes to the implementation of local content

As an additional finding from the research, based on the case study of Colombia, the evidence shows that a favorable business environment will lead to better local content outcomes. Issues like how easy it is for companies to engage in business with government, whether there are incentives for businesses to be competitive, and the nature of the general conditions and rules for investment, establish the environment where companies operate.

Similarly, the country's tax regime is important, influencing the investment incentives for companies, and the ability of local companies to participate and compete in the hydrocarbons value chain.

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Graphic 3: Relationship between LC outcomes and WB's Doing Business Index Ranking

Oil and gas companies must have guarantees of a competitive environment with the necessary incentives to encourage local content. Graph 3 shows the relationship between the Local Content results in countries Included in the study and the [Doing Business World Bank indicator](#),¹ commonly used to measure this concept.

¹ This indicator is performed annually to a sample from 189 countries, and is measured on 100 points.

Public Policy Recommendations

- Local Content strategies have the potential to be more successful if they are backed by sector-specific legal frameworks guaranteeing their measurement, implementation and monitoring. More specific Legal frameworks of Local Content tend to result in better development outcomes.
- In addition to employment generation and capacity building, when designing and adopting a local content policy, it is advisable to focus on long-term goals that prioritise productive diversification and the strengthening of domestic industry.

Bibliography:

Morales, M .; Herrera, JJ.; Jarrin, S. **Local Content Frameworks in Latin American and African Oil and Gas Sector: Lessons from Ecuador and Colombia.** Practical Action, Lima, Peru (2016).

- Capacity building programs aimed at the extractive sector providers are likely to generate positive returns and enhance competitiveness and productivity of domestic industries.
- A Local Content strategy must be accompanied by a friendly business environment. Local content strategies are most successful when they are accompanied by favorable industry conditions and a collaborative relationship between the government and the corporate sector.

Programa ELLA



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