POLICY OPTIONS FOR STRENGTHENING LOCAL CONTENT IN MOZAMBIQUE

DRAFT REPORT FOR REVIEW

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ACRONYMS

BC Business concession

BEE Black economic empowerment

BBEE Broad-based black economic empowerment

BP British Petroleum

CSSDP Copperbelt SME supplier development program

CTA Confederacao das Associacoes Economicas de Mocambique

EITI Extractive industry transparency initiative

FDI Foreign direct investment

LC Local content

LSP Large-scale project

LP Local procurement

Mtpa Metric ton per annum

NCDMB Nigerian Content Development and Monitoring Board

PPP Public private partnership

PRAP Poverty Reduction Action Plan

SADC Southern Africa Development Community

SME Small and medium-sized enterprise

TRIMS Trade-related investment measures

USAID United States Agency for International Development

EXECUTIVE SUMMARY

Mozambique finds itself at a unique junction in economic development. New gas deposits found offshore have the potential to bring significant increases to public revenues through natural gas extraction and exports. This just adds to the ongoing heavy investments oriented at extracting and exporting Mozambique's coal and other precious metals. What this surfaces is how the Government of Mozambique will work with the private extractive companies to ensure that the benefits all this investment flows to the local private sector and helps improve the overall business environment in Mozambique. The best case scenario would result in a growth of competitive SMEs providing services to the extractive industry as well as other related service sectors in the economy such as hospitality and logistics.

Local content, narrowly defined as the percentage of a product whose added value originates domestically (within the country) or more apt in the case of Mozambique as the purchasing of goods or services from a local supplier, remains to be clearly defined and its policy shaped in Mozambique. Instead, one finds divergent spurs of policy and law that treat local content throughout different government ministries. Nor is their consensus on the role of the government in supporting local content, the role and responsibility of the private sector and the operational platform from which these two will cooperate to achieve success.

Mozambique has three main options moving forward on how to treat local content. First, the Government can choose to do nothing and by default permit various ministries to potentially pursue their own local content approach. Secondly, the Government can decide to enact a local content specific law that would specify particular local content targets by industry or sub-sector. Thirdly, the Government can use this opportunity to begin by composing a local content policy framework that would define the parameters of local content in Mozambique; shapes the governments approach to supporting local content while maintaining focus on improving the overall business enabling environment; how the government will work with the private sector and roles and responsibilities across key actors in the local economy. Each options carries with it advantages and disadvantages that will directly impact market development.

This assessment provides an overview of the potential impact of the new gas and mining revenues examines the existing legal and policy framework currently treating local content in Mozambique. It then reviews examples of other local content experiences in the region with South Africa, Angola, Ghana, and Nigeria and outside the region with Norway and Trinidad and Tobago. The assessment highlights the strengths and weaknesses of these experiences and the lessons learned that Mozambique can use in selecting a way forward. Finally, the assessment makes recommendations on a way forward to Mozambique regarding local content while stressing that any action must underscore a continued focus on improving the business enabling environment.

INTRODUCTION

Mozambique has been increasingly relying on large amounts of foreign direct investment to exploit its natural resources in oil, gas and mining. Over the last few years from 2008 onwards, the state has benefitted from greater revenues as the extractive industry has broadened from just hydrocarbon to now include significant investments in petroleum, gas and precious metals extraction. Between 2008 and 2010, government revenues increased from around US3.8mn to US55.5mn, over a 93 percent rise[1] and clear indication that the benefits from these investments are starting to reach the government. These sums, however, are mere fractions of the revenues the country is expected to receive over the next several decades as more mega extractive industry projects move from the exploration to production stage. As of December 2012, there are 44 extractive companies officially registered with Mozambique's Extractive Industry Transparency Initiative National Secretariat with more known to be operational but not yet contributing official data; there have been over 100 exploration licenses in the last three years.[2]

The government has already undertaken meaningful reforms to improve the governance of this sector without thwarting additional investment through over-regulation. In 2008, the Ministry of Mineral Resources initiated the process of reaching EITI compliance. By 2012, EITI officially recognized Mozambique with this designation. Similarly, the Government has increased its focus in recent legislation on strengthening local business linkages with the private sector extractive industry. Its 2011 PPP legislation and the 2012 accompanying Regulations both make explicit mention of requirements for private companies to help develop Mozambique's local enterprises and markets.[3]

Table 1: MOZAMBIQUE MINING STATISTICS, 2008-2011

	2008	2009	2010	2011
NO. EITI Registered enterprises (mining, oil and gas)	6	31	44	--
Mining Revenue Reported (US$mn)	8.5	39.6	58.5	--
GDP (US$ bn)	9.9	9.7	9.3	12.6
FDI (US$ bn)	559	896	1000	2100
Exports of goods and services (% GDP)	32	25	26	29
Imports of goods and services (% GDP)	46	43	45	46

Source: WDI 2012, EITI

[1] EITI Report, 2012.

[2] National Petroleum Institute of Mozambique, 2013.

[3] Regulation of the Law about Public-Private Partnerships (PPP, Large-Scale Projects (LSP) and Business Concessions (BC) 2012 and Law on PPP, LSP, and BC 2011.

The Government is also in the process of revising its Mining, Petroleum and tax laws for both sectors to establish a more equitable profit-sharing fiscal structure with international extractive companies, strengthen the governance arrangements supporting these sectors, and clarify the public sector and private sector's role in exploiting and managing these resources. It is within this atmosphere of developing improved fiscal and governance frameworks for the booming extractive industry in Mozambique that the Government is also exploring options to support local content development. Specifically, the Government of Mozambique is interested in identifying successful ways to use the new sources of economic growth around the extractive industries to invest in and build up local SMEs and create jobs in the economy.

"Local content (LC)" narrowly defined refers to the percentage of a product whose added value originates domestically (within the country). A more common definition of LC, sometimes referred to as Local Procurement (LP), is the purchasing of goods or services from a local supplier.[4] While there is no clear and unified definition of LC in Mozambique, current dialogue focusing on local content liens in the direction of defining LC as the purchasing of goods or services from local suppliers.

LC initiatives are not entirely new to Mozambique neither to economies with a heavy economic reliance on natural resource extraction. Around the world, resource-rich countries have found creative ways to leverage the private extractive companies capital and expertise to build up local industry and labor markets. The results have been mixed and have varied according to the regulatory enabling environment, government vision, private sector participation and the ability to identify the most promising opportunities on which to focus.

In the recent past, the Government of Mozambique has cooperated in the recent past with private companies like Mozal and with the IFC to pilot and scale-up business linkage programs that touch on the fundamentals of the local business development objectives called for by local content initiatives. There are also ongoing programs in the making with Vale, Rio Tinto, Anadarko, and ENI.[5]

Currently, most local content requirements now are embedded in individual contracts for mining, oil and gas exploration, extraction and production. Each tends to touch on similar aspects of local content such as rates of local labor employment and some local supply chain strengthening activities. Yet the scopes for each vary greatly.

In an attempt to improve the governance of the sector, leverage the projected increase in foreign direct investment set to occur in the extractive industry in Mozambique, and to facilitate greater inclusive economic growth in the local markets supplying goods and services to these private companies, the Government of Mozambique is now exploring policy options to explicitly stimulate Local Content development. These options range from LC specific legislation and regulation to no immediate action at all.

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[4] IFC, A Guide to getting started in local procurement, 2011.

[5] USAID, Mozambique Business Linkages Review: An Overview of Key Experiences, Issues and Lessons. USAID SPEED. October 2012.

What is certain is that any option for LC, including no action at all, will have serious consequences on the political economy of the country and development of the extractive industry moving forward.   For example, LC specific laws and regulations could be successful in satisfying local political expectations but have unintentional economic distortionary effects. Too much regulation and protection of local goods and services can drive prices up and create an uncompetitive business environment for investment. Government's must also be careful not to extend long-term subsidies to local business and industries that create unreasonable expectations and become impossible to dismantle or eliminate when the local market reaches a competitive level.

There is a substantial amount of international experience with local content laws, policies and regulations. Overall, the experience is inconclusive in the long-term effects of using LC initiatives in building and expanding local product supply and associated jobs. These experiences will help inform the development of policy recommendations to the Government of Mozambique on the advantages, disadvantages and design of local content policy options in Mozambique taking into considerations the specific political-economy and market forces already in play.

OBJECTIVE OF ASSESSMENT

This assessment is intended to help the Government of Mozambique make the best-informed decision for shaping local content policy moving forward. This will build off an understanding of the international experience with local content laws, policies and regulations as well as close consultation with the private sector and government in Mozambique. This analysis responds to The Confederacao das Associacoes Economicas de Mocambique (CTA), an influential private sector association that facilitates dialogue between the Government and the private sector, request for USAID SPEED assistance to conduct this review. It relies heavily on input from stakeholders from the Government of Mozambique including key ministries as well as representatives from the private sector including the large multinational extractive companies and local MSMEs and business associations. The review will be used as the platform for stakeholder discussions to build consensus and agree upon an action plan for local content moving forward. Thereafter, it is intended to be delivered to the Government and inform their policy process moving forward.

METHODOLOGY

The results of this assignment will benefit from a methodology that relies of research, stakeholder consultation and close interaction with key public and private agencies such as CTA. The work has been divided into three main phases:

- Phase I: desk review of international experience with local content regulations including Norway, Brazil, Angola, South Africa, Ghana, Nigeria, Sierra Leone, and Trinidad and Tobago. The product of this desktop review was an inception report and guiding documents (such as a table comparing various country's local content initiatives) that were used to shape the discussions with key stakeholders. Phase I work was carried out in mid-July 2013.
- Phase II: in-country consultations with key private sector companies and public sector agencies with an important role in the setting of local content policy and the implementation of its requirements. This work was carried out over a two-week period

between July 22- August 2, 2013. Consultations where conducted in the capital city of Maputo as well in the field in Tete. Three final presentations on initial findings and recommendations from these consultations.[6] These included a stakeholder meeting with the Private Sector Working Group that represents the development and donor community in Mozambique; USAID Mission director and staff; and CTA. These stakeholder presentations resulted in a presentation outlining the initial findings and recommendations.[7] Phase II work produced a draft Assessment that will be shared with key counterparts in Mozambique for comments.

- Phase III will involve focused workshops to discuss the draft Assessment. These will take place in Maputo, Tete and Pemba in September 2013 (to be confirmed) and include both public and private sectors. The feedback from these workshops will be incorporated and used to adjust and produce the Final Assessment.

NATURAL RESOURCES AS A NEW SOURCE FOR LOCAL ECONOMIC GROWTH IN MOZAMBIQUE

Mozambique is on course to experience a transformational change over the next decade due to its new boom in natural resource extraction, specifically in coal and gas. What began as exploration contracts five years ago has turned recently into impressive discoveries of natural gas off the northeast coast and larger reserves of coal and other heavy metals around Tete and other regions in the country. Seen through the lens of economic growth for the country these discoveries have equally transformed the discussion in of Mozambique's economic development moving forward.

Priority is now placed on figuring out the best way to manage the new sources of revenues for the state, how to best invest this money into the core pillars of the economy such as infrastructure, health and education, and how to ensure that the tremendous investment tied to the extractive sector helps stimulate local market growth, SME development and jobs for locals. While only a handful of companies have moved from the exploration to the production phase there are 112 licenses granted to 45 national and foreign companies over last two years of which it is reasonable to expect that additional reserves will be discovered.[8]

To get a better sense of the overall size of this new investment market and associated potential for local suppliers and the workforce a look at the estimates of the two main commodities- coal and natural gas- provides a general

Coal estimates

Mozambique's coal estimates are sizeable and have the potential of providing 20 percent of world's sea-borne coking coal by 2025. Production began only recently in 2011 with Vale's Moatize mine near Tete. Rio Tinto and Beacon Hill, two other large international investors, began their production only in 2012. Table 2 below shows the projected estimates of coal production

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[6] A full list of stakeholders consulted for the draft report can be found in Annex 1.

[7] See USAID SPEED website for presentations in English and Portuguese.

[8] Ministry of Minerals, 2013.

through 2035 pointing to a sizeable increase in production around 2015. By 2020 composite estimates are around 50 million tons per year. [9]

Table 2: MOZAMBIQUE'S ESTIMATED COAL PRODUCTION, 2011-2035

Mine/prospect		Estimated production kt*							
		2011	2012	2013	2015	2020	2025	2030	2035
Moatize	Vale	1,000	6,000	11,000	11,000	11,000	11,000	11,000	6,000
Zambeze	Rio Tinto 100%			2,000	8,000	15,000	15,000	15,000	15,000
Benga	Rio Tinto 65%; Tata Steel 35%	300	3,000	5,500	10,000	10,000	10,000	10,000	10,000
Ncondezi	Ncondezi S.A.				2,500	10,000	10,000	10,000	10,000
Minas Moatize	Beacon Hill S.A. 100%	96	1,000	2,000	2,000	2,000	2,000	2,000	2,000
Total		1,396	10,000	20,500	33,500	48,000	48,000	48,000	43,000

Source: Ministry of Minerals, 2013.

The delay in reaching larger production capacities is largely due to infrastructure bottlenecks. In Tete there is currently only one transport option to move the commodity to port- the Sena (Tete to Beira) rail line. In 2012, this was only able to accommodate around 3 million tons. While the Beira line being upgraded to accommodate 6.5mtp and reaching 20 by 2017, progress has been slow.

A second option to move the goods on rail to the port of Nacala where there is a deep water port is also under development. Upgrades valued at $4bn are underway to rail line running from Malawi to Nacala to manage up to 18mtpa (metric tons per annum) by 2015 and expand to 30 mtpa if needed.

Natural Gas

Mozambique's natural gas deposits are only a very recent discovery. However, the estimates of gas reserves are promising. Current estimates are between 30-40 trillion cubit feet (tcf). If true, this places Mozambique's gas deposits in the top 15 of total gas reserves in world. Yet, the country has some time before it will be exporting natural gas to the world market. It is unlikely that exports will take place before 2020 as expensive infrastructure must be built (such as liquefied natural gas processing plans or "trains") to process the raw extracts. Currently, Sasol is the only company already selling gas via a 860km pipeline to South Africa (which required

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[9] Hubert 2012. Merrill Lynch Research, Vale SA, 12 October 2011. "Mozambique 2012," African Economic Outlook, p 4. Chris Callaghan, Mozambique Mineral Scan, Trademark Southern Africa, 2011, p. iii.

around a US$1.5bn investment). There are now two trains in the planning and design phase to harness the raw gas for export (with a planned capacity of 10mtpa).

Other *minerals*

Mozambique also has potentially large deposits of other valuable minerals. Current projections estimate that there is around 100 million tons of heavy mineral sands could provide 20 percent of global demand for titanium. Others include tantalum, limestone, gold, uranium, and iron ore. Most of these to date have been found around Nampula where large companies such as Kenmare are already producing ilumenite at 750,000 tons annually and could grow to 1.2 million tons. Other exploratory activity is taking place in Gaza Province.

Understanding how this activity around natural resources extraction and production will affect Mozambique's path of economic development moving forward is important to the discussion of local content in two main ways. First, how the government responds and adjusts its behavior and structures to accommodate the future windfall profits gained from this growing sector will have serious consequences on the overall business environment in the country. In 2011, the extractive sector accounted for around 9 percent of GDP. This has the potential to grow to 15 percent by 2015.[10] The IMF estimates that the government's share of profits from the sector could contribute to about US$3.5bn a year, or18 percent of GDP, by 2025 (GDP in 2011 was 12.6bn).[11] Megaprojects alone could reach 40-50 percent of GDP.[12]

How the government manages these large sums of money and invests it properly back into the economy to improve the overall business environment will have either transformational positive effects or, if managed poorly, lackluster and disappointing results (this is the subject of a separate set of analyses and not the purpose of this assessment).

Secondly, and more directly related to LC, is effect this sector will have on stimulating growth in the local market for new jobs and private sector enterprise development. Forming around the areas of natural resource extraction and export, shown in the figure below, are growth poles that can become drivers for job creation, enterprise formation, innovation and wealth creation.

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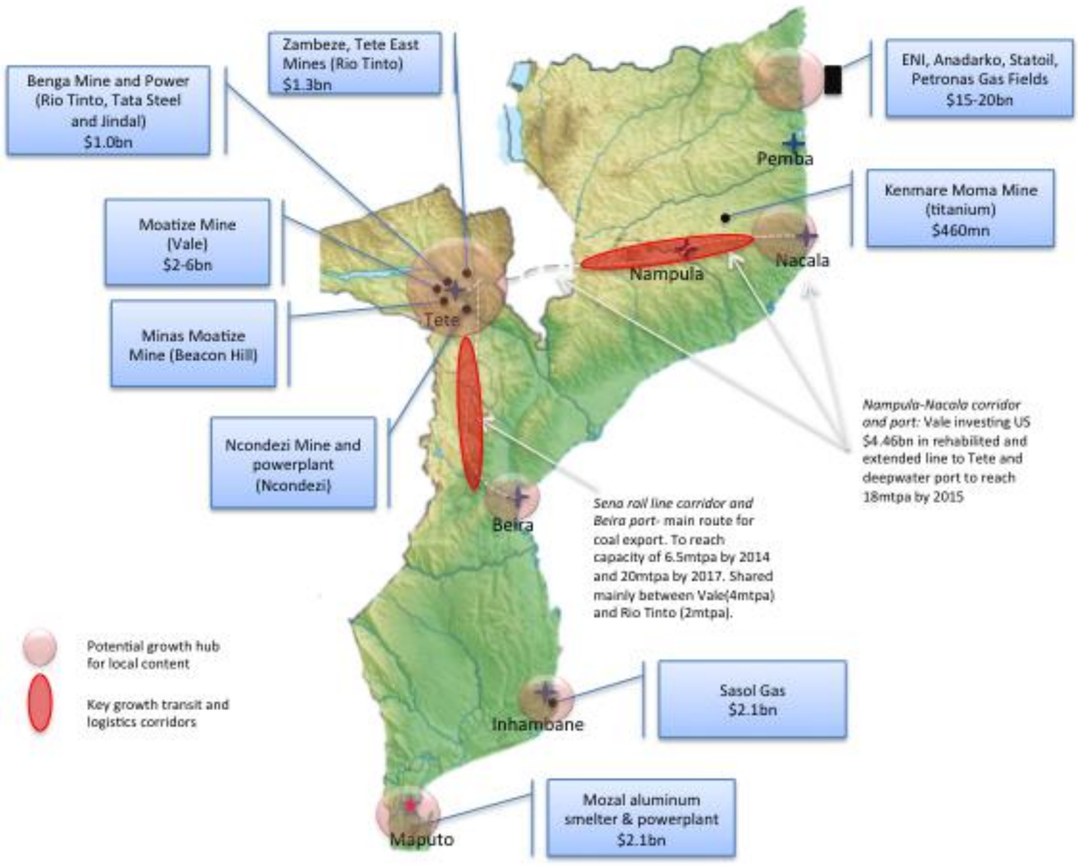
[10] MOF, 2012. Cenário Fiscal de Médio Prazo 2013-2015

[11] Africa Progress Report 2013, P. 45.

[12] 2012 Speed Report. Mozambique Coming Natural Resource Boom. 2012. This figures assumes the value of discoveries to be about US$400bn over 4 decades; exports of $10bn each year; extraction companies take 50 percent share; Mozambique's revenues would be roughly $5bn; gas-related mega projects could then add another 20 percent to IMF projected GDP in year 2020

Figure 1: POTENTIAL GROWTH CENTERS AND CORRIDORS LINKED TO MOZAMBIQUE'S NATURAL RESOURCE EXTRACTION INVESTMENTS



Source: Author

Although mapping these large investments around gas and coal in Mozambique is useful in showing the large amounts of direct investment that will likely flow into the country, it is difficult to conclusively determine what the precise effects for local suppliers and for creating jobs. This, in part, is due to a lack of available information and data on local procurement projections for these companies and also insufficient information on existing local capacity in key supply chains. Having a better idea -of a disaggregated procurement schedule by goods and services from large operators and sub-contractors leading each large investment project will provide a more accurate estimate of the potential new end market for goods and services. Likewise, being able to gauge the scope and size of existing local capacity to provide such services and goods will allow us to determine a realistic estimate of the degree of local participation and where it can be strengthened.

What is known is that natural resource based exploration and production investments do not create large numbers of direct jobs. As a comparison, manufacturing produces nearly 10 times the number of positions than the extractive industry. According to the United Nations Economic Commission for Africa, Africa manufacturing has shown to produce nearly 17.5 times more jobs than mining. The ratio of indirect jobs to direct jobs in the extractive industry favors indirect job creation in a ratio around 3:1.[13]

Experience in Mozambique to date reinforces this trend. Sasol's investment of $1.2bn has resulted in fewer than 700 long-term jobs to date. Similarly, Vale's $1.7bn investment so far has resulted in fewer than 900 long-term jobs.[14] Using these data points, with full coal capacity the mines will only create 7,000 direct jobs and total direct and indirect job growth will be in the tens of thousands (labor market growing by estimated 300,000 annually). Given there is an estimated workforce size is currently about 10.2 million in a country of 23.4 million this would account for only around 0.01 percent of the workforce. Contributions to direct job growth from the gas sector will also likely be quite small and the indirect job growth smaller than for coal.[15] As a point of regional comparison, by 2008 Tanzania's large-sale mining sector had created about 8,000 direct jobs and 45,000 indirect; by 2009, large-scale mining in Ghana employed around 17,000 people directly.[16]

This evidence on the effect of the extractive industry on job creation, especially in these growth centers and corridors, emphasizes the importance of linking any LC policies, laws and regulations directly into supporting the strengthening of the overall business enabling environment and focusing local content development on strengthening local supply chains in sectors that are broad-based and can sell into many end markets, not just the extractive industries. Good examples of these include agribusiness; light manufacturing for common goods such as safety equipment and products; support services like catering and laundry; maintenance and repair; logistics and transport; and hospitality and tourism. Running parallel should be investments in education and technical training to build a trained workforce to takeover high-skilled direct jobs in the medium-term.

DEFINITIONS AND PURPOSE OF LOCAL CONTENT

DEFINITION OF LOCAL CONTENT

LC does not have any one agreed upon definition. This often contributes to the confusion found in discussion around LC. As mentioned previously, LC narrowly defined refers to the percentage of a product whose added value originates domestically (within the country) while a more common definition of LC, sometimes referred to as Local Procurement (LP), is the purchasing of goods or services from a local supplier.

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[13] World Investment Report 2007, p.154. Minerals and Africa's Development: The International Study Group Report on Africa's Mineral Regimes, Economic Commission for Africa, 2011, p. 61. World Investment Report, 2007, p. 134. Mining in Tanzania: What Future Can We Expect, International Council on Minerals and Metals, 2009, p. 5.

[14] Appendix II. The Impact of Megaprojects on growth in Mozambique, IMF Country Report No. 11/350, p. 51. Minerals and Africa's Development: The International Study Group Report on Africa's Mineral Regimes, Economic Commission for Africa, 2011, p. 111.

[15] Appendix II. The Impact of Megaprojects on growth in Mozambique, IMF Country Report No. 11/350, p. 51.

[16] ISG Report p.61

LC in Mozambique encounters similar definitional issues. There is no clear and unified definition of LC in Mozambique. Generally, most dialogue on LC focuses on defining LC as the purchasing of goods or services from local suppliers. What constitutes "local" is still under dispute. This can simply be a designation of a firm that operates in the country or it can link back the criteria used to classify a firm as "Mozambican." In the latter case, there are varying requirements of what constitutes a firm as "Mozambican"; no single definition exists in Mozambique (see discussion on existing policy and legal framework).

LC can also be disaggregated and defined at varying levels by ownership type (such is the case with "local" criteria with South Africa's Broad-based Black Economic Empowerment program) or by geography (such as is done in Nigeria with Local Community Content which refers to Nigeria-owned firms located in the Niger Delta region). Local ownership as a criterion can also assume varying levels. The IFC has developed a tiered approach to local ownership whereby a Level 1 means a supplier owned by foreign capital but located in the country; Level 2 means a supplier partly owned by locals with foreign majority stake; Level 3 is a supplier partly owned by locals with local majority stake; and Level 4 is a supplier wholly owned by locals.[17] A similar tiered approach could be applied geographically whereby different level designations are given to firms on account of their proximity to the main source of operations.

"Local" can also be used to define the size of an enterprise to target micro or small-size enterprises within a particular catchment area or it can refer to a particular set of under-represented enterprises such as women-owned firms or, in the case of South Africa, black-owned firms.

What will be important in Mozambique moving forward will be to adopt an agreed upon definition of "local" which will then help determine how to measure LC. Experience with various definitional approaches speaks to one key theme- while the definition of local and LC is important, it should not be the central tenet of any local content initiatives. Rather, focusing on the results of local content support such as job creation, inclusive economic growth within a particular production area, and wealth creation is more important and should drive decision-making.

OBJECTIVES OF LOCAL CONTENT

In the conversation around LC in Mozambique, it is equally important to clarify and agree upon the long-term objectives of local content activity. Too often not enough attention is given early in the process in communicating clearly the reason to have local content public policies and to set the expectations of what these are meant to accomplish. It can not be overemphasized enough that any local content work must be seen as complimenting and reinforcing larger business enabling environment reforms that are either under way or must be undertaken.

The objective of local content is to use a new source of sector growth (such as the investments around Mozambique's extractive industry) to improve productivity and competition in local markets. This is done by coordinating and leveraging resources to address key market failures

[17] IFC, Local Procurement Guide.

that are preventing local firms from accessing and benefitting from new markets (in this case the consumption of goods and services from the extractive companies).

While there are many constraints and obstacles to doing business in Mozambique, a few market failures in particular stand out when discussing how to help local firms sell into the new end markets created by the extractive industry. Any LC action must build off these market failures in designing its activities.

First, the market structure that is developing in Mozambique as the natural resource extractive sector comes online is creating high barriers to entry. There are few buyers (the large extractive companies) and not enough sellers (local businesses). Making matters worse, the local businesses that do exist are most often not producing the quality or have the capacity to suit the consumption demands from the large international companies. This results in goods and services being imported almost entirely save a few small contracts with local firms. This is made worse by the timing issue. Although full-scale production of coal and gas will not come online for several years, investments in the enabling infrastructure is already underway and ahead of the capacity of the local private sector to respond. The timing of new investments is out of sync with the time it will take for the local private sector, even operating in the best of environments to develop the capacity needed to satisfy the demand.

Secondly, there is an overriding information asymmetry issues in the market place, both between government and the private sector and within the private sector. In the former, the government has not been effective in facilitating the communication and dissemination of market conditioning information such as laws, policies, regulations, industry standards, and procurement notices. In the latter, the large international private sector extractive firms are not sharing procurement plans and projections of goods and services, employment requirements and needs, purchasing standards and grades, and procurement notices. Both have resulted in local firms unable to compete fairly due to not having a full set of information from which to adjust their business behavior.

Third, the market in Mozambique is not as competitive as it needs to be in order to facilitate equal access into new markets for businesses. Mozambique ranks 146 out of 185 on the Doing Business ranking system in 2013.[18] Starting a business, permit processes, access to finance and poor access to infrastructure drive up the cost of doing business and make it difficult for local businesses to compete fairly. A 2007 Enterprise Survey of 479 small, medium and large enterprises found that around 23 percent cited access to finance as the largest constraint to doing business.[19] In close second were practices of the informal sector that undercut firms adhering properly to laws and tax codes. KPMG's Business Confidence Index 2011 Report for Mozambique , an index based on the key economic agents in the country, also pointed to the issue of informal practices and corruption

[18] Doing Business Mozambique, 2013.

[19] Enterprisesurveys.org. Mozambique Country Profile 2007.

as extreme hindrances on the growth of businesses. Both corruption and crime were amongst two of the three highest deterants expressed by survey participants.[20]

MAPPING CURRENT LEGAL FRAMEWORK AND INITIATIVES FOR LOCAL CONTENT IN MOZAMBIQUE

The existing legal framework in Mozambique that relate to LC or LC issues is decentralized to the sector level and does not address LC in a coherent manner. Instead, LC related topics are found in various locations throughout laws and regulations and are not directly identified explicitly.

EXISTING POLICY FRAMEWORK RELEVANT TO LOCAL CONTENT IN MOZAMBIQUE

While there is no overriding legal and policy framework that guides local content requirements and programs in Mozambique there are important existing policy and legal structures already in place that support local content development if not outwardly requiring local sourcing of products and labor.

Policy and Strategy

While LC is not an explicit focal area in the development plans and strategies for Mozambique, broader business enabling environment reform and domestic private sector growth are priorities. These agenda items must not be overlooked as they form the broader development context in which any local content initiatives must be structured and supported.

- PARP, the Poverty Reduction Action Plan (2011-2014) outlines the government's vision for economic development and poverty reduction. The Plan explicitly indicates pursuing a policy that promotes "broad-based" growth; diversifying the economy, creating jobs and linkages between foreign investment and the local economy. .
- Government 5-year Plan, 2010-2014, speaks of crowding-in additional foreign direct investment as a means to stimulate local economic growth. Presumably, the plan is referring to the large sums of FDI associated with the mining, oil and gas investments. The envisioned outcome is greater local enterprise growth and supply chain development in the areas of infrastructure, agribusiness, fisheries, forestry, tourism, mining and export-oriented manufacturing.

Petroleum and Mining

The older regime of petroleum and mining laws, now under the process of revision, do not have any significant local content requirements. However, there are some clauses found in this regime that do relate to local content.

- Petroleum Law 2001- Article 9 Section 2 states that Mozambicans have preferential right in the granting of petroleum blocks. Article 17 section (g) states that companies must

[20] KPMG, Business Confidence Index Mozambique 2011.

"give preference to Mozambican products and services whenever they are competitive in terms of price and comparable in terms of quality and supply."

- Draft Petroleum Law 2013- Article 20 (4) calls for the same preference for Mozambican firms with a 10 percent margin of preference assuming equal quality, time in delivery and quantity availability.
- Draft Oil and Gas Tax Law 2013 provides five year customs and VAT tax exemption on imports of goods related to mining exploration and exploitation only when local goods are not available (article 41 (1-3)).
- Mining Law of 2002 does not make any specific mentions of local content.
- Draft Mining Law 2013 requires a percentage of revenues generated by mining will be placed to local community development as channeled through the State budget (article 51). All companies wishing to provide services to foreign mining companies must associate with a Mozambican firm (article 53 (2)). Preference must be given to local firms when the quality of materials, time of delivery and quantity is available and the price, including taxes, does not exceed additional 10 percent than the imported good (article 53(4)).
- Draft Mining Tax Law provides five year customs and VAT tax exemption on imports of goods related to mining exploration and exploitation only when local goods are not available (article 60 (1-3)). This is meant to act as an incentive to source goods locally first if available.
- Individual mining contracts must include (i) a local employment and staff training strategy; (ii) ore value-adding incentives; and (iii) a pro bono/corporate responsibility plan.

Other related laws

Traces of LC are also found in the recent PPP legislation. Of particular importance are the definitions and the content in the Procurement Law and Law on Investment and how they influence the definition of LC in any future policy.

- PPP, Large-scale Projects (LSP) and Business Concession (BC) Law 2011 and PPP Regulations 2012- Article 34 of the PPP Law states that the PPP investment must benefit the Mozambican economy and create jobs for Mozambicans should offer opportunities for technology transfer to locals, and help build local SMEs. Article 33 makes provisions for PPP, LSP and BC projects to promote the inclusion of Mozambican investors by encouraging between 5-20 percent of investment shares to be offered on the local stock market. Article 34
- Law on Investment, Regulation of the Investment Law and Code of Fiscal Benefits- While these do not apply to the petroleum and mining sector, they are relevant to supporting companies such as construction, hospitality, catering, equipment supply that will likely grow as a result of the extractive sector and should be participating in local content work.

Related to the definition of "local," or "Mozambican," Article 1(r) of the Investment Law defines a Mozambican firm as "any company or institution formed and registered under Mozambican laws, with headquarters in the Republic of Mozambique, and in which the respective share capital belongs to at least 50 percent to Mozambican citizens, companies or institutions, whether public or private."

Article 18 of the Code of Fiscal Benefits permits tax benefits for the cost of investment in professional training of Mozambican employees up to a maximum amount equal to 5 percent of taxable income. Training spent in the utilization of equipment considered to be new technology can equal up to 10 percent of taxable income.

There are additional fiscal benefits afforded to key sectors such as rural commerce and industry (article 24), manufacturing and assembly (article 25), agriculture and fishery (article 27), hostelry and tourism (article 30) and in special development areas (i.e. Zambezi River Valley including all Tete, article 40). While these are not directly related to local content they are fiscal incentives that will help emerging SME's increase their profits and help growth.

- Procurement Regulations 2010 contain nationality criteria to favor local firms. It requires tenders to either restrict participation based on nationality or provide a preferential margin to national bidders or nationally produced goods (Article 26 (2-4)). The margins are 10 percent of the pre-tax contract value for public works and 15 percent of the pre-tax contract value for nationally produced goods. These criteria must be specified at the time of the tender. For the bidder to benefit from the margin of preference they must demonstrate that at least 25 percent of the finished item at factory door contains national inputs. "National" is considered either a person of Mozambican nationality or a company with at least 50 percent of their social capital held by Mozambicans.
- Decree 63/2011-Regulation of employing citizens of foreign nationality in the Petroleum and Mining sectors requires that investors make their best effort to hire Mozambicans where possible throughout their operations and all foreign workers can be hired through the quota system set by the Government.

TRADE-RELATED LEGAL ENABLING ENVIRONMENT RELEVANT TO LOCAL CONTENT POLICY

Existing trade laws, agreements, protocols and bi-lateral agreements are also important influences on local content. They often restrict the protection of certain goods and labor requirements. Given Mozambique is a member of WTO and a signatory to the SADC trade protocol of 2012, it must be careful to craft any local content policies without violating these agreements.

- WTO Agreement on Trade-related Investment Measures (TRIMS) does not allow local content requirements to protect domestic industry. It states that "measures requiring the purchase or use by an enterprise of domestic products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production (violation of General Agreement on Trade and Tariffs Article III (4)." However, developing countries are permitted certain transitional periods and exceptions by virtue of the economic development needs.

- SADC Trade Protocol of 2012 Article 14 ensures equal market access by limiting the right of States' to pass protectionist measures on service suppliers by quantity or value. However these is dependent on the "in line with individual countries' level of development." Article 15 allows for "national treatment" as long as it is set out in their lists of commitments. Article 16 calls for the liberalization within 3 years of six priority service sectors including communication, construction, energy-related, financial, tourism and transport sectors.[21]
- General Agreement on Trade in Services (GATS 1995) makes some provisions for each country to commit to particular goals with market-access commitment and market-access limitation in the service industry. Mozambique has only committed to financial services to allow foreign banks or financial institutions to operate in Mozambique as long as they abide by the rules and regulations governing investment and operations of such institutions.

WEAKNESSES IN EXISTING LEGAL AND POLICY FRAMEWORK

Reviewing the existing legal and policy framework that relates to LC we are able to see that while LC is not an explicit focus in any place it is also not absent. Instead, where LC requirements already exist they are decentralized to the mandate of each sector. Discussions with the government and local business also uncovered important weaknesses affecting the existing LC-related content in the existing laws and policies. These can be summarized into three main categories: (i) conflicting definitions and requirements that create confusion and sometimes legally conflicting guidance; (ii) insufficient dissemination and education on existing laws with key stakeholders, both public and private; and (iii) poor levels of consistent and fair enforcement. This has resulted in confusion in the marketplace as to what rules firms are expected to follow and what the penalties are for non-compliance. Small and medium-sized firms are largely unaware of these existing requirements and instead are frustrated with government for not doing anything to protect and help local suppliers. For example, many discussions with SME firm owners in both Maputo and Tete revealed that few were aware of the 10-15 percent price margin preference already in place for local firm contracting in the Procurement Law. Finally, it also calls into question that ability of the government to enforce any new legislation and regulation that deals directly with LC.

EXPERIENCE WITH LOCAL CONTENT INITIATIVES TO DATE IN MOZAMBIQUE

Complementing this framework, Mozambique has recent relevant experience with some local content and business linkages initiatives that underscore the challenges in Mozambique. Assessments on the success and failures of these local content and business linkages in Mozambique have already been completed, specifically with the MozLink programs.

[21] SADC. Protocol on Trade in Services. 2012

These assessments have uncovered several important weaknesses in the local market and with local enterprises that are thwarting greater success with building local supply chains.[22] These include:

- Varying levels of corporate commitment that, in part, determined the success of the program. Identifying and working collaboratively with good private sector companies with genuine interest in investing in the local economy is a critical factor for success for local content implementation.
- Mixed understanding from local SMEs on what local content outreach and support programs can offer and do to help their business resulted in occasional mismatch between expectations and outcomes. For Mozambique moving forward, it will be important to provide a clear definition and explanation of the purpose, objective, definition and process of local content policy initiatives and to use these to educate participating SMEs so expectations are mitigated and matched correctly to the realities of the program process. The current unclear policy framework and uncoordinated treatment of local content does not facilitate the success of any local content initiatives and associated business linkage activities.
- Understanding the constraints in the local financial markets that must be dismantled to facilitate local enterprise growth requires careful analysis and attention. While business development services are a necessary component to local content support work they must be pursued alongside access to finance strengthening. Mobilizing sources of new capital and investment for many growing local businesses is a fundamental enabler for a successful local content program and policy initiative.
- Local content policy must stress the objective to move local enterprises to be internationally competitive in both price and quality. Successful business growth reached best results when businesses improved their goods and services to a level where their potential market includes locally operational extractive companies but extends beyond borders.
- Competitive and transparent procurements and tendering processes for selecting local business to participate and for all procured services along any value chain must be followed in order to avoid market distortions.

Mozlink's results showed some promise for business linkage programs that fall under the theme of supporting local content development. Data for the three year Mozlink II program (supported by both Mozal and the IFC) shows that the program was able leverage around US$15mn in contract value and US$53 million in additional sales revenues for local SMEs from an investment budget of around US$700,000.[23] A total of 336 formal jobs were created as well. These results are in line with other regional local content business linkage support projects. The table below

[22] USAID, Mozambique Business Linkages Review: An Overview of Key Experiences, Issues and Lessons. USAID SPEED. October 2012.

[23] Ernst and Young, Evaluation of Mozlink II, 2012.

compares Mozlink II with the Ahafo Linkages Program (ALP) in Ghana and the Copperbelt SME Suppliers Development Program (CSSDP).

Table 3: BUSINESS LINKAGE KEY PERFORMANCE RESULTS COMPARED

	Mozlink II	ALP	CSSDP	Simandou Guinea Linkages	Chad Linkages	Azerbaijain Linkages	Nigeria linkages
Program Budget (US$mn)	1.01	--	1.2				
Duration of program support (years)	4	3	4			4	
# of SME's receiving assistance	45	210	35	100	102	41	
Value of contracts signed (US$mn)	15	14	21.5	9.1		249	
Total incremental sales revenue (US$mn)	53	--	18.5				46.9
Formal jobs created	336	--	135	700			171
Total finance facilitated for local SMEs	0	--	1.5			1	10
Cost per job created (US$)	2,976		8,889				

Source: Ernst and Young, Evaluation of Mozlink II, 2012. Ahafo Linkages Program: Lessons Learned, 2009. commdev.org last accessed August 7, 2013.

Similar programs have also been undertaken in Nigeria, Chad, Azerbaijan and Guinea. Program in Nigeria and Azerbaijan included an access to finance component as well. Data availability makes it difficult to draw convincing conclusions on the value-for-money of these local supplier business linkages programs and they long-term sustainability of the contracts won and jobs created. The figures on the amount of contracts signed and sales revenue incurred are significant when compared to a scenario with no intervention. Yet, these amounts are still miniscule when placed in the larger context of the overall expenditures (annually in the 100's of millions) that these large extractive companies oversee.

In Mozambique, other companies such as Vale and Rio Tinto have already spent several billion dollars in infrastructure and services that have impacted the local economy. However, there has been no systematic collection of impact of this on the number of local contracts issues, the value added from local industry and labor nor the number of local jobs created.

LESSONS FROM OTHER LOCAL CONTENT POLICY EXPERIENCES

A brief look at the research and past experiences with local content requirements found in policies, laws, and regulations suggests that the evidence is mixed on the ultimate success of these requirements in rendering local enterprises market competitive in supplying goods and services into the extractive industry-related supply chains. What the literature does agree on is that any local content initiatives must be approached cautiously so as to not further distort the market by creating government failures that then become perpetuated and embedded in public policy.

For example, local content requirements can have the same economic effect as a tariff and this can result in lower prices and hurt business revenues.[24] Local content requirements that require companies to purchase target amounts of goods from local suppliers regardless of whether the local goods and services are competitive in price and quality increase the cost to the purchasing firm. In turn, they may demand lower prices from local suppliers to balance out the increased cost they have incurred. The result of this can be a reduction in business revenues to the local company.

A comparison of other countries' experiences with local content laws, policies and regulations is useful in comparing and contrasting the results of various approaches. There is an unfortunate dearth of reliable data that quantifies the effect that local content policies have had on stimulating local business growth and creating jobs. The comparison also underscores that there is no one model for local content that should be replicated exactly in Mozambique. Instead, understanding the successes and failures and drawing forth the lessons learned will help the Government of Mozambique structure an informed and customized approach that addresses the specific market conditions in the country. Table 4 provides an overview of the key features of each country's legal/policy framework.

Nigeria

Following years of having local content requirements dispersed throughout various legal instruments, in 2010 Nigeria approved its Nigeria Oil and Gas Industry Content Development Act. The Act is intended to stimulate the development of Nigerian firm participation in the oil and gas industry and improve the coordination, monitoring and implementation of Nigerian content support. It creates the Nigerian Content Development and Monitoring Board (the "NCDMB Board) with the responsibility to oversee the implementation of the Act and a Nigerian Content Development Fund funded by the sum of one percent of every contract awarded to an operator, contractor or sub-contractor. The NCDMB includes representatives from the Nigerian National Petroleum Company, the Agency in charge of technical regulation, Ministry of Petroleum Resources, the Petroleum Association of Nigeria, Nigerian Content Consultative Forum, Council of Registered Engineers of Nigeria, and the National Insurance Commission. This Fund is intended to help support Nigerian content development through training, business support services and other programs. It also includes a detailed Schedule that prescribes the amounts and percentages to be awarded for each broad category of good and service to a Nigerian firm. In the Nigerian Act, "Nigerian content" is defined by the value added or created in the Nigerian economy by Nigerians. It does not go into details about firm ownership nor provide a clear definition of what is considered "Nigerian."

[24] Mussa 1984.

The Nigerian Act is also rigorous in the bidding and procurement requirements it asks of all contractors, operators and sub-contractors. It requires a Nigerian Content Procurement Plan, an Employment Plan for a 4-year period, and frequent review and evaluation of both by the Board. The Board also is required to review all bidding document at the pre-qualification stage and the award stage to review them to ensure they meet he Nigerian content requirements and are compliant.

The Nigerian experience provides some important lessons that should be considered in Mozambique. First, the Nigerian approach does a good job at requiring the disclosure of information on local ("Nigerian") procurement and employment for contracts above US$1mn. It also employs the value-added definition for local content rather than focusing on ownership explicitly. Finally, the creation of a specific Fund that targets local business development and training for the industry is a right step forward.

Yet, what is thorough on paper has not correlated into results. There is not consistent and equally enforced implementation of the Act and this has created confusion within the sector. The prescriptions and targets for each good and sector in many cases are not realistic and instead distort the market further by mandating quotas that uncompetitive firms demand they deserve rather than they fairly earned. This has ingrained a certain level of uncompetitive behavior amongst local firms that seek the Act as setting aside certain amounts of contracts for them regardless of their ability to provide quality and competitive goods and services. Likewise, the increased levels of scrutiny from the NCDMB associated with larger contracts has slowed down operations and pushed many operators to pursue contracts that have large amounts of local content into smaller sizes to avoid constant scrutiny. For example, in order to avoid the extra burden of having the NCDMB reviewing all contracts, large oil companies are dividing up local contracts into sizes that fall below the NCDMB threshold for review. This has the effect of limiting local firms from obtaining larger contracts and building business systems that are required to win and manage larger service engagements.

While the value-added approach to defining Nigerian content is included in the law poor data and a difficulty in calculating the value added of a good or service in Nigeria has resulted in a de facto measurement of Nigerian content by firm ownership. This has presented some issues of morale hazard whereby the true ownership of firms seeking contracts is unclear and often times third-party "pass through" businesses are created to get contracts without having real links into the local market or local employment.

Poor data collection and availability makes it difficult to verify the extent to which the Nigerian Act has resulted in new jobs in local markets and increased firm revenues linked to the oil and gas sector. It has likely resulted to a degree in more local contracting and some jobs. However, whether this is attributable to the prescriptive and protectionist measures or rather better information that is required to be disclosed is uncertain.

Ghana

Ghana has a well-established history of gold mining but oil production only came on line as recently as 2010. Ghana acted early to develop a policy framework to encourage local content in the oil and gas industry and to take a long-term vision on how to use this new growth sector to stimulate local private sector development. Ghana began by developing a Local Content and Local Participation in Petroleum Activities Policy Framework in 2010. This Framework defines "local" as "the level of use of Ghanaian local expertise, goods and services, people, businesses and financing in oil and gas activities.

The Policy Framework sets out the obstacles in the sector, the vision, objective and goal of local content and how local content fits into the larger economic development agenda for the country. It requires an Annual Local Content Plan and an Annual Recruitment and Training Program and creates the National Local Content Committee to oversee the implementation of the Policy Framework. Finally, like Nigeria, it creates the Oil and Gas Business Development and Local Content Fund to support the capacity development of local suppliers in the oil and gas industry.

Although still early since its passing a key positive lesson that can be taken away from the Ghanaian experience is that of process. Rather than starting immediately with a law and regulation, Ghana began the process of local content with a Policy Framework that was used to define the broad approach, define goals and vision, and build consensus and support across both public and private sectors. Ghana is said to be developing a new Regulations for local content in the petroleum sector but to date nothing has been approved by Parliament.

Angola

Angola's local content legal framework is spread across over 9 separate pieces of legislation.[25] Of particular distinction in Angola is the heavy requirement of government full or partial ownership of key enterprises in the oil and gas sector (i.e. Sonangol). The legal framework for local content in Angola is not clear and diffused in several separate legislative pieces making it difficult to understand. There is a strict requirement to make sure that at least 70 percent of employees are Angolan workers. This has not, however, resulted in the transfer of skills and training of local Angolan broadly speaking. Nor has Angola's wealth generated from oil exports stimulated private sector growth. Angola ranks an abysmal 172 out of 185 in Doing Business.[26]

Angola's experience with local content is limited in what it offers to Mozambique as an example. No reliable data exists to gauge the success of the activities supported by the Fund for Training and Development of Human Resources nor on the levels of enforcement of existing local content requirements that exist in Angola to date.

South Africa

South Africa's local content experience is very unique given its history with apartheid. South Africa established the Black Economic Empowerment (BEE and later Broad-based Black Economic Empowerment, BBEE) to redress much of the inequality created during apartheid. The

[25] Oil Activities Law (Law 10/04); Oil Taxation Law (Law 13/04); Oil Customs Law (Law 11/04); Law for the Promotion of Business for Local Private Companies (Law 14/03); Mandatory Hiring and Training of Angolan Citizens (Decree 20/82 and Law 17/09); Fund for Training and Development of Human Resources (Decree 14/10); Contracting Services from Local Companies in the Oil Industry (Decree 127/03 and 48/06); Exchange Regime for Petroleum Sector (Law o2/12); and Private Investment Law (Law 20/11).

[26] Doing Business 2013.

program prescribes very specific measures and targets by sector that includes procurement preferences, employment preferences, and management and ownership. Since its inception around 2001, the BEE program has expanded to become the Broad-based Black Economic Empowerment (BBEE) program and is highly decentralized and sector-specific. Recently the Government passed Guidelines on how to calculate local content using a specific mathematical equation. This followed from the Local Procurement Accord in 2011 that was a jointly created public and private commitment to improving local procurement in core sectors of the economy.

Given the complexity of South Africa's BEE/BBEE system, which can be fairly classified as their equivalent to local content, it is difficult to make broad ranging conclusions. A more fair analysis would look at the effect of the BBEE requirements by sector. For example, in 2010 the Government passed an Amendment to the BBEE Charter for the Mining and Minerals Industry.[27] The amendment calls for highly specific targets for local enterprise participation, employment, human resource development and training and community development.

While South Africa's model is quite thorough, it has resulted in some negative consequences. First, the BBEE codes are highly complex and complicated and difficult to understand easily. This has raised the cost of doing business in South Africa significantly and, in some cases, driven business away from investing further. Another criticism of the BBEE codes is that they have not resulted in sustainable private sector development and enterprise growth. In many senses this can be attributed to the approach of mandating firm purchasing behavior rather than finding a more balanced mix of regulation, support to improving the business enabling environment, and incentives to catalyze local procurement without sacrificing quality and cost.

[27] Amendment to Broad-based Black Economic Empowerment Charter for the South African Mining and Minerals Industry, September 2010.

Table 4: COMPARING LOCAL CONTENT LAWS, POLICIES AND REGULATIONS ACROSS COUNTRIES

	Nigeria	Ghana	Angola	South Africa
Legal Framework	Nigeria Oil and Gas Industry Content Development Act, 2010	Local Content and Local Participation in Petroleum Activity Policy Framework, 2010	Spread throughout nine difference pieces of legislation	Broad-based black economic empowerment (BBEE) Charters and Codes (by sector)
Local Content definition	Value added or created in the Nigerian economy by Nigerians; Nigerian ownership defined by 51% of firm equity owned by Nigerian national	Level of use of Ghanaian local expertise, goods and services, people, businesses and financing in oil and gas activities	Value-added of goods and services in country; Angolan ownership defined by 51% of firm equity owned by Angolan national	Multiple criteria including value-added of goods and services, ownership and location
Key Requirements	Nigerian Content Procurement Plan Employment Plan	Local Content Plan Annual Recruitment and Training Program Plan	Angolan partnership for any firm	Disaggregated by sector and between employment, services and goods
Leading Institution	Nigerian Content Development and Monitoring Board	Local Content Committee	Ministry of Petroleum	By sector ministry
Local content targets specified	Highly specific requirements by sector and goods	Sets long-term targets but does not prescribe by sector	At least 70 percent Angolan employees; general listing of key sectors without specific targets	Sets specific strict targets by sector
Distinguishing Features	Stringent and detailed requirements per sector and good; introduces many new procurement approvals and checks; establishes Nigerian Content Development Fund.	Process of dealing with local content began with a policy, rather than law, and useful in defining vision, strategy, goals and approach for implementation.	Unclear local content objective and policy and implementation responsibility	Complex and complicated system of requirements by sector; Social Development Fund

Trinidad and Tobago

Trinidad and Tobago's approach to local content is centered on their Energy Sector Local Content and Local Participation Policy Framework passed in 2004. This Policy Framework defines LC " in terms of ownership, control and financing the citizens of Trinidad and Tobago."[28] The Policy Framework does a thorough job at defining LC, stating how each key institution and the private sector will cooperate to achieve the vision, and how the Government intends to implement its LC activities. The Framework also calls for the establishment of a Local Content Committee to drive the process forward.

The Trinidad and Tobago model for increasing local content has relied heavily on the use of joint ventures to facilitate skill and technology transfer. One successful example of the use of joint ventures to build local capacity is that of the BP's local Trinidad and Tobago subsidiary bpTT. With a local partner, BP decided to build its Cannonball platform in Southern Trinidad with a US$10mn price premium (rather than importing). However, this project was used as a capacity building endeavor to transfer skills and knowledge to BP's local partner firm. Five years later, BP engaged the same local partner to build two more gas platforms at a cost savings of around US$11mn.

Another positive lesson to draw from Trinidad and Tobago's local content activity is the creation of the Local Content Chamber. This independent institution is funded by the large international oil companies and focuses on providing local suppliers training and technical assistance to help them be more competitive as service providers to these large firms.

Norway

Norway is often cited as a case study of how local content policies can successfully leverage a natural resource to build a stronger domestic private sector and capable supply chain. Although the international free trade rules and global competitive landscape (i.e. China, India and Brazil did not command the same market presence they do now as suppliers), there is indeed much to be learned from Norway. Through its state-owned oil company, Statoil, Norway prioritized investing in research and development, partnerships with research institutions, and skill transfer as a strategy to diversify its economy to participate in the oil and gas industry. Norway provided tax incentives for firms that invested in research and development with local academic institutions and also provided incentives during the procurement process whereby bidding firms that brought Norwegian firms onto their bid were awarded more points than those that did not. Norway also took a long-term perspective by using profits from the oil and gas industry to leverage its existing manufacturing base to diversify and innovate for the oil and gas industry and service sectors.

There are many other examples of governments that have either used local content policies and laws to stimulate local economic development broadly or in specific sectors (like Brazil) and others that are in the process of forming their frameworks (Sierra Leone recently passed a Local Content Policy in 2012). Each have their own lessons learned and experiences that are useful for Mozambique. These discussed here, however, along with Mozambique's own experience and the

[28] Energy Sector Local Content and Local Participation Policy Framework 2004, Government of Trinidad and Tobago.

current political-economy environment are sufficient to put forward three main options for local content moving forward.

OPTIONS OF LOCAL CONTENT IN MOZAMBIQUE

Based a mapping of the existing legal framework, the market failures and challenges to economic growth tied to the natural resource sector, and lessons from other countries' experience with local content, Mozambique has three main options from which to address the issue of local content. These options range from no action at all to developing a specific local content law and regulations or starting with a Local Content Policy Framework. Table 5 below summarizes the benefits, costs, lessons learned from other countries, and potential consequences of each for Mozambique. Regardless of what is selected and determined to be the best fit for Mozambique today all must be accompanied by a renewed commitment and prioritization to improve the business enabling environment and maximize the effectiveness of ongoing business reform and SME development programs.

OPTION 1- NO GOVERNMENT ACTION

The Government can decide not to take any specific action on local content and instead allow the existing mechanisms in place guide local content activity. This would mean a greater enforcement of existing clauses that help stimulate local SME development like the 10-15 percent price margin preference already found in the Procurement Law. It also would mean that local content initiatives will move forward in a highly decentralized manner with various Ministries leading their own efforts and individual mining companies structuring their own local content and local procurement programs without any guidance from Government.

The benefits of this approach is that it does not introduce any additional government and bureaucratic procedures and institutions that complicate doing business. Likewise, it does not insert any requirements that impose protectionist requirements on international companies doing business in Mozambique. The great cost that is at risk is that the Government fails to take advantage of the new investments in the extractive industry to leverage local economic development, improve productivity and competition. It also fails to address the political-economy reality that many Mozambicans living in the areas where the extractive activity is occurring are looking towards Government to provide a signal that exploiting national resources will lead to inclusive economic growth. Lessons from other countries also point to the trend that no government intervention usually results in lost opportunity for local economic development as market forces fail to facilitate growth naturally and private companies don't often take it upon themselves to address market failures and build strong local supply chains.

OPTION 2- PASS NEW LOCAL CONTENT LAW AND REGULATIONS OR LOCAL CONTENT-SPECIFIC REGULATIONS TIED TO THE FORTHCOMING AMENDED MINING AND OIL AND GAS LAWS

The Government's second option is to address local content through laws and regulations immediately. This would either have to be done by drafting and passing a new and separate Local Content Act (and accompanying Regulations) or passing new regulations tied to the amended mining and oil and gas laws that will likely be approved in the coming year. This path confers some important benefits. First, laws and regulations carry the full force of the law and are enforceable by courts. This would allow the Government to set targets and requirements for companies and hold them accountable for reaching these targets. Secondly, a well-crafted law will be clear and should be equally applied to all and thus, in theory, be clear and transparent. It would also satisfy an immediate demand from those who want to see immediate government action on large international companies operating in Mozambique.

The costs of this option for Mozambique right now are much greater. A separate Local Content Law and Regulation can improperly prescribe targets and requirements for local content without reliable information available to inform what targets are realistic and proper. As a result, the Law would require local content targets that are unattainable and would thereby cause confusion and unfair expectation setting within the private sector amongst SMEs and large contractors. Introducing another law requires proper and fair enforcement. Should this not be done the law would grant greater discretionary powers to a government entity and be susceptible to abuse. Based on current experience of poor communication, dissemination and enforcement of existing laws that have elements of local content support already in them it is also likely that, without a rapid increase in government capacity, this new law would suffer a similar fate in the short-term. Finally, another serious consequence of passing a local content law and regulation prematurely would be to drive out foreign investment in the country by driving the cost of doing business up significantly through local content requirements. While some local content requirements are appropriate where there is a base of capacity locally to fulfill these, right now in Mozambique the capacity does not exist and therefore specific local content requirements (i.e. percentages by sector) are premature.

OPTION 3- DEVELOP A LOCAL CONTENT POLICY FRAMEWORK

Mozambique's third option is to develop a local content policy framework as a starting point for addressing the issues around local content. A policy framework would provide the opportunity to take a long-term perspective for the role of local content in Mozambique, define local content, set the vision, objectives and targets, and explain how the Government will pursue a coordinated approach in implementing local content.

Given the current unclear and uncoordinated nature of the dialogue around local content in Mozambique at present, the process of developing a policy framework would help the government engage with key stakeholders including the private sector and civil society on shaping the local content approach in the short, medium and long-terms. This would have the benefit of building consensus and a common understanding of local content so that expectations can be aligned with realistic outcomes. A Policy Framework would also send a strong market signal to the private sector, specifically the large international extractive companies, who engage the local private sector and build local content into their operations is central to doing business in Mozambique.

There are also potential costs associated with developing a Policy Framework. First, the policy process can take time, and without good leadership and commitment, it can result in a lengthy and frustrating process that fails to add value to improving the business enabling environment. Secondly, there must still be capacity within the government to implement the contents of the Policy once approved. The capacity weaknesses that could limit the enforcement of a local content law or regulation might also divert the effectiveness of a policy. Third, policies do not carry the same weight as laws or regulations. This could mean that some private extractive firms may not take the policy seriously and not be active participants in developing local content initiatives. As a result, there may be some instances where opportunity is lost to leverage large extractive companies' investments for local content development. Finally, developing a Policy Framework may be the first step in a process for local content work that might require follow up legislation or regulation. This would require a longer time in building the complete legal framework for local content than bypassing policy and moving straight to law and regulation.

Table 5: LOCAL CONTENT POLICY OPTIONS

	Option 1: No government action	Option 2: Local Content new law and regulation *or* regulations tied to forthcoming revised mining and oil and gas laws	Option 3: Develop a Local Content Policy Framework
Benefits	Does not introduce any market-limiting activities into the economy. Avoids creating additional bureaucracy that could disrupt the investment climate if not structured properly and enforced fully.	Clear and enforceable legal instrument that is equally applied to all participants. Strongly responds to citizen expectations.	Send strong and clear market signal to public and private sectors on government priority and roadmap for action. Opportunity to develop comprehensive approach and work out objectives, definitions, strategy, principles, and institutional arrangements before codified into law or regulation. Platform to build consensus between public and private sector and civil society. Does not impede on market openness.
Costs	Fails to address the market failures that are anticipated to worsen without government intervention. Does not result in more efficient allocation of resources and opportunities associated with the growth in the extractive industry. Does not respond to citizen demand and expectations and can lead to social unrest which has a cost to the economy in productivity, revenue, and the investment climate.	Limits free market accessibility by imposing restrictions, quotas and/or regulations. Can drive costs up by prescribing specific quotas, percentages and requirements for local content goods and services which are passed on from consumer to supplier. Negatively affects business enabling environment for large international firms mobilizing large sources of FDI for Mozambique. Requires immediate resource	Does not carry the same legal enforceability as law or regulation.

	Option 1: No government action	Option 2: Local Content new law and regulation *or* regulations tied to forthcoming revised mining and oil and gas laws	Option 3: Develop a Local Content Policy Framework
		allocation to ensure proper enforcement.	
Lessons learned from other countries	A lack of government leadership in encouraging domestic private sector growth linked to the extractive sector resulted in capital flight, limited technical and skill transfer and isolated economic growth in Nigeria prior to recent legislation.	The passage of the Nigeria Local Content Act is said to have resulted in immediate creation of local firms. However, there are no reliable statistics and data that can substantiate these claims. The Nigeria case study does show that there is very inconsistent enforcement and measurement of the strict local content requirements resulting in confusion in the market, frustration amongst participants, and poor adherence in many key sectors from international companies.	Starting with a policy framework has allowed countries to work through key issues related to local content prior to legislating. It has also succeeded in pushing extractive firms to improve their local content initiatives. There is good evidence of this in Ghana and Trinidad and Tobago.
Potential Consequences for Mozambique	Inaction does not respond to widespread public outcry to leverage new FDI associated with the extractive industries to strengthen the local economy and stimulate enterprise growth. Inaction also relies solely on the extractive industry companies being proactive in local market development and using their market presence to strengthen the business	Legislated local content requirements raise local expectations that cannot be met from local SMEs (cost, quality, capacity) and large buyers (time, cost). This creates wider discontent in local communities and the country. Creates uncompetitive market conditions by allocating specified amounts to local firms. Potential conflicts may arise with multi-lateral, regional and bi-lateral trade	While a policy framework is a good step towards addressing Mozambique's local content approach, it will likely require follow-up legislation that carries greater legal force. This may require a longer overall time period between initial decision and the establishment of the final legal framework.

	Option 1: No government action	Option 2: Local Content new law and regulation *or* regulations tied to forthcoming revised mining and oil and gas laws	Option 3: Develop a Local Content Policy Framework
	enabling environment.	agreements. Ideas and requirements are legislated before being thoroughly thought out and understood as to if they are best placed and effective. Difficult to administer equally and enforce. Requires significant capacity support and technical assistance.	

RECOMMENDATIONS

Taking into account the current political economy in Mozambique and the pressure to have action on local content and also considering the overriding agreement on definition, vision, of local content, the Government of Mozambique should consider developing a Local Content Policy Framework. This option would facilitate working through the fundamentals of local content and allow the Government to build a unified and coordinated approach rather than one that is ad hoc and confusing to the private sector. This approach will also enable participation from the private sector and civil society in crafting this Policy and thereby use it as a platform to build a common understanding. Good lessons on a strong consultative process can be learned from South Africa's Local Procurement Accord process as an example.

The following recommendations should be considered in developing this Policy Framework:

1. The Local Content Policy Framework should be used to clarify the definition, vision, objective and strategy for local content in Mozambique. It must be an inclusive process that brings in the private sector and civil society. The Policy Framework should clearly set out the roles and responsibilities of government and the private sector in reaching the goals, the key institutional arrangements that will facilitate success and how local content links into the larger business environment reform process already underway in Mozambique.

2. The Government of Mozambique must clearly determine its objective and strategy for the fiscal management of the revenues it will receive from the extractive sector. These resources should be transparently managed and invested to support the broader economic development agenda by building infrastructure and strengthening human capital through health and education. Having a clear strategy and process for doing so will enable any local content activities to link back into the broader economic development agenda that will be fueled by this new source of capital for the state.

3. Mozambique should focus the design of local content on outcomes rather than requirements. This is particularly important when it comes to agreeing on the definition of local content. For example, too often governments get side-tracked by agreeing on a definition of "local" which often relies on a specific numeration of national ownership in a firm. Experience in places like Nigeria have underscored the difficulties of ensuring that local firm ownership results in inclusive economic growth locally or creates more formal jobs than foreign ownership. Instead, Mozambique's Local Content Policy Framework should emphasize job creation across all levels, from unskilled to highly skilled, and enterprise development. The Policy should then describe how the government and private sector in the extractive industry must collaborate to reach the development objectives.

4. The Government should consider an incentive-based approach for local content development rather than a regulation-heavy approach. A Policy that rewards private companies for investing in local supply chain development, local enterprise strengthening, and local market deepening may results in quicker and more effective success than a Policy based on requirements and penalties. These rewards can be integrated into procurement processes where firms demonstrating greater local content and local supplier linkages receive higher points than those that do not. Other

countries, such as Norway, have granted fiscal incentives such as tax benefits for expenditures on investments in local research and development with local institutions.

5. The Policy must require operators, contractors and sub-contractors to develop and share Local Content Procurement Plans and Local Employment Plans. These plans will be critical pieces to overcome the information gap that currently exists. However, developing these plans is not sufficient. Targets should be realistically set and progress should be monitored and evaluated at least bi-annually. This will create a useful set of information on local employment and contracting linked to the extractive industry to inform future plans. The plans should also be standardized to a large degree so that they are easily disseminated and understood in the local market.

6. The Government of Mozambique must recommit itself to enforcing existing local content clauses already found in the legal framework such as the Procurement Law. The Policy would be a good opportunity to do so in a cohesive manner under a unifying theme. The Resource Governance Index gives Mozambique a failing grade. Across its four components used to formulate the Index- institutional and legal setting, reporting practices, safeguards and quality control, and enabling environment- Mozambique scores poorly- 46 out of 58. While these don't directly address local content issues, they do underscore the weaknesses in the overall governance of the sector and point to the current inability to properly manage the foundational elements of the extractive industry.[29]

7. Any Policy should be tied into sector planning and development strategies. This will help coordinate an approach to industry support and could be useful in synchronizing local content targets with baseline measures already accepted by the Government.

8. Local Content Policy must stress partnership with the private sector through co-funding, co-design and aligning objectives. There are strong reasons for large extractive companies to want reliable local supply chains. They can reduce cost and provide greater security of resources. It will be important to the success of any LC initiative that it target in the short and medium term value chains that pose a strong commercial viability for the extractive industries. This approach will facilitate greater participation and investment from the large companies in the sector.

9. A Local Content Policy should also make provisions for strengthening the financial sector in Mozambique through local commercial banks and the capital market. An underlying enabler to greater growth for enterprises will be the ability to access finance. It is equally important to help strengthen the capital markets and banking system so greater percentages of profits can be retained locally and this money can be then reinvested into the economy.

[29] RGI Report. 2012.

10. The Government should consider collaborating with the large extractive firms the establishment of independent business development centers (with third-party technical assistance) to help SMEs improve their capacity and quality (see Trinidad and Tobago Local Content Chamber) located around key growth centers and corridors (decentralized and in the field). This “third-party” approach may be most effective in allocating responsibility between public and private sectors most efficiently and result in better results in market linkage programs, technical support and advisory services to SME’s, information dissemination and sharing, procurement support to SMEs, and overall business support services. The example of the Economic Development Center (EDC) in Nigeria’s Delta is useful as a model. Although too soon to claim complete success, signs that the EDC is being effective in addressing local content and supporting local supply chains in a market-driven manner are positive.

11. All local content initiatives should be synchronized with ongoing business enabling environment support projects and SME development support initiatives. Examples such as the World Bank’s new Growth Pole project offer great opportunities to leverage existing resources and technical assistance to accelerate the implementation of local content activity and to reach a greater scale of effectiveness.

NEXT STEPS

This Assessment is intended to initiate a conversation within the Government of Mozambique on how to best treat local content in the current economic atmosphere where natural resource exploitation dominates the development agenda. While both politically and socially sensitive, the Government must be cautious in weighing its options in an effort to select the optimal course of action based on the lessons learned from other countries and the economic development needs of Mozambique. As a starting point, developing a Local Content Policy Framework can be a first step towards addressing not only how the growth in the extractive industry can benefit local economic development but also how the Government can use this new opportunity to recommit to a wide-scale improvement of the business enabling environment.

Following an initial review of this Assessment, it will be critical to conduct several workshops to discuss the various policy options set forth for local content. These workshops must have strong representation from government, local government, the private sector (large extractive companies and SMEs), and key civil society organizations. A senior-level Local Content Task Force should be established and provided with strong political support to then lead the design of an action plan for the drafting and implementation of a Local Content Policy Framework. The Task Force must have cross-ministerial and private sector representation as well. The Action Plan should set out a clear strategy and timeline for final delivery.

ANNEX 1- LIST OF STAKEHOLDERS CONSULTED

Government and Public Institutions	
Chadreque, Legal Affairs	Ministério dos Recursos Minerais
Naima Capão, Legal Affairs	Instituto Nacional de Petróleo
Rita Freitas, Director, Gabinete de Apoio ao Sector Privado	Ministério do Comércio e Indústria
António Macamo, Director, Divisão de Linkages	Ministério do Plano / Centro de Promoção de Investimentos
Private Sector and Private Sector Associations	
Munir Sacoor	Meterial Electrico Electrificacao Construcao
Filipe Manjate	Praiasol
Constatino Pedro Marrengule	AIMO - FI
Salvador Gawhane	AIMO - FI
Artur Adamugy	KACS Construções
Luis Lifanissa	AICAJU
Mauro Ferrão	CTA
Romeu Rodrigues	CTA
Eduardo Sengo	CTA
Eduardo Macuacuá	CTA
Hipólito Hamela	CTA
Nuno Uige	CTA
Chivambo Mamadhu	CTA
Dique, Presidente do Conselho Empresarial Provincial de Tete	CTA/Tete
Large Extractive Companies	
Fabrizio Trilli, General Manager	ENI East Africa SPA
Michele Renda, Legal Manager	ENI East Africa SPA
Luca Ferri	ENI East Africa SPA

Nordy Hidayat Bin Salleh	ENI East Africa SPA
Andrew Lloyd	Rio Tinto
Alcido Mausse, Director Government and Social Affairs	Anadarco Moçambique
Sérgio Chitara,	Vale
Cirineu Ferreira, Relações Institucionais	Vale
Development Partners And Other Institutions	
Jaime Comiche	United Nations Industrial Development Organization
Nelson Guilaze	USAID
Mazen Bouri	The World Bank
Henriqueta Hunguana, Directora Geral	ICC
Carrie Davies	ACIS
Knut Laksa	Embassy of Norway
Carlos Mate	Embassy of Norway
Samuel Levy	Sal & Caldeira

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