IGF

INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development

SUMMARY

IGF GUIDANCE FOR GOVERNMENTS LOCAL CONTENT POLICIES

Aaron Cosbey, Somine Dolo, Jeff Geipel, Tim Grice, Nicholas Maennling, Emily Nickerson, Martin Odendaal, Isabelle Ramdoo, Guire Togo and Perrine Toledano

February 2018

INTRODUCTION

An estimated 90 per cent of resource-rich countries employ some sort of local content policy, and many of them are in the process of reviewing or revising mining and investment codes and contracts, with a view to better exploiting mining's powerful potential for inclusive economic development. In countries where there are few other strong sectors, success is critically important.

While there appears to be broad agreement on the need for local content policies, it remains unclear which policies work best, produce results and minimize unintended consequences. There is no simple template for success. Each country has different resource endowments, different skill sets in their local suppliers and labour force, different infrastructure assets and challenges, and different investment environments. As well, the success of such policies depends heavily on the success of other policies and regulations—such as education, science and innovation policies; infrastructure development; finance policies; support for entrepreneurs; and trade and investment policies—responsibility for which is scattered across many ministries.

The history of practice in this area yields more cautionary tales than best practices. But the fact remains that there are success stories. The mixed record of the past should be warning rather than a deterrent: countries need to invest heavily in getting it right. With this understanding, the IGF members requested the present guidance on local content policies.

This guidance defines local content policy broadly, considering five types of policies, aimed at:

- Increasing mining operation procurement of local goods and services (upstream linkages);
- Increasing mining operation hiring of locals (direct linkages);
- Increasing the spillover benefits of mining investment into non-mining sectors (horizontal linkages);
- Increasing the local processing (beneficiation) of the products of mining operations (downstream linkages);
- Increasing the capacity of local actors as mining sector operators, including state-owned enterprises.

WHO IS THIS GUIDANCE INTENDED FOR?

This guidance is aimed at government policy-makers. That said, it should also be useful for others interested in the successful conduct of local content policies: mining firms; inter-governmental organizations, development banks and development agencies with an interest in mining-based development; and non-governmental organizations and researchers focused on mining-related issues.

HOW SHOULD IT BE USED?

As noted above, local content policies are highly context-specific; there are no one-size-fits-all solutions. IGF's guidance on local content policies will help policy-makers ask the right questions to guide them toward workable made-in-country solutions, and will help in the process by highlighting the many lessons of history—positive, negative and mixed—and by pointing to the many helpful resources in this area. This guidance is part of a suite of guidance products produced by IGF and, like the others, can be used as a stand-alone resource, as well as being used as a basis for IGF's country- or regional-level in-depth training programs.

STEP 1: ENSURING A FIT WITH NATIONAL DEVELOPMENT OBJECTIVES

The first step for governments developing local content policies in the mining sector is to create a picture of the role that the sector plays in national development plans. In nascent producing states in particular, it is important for host governments to assess their domestic landscape, to determine where the mining sector fits in relation to national development plans. Local content policies can then serve as part of the overall approach to ensure that mining investment plays its full potential role in achieving the objectives those plans entail.

WHAT SORTS OF OBJECTIVES CAN DIFFERENT LOCAL CONTENT POLICIES SERVE?

Local content policies can serve a number of national development objectives. Different objectives will call for a different mix of policies, and there may even be trade-offs between the different policy outcomes. This dynamic underlines the importance of having policy-makers clear on the national development objectives they expect to achieve through the use of such policies; it will help governments decide which policies to pursue. Being clear on objectives (and communicating them) also helps to ensure that all stakeholders have realistic expectations about the results.

Objectives achieved by successful local content policies include:

- Increase in employment levels (most strongly served by focus on direct linkages)
- Economic development via diversification:
  - More local entrepreneurs supplying goods and services to mines (upstream linkages);
  - More economic activity outside of the mining sector, from transfer of skills or infrastructure into other sectors (horizontal linkages);
  - More economic activity derived from the products of the mining sector (downstream linkages).
- More inclusive economic development: increased well-being for women, minorities, the historically disadvantaged, and for local communities (direct and upstream linkages)
- More government revenues from mining corporate income taxes, royalties, employment income tax (all types of linkages, if successful)

Properly carried out, local content policies can also serve private sector objectives, including reinforcing firms' social licence to operate, relieving shortages of skilled labour, shortening supply chains by cultivating a network of competent reliable local suppliers, and increasing profitability. All of these outcomes are good news for host governments as well—especially for resource-rich governments whose fiscal and political fortunes are strongly linked with the fortunes of their mining sectors.

STEP 2: TAKING STOCK

The second step for governments after clarifying their objectives is to take stock of their current situation. This crucial step helps highlight what opportunities might exist, what targets are reasonable, what gaps need to be addressed, what parallel initiatives might be needed, what leverage governments might have with investors and, ultimately, what types of local content policies might be feasible, given their objectives.

SECTORAL CONTEXT

Governments can demand more of existing and new mining sector investors if they are bargaining from a favourable position, or if existing or potential mining operators are looking at highly profitable prospects. Determining factors include:

- **The existing resource endowment:** A world-class resource, situated with easy access, with many years of potential exploitation, will mean there are higher potential rents to be devoted to local content efforts, as well as more significant potential linkages.
- **Prospects for development**: What are the international market trends for the country's resources, in terms of both demand and supply? The more scarcity and the higher projected future demand, the more profitable the potential operations, and the more governments can expect from the sector.
- **State of current operations:** If local content policies are being imposed on existing operations, what is the expected lifespan and profitability of those operations? This will determine how able and willing they will be to bear the short-term costs of any new policies.

OPPORTUNITIES

Governments need a picture of what goods and services will be needed in future, in the form of spending projections for existing and potential mining operations, broken into specific categories. This allows them to identify and focus on those goods and services where there is a nexus of high demand and good potential for domestic supply.

Governments also need a picture of the various skills and competencies that are required by the mining industry, as well as the timing and quantum of labour force requirements. For most countries, understanding and forecasting labour demand in the mining industry is a gradual process, informed by ongoing dialogue and collaboration with mining industry stakeholders. This allows for a focus on skills upgrading to match those demands from the domestic labour pool.

ASSETS: EXISTING AND POTENTIAL LOCAL CAPACITY

An important part of the stock-taking is assessing the capacity of local firms to supply the goods and services forecast to be purchased in the coming years, at prices and quality standards that make them competitive with international suppliers. Where local suppliers are not competitive, it is important to understand what it would take to get them there; what are the gaps and obstacles? This helps determine in which sectors to focus capacity building efforts.

Similarly, governments need to assess the state of human resources and the educational infrastructure that can underpin skills upgrading. Where are the gaps between the existing capacities and the requirements of the mining sector, and what educational institutions have the potential to help bridge those gaps?

BUSINESS ENVIRONMENT

Taking stock of the business environment helps governments understand what parallel measures they might take to complement the effectiveness of any local content policy efforts. A business-friendly environment serves those efforts in two ways. First, it makes it easier for local entrepreneurs to establish and successfully run businesses supplying mines, processing mining products or building on mining investment to diversify into non-mining activities. Second, it makes it easier for mining operations to run profitably—a basic pre-requisite for leveraging their spending to achieve greater local content.

Taking stock in this area involves meaningful ongoing consultation with the private sector. It asks among other things:

- What current laws, contract provisions, regulations are there related to local content? How effective are they?
- What is the ease of doing business, in terms of for example approval procedures to obtain permits and licences or property registration? What are key obstacles?
- Do local firms have access to finance on reasonable terms?
- Is there macroeconomic stability?
- What is the state of service infrastructure in areas like energy, transport, communications/IT and finance?

INTERNAL CAPACITY

A final element of stock-taking involves assessing government capacity to successfully carry out local content policies.

- Are there any established means for consultation and communication with mining sector actors?
- Is there an inter-ministerial vehicle for coordinating local policy efforts?
- Within the ministry responsible, what capacity is there to take stock, to propound policies and initiatives, to review and monitor, to revise policies?

STEP 3: CRAFTING THE POLICIES

As noted above, there are many types of local content policies. This guidance covers five broad types, each aimed at different, but related, objectives. The first two steps—clarifying objectives and taking stock—should help make it clear which type of policies governments should focus on. What follows will help them to decide what sorts of tools are most suitable within the chosen policy areas.

A few words of context at the outset, however: local content policies are not always the answer. The most fundamental decision policy-makers will face is whether to undertake any sort of local content policies. If current capabilities and skills are very low, if internal capacity for monitoring is thin, if profitability of the resource is questionable, it may be that focusing on other policy areas, such as infrastructure and basic education, is more appropriate in the short term, and local content policies can be planned for the medium term when the prerequisites are more suitable.

It also bears noting that there is something like a logical sequence or hierarchy to the choice of policy instruments. Countries embarking on their first efforts at local content policy will probably want to focus first on measures to boost direct employment in the mining sector. The skills training efforts necessary for this goal are a foundation for other forms of local content policy as well. If supplier capacity is good enough, they may also want to focus on boosting local procurement at the same time, or may want to wait until there is a larger cadre of skilled locals to fuel such efforts.

As noted below, downstream linkages are difficult to get right, and require circumstances that simply don't exist in all countries. These sorts of efforts will, in any case, probably need to wait on success in local skills upgrading and supplier development to be viable. Fostering horizontal linkages is also difficult, and demands such things as a skilled labour force and a core of viable entrepreneurs—typically suppliers to mining sector—to branch out into other pursuits. As such, it will usually be pursued only where there is already some success in local content via direct and upstream linkages.

LOCAL PROCUREMENT

Policies of this type aim to boost the amount of local goods and services purchased by mining operations. Carried out successfully, they can significantly increase mining's contribution to national GDP. Indeed, they typically hold much more potential than taxes and royalties. Local procurement can eventually be a gateway to economic diversification, with suppliers maturing into exporters, and moving horizontally into non-mining sectors.

Defining "local" is key to the implementation of local procurement policies. There are three basic approaches, each with its strengths and weaknesses:

- **Geography:** Local can mean registered, incorporated or carrying out business activities in various geographic delineations—national, regional, state or provincial, or communities close to the mine site. Or it can simply mean located within the country.
- **Value addition:** Local can mean that a substantial amount of value was added in country. Unlike the geographical definition, this means the goods cannot simply be imported and resold by locals. However, measuring local value added is challenging.
- **Ownership:** Local ownership focuses on participation, which can mean some proportion of locals in management, or as owners of equity, or as employees. This requirement can be subject to gaming.

There is a wide variety of policies for encouraging local procurement. On the demand side, they focus on creating demand for local procurement of goods and services. These can range from mandatory specified percentages to voluntary incentives for achieving targets. On the supply side, the focus is on building the capacity of local suppliers to bring them up to global standards on price, quality and reliability. Both types of policies are usually needed; supplier development helps to ensure that demand-side policies do not require more than local firms are able to supply.

LOCAL DIRECT EMPLOYMENT

Policies of this type aim to enhance the amount and quality of local employment by mining operations. Carried out successfully, they can create new local jobs, grow and develop the skills of the national workforce, and support efforts to progress gender equality and social inclusion.

There are two types of local employment policies. Regulatory approaches, which typically result in prescriptive, "stick"-based policies, are generally mandatory and rely on strong compliance mechanisms. These include:

- Mandated local employment percentages, often different for different types of jobs;
- Requirements to conduct training of locals, or support training facilities;
- Required succession, or localization, plans;
- Visa restrictions on foreign workers;
- Mandated employment of indigenous people, women or disadvantaged groups.

Facilitative approaches, which typically result in incentive-based, "carrot" policies, offer support and incentives for the development and employment of local workers. For example:

- Preferences in the awarding of mining contracts;
- Non-binding requirements to hire locals (e.g., "to the extent possible");
- Fiscal incentives for local hiring.

Most resource-rich countries adopt a combination of both regulatory and facilitative approaches, with a gradual transition from regulatory to facilitative strategies as a country builds capacity and global competitiveness.

Governments occupy a unique position in being able to influence both the supply and demand sides of local employment in the mining sector. A government can regulate that a company complies with local content requirements; it can also facilitate education and training measures to prepare the local labour force to fulfill these requirements. In almost all cases both types of measures are imperative—simple regulation without parallel efforts to ensure adequate skills are available is not a recipe for success.

HORIZONTAL LINKAGES: DEVELOPMENT BEYOND THE MINING SECTOR

Policies of this type aim to foster the development of other (or new) economic sectors using the skills, capabilities and infrastructure developed by the extractive industry value chain. Carried out successfully, they can lead to economic diversification away from reliance on the extractive sectors, insulating the economy from cyclical volatility of commodity prices, and steering the economy toward structural transformation and industrialization. They can also set the stage for economic vitality after mine closure.

Horizontal linkages can develop via two distinct channels. Infrastructure-led linkages develop when infrastructure developed for the resource sector (e.g., roads, rail, ports, water treatment, electricity, and Internet) benefits another productive sector. This type of policy seems straightforward, but requirements to build multipurpose infrastructure impose costs on the affected operations, and negotiations and governance are often complex.

Capabilities-led linkages generally develop from upstream linkages, as technology or skills developed in supplying the resource sector are then used elsewhere. There are relatively few examples of government policies explicitly targeting capability-led horizontal linkages, but options in this area include supplier development programs aimed at equipping suppliers to serve a diverse client base, and broader capacity building/education initiatives that equip entrepreneurs to evolve, such as national systems of innovation.

DOWNSTREAM LINKAGES: BENEFICIATION OF MINING PRODUCTS

This type of policy aims for economic diversification but does so within the mining sector by encouraging processing or value addition for the products of mining. Carried out successfully, such policies deliver new jobs, higher-value export streams and diversification of the economy away from commodity dependence. For certain commodities, such as petroleum and steel, downstream linkages are driven by national security concerns.

Policies to encourage downstream linkages include incentives in the form of subsidies (e.g., tax breaks, concessional loans, land grants, infrastructure), conditioned on establishment of processing operations. They also include prescriptive measures such as export duties, quotas and bans of unprocessed minerals, designed to incentivize the local use of inputs. There are also some negotiated agreements on processing, as well as preferences given in the bidding process to vertically integrated firms.

Here as much as anywhere, it is critically importance to take stock, understanding the markets and trends for the processed goods through an exercise that includes a market analyses, a comparative advantage review and cost-benefit analyses of new downstream sector development. The success of downstream policies will depend on whether the country can become competitive in the downstream sector over the medium term. It is therefore important for governments to provide policy cohesion by supporting downstream investment incentives/requirements by committing resources into supporting infrastructure and investing in education and technical institutions to build up capacity and skills of the labour force.

A number of critical prerequisites will determine the success of efforts to create downstream linkages, including: location and good infrastructure; (often) reliable and inexpensive energy access; a competitive labour force, and proximity to high-value raw materials. There are only a handful of successful examples of state-led efforts to create downstream linkages in the mining sector.

BUILDING DOMESTIC CAPACITY: FOSTERING NATIONAL MINING FIRMS

This type of policy aims to foster more mining activity in the hands of nationals, whether private sector actors or state-owned enterprises (SOEs). There is a presumption that national firms will tend to act more consistently in the national interest, including by fostering the sorts of linkages described above. SOEs are often given explicit social development mandates to accompany their economic goals.

The policy options of this type include:

- Free carry obligations: requirements that firms grant free of charge a specified percentage interest in their venture to the host government.
- Joint venture requirements: requirements that any foreign investor in a particular sector must operate as an equity joint venture with some local partner.
- Creation/promotion of SOEs as sole actors: involving a high level of government involvement in the sector; may entail suppression of anti-competition laws, forced mergers of existing SOEs and forced closure of smaller competitors.
- Expropriation of private firms: involving the transfer of ownership and control of an existing private sector operation to the state, or by force of law to some third party.

Each of these policy tools has strengths and weaknesses. Generally, any government involvement in ownership must navigate a delicate balancing act between imposing the kind of sovereign control that seeks domestic benefits, and granting the kind of independence necessary for commercial success. Several of these strategies face potential conflicts with trade and investment law (discussed below).

STEP 4: MONITORING, REVIEW, ENFORCEMENT

Once designed, local content policies must be administered and enforced, and progress must be measured against explicit benchmarks in the form of targets. They therefore must include a built-in independent monitoring and enforcement mechanism, which ensures that various stakeholders (including public institutions) can be made accountable. Such a mechanism needs clear reporting requirements for mining companies, and strong systems for collecting data on the results of the interventions. The mechanism should include a review function, such that failure is not simply met with punishment, but also involves consultation and critical assessment of the policies themselves for potential revision and improvement. It should also be mandated to propose the phasing out of certain support measures when industries become competitive enough to succeed on their own, or if, after a given timeframe, it is clear that the support measures will not have their desired effects.

CROSS-CUTTING CONCERNS

THE CHALLENGE OF TECHNOLOGICAL EVOLUTION

In the coming years, automation will change the face of the mining industry. One of the biggest impacts will be a drop in employment per unit of value, as automation is brought to bear on low- and mid-level skilled jobs. The immediate implications, and the primary reasons for uptake, are that mine sites will be more efficient, will have lower greenhouse gas emissions and will suffer fewer workplace accidents.

But because the mine of the future will have fewer employees, it will also have lower spending on domestic procurement for those items that are linked to employees, such as food and housing. New technology may also mean fewer opportunities for local maintenance and servicing of capital.

Governments need to be aware of this as they plan local content strategies. Less employment ultimately means more difficulty in capturing national-level benefits from procurement spending, from the horizontal linkages that evolve from supplier development, and from direct employment.

THE CHALLENGE OF INTERNATIONAL TRADE AND INVESTMENT LAW

By their nature, local content policies underscore preferential treatments for local suppliers against foreign goods and services providers. Such measures may contravene countries' obligations under trade and investment agreements.

Some of the most prominent of those obligations are found in prohibitions on performance requirements. The World Trade Organization's rules on trade-related investment measures prohibit any advantage conditioned on the use of local content requirements, and many modern investment agreements (e.g., bilateral investment treaties) go further, prohibiting requirements for technology transfer and joint ventures. The WTO also prohibits using local content requirements as a condition for subsidies. A number of other common subsidies, such as targeted (specific) tax preferences, may also be illegal under WTO rules.

While governments must be conscious of their international commitments, there has never been a WTO case brought on local content policies in the extractive sectors. Countries tend to have some leeway to implement illegal measures in this sector without being taken to dispute settlement—leeway that would probably disappear if the measures in question were particularly unreasonable, and negotiations were unlikely to succeed.

IN CLOSING

IGF's guidance on local content policies is a guide to the questions that policy-makers need to ask to help them decide on how best to proceed in this area. While it includes a large number of brief case studies to illustrate the lessons of history, each country's solution will be unique, dictated by its objectives and circumstance. The aim is to help governments, firms and citizens collaborate to ensure that mining provides governments significant, inclusive and sustainable development.

IGF

INTERGOVERNMENTAL FORUM
on Mining, Minerals, Metals and
Sustainable Development

1100-220 Laurier Avenue W.
Ottawa, Ontario, Canada K1P 5Z9
+1 613-778-8767 (x105)

Secretariat@IGFMining.org
www.igfmining.com
@IGFMining

Secretariat hosted by

IISD

Secretariat funded by

Canada