Local Content in the Oil and Gas Industry: Implications for Uganda

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ABSTRACT
It is now generally agreed that Local/National Content in the oil and gas (petroleum) industry is a key driver for value addition in the domestic economy and improvement in welfare of cities where oil has been discovered and produced. The paper is based on various studies by various researchers and oil and gas producers' experiences. It presents recommended practices to promote local content and describes implications for Uganda as the country enters midstream oil and gas activity.

Keywords: Local Content; National Content; Petroleum; Oil; Gas; GDP; HSE

1.0 INTRODUCTION
Local Content, at times referred to as "National Content", connotes the competitive and gainful participation of citizens and the private sector in an economic activity (Paul, 2005). Local Content should lead to value addition, skills and knowledge development and retention, enhancement of the economic multipliers, the prerequisites for economic growth and improvement in the citizens' welfare. Local Content development should be pursued under a framework of sustainable environment management practices. It is promoted through supplies of goods and services, inputs, raw materials, financial services, skills, logistics, security and other requirements of an economic activity, in this case the petroleum industry. Some definitions of Local Content include socio-economic infrastructure development, research and development (R&D), and private sector ownership. However, what is crucial is that there should be industrial value addition to the domestic economy and improvement in citizens' welfare and sustainable environment management practices. The petroleum industry is a high technology and capital intensive activity. Its Local Content is usually developed through anticipation along the supply/value chain. It is therefore important that the non-oil sector which supplies goods and services, provides skills, financial services, technology, logistics, security, raw materials, food, R&D services and other inputs/products to the oil and gas sector is deliberately grown and diversified and to serve the changing needs of the petroleum industry.

2.0 THE CHALLENGE OF LOCAL CONTENT DEVELOPMENT
The oil and gas industry is a volatile business. It is cyclical with volatile prices and volumes. It has a long investment lead time that requires sustained effort, policy, institutional, regulation, cultural/ethical and governance reforms. It is capital intensive and has high variable costs. The oil and gas industry stakeholders include government, oil companies, financial sector, educational sector, oil service companies, local private sector and other development partners. These stakeholders have different and at times conflicting priorities. For example, government wants fair share of revenues, local capability development, job and skill creation, improved infrastructure, a diversified and developed nation to underwrite and deliver a sustainable future. Oil companies want to maximize oil reserves and production growth, competitive profitability, supplier chain cost efficiency, cost effective local content compliance and licenses to operate and enhance shareholder value. The financial sector may be weak, lack depth and adequate width

outreach leading to high cost of services. The education sector could lack the necessary skills and capacity to provide the required manpower while the local private sector may be underdeveloped and weak. Yet all these stakeholders have to operate in a harmony to deliver Local Content. Additionally, globalization and liberalization of trade and investment paradigm and economic integration processes espoused and promoted through global and regional conventions, treaties and agreements in the short run may conflict with the Local Content laws, regulations and practices.

Local Content therefore demands focused consistent pursuit of enabling policy, incentives, and structural reforms in a conducive investment climate with sustainable environment management. Furthermore, local firms must overcome a number of hurdles to competitively participate along the supply/value chain of the oil and gas industry. Their participation will depend on:

- Available skills
- Technological capacity and innovation
- Management system and health, safety and environment (HSE) standards
- Access to and affordability of finance
- Certification with internationally recognized quality assurance organisations for such requirements as HSE, HIV/AIDS, gender, and labour rights.

3.0 LOCAL CONTENT IN THE PETROLEUM INDUSTRY: THE AFRICAN EXPERIENCE

Empirical data available shows that until recently, the major Africa oil producing countries have not appropriately promoted a supported Local Content in the petroleum industry. In countries such as Nigeria and Angola, oil discovery increased imbalance in the economies and dependence on oil revenues for socio-economic development programmes and projects. There have been significant oil revenue leakages through red tape and corruption, poor planning and incompetence. Poor oil resource and environment management characterized most African oil producers (Adelufu, 2010).

When Nigeria and Angola attempted to develop local content, it was legislated and many contracts to supply the oil industry were awarded to shell companies, inflating cost, increasing project cycles and slowing oil sector and non-oil sector growth. Conflict of interest manifested in National Oil Companies (NOCs) responsible for oil production and distribution, policy formulation and implementation, in addition to regulation. In the case of Angola's NOC, Sonangol, conflict of interest in the above mentioned roles was compounded by its ownership of industries, training facilities, investment in roads, agriculture, R&D, hospitals, and hotels, among other subsidiaries. Yet these countries suffered a dearth of requisite skills to manage and support the oil and gas industry. In Angola, it is often said Sonangol is everywhere because of its size, diversity and influence on policy and economic operations (Hanson, 2008). On the other hand, sustainable environment management principles and norms were not rigorously adhered to. In addition to poor governance, unsustainable environment practices are largely responsible for the Niger Delta conflict between Movement for Emancipation of Niger Delta (MEND), oil companies and the Nigerian Government. The operation of oil reserves by few companies in Nigeria and Angola and collusion between state operatives and politicians often fuelled poor practices of waste management, poor technology and significant revenue leakages (The Association for Environmental Health Sciences, 2001). To make matters worse, African oil producing activity started in an environment of macro economic instability with policy regimes that engendered economic repression, corruption, and poor governance and democracy deficits.

The public sector represented by state enterprises and parastatals dominated business to the disadvantage of weak private sectors.

The foregoing structural weaknesses underpinned some of the conflicts and disputes in the oil producing regions and states of Africa. Suffice to note that in the line with the shift from public sector driven to private sector led economic growth paradigm, most African oil producers are, albeit belatedly, engaged in reforms to promote local content

4.0 BEST PRACTICE FOR DEVELOPMENT IN OIL AND GAS LOCAL CONTENT
Experiences from the North Sea, North America, the Caribbean, Sub-Saharan Africa, Asia Pacific, the Middle East, and other oil and gas producing regions, suggest that for Local Content to grow, the following conditions should obtain:

- Create and maintain sound macro economic stability
- Promote competition in the licensing of oil reserve exploration and production.
- Issue long-term contracts with oil explorers and producers
- Long- term national commitment and political will to promote Local Content
- Promote transparency and accountability through participatory approach involving communities, civil society, local government, academic and research institutions, media, private sector and central government.
- An appropriate information system that describes short, medium and long term opportunities, risks and challenges associated with the oil and gas industry.
- Support from communities where oil exploration and production is located.
- Appropriate exploration and production contracts and laws where oil reserves spread across borders.
- Appropriate fiscal and monetary policy incentives and budget support to develop local content as opposed to legislated Local Content.
- Manpower development programmes with incentives for research and development linked to the consumers of the research products.
- Formation and prudent operation of a National Oil Company and oil industry regulator, and formation of an appropriate legal and policy framework from the inception of oil exploration and production.
- Development of adequate socio-economic infrastructure to support oil and gas industry operation
- Create and maintain a private sector led balanced economy with an investment climate favorable to domestic and foreign direct and portfolio investment.
- Financial sector depth to enhance insurance, factoring, affordable short and long term finance, private equity finance, project management, hedging, etc.
- Good governance, democracy, transparency and accountability ethos in the private and public sectors.
- Prudent managed oil/sovereign fund invested in socio-economic infrastructure, manpower training and development, research and development, technology development and diversification of the economy.
- Efficient private sector self and external regulation.
- Local Content development monitoring and evaluation framework.
- Emphasize value addition to the economy and empowerment of citizens' welfare and not bias/favoritism to local service providers versus foreign owned/controlled service providers.
- Prudent, transparent and cost-effective procurement systems and practices.

- Harmonize Local Content development policies and practices with international and regional covenants, agreements, treaties and obligations and resolve contradictions without undermining economic growth and international trade.

5.0 BRIEF REVIEW OF UGANDA'S PRIVATE SECTOR STRUCTURE

According to statistics released by Uganda Bureau of Statistics (UBOS, 2010a) based on the findings of National Household Survey and National Panel Survey, Uganda had a total of 1.8 million formal (14%) and informal (86%) businesses in 2010, 80% of which was home based. 51% of the businesses were less than 6 years old, while 13% had operated for over 20 years. Most of these enterprises were need-based/lifestyle not growth oriented; 94% are sole proprietorships with hawkers accounting for 1%. Many of these businesses (36%) are found in the Central Region which covers Kampala – the Country's capital and commercial city.

Reports from Uganda Investment Authority (UIA, 2008) identify, among others, the under-mentioned constraints to business growth:

- Lack of market based Information
- Lack of supply chain information
- Access to land
- Lack of laboratory and accredited testing facilities
- Lack of Packaging technology
- Poor quality, unreliable and insufficient energy
- High fuel costs
- High landing and handling fees at airport
- Lack of refrigeration facilities at Entebbe Airport
- Low volume at Entebbe few carriers
- Poor, inefficient, inadequate and dilapidated road, water and railway transport infrastructure
- Lack of an oil pipeline for the speedy delivery of oil products
- Inadequate legal and regulatory framework
- Inadequate ICT facilities
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Sectoral contribution of Growth Domestic Product (GDP) is shown in Table 1 below (UBOS, 2010b). As captured in the table, as at end of June, 2010, agriculture, forestry and fishing contributed 23.9%, industry 24.6% and while services accounted for 45.4% of the GDP most of the services are provided by the informal sector. It should be noted that the industrial sector has registered growth over the past five years. This calls for industry situation analysis with a view to removing any possible underlying bottlenecks to sectoral growth.

Private sector self regulation in Uganda is very weak while anti-trust laws, anti-usury laws, bankruptcy laws and other commercial laws are non-existent, obsolete or nascent. External regulation and supervision of the private sector in general and financial markets need fundamental upgrading.

Table 1: GDP by economic activity at current prices, percentage share, fiscal years

	2005/06	2006/07	2007/08	2008/09	2009/10
Total GDP at market prices	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
Agriculture, forestry and fishing	**24.1**	**22.3**	**21.4**	**23.1**	**23.9**
Cash crops	1.9	1.9	2.3	1.7	1.5
Food crops	14.5	12.6	11.2	13.3	14.6
Livestock	1.6	1.5	1.6	1.9	1.7
Forestry	3.4	3.5	3.6	3.6	3.5
Fishing	2.7	2.8	2.7	2.5	2.5
Industry	**22.8**	**25.1**	**25.8**	**24.7**	**24.6**
Mining & quarrying	0.3	0.3	0.3	0.3	0.3
Manufacturing	7.1	7.1	7.3	7.9	7.7
Formal	5.2	5.2	5.4	6.0	5.8
Informal	1.9	1.9	1.9	1.9	1.9
Electricity supply	1.5	2.0	2.0	1.8	1.6
Water supply	2.3	2.5	2.5	2.4	2.4
Construction	11.7	13.2	13.6	12.3	12.6
Services	**47.2**	**47.0**	**46.9**	**46.4**	**45.4**
Wholesale & retail trade; repairs	11.1	11.4	11.3	13.0	12.3
Hotels & restaurants	4.2	4.2	4.2	4.1	4.3
Transport & communications	5.8	6.2	6.8	6.4	6.4
Road, rail & water transport	2.7	2.5	2.8	2.6	2.3
Air transport and support services	0.6	0.7	0.8	0.7	0.6
Posts and telecommunication	2.5	3.0	3.2	3.1	3.5
Financial services	2.6	2.7	3.2	3.2	3.1
Real estate activities	7.1	6.8	6.7	6.2	6.1
Other business services	1.6	1.6	1.7	1.6	1.6
Public administration & defence	4.0	3.3	3.3	3.1	3.0
Education	7.2	7.1	6.1	5.6	5.3
Health	1.7	1.5	1.2	1.0	1.0
Other personal & community services	2.1	2.2	2.3	2.2	2.3
Adjustments	**5.9**	**5.6**	**6.0**	**5.7**	**6.1**
FISIM	-1.7	-1.7	-1.8	-2.0	-2.0
Taxes on products	7.5	7.3	7.8	7.7	8.1

Source: Uganda Bureau of Statistics

6.0 RECOMMENDATIONS TO PROMOTE LOCAL CONTENT DEVELOPMENT IN UGANDA

- Agree on national priorities and protect them from political expediency
- Invest some oil wealth for future generations
- Emphasize corporate social responsibility (CSR)
- Protect the environment
- Maintain and grow the non-oil sectors (notably agriculture, tourism, education and financial sector)
- Create capacity and enhance human resources
- Develop economic infrastructure for oil exploration and production and economic diversification
- Improve the capacity to negotiate contracts
- Encourage private sector participation in the oil and gas industry
- Provide information to the public about opportunities, risks and challenges relevant to the oil and gas industry
- Provide good governance and promote transparency and accountability
- Maintain and enhance macro-economic stability for sustaining prosperity
- Ensure competitive licensing of oil fields
- Issue long-term contracts to avoid shell companies
- Enter relevant oil reserves cross border contracts before midstream and downstream activity

- Fight corruption to reduce on revenue leakage and strengthen public and private institutions to support Local Content
- Harmonize East African Economic Integration project and international trade and economic agreements with Local Content development.

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