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The Local Content Law and Value Addition in the Mining, Oil and Gas Sector in Mozambique: The Context and Resource Governance

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Abstract

This policy paper is a contribution to understanding the importance of Local Content legislation as a contributor to value addition and industrialisation in Mozambique. The emphasis on the mining, oil and gas sector is triggered by the recent discoveries of natural gas and the fact that the coal mines in Mozambique came into production.

Mozambique is endowed with significant mineral and gas resources which makes the country rank fifth in the world in terms of natural gas resources (in place). This is because of the recent gas discoveries in the West Indian Ocean that amount to c. 200 trillion cubic feet (Tcf), while a considerably smaller field with c.5 Tcf has been producing natural gas and light condensate since 2004 in the Pande-Temane area. The country also has significant coal reserves in the Tete Province, a central part of Mozambique, where production reached the historic record of 19 million tons in 2017. Mozambique is also a 'game changer' in the world market with regard to other resources. These include rubies (producing one of the best ranked rubies in the market which are compared to the Burmese rubies in quality)², graphite with world class reserves and two mines already in production (the Ancuabe Graphite Mine producing 6,000 tons of graphite and Balama Graphite Mine producing 180,000 tons), and heavy mineral sands (ilmenite, rutile and zircon) also in production at a large scale (Kenmare produced 1.4 Mt heavy mineral concentrate in 2016)³. It is because of this resource boom that the country has been aiming to generate endogenous growth based on increased domestic content for economic diversification and industrialisation. The country is in the late stages of approving its Local Content (LC) Law which will strategically regulate and foster domestic value addition and local industry diversification. It is expected that LC Law will constitute an opportunity for good governance of natural resources by creating spaces for local participation, better resource rent distribution, local supply chain development, technology transfer, and employment creation in the country.

The development of the extractive industry enforces adjustments to legal instruments that govern the sector so as to make them more consistent and consentaneous to the sector dynamics. In this regard, and with the objective of harnessing the mineral resources sector as one of the primary contributors for the economic development of the country, laws related to mines and petroleum, including respective forms of taxation and fiscal benefits, were reviewed and approved by the Assembly of the Republic in 2014 and 2015. The government of Mozambique has equally approved policies and a strategy for the mining resources, including the Regulation on Resettlement Resulting from Economic Activities and Policies of Corporate Social Responsibility for the Extractive Industry in 2015 and 2016.



²<https://www.ajsgem.com/articles/mozambique-ruby.html> (accessed in November 2017)

³<http://www.kenmareresources.com/~media/Files/K/Kenmare-Resources-PLC/pdf/Annual%20Report/ar-2016.pdf> (accessed in December 2017)

What is Local Content?

The definitions of a 'local content policy' vary widely depending on the context and user. This paper defines it broadly as a policy governing foreign investors or investments, that aims to more actively embed foreign investment in, and catalyse spillovers into and linkages with, the domestic economy. This definition includes, but is not limited to, measures expressly requiring or incentivising the use of local goods, services, and labour. It can also include measures such as those requiring foreign investors to incorporate firms in the host economy, or to make intra-firm expenditures in the host economy⁴.

In Mozambique, LC is narrowly defined and 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 supplier⁵. In Mozambique, other compelling legislation comes into play when one is to define a local supplier. There is no clear understanding of whether an international supplier, registered in Mozambique, qualifies as a local supplier or if the company is regarded as having an element of Mozambican ownership as is done in Trinidad and Tobago.

Space of Local Content in the Value Chain of Minerals, Oil and Gas (MOG) in Mozambique

From the draft law on Local Content and Value Addition, it is clear that for the government of Mozambique, the extraction of hydrocarbons, oil and gas will be a priority sector. The draft Local Content Law aims to establish a mandatory preference for products and services containing a certain portion of local inputs (content); the maximisation of added value and job creation through the use of national capacities, products, services and companies, as well as the use of the entire value chain of domestic products; the development of local capacity through training, the transfer of skills, knowledge and technology by doing active research and developing programmes; promoting the domestic industry and domestic production; and establishing the rules for preference with regard to qualified Mozambicans for training and employment.

The government of Mozambique believes that natural gas constitutes the single most promising opportunity to industrialise the country, making it necessary to ensure that part of the natural gas being produced (25 per cent) in Mozambique is used for this purpose, at a price that allows for the viability and competitiveness of industries in the entire value chain (Fig. 1).

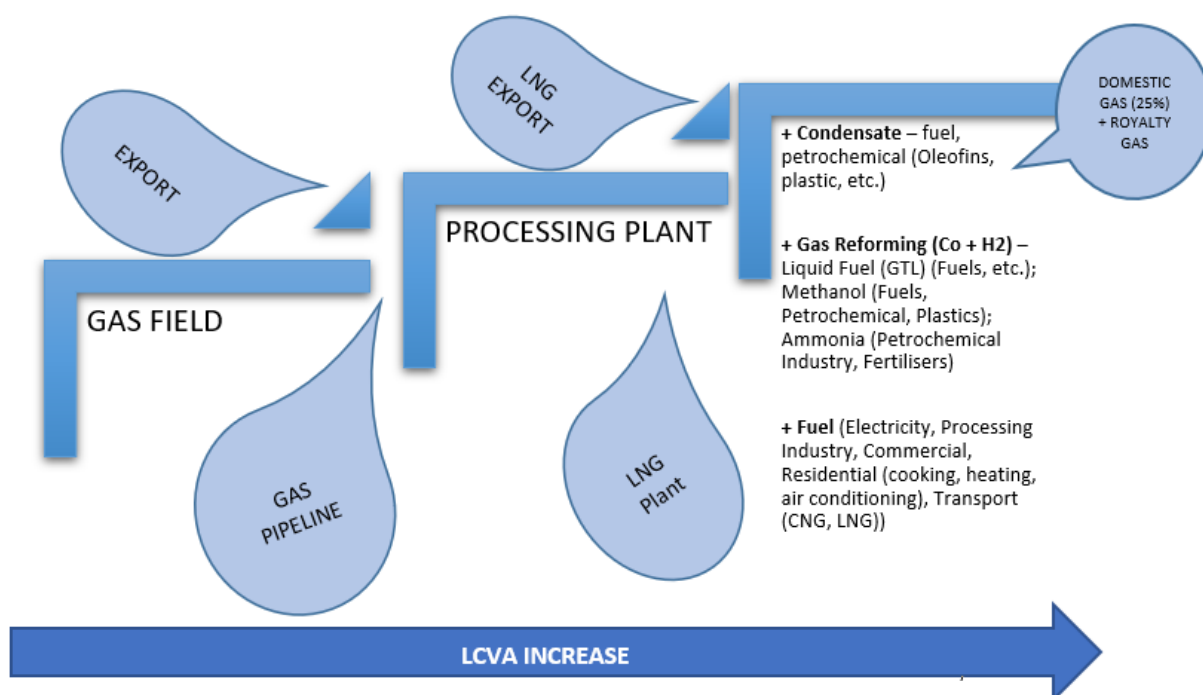


Figure 1. Gas market opportunities in Mozambique (Authors' concept, based on the GMP, 2014)

⁴GIZ, 2016. Space for Local Content Policies and Strategies: A crucial time to revisit an old debate.

⁵Kaplan, Z. 2013 – Policy option for strengthening local content in Mozambique; SPEED – USAID/Mozambique.

Local Content Policies and Value Addition in Mozambique

In Mozambique, there is an ongoing debate about capital gains⁶ from mineral resources. Some segments of the society favour the establishment of a sovereign fund, while others defend the fact that such revenues must be used to reduce the budget deficit and make the country financially more autonomous. Around the world, resource-rich countries have found creative ways to leverage private extractive companies' capital and expertise to build up local industries and labour markets. The results have been mixed, varying according to the enabling regulatory environment, the government vision, private sector participation, and the ability to identify the most promising opportunities on which to focus⁷.

For Mozambique, the priority is and should now be placed on figuring out three things. Firstly, what is the best way to manage new sources of revenues for the state? Secondly, how can this money be invested in the best possible way into core pillars of the economy such as infrastructure, health, and education? Finally, how can it be ensured that the tremendous investment tied to the extractive sector helps stimulate local market growth, SME development, and jobs for locals? What is known is that natural resource-based exploration and production investments do not necessarily contribute to the national economy. This is mainly because its enclave nature does not necessarily result in direct job creation and only allows limited economic and industrial linkages.

Mozambique expects that the draft LC Law, under discussion at different levels, will benefit both Mozambique and the external investors. The government of Mozambique is also reviewing its tax laws in order to establish more equitable profit-sharing structures, strengthening government capacity and clarifying the public and private sector's roles in the extractive industry.

In parallel, Mozambique is reviewing a number of success stories regarding the leveraging of natural resource wealth for industrialisation and domestic development, including the Norway and Trinidad and Tobago models.⁸ LC policies in Norway have resulted in oil companies sourcing more than 50 per cent of capital inputs and more than 80 per cent of operations and maintenance inputs from other Norwegian firms. The acquired expertise has also enabled Norwegian firms to expand into export markets, with exports comprising nearly half of their sales by the early 2000s.⁹ In Trinidad and Tobago, their approach to LC is centred on their Energy Sector LC and Local Participation Policy Framework passed in 2004.¹⁰ The Trinidad and Tobago model for increasing local content has relied heavily on the use of joint ventures to facilitate the transfer of skills and technology. One successful example of the use of joint ventures to build local capacity is that of the BP's local

Trinidad and Tobago subsidiary, also known as bpTT. With a local partner, BP decided to build its Cannonball platform in Southern Trinidad with a US\$10 million price premium (rather than importing). This project was used as a capacity-building endeavour 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 cost savings of around US\$11 million.

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

Mozambique LC Law borrows from both the Norwegian and the Trinidad and Tobago models. It envisions diversification and the promotion of industrialisation by regulating the quantity of natural gas. This natural gas must add value locally and promote the local ownership of the small and medium-sized enterprises (SMEs) that can provide a service to the natural gas industry. The Mozambican LC Law also establishes the High Authority on LC to oversee the implementation of related laws.

Policy Conclusions and Options for Mozambique

Existing legal frameworks in Mozambique that relate to LC or LC issues are scattered throughout a number of policies and laws and does not address LC in a coherent and holistic manner. Thus, the draft LC Law is seen as the magic solution for addressing the LC in Mozambique.

Literature advises that it is key that the governments understand that there is no one key fits all solution, each country is specific and requires its own unique remedies¹¹. Some of the success stories discussed in this paper are good experiences to learn from, but they may not be uniformly applicable to Mozambique and have the same rate of success.

The Mining and Petroleum Laws, and their regulations make an attempt to establish more equitable profit-sharing structures, strengthening government capacity and clarifying the public and private sector's roles in the extractive industry.

The Petroleum Law highlights the following elements related to Local Content:

- 'Oil and gas companies' must be registered on the Mozambique Stock Exchange.
- A requirement for national preference and a 10 per cent price benefit to local companies and products.
- A requirement for foreign companies to associate with Mozambican companies to provide categories of goods and services which require specialised

⁶A capital gains tax is a type of tax levied on capital gains, profits an investor realises when he sells a capital asset for a price that is higher than the purchase price.

https://www.investopedia.com/terms/c/capital_gains_tax.asp#ixzz536pzMkUf

⁷Kaplan, Z. 2013 – Policy option for strengthening local content in Mozambique; SPEED – USAID/Mozambique.

⁸GIZ, 2016. Space for Local Content Policies and Strategies: A crucial time to revisit an old debate.

⁹Håvard Halland et al., "The Extractive Industries Sector: Essentials for Economists, Public Finance Professionals, and Policy Makers," (World Bank Group 2015).

¹⁰Energy Sector Local Content and Local Participation Policy Framework 2004, Government of Trinidad and Tobago.

¹¹Elena Paltseva and Jesper Roine, SITE: 2011. Resource Curse: What Do We Know About It?

knowledge.

- Decree n.º 15/2010, of the 24th of May, on the Procurement of Goods and Services from Public Entities.

The Mining Law highlights the following elements related to Local Content and Value Addition:

- The state shall always consider the national interests of Mozambique, in particular in relation to the conservation of natural resources, environment, domestic economic activities and food and nutritional needs.
- Increasing local development and the participation of Mozambicans in the mining sector.
- Local Content requirements for the procurement of goods and services for mining activities which are designed to promote the development of Mozambican business linkages and knowledge.
- Requirement for foreign persons/entities to associate themselves with Mozambican persons/entities to supply goods and/or services to the mining sector in Mozambique (Article 53(2)).
- The percentage of revenues generated by mining activities to the state shall be allocated by the state towards the development of communities located near mining activities.
- The employment of non-Mozambican nationals is regulated by the Decree n.º 63/2011.
- Minerals Processing and Value Addition in Mozambique, 'if economically viable', any processing activities relating to minerals produced in Mozambique must be undertaken in Mozambique (Art. 57).
- The state is required to progressively increase its participation in mining projects.
- The Mining Law provides that mining companies

must be listed on the Mozambican Stock Exchange (Bolsa de Valores de Moçambique).

The draft LC Law will provide a framework and better alignment of the legislation that aims to involve Mozambicans in mineral resources development activities.

On developing a general policy, strategy, legislation, and a conducive environment, Mozambique's Local Content policies need to be aligned with national and regional industrialisation strategies. This is to allow proper maximisation of synergies, economy of scale and comparative advantages in the country and in the region. LC regulations will need to make provision for sector specific actions and for finance mobilisation or the facilitation of concessional lending for the industrialisation purpose. A starting point is the Mozambican national procurement law, which includes some benefits for SMEs and places a central focus on SME development and the promotion of investment linkages. Additionally, the development of the financial sector will positively generate financial products that will finance the SMEs in the country.

The LC approach in Mozambique is also aligned with other efforts, such as the African Development Bank's (AfDB's) effort to promote inclusive private sector development and SME linkages with large investments. The AfDB and the government's efforts aim to also promote economic development through the integration of economic activities within infrastructure development (e.g. the Nacala Corridor for Moatize coal transportation and export through the Nacala Port in the North of Mozambique)¹².

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