Blessing or curse: Local content policies in the petroleum industry

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Host governments increasingly impose local content policies (LCPs) to try to gain as much economic and social benefit as possible from their oil and gas reserves, beyond just extracting taxes and royalties from oil and gas companies. Governments of country members of the World Trade Organisation are not allowed to have overly restrictive regulations in this regard. Nonetheless, the local content issue often puts them at odds with companies, whose traditional approach is to "do the minimal possible to be in compliance." Very often this situation creates insoluble conflicts; governments want more local content in equipment and employment, while the international oil companies want less, particularly when they are under market pressure to be more cost-efficient.

What is the correct way forward, and the correct attitude, to prevent a worsening of this conflict? How can we reverse the gathering momentum of LCPs in order to create a more fruitful form of cooperation?

Firstly, parties must reconsider their standpoint and better align their collective interests. It is not difficult to understand that a common interest exists. An oil and gas reserve in its original form has no value, neither for governments nor for oil companies. Both parties have a basic interest to explore, and to produce something useful for the market. Both parties have an interest to do this as effectively and as efficiently as possible, and in a controlled and regulated manner. Efficiency is in the interest of the government because the more efficient a company, the more competitive it is, and the higher its potential profit, for eventual distribution between the state and the company.

It is realistic for both parties to want the host country's industry and services to be developed, and for work possibilities for local people to be increased. It is also quite obvious that certain imported products and services can be extremely expensive (for instance, expatriate employees), and this increases so-called "cost oil" expenses, reducing an oil company's earnings and the host country's tax revenue.

In addition, stable and well established rules and regulations can help companies to continuously improve their processes and performance. In such circumstances, local employment is beneficial, and its development a critical factor for success. But to identify and utilise the common interests of governments and oil companies, collaboration and close cooperation is an absolute necessity.

Very often a lack of cooperation, and poor communication, results in a lose-lose situation, widening the gap between the two parties. The host government introduces more restrictions and bureaucracy focusing on compulsory targets (set percentages of local services and employees), and then financially penalises non-fulfillment of these targets. On the other side of the fence, oil companies try to minimise their activity in order to fulfil their obligations defined in the LCPs.

While I do not believe there is a general solution, or a well-functioning recipe that can be applied to every case, I would like to pick up on an element that I consider to be one of the most important of these LCPs. It is also the most long-lasting and difficult to change: the need for local expertise and local management to be employed, and for local services to be used.

In many cases, the quality of services and employees currently does not exist. This leads to a "catch-22." Local workers don't get jobs because they don't have the expertise, but they cannot get the expertise because they are not being given the jobs.

The solution to this situation can be found by looking outside of our particular industry. Both the petroleum industry and governments could learn much from more manpower-intensive industries such as car manufacturing. A good example can be found in how the car manufacturing industry has boomed in central and eastern Europe.

Slovakia is today the biggest car manufacturer in the world, based on production of cars per capita, and its neighbour, Hungary, is also among the top players. Things didn't start this way. In the beginning the situation was poor, but in many cases car manufacturers participated intensively in local high school and university education – even though high-quality basic education was, and is, the fundamental task of the local government. Input from both players was very much needed for the industry to acquire correctly qualified workers. Of course, the beginning was difficult and at first more 'expats' were needed to start, and then build up, production.

At that time the Slovak government had to tolerate a low level of local content and, additionally, support the necessary steps to boost the education system. After some years, however, the common efforts paid off. Not only was the local content, the number of local employees and local services increased, but companies successfully trained highly-qualified experts who can now be sent to production facilities in other countries.

The Khushal Garh Bridge over the Indus River, built in Pakistan in 2016, with financial support from MOL

Almost all oil companies have their own recruitment and introductory programme for fresh graduates. MOL Group has its international 'Growww' programme that takes newcomers, from all countries where MOL operates, and provides intensive classroom and on-the-job training in their first year.

To find the best candidates before graduation, and particularly to increase their knowledge, in some countries university departments were established and these have been partly, or completely, financed by the company.

One further element of local content policies is unavoidable today – namely, society's expectations of company behaviour. Expectations related to corporate responsibility are growing in developed countries. They are even clearer in less developed ones, where most of the oil and gas reserves are found. In these countries, company contributions to infrastructure development, or healthcare system improvement, are expected.

The key factor for success is to tailor the local content programme to the specific needs and capabilities of the company and the country. Close collaboration is a must between the partners. It requires an understanding of each other's priorities and goals, and the willingness to remain flexible when finding the means to meet these goals.

Ultimately, successful collaboration between companies and host countries will be based on flexibility, transparency, and good faith. Without these elements, no local content policy will reach its goal, and will instead be a curse placed on everyone.