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**Local Content Requirements & the
Green Economy**

Summary of Study by

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Local Content Requirements & the Green Economy

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Executive Summary

This study explores the use of local content requirements in the green economy, with a specific focus on South Africa. The study has been prepared at a time when the “green economy” concept moved from theory to practice, with a range of developed and developing countries placing local content at the heart of their green economy strategies, and their green economy plans at the heart of their industrial policies. The study also reflects developing countries’ increasing emphasis on the “sustainable” element of traditional development objectives, such as rural development, urban planning and industrialization. The study has also been prepared at a time when countries across the income spectrum are taken a fresh look at local content requirements, after having largely phased them out in traditional strategic industries such as fossil fuel energy and automobiles.

The aim of local content requirements is to create rent-based investment and import substitution incentives. They ensure that within strategic sectors – particularly those such as oil and gas with large economic rents, or vehicles where the industry structure involves numerous suppliers – domestic goods and services are drawn into the industry, providing an opportunity for local content to substitute domestic value-addition for imported inputs. The economic rationale/impetus can arise from several sources – whether to strengthen a weak or infant domestic industry, address market failures, leap-frog technological barriers, or ensure that economic benefits are channelled to a given region or group. Local content (along with other so-called performance requirements) are often used by governments as one side of a “carrot and stick” approach to attracting investment, often pairing performance measures with incentives such as subsidies and tax breaks.

There are several key lessons to draw from the best (and worst) practices of local content. Local content requirements have been widely used at the global level, and the study outlines the use of local content measures – focusing on the energy sector – *inter alia* in Brazil, Malaysia, and the UK. The study draws five key lessons from the literature on local content:

- Local content regimes must be couched in a wider strategy of value-added creation and the “golden rule” of competitive tendering – rather the merely transferring ownership from foreigners to locals – given that local content is a high-cost and second-best strategy to develop an industrial base;

- The process of local content policy formulation must be open and transparent, backed by institutions that are adequately resourced and act within a clearly limited mandate;
- Local content targets should be realistic, based on plausible economic assumptions, and modified as conditions change, without which the Government will be faced with chronic undershooting;
- Local content regimes – like any form of protection – should be carefully calibrated implemented over time, and ideally reduced over time as capacity improves, to avoid the entrenchment of special interests that thrive on regulatory barriers; and
- Local content should not to be seen as a panacea for every challenge within the domestic economy, particularly when divorced from a wider trade and industrial development strategy.

South Africa is only one of many countries that have placed local content measures at the heart of their green economy strategies. South Africa’s Green Economy Accord is a comprehensive strategy covering both energy and non-energy sector, envisaging the creation of 300,000 ranging from energy generation and “clean manufacturing” to eco-tourism and environmental services. Together with other key trade and industry strategies, South Africa’s green economy measures – particularly its bidding process for renewable energy – include local content targets across all relevant technologies. Similar uses of local content to promote green goals are also found in global energy producers (e.g. Canadian provinces, China, Brazil, Spain and India) as well as newer entrants into the global market for renewables.

Many of the same concerns raised earlier are relevant when linking between green economy measures and local content. With respect to growth and competitiveness, the use of local content requirements has, in several instances, attained its key policy objectives – the creation of green jobs and the attraction of green investments. There are strong concerns however over the cost-price trade-off in using local content: ambitious local content targets in a context of weak domestic capacity risk raising energy prices in the absence of large government subsidies, which may not be a viable option for many developing countries. In addition, high-level political concerns have been expressed over whether local content funded by large transfers from taxpayers are the best and most stable means of encouraging the growth of green jobs. While many green economy programs are in their relative infancy, some observers have expressed concerns that local content targets – relative to the current capacity of green economy suppliers – have been overly ambitious, especially given the current oversupply in the renewables market and substandard infrastructure to link renewable suppliers to traditional energy grids.