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The Paradox of Plenty: Why Guyana's Local Content Law Needs a Reality Check

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The Paradox of Plenty: Why Guyana's Local Content Law Needs a Reality Check

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In October 2022, the Guyana Business Journal (GBJ) challenged a panel of experts to deliberate on how Guyana could maximize local capture from its oil and gas sector. The question is pregnant with possibilities. However, Guyana, like other developing countries before it, assumes that a local content law is the secret sauce. Therefore, the discourse focuses on implementing coercive local content requirements (LCRs). Omitted from consideration is whether a local content law is even necessary.

Coercive local content requirements did not live up to the hype in countries that relied on them[i]. Additionally, Guyana is different from countries that implement aggressive local content requirements. Those countries share three distinct features. They are less integrated in the global economy; have a wide array of suppliers; and a large labor force. With fewer than a million people and an infant manufacturing sector, Guyana lacks a robust array of suppliers and labor force. Moreover, isolationism would be suicidal given its reliance on allies.

Further, Guyana lacks five factors that decades of research found are necessary for effective LCRs implementation[ii]. These factors are:

1. *Large Market size and stability*
2. *The right level of local content requirements*
3. *Cooperation and financial incentives*
4. *Potential for knowledge transfer*
5. *Technology*

Essentially, Guyana, now the world's fastest growing economy, is an anomaly. It is extremely small, lacks technological sophistication and has low potential for knowledge transfer. The potential for knowledge transfer is less when the knowledge gap between local and foreign firms is wide. Particularly, knowledge transfer is slower when LCRs mandate a high level of managerial control by locals[iii]. Guyana has set managerial control by locals at 75%. Additionally, it requires 51% local ownership of firms and 90% of the employees to be locals. More than half of the 40 sectors the law applies to require 70% or more local content.

3 Obstacles to Effective Local Content in Guyana

1. Limited Supply of Local Content

A law that mandates the use of scarce products and services, will create more problems than solutions. Therefore, local content requirements cannot exceed the available supply. In the short run, the supply problem could be solved if firms have excess capacity to respond to a sudden increase in demand.

Guyanese firms do not have excess capacity and the level of supply needed to satisfy demand created by the new oil and gas sector. This includes relevant skills, products, and services. Apart from a shortage in total units of the various products and services, individual suppliers operate on a very small scale. While local firms operate on a small scale, oil and gas procurements are bundled in large orders. This means products and services are not produced in sufficient quantities to satisfy purchase orders.

The benefits from large scale procurement are (a) effective supply chain management; and (b) efficiency gains from economies of scale. Therefore, any mandate that oil companies break up procurement orders into smaller bundles to facilitate micro enterprises will create inefficiencies.

Small firms will either be excluded from the oil and gas sector or will have to scale their operations. However, there are impediments to scalability. Local firms do not have excess capacity to scale production. If they reposition and reallocate assets from the non-oil sector, they would be heading down the road to the Dutch Disease.

2. Inadequate Structure, Size and Culture of Local Firms

To avoid the Dutch Disease, Guyana pins its hope for local content success on local firms building non-existent capacity rapidly. However, capacity building also faces major constraints. First, decades of massive brain-drain left the country depleted of human capital. The government and the private sector estimate that labor supply would need to increase by approximately 150,000 to satisfy demand created by the oil boom.

Another limitation is unavailability of the capital needed for expansion in the country. This means the country must look outward to build the capacity it needs. Partnering with foreign firms is necessary. Therefore, an important question is whether the local content law furthers or hinders this partnership. Basic common sense would tell us that foreign firms will not contribute 80% of the capital needed to build the required capacity and accept 49% ownership of a firm. Common sense would also tell us that foreign firms cannot contribute to rapid knowledge and technology transfer in firms where locals have 75% managerial control.

Andrew Schnitzer, one of the Guyana Business Journal's panelists, underscores the importance of trust. If foreign firms do not trust local firms to perform at an adequate level of efficiency, they may stay out of the market completely. Qiu and Tao[iv] have found evidence of this in their study of countries that have coercive local content requirements. They found that LCRs (a) generate less foreign direct investment (FDI) than market forces; and (b) attract inefficient firms to the host country.

Therefore, to succeed, Guyana must create an environment of trust to foster partnerships between local firms that lack capacity and foreign firms that have capacity. Trust is built by easing into local content. Such an incremental approach would result in gains without market distortions. Perhaps, to drum up political sentiments, Guyana has plunged into local content with aggressive requirements. However, the ambitious local content requirements need a strong institutional framework to be effective.

3. Weak Institutions and Enforcement Capacity

Guyana has very weak institutions. It therefore faces enormous difficulties enforcing basic laws, regulations, and rules. Even institutions that have decades of experience and appear to be robust, fail in high stakes matters. The local content law is a new legal regime that is particularly fragile and lacks the wisdom that comes from experience. Yet, it has been tasked with matters of the highest stake.

Several problems arise from weak institutions. First, the marginal success obtained are for low-level infractions. However, the system crumbles in high stakes matters. Consequently, the impact is largely felt by the poor and powerless. Weak institutions tend not to succeed in enforcement against the rich and powerful. They therefore create imbalances that increase inequality.

Developing countries like Guyana cannot go forward merely speaking of the rule of law as compliance with existing laws. Where existing legal structures create fertile ground for discrimination and inequality the rule of law is either failing or absent. It is for that reason that this generation is still grappling with the failings of the rule of law from centuries ago. The lesson from history is that the rule of law must be measured against the quality of law.

Countries with weak institutional structures have taught us that local content laws have the following effects:

a. increases corruption
b. distribution of benefits to the politically connected
c. weakens enforcement against the rich and politically connected

Therefore, in countries with weak institutions, local content laws inflame political and social tension and widen the gap between the rich and the poor. Consequently, contentions of adherence to the rule of law must be tempered by consideration of diversity, equity, and inclusion.

The imperative of Diversity, Equity, and Inclusion

The movement towards diversity, equity, and inclusion has not gained traction in developing countries where it is most needed. Plural and tribal societies that are built on ethnic dominance, have shunned diversity, equity, and inclusion. The inclination in these societies is to preserve the infrastructure for ethnic dominance though it is a blight to progress.

One of local content's dark side effects is it contribution to the infrastructure for ethnic and political dominance. Guyana presents both the context and the mechanism for dark side effects. It is a plural society that is split along racial lines. Ethnic insecurities and tension are high. Additionally, the Constitution, institutions, and political culture provide for a winner-take-all system. Because the two major political parties are ethnically based, winner-take-all gives rise to ethnic domination.

A movement towards diversity, equity, and inclusion would ease ethnic suspicion and tension while strengthening cohesiveness. Government should therefore lead the movement towards diversity, equity, and inclusion. This problem may not be solved simply by grouping companies into ethnic classifications and then distribute benefits based on ethnic classification. Instead, the government should push local firms to be more diverse, equitable and inclusive.

The government should use it dominance in public procurement and private procurement - through local content requirements, to impose diversity, equity, and inclusion measures on companies. The gravity of the inequities means that economic factors should not be the only procurement considerations. To avoid the paradox of plenty, there must be a social and political component.

Reality Check

Policy makers in Guyana have adopted the approach that presents local content as a necessary and supreme option. Perhaps, embedded in the assumption of the supremacy of coercive local content requirements is a folly that triggers the paradox of plenty – an irrational sense of self.

The challenge for Guyana is to be true to itself. In doing so it will find three fundamental pillars of change that are necessary for successful implementation of local content requirements. The three pillars of change are (a) local firm structure; (b) local firm size; and (c) local firm culture. The first two pillars of change are necessary to produce greater efficiency and capacity. The third pillar is needed for diversity, equity, and inclusion. Here is where some sage advice is provided by the panelists who gathers at GBJ roundtable.

The sobering tone of the GBJ roundtable is that change will not be overnight. This is the lesson, decades of experience from dozens of countries have taught us. Forebearers of coercive local content are now waking up from their delusion with shattered dreams. One of the questions that has come back to haunt is – was coercive local content requirements even necessary? Guyana should confront that question before leaning too heavily on local content laws. It could learn from the collective experiences of other countries or bury its head in the sand and pray that it avoids the resource curse.

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[i] Ivar Kolstad & Abel Kinyondo, Local Content Requirements in Resource-Rich Countries, Oxford Development Studies, Vol. 45 (2017) 409-423

[ii] Jan-Christopher Kuntze & Tom Moerenhout, Local Content Requirements and the Renewable Energy Industry - A Good Match? (2012). Available at
SSRN: https://ssrn.com/abstract=2188607 or http://dx.doi.org/10.2139/ssrn.2188607

[iii] Gary Clyde Hufbauer, et al., Local Content Requirements: A Global Problem, Policy Analyses in International Economics, Peterson Institute for International Economics, (2013)

[iv] Larry D. Qiu & Zhigang Tao, Export, Foreign Direct Investment, and Local Content Requirement, Journal of Development Economics, Vol. 66 (2001) 100-125