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**Introducing Local Content Regulation in Kenya's Economy: A Case Study of Kenya's
Energy, Oil and Gas Sector**

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**This Research Paper is submitted in Partial Fulfilment of Master of Arts Degree –
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DECLARATION

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DEDICATION

To Tito my beloved Son, may you always stand on the shoulders of giants.

ABSTRACT

This study explores Kenya's proposal to implement local content regulations in its energy oil and gas sector, beyond politics and rhetoric. It investigates what needs to be done after all the fancy conferences and charismatic speeches by politicians. What needs to be in place practically in Kenya to implement local content policies?

This paper investigates the existing legal and socio-economic environment within which Kenya seeks to introduce local content regulation in its energy, oil and gas sector. Having recently discovered commercially viable quantities of oil and gas; Kenya is determined to ensure that its fingers are not burned by the proverbial African 'resource curse' but rather that actual socio-economic development is achieved from the extraction and exploitation of Kenya's natural resource. However as these local content regulations are promulgated, industry players and the government must ask one question. Is Kenya's legal space, infrastructural, socio-economic and educational space ready to foster the capacity development that is required locally prior to implementation of the local content regulations? Is Kenya ready? What existing legal regimes, infrastructure, socio-economic security and education systems are needed to lay the foundation for the successful implementation of local content regulations?

This study was conducted through a series of interviews and focus groups of strategic key players, government officials, local entrepreneurs and international investors in Kenya's energy oil and gas sector as well as an analysis of secondary data such as journals, statutes, books, reports and audits. This study hopes to inform the Government of Kenya and policy makers on how best to implement these local content regulations, and what (if anything) needs to be done or implemented prior to the promulgation and adoption of local content regulations in Kenya's energy oil and gas sector. It analyses the existing and proposed legal

framework for local content regulation in Kenya, as well as the infrastructure currently in Kenya in terms of electricity, water, roads it also looks at the education system, the ease of registering and doing business in Kenya, social acceptance of foreign investors, the tax regime in Kenya, as well as the existing efforts to develop Kenya's technical capacity such as the World Bank -Kenya Petroleum Technical Assistance Project (KEPTAP).

LIST OF ABBREVIATIONS

AICD	Africa Infrastructure Country Diagnostic
ADF	Africa Development Fund
BNDES	Brazilian Development Bank
CAP	Chapter (Laws of Kenya)
CEO	Chief Executive Officer
DFID	Department for International Development - UK
FDI	Foreign Direct Investment
ICES	Information Centre for the Extractives Sector
IOC	International Oil Company
LCRs	Local Content Regulations
GATT	General Agreement on Tariffs and Trade 1994
GDP	Gross Domestic Product
GIZ	Gesellschaft für Internationale Zusammenarbeit
GEMS	Growth Enterprise Market Segment
KCA	Kenya College of Accountancy University
KEPTAP	Kenya Petroleum Technical Assistance Project
KPC	Kenya Pipeline Corporation
LWD	Logging while drilling

MIMS	Main Investment Market Segment
MOEP	Ministry of Energy and Petroleum
NCA	National Construction Authority
NOCK	National Oil Corporation of Kenya
PLC	Public Listed Company
R&D	Research and development
SMEs	Small and Medium Sizes Enterprises
SOGA	Skills for Oil and Gas Africa
TRIMs	Trade Related Investment Measures
UK	United Kingdom
US	United States
USD	United States Dollars
WTO	World Trade Organization

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CHAPTER ONE: INTRODUCTION TO THE STUDY

“There is little chance that (foreign) companies trying to do business in the developing world will escape the rising tide of local content demands”

Wall Street Journal

31 July 1984

1.1 Background

In March 2012, it was announced that Tullow Oil had discovered commercially viable oil in Kenya¹ and this saw an influx of International Oil Companies (IOC), looking to get a piece of the action as well as Kenyans in the villages of Turkana celebrating at their new perceived instant wealth. This announcement also led to a significant increase in the interest of foreign direct investment in Kenya’s economy.²

However, as the rate of economic activity in the energy, oil and gas sector increases it has become clear that Kenya’s vibrantly celebrated oil find might lead to civil strife and political unrest amid suspicion towards the oil prospectors and persons not from the Turkana community who were working in the area. Social unrest led Tullow Oil to temporarily stop operations six months after its operations began in October 2013 citing political wrangles and

¹ BBC “Kenya Oil Discovery after Tullow Oil Drilling” 26 March 2012 <<http://www.bbc.com/news/world-africa-17513488>>

² “Kenya’s Oil and Mineral Prospects Fire Global Interest” The Financial Times Katrina Mason <http://www.ft.com/cms/s/0/20badca4-504b-11e3-9f0d-00144feabdc0.html#axzz2uzmExsrJ> last accessed on 4 March 2014

social unrest regarding Tullow Oil's perceived failure to employ members of the local community at the exploration wells.³

From the foregoing it has been argued that lessons must be learnt from other resource rich developing countries whose interactions with foreign investors have not yielded the most beneficial developmental results for the host country and its citizens.⁴ It has been said that developing countries and more particularly in Africa suffer from a “*resource curse*” where the discovery of extractive resources has led to massive economic inequalities being created leading to political and civil unrest, corruption and in the worst cases violent conflict over control of the resources⁵.

It has been stated that one way for developing countries to avoid this resource curse, is to ensure more equitable sharing of revenue and opportunities arising from the resources being exploited by employing economic policies that encourage socio-economic development and ensure that the host country benefits as much as possible from the foreign investments. Local content regulation has been championed as Africa's solution to the resource curse.⁶

1.2 Statement of the Research Problem

There has been very little focus on the enabling legal and socio-economic conditions required to successfully implement LCR's in an economy and more importantly whether these enabling conditions exist in Kenya as it seeks to implement LCRs in its energy, oil and

³ Tullow oil suspends operations over conflict with locals

Read more at: <http://www.standardmedia.co.ke/business/article/2000096359/tullow-oil-suspends-operations-over-conflict-with-locals>

⁴ Kiraitu Murungi, ‘*Maximizing Local Content In Kenya's Upstream Oil And Gas Sector*’ *Daily Nation* (Nairobi, February 2014)

⁵ This has been witnessed in Nigeria's Delta where there have been conflict over Nigeria's oil and in the Democratic Republic of Congo which has been in conflict since 1994 mainly over its rich natural resources such as diamonds, gold, copper, cobalt, coltan and zinc. Democratic republic of Congo is one of the richest countries in the world in terms of resources; however its citizens live in abject poverty.

⁶ Murungi (n4)

gas sector. These enabling factors could include the development level of infrastructure, commercial protection offered under the legal system, institutional framework, fair and transparent tax regimes, suitability and development of education policy and system, ease of doing business in a country, availability of affordable electricity, adequate water and such other amenities that provide an enabling environment for both local and foreign investors.

It is important to understand whether implementing LCR's in Kenya's energy, oil and gas sector in the current legal and socio-economic environment would be prudent or whether it would create superficial bottlenecks and impediments to investment in the sector. It is paramount to see the practical workability of LCR's in Kenya, beyond populist politics of creating more jobs and investment opportunities in Kenya, what does Kenya really need to do (*if at all*) in order to smoothly implement LCRs? Has the foundation for LCR's been laid?

Since the end of World War II, various forms of LCRs have been employed by countries at different levels of development to achieve specific economic goals or developmental gains. However, previous studies and research on LCRs have mainly focused on the types of LCR's employed, LCR's attendant weaknesses, LCR's as protectionist measures, the measurement and monitoring of LCR's and the pros and cons of employing LCR's. However, a gap exists in analysing the pre-requisite enabling conditions for the successful application of LCR's to an economy.

1.3 Research Objectives

The overall aim of this research is to look at the feasibility and the foreseeable implementation challenges of introducing local content requirements (LCR's) in Kenya's energy, oil and gas sector.

This research will analyse how the Government of Kenya proposes to introduce local content regulations in the energy oil and gas sector, the legal and institutional framework underlying the introduction of local content regulations in the oil and gas sector, the foreseeable challenges international investors and local entrepreneurs are likely to face in implementing the proposed local content quotas and the initiatives being undertaken to develop local content capacity in Kenya and more particularly:

- 1.3.1 To analyse the underlying statutory and institutional framework within which the Government of Kenya seeks to introduce local content regulations in Kenya's energy, oil and gas sector;
- 1.3.2 To understand the historical evolution and role of LCR's and similar measures or policies worldwide;
- 1.3.3 To evaluate the existing socio-economic environment within which the Government of Kenya, proposes local content regulations in Kenya's energy, oil and gas sector; and
- 1.3.4 To understand what current measures are being undertaken to develop local content capacity in locally in Kenya.

1.4 Definition of Key Terms

“Local Content Requirements” in this research shall be understood to be the mandatory requirements placed by host countries on investors (whether local or foreign) to obtain a certain threshold of the various goods and services to be used in their production in the host country. These local content requirements could be measured in value, man-hours or quantity as stipulated in the relevant policy or legislation.

“Foreign Direct Investment” (FDI) in this study shall mean a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy in an enterprise that is resident in an economy other than that of the resident enterprise. The lasting interest implies the existence of a long-term relationship between the economy and the enterprise and a significant degree of influence on the management of the enterprise.⁷

“Extractive Sector” shall in this research be taken to refer to any commercial activity relating to the extraction of any minerals, precious metals, precious stones, oil gas or geothermal resources from Kenya’s land including the seabed and the subsoil.

“Economic Development” shall mean as defined by Todaro the steady growth by which the productive capacity of the economy is increased over time to bring about rising levels of national income.⁸ This term shall not only be taken to be an improvement of a country’s GDP but include the social and economic improvement of the citizens of that country in terms of improved living conditions/standards.

1.5 Literature Review

As developing countries such as India, Brazil, Malaysia, Trinidad and Tobago, Kazakhstan, Indonesia and Nigeria advocate for and implement LCR’s⁹, this campaign has generated a lively debate among scholars both on the viability and legality of LCR’s.

⁷ OECD Library <<http://www.oecd-ilibrary.org/sites/factbook-2013-en/04/02/01/index.html?itemId=/content/chapter/factbook-2013-34-en>> last accessed 28 May 2014

⁸ Michael P. Todaro , *Economics for a Developing World: An Introduction to Principles Problems and Policies for Development* (first published 1977, Longhorn, Malaysia)

⁹ Rabiun Ado “*Local Content Policy and the WTO Rules of Trade Related Investment Measures (TRIMS): The Pros and Cons*” *International Journal of Business and Management Studies*” _UniversityPublications.net p.

1.5.1 LCRs for Economic Development

One school of thought propounds the use of LCR's as a measure which can be used to enhance development, grow local industries, ensure transfer of technology, increase the rate of employment among its locals, ensure that there are no balance of trade deficits, enhance political stability and improve the general socio-economic status of its citizens. Fredrich List and Rabiun support the use of LCRs propounding the infant industry argument, political harmony argument, market power argument and strategic sectors (national security) arguments as justifications for the use of LCRs.¹⁰ Gillian Moon¹¹ and Sornarajah¹² in support for LCRs state that local content policies are a fool proof method through which developing countries can ensure that the presumed advantages of FDI in the host country are actually achieved.

Kuntze and Moerenhout¹³ argue that despite the challenges that LCRs face of being considered protectionist, inefficient and impermissible under the WTO rules, they acknowledge that increasingly governments seek to “*localize as many benefits (of FDI) as possible*” and that governments would be reluctant to support foreign investment that primarily benefited businesses from other countries.

Claudine Sigam¹⁴ also supports the use of LCRs by resource rich developing countries, noting that less than twenty per cent of investments made by multinational corporations in developing host countries actually remains in the host country. Sigam however notes that for

¹⁰ Ibid, p 142, and Friedrich List, “The National System of Political Economy”, 1841

¹¹ Gillian Moon, “*Capturing the Benefits of Trade? Local content requirements in WTO law and the human rights-based approach to development*” University of South Wales Faculty of Law Research Series, 2008, Paper 5 Available at <<https://law.bepress.com/unswwps-flprs08/art5>> last accessed 24 March 2014

¹² Sornarajah M. , “*The International law on foreign investment*” Cambridge University Press, United Kingdom (2004)

¹³ Jan- Christoph Kuntze and Tom Moernhut “*Local Content Requirements and the Renewable Energy Industry – A Good Match?*” Available at <http://ssrn.com/abstract=2188607> last accessed on 24 March 2014 p.36

¹⁴ Sigam C “*Human Capacity Problems in Developing Countries and Local Content Requirements in the Extractive Industries*” GREAT Insights Volume1, Issue 5, July 2012

LCR's to be effective, this policy must be driven by "an optimal balance of both incentives and strict regulation" of foreign investors. Gbegiin support of the employment of LCR's goes a step further and posits for the implementation of LCRs even by local producers.¹⁵

Nwaokoro Joseph supports the use of LCR's by resource rich countries, but in an analysis of Nigeria's national content laws sharply critiques the manner in which the LCR policies have been implemented in Nigeria.¹⁶ Nwaokoro recommends the use of contracts to enforce LCRs with foreign investors, claiming that the enactment of "blanket" national laws without due regard to existing bilateral investment treaties and international treaties and agreements could render national local content laws impotent and unenforceable.¹⁷

1.5.2 Arguments against the use of LCRs

Another school of thought however posits that the use of LCRs by developing countries is not the appropriate avenue that should be employed to achieve the best outcomes from FDI. They argue that LCR's promote protectionism, prevent the development of free enterprise and result in costly inefficiencies for the host countries. Tomsik and Kubicek empirically show that LCR policies as employed by developing countries to achieve certain economic objectives may eventually turn out to be "economically unjustifiable" and would also lead to suboptimal allocation of resources, and reduced efficiency.¹⁸ Garry Pursell analyses the use of LCR's in Australia's automobile industry and identifies some lessons that should be learnt

¹⁵ Gbegbi O.D. "Managing Local Content in the Extractive Industries" A paper presented at the 2nd African Congresses of Accountants (ACOA), Accra 14th -16th May 2013

¹⁶ Nwaokoro Joseph "Nigeria's National Content Bill: The Hype, The Hope and The Reality" Journal of African Law, Volume 55, Issue 01, April 2011 pg. 128-155

¹⁷ ibid

¹⁸ Tomsik Vladmir and Kubicek Jan "Can Local Content Requirements in International Investment Agreements be Justified?" Working Paper No. 2006/20 NCCR Trade Regulation. Available at <www.nccr-trade.org> last accessed 27 March 2014

by developing countries exploring the possible use of LCRs from Australia's experience.¹⁹ Pursell's study reveals that the LCRs used in Australia failed to achieve the envisioned economic results and adversely led to market fragmentation, the creation of cartels, increased cost of material, reduced national income, retarded technological development and higher rates of unemployment. Pursell further encourages developing countries to use tariffs instead of LCRs, which in his view would achieve the desired development goals.

Adejube on the other hand in analysing the effect of national content legislation in Nigeria concludes that LCR's also have the adverse effect of discouraging the very FDIs that developing countries seek to benefit from in the first place.²⁰ It is evident that reduced FDI would also lead to reduced economic benefits for the host developing country. He encourages developing countries to adopt economic policies that are both flexible and responsive to the need of foreign investors instead.

Rivers and Wigle empirically analyse local content and renewable energy legislation and conclude that in the short term LCR policies may result in unintended adverse results such as increased unemployment rate due to sharp/sudden increase in the cost of production due to increased cost of material due to inefficiencies created by LCRs.²¹

Both Adejube and Pursell both consider the recent push by developing countries to introduce LCR policies, and campaign for a paradigm shift at the WTO legitimizing the use of LCR

¹⁹ Garry Pursell "Australia's Experience With Local Content Programs In The Auto Industry; Lessons For India and Other Developing Countries" Paper presented at the Conference on WTO Technology Transfer and Globalisation of Firms, Institute of Economic Growth, New Dehli, March 25-26, 1999

²⁰ Aderonke Adejugbe "Foreign Direct Investment in Nigeria; Overcoming Legal and Regulatory Challenges to Foreign Direct Investments in Nigeria: Is the Nigerian Government Doing Enough?"

²¹ Rivers Nic and Wigle Randy "Domestic content requirements and renewable energy legislation" Available at < <https://ssrn.com/abstract=2129808> > last accessed on 26 March 2014

policies as short-lived and futile, as they confidently foresee the successful challenge and dismantling of any LCRs that are employed contrary to WTO's TRIMs.

1.5.3 LCRs and the WTO

Strictly speaking, LCRs are prohibited under the WTO framework. The General Agreement on Tariffs and Trade 1994 (GATT) provides under Article III for "*National Treatment on Internal Taxation and Regulation*"²² and under Article XI for the "*General Elimination of Quantitative Restrictions*".²³ In order to give life to these articles of the GATT, the Agreement on Trade Related Investment Measures (TRIMs) was negotiated during the Uruguay Round in order to restrict the application of economic measures would have the effect of distorting or restricting international trade.

The Agreement on Trade Related Investment Measures, Article 2 (*National Treatment and Quantitative Restrictions*) specifically states that:

*"Without prejudice to other rights and obligations under GATT 1994, **no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.**"* (Emphasis mine)

Additionally the preamble of the Agreement on Trade Related Investment Measures states that it seeks to promote:

²² GATT Article III (4) "*The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment **no less favourable** than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation... distribution or use.*"

²³ GATT Article XI (1) "*No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party*"

“The expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners particularly developing countries; whilst ensuring free competition.”²⁴ (Emphasis Mine)

The Agreement on Trade Related Investment Measures includes an illustrative list of TRIMs for the avoidance of doubt. As relates to LCRs:

“TRIMs that are inconsistent with paragraph 4 Article III of GATT which are mandatory/enforceable under domestic law which require the purchase/use by an enterprise of products of domestic origin or from any domestic source... in terms of volume/value or the proportion of volume/value of its local production”²⁵

Developing countries (which are member states of the WTO) were required to comply with the provisions of this agreement by 1st January 2000, whilst least-developed countries were required to comply by 1 January 2002.²⁶ These deadlines are yet to be met, as developing countries seek to make and implement autochthonous investment measures and policies. Additionally under the Agreement for Trade Related Investment Measures Article 4 developing countries are permitted to deviate temporarily from the provisions of Article 2 (*National Treatment and Quantitative Restrictions*) for balance of payments purposes as permitted by the GATT.²⁷

²⁴ WTO, Agreement on Trade Related Investment Measures, 1998

²⁵ WTO, Agreement on Trade Related Investment Measures – Annex

²⁶ WTO Agreements and the Developing Countries: Problems and Implementation
<http://www.wto.org/english/thewto_e/minist_e/min99_e/english/about_e/05impl_e.htm>

²⁷ TRIMs Article 4 “A developing country Member shall be free to deviate temporarily from the provisions of Article 2 to the extent and in such a manner as Article XVIII of GATT 1994, the Understanding on the Balance-of-Payments Provisions of GATT 1994, and the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted on 28 November 1979 (BISD 26S/205-209) permit the Member to deviate from the provisions of Articles III and XI of GATT 1994.”

As relates to the introduction of LCRs by developing countries, the Agreement on Trade Related Investment Measures does not permit the introduction of new investment measures that are inconsistent with the Agreement.²⁸

Recently investment measures that amount to LCRs have successfully been challenged at the WTO. For instance Japan and the European Union (EU) successfully challenged Canada's Ontario Green Energy Act of 2009 which required entities participating in the FIT (Feed in Tariff) as energy generators to source a minimum quota of the goods locally e.g. 25% in the case of wind energy and 60% in the case of solar energy. The WTO appellate body confirmed the earlier ruling of the panel and ruled that Canada remove all LCRs.²⁹ In the same breath the United States has lodged a complaint at the WTO regarding India's National Solar Program and the local content requirements therein.³⁰ Most recently, the EU, US and Australia raised questions about Nigeria's local content statutes at the WTO's the Council for Trade in Goods meeting on 11 July 2013.³¹

As has been shown above, LCRs have and will continue to be challenged at the WTO. However, there is a loophole in the WTO regime regarding TRIMs, in the Japan- Alcoholic Beverages Case II, the Appellate Body stated that "*Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation as long as they do not do so*

²⁸ WTO, *Agreement on Trade Related Investment Measures* Article 5

²⁹ ICTSD, "WTO Appellate Body rules against Canada in renewable energy case" <http://www.ictsd.org/bridges-news/biores/news/wto-appellate-body-rules-against-canada-in-renewable-energy-case-0> last accessed on 3 June 2014

³⁰ ICTSD, *US Lodges WTO Challenge Over India Renewable Energy Incentives* < <http://www.ictsd.org/bridges-news/bridges/news/us-lodges-wto-challenge-over-india-renewable-energy-incentives> > Last accessed on 3 June 2014

³¹ WTO "*Trade concerns raised against Ukraine, Russia, Brazil, Japan, Indonesia and Nigeria*" July 2013 available at < http://www.wto.org/english/news_e/news13_e/good_11jul13_e.htm > last accessed on 2 June 2014

in a way that violates any commitments they have made under the WTO Agreements.”³²

Developing countries need to do is to understand how to implement LCRs below this threshold.

1.5.4 LCRs and Expanding the Policy Space of Developing Countries

Amid the raging debate of the efficacy and legality of LCR’s there are some scholars who postulate that developing countries should be permitted to enforce any domestic (economic) policy that they believe would lead them to economic growth including protectionist policies. Joseph Stiglitz argues that the only manner in which globalization would produce positive outcomes for both developing and developed nations is if markets liberalization is not applied to all nations in a “*one size fits all*” manner, but rather in a systematic and developmentally acceptable manner, with developing countries being given the leeway to liberalize their markets in phases, as and when they are they find it economically viable.³³

Dani Rodrick argues that the WTO’s rules amount to hyper globalization with WTO rules permeating into sectors previously under the ambit of national regulation such as intellectual property, health and safety rules and subsidies which were not regulated under the previous GATT.³⁴ He criticizes the current international economic law regime for placing restrictions on developing countries’ economic policies that could potentially lead to their economic development.

³² Lester S et al “ *World Trade Law, Material and Commentary*” Hart Publishing, 2008

³³ Stiglitz J “ *Globalization and its Discontents*” W.W. Norton & Company, United States, June 2002

³⁴ Dani Rodrick “ *The Globalization Paradox: Democracy and The Future of the World Economy*” New York, Norton, 2011

Ha- Joon Chang³⁵ on the other hand equates the limitation of the economic policies available to developing countries (such as LCRs) to *kicking away of the ladder* by developed countries. Chang argues that by doing so, developed countries seek to prevent developing countries from using the same economic (protectionist) policies they themselves to attain economic development. Chang in his research even undertakes an in depth analysis of the protectionist measures previously applied by the developed countries that now deny developing countries the use of the exact same policies. The United States (US) for instance encouraged the inflow of FDI, but wanted to ensure that these foreigners had minimum control over the US economy. To this end they enacted federal laws restricting the right of foreigners to own land, open foreign banks, vote as shareholders in local banks, access to mining and logging rights, and finally in the shipping sector a navigation monopoly was established for US ships in 1817 at the US coastline.³⁶

The United Kingdom on the other hand had in place the Foreign Exchange Control Law between 1947 and 1979 which limited the amount of foreign exchange a company had access to and in effect limiting the importing power of the foreign investor. France and Germany had state operated entities which acted as an entry barrier to foreign investors in certain industries such as Volkswagen in Germany's car manufacturing industry. The UK also allegedly placed informal performance requirements on Asian countries seeking to enter the UK market by making them sign voluntary restraint agreements with the Department of Industry ensuring local sourcing of components of production.³⁷ Finland, Russia and Japan also had similar restrictions on foreign investors.

³⁵ Ha-Joon Chang “*Kicking Away The Ladder – Globalization & Economic Development In Historical Perspective*” in Michie J ,(ed) *The Handbook of Globalization*, Edward Elgar (2006)

³⁶ Chang 2004, 693

³⁷ Chang 2004, 696 “Nissan in UK was forced to procure up to 60% of the value added locally”

Korea provided more intricate protectionist measures, requiring all foreign investments to be in line with Korea's developmental goals, ensuring technology brought in by FDI was not obsolete, favouring investors who were more willing to engage in transfer of technology. Korea strictly imposed LCRs in order to maximize technological spill overs. It eventually had to relax these policies during the 1997 Asian Financial Crisis.³⁸ Chang clearly illustrates that the developed countries heavily rely/relied on the very same measures that they seek to restrict developing countries from applying.

Chang, Rodrick and Stiglitz all advocate for more policy space for developing countries as a route to sustainable economic development.

1.6 Justification of the Study

This research shall prove a useful tool to the Government of Kenya and policy makers (including economic and those concerned with specific areas such as insurance and banking) in its review of the current and proposed policies and legislation by identifying the gaps therein which could pose possible impediments to the implementation of local content regulation in Kenya.

Further this research should be an invaluable resource to legislators seeking to propose, enact and implement legislation or regulations imposing LCR requirements on investors, by analysing the existing and proposed LCR's and laws, as well as institutional framework around LCRs.

³⁸ Chang 2004, 703

Finally, this research shall prove invaluable to local entrepreneurs by looking at Kenya's socio economic situation and responsiveness so far to existing local content regulation, the challenges an investor might face and the opportunities and initiatives for capacity development for local industry.

1.7 Hypotheses

- a) That the existing and proposed local content regulations are sufficient to encourage local content development in Kenya;
- b) That Kenya's socio- economic environment enables the implementation of local content regulations; and
- c) That there are adequate local content development initiatives currently underway in Kenya.

1.8 Theoretical Framework

This section shall analyse and make comment on the various economic /international relations theories that could be used to analyse the relationship between LCRs and the market. Broadly this research shall look at the theoretical framework around free market capitalism and non- intervention of government against those theories that would seem to support government regulation and government interference with the market.

First, an analysis of the interrelation between free market theories and idealism and how these two schools of thoughts relate with the use of protectionist measures such as LCRs by developing countries. Adam Smith propounded the classical economic thinking on free market theories and is also considered an idealist.³⁹ Classical economic thinkers envisioned

³⁹ Daddow O, *International Relations Theory*, Sage Publications Limited, London, 2009 pg 69

free markets controlled purely by demand and supply. Adam Smith argued that such free markets would lead to the most efficient use of resources as merchants left on their own would only employ the use of their resources in the most profitable manner. Adam Smith in his book the Wealth of Nation reads:

*“It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages”*⁴⁰

Accordingly, classical economists accept mankind’s self-interest as an important economic force because in seeking to maximize self-interest an individual would strive to produce high quality produce cost effectively. They view self-interest as promoting competition and high standards in the economy.

Butler⁴¹ neatly summarises the main themes of Adam Smith’s book “The Wealth of Nations” as being:

- a) that regulation on commerce is ill-founded and counterproductive;
- b) that a country’s productive capacity rests on the division of labour and the accumulation of capital;
- c) that demand and supply will self-regulate where there is free trade and competition;
and
- d) that the government’s role in commerce should be limited to its primary functions i.e. defence, security, infrastructure, education and keeping the markets free and open.

⁴⁰Smith, A, *The Wealth of Nations* Book I, ch. II, pp. 26–7, para. 12.

⁴¹ Buttler E, *Adam Smith Primer*, Institute of Economic Affairs, London

In countering the assertion that free trade would lead to a “man- eat- man” capitalist society, Smith in his book *Theory of Moral Sentiments* argued that human beings having natural empathy for each other would be able to moderate their actions so as not to hurt each other.⁴² It is evident that Adams did not advocate for free market capitalism only driven by the greed of profits at the expense of some members of the society.

Additionally, Smith propounded the earlier version of absolute advantage advocating for countries to produce what they are best at and to engage in the exchange of whatever surpluses they had in order to obtain whatever else they required. However, David Ricardo took this theory one step further arguing for comparative advantage in making a case against protectionism.

The classic economic schools of thought (free market theories) resonate with idealism theories in international law. For starters Adam Smith is considered an idealist. Idealism is based on the co-operation of mankind in order to achieve the greater good. Idealists believe in the altruistic nature of man and believe that humanity in coming together to form international organisations such as the World Trade Organisation (WTO) and the Bretton Woods Institutions would be able to address such issues as free trade and economic development of developing countries. Idealists and Classical economists alike would not support the use of LCRs by developing countries because the use of protectionist theories are considered “*beggar thy neighbour*” and hinder the opening up and liberalization of international markets. According to these scholars the government should not interfere with free markets which should be left to self-regulate through the mechanisms of demand and

⁴² Smith A “*The Theory of Moral Sentiments*” part I, ch. I, p. 9, para. 1.

supply. These theories could be taken to support modern day scholars such as Tomsik & Kubicek, Garry Pursell, Rivers & Wigle and Adejudbe who oppose the use of LCRs be developing countries for various reasons.

However, on the other side realists such as Hans Morgenthau and Thomas Hobbes on the other hand believe that mankind (states) is selfish and only motivated by the achievement of their interests and self-preservation. They argue that states only conduct foreign policy in their own best interests. This would explain the notion that developed countries urge the liberalization of markets in the name of free market capitalism because this is the form of market that suits them most. Realism would also explain the power imbalance between developing and developed countries at international organisations and most relevant to this study, the WTO. In this regard, free market capitalism is one of the most dangerous theories for developing countries as developed countries only propound and participate in free trade to the extent that it serves their interests.

This realist theory as read with the Keynesian Economic Theory would explain why it would be necessary for a developing country to employ the use of protectionist measures such as LCR's in order to achieve their economic interests in the engagement of trade with developed countries or foreign investors from the developed countries. Keynesian economic theory propagated after the 1930 market crash, proposed circumstances where the government should interfere with the market forces where the market failed to self-regulate adequately.

According to the World Systems Theory, Wallerstein identifies the developed countries as forming the core of the international economy, with the developing and least developed countries forming the periphery of the international economy. In this set up, countries from

the periphery supply the core countries with raw materials, with the periphery being coerced into the continuation of supply of raw materials and buying processed goods from the developed countries leading to the worsening state of the economies of developing countries over time. According to this theory, uneven (unfair) economic development is one of capitalism's core tenets. This theory could be used to show why it is important for developing countries to apply LCRs so as to enable them move from the periphery to the core and fight capitalism's uneven development.

The employment of LCR's by developing countries would also be justified by Marxist theories about capitalism. The use of LCR's could be seen as a revolt by the developing countries (*proletariat*) against the developed countries (*bourgeoisie*) who propound for the liberalization of markets and free market capitalism to the detriment of the developing countries.

1.9 Research Design

This study was mainly undertaken by a qualitative analysis of information supported by quantitative data analysis where available.

a) Research Methods

This research was undertaken mainly by conducting formal and informal interviews and focus groups with foreign and local investors, IOCs, consultants, policy makers, personnel from government agencies and such other relevant persons deemed fit. Additional research was carried out by literature review of various books, journals, reports, conference papers, cases, newspaper articles, government publications, and a

content analysis of relevant laws bills policies, codes of conduct and treaties. Finally, the Annual Kenya Oil & Gas Services – Local Content Convention were attended both in 2014 and 2015.

b) Interviewees and Focus Group Panel Members

- Policy Makers and Legal Drafters – Technical Committee on the Implementation of the Constitution, Joint Technical Committee Energy Policy and Bill
- Local Entrepreneurs – Oil and Energy Services, Oilfield Movers, Anjarwalla & Khanna Advocates, Chase Bank, Burbridge Capital, Petroleum Focus Consultants
- State Corporations and Departments - KIPPRA, Kenya Chamber of Mines, Nigerian Local Content Development and Monitoring Board, Commissioner for Natural Gas, Ministry of Energy and Minerals Tanzania, Petroleum Exploration and Development Department (Uganda)
- International Investors (IOC's) – Tullow Oil PLC, Baker Hughes, Weatherford International, Anardarko, Base Titanium, General Electric,
- Officers - Ministry of Energy
- Legislators - Senators

1.10 Chapter Outline

Chapter 1:

Introduction to the Study

Chapter 2:

Productive Development Policies, Import Substitution and Local Content Regulations: A Brief History

Chapter 3:

Analysing the Local Content Regulation Legal Framework in Kenya

Chapter 4:

Local Content Experience in Kenya

Chapter 5:

Local Content Development Initiatives in Kenya

Chapter 6:

Key Findings, Analysis and Recommendations

CHAPTER TWO

PRODUCTIVE DEVELOPMENT POLICIES, IMPORT SUBSTITUTION AND LOCAL CONTENT REGULATIONS: A BRIEF HISTORY

Countries since time immemorial have adopted certain trade and industrial policies aimed at achieving economic development, growing their industries and reducing their dependence on imports. These policies have been broadly described by the World Bank as Productive Development Policies (PDP's) defined as follows: *“initiatives that aim to strengthen the productive structure of a particular national economy”*⁴³ Historically, these policies are founded in mercantilism and protectionism.

The arguments for the application of productive development policies have been propounded for many years with certain scholars doubting the sincerity of calls by the developed world for all nations to embrace free trade. Fredich List is one such scholar who strongly propounded the infant industry argument and encouraged developing nations to embrace free trade only to the extent that it benefited them.

*“Any nation by which of protective duties and restrictions on navigation has raised her manufacturing power and her navigation to such a degree of development that no other nation can sustain free competition with her can do nothing wiser than throw away these ladders of her greatness to preach to the other nations the benefits of free trade and declare in pertinent tones that she has hitherto wondered in the paths of error.”*⁴⁴

Phillip Wilhelm van Hornick, also a proponent of productive development policies summarised the main tenets of mercantilism as *inter alia*:

⁴³ The World Bank *“Local Content Policies in the Oil and Gas Sector”*, Washington DC, 2013

⁴⁴ Friedrich List, *“The National System of Political Economy”*, 1841

- i. *Encouraging domestic manufacture of raw materials as manufactured goods are more valuable than primary goods*
- ii. *Encouragement of a large working population*
- iii. *Prohibition of the export of gold and silver (amass wealth)*
- iv. *Discouraging the importation of foreign goods*
- v. *Where import is unavoidable, exchange for other domestic goods not gold or silver*
- vi. *Limit importation to raw materials only*
- vii. *Encourage as much export as possible in exchange for gold and silver*
- viii. *Restrict importation of goods that can be suitably supplied at home*⁴⁵

From the above summary it can be deduced that many centuries later, local content regulations largely seek to achieve many similar outcomes as mercantilism such as increased rates of employment, maximum utilization of domestically available raw materials and limited dependence on imported goods. France in 1539 banned the importation of wooden items from Spain and until the 17th Century. Britain between 1640 and 1660 endeavoured in the protection of its merchants by imposing trade barriers, import regulations, introducing subsidies in certain sectors and banned the export of raw materials. The Navigations Acts⁴⁶ in particular banned foreign ships from importing goods to England that did not originate from England or Europe; these acts were specifically targeted at limiting the activities of Dutch Merchants.

⁴⁵ Ekelund & Hebert “ A History of Economic Theory and Method”

⁴⁶ Navigations Acts, 1651 - England

However, these “*beggar thy neighbour*” policies soon led to increased conflicts in Europe and America. “*When goods do not cross borders freely, armies will*”⁴⁷ One of the causes of the American Revolution (1765-1783) was the trade restrictions placed by the Crown (England) on its American Colony. However in a somewhat ironic turn, America thereafter itself turned to protectionist measures in order to encourage the growth of its own domestic market for instance it closely regulated its shipping and navigation industry.⁴⁸

Alexander Hamilton advocated for the use of bounties or subsidies to fuel domestic development of US Manufacturers. Hamilton and List’s arguments for the protection of infant industries were mainly relied upon in order to encourage America’s industrial growth. However, these infant industry protection arguments were soon abandoned after the United States of America and Germany attained some form of sustainable industrial growth.

The climax (or anti-climax) of the protectionist policies was World War Two, after which the world collectively acknowledged the folly of protectionist policies and tried (unsuccessfully) to capture these sentiments in the formation of the International Trade Organisation. This was also compounded by the economic politics around the cold war, with socialist countries again leaning towards market protectionism in a bid to wade off the perceived threats posed by capitalism and western culture.

Soon after the end of the cold war, the next big thing was the Washington Consensus propounded by John Williamson in 1989 was aimed at encouraging responsible management of the economies of Latin America which were facing a terrible debt crisis. However, a narrower version of the Washington Consensus aimed at market liberalization was thereafter adopted by the World Bank and IMF and was soon applied in a one size fits all approach to all developing countries through structural adjustment loans and structural adjustment

⁴⁷ Michael A. Heilperin, “*Studies in Economic Nationalism*” Geneva, 1960

⁴⁸ Ibid pg 5

programs. These structural adjustment programs focused on the comparative advantage of free trade, and reduction of government intervention in the market. The market was supposed to be allowed to correct itself.⁴⁹ However, this narrow approach based on neoliberalism and market fundamentalism was soon seen to be the reason for underdevelopment of developing countries, deteriorating standards of life⁵⁰, increased debt and the 1997 Asian Financial Crisis that threatened to cripple the world economy through contagion. This lack of faith in the Washington Consensus is what led to the renewed push for production development policies (more particularly local content regulations) in a bid to spur national development especially in Latin America. Throughout this discourse, it should not be lost upon us that the developed world, primarily the United States and United Kingdom still retain numerous protective measures such as subsidies in certain sectors such as agriculture. Paradoxically the Queen of England received Seven Million Sterling Pounds in agricultural subsidies between 2002 and 2012 under the Common Agriculture Policy.⁵¹

2.1. LOCAL CONTENT MEASURES IMPLEMENTED IN LATIN AMERICA AND ASIA

Generally, import substitution policies have been implemented in Latin America and Asia between 1930's and 1980's as a result of the great depression and again in the mid-1990's as a reaction to the Asian Financial Crisis. There was state induced industrialization based on a belief of strong government (intervention) to push the industrialization agenda. Actually, strong governments with benevolent dictators are a common feature of the governments

⁴⁹ John Williamson, "A short history of the Washington Consensus" Institute for International Economics, Conference: From the Washington Consensus towards a New Global Governance, Barcelona September 24-25, 2004

⁵⁰ The market in many instances did not fill the gap left after the privatization of certain public services by governments

⁵¹ George Monbiot, *Farming Subsidies: This Is The Most Blatant Transfer Of Cash To The Rich* (The Guardian, London, 1 July 2013)

which have implemented PDP's both in Latin America and Asia. Argentina, Brazil, Mexico, Chile, Uruguay, Venezuela, Ecuador Honduras and the Dominican Republic are some of the countries that have implemented these measures.

2.1.1. BRAZIL⁵²

Local Content Regulations in Brazil were introduced by the Petroleum Law 9478/97. The ANP Regulation no.6/2007 and Resolution No. 36/2007 introduced the circulation and certification of local content in companies. The main objectives of these regulations were to facilitate industrialization, transfer of technology, transfer of skills, increase levels of employment and growth in income.

Restrictions were mainly in the oil and gas sector with a monopoly being held by Petrobras from 1953 until liberalization of the sector in 1997 and the shipbuilding sector. Brazil has minimum local content requirements in each subsector, and these limits are linked to licensing. Additionally, companies are obliged to spend at least 1% of their gross revenue on research and development in the oil and gas sector.

2.1.2. INDONESIA

LCR's in Indonesia were introduced in 2001, by the Oil and Gas Law No. 22/2001. These regulations were further revised by the Presidential Regulation No. 54/2010 (*Procurement of Domestic Goods and Services*) and Ministry of Industry Regulation No15 -16/2011.

The main objective of the LCRs' in Indonesia is to develop capability in oilfield services to improve competitiveness of domestic Indonesian companies. This is done by government

⁵² www.nocal.com- Local content in Brazil Oil Industry

regulation of salaries payable to locals, prioritization of local employment especially from the area of operation, using expatriates only where there are no Indonesians available who can do the job, company's expatriates costs only recoverable to a certain maximum cost dictated by government. Service contracts are required to attain at least 35% local content, there are minimum local content levels for goods, recruitment target regarding workers and tax exemption for imported inputs to local industries.⁵³

In Indonesia, LCR's are tied to the issuance and renewal of business permits and licencing.

2.1.3. MALAYSIA

The main tools for LCR's in Malaysia are:

- i. The Petroleum Mining Act, 1966
- ii. Petroleum Development Act, 1974
- iii. Economic Transition Program, 2010
- iv. Companies Act 1965

The introduction of these regulations was aimed at making Malaysia the hub for oilfield services by 2017 and increasing Malaysia's competitiveness in oilfield services. The mechanisms employed by Malaysia include: linking the number and type of work permits available to a foreign firm to their share capital structure, including employment targets in petroleum sharing agreements, obligation placed on oil companies to train Malaysians with an aim to replacing foreign workforce. Additionally, domestic shipping is reserved only for Malaysian vessels and there are tax incentives tied to meeting LCR requirements. Malaysia has a mix of incentives and mandatory local content regulations.

⁵³ World Bank Report (Local Content)

2.2. LOCAL CONTENT REQUIREMENTS IN NIGERIA

2.2.1. NIGERIA

In 2001 Nigeria began the process by founding a national committee to review the level of local content in Nigeria, this process culminated in the assent of the Nigeria National Content Act on 22nd April 2010 by the then President Good Luck Jonathan, which prescribed certain minimum local content requirements progressively over the life of foreign investments in Nigeria. It established a Nigeria Local Content Development Fund to which would be funded by 1% of each contract awarded to foreign companies in Nigeria. Failure to meet the local content conditions would lead to cancellation of the contract. During tendering, companies which propose to employ Nigerians are given first priority, and foreign companies are required to set up factories and production units in Nigeria.

Sixty six per cent (66%) of employees in any one grade must be Nigerian. It is yet to be seen whether these Nigerian Local Content mechanisms will meet the agenda they set out to achieve.⁵⁴

2.2.2. SOUTH AFRICA

The various ills that LCR's seek to cure is best exemplified by the local content provisions employed in South Africa as a cure to the economic challenges blacks face stemming from systemic discrimination and apartheid. South Africa introduced the Broad Based Black Economic Empowerment Act and the Mineral & Petroleum Resource Development Act, with a provision that 9% of employment should be for "*Historically Disadvantaged Persons*" participation.

2.3. LOCAL CONTENT REQUIREMENTS IN UK AND NORWAY⁵⁵

⁵⁴ Nwaokoro, "*Nigerian National Content Bill : The Hype*"

UK and Norway had to respectively abandon direct local content regulations prior to joining the European Union. It is interesting to analyse the approach UK and Norway took after the discovery of oil reserves within their border. UK took an expedited depletion approach because it was facing a balance of payments crisis and high unemployment rates and therefore needed to develop the oil and gas sector quickly. Norway on the other hand, sceptical of the Dutch Disease, took a much slower approach in order to avoid instability caused by inflation. However, at the end of the day, both countries achieved their goal and relying on local content regulation were able to develop their capacity in oilfield services. With UK leading in operational innovations whereas Norway has technologically driven innovation. UK employed a “*Buy British*” policy; whereas Statoil in Norway made transfer of technology a licencing condition and rewarding companies contributing to domestic capacity building. UK managed to have between 900- 1000 companies engaged in domestic production in the oil and gas sector, whereas Norway attracted 500-600 companies.

2.4. IMPORT SUBSTITUTION IN KENYA: A BRIEF HISTORY

Independent Kenya inherited its initial import substitution policies from the colonial government. The Kenyan Colony envisioned the growth of its industry base through the policy of import substitution. The rationale for this being protection of infant industry, availability of ready domestic market and reduction of dependence on imports.⁵⁶ This was how the colony aimed at raising income and foreign exchange by exporting primary products e.g. tea, coffee. The main aim of introduction of import substitution by the colonial government was to stem the loss of Britain’s market share in Kenya to other countries. The colonial government thus resorted to growth of the domestic market.

⁵⁵ World Bank Study, Ibid

⁵⁶ Henk. A. Menelik, *The Effects of Import Substitution: The Case of Kenya’s Manufacturing Sector* (University of Nairobi, Institute for Development Studies, June 1982) – Discussion Paper No 276

President Jomo Kenyatta's government upon independence continued with the same importation substitution policies and aimed at attracting FDI to produce locally for both the domestic market and export. This saw MNC's such as Delmonte, Firestone, Schweppes, United Steel and Lonhro set up shop in Kenya. The main exports at this time were textiles, apparel food, beverages and tobacco. The economy was adversely affected in the 1970's by a Balance of Payments crisis compounded by the oil shock some two years later. This led the Government of Kenya to increase tariffs and import licencing requirements. A coffee boom in the mid- 1970's averted a foreign exchange crisis, but the collapse of the EAC in the late 70's led to reduced market for Kenya's Goods.⁵⁷

These economic challenges as well as an attempted coup led the then President Daniel Arap Moi to engage with the World Bank and later the IMF in order to borrow some money to stabilize the economy. This led to the introduction of structural adjustment programs and conditionalities that saw the government of Kenya reduce government intervention in the market, privatise some parastatals, reduce its wage bill, abolish import quotas and licencing as well as liberalize the foreign exchange market which up to then had been highly controlled. Kenya has had a functional capitalist economy since the early 1990's (in tandem with democracy in Kenya) up until the proposal to introduce local content regulations in the energy, oil and gas sector following the discovery of commercially viable oil in Kenya in 2010. According to the WTO trade Policy Review 2000, Kenya has managed to control inflation and decrease fiscal deficit by economic policy reforms dismantling quantitative restrictions and price controls, and reliance on tariffs as its major policy instrument

⁵⁷ Geoffrey Gertz, *Kenya's Trade Liberalization of the 1980's and 1990's – Policies, Impacts and Implications*, background paper for the recent report *The Impact of the Doha Round on Kenya* published by the Carnegie Endowment for International Peace, which can be downloaded at http://www.carnegieendowment.org/files/impact_doha_kenya.pdf. (See also Peter E Coughlin & Gerrishon K. Ikiara *Industrialization in Kenya: In search of a Strategy* (East African Publishers, 1998),

CHAPTER THREE

ANALYSING KENYA'S LEGAL FRAMEWORK FOR LOCAL CONTENT REGULATION

3.1. Introduction

This chapter seeks to analyse the legal environment within which the government of Kenya seeks to introduce local content regulations both in International Law and Kenyan Law. The first part looks at Kenya's international obligations as regards local content regulation within the ambit of its membership to the WTO. It also looks at how the WTO has dealt with the local content regulations by its member states in the recent past. The second part of this chapter scrutinizes the plethora of laws, regulations and proposed bills in Kenya to tackle various aspects of local content.

3.2. International Law, WTO and Local Content Regulation

Kenya has been a member of the WTO since 1st January 1995.⁵⁸ Thus, the General Agreement on Tariffs and Trade 1994 and the Agreement on Trade Related Investment Measures apply to trade in Kenya. The Agreement on Trade Related Investment Measures recognises that some economic policies/measures applied by some WTO member countries could have a trade restricting or trade distorting effect. LCRs are identified by the WTO as one type of such trade restricting or distorting measures.

The Agreement on Trade Related Investment Measures prohibits member states from applying investment measures that would be in contravention of General Agreement on Tariffs and Trade 1994 GATT Article III and Article XI. The GATT provides under Article III (*National Treatment on Internal Taxation and Regulation*) that:

⁵⁸ WTO, <https://www.wto.org/english/tratop_e/tpr_e/tp124_e.htm> last accessed 6 October 2015

*“The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment **no less favourable** than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation...distribution or use.”*

GATT Article XI (1) (***General Elimination of Quantitative Restrictions***) provides that:

“No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party. “

Further, the preamble of the Agreement on Trade Related Investment Measures expressly states that it seeks to promote ***the expansion and progressive liberalization of world trade and to facilitate investment across international frontiers so as to increase the economic growth of all trading partners particularly developing countries; whilst ensuring free competition.***⁵⁹ (Emphasis Mine)

For the avoidance of doubt, the Agreement on Trade Related Investment Measures includes an illustrative list of prohibited TRIMs which expressly includes LCRs:

“TRIMs that are inconsistent with paragraph 4 Article III of GATT which are mandatory/enforceable under domestic law which require the purchase/use by an

⁵⁹ WTO, Agreement on Trade Related Investment Measures, 1998

*enterprise of products of domestic origin or from any domestic source... in terms of volume/value or the proportion of volume/value of its local production”*⁶⁰

3.2.1. Application of International Law to LCRs

It is important to note that many WTO member states are continually flouting the GATT and TRIMs provisions and employing LCRs in a bid to meet various policy objectives such as protecting their infant industries, reducing reliance on imports in key sectors such as health⁶¹, improving national technological development⁶², creating job opportunities and growth in income⁶³.

Even though these LCRs have been employed by a multitude of countries, very few complaints have been made to the WTO Committee on Trade-Related Investment Measures. For instance of the 14 complaints brought to the Committee on Trade-Related Investment Measures for discussion on 16 April 2015, most of the complaints related to investment measures taken by Russia, Indonesia and India.

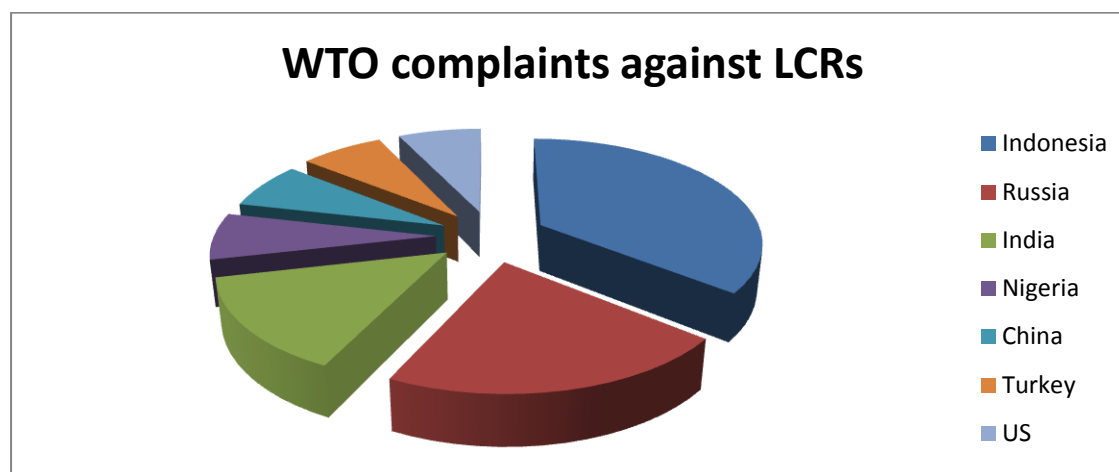
⁶⁰ WTO, Agreement on Trade Related Investment Measures – Annex

⁶¹ , Russia, WTO News, https://www.wto.org/english/news_e/news15_e/monit_16apr15_e.htm last accessed 30 June 2015 and Kazakhstan in the Petroleum Sector Local Content Policies in the Oil and Gas Sector, A World Bank Study pg. 107

⁶² Brazil, Indonesia, Local Content Policies in the Oil and Gas Sector, A World Bank Study pg. 99

⁶³ *ibid*

Figure 1: LCR Complaints Lodged Against WTO Member States



(Source: WTO, 2015)

Table 1: Complaints to Committee on Trade-Related Investment Measures Regarding LCRs as at April 2015

Issue	Complainant(s)	Respondent
LCRs in the Telecommunication Sector	Japan	Indonesia
LCR Provisions in Mining Oil and Gas Sector	EU, Japan, US	Indonesia
Industry Law and Trade law	EU, Japan, US	Indonesia
Minimum Local Product Requirement (Modern Retail Sector)	EU, Japan US	Indonesia
LC Requirements which might be extended to Public Entities – Automotive, Agricultural and Health Sectors	US & EU	Russia
Solar Power Generation Project,	EU	India

Electronic goods and Telecommunication		
Oil & Gas Sector	EU, US, Austria, Norway, Canada and Japan	Nigeria
LCR in telecommunication equipment used in banking sector	US and Japan	China
LCR in electricity Generation	EU	Turkey
LCRs in renewable energy sector	India	US

(Source: WTO, 2015)

It can be seen from the data above that most of the complaints were made against developing countries and only one African country - Nigeria had a complaint made against it. No complaints were made against other African states that have also applied LCR's such as Uganda, Tanzania, Angola and other developing countries such as Malaysia. It is profound that almost all the complaints were made by developed countries, United States, the European Union and Japan; it would seem that it is the developed countries who are eager to open up markets in developing countries. It is also quite absurd for Norway to be among the countries complaining about Nigeria's LCRs and yet these are the same policies Norway used to develop its oil and gas industry from the 1960's.⁶⁴

⁶⁴ Per Heum, Local Content Development - Experiences from oil and gas activities in Norway <http://brage.bibsys.no/xmlui/bitstream/handle/11250/166156/1/A02_08.pdf> last accessed on 30 June 2015

It is also well worth noting that developing countries have not made as many complaints as developed countries to the WTO regarding the application of LCRs. What is not clear is whether this is a case of not throwing stones while you live in a glass house as the other developing countries apply similar measures or simply not being bothered because they have no access to those markets either way. This failure to make complaints could also be due to the alleged inaccessibility of the WTO dispute resolution mechanisms due to reasons such as lack of specialized personnel who understand the complex WTO dispute resolution mechanism, fear of political reprisal, lack of adequate financial resources needed to sustain a complaint at the WTO or trade barriers being imposed on the complainant during the determination of the case which could take up to two years.⁶⁵

3.3. Laws of Kenya and Local Content Requirements

The legal framework underlying local content regulation in Kenya is manifold constituting laws, regulations and bills proposed to manage local content requirements in Kenya. This part analyses these laws, regulations and proposed bills in order to get a clearer understanding of the legal environment within which the Government of Kenya seeks to introduce Local Content Regulations.

Table 2: Statutory Provisions Dealing With Local Content in Kenya

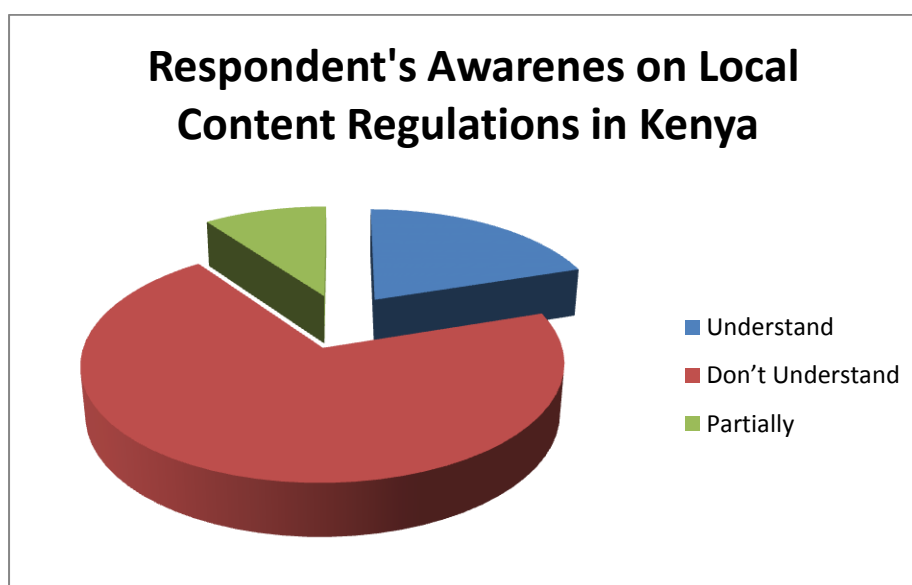
	Statute/ Regulation or Bill	Status <i>(as at 30 June 2015)</i>
1.	The Constitution of Kenya, 2010	In force
2.	The Mining Bill, 2014	Pending Presidential Assent
3.	National Construction Authority Act	In force

⁶⁵ Lester S et al “ *World Trade Law, Material and Commentary*” Hart Publishing, 2008

	(National Construction Authority Regulations)	
4.	Natural Resource Benefits Bill, 2014	2 nd Reading Stage (Senate)
5.	Local Content and Participation Bill	Bill for Introduction to the Senate
6.	Petroleum Exploration, Development and Production Bill, 2015	Forwarded to Attorney General for Publishing
7.	Petroleum Exploration, Development and Production (Local Content) Regulations, 2014	Forwarded to Attorney General for Publishing
8.	Energy Bill, 2015	Forwarded to Attorney General for Publishing
9.	Energy (Local Content) Regulations, 2014	Forwarded to Attorney General for Publishing
10.	Public Procurement and Disposal Act Cap 412A Legal Notice 114	In Force

(Source: Kenya Law Reports, 2015)

Figure 2: Respondent's awareness of Local Content Regulations in Kenya



(Source: Author 2015)

3.3.1. Definitions and Scope of Local Content in Kenya

Following from the multiplicity of statutes that purport to deal with local content regulation in Kenya, there are numerous definitions of what constitutes local content in Kenya.

Table 3: Various Definitions of Local Content in Kenyan Statutes

Statute/Bill	Article/Section/ Regulation	Definition of Local Content
1. The Constitution of Kenya, 2010		Not expressly defined
2. The Mining Bill, 2014	Section 45 and Section 47	Not expressly defined, however some of its provisions have the effect of introducing local content regulation
3. National Construction Authority Act (<i>National Construction Authority Regulations</i>)	Regulation 12(3)	Not expressly defined, however some of its provisions have the effect of introducing local content regulation
4. Natural Resource Benefits Bill, 2014	Section 3	Not expressly defined, however some of its provisions have the effect of introducing local content regulation
5. Local Content and Participation Bill	Section 2	<p>“Local content” means maximizing the level of use of local goods and services, people, businesses and financing</p> <p>“Local Participation” means maximizing the depth and breadth of local ownership, control and</p>

		financing, in order to increase local value –capture from all parts of the value chain created from the resource, including those activities in which nationals, local businesses and capital are not currently engaged at home and abroad
6. Petroleum Exploration, Development and Production Bill, 2015 Petroleum Exploration, Development and Production (<i>Local Content</i>) Regulations, 2014	Regulation 2	“Local Content” means the quantum or percentage of locally produced materials, personnel, financing, goods and services rendered in the petroleum industry value chain and which can be measured in monetary terms
7. Energy Bill, 2015	Section 2	“Local content” means the use of Kenyan local expertise, goods and services, people, businesses and financing for the systematic development of National capacity and capabilities for the enhancement of the Kenyan economy;
Energy Bill (<i>Local Content</i>)	Section 2	“local content” means the use of

Regulation		Kenyan local expertise, goods and services, people, business and financing before the systematic development of national capacity and capabilities for the enhancement of the Kenyan economy
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(Source: Kenya Law Reports, 2015)

As can be seen above, the policy makers do not seem to be in agreement as to what constitutes local content in Kenya. Each statute has a distinct definition of local content. Each Bill seems focused on a completely different policy objective for Kenya. For instance the Constitution as read with the Natural Resources Benefits Bill seems most interested in how the investment benefits the local community.

The Petroleum Bill in the other hand focuses on what percentage or quantum of locally produced goods or services, measurable in monetary terms can be extracted from an investment. The Energy Bill and Energy Regulations in turn lay emphasis on the policy objective of development of national capacity and capabilities for enhancement of the Kenyan economy. Finally the National Construction Authority Act primarily focuses on Kenyans having equity in Joint Ventures with foreign entities undertaking construction projects in Kenya. Each of these statutes has Kenya's socio- economic welfare at heart.

However, without a clear definition of local content, it may be hard for investors to determine how to meet the prescribed thresholds, especially where different statutes each make different demands on the same investors. It would also render the monitoring and enforcement of local content regulations a futile endeavour without a clear definition of what is being monitored or enforced.

In addition to having a plethora of definitions of local content, each statute covers a different scope or economic sector.

Table 4: Economic Scope of Various Local Content Regulations in Kenya

Statute/Bill	Article/Section/ Regulation	Provisions	Scope/ Application
The Constitution of Kenya, 2010	Article 66(2) (Regulation of Land Use and Property Article 69(1)(h) (Environment and Natural Resources) Article 69(1)(a) (Environment and Natural Resources)	Parliament shall enact legislation ensuring investments in land and property benefit local communities and their economies State shall utilize the environment and natural resources for the benefit of the people of Kenya The State shall ensure sustainable exploitation, utilization and management of environmental and natural resources and ensure equitable sharing of accruing benefits	All Natural Resources
The Mining	Section 45	Holder of mineral right shall:	Any geological

Bill, 2014	(Preference in Employment)	<ul style="list-style-type: none"> - give preference in employment to citizens of Kenya - conduct trainings and capacity building for the benefit of employees - only engage non-citizen technical experts in accordance with such local standards for work permits - work at replacing non-citizen technical experts within a period stipulated by the cabinet secretary - provide linkage with universities for research and environmental management - implement a community development 	substance whether in solid, liquid or gaseous form occurring naturally in or on the earth, in or under water, in mine waste or tailing (<i>not including petroleum, hydrocarbon gases or groundwater</i>)
National	Regulation 12(3)	Registration applications by	Any construction,

<p>Construction Authority Act <i>(National Construction Authority Regulations 2014)</i></p>		<p>foreigner shall be accompanied by an undertaking that the contractor shall:</p> <p>a) Subcontract/enter into a JV with a local company or person for not less than 30% of the contract value</p> <p>b) Shall transfer technical skills to a local community/person as the National Construction Authority may from time to time determine</p>	<p>extension, installation, repair, maintenance, renewal, removal, renovation, alteration, dismantling, or demolition of—</p> <p>(a) any construction</p> <p>(b) any road, harbour works, railway, cableway, canal or aerodrome;</p> <p>(c) any drainage, irrigation or river control works;</p> <p>(d) any electrical, mechanical, water, gas, petrochemical or telecommunication works;</p>
<p>Natural Resource Benefits Bill, 2014</p>	<p>Preamble and Section 3</p>	<p>Aims to establish a system of benefit sharing in resource exploitation between resource exploiters, the national</p>	<p>This Bill is proposed to cover:</p> <p>a) petroleum;</p> <p>(b) natural gas;</p>

		government, county governments and local communities	(c) minerals; (d) forest resources, (e) water resources; (f) wildlife resources; and (g) fishery resources
Local Content and Participation Bill, 2015	Preamble and Section 2	Aims to maximize local ownership, control and financing in order to increase local value capture from all parts of the value chain created from oil, gas and mineral exploitation	Oil, gas and mining sectors
Petroleum Exploration, Development and Production Bill, 2015- <i>Petroleum Exploration, Development and Production</i>	Regulation (3)	These regulations apply to local content with respect to upstream petroleum operations, and it applies to contractors who have entered into a petroleum agreement with the Government to undertake petroleum exploration and production activities	Upstream petroleum operations

<i>(Local Content Regulations, 2014)</i>			
Energy Bill, 2015 Energy Bill (Local Content) Regulation	Section 265	Local Content Requirements: -Submission of an annual and long term local content plan including sub-plans on : (a) employment and training; (b) research and development; (c) technology transfer; (d) industrial attachment and apprenticeship; (e) legal services; (f) financial services; and. (g) insurance services.	This bill shall apply to any source of electrical, mechanical, hydraulic, pneumatic, chemical, nuclear, or thermal power for any use; and includes electricity, petroleum (<u>excluding upstream petroleum activities</u>), coal, geothermal, biomass and all its derivatives, municipal waste, solar, wind and tidal wave power

(Source: Author, 2015)

It is clear from the above table that there is no congruence in Kenya's law making regarding local content in Kenya. There are deep contradictions in the scope of coverage of local content regulation in Kenya. For instance the Energy Bill states that where any other act

purports to make provisions concerning energy the provisions of the Energy Bill shall prevail.⁶⁶ Notwithstanding that the National Construction Authority Act provides that any electrical, mechanical, gas and petrochemical works fall under the National Construction Authority and contractors are required to obtain registration before commencing constructions on these works or face demolitions and fines.

On the other hand the Petroleum Exploration, Development and Production Bill is very well thought out and detailed but only covers upstream petroleum operations. The Local Content and Participation Bill, which is an attempt to consolidate local content regulation in the extractive sector (including oil and gas) is very shallow and seems to have been written by political activists using such phrases such as “depth and breadth of local ownership” which have no real meaning nor add any value to the statute. It also introduces a concept of local participation but it is not immediately clear how this is different from local content requirements on goods and services provided by the local community in the area of operation. The Local Content and Participation Bill also aims to encompass the area of mining which is well catered for under the Mining Bill, 2014.

3.3.2. Threshold of Recommended Local Content

Only two out of the seven statutes in Kenya expressly provide for percentages of local content required. The National Construction Authority Act⁶⁷, provides that any foreign company

⁶⁶ Energy Bill, 2015

“4(1) If there is a conflict between this Act and any other Act, in matters relating to energy, this Act shall prevail.

(2) For greater certainty, a provision of an Act that provides for a person or body to approve any work or authority to permit or deny any act or omission shall not be construed as giving that person or authority any power with respect to energy.”

⁶⁷ *National Construction Authority Regulations 2014), Regulation 12(3)*

seeking registration from it must give an undertaking to enter into a joint venture with a local company/person for not less than thirty (30%) of the contract value.

The Petroleum Exploration, Development and Production (Local Content) Regulations, 2014 in turn prescribes minimum local content threshold in goods and service to be met by contractors.

Table 5: Local Content Thresholds to Be Attained From Date of Effectiveness of Licence or Petroleum Agreement under the Petroleum Exploration, Development and Production (Local Content) Regulations, 2014

	Item	Start	5 Years	10 Years
1.	Goods and services	10%	50%	60% - 90%
2.	Recruitment and training			
(a)	Management staff	30%	50% - 60%	70% - 80%
(b)	Technical core staff	20%	50% – 60%	70% - 80%
(c)	Other staff	80%	90%	100%

(Source: Petroleum Exploration, Development and Production (Local Content) Regulations, 2014)

In addition to the levels tabulated above, a contractor will be required to obtain a written approval from the Insurance Regulatory Authority before procuring insurance services offshore. Further, the contractor is obligated only to retain only the services of Kenyan legal Practitioners or a firm whose principal offices are located in Kenya, and also only retain the services of a Kenyan financial institution or organisation. Contractors are also required to operate a Kenyan bank account and transact business through a bank licenced by the Central Bank of Kenya to conduct banking business in Kenya.

The Petroleum Exploration, Development and Production (Local Content) Regulations, 2014 also prescribe Specific Levels to be achieved in specific areas such as engineering, fabrication and construction, materials and procurement, well drilling services, R&D, Exploration, subsurface , petroleum engineering and Seismic services, transportation, supply and disposal services.

Table 6: Local Content Levels in Well Drilling Services Petroleum Exploration, Development and Production (Local Content) Regulations, 2014

Well Drilling Services				
Description	Start	5 Years	10 Years	Measured Unit
Reservoir services	20%	40%	75%	Spend
Well completion services (permanent gauges & intelligent wells)	20%	40%	80%	Spend
Wireline services (electric open holes, electric cased hole, slickline)	10%	50%	60%	Man-Hour
Logging while drilling (LWD) (direction and inclination or Gamma ray)	10%	50%	70%	Man-Hour
Wellhead services	30%	60%	85%	Man-Hour
Well watch services	30%	50%	70%	Man-Hour
Cement services	40%	60%	75%	Man-Hour
Coiled tubing services	20%	40%	75%	Man-Hour

Pumping services	40%	70%	95%	Man-Hour
Fluid or bottom hole sampling services	40%	60%	80	Man-Hour
Well crisis management services	20%	60%	90%	Man-Hour
Other drilling services	30%	60%	80%	Man-Hour

(Source: The Petroleum Exploration, Development and Production (Local Content) Regulations, 2014)

It can be seen from the foregoing that different thresholds for meeting the local content regulation are found under the respective statues, whereas some statues are quiet on the levels of local content sought to be achieved.

Most of the respondents (investors) to this study cited multiplicity and lack of clear legislation and policy as their main concern regarding local content regulation in Kenya. There is a general lack of understanding of the local content regime in Kenya, which is full of glaring contradictions and ambiguity. It is also important to ask whether this is the manner in which to maximize benefits from natural resources in Kenya.

3.3.3. Proposed bodies to monitor local content in Kenya

Due to the multiplicity of acts, regulations and statues created to regulate local content in various sectors in Kenya, there are multiple bodies proposed to be set up to monitor local content in Kenya.

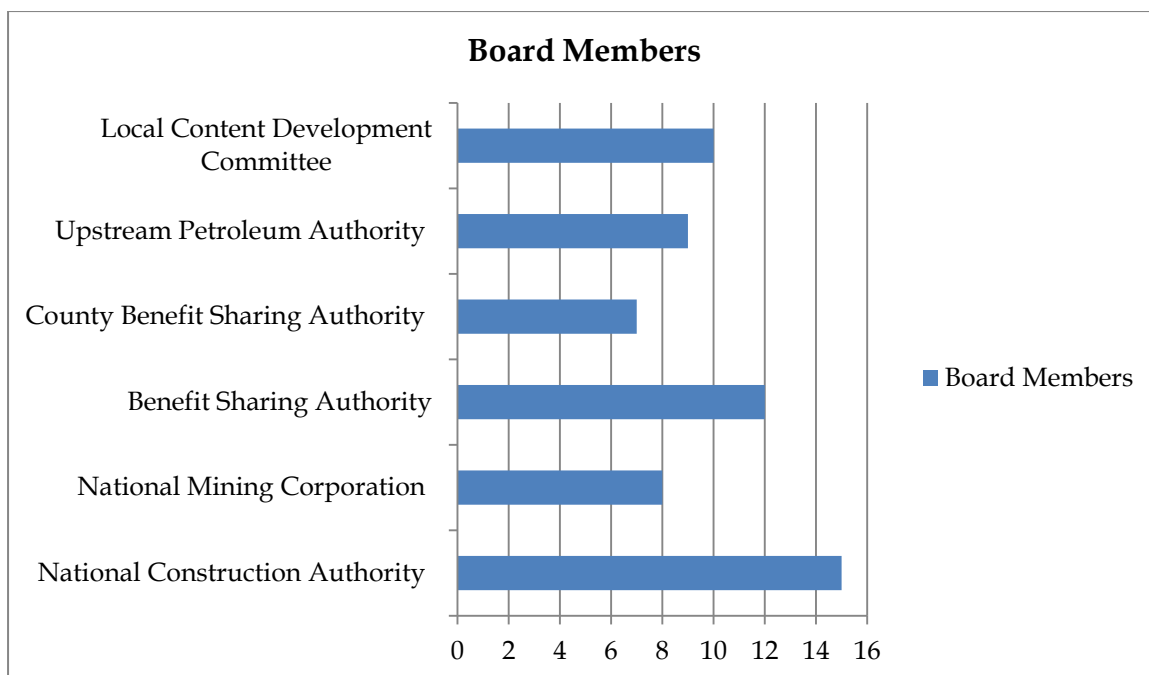
Table 7: Institutional Framework for Monitoring Local Content Regulation in Kenya

Proposed Institution	Monitoring	Act established under	Economic Sector
National Authority	Construction	National Construction Authority (Section 7)	Construction, roadwork, waterworks, electrical, mechanical, petrochemical and telecommunication, site clearing
National Corporation	Mining	Mining Bill, 2014	Natural Minerals (<i>Not including petroleum, hydrocarbon gases or groundwater</i>)
Benefit Sharing Authority		Natural Resources Benefits Bill,2014	a) Petroleum; (b) natural gas; (c) minerals; (d) forest resources, (e)water resources; (f) wildlife resources; and (g) fishery resources
Local Content Development Committee		Local Content and Participation Bill, 2015	Oil, gas and mining sectors
Upstream	Petroleum	Petroleum Exploration,	Upstream petroleum

Authority	Development and Production Bill, 2015	operations
Local Content Development and Monitoring Unit	Energy (Local Content) Regulations, 2014	Any source of electrical, mechanical, hydraulic, pneumatic, chemical, nuclear, or thermal power for any use; and includes electricity, petroleum (<u>excluding upstream petroleum activities</u>), coal, geothermal, biomass and all its derivatives

It is not clear the hierarchy in which these institutions are constituted and which institution has the ultimate final say as regards local content in Kenya. As it is right now it would be confusing for both the foreign and local investor to know which body to deal with especially where the mandate of the bodies overlap for instance with Local Content Development and Monitoring Unit and the National Construction Authority having overlapping mandate over electrical energy works, and similarly the National Mining Corporation and Benefit Sharing Authority having the same mandate over mineral resources in Kenya.

Figure 3: Number of Directors for Various Local Content Institutions in Kenya



As Figure 3 and Table 7 above show, there are currently too many proposed monitoring authorities and boards, the financial burden on the tax payer may end up depleting the benefits made from our natural resources. Running all these boards and authorities may prove too expensive in the long run and may lead to a lot of politicking and supremacy battles between the monitoring bodies.

3.3.4. Beneficiaries of Local Content Regulations:

Finally, the policy makers in Kenya do not seem to be in agreement as to who should be the beneficiaries of opportunities of the local content requirements. Some argue that the local community should be given first priority in meeting the local content requirements.⁶⁸ Whereas the National Government argues that the resources are national resources and therefore all Kenyans should have equal opportunities to invest and benefit from LCR's.

⁶⁸ Senator Gideon Moi (Chair Senate Committee – Energy) has been quite vocal about this. Senator John Munyes – Turkana, Turkana Professional Association – 2015 – Local Content Convention- Nairobi (16th -19th June 2015)

Most respondents (foreign investors) however stated that their primary concern would be to appease the local communities in order to get social licence to operate in the vicinity. The Mining Bill identifies the beneficiaries of the local content regulations therein as the “*local community*” which it further defines as “*a group of individuals or families who share common heritage interest or stake in identifiable land, land based resources or benefits that may be derived from land based resources*”.⁶⁹ The Energy Bill on the other hand defines local community as “*all the persons found within the ward in which the resource is situated*”.

Other LCR Sources

In addition to the proposed and existing statutes, there are soft law mechanisms through which international investors have already been cajoled into local content provision. These include Petroleum Sharing Agreements with local content clauses, and government policy that thirty per cent of the value of all procurements by public entities in Kenya shall be reserved for the youth, persons living with disabilities and women.⁷⁰

Legal Notice 114 under the Public Procurement and Disposal Act requires Public Entities to give preference to local contractors offering:

- motor vehicles, plant and equipment that are assembled in Kenya;
- construction material and other material used in the transmission and conduction of electricity made in Kenya;
- furniture, textiles, foodstuffs and other goods made or locally available in Kenya.

⁶⁹ Mining Bill 2014, Section 1

⁷⁰ Public Procurement and Disposal Act, Legal notice No. 210

More recently, the President decreed that 40% of all public entity procurements shall be from Kenya.⁷¹ Although it is not immediately clear how these provisions will work in tandem with each other. According to the Petroleum Exploration and Development Department (Uganda)⁷² The following procedure should be followed prior to law making regarding local content

Figure 4: Proposed Law-making Procedure for Local Content Regulations



(Source: Uganda- Petroleum Exploration and Development Department, 2015)

Conclusion

It is evident from the above analysis that Kenya has no congruent policy regarding local content. There is superfluous legislation regarding local content in Kenya, forming a cacophony of laws and regulations that are hard to follow understand and abide by. The attempt to consolidate all the local content legislation is weak and lacks focus on what Kenya's national objectives are as regards local content. Kenya needs to start from the point of a national local content policy involving all stakeholders. Additionally, Kenya's legislators also need to keenly assess what Kenya's options are under the WTO regimes applicable to Kenya and more particularly as regards LCRs. The next chapter shall assess socio-economic environment within which Kenya seeks to introduce local content regulation mechanisms.

⁷¹ Presidential Decree at Madaraka day Celebration – 1 June 2015

⁷² Interview with Dozith Abeinomugisha Petroleum Exploration and Development Department

CHAPTER FOUR

LOCAL CONTENT EXPERIENCE IN KENYA: REALITY OF DEVELOPING AND IMPLEMENTING LOCAL CONTENT

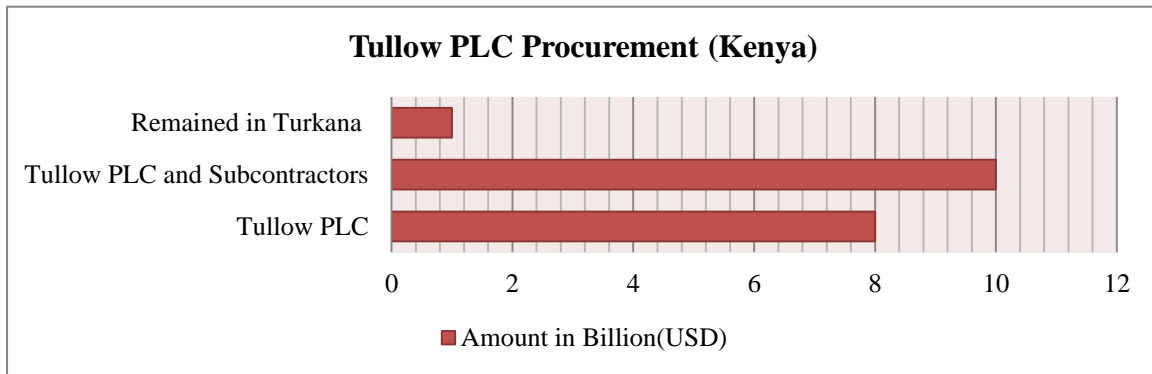
4.1. Introduction

This chapter focuses on the current socio-economic environment and experience in Kenya *vis- a – vis* local content regulation from the perspective of IOCs, foreign investors and local investors. One of the interviewees, Tullow Oil PLC, acknowledges that it is useless to fight a host country that has decided to implement LCR's and ventured that it is actually cheaper to hire and procure locally if the goods and services are of the right quality and delivered efficiently.⁷³

Foreign investors also acknowledge the shared prosperity that LCR's would bring between the foreign investor and the local community. Respondents also agreed that the implementation of LCR's in Kenya would give them the social licence to operate in Kenya thereby reducing the likelihood of stalled or interrupted work due to local community conflicts centred on the natural resources. A screen shot of one international oil company's impact in the past three years in the Kenya's goods and services market is shown below in figure 5. Out of ten billion US Dollars spent by Tullow Oil PLC in Turkana, only a paltry One Billion US Dollars remained in Kenya. Not to say that this amount is not beneficial to the local economy as it is, but there is an opportunity to have more forward and backward linkages with this company to ensure that more of that procurement is locally sourced and more of those dollars are injected into Kenya's economy. Imagine what four billion US Dollars could do in terms of creation of employment in Kenya.

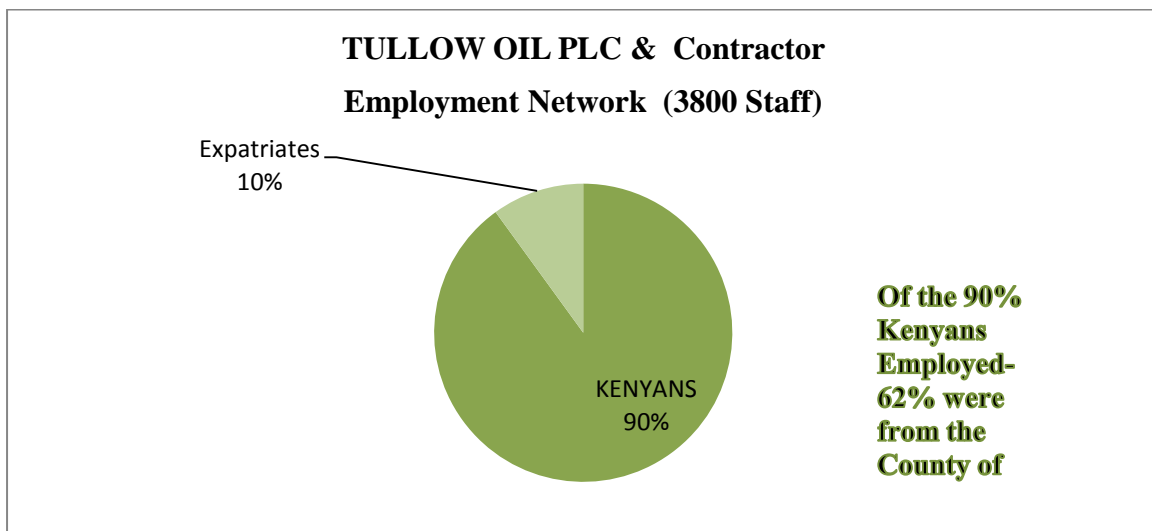
⁷³ Edward Mungatana - Tullow Oil PIC – Head of HR Tullow Oil

Figure 5: Tullow Oil PLC Procurement Statistics in Kenya since 2013



(Source: Tullow Oil PLC 2015)

Figure 6: Tullow Oil PLC Employment in Kenya

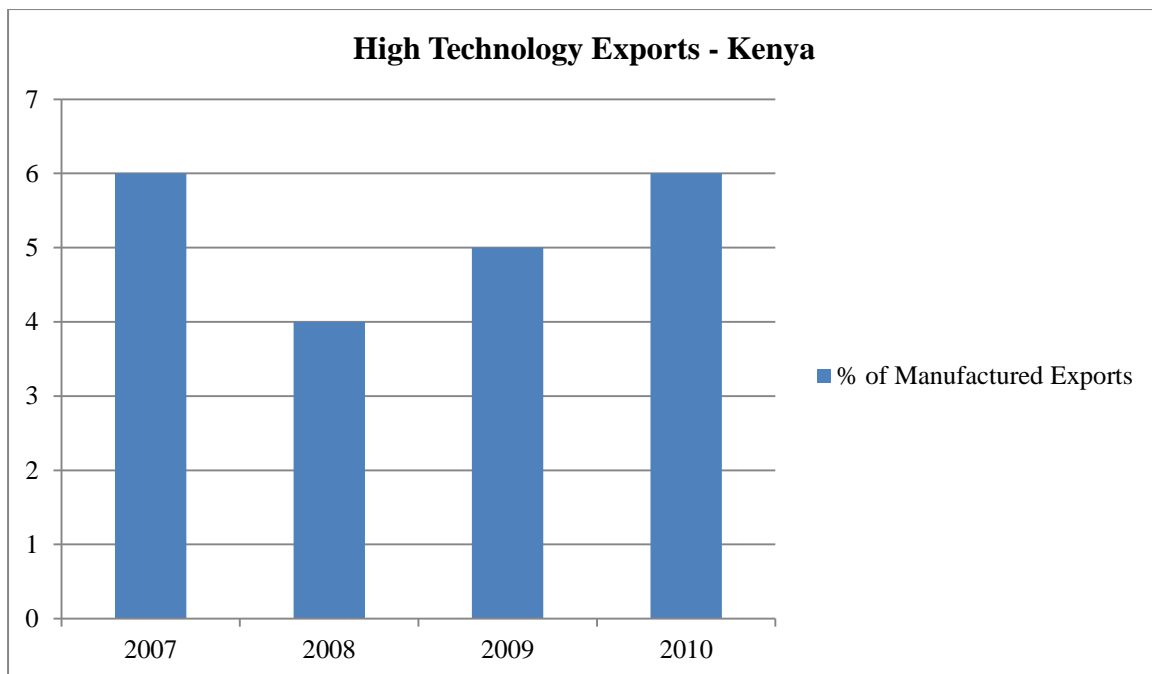


(Source: Tullow Oil PLC,2015)

The potential of the positive impact of LCR's can be seen from Figure 5 and 6 above which gives an indication of the colossal sum of money spent by one firm only in the exploration phase of oil in Turkana, Kenya. There is certainly room to significantly increase the amount of money remaining in Kenya through local content regulations and the multiplier effect thereof.

According to a World Bank Survey, out of Kenya’s exports less than ten per cent constitutes high technology goods. High Technology goods in this case being products with high research and development technology such as in aerospace, computers, pharmaceuticals, scientific equipment and electrical machinery. This tells us two things, that there is need to develop Kenya’s high technology goods if Kenya is to meet its ambitious local content quotas and that Kenya in its current situation may not be able to meet the highly specialised needs of the energy oil and gas sector that requires very high technology.

Figure 7: Kenya Secondary (High Technology) Exports



(Source: World Bank Data Bank, 2015)

Respondents in this study cautioned that Kenya faces some inherent challenges that need to be adequately addressed to create an enabling environment for both local and foreign investors if the LCRs were to achieve the goals they set out to achieve in Kenya. These challenges are now expounded in the following section of this chapter backed by statistical data and empirical evidence where available.

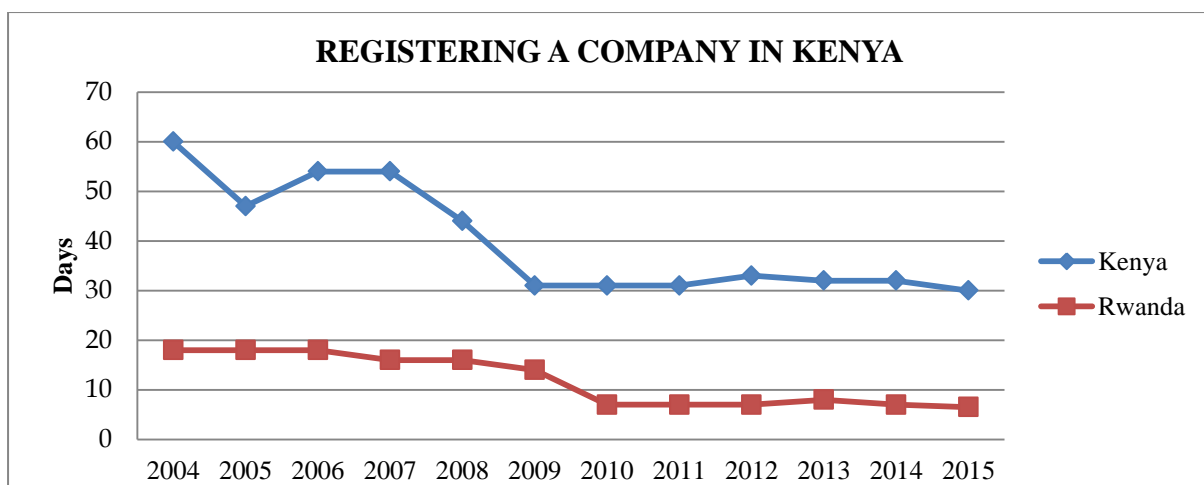
4.2. Barriers to Doing Business in Kenya

Local investors interviewed earmarked barriers to doing business in Kenya as some of the main challenges to local content development by Kenyan entities. According to the World Bank Doing Business (2015) Report, Kenya in the year 2015 was ranked 143 out of 189 countries, a drop from rank number 134 in the year 2014. This would seem to indicate that it has actually gotten more difficult to do business in Kenya between 2014 and 2015. The report indicates that this drop may be largely due to increased tax burden placed on the investor with the re-introduction of capital gains tax, whose calculation and mode of collection is still unclear and highly contested. Below we also look at the main factors constituting barriers of entry in the Kenyan Market for local investors.

4.2.1. Registering a Company in Kenya

Figure 8 below illustrates the average number of days required to register a Company in Kenya as compared to Rwanda. In Kenya an average of thirty (30) days are required to fully register a company. Keep in mind that this thirty (30) day period is the ideal best case scenario. This being a huge improvement from the average 60 days required to register a company in Kenya in 2004.

Figure 8: Average No. of days taken to register a company in Kenya and Rwanda

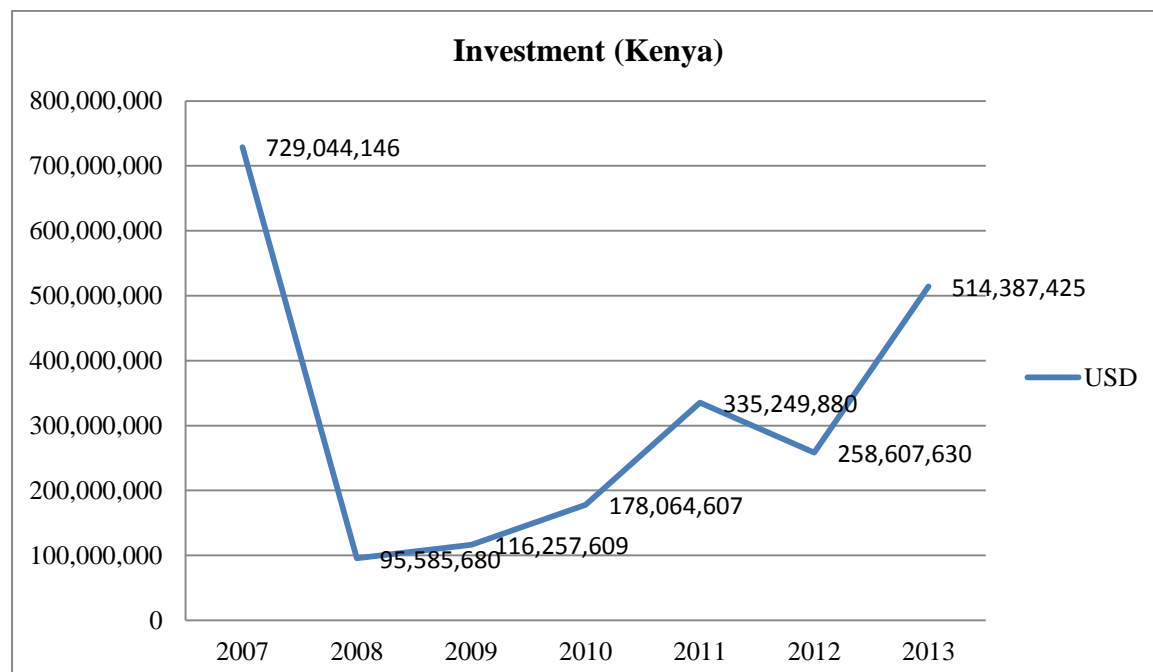


(Source: World Bank Group: Doing Business Report)

In order to register a company in 30 days, an average of 10 procedures must be followed in which a prospective investor would have to deal with more than five government offices. The multiplicity of procedures and persons to deal with in registering a company, not to mention the disorganisation, loss of documentation, bureaucracy, corruption and general lethargy in government offices are some of the barriers an investor is faced with whilst registering a new company. One of the respondents interviewed with great fatigue stated that in order to register a business in Kenya, one must know a government official, one must know that government official really well, and thirdly that government official must owe you a favour. Kenya's company registration regime is unfavourable as compared with Rwanda, where a company can be registered within six and a half days, and where the investor mainly deals with one state department.

4.2.2. Political Environment and Strength of Legal Rights

Figure 9: Co-relation between rate of investment and Political Environment in Kenya



(Source: World Bank Data Bank 2015)

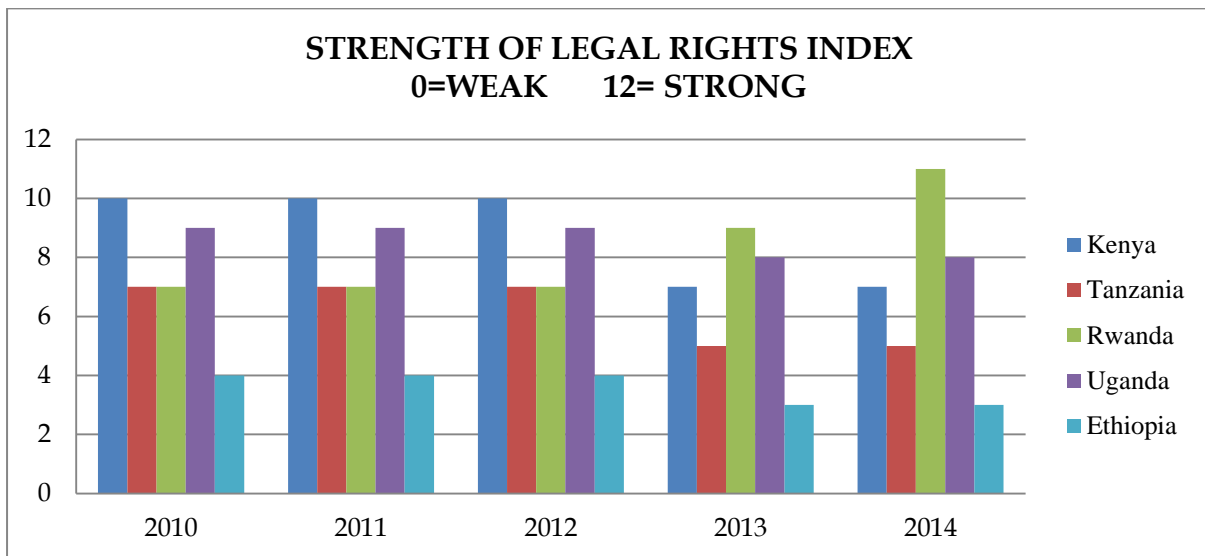
Figure 9 above is indicative that investment in the Kenyan market fell sharply after the year 2007 and perhaps this is attributable to the 2007 post-election violence that shook investors' confidence with numerous businesses recording colossal losses and losing assets in the violence. However, there is also indication that the rate of investment⁷⁴ is steadily increasing having reached Five Hundred and Fifteen Million, Three Hundred and Eighty Seven Thousand Four Hundred and Twenty Five US Dollars (USD 515, 387,425) by the year 2013.

It is well worth noting that the rate of investment fell again during the next election year 2012 to Two Hundred and Fifty Eight Million, Six Hundred and Seven Thousand, Six Hundred and Thirty US Dollars (258,607,630 USD). This is a very strong indication that the political situation of Kenya directly affects the rate of investment in Kenya. It is still yet to be seen how the next election in 2017 and the politics in the run up to that election shall affect the more long term investments found in the energy oil and gas sector.

The political situation in Kenya is further adversely affected by the fact that Kenya does not fare too well on the legal rights index (below) meaning investor's and their investments are not accorded the strongest legal protection especially in times of political upheaval when they need it the most.

⁷⁴ Foreign Direct Investment as defined by the World Bank as “ Direct Investment equity flow in the reporting economy, sum of equity capital reinvestment of earnings and other capital associated with a resident in one economy having control/significant degree of influence on the management of an enterprise but resident in another economy”

Figure 10: Strength of Legal Rights Index Comparison



(Source: World Bank Data Bank 2015)

4.2.3. Other Barriers to doing business in Kenya

4.2.3.1. High Cost of Electricity in Kenya

According to the Kenya Association of Manufacturers, energy costs account for up to forty (40%) per cent of all production expenses in Kenya.⁷⁵ They have continually decried the high cost of electricity in Kenya, with over 34% of Kenya’s energy being generated from thermal sources i.e. diesel generators which are constantly affected by the rising cost of fuel and adversely affected by the weakening Kenya Shilling. According to a report by the Energy Regulatory Commission former Chairman, high energy costs are further propagated by the high percentage of the cost of foreign input in the energy sector in Kenya.⁷⁶ Apart from fuel most of the plants, equipment used in generation, transmission and distribution, as well as personnel are imported. Design, engineering and construction of most energy related

⁷⁵ The East African, Kennedy Senelwa – 12 January 2013, <http://www.theeastafrican.co.ke/business/Kenya-injects-668MW-into-national-grid/-/2560/1663910/-/item/0/-/8kn25t/-/index>.

⁷⁶ H.S Jabal, Chairman ERC, *Power Situation in Kenya*, Energy Regulatory Commission

⁷⁶ <https://stima.regulusweb.com/> Last accessed 29 September 2015

infrastructure is also foreign. All these factors, have contributed to Kenya’s high energy costs.

To add insult to the injury, the manufacturers are further aggrieved by frequent power cuts and electricity surges. Betty Maina, the CEO of KAM states that manufacturers would rather have expensive electricity rather than unreliable electricity supply and this has seen an exodus of manufacturers to Egypt, South Africa and South East Asia.⁷⁷ Devki Steel Mills CEO, Narendra Raval argues that expensive and unreliable energy has placed Kenyan manufacturers in a very uncompetitive position with Kenya’s local energy tariffs are double the international energy tariffs.⁷⁸

Figure 11: Cost of Electricity in Kenya, compared to costs in South Africa and Egypt

	KENYA		SOUTH AFRICA		EGYPT	
	Ksh per Kwh	% Cost of Foreign Input	Ksh per Kwh	%Cost of Foreign Input	Ksh per Kwh	% Cost of Foreign Input
Generation (Capacity)	4.0	70%	1.5	60%	1.5	70%
Fuel Cost (Av)	5.5	90	1.5	30	2.0	30
Total Gen. Cost	9.5	83	3.0	45%	3.5	37

⁷⁷ The East African, Kennedy Senelwa – 12 January 2013, <http://www.theeastafrican.co.ke/business/Kenya-injects-668MW-into-national-grid/-/2560/1663910/-/item/0/-/8kn25t/-/index.html>

⁷⁸ All Africa , Ricahard Mungai – Manufacturers concerned over High Power Costs – July 2014 Accessed at <<http://allafrica.com/stories/201407150271.html> > last accessed 25 July 2015

Transmission	0.7	80%	1.0	70%	1.0	70%
Distribution	2.8	50%	2.0	40%	1.5	40%
Total Ksh/kWH	13.0	75	6.0	48	6.0	50%
UScts/kWH	17.0		8.0		8.0	

(Source: Energy Regulatory Commission)

Figure 12: Electricity Tariffs in Kenya

	Before December 2013		Dec 2013 – June 2014		June 2014 – June 2015	
	Fixed (Ksh)	Energy Charge per kWh	Fixed (Ksh)	Energy Charge per kWh	Fixed (Ksh)	Energy Charge per kWh
CI1	800	5.75	2000	8.70	2000	9.45
CI2	2500	4.73	4500	7.50	4500	8.25
CI3	2900	4.49	5000	7.00	5500	7.75
CI4	4200	4.25	6500	6.80	6500	7.55
CI5	11000	4.10	17000	6.60	17000	7.35

(Source: Energy Regulatory Commission)⁷⁹

4.2.3.2. Poor Infrastructure

Recent studies show that infrastructure constraints are responsible for up to 30% of Kenya's productivity handicap,⁸⁰ with electricity and transport constraints being the top two

⁷⁹ <https://stima.regulusweb.com/> Last accessed 29 September 2015

⁸⁰ IBRD, Africa Infrastructure Country Diagnostic – A Continental Perspective – Kenya, 2010 Washington, World Bank

infrastructural constraints. Only 30% of rural Kenya is within 2 kilometres of an all season road⁸¹. A breakdown of Kenya’s infrastructural challenges is given below:

Table 8: Infrastructural Challenges in Kenya

Infrastructural Challenges in Kenya	
Area	Challenge
Air Transport	Achieving US Category 1 Security Clearance
ICT	Strengthen completion and bring down prices and create a competitive international gateway
Electricity	Ensure reliable supply at competitive prices
Ports	Increase efficiency and capacity
Roads	Increase paved road network density
Railways	Upgrade and Redesign railway
Urban Infrastructure	Low access to services
Water and Sanitation	Improve water and sanitation

(Source: ADF - Africa Infrastructure Country Diagnostic -AICD) ⁸²

4.2.3.3. Complicated Tax Regime

Most of the interviewees decried Kenya’s complicated tax regime, with investors being liable to comply with more than five tax laws and the continual review of tax laws and tax bases by both the national and county governments. The last three years has seen the re-introduction of capital gains tax, introduction of the railway development levy, introduction of excise duty on all financial services and a review of value added tax law not to mention the numerous taxes concurrently imposed by the county governments in the areas of operation.

⁸¹ Ibid, pg 6

⁸² www.infrastructureafrica.org

Additionally, there has been poor administration of tax and therefore the Kenya Revenue Authority has been relying on 0.34% of the registered companies to generate 70% of the total revenue collected.⁸³ This means the few entities that actually pay taxes are over taxed whereas some registered companies have never paid their taxes. The review of Kenya's tax regime has actually negatively impacted Kenya's position on the World Bank Doing Business Index.⁸⁴

Kenya's tax regime is further complicated by the devolved government structure introduced by Kenya's 2010 Constitution which allowed county governments to levy taxes for services devolved to the county government. This has seen an ambitious bid by county governments to introduce taxes on all sectors of investment including chicken rearing. For instance the Mombasa County Government proposed to introduce a levy of \$2 per tonne or \$10 per consignment for cargo shipped to Mombasa Port, in addition to the already existing customs and excise duties as well as railway development levy.⁸⁵ This increased tax rates would make the cost of doing business in Kenya highly uncompetitive for local businesses seeking to enter the energy, gas and oil sector.

4.2.3.4. **Corruption**

The Transparency International Corruption Perception Index placed Kenya at position 145 out of 175 countries analysed. On a scale of 0-100, where 0 was highly corrupt and 100 was clean, Kenya scored 25 in 2014 a drop from a score of 27 in 2013 and 2014. So despite the Government of Kenya's efforts to stamp out corruption, faith in Kenya's public service, judiciary and police is on the decline. In the recent past corruption has been blamed for the increased terrorist activity in Kenya, terrorism and the attendant travel advisories scares away Kenya's investors.

⁸³ World Bank Doing Business Report (2015)

⁸⁴ World Bank Doing Business Report (2015)

⁸⁵ Sarah McGregor, Bloomberg, November 2014 "Kenya Counties Wider Tax Plans Scare Investors"

Additionally, corruption increases the transaction cost of doing business as extra money is required by investors to pay off bribes. Corruption also prevents foreign investment in Kenya as many investors e.g. those from the United States are legally bound by law to “know their customer” i.e. carry out due diligence on the companies they engage with to prevent dealings with corrupt individuals.

4.3. Challenges to Local Content Development and Implementation in Kenya

4.3.1. Information Asymmetry

Out of the respondents interviewed, all the respondents acknowledged that there is an information gap in the Kenyan market regarding the foreign investor’s needs and the goods and services locally available in Kenya. Some respondents also felt that it was important to provide more innovative autochthonous solutions to investors and not just allocate quotas that need to be met by the investors in the local content regime.⁸⁶

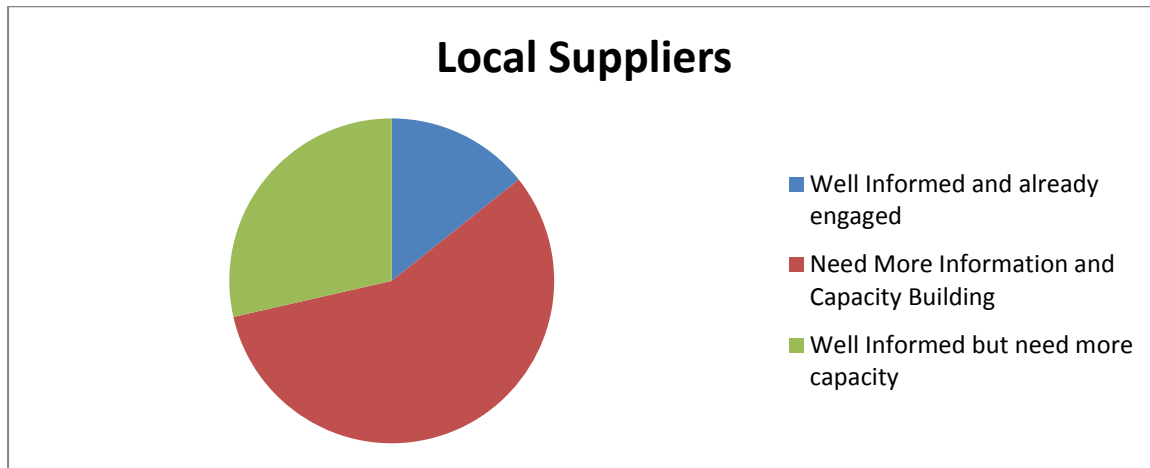
There seems to be consensus among the industry stake holders that there is an information gap that threatens to hamper the local content regulation drive. Foreign investors do not have adequate information about what is available in the Kenyan market and the actors in the Kenyan market do not know the specific needs of investors in the energy, oil and gas sector and the opportunities therein. There is no data base with this information. This leaves both international and local investors groping in the dark and spending large amounts of time and money trying to understand the sector and the market.⁸⁷ Senator Gideon Moi opines that Kenya faces systemic challenges that make it difficult to know who locally is already

⁸⁶ Stephen Mwakesi – Ag. Chief Executive Officer, Kenya Chamber of Mines

⁸⁷ Joel Macharia, Abacus Limited Global Enterprise Summit (July 2015)

engaged in the sector, the extent to which Kenyans have the goods and services needed by foreign investors and the goods and services actually needed by the investors.⁸⁸

Figure 13: Local Suppliers and the Information Asymmetry



(Source: Author, 2015)

Out of the local suppliers interviewed, only three firms were already mobilized on the ground providing specialised oil field services, geo-consultancy services and rig move services respectively. The rest of the local suppliers interviewed e.g. banks, auditors and law firms only provided the investors with routine non-specialised services, but strongly felt the need to understand the energy, oil and gas sector and its needs better in order to come up with more innovative solutions to the investor's needs.

Conversely, the international oil companies interviewed also decried the lack of a baseline study in Kenya detailing all the locally available resources in terms of goods and services that are currently available to enable them meet their local content quotas. Currently, investors can only access information available from the World Bank Doing Business Index and Report and the Africa Development Bank – Information Centre for the Extractives Sector

⁸⁸ Remarks By The Sen. Gideon K. Moi, Mp, Chairman Standing Committee On Energy Of The Senate Presented During The Oil And Energy Services Local Content Convention (16th -19th June, 2015 At Safari Park Hotel, Nairobi.

(ICES) which was launched in December 2013. ICES seek to promote stakeholder dialogue based on neutral transparent and evidence based information. A perusal of both fora does not address the systemic challenge mentioned earlier because they do not specifically analyse the goods and services available in Kenya and there is no data regarding which specific firms locally are capable of provide the goods and services and which goods and services these Kenyan firms actually provide.

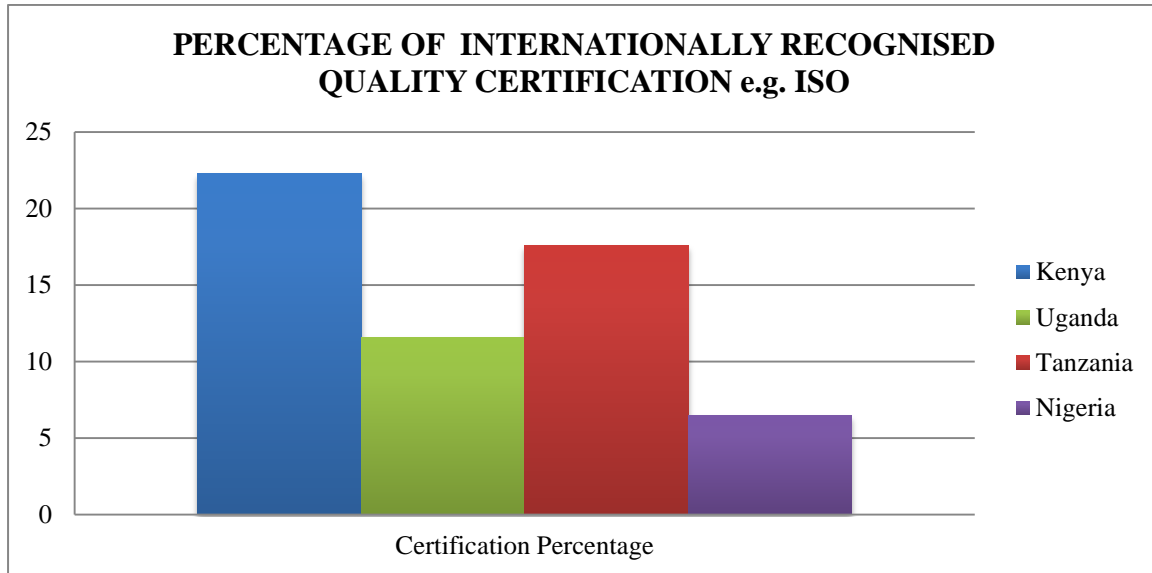
There is no information on the specific goods and services required by the international investors, the quantities and durations for which they are needed, the international standards the investors follow, the average lead times and turnaround times. It is still unclear how and whether all these factors were taken into consideration whilst coming up with the proposed local content quotas and how the government quantified the investors needs *vis- a- vis* the local market without a proper baseline study. This information asymmetry needs to be addressed as a matter of priority.

4.3.2. Quality Control

Also of significant concern to the investors was the quality of goods and services available in Kenya. As can be seen in Figure 14 below according to the World Bank, Kenya has a relatively high percentage of internationally recognised quality certification, however at 22.3% there is still a lot of room from improvement on this front. It is absurd that Nigeria which has implemented local content regulations has a rate of international quality certification of merely 6.5%. George Wachira, a director at Petroleum Focus Consultants reiterates the need for the alignment of local content with industry energy oil and gas

expectations. At present there are more than 200 ISO standards applicable to enterprises in the oil and gas sector.⁸⁹

Figure 14: Percentage of Level of recognised Quality Certification in Kenya



(Source: World Bank Data Bank 2015)

4.3.3. Technicality of Drilling and Oilfield Services and Goods

Another major concern for the respondent foreign investor companies was the co-relation between the proposed high levels of local content quotas in contrast with the highly technical services required in the energy, oil and gas sector. For instance some local content quotas under the Petroleum Exploration, Development and Production (Local Content) Regulations (2014) are illustrated below:

⁸⁹ These can be accessed at < <http://www.iogp.org/Portals/0/Standards/standardsposter.pdf> >

Table 9: Extract of Kenya’s Local Content Quotas

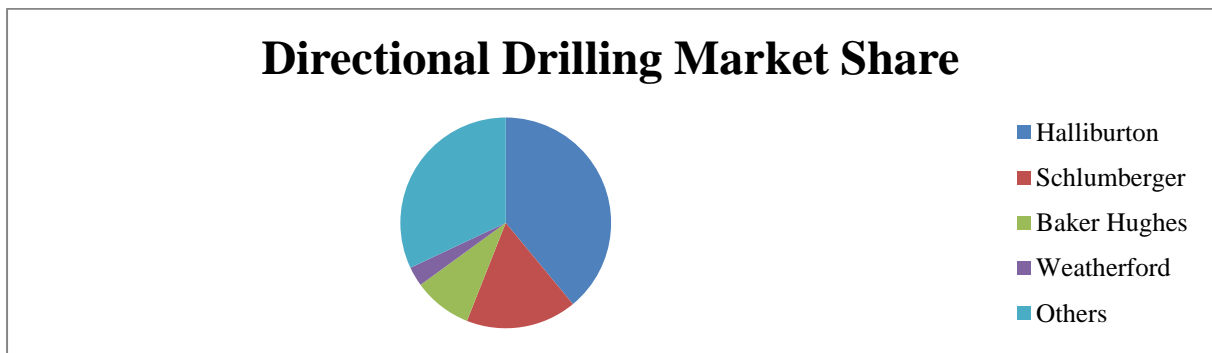
Service	Start	5 years	10 years	Measured Unit
Reservoir Services	20%	40%	75%	Spend
Well Completion Services	20%	40%	80%	Spend
Wireline Services	10%	50%	60%	Man- Hours
Logging while drilling	10%	50%	70%	Man- Hours
Production/Drilling Services	30%	60%	85%	Man-Hours
Well Head Services	30%	60%	85%	Man-Hours
Cement Services	40%	60%	75%	Man –Hours
Coiled- Tubing Services	20%	40%	75%	Man-Hours
Pumping Services	40%	70%	95%	Man- Hours
Well- Crisis Management Services	20%	60%	90%	Man-Hours
Rental of Drill Pipe	40%	60%	75%	Spend

(Source: Petroleum Exploration, Development and Production (Local Content) Regulations, 2014)

Respondents felt that the level of some of the well drilling services included as part of the local content quotas may be hard to obtain locally due to the highly specialized level of skill required to provide some of these services. Tullow Oil was concerned about the high level of skill required considering that the technology required in energy services is bespoke using patented technology owned by a few global players. Tullow Oil and Anadarko both concurred that the level of skill required to provide this level of services required a lot of

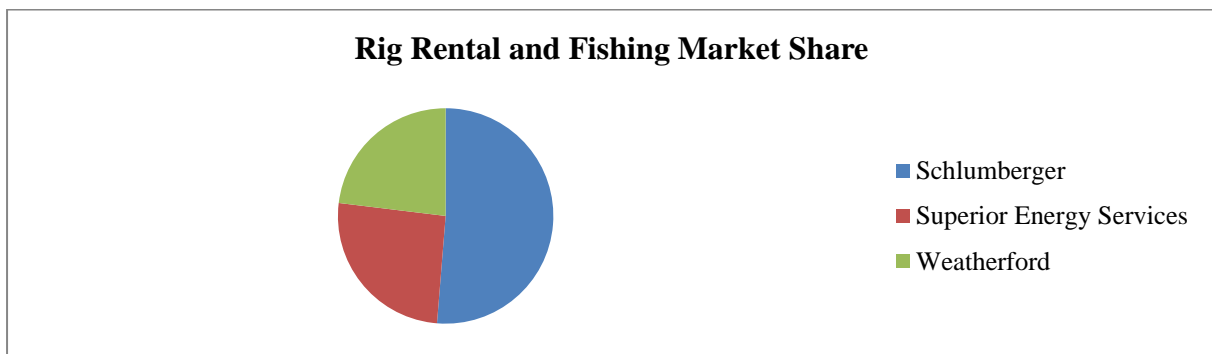
specialised training and extensive hands on experience. Anardarko states that highly technical skills are needed for drilling services such as: wireline logging, surveys, drilling, logging, casing, cementing, drill stem testing, fishing (stuck tool retrieval), drilling & materials, mud and data logging, core logging rig hire and rig operation. Weatherford emphasised this by showing how limited competition was in the energy, oil and gas sector. An indication of the market share in various services is illustrated below:

Figure 15: Market Share Directional Drilling



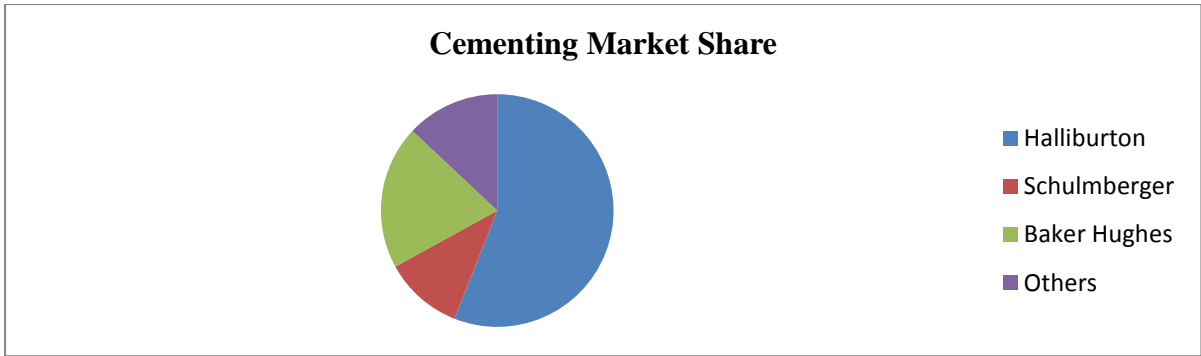
(Source: Scotia Howard Weil 2015)

Figure 16: Market Share – Rig Rental and Fishing



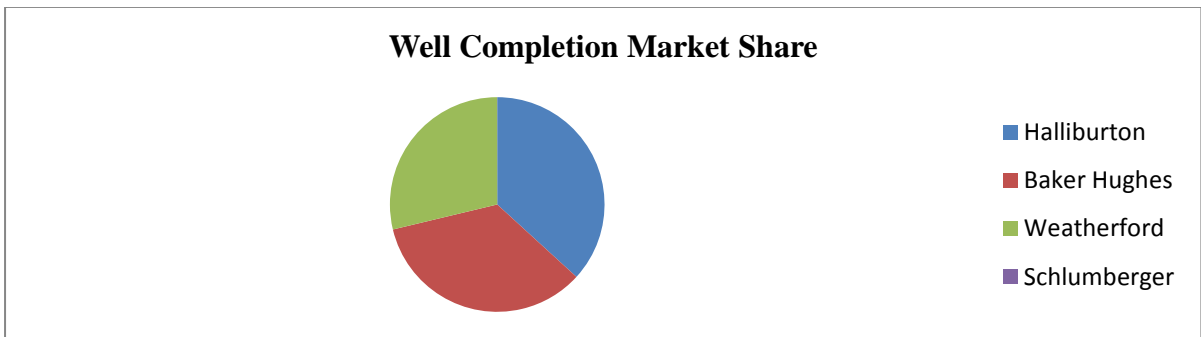
(Source: Scotia Howard Weil 2015)

Figure 17: Market Share - Cementing



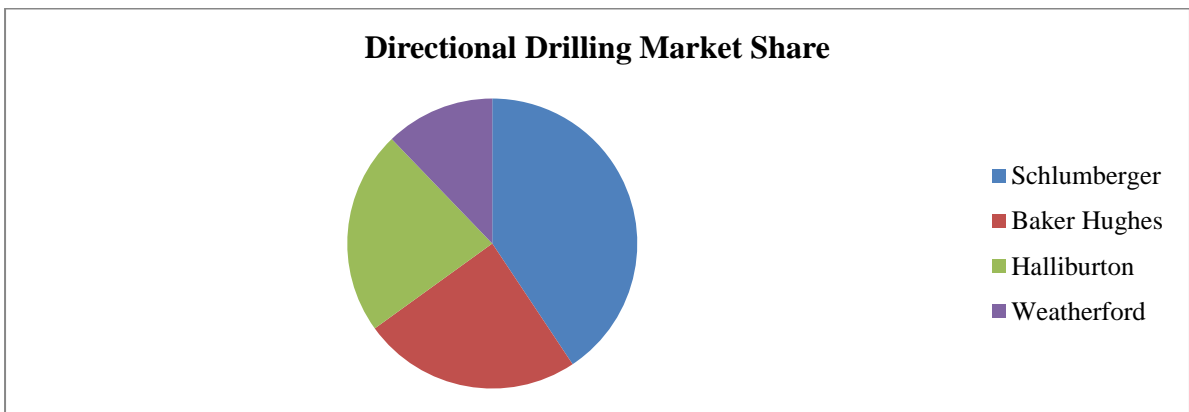
(Source: Scotia Howard Weil 2015)

Figure 18: Market Share – Well Completion



(Source: Scotia Howard Weil 2015)

Figure 19: Markey Share – Directional Drilling Share



(Source: Scotia Howard Weil 2015)

As illustrated above, the oil and service drilling sector has very limited competition with only four companies – Halliburton, Schlumberger, Baker Hughes and Weatherford dominating the

oilfield services market globally. This could be because of the highly capital intensive nature of energy , oil and gas services, requiring numerous years of training and hands on experience never mind the expensive research and development required to hone top level skill sets.

It is yet to be seen how young Kenyan companies will compete with these well-established gigantic companies in the provision of drilling services to meet local content requirements. This is compounded by the fact that some of the technologies and techniques used in the oil field services have been patented and may not be readily available to Kenyan companies as they are owned by a few international companies who are in the service market themselves.

Additionally, in order to gain the required skill and competence, considerable amounts of physical experience are required, which would entail Kenyan workers gaining skills from these foreign companies for long periods of time. Additionally it will be interesting to note that some of the companies Kenya seeks to compete against have been in existence for a long time and have acquired a lot of experience and intuitional memory. The 10 years envisaged by the 2014 Local Content Regulations may not be enough to develop the skill set base in Kenya enough to provide equivalent or better services as the big four companies mentioned above.

The respondents concur that the most opportunity in the Kenyan market for local companies is in the area of non- specialised services (*see figure 20*) which are not capital intensive, and common place, without requiring very highly specialised services.

Anardarko, a company already engaged in exploration drilling off Kenya's shores states that the local skills it currently uses include: accommodation, catering, logistics, shipping agency services, moving equipment and crane services, chartered flights, fuel and immigration service. Anardarko additionally stated that due to the very nature of off-shore drilling, it has

extremely high safety requirements including extensive training on offshore survival training which is not currently available in Kenya. Also since Anadarko undertakes its work on small deep water rigs with limited space, it carries out its operations with minimal but highly skilled workers who are transported to the deep water rigs using chartered helicopters. In this regard, it cannot afford to have any person on the rig who is not absolutely pivotal to the drilling work.

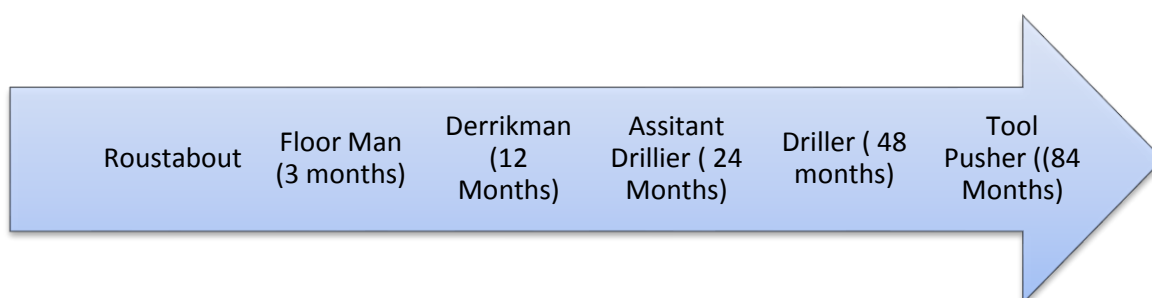
Figure 20: Various Levels of Investment Opportunities in Local Content in the Energy, Oil and Gas



(Source: Tullow Oil PLC)

Respondents also cautioned that it takes a long time to train personnel and equip them with the requisite level of experience, and they wanted to know what considerations Kenya had taken to this end as regards the imposition of certain levels of LCRs. For instance the time taken to train a tool pusher is illustrated below:

Figure 21: Training a Tool Pusher in the Oil and Gas Sector



(Source: Societe de Maintenance Petroliere et de Forage SMP)⁹⁰

In this regard, most international foreign investors feel that the timeframes envisioned in the local content regulations are not feasible to enable interested local companies and personnel adequate time to learn and gain experience to provide specialist and specialist oil and gas services.

4.3.4. Raising Capital

The Government of Kenya is ardently encouraging foreign investors and local investors to raise capital in Kenya through Kenya’s robust capital markets and securities exchange.⁹¹ However both local and foreign investors interviewed indicated that there are numerous challenges in accessing credit in the Kenyan market such as low risk appetite for start-up companies and early exploration firms, expensive credit, high inflation rates and extremely

⁹⁰ A French Company in charge of drilling and work overs

⁹¹ William Ruto, Deputy President- Local Content Convention (16th -19th June 2015)

high interest rates and general lack of information regarding raising capital. George Wachira a director at Petroleum Focus Consultants opines that the local market is not supportive of “pioneer local content organisations” but no local content can take off without availing sufficient credit to Kenyan enterprises venturing into the energy oil and gas sector. Local firms are also not well informed of the financial options they have e.g. equity capital, private equity, debt venture capitalism. They may need financial advice as to whether to engage in debt capital or equity capital and when this would be advantageous to them.

Additionally, local investors interested in taking advantage of the local content quotas proposed by the Government of Kenya find it harder to raise capital locally than their international competitors. For instance international competitors have easier access to capital with lower interest rates of around six (6%), per annum⁹² whereas Kenyan entities can access capital at an average rate of 19.56% per annum for the last five years as illustrated below.

Table 10: Kenya Commercial Bank Average Lending Interest Rate

Commercial Bank Average Lending Interest Rate		
Year (January)	Lending	Overdraft
2010	14.98	14.25
2011	14.03	13.93
2012	19.54	20.38
2013	18.13	17.97
2014	17.03	16.82
2015	15.93	15.95

(Source: Central Bank of Kenya, 2015)

⁹² Vaaland I. T Soneye S.A and Owusu A.R – Local Content and Struggling Supplier; A Network Analysis of Nigeria Oil and Gas Industry - 2012

Although the Central Bank of Kenya has tried to contain the levels of inflation in the country, it is and has been a reality that Kenyan entities have to deal with and in terms of generating local content; it may be a challenge as it portends higher cost of locally manufactured goods.

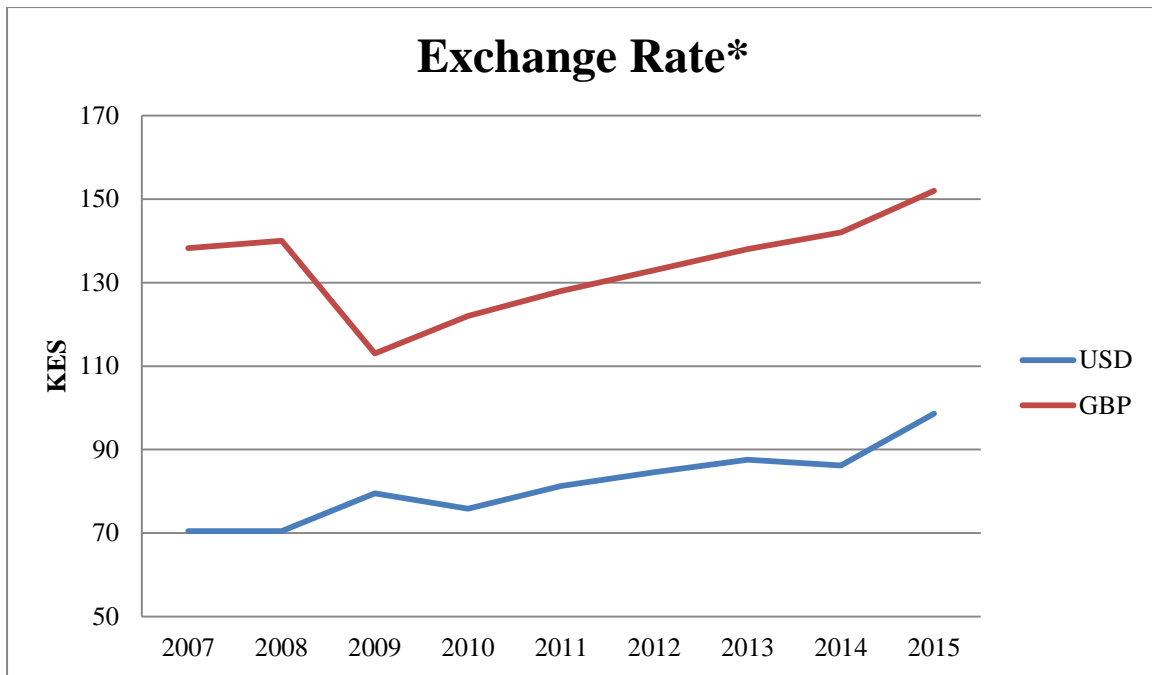
Table 11: Inflation Rates in Kenya 2007-2015

Inflation Rate (Kenya)	
Year	Inflation Rate*
2007	6.08
2008	4.69
2009	16.56
2010	8.64
2011	3.93
2012	15.1
2013	8.2
2014	6
2015	6.72

(Source: Kenya National Bureau of Statistics, 2015)

**Inflation based on percentage change of the consumer price index over a one year period*

Figure 22: Exchange Rates in Kenya 2007- 2015



(Source CBK 2015)

*Unweighted Average of buying and selling rates

Also in an effort to contain the steadily depreciating value of the Kenya Shilling against major currencies such as the US Dollar and the Great British Pound, the Central Bank of Kenya has consistently raised interest rate in Kenya in 2015, this having the ripple effect of raising the cost of credit to the disadvantage of local entrepreneurs.

Burbridge Capital sees a real opportunity for Nairobi to become a specialist hub for raising capital for regional natural resource firms stating that there are strong indications that the Growth Enterprise Market Segment (GEMS) could be highly beneficial to investors in the energy, oil and gas sector as the listing requirements have been favourably adjusted to make entry into the market easier in this segment as shown below.

Table 12: Comparison of GEMS and MIMS in Kenya

MIMS	GEMS
Minimum Capital KES 50 Million	Minimum Capital KES 10 Million
No Induction for directors	Directors inducted
3-5 year record of profitability	No record of profitability required
Company must be registered in Kenya	A Branch registered in Kenya is sufficient

(Source: Burbridge Capital, 2015)

As has been seen in the past, most initial public offerings (IPO's) in the recent past have been oversubscribed. Kenyans are increasingly gaining more knowledge and information about the capital markets. It remains to be seen how the capital markets shall support local enterprises venturing into the energy oil and gas sector. It will also be interesting to see whether the Government of Kenya would be willing to provide credit at lower interest rates specifically for the energy oil and gas sector as has been done in Brazil by BNDES the Brazilian state owned development bank which has a R\$4 Billion Fund for the Support Program for the development of the supply chain for oil and gas related goods and services. This program aims at removing the main obstacles impeding competitiveness such as difficult access to credit and high cost of capital. BNDES offers interest rates of 4.5% p.a. for innovation and 11.04% p.a. for financing working capital.⁹³

4.3.5. Local Community Expectations and Devolution

⁹³ See http://www.bndes.gov.br/SiteBNDES/bndes/bndes_en/Institucional/Press/Noticias/2011/20110803_petroleo.html last accessed 25 July 2015

Tullow Oil PLC decried the high expectations from the community immediately when the Government of Kenya announced that commercially viable reserves of oil had been found in Turkana; notwithstanding that during the development phase which would only last for a limited period the main work available would be construction and logistics. They further emphasised that during the production phase only hundreds of jobs not thousands would be created.

4.3.6. Local Content and Education in Kenya

Another key concern of the investors was whether Kenya’s education policy as it is at the moment will sustain the local content employment quotas as proposed. First, there is no equality in terms of access to education by the poor.

Table 13: Analysis of Access to Education in Kenya

	Public Primary	National Secondary	Public University
Poorest	23.1%	5%	0%
Richest	9.7%	29.5%	79.3%

(Source East African Centre for Human Rights, 2014)⁹⁴

Although there is equality in terms of the right to education being a universal right to all children in Kenya, there is no equity in terms of which children actually access the education. The result of this is that those children from poor back grounds have limited or little access to tertiary education. This compounded by the fact that most of the oil and gas reserves in Kenya have been found in arid and marginalised areas, means that the local communities living in the project area have no access to education to enable them access employment in the IOCs as envisioned by the proposed local content regulations.

⁹⁴ East African Centre for Human Rights – Economic and Social Rights Conference, 9-10 July 2014, Nairobi

Another concern of the interviewees is the quality of education being offered at institutions of higher learning in Kenya. They cited reports that certain universities and colleges in Kenya were offering courses such as engineering and law without proper accreditation. Most recently the Moi University, Catholic University and University of Nairobi (Kisumu and Mombasa Campuses) were barred from training Lawyers by the Council of Legal Education after being found unfit to offer the course.⁹⁵ Additionally, Universities in Kenya have recently been taken to task for offering engineering degrees that are useless in the job market because the courses taught are obsolete and not keeping in time with technological changes.⁹⁶ There is also the concern that there is no overarching body or rules that regulate technical courses across the polytechnics, colleges and universities and no body co-ordinates the curriculum offered at universities and technical institutes to ensure they are congruent and relevant to the job market.

There is also concern at the high rate of polytechnics, colleges and technical institutes being converted into universities. The effect of this is that Kenya's workforce will suffer a reduced number of a certain echelon of artisans and technicians such as electricians, plumbers, masons and welders with the requisite certification and training to work in the oil and gas sector. For instance Kenya College of Accountancy, Kenya Science Teachers College and Kenya Polytechnic have all been converted into universities and have stopped offering much needed technical diploma and certificate courses.

IOCs are also concerned that Kenya's education policy has not catered for the long periods of time it takes to train personnel to work in the oil and gas industry. For instance to train a tool pusher to work on an oil rig would take an aggregate of eighty four months not to mention the

⁹⁵ 'Moi University ordered to close Law School' *Daily Nation* (Nairobi, 29 September 2015)

⁹⁶ 'Universities on the spot over Bogus Engineering Degrees' *Business Daily* (Nairobi 16 September 2015)

number of years it takes to gain relevant experience. (See Figure 21). The long period of time it takes to fully train personnel could be one of Kenya's main local content regulation stumbling blocks as Kenya seeks to have certain LCR quotas in each subsector such as cementing 40%, well line services 10% reservoir services 20%, drilling 30% pumping 40% met immediately. Kenya simply does not have the required personnel to cater for the proposed local content levels for instance currently there are only 20,000 registered engineers in Kenya most of whom are in the retirement bracket. A baseline survey and national skills data bank would go a long way in determining what capacity Kenya has for local content immediately.

Finally, the IOC's advice that Kenya's education policy should consider the various skill types required at different phases of oil and gas exploration, development and production. It would be futile to have Kenyan personnel with production skills at the time the local content company is undertaking development or exploration.

CHAPTER FIVE

LOCAL CONTENT DEVELOPMENT INITIATIVES IN KENYA

5.1. Introduction

According to respondents, only a small proportion of the opportunities in the oil and gas sector are being tapped by Kenyan entrepreneurs, most of which are in the non-specialised sector. Local industries and personnel are not well equipped to provide most energy oil and gas specialist services and goods. Petroleum Focus Consultants undertook a survey of the business opportunities available in production development of the oil and gas sector and found the following areas of opportunity:

- Engineering and Construction – civil, mechanical, electrical, petrochemical engineering
- Logistics and Field services – clearing and forwarding, movers, security, catering, accommodation and power backup
- Materials Supply (locally produced)
- Consultancy Services e.g. technical and environmental impact assessments
- Financial Services – banking, insurance, financing (debt and equity finance)
- Exploration and Production – seismic survey, drilling- onshore and offshore, crude production facilities, crude oil pipeline, refinery, power plant construction, operation and maintenance

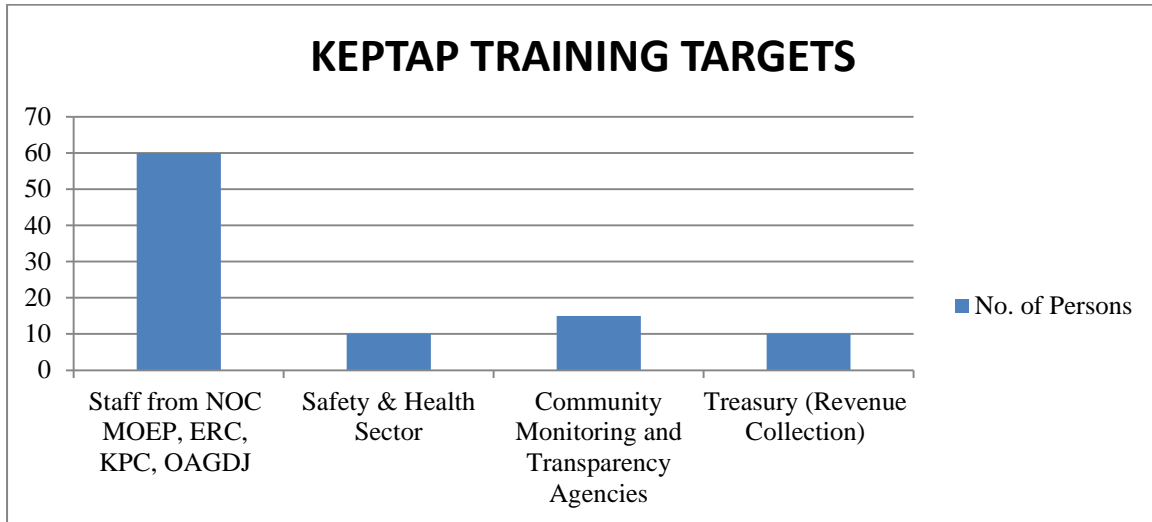
In a bid to meet this expansive gap the government, the private sector and some donors have local content development initiatives to help Kenya bridge the gap e.g. KEPTAP, and Skills for Oil and Gas Africa. These initiatives are discussed in detail below.

5.2. KENYA PETROLEUM TECHNICAL ASSISTANCE PROJECT (KEPTAP)

KEPTAP is a World Bank funded project whose objective is to develop the Government of Kenya's capacity to help it manage the oil and gas sector and wealth for sustainable development impacts. The World Bank through the International Development Association has given the Government of Kenya a technical assistance loan in the tune of Fifty Million US Dollars (50,000,000 USD) to finance this project. The project is set to run from October 2014 to February 2021.

KEPTAP has four major components. The first component is capacity building of the Government of Kenya's main institutions engaged in the energy, oil and gas sector that are engaged in the development and governance of the petroleum sector. This is aimed at building the government's institutional capacity in a manner that is conducive to investment and to ensure that international standards are met with regard to safeguards and safety. The second component entails strengthening the Government of Kenya's revenue management capacity. The third component of KEPTAP is ensuring sustainability of industry reforms to enable the Government of Kenya integrate petroleum sector in the broader economy. The fourth and final component of KEPTAP is to give project management support to the Government of Kenya in terms of: managing and co-ordinating projects, procurement, financial management, technical advisory services and training.

Figure 23: KEPTAP Targets

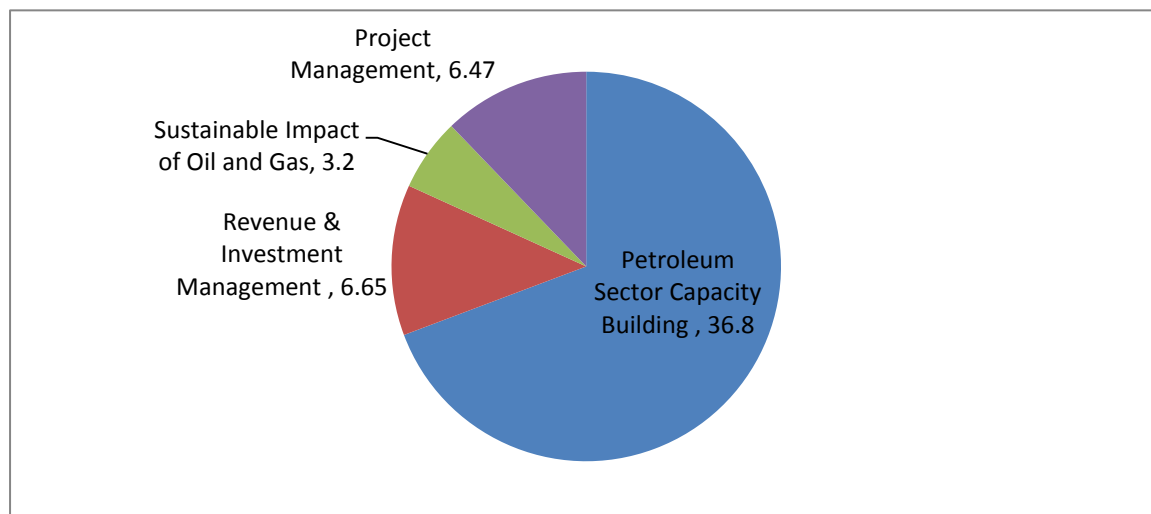


(Source: The World Bank, 2015)

For example NOC alone has sent out 34 management trainees to different universities globally to study oil and gas related courses. These trainees comprise of lawyers, economists, drilling engineers, reservoir engineers, petroleum geologists, petroleum geophysicists and petroleum geochemists.

It is important to note that the first component of KEPTAP has been accorded the highest proportion of money of the 50 Million allotted to the Project.

Figure 24: Allocation of KEPTAP Project Funds



(Source: World Bank 2015) *Amounts stated above in Million USD

More specific key performance indicators of the KEPTAP include⁹⁷:

- Enactment of a Petroleum Act, a Sovereign Wealth Fund Act, a National Energy Policy
- Establish an operational sovereign wealth fund
- Put in place a fiscal policy on the transfer of oil and gas revenues
- Establish a legal framework for resource revenue management including: laws on resource taxation, revenue sharing, stabilization and saving funds, a system for revenue forecasting
- Training National Treasury staff to forecast, collect and manage oil revenue
- Establish a new regulatory body for the petroleum sector – Kenya Petroleum Authority

⁹⁷ World Bank, KEPTAP Implementation Status & Results Report 2015 available at <http://www.worldbank.org/projects/P145234?lang=en> last accessed on 28 July 2015

- Restructuring of the National Oil Corporation to enable it to take commercial positions in the oil and gas licencing and represent the State in joint ventures
- Supplier and SME skills development program

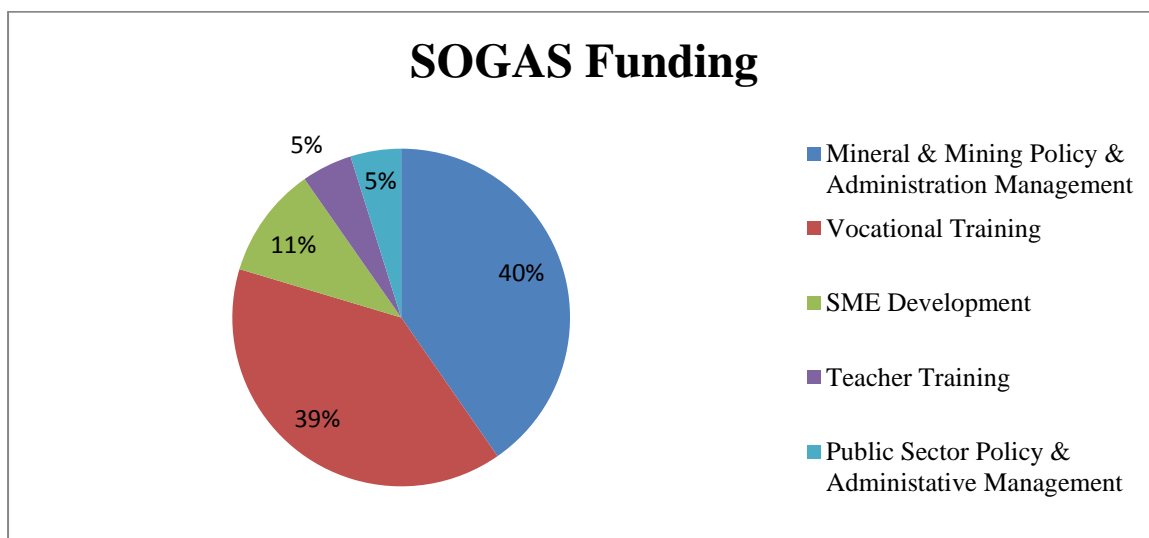
This initiative is a commendable one and should yield substantial local content development in Kenya by 2021.

5.3. SKILLS FOR OIL AND GAS AFRICA (SOGA)

SOGA is a regional program supported by the Federal Ministry for Economic Co-operation and Development (Germany) and the Department for International Development (United Kingdom) implemented by GIZ. The project has a budget of Forty Million Euros, covering Kenya, Tanzania, Uganda and Mozambique. The general objective of this project is to improve access to jobs and economic opportunities for people in the oil and gas sector in Eastern Africa by 32,000 jobs at least 35% of which is targeted to go to women and 40% of which is targeted to go to young people.

The project is set to run from 2015 to 2019 broken down as follows:

Figure 25: SOGAS Funding Allocation



(Source: DFID 2015)

SOGAS's specific objectives for Kenya are to:

- Develop capacity of selected training institutions in highly populated areas to deliver training in construction (to include curriculum development, development of learning materials, staff training etc.)
- Support delivery of technical trainers in partnership with Kenya Technical University
- Develop a 'challenge fund' to support private training institutions according to criteria such as gender
- Support Government of Kenya in producing a skills needs analysis

In addition, SOGA has the regional objectives of:

- Supporting KCA University in Kenya as regional 'Training of Trainer' centre
- Supporting the development of Regional Qualification Frameworks across East and Southern Africa

SOGAS intends to meet these objectives by undertaking a skill needs assessment in Kenya, stakeholder mapping, facilitation of industry placement, harnessing transferrable skills in the upstream oil and gas sector as well as specialised oil and gas modules, actively involving private sector, government, civil society and training institutions, institutional benchmarking, curriculum development and establishing overseas partnerships with the local job market. SOGAS also seeks to deliver targeted support to technical and vocational educational training institutes to improve quality and relevance of the training given.

GIZ admits that it has faced certain challenges in implementing this project such as there being no standards and quality control in skill development, and there being no national framework and strategy on technical and vocational educational training.

5.4. OTHER INITIATIVES

Other initiatives mainly revolve around the information asymmetry in the energy oil and gas market between the IOC and the local suppliers. We have the World Bank (*Doing Business*) which seeks to give investors an insight of the market and the possible challenges such an investor could face upon entering the market. Another initiative by the Africa Development Bank – Information Centre for the Extractives Sector (ICES) seeks to promote stakeholder dialogue based on neutral transparent and evidence based provision of information.

5.5. CONCLUSION

Whilst the efforts to develop Kenya's local content are noble, care must be taken to prevent the perception that international donors such as the World Bank have hijacked the local content development process. For instance some of the KEPTAP key performance indicators being monitored by the World Bank borderline infringe on Kenya's sovereignty. For instance some of the funds are being used to review Kenyan Laws, establish a sovereign fund, introduce a fiscal policy on transfer of oil and gas revenues and restructure or introduce new

statutory bodies in Kenya. It may be perceived that these funds are being used to push the agenda by foreign countries or international oil companies to set up Kenya's oil and gas sector in the manner that best suits them.

CHAPTER SIX

KEY FINDINGS, RECOMMENDATIONS AND CONCLUSION

6.1. KEY FINDINGS:

6.1.1. KEY FINDING 1: KENYA HAS A WEAK STATUTORY AND INSTITUTIONAL FRAMEWORK TO GOVERN LCRs

This study has shown that Kenya's current legal and institutional framework is weak, contradictory, poorly co-ordinated and ambiguous at best. One of the biggest hurdles Kenya needs to jump in this LCR initiative is International Law in light of its membership to the WTO. Although the initiative has not yet been officially challenged, if it is Kenya would face the prospect of economic sanctions and retaliatory policies aimed at forcing it to comply with the GATT and TRIMs. Not to mention the colossal sums that would be spent in trying to defend this policy decision.

Additionally this study in chapter three has shown that Kenya's proposed LCR legal framework has at best been haphazard and contradictory. This has led to the respondents and IOCs stating that they are confused by the multiplicity of Laws. Each act/ regulation has a distinct definition of what constitutes local content. This makes it difficult for foreign investors to know what they need to do in order to meet the thresholds. Secondly as shown in Table 4 a section of statutes such as the Local Community Participation Bill focus on the level of local content provision strictly in terms of goods and services sources locally by international investors whereas other acts such as the National Construction Authority Act focus on equity. Additionally each statute is focused on a narrow or specific sector of the economy, this has led to a plethora of laws for local contents in the petroleum, mining, all natural resources and construction sectors.

Finally, there is a contradiction in the level/ or quotas of local content prescribed by the various acts, bills and regulations. For instance the Petroleum Exploration, Development and Production (Local Content) Regulations, 2014 has prescribed LCR level for among others engineering, fabrication and construction, procurement, well drilling services, research and development, transport, health safety and environment, ICT, maritime operation. The National Construction Authority Act prescribes a joint venture with a Kenyan owing 30% equity. The Public Procurement and Disposal Act prescribes 30% of all Public Entity Procurements shall be from the youth, women and persons living with disabilities. Other acts such as the Local Content and Participation Bill have no prescribed local content levels.

Finally, Table 7, Institutional Framework for Monitoring Local Content Regulation in Kenya shows that there are too many proposed monitoring bodies (6 Committees) each with an average of 10 board members, this will lead to supremacy battles, confusion for the investors, and will be very expensive for the tax payers.

6.1.2. KEY FINDING 2: NUMEROUS BARRIERS TO ENTRY AND INFRASTRUCTURAL CHALLENGES FACE BOTH LOCAL AND FOREIGN INVESTORS

There are currently many barriers to entry into the Kenyan market and infrastructure challenges faced by local companies seeking to meet local content demands. This was discussed in Chapter four of this study. It was shown that only a very small percentage of revenue from the energy sector is actually left in Kenya, and that IOC's are willing to adhere to local content requirements in order to get social licence to operate. However, investors face numerous challenges. Registering a company in Kenya takes an average of thirty days as compared to Rwanda's six and a half days. Secondly, investor confidence ebbs and flows

depending on Kenya's political climate (election fever). FDI dropped by 80% from USD 729,044,146 in 2007 to USD 95,585,680 due to the December 2007 post-election violence.

Investors in Kenya also have to content with weak legal protection of their commercial rights, the Weak Legal Rights Protection Index places Kenya at an 8 whereas Rwanda has an index of 11. Investors in Kenya also face unreliable and expensive electricity supply at the cost of US cents 17 per Kwh whereas Egypt and South Africa operate at 8 US cent per Kwh. This has led investors such as Cadburys to pack up and relocate to Egypt. Additionally, only 30% of Kenya is within 2 kilometres of an all season road.

Kenya has also imposed a convoluted and complex tax regime both at the National government level and County government level and Kenya ranks 145th out of 175 on the Transparency International Corruption Perception Index. Finally, Kenyans are not accessing the right type of education to prepare them to meet the strict industry standards required by the investors with 0% of the poorest actually joining public universities, some Kenyan engineering degrees being rejected as bogus and some Kenyan universities being declared unfit to offer law programs. Kenya does not have a vocational and technical training educational policy.

6.1.3. KEY FINDING 3: MORE LOCAL CONTENT CAPACITY DEVELOPMENT NEEDS TO BE UNDERTAKEN BY THE GOK

Currently there are two main initiatives under the Kenya Petroleum Technical Assistance Project (KEPTAP) and Skills for Oil and Gas Africa (SOGA), concerned with the development of technical capacity in for Kenya's oil and gas sector. The objectives and aims of these initiatives have been discussed in Chapter five in greater detail. It was observed that both these initiatives are external with KEPTAP worth Fifty Million US Dollars being a World Bank initiative, whereas SOGAS for Forty Million Euros is being implemented by the

GIZ funded by the UK and German governments. The Government of Kenya has not taken any initiative on its own to develop technical capacity locally. It is also noteworthy that SOGAS is an initiative for East African Countries; therefore KEPTAP is the main capacity developing initiative in Kenya's oil and gas sector. In light of the deficiencies and concerns raised by IOC's as regards Kenya's education and capacity, it is evident that an overhaul needs to be undertaken and more resources committed to the technical capacity development in Kenya. Additionally, all the efforts taken so far have largely been geared towards government agencies and public officers. This needs to be extrapolated to the common Kenyan man.

6.1.4. KEY FINDING 4: THERE ARE DEEP INFORMATION ASSYMETRIES IN THE ENERGY SECTOR

As was discussed in Chapter four herein, there exist deep information asymmetries in the energy, oil and gas sector. This poses particular difficulty to the IOCs and local investors trying to implement local content regulations. The GOK has not yet undertaken a baseline survey upon which it has based the proposed local content quotas which at present are simply guesstimates. On the other hand foreign investors are not fully aware of the goods, services and available in Kenya. Investors at the 2015 Oil and Gas Local Content Convention were also very concerned about the quality of locally sourced goods and services and how standards and efficiency will be maintained. Similarly, local investors do not know the exact opportunities available in the energy oil and gas sector. They need to know what skills or resources are required at each stage, what international standards the foreign investors adhere to, how long they require the services, what kind of goods are required. Kenya's capacity need to be clearly stated and IOCs demystified. A base line study is paramount.

6.2. RECOMMENDATIONS

6.2.1. BASELINE STUDY AND LAW REVIEW

The most urgent recommendation Kenya needs to undertake immediately in order to successfully apply LCRs in Kenya is to undertake a baseline study. This study should be able to analyse the available skills and goods in Kenya in all sectors as well as identify gaps and areas of capacity development. This baseline survey will help level out the information asymmetries both for the local and foreign investors. It will also help the GOK know what local content demands it can make and what aspects of the economy need a boost in terms of education and capacity building. This would greatly aid the development of a much needed National Skills Development Strategy. A baseline survey would be key in helping the GOK set clear, achievable and realistic local content goals. This baseline survey would be well complemented with a skills database easily accessible to the international investors.

After undertaking a baseline survey, the next important recommendation is that Kenya adopts an overarching National Local Content Policy for the Kenyan economy. This policy would regulate the general tenets of local content in Kenya across all sectors. Thereafter, any specific sector wishing to adopt local content regulations would be guided by that policy. This would avoid the unregulated plethora of local content requirements proposed at the moment. Through this policy Kenya would be able to articulate its local content policy objectives, which would translate to achievable goals for investors.

To avoid a situation where six bodies are tasked with local content monitoring, I propose that only one institution be put in place to monitor and measure local content development and achievement levels. This would tremendously reduce the financial burden on taxpayers required to sustain and run six bodies. This institution should ideally have representation from the government, private sector and local communities. Where there is necessity for

various institutions, it must be ensured that there is interagency co-ordination and avoidance of overlapping and duplicity, supremacy battles and funding challenges.

6.2.2. REVAMPED EDUCATION SECTOR AND CAPACITY DEVELOPMENT

Education is the backbone of local content regulation in Kenya. A weak education policy would frustrate the entire local content regulation initiative in Kenya. For a start, IOCs and foreign investors should be involved in the review of curriculum in fields such as engineering which directly impact their works. These curricula should be streamlined to international education standards as well as the specific industry standards, health safety and environment standards that are adhered to by the foreign investors. In addition to this the GOK should implement affirmative action to ensure that at least a certain percentage of persons from the area of operation have access to the requisite education and skills.

However, as noted by the Nigeria Content Development and Monitoring Board⁹⁸ education is not enough, foreign investors also require persons with considerable experience. The GOK has done a commendable job of providing tax incentives to Kenyan firms that take in graduate trainees or interns to enable them acquire experience.⁹⁹ It is also paramount that the training of Kenyans is tied to the needs of the sector in terms of timing, to ensure that the right personnel is available at each stage of the petroleum lifecycle i.e. exploration, development, production, operation and maintenance.

Kenyan local investors need not only to develop their capacity but make sure they are in a strategic position to work with foreign investors in light of their “know your client”

⁹⁸ Eng. Ernest Nwapa – Chairman, Nigeria Content Development and Monitoring Board, Oil and Gas Local Content Convention 2014

⁹⁹ Budget Speech 2015

obligations. To this end, local investors must maintain spotless human right records, uphold internationally recognised labour standards, steer clear of corruption (real or perceived) and uphold health safety and environment standards.

6.2.3. CLUSTER BASED LOCAL CONTENT DEVELOPMENT

Third, it is recommended that Kenya seeks to undertake cluster based local content development in order to build a competitive supplier base. In deciding which cluster to develop the GOK needs to consider the baseline survey and local technical capacity, access to capital, employment levels, existing skill set base, skill development opportunities, scale of availability of inputs, whether the inputs shall be imported or not, rate of returns, level of maturity of sector, risk factor, sustainability. It would be advisable to start with “low hanging fruit” before venturing into very technical and capital intensive services and goods in the oil and gas sector.

For instance, Kenya could build a base around well logging and well services, and once this cluster is established it could move on to another cluster such as cementing services. In developing each cluster the GOK would focus on establishing efficient and competent local corporations in a certain subsector possibly including the development of SME’s in the sector as well. The Education policy would have to be aligned to this cluster development policy to ensure Kenyans are accessing relevant skills and transfer of technology. There also needs to be an audit of the training of professionals and SME’s. The GOK would be tasked in ensuring that reasonable returns are achieved in this cluster not only for the local contractors but also for the national government, county government, and local community. The GOK might even consider giving tax incentives to these clusters. The development of clusters could be done with the establishment of a regional hub for these services as the end game

especially with our neighbours in Uganda, Tanzania and Ethiopia discovering commercially viable natural resources.

6.2.4. MEETING BASIC SOCIAL AND HUMAN NEEDS

It is also the recommendation of this study that the GOK needs to better meet basic socio-economic needs in Kenya. The effect of this is two-fold. First, access to basic amenities such as affordable and reliable electricity, potable water, food, healthcare, infrastructure, roads, would encourage more investment (both local and foreign) in Kenya which would afford more opportunities to Kenyans in light of the proposed LCRs. Secondly, it will shift the focus of communities in the area of operation from viewing the investment/natural resource as a source of their very livelihood for which they are willing to fight to the death, to the next level of human needs. This would see foreign investors and local investors who are not from the area of operation gain social licence operating with more ease. Benefits from local content in this context will not then be viewed as a preserve of the locals in the area of operation.

6.3. CONCLUSION

“We should have implemented local content regulation forty years ago”, these were the words of Eng. Ernest Nwapa, the immediate former chair of the Nigeria Content Development and Monitoring Board at Kenya’s 2014 Oil and Gas Local Content Convention. As can be seen from the success stories of LCRs in Norway, Brazil and Malaysia, LCRs have the capability of revitalizing an economy. Kenya is now just awakening to that reality. However, beyond the populist politics around the creation of jobs and opportunities for the average Kenyan in the oil and gas sector, a lot needs to be done in order to create an enabling environment for local content regulation in Kenya.

The real value of the benefit of LCRs cannot be measured in dollars and cents, human development is more important. If Kenya's economic and human development is achievable through LCR's then by all means, the end justifies the means. However, Kenya needs to overhaul the current legal and socio-economic framework in order to lay the necessary ground work and create an enabling environment for LCRs in its oil and gas sector.

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