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# Local Content Policy Position

## CCI Advocacy – February 2011

Western Australia is experiencing an unprecedented surge in resources and energy development. With more than \$170 billion worth of projects planned or under construction, a unique opportunity exists to enhance the State's industrial and service base.

To do so, WA will need to work hard to ensure local firms are well placed to make the most of these opportunities. Sections of the WA community are calling for the development of a new "local content policy" that ensures WA receives a long-term social and economic benefit from the planned investment.

The challenge for government and industry is to ensure that local content policy is part of a wider strategy to build WA's industrial capability and that is internationally competitive. This paper puts forward a local content strategy for WA that assists in the growth of local industry participation on major projects.

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## Local Content Policy Position

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To do so, WA will need to work hard to ensure local firms are well placed to make the most of these opportunities. Sections of the WA community are calling for the development of a new local content policy that ensures WA receives a long-term social and economic benefit from the planned investment.

Local content policy cannot be viewed in isolation. The challenge for government and industry is to ensure that local content policy is part of a wider strategy to build WA's industrial capability that is internationally competitive.

The Chamber of Commerce and Industry of WA (CCI) has developed this paper on local content in WA. This paper puts forward a local content strategy for WA that allows local industry to better compete for work on these valuable projects

### What is local content?

Local content is defined as: *"the total value added to a national economy through the localized production of select services and key materials, equipment and goods related to target sectors of the economy (upon which such nation is dependent)"*.

Increasing local content on projects is a long-term means of delivering long term benefits to the State, its economy and people from the current strong economic conditions.

An important consideration for any local content policy is the international trade framework overseen by the World Trade Organisation (WTO) that Australia is party to. WTO rules prohibit governments forcing businesses operating in its territory to source all, or part of, the components of their manufacturing processes from local suppliers.

Any Australian State that attempted to impose mandatory local content measures or quotas would be in clear violation of Australia's WTO obligations and raise sovereign risk issues, putting at risk the \$170 billion worth of investment that's currently in the pipeline.

### Local content policies overseas

Creating local content opportunities is a challenge not unique to WA. Host countries across the world of major projects (particularly oil and gas) have developed a raft of policies to maximise local content as a way of enhancing their skill levels and industrial capacity. CCI research reveals that more than 20 countries have enacted local content policies in relation to the oil and gas sector

*Creating local content opportunities is a challenge not unique to WA*

The most successful examples of these are ones which do not mandate content levels:

#### Norway

Local content in Norway has been driven by a strong research & development focus. Foreign companies investing in Norway in the 1970's were strongly encouraged to form R&D partnerships with Norwegian companies, education & research institutions. A commitment to R&D by foreign investors was a major determinant in government licensing of their projects.



Norway is now the world's sixth largest gas producer and eighth largest oil exporter and is considered a leader in oil & gas extraction technology. The R & D requirements that Norway placed on project proponents in the 1970's would now be considered a violation of WTO rules

#### Canada

Atlantic Canada's offshore petroleum industry is governed by a series of Accords negotiated between the Canadian Federal Government and the Provincial Government of Newfoundland, Nova Scotia and Labrador. The Accords are the framework that local content policies in these provinces are developed under. Generally, Offshore Petroleum Boards (OFB) require companies to submit documentation containing information about the benefits to the provinces (4).



In Newfoundland, Section 45 of the *Atlantic Accord Implementation Acts* require that before any work or activity is approved for an off-shore project, the proponent must submit a Canada-Newfoundland benefits plan that requires approval by the relevant OFB.

Typical items in a benefits plan include the proponent establishing an office in the province where appropriate levels of decision-making are to take place. Further developers must give consideration to provincial residents for training and employment and provincial business for goods and services. The benefits plan must also have a provision for research and development expenditure in the province as well as providing a fair opportunity for Canadian suppliers to participate on a competitive basis in the supply of goods and services.

However, the Board is not allowed under the Accord legislation to force developers to enter into contracts for goods and services that are not competitive.



Other countries have opted for mandated local content requirements, which in most cases, have produced unintended negative consequences..

#### Brazil

Until 1997, Brazil's petroleum sector was monopoly controlled by the State owned company Petroleos Braserios S.A (Petrobras). Established in 1953, Petrobras controlled all oil exploration and production activities in Brazil with the exception of wholesale distribution and retail via service stations. In 1997, Brazil's petroleum sector was deregulated and opened to foreign participation by the *Petroleum Law 1997*. This law ended Petrobras' monopoly and created an industry regulatory agency the National Petroleum Agency (ANP).



The ANP initiates annual rounds of tenders for oil exploration and production concessions, the first being held in 1998. The rounds have strong local content requirements averaging between 25 to 48 per cent in the first four rounds (5). Further, finished goods that can be supplied by Brazilian firms to the oil and gas sector are protected by import duties ranging from 10 to 20 per cent.

While it can be argued that Brazil's local content policy has lead to growth and diversity in the Brazilian petroleum services sector, its prices tend to be relatively high. In the words of one observer: "...having a captive client at high protected prices, they [Brazilian suppliers] lack incentives to improve their productivity, achieve economies of scale and thereby lower prices. Local content is therefore often an excuse to hide behind protectionist barriers, whether explicit or implicit" (6).

The WTO reported in 2009 that discussions are underway on possible changes to the sector's regulatory framework in light of new petroleum discoveries in Brazil.

#### Nigeria

In order to meet the concerns of communities located on its oil rich Niger Delta, in 2006 Nigeria initiated a Local Content Policy to increase local capacity in the petroleum industry.

The Policy explicitly required a 40 per cent local content component for all oil and gas projects in its jurisdiction by the end of 2007. This component increased to 70 per cent by the end of 2010. In addition, every multinational oil company in Nigeria must place a minimum of 10 per cent of its annual profit in Nigerian banks. Also at least 50 per cent of the asset of any company seeking to execute oil and gas contract in Nigeria must domicile in Nigeria. This is to ensure that a large chunk of the payment for the contract resides in Nigeria (7).



The effectiveness of the mandatory component is still being examined as Nigeria is still developing a number of manufacturing and fabrication industries that are essential for the oil and gas sector. In fact one estimate is that despite the Local Content Policy, value creation in the country was only some 5 to 15 per cent (8). A high number of Nigerian firms sourced most of their own work outside of Nigeria with local firms acting as agents for international companies.

Australian States also have local content policies. A number of these policies are focused on providing opportunities to local suppliers to tender on State Government building projects. The Victorian Industry Participation Plan (VIPP) is a Victorian Government initiative designed to promote greater access to for small to medium enterprises to work with major projects. The VIPP must be applied to Government projects (or grants) valued at \$3 million or more in metropolitan Melbourne, or \$1 million and over in regional Victoria. Under a VIPP a tenderer must demonstrate their plans in relation to:

- Local content commitments (Australia/ New Zealand Value Added Activities);
- Employment (created/retained);
- Apprenticeships/Traineeships (created/retained); and
- Training, skills development and technology transfer.

These commitments are part of the selection criteria for the awarding of the tender. The successful tenderer has their VIPP commitments incorporated into their contract with the State Government. The VIPP does not mandate local content preferences for tenders or seek to erode the 'value for money principle.

# Local Content Policy Position

## Local content – current WA situation

There has been significant debate in recent times about the ability of local suppliers to win work on major resource and energy projects. The current debate on local content is ultimately tied to issues of WA industry's international competitiveness, the role of the WA and Federal Governments, and the State's knowledge and technological capabilities.

Major resource and energy projects in WA over the last 20 years have increasingly grown in scale and complexity which has impacted on local firms to meet the needs of these projects. At the same time globalisation of the market has allowed project proponents to meet their supply requirements from overseas.

These factors have led to a number of permanent structural changes that influence local industry's ability to compete globally:

- increasing difficulty local suppliers and contractors face in identifying the correct time and contact point to market their goods and services;
- increasing size and complexity of tender packages;
- overseas engineering and design;
- improved overseas technological capability;
- multinational preferred supplier tender lists;
- modularisation of projects;
- rapid technological change;
- alliances;
- outsourcing;
- leasing;
- lack of infrastructure; and
- skills shortages.

Feedback from CCI Members and stakeholders is that the current local content policy is not adequately planning for the future. In shaping a new local content policy for WA it is essential to review the framework that has delivered current policy.

### Australian Industry Participation Plans

In April 2001, Federal and State Industry Ministers agreed to the *Australian Industry Participation National Framework*. Its aim is to create a nationally consistent approach to maximising Australian industry participation in all major investment projects. A key component of the Framework is that proponents of Australian projects are encouraged to adopt an Australian Industry Participation Plan (AIPP). AIPPs help project proponents understand Australian capability, identify qualified suppliers and to demonstrate a commitment to the principle of full, fair and reasonable opportunity for local industry.

### Chamber of Commerce & Industry of WA

Two key services aimed at enhancing local supplier access with WA based projects are the Industry Capability Network and ProjectConnect. Both these services are operated by CCI.

### Industry Capability Network WA

The Industry Capability Network (ICN) is a decade old national network of independent industry consultancies managed by industry and sponsored by state governments to achieve beneficial outcomes for local Australian and New Zealand industry and economy. In WA, the ICN focuses on WA projects and suppliers.

ICN has as clients some of the largest project proponents in WA. ICN's role is to match this data against Australian capabilities and then provide qualified support on experienced suppliers.

ICN in WA is an integral part of the Western Australian Government's Local Content Policy aimed at maximising local industry capability on major WA investment projects. ICN assists project proponents towards their local content objectives that WA businesses are afforded 'Full, Fair and Reasonable' opportunity to quote and tender for work.

ICN also administers the Australian Government's Supplier Access to Major Projects (SAMP) program. Introduced in 1997, SAMP is designed to underpin long-term, coordinated and strategic approaches to pursue opportunities for Australian industry in major projects globally.

### ProjectConnect

The ProjectConnect website is an online electronic library which stores, organises and distributes information on suppliers, development projects and project supply opportunities.

ProjectConnect allows project proponents to list the goods and services it intends purchasing.

Suppliers can then register their interest on listed items, either as a:

1. Full package supplier that has a demonstrated in-house capacity to provide the complete item.
2. Component package supplier that it interested in providing parts of the item to the successful full package tenderer.

ProjectConnect is unique in that it also allows registrations from component suppliers that want to provide goods and services to a project's successful tenderers. To support component suppliers, projects publish the name and contact details of successful tenderers (on award of contract).

### Current WA Local Content Policy

The current WA Government policy on local content – *Building Local Industry Policy* – was released in April 2004. Some of the key initiatives relating to the Policy include:

- Ongoing WA Government commitment to the Australian Marine Complex (AMC) located 23km south of Perth;
- Ongoing support for the Industry Capability Network WA;
- Ensuring that Industry Participation Plans formulated under the Policy are consistent with the requirements of the national policy;
- Government Trading Enterprises and other State agencies will ensure that Industry Participation Plans are prepared for all eligible projects;

*Demonstrate a commitment to the principle of full, fair and reasonable opportunity for local industry*



*Current maintenance work is estimated to be worth billions of dollars annually and this figure is likely to increase as more major projects come online.*

- Government provision of infrastructure to support increased local industry capability;
- Ensure application of Buy Local policy in all public sector procurement contracts; and
- Establishment of a Local Content Unit (LCU) in the Department of Commerce.

In compiling this report, a number of WA suppliers advised CCI they believe they are at an immediate disadvantage when tendering for work on major projects. According to suppliers, proponents advise them that they have already decided that some project will be done overseas. Suppliers argue this contravenes the objectives of AIPP Framework that local suppliers shall be given 'full, fair and reasonable' opportunity to tender for major project work.

On the other hand, project proponents have stated the importance of a free and open market to source supplies. Proponents indicate local suppliers that are internationally competitive would be well placed to secure work on major projects as some currently are. While acknowledging that lower overseas labour costs is a significant factor in some tender decisions, proponents have also indicated there are other factors that influence their decisions including scale advantages and technical expertise.

Any mandated local content policy would be seen by project proponents as a significant disincentive to invest in WA.

CCI understands that the WA Government is reviewing its local content and looks forward to commenting on the policy when it is released.

## **A local content policy for Western Australia**

*A local content policy should have the goal of facilitating the long-term development of an internationally competitive industrial and service sector that can secure a share of work on development projects as well as become a significant player in the global supply chain.*

*The policy should be an integral part of a strategy to build Western Australia's industrial capability.*

This vision is based on following principles:

- The importance of free trade and open markets;
- That local industry becomes internationally competitive and their operations are as efficient and effective as possible;
- That local business is provided with information about procurement opportunities; and
- WA businesses should be afforded 'full, fair and reasonable' opportunities to quote and tender for public and private sector contracts in Western Australia.

Local content policy should also look beyond the construction phase of major projects and also take into account the opportunities for local industry to supply and carry out maintenance on those projects during their operational life which often lasts for decades. Current maintenance work is worth billions of dollars annually for the life of a project.

Local content policy should not mandate a quota or percentage of content value or hours worked on a major project to be done by local firms:

- It would violate Australia's obligations to World Trade Organisation ensuring it would damage Australia's reputation as a place in which to do business and as an economy that depends on free trade and investment flows, would risk our economic strengths.
- It is unclear that WA or Australian firms have the capacity to meet particular, arbitrary percentage of work on a project.
- It will add to the cost of doing business in WA and potentially drive away investment.
- Major development projects are large and complex with significant engineering, technical and planning challenges. A mandatory quota applies a "one size fits all" approach that ignores the specific needs of each project.
- Can act as a disincentive for local firms to improve productivity, adopt global best practice and limit technological development.

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## Recommendations

The issues of local content cannot be resolved by government policy alone. Business and government has a role to play to build a more competitive local industry. After extensive consultation with business, industry and government CCI has developed the following nine recommendations:

### 1. Federal and State Government to reduce the burden on local industries.

- Taxation reform – the tax system needs to be internationally competitive, simple to comply with and provides incentives to save, invest and encourage greater workforce participation;
- Regulatory reform – excessive regulation and red tape can adversely impact on the ability of the businesses to operate efficiently. Reforms to regulation must be undertaken to reduce unnecessary, complex and costly regulations;
- Industrial relations reform – that is simple, effective, relevant and flexible which focuses on the enterprise and the relationship between employers and employees and reduces regulations and interference by third parties; and
- Labour supply – the future needs of business and can only be achieved by ensuring the labour supply is responsive to demand. Central to this must be strategies to streamline migration rules, targeted learning and training and encouraging greater workforce participation.

### 2. WA to become an international centre of excellence for the supply chains to resources and energy sector.

A long-term strategy is needed to build the technical capacity and expertise of WA industry so it can be a major player in the global supply chain. The wealth of new developments proposed for WA gives it a chance to achieve this with the right policy settings. The WA Government has a strategic role to play to include this objective as part of any long-term industry policy for this State.

Key to the long-term participation of WA industry in global supply chains will be its ability to be an acknowledged leader in innovation that will improve industry productivity and compete on expertise, quality and not price alone. Building this capability should align with WA's comparative advantage in the resources and energy sector.

An initiative such as the WA Energy Research Alliance (WAERA) could provide a template to create future research and development collaboration between project proponents, WA suppliers and education institutions. The WAERA is an alliance between leading WA research institutions (CSIRO, University of WA, Curtin University) and major oil and gas proponents and industry partners (Woodside Energy, Chevron Australia, CGG Veritas). WAERA combines state-of-the-art facilities and multi-disciplinary expertise to deliver technology based solutions to the global energy industry.

The Federal Government can also assist in the creation of a centre of excellence through its AusIndustry support programs. The Industry Cooperative Innovation Program (ICIP) encourages business-to-business cooperation on innovation projects both within Australia and internationally that enhance productivity, growth and international competitiveness in Australian industries. There has been no new funding round for the ICIP since 2007. The Federal Government should revive the ICIP or initiate a similar program to support private sector research & development initiatives that lead to the creation of a centre of excellence focused on the resources and energy sector.

### 3. Project proponents work with the WA Government to build WA's knowledge base.

As part of their AIPP, project proponents should advise the WA Government of the key skill requirements needed over the life of their project to assist with State and industry workforce planning activities. This would also assist the WA Government with its long-term strategic planning on education, training and migration requirements.

Labour migration programs should not unduly hindered by red tape or unnecessary qualifications. This includes the removal of the current skill assessment process from the temporary migration program and the reversal of narrowing occupations classified under Subclass 457 visas.

### 4. Government to invest in infrastructure that will promote business growth, investment and innovation.

The WA Government has a strategic role in ensuring the long-term infrastructure needs of the State are met.

A State infrastructure plan must ensure the appropriate prioritisation of projects, and provide certainty around future infrastructure projects that will be undertaken in the State. Meeting WA's infrastructure needs will assist WA industry compete for local content opportunities.

### 5. The Australian Industry Participation Framework be updated

The current Australian Industry Participation Framework (AIPF), which forms the basis of WA's current local content policy, was developed more than a decade ago and no longer reflects current market realities.

The AIPF needs to be updated immediately, and reviewed every five years, to ensure it reflects the dynamics of the global supply chain.

The Federal Government is currently undertaking a review AIPF in consultation with State and Territory Governments. For this review to be fully effective the views of business and industry must be sought.

Future Australian Industry Participation Plans for WA projects must receive the bilateral approval of both the Federal and WA Governments before their adoption.

### 6. The WA Government to clarify the role of its Local Content Unit and better promote its effectiveness among project proponents and local suppliers.

The WA Government should clearly define the role and objectives of the Local Content Unit (LCU) and publicly promote it to industry. One role the LCU should be assigned is to be the lead agency to collect data on the value and volume of local content work awarded on major projects located in WA.

If local content is to be part of a broader industry development strategy for the State, consideration should be given to locating it in the Department of State Development rather than the Department of Commerce.



**7. Project proponents should be encouraged have a procurement presence in WA.**

A key concern of local industry is that often procurement decisions on major projects are centralised or made outside of WA. Project procurement decisions made outside of WA disadvantage to local suppliers if project proponents are unaware of their existence.

A number of resource and energy projects in WA are being financed by a number of new overseas investors. This has resulted in situations where many first time project investors may be unaware of the skills and capabilities of local suppliers.

In framing Australian Industry Participation Plans for WA projects, proponents should be encouraged to a procurement presence within the State. The Federal, WA Government and relevant industry associations should promote this concept to industry as part of a project's "community licence to operate".

A local procurement presence will allow WA firms a direct line of communication with project proponents to facilitate a better understanding of their capabilities.

**8. Suppliers to act jointly to better showcase their capabilities.**

The reality of global supply chains is that a number of WA firms are too small, and therefore do not have the capacity to successfully tender for work on multi-billion dollar development projects. Joint tendering is one way that small firms that do not have the scale of their international competitors can better meet the requirements of project proponents.

The LCU could take a lead role along with ICN and, where relevant, industry associations to assist WA firms and suppliers to discuss joint tendering and advise the means for doing so. These organisations can also communicate to proponents on the willingness of local suppliers' to joint tender if it means improving their chances for consideration for work on major projects.

Local firms could be encouraged to partner with international suppliers to not only secure major project work but also demonstrate local capacity and learn best industry practice.

**9. Industry Capability Network WA and the WA Local Content Unit better promote successful local content participation examples on major projects in WA.**

ICNWA and the WA Government's Local Content Unit should jointly promote as case studies those WA firms that have been successful in securing work on major projects. The WA Government should create an annual award for local content excellence for both suppliers and proponents as a means of raising awareness of successful local content programs and partnerships between project proponents and local suppliers.

The WA Government, with the assistance of industry associations, should also consider providing support for study tours for local suppliers to key world markets to help identify project opportunities and raise overseas awareness of the capability of local suppliers.

*A long-term strategy is needed to build the technical and expertise capacity of WA industry so it can be a larger player in the global supply chain.*

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