Africa – from petrodollars to progress

The shift in approach by a growing number of African states to the exploitation of their oil and gas resources could help transform Africa's economies. **Jason Kerr**, **Joshua Siaw** and **Anthony Elghossain** of global law firm White & Case explain

African states rich in resources are striving to increase domestic involvement in their economies – especially in oil and gas. In attempting to increase domestic participation throughout the value chain, some African states have begun introducing local content laws, supporting industrial diversification and creating a broader economic base for the future. If effective, these measures could provide a framework to enable resource-rich states to benefit from Africa's potential and transform their economies.

Africa holds around 8 per cent of the world's oil and natural gas reserves. Some states have developed their oil and gas sectors significantly. Nigeria and Angola, in particular, have established themselves as exporters and borrowers in the international market, and rank as the top two producers in sub-Saharan Africa. Buoyed by significant new energy finds, other states, such as Ghana, the Ivory Coast, Kenya, Tanzania, Uganda, Mozambique and Chad, offer new opportunities. In 2012, about half the world's discoveries of conventional oil and gas were in East Africa alone.

Natural resource exploitation provides important sources of revenue for African states through investments, sales and commodities-backed borrowings. But this investment has not necessarily broadened the economic base, promoted employment or added value domestically. African governments have reaped financial rewards without maximising residual benefits, such as ownership, skills development and the growth of related sectors.

With their new policies, however, African states will look to encourage international investors and Africans to progress in shaping the continent's economic destiny.

LOCAL CONTENT LAWS

In recent years, states such as Nigeria, Ghana and Uganda, have passed local content laws. By encouraging domestic participants to become stakeholders in a range of enterprises relating to oil and gas, African states have sought to ensure that their citizens increase their role in developing the broader economy.

In 2010, for example, Nigeria enacted local content laws. Oil and gas deals now require certain types of domestic participation, including profit-sharing, equity involvement, training and employment. Nigerians have since benefited from 38,000 jobs in exploration and production, engineering, transportation and logistics, in large part due to local content requirements. In that time, local companies have increased their participation in the oil and gas business from 10 per cent to more than 30 per cent.

Partnerships between local businesses and junior oil companies are growing in the upstream oil sector of exploration and production, especially in more accessible fields that may not require significant capital or new technologies. Arguably, local participation has yielded benefits that would have been absent otherwise. Production in some places has increased by 40 per cent, according to some estimates, and interruptions are down significantly. (By responding effectively to community concerns and building on their domestic relationships, local companies may have reduced the interruptions that plagued foreign oil companies' operations in the relevant fields.)

In a deal demonstrating the potential effect of local content laws, including on political and operational risks, Shoreline Natural Resources, a joint venture between UK-listed Heritage Oil and local company Shoreline Power Company, acquired a significant interest in a major Niger Delta oil-producing block from a consortium led by Shell. As Nigeria's largest-ever upstream acquisition financed by international banks, the deal was originally bridge-financed and subsequently completed through a reserves-based loan arranged by Standard Bank.

Other African states have adopted similar measures. Ghana, for example, has legislated to increase local participation in the form of equity, employment, training and services. Beyond those requirements, Ghanaian legislators have also established parameters for minimum equity participation by indigenous companies. Without this participation, petroleum-related agreements and licences will be invalid. Since passing local content laws in 2013, Ghana has awarded several oil blocks to consortiums, including Ghanaian companies, and has seen related services in insurance and finance grow.

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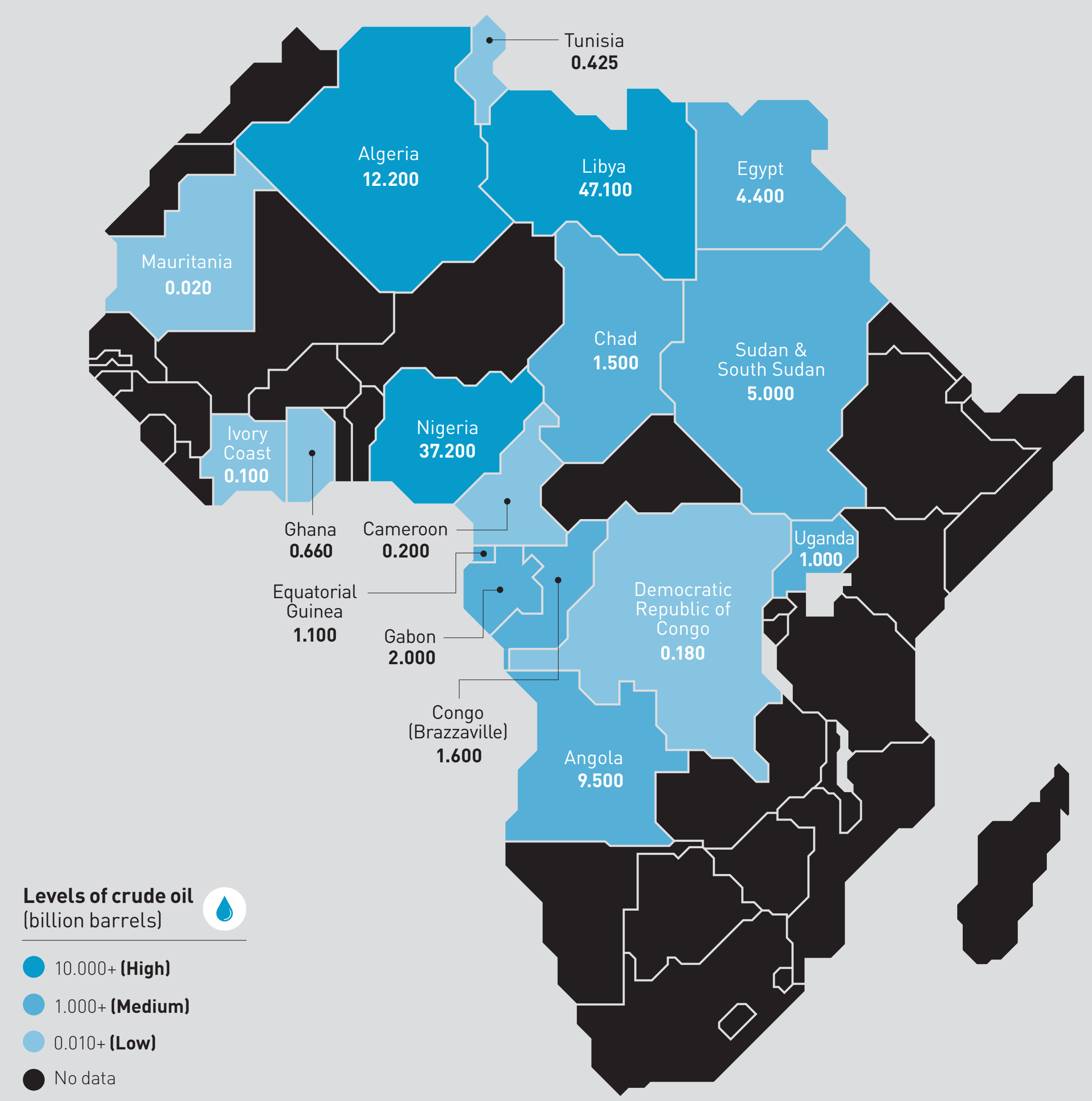
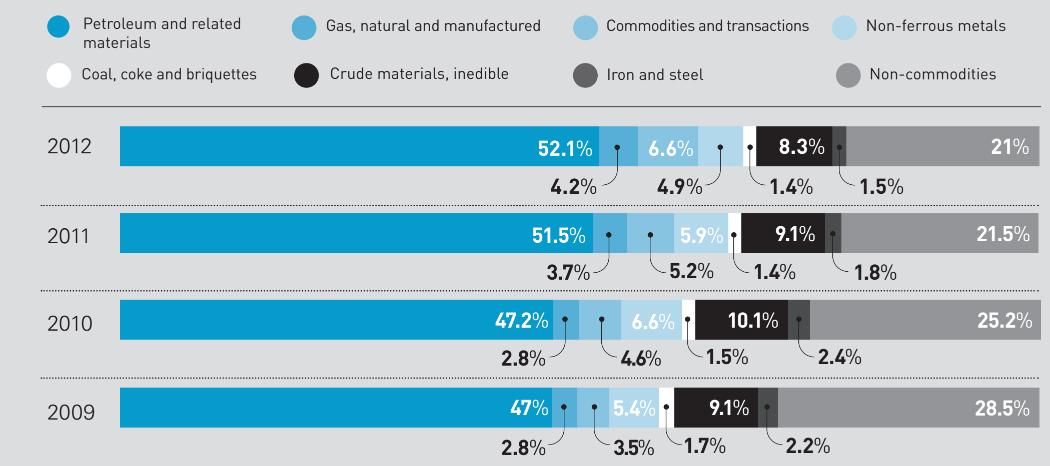
MAPPING RESOURCES IN AFRICA

PROVEN RESERVES OF CRUDE OIL IN AFRICA 2012



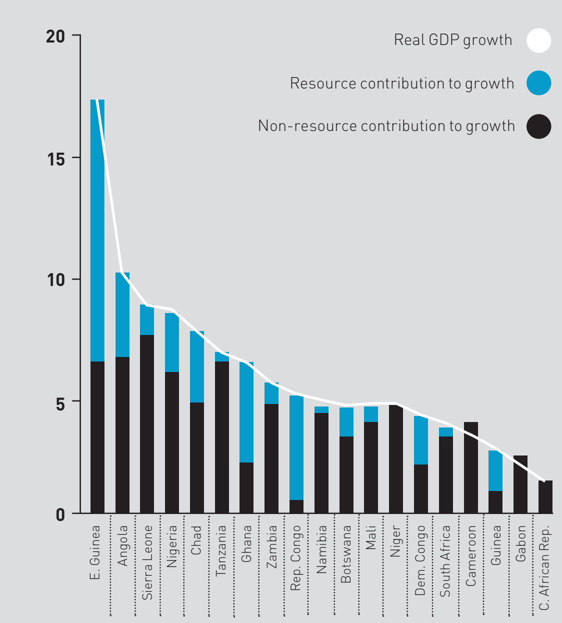
Source: US Energy Information Administration, *Oil and Gas Journal*

TOP AFRICAN EXPORTS BY PRODUCT 2009-12



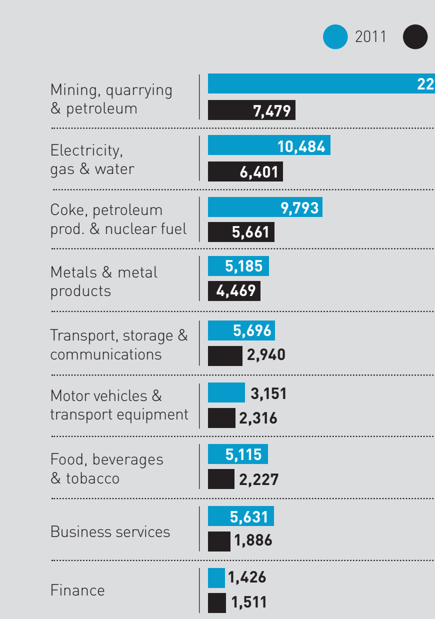
Source: UNCTAD

RESOURCE AND NON-RESOURCE CONTRIBUTION TO REAL GDP GROWTH 2000-11 (%)



Source: IMF, African Department Database

FOREIGN DIRECT INVESTMENT INFLOWS INTO AFRICA BY SECTOR (US$m)



Source: UNCTAD, based on information from *The Financial Times*, fDi Markets

ENHANCEMENT OF VALUE CHAIN AND INDUSTRIAL DIVERSIFICATION

Alongside the enactment of local content laws, African states and citizens have begun harnessing reserves to support industrial diversification and broaden their economic base. For decades, outside investors have extracted resources and the value derived from processing and manufacturing as African states have raked in petrodollars without increasing their stakes in the value chain.

Nigeria, for example, imports 95 per cent of its diesel, subsidised at great expense with crude oil exports, and has historically flared much of its natural gas, in part because of inadequate infrastructure. To move forward, Nigeria has sought to develop its refining capacity, for petroleum products such as diesel and fertilisers, and monetise its natural gas reserves. While several foreign firms have failed to deliver on oil refineries announced over the last 15 years, the Nigerian Dangote Group is poised to construct a major refinery and related petrochemical and fertiliser plants. Once complete, at a projected cost of $9 billion, the refinery will have a production capacity of 445,000 barrels a day and employ thousands of workers.

Similarly, having exported liquefied natural gas (LNG) for more than a decade, Nigeria has passed laws that require oil producers to supply natural gas for domestic uses such as power generation or petrochemical production. Operating under these laws, Indorama Eleme, a Nigerian poly-olefins producer, owned by the Indorama Corporation based in South East Asia, has sold 95 per cent of its production domestically since 2006. Building on that success, Indorama Corporation closed on the financing of a large-scale fertiliser project in 2013. The new plant will be the largest of its kind in Africa, and will benefit from competitive feedstock pricing and a growing domestic market.

> **International investors must understand that the landscape is changing and push forward partnerships with domestic participants**

In Ghana, meanwhile, the government spends roughly $1 billion a year importing crude oil to fuel power plants. To reduce reliance and allow public and private entities to benefit from cheaper power, the Ghana National Gas Company is building a $1.4-billion gas processing plant to supply the domestic market with natural gas from the nearby Jubilee Field. Equatorial Guinea is also building a new LNG train, which will add 4.4 million metric tonnes a year to an existing facility's production - now at 3.4 million metric tonnes per annum - and a multi-billion-dollar gas pipeline project to connect Nigeria, Cameroon and Equatorial Guinea gas fields to the plant. The government has partnered with a US company to develop the petrochemical sector to meet domestic and regional industrial demands, create jobs and grow the economy.

COMMON CHALLENGES

Despite moving towards local ownership and participation in the value chain, African states must overcome common challenges. Although policies on local content and diversification could be transformational, African states and local businesses - even in relatively established markets such as Nigeria or Angola - have struggled to raise capital, acquire new technologies and improve inadequate infrastructure.

While states with new discoveries may seek to learn from history and avoid the "resource curse" that confronted some of the more established oil and gas producers, they will also face challenges. States such as Tanzania and Mozambique have found that their plans to monetise natural gas reserves will require extensive international participation to succeed, given the high-risk and capital-intensive nature of these projects. Mozambique, in particular, may find it difficult to finance and develop massive new gas finds, which could require initial investments of more than $50 billion. Newer resource-rich states will need to balance the desire to promote these policies against the need to attract international investment if they are to maximise their natural resource potential.

In pursuing their policies, African states must avoid deterring international investors who can provide funds, management expertise and technical knowhow necessary to achieve their goals. Indeed, local content laws could have counter-productive effects as international investors may elect to engage other states or regions with less onerous requirements, such as taxes, training, procurement and other costs of conformity. And because these laws and related policies are relatively new, investors may prefer to engage states with legal frameworks seen as more established and predictable.

WAY FORWARD

Despite these risks, African states will continue to explore new ways to manage their natural resources and resultant windfalls. They will seek to grow domestic industry, build institutions, and develop services to allow industry and agriculture to flourish. As local companies continue to increase their participation in domestic industry, they will gradually develop necessary experience and expertise. International investors must understand that the landscape is changing and push forward partnerships with domestic participants. If successful, the oil and gas industry could help Africa achieve its potential.