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This publication, Local Content Requirements and the Green Economy, is a product of the Trade Environment, Climate Change and Sustainable Development Branch, DITC, UNCTAD. It was commissioned for and forms part of the background documentation for an ad hoc expert group, entitled: "Domestic Requirements and Support Measures in Green Sectors: Economic and Environmental Effectiveness and Implications for Trade", held in Geneva on 13 and 14 June 2013.

The study is far from an exhaustive examination of these issues. In many areas, the analysis is speculative, aimed at raising questions and suggesting areas where domestic and international policy makers may need to consider undertaking further analysis. Above all, it should be stressed that the study raises these matters at a very general level. Whether any given governmental measure is consistent with WTO rules is a highly contextual question, that may well depend on the exact design features of that particular measure, and its broader context – regulatory, technological and commercial. Thus, nothing in this study should be considered as a judgment that any actual measure of any particular government violates WTO rules.

The study and the meeting are part of a larger effort by UNCTAD to analyze issues arising at the intersection of green economy and trade policy. The study has been prepared at a time when the "green economy" concept moved from theory to practice, with a range of developed and developing countries placing local content at the heart of their green economy strategies, and their green economy plans at the heart of their industrial policies. It reflects developing countries' increasing emphasis on the "sustainable" element of traditional development objectives, such as rural development, urban planning and industrialization. The study has also been prepared at a time when countries across the income spectrum are taking a fresh look at local content requirements, after having largely phased them out in traditional strategic industries such as fossil fuel energy and automobiles.

What do we know about the economic and environmental effectiveness of performance requirements in green sectors? Do performance requirements provide a compelling business case, with short- and long-term returns? Is there anything unique about renewables that makes them a special case for performance requirements? Does the politics of accommodating the higher cost of renewable energy demand a clear-cut avenue towards job creation through localization? Does greening the value chains provide a new rationale for performance requirements? Can better governance play a role in dealing with protectionist elements of support measures? Are there any upsides for developing countries in a world where performance requirements are extensively used? Objective evidence on the economic and environmental effectiveness of trade-related measures such as subsidies or local content requirements can provide the answers.

Guillermo Valles,
Director,
Division on International Trade
in Goods and Services, and Commodities.

Acronyms

B-BBEE	Broad-Based Black Economic Empowerment
BNDES	Brazil National Development Bank
BOP	Balance Of Payments
COP	Conference of the Parties
COSATU	Congress of South African Trade Unions
EEG	Export Expansion Grant
EPA	Economic Partnership Agreement
FIT	Feed-In Tariff
HDSA	Historically Disadvantaged South African
IPAP	Industrial Policy Action Plan
IRP	Integrated Resource Plan
kWh	KiloWatt Hour
NNPC	Nigerian National Petroleum Corporation
PPPFA	Preferential Procurement Policy Framework Act
PV	Photovoltaic
REIPPP	Renewable Energy Independent Power Producer Programme
SARI	South African Renewables Initiative

I. BACKGROUND AND INTRODUCTION

This study explores the use of local content requirements in the green economy, with a specific focus on South Africa. The study examines the emerging use of local content as an increasingly common tool in industrial policy; one aimed both at higher (and higher-skilled) job creation and the shifting of economies towards low-carbon, resource-efficient and socially-inclusive bases. In terms of approach, the study:

- Outlines the basic definition, rationales, history and traditional practice of local content requirements, with emphasis on the energy sector (Chapter II);
- Notes some of the lessons from the successes and failures of local content measures, particularly in the developing-country setting (Chapter III);
- Outlines the emergence of local content to promote industrial objectives based on a green economy platform, with a specific focus on South Africa (Chapter IV); and
- Explores some of the same key lessons highlighted earlier, but in the context of the green economy (Chapter V), and provides concluding thoughts (Chapter VI).

The study was prepared at a time when developed and developing countries are increasingly adopting both green economy and local content objectives. As the green economy concept has moved from theory to practice, and as green industrialization is seen as a promising avenue for increasing employment, a number of developed and developing countries are increasingly placing local content at the heart of their green strategies, and their green strategies at the heart of their industrial policies. Among the developed countries, Canada (in Ontario and Quebec), The EU (in Spain, Italy, France, Greece and Croatia) and the United States have used local content requirements in some form to stimulate the growth of renewable energy projects. Among the developing countries, the use of local content in green economy strategies extends from large global players such as China, Brazil, Argentina, India and South Africa, to smaller countries such as Tunisia, Ecuador and Nepal. Outside of the green sector, both developed and developing countries have strengthened the role of local content policies in stimulating job creation, providing – in a time of global recession – investment incentives (via, for example, government procurement) to domestic producers in key sectors.

The analysis comes at a time when a green economy and local content linkage is viewed as a tool for development. There is an emerging body of work emphasizing the need for a sustainability push within traditional development objectives, such as rural development, urban planning and industrialization. Moreover, many developing countries see growth and income opportunities (or risks to be managed) in the international climate change architecture, whether it implies complying with carbon limits, or seeking economic opportunities in the new markets for managing emissions. At the same time, the job creation imperative – one particularly strong given the aftershocks of the 2008 global financial crisis – and the need to "leap-frog" technological barriers has led many developing countries to re-visit the use of local content requirements, which have rapidly spread outside of traditional heavy industries (e.g. energy and automobiles) into green economy investments and regulations.

The study also emerges at a time of increasing recognition of the link between trade and the green economy. The link between trade and the environment, once considered a marginal policy discussion, has now become mainstreamed to the degree that it forms a core area of WTO negotiations, and enshrined in key trade documents such as the legal texts establishing in the WTO. While there is no specific agreement dealing with green economy issues, under WTO rules members can adopt trade-related measures aimed at protecting the environment, provided a number of conditions to avoid the misuse of such measures for protectionist ends are fulfilled – an issue which has generated significant interest within the WTO (particularly the issue of local content). The WTO legal aspect is outside of the scope of this paper, which focuses instead on the practical, industrial planning elements of the link between local content and the green economy.

The study was prepared on the basis of desk research and stakeholder interviews. The study, written in November-December 2012 and revised in April 2014, was primarily based on desk research drawing from documents prepared by the United Nations (especially UNEP and UNCTAD), outside sector-specific research, and materials collected during the author's previous work on local content in both the global energy sector and the Nigerian economy. The paper also benefited from interviews held with stakeholders in Sub-

Saharan Africa, most of which were held off-the-record given stakeholder sensitivities when discussing the issue of local content. The list of documents cited can be found in the **References** section at the end of this study.

II. LOCAL CONTENT: RATIONALE AND PRACTICE

A. What are local content requirements?

The aim of local content requirements is to create rent-based investment and import substitution incentives. Local content requirements are provisions (usually under a specific law or regulation) that commit foreign investors and companies to a minimum threshold of goods and services that must be purchased or procured locally. From a trade perspective, local content requirements essentially act as import quotas on specific goods and services, where governments seek to create market demand via legislative action. They ensure that within strategic sectors – particularly those such as oil and gas with large economic rents, or vehicles where the industry structure involves numerous suppliers – domestic goods and services are drawn into the industry, providing an opportunity for local content to substitute domestic value-addition for imported inputs. Thus – in contrast to the traditional protected export platform proposed by many development advocates in the 1960s and 1970s – local content requirements seek to attract foreign direct investment (FDI) by firms.[1] Moreover, through local content requirements, government can achieve these goals often without sharing in the risk of commercial undertakings.[2]

Local content requirements are often paired with investment incentives, as part of a "carrot and stick" approach to attracting FDI. While the use of local content measures has attracted outsized attention inside and outside the WTO, governments (both developed and developing) employ a range of measure to attract investment, using a "carrot and stick" economic agents. The use of some measures is restricted at various levels – the WTO Agreement on Trade-Related Investment Measures (TRIMs) prohibits the use of measures related to local content, trade balancing, export controls and certain foreign-exchange restrictions, and certain bilateral treaties limit the use of other performance requirements. These measures however are nonetheless widely used by governments to align investment with industrial planning.[4]

- On the "carrot" side, governments use a range of investment incentives to offset costs incurred by firms that choose to establish in the host market. These incentives range from direct transfers – e.g. grants (for R&D projects or new capital investment) and dedicated public-private investment funds – to indirect transfers, such as low- or no-cost government services in marketing and distribution. The sum of government resources used for investment incentives is significant: available information indicates that, in 2003, 21 developed countries spent nearly US$250 billion on subsidies; the total for the world was more than US$300 billion in that year, with state and local incentives in the United States (US$50 billion) nearly equally the total subsidies in developing countries.[5]

This carrot-and-stick approach has been used successfully by several countries as an integrated package of industrial planning policies. Chile, for example, successfully used cash subsidies and local content requirements – prior to their phase-out under Chile's WTO obligations – to develop a more diversified exporting base, with small and medium-sized enterprises in particular seeing a rapid increase in growth and export volumes. Malaysia employed a combination of "pioneer status" tax incentives with employment requirements from the 1960s through the 1990s to