BANK OF TANZANIA

The Seventh Gilman Rutihinda Memorial Lecture, Delivered on June 10, 2014 by Professor John Sutton of the London School of Economics (LSE) and International Growth Centre (IGC)

<u>THEME:</u>

Gains from the Natural Gas: Local Content and Tanzania's Industrial Development

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PREFACE

Since its inauguration in June 1995, the Gilman Rutihinda Memorial Lecture has served as a forum for academics and policy makers to discuss and debate on current issues affecting our economy. Over the past 19 years, a total of six lectures have been delivered on various topics to reflect the need of the time. This year's lecture was the 7th in the series and it focused on the natural gas and industrial policy in Tanzania. This is an important topic in the context of the recent discovery of natural gas in our country. Tanzania's policy makers are anxious to put in place policies that will ensure that Tanzanian's obtain the greatest benefits from the extraction of this exhaustible resource. One important theme of such policies is the so called "local content policy" whose objective is to ensure that gas exploration and production activities generate benefits to the economy, by linking the gas sub-sector to other sectors of the economy in order to generate employment, foster national development and poverty reduction. An effective local content policy can potentially promote the expansion of upstream and downstream sectors of the gas industry, support indigenous participation, as well as foster technological transfer. The Gilman Rutihinda Memorial Lecture 2014 focused on practical steps towards implementation of local content policy in the gas sub sector in Tanzania. Discussions during the lecture were very insightful and extremely relevant to the current Government's efforts of putting in place a local content policy in oil and gas industry in Tanzania.

I wish to thank the guest speaker Prof. John Sutton who gave his valuable time to share his expertise and experience on this important topic for our country. I also wish to thank all those who attended the lecture and actively contributed to the debate. In a special way, I wish to thank members of staff of the Bank of Tanzania who developed the program and directed the lecture.

Prof. Benno Ndulu
Governor,
Bank of Tanzania

OPENING REMARKS BY RPOFESSOR BENNO NDULU- GOVERNOR, BANK OF TANZANIA

Your Excellencies, Members of the Diplomatic Corps

Members of the Board of Directors, Bank of Tanzania

Rutihinda's family

Guest Speaker, Prof. John Sutton

Heads of Financial Institutions

Distinguished Guests

Ladies and Gentlemen

It is my pleasure to welcome you to the seventh Memorial Lecture in Honour of the late Gilman Rutihinda, the third Governor of the Bank of Tanzania. I would like to thank you all for accepting our invitation and making time to attend this important memorial lecture. I wish to thank, in a special way, Prof. John Sutton our guest speaker today, for accepting our request to deliver a lecture at this forum, despite his busy schedule. I have great honour to welcome you to Tanzania. I also wish to pay particular tribute to the members of Rutihinda's family present here today, for once again making time to attend this event. It is always a pleasure to have you with us.

Distinguished guests,

Ladies and gentlemen,

As some of you may be aware, Governor Gilman Rutihinda played a key role in the process of economic restructuring and transformation to the market oriented economy in Tanzania. He championed the initiation and implementation of the first generation financial sector reforms in early 1990s, which laid foundation for a guided restructuring, privatization and development of the financial sector. The broad objectives of these reforms were to liberalize the sector in order to improve the capacity of financial institutions to mobilize domestic savings, enhance the effectiveness of monetary policy instruments, and to promote competition among financial institutions in order to improve their efficiency. It was during his Governorship that a number of legislations were enacted to pave way for licensing of private banks and financial institutions, and to allow for market determined financial resource allocation as well as financial asset prices. Indeed, a lot of the developments and stability in the financial sector we observe in Tanzania today owes much to Governor Rutihinda's efforts.

Distinguished guests,

Ladies and gentlemen,

It is in recognition of Gilman Rutihinda's outstanding contribution to the economy and particularly to the development of the financial sector that the Bank of Tanzania decided to set up "The Gilman Rutihinda Trust Fund" for the purpose of financing various activities, including the Gilman Rutihinda Memorial Lectures. The series of these memorial lectures was launched in June 1995 with the objective of bringing together relevant players to discuss public policy issues affecting our economy. I had the honour to deliver the first lecture in the series. Over the years this forum has grown in size and influence; and topical themes have been selected for each lecture to reflect the need of the time. Today's lecture, ranks seventh in the series, and it seeks to share experience under the theme "***Gains From the Natural Gas: Local Content and Tanzania's Industrial Development"***.

Distinguished guests,

Ladies and gentlemen,

As you are aware, the last decade has seen major changes in global energy markets, on both the supply and demand side, and the recent and rapid exploration of the Indian Ocean Basin has brought this hugely important market to our own doorstep. Major oil and natural gas exploration activity has been undertaken in Tanzania over the last few years, involving companies such as British Gas, Statoil from Norway, Petrobras from Brazil and Royal Dutch Shell. Since 2010, thanks to numerous foreign investments and sub-surface exploration, important gas fields have been discovered, propelling the country within the space of only three years from 80th to 28th in international rankings of proven reserves. Today Tanzania has approximately 46 trillion cubic feet of proven natural gas reserves in its subsoil, which represents an incredible opportunity for the country and its citizens.

Distinguished guests,

Ladies and gentlemen,

Much as the development of the gas sector holds potentials to transform the Tanzania's economy, it also raises many challenges. Let me highlight just three challenges that I think are of central importance as we develop our strategic vision for the future.

- The first – and probably the trickiest – is how to steer the economy until the revenues from gas production begin to flow into the treasury, which will be quite a number of years. Hence we will have to manage the public's growing expectations and avoid mortgaging future revenues for present consumption.

- Second, the revenues from gas exports will need to be managed carefully to support economic diversification and avoid the risk that gas revenues undermine the competitiveness of the rest of our export economy: in other words we need to be vigilant in setting policy to mitigate the effects of the so called 'Dutch Disease' if we want to maintain a balanced and inclusive economic growth and development strategy. Our objective, therefore, must be to ensure that our economic policies help the emerging natural gas sector to complement rather than suffocate the rest of the economy. This requires well-designed policy across government as a whole, but particularly in the areas of industrial trade, fiscal and monetary policies.

- Third, and finally, we must recognize that by itself the offshore natural gas sector is not going to generate large amounts of employment. If we do not generate robust employment opportunities from this wealth we will be vulnerable to the divisive social tensions that plague many resource-dependent economies. We cannot use public transfers as a substitute for jobs but rather we must ensure that our broader economic policies around the natural resource revenues support the generation of what the World Bank is now calling "good jobs for development". In other words, we want to support the generation of plentiful jobs that harness our skills, support the diversification of the economy, and foster a deep sense of social cohesion.

Distinguished guests,

Ladies and gentlemen,

The key vehicle through which this third challenge could be addressed is by integrating local firms into the supply chain of the multinational gas companies in order to advance the capabilities of Tanzania's industrial sector and create more stable jobs for Tanzanians. One of the most potent ways for achieving this integration is by putting in place a supportive local content policy designed to harness the opportunities available to local firms and individuals from the gas industry. It is against this background we chose this theme and invited Prof. John Sutton who is an expert in this area to share with us knowledge and international experience on the potential benefits of local content policy and the conditions that may lead to successful outcomes of such a policy.

Distinguished participants, Ladies and Gentlemen, with these brief remarks, I present you Prof. John Sutton to deliver the seventh Gilman Rutihinda Memorial Lecture

"Prof. John Sutton the audience is ready for you"

Thank you very much for your kind attention

GAINS FROM THE NATURAL GAS: LOCAL CONTENT AND TANZANIA'S INDUSTRIAL DEVELOPMENT

By Prof. John Sutton
London School of Economics

1 The Case for a Local Content Unit

One of the most urgent questions in relation to Tanzania's offshore gas industry is: how can this activity open the door to expanding and deepening the country's own business sector? How can the jobs created directly by this activity be complemented by indirectly created jobs, that come about through the opportunities afforded to existing and newly formed Tanzanian companies that slot into the supply chain of the multinational gas companies? And how can this 'indirect' effect be harnessed in order to advance the capabilities of Tanzania's industrial sector? In other words, the challenge now confronting Tanzania is: how many good, stable jobs can be generated for Tanzanians as the gas industry grows and matures?

Much thought is being given to these issues by the Government of Tanzania, which has already established a high level Expert Group to provide a lead on issues relating to the Offshore Gas industry. What concerns me in this lecture is one particular aspect of the agenda: the setting up and operation of a Local Content Unit (LCU) and an associated Enterprise Development Centre (EDC). In other words, my focus in this talk is not on high level policy formulation; rather, I want to direct attention to issues of practical implementation. The LCU I describe in what follows is an administrative body, reporting to the Government's Expert Group, whose responsibilities encompass the twin functions of negotiating with multinational companies (MNCs) on local content, and bringing forward the capabilities of potential domestic suppliers via an EDC.

There is no substitute for a well-organized and effective LCU. Crude measures such as an 'x% local content rule' are ineffective: rules of this kind are too easily circumvented, and may generate an unfortunate bias in the supplier base towards those activities that contribute little to the development of the host country's industrial capabilities. Only a well-informed LCU that enjoys the full support of the Expert Group and the backing of the relevant Minister, and the Prime Minister, can achieve the kind of broad-based involvement of local companies that will maximize the long term benefit to the Tanzanian economy.

What a well-designed Local Content Office (LCU) can do, in acting with and on behalf of the Expert Group and the Minister, is to engage in an on-going dialogue with the lead MNCs and their first tier international suppliers, in order to arrive at a pattern of involvement by local firms that is feasible, practical and achievable over an agreed timescale. To do this, the LCU needs to be staffed by high calibre executives who are well prepared in terms of having a deep knowledge of the capabilities of existing Tanzanian companies across the full range of productive activity. This small group will play a crucial role in underpinning, implementing and developing the content of understandings, agreements and contracts between the government and the Gas multinationals. It is the design and operation of such a unit that is the subject of this lecture.

The issue is urgent. Tanzania is now at the stage when the measures described here need to be put in place. Other countries have in many cases failed to reap the full benefit from the integration of local firms in the supply chain because they have waited until too late in the process to initiate the measures recommended below. This is the right time for Tanzania to move forward in getting these structures into place.

So what are the practical steps that need to be taken? The first step is to establish an LCU, consisting in the first instance of some half dozen highly capable and motivated members drawn from the appropriate ministries. The Expert Group and/or the Minister may also wish to consider recruiting a further two members who have relevant experience in the domestic private sector, and with relevant technical expertise. Finally, it is advisable to recruit from abroad some two members who have experience in negotiating such issues with oil and gas multinationals in their home countries. This will lead to a group of about 10 professional staff; and they should be supported by a small but effective group of administrators. The group's first task will be to acquaint themselves with the range of firms in Tanzania that are potential participants in the supply chain, either in the short run or in the medium term (Section 5b below). The second task of the unit is to work with the Expert Group and the Minister to establish an EDC (Section 5b below). Early decisions will relate to the outside partners that will be invited to assist in the formation of this unit (Section 5c below).

2 Background: Current Capabilities in Tanzanian Industry

In the book titled 'An Enterprise Map of Tanzania',[1] John Sutton and Donath Olomi survey the full range of Tanzania's current industrial capabilities. Similar volumes are available for Ethiopia, Ghana, Zambia, and Mozambique. What these five countries have in common is that they have all experienced a decade of rapid economic growth, and this growth has been based in part on a substantial expansion in industrial output. In all four countries, there is a huge interest in asking, how can this growth be sustained?

Now a large part of the growth of the past decade has come from agriculture, including agribusiness, and this will continue to be a key source of growth in the future. Another growth component has come from extractive industries, and it is of course clear that the direct gain to Tanzania from offshore gas activity will be of great importance. But the focus I want to take here is on the level of industrial activity, and on the way the growth of the offshore gas industry can be used as a springboard for new industrial activity – for it is here that Tanzania has the opportunity to hugely increase the payoff the country stands to gain from offshore gas activities.

So what kinds of industrial capabilities does Tanzania currently have? The answer is, that there are very solid capabilities already in place across a substantial range of basic manufacturing activities. The industries in question include Food Processing, Cement and Building Materials, and a number of specific areas of Metals and Plastics. This is exactly the same profile that exists

[1] Downloadable at http://personal.lse.ac.uk/sutton/

in Ethiopia, Ghana, Zambia and Mozambique. Across this set of industries, the best companies currently in operation are achieving high levels of quality.

So if we look across this set of industries, the picture looks bright. But there is another side to the story.

The minus side is that the range of industrial activity remains very narrow – and the driving argument behind the present report is that a broadening of the range of industrial activity is a necessary component of any coherent economic plan that aims to maintain the high growth rates of the next decade. Much can be achieved by raising productivity in existing agricultural and manufacturing activities – but to maintain the rapid growth rates of the past decade will be very difficult unless a broadening of the range of industrial activities can be achieved.

What the offshore gas industry provides is a once-in-a-lifetime opportunity to broaden the country's industrial capabilities by integrating domestic companies into the supply chains of multinational firms. The benefits that can be gained from this are widely underestimated: few countries have fully exploited their opportunities, for they have failed to see how widely these opportunities are spread. By thinking too narrowly, they miss the target. For example: the typical policy maker's response to this opportunity is to ask: can some of our local firms be involved in building rigs and terminals? Even when the answer to this is yes, the focus is wrong. For by looking to the most immediately visible gains, the majority of opportunities are simply let slip. It is essential to begin from the big picture, by first examining the full range of potential opportunities.

3 The Big Picture: Where Gains Come From

One of the most dangerous misconceptions in this area lies in underestimating the range of firms and activities that can be developed as part of the process. There is a tendency to focus on the engineering side alone, and to miss the fact that this is only one of three major areas of opportunity. It is important to begin with a different, broader perspective if the full potential benefits are to be realized. This broader perspective focuses, not on specific products or activities, but rather on the country's stock of efficient, well-functioning mid-size firms.

For Tanzania, this is a crucial point: the Enterprise Map volume shows that every industry has a few large, relatively well run companies. But the number of well run mid-size companies is in every case fairly modest, and one of the most central engines of Tanzania's drive to become a middle-income country lies in raising the number of well functioning mid-size companies.

When I refer here to a mid-size company, I have in mind a firm employing 30 or more people – up to say 100 or so. Companies of this size pay wages that are many times those earned by workers in small firms employing 10 or fewer people. (Figures for Tanzania are unavailable, but a useful point of comparison is provided by Ethiopia, where manufacturing firms employing 50 or more people pay wages almost 4 times higher than small firms with 10 or fewer employees.)

The central role of these mid-size firms in Tanzania's future growth should not be under-estimated. One of the most important channels of growth lies in the migration of individuals from low paid jobs in agriculture, and from small industrial firms, into well functioning mid-size enterprises that generate much higher levels of value added.

Now if we begin from this picture, the whole question of benefiting from the Offshore Gas industry's integration into the Tanzanian economy begins to look different. Instead of thinking narrowly about 'what can we make/provide', it suggests thinking instead of 'where can we begin to develop new local firms, or expand the activities of existing small companies, through widening the range of business opportunities open to them?

Once we ask the question in this way, two pictures emerge immediately. The first picture illustrates a time-line, or sequence of events (Figure 1)

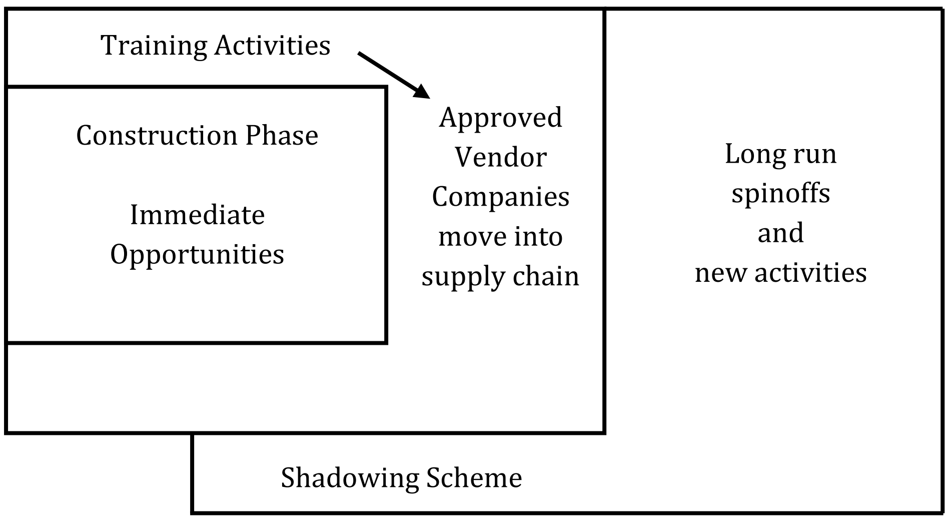

Figure 1: A Timeline in Three Phases

The first phase, which is easily forgotten in this kind of discussion, and is therefore under-exploited, concerns the immediate opportunities available to local individuals and firms from the very outset of the construction phase. No picture illustrates this issue better than the Takoradi port in Ghana. The exploitation of offshore oil or gas involves a huge and dramatic transformation of a port from its traditional form to a modern world-class industrial facility. The huge investments that pour into this process generate enormous immediate opportunities for local businesses. It is the sheer range and variety of such opportunities that need to be appreciated.

To put this in perspective, consider how much even a very small project can do: take for example a single small construction project in Uganda, where Tullow Oil built a road across a rural area to allow access to a lake. Within eighteen months, hitherto sleepy villages between which little communication occurred were thriving, as villagers acquired bicycles, the road buzzed with cycle traffic, the lake's fishermen had moved from fishing for their families to trucking commercial quantities to an urban market, and new retail businesses (from grocery stores to bicycle repair shops) had sprung up in the villages along the road. If the construction of a single rural road can catalyse this range of activity, perhaps it is easier to understand the dramatic effects that flowed from the building of Ghana's Takoradi port.

The point I want to emphasise here is the broad range of business opportunities that appear for local firms at this very first construction stage of the process (Figure 1). Enterprising local firms will appreciate the huge new demand for:

- cafés, restaurants etc.
- retail outlets offering a wide range of international brands.
- car hire services, trucking services, and helicopter rental and leasing companies.
- construction business of all kinds: residential, civil engineering, and the full gamut of general sub-contracting.

The list could be continued indefinitely, but these few examples serve to illustrate the point.

So what are the key steps that need to be taken in order to allow local firms and individuals to achieve the maximum benefit in this phase? There are two key points:

1. Review immediately the regulations around firm formation and entry: there will be a sudden surge in new firm formation, and this must be facilitated.
2. Begin an active dialogue with the Offshore Gas Multinationals with a view to scoping their vision of needs and opportunities and understanding the specific factors that will encourage them to source and purchase goods and services of all categories locally. One useful preparatory action would be to send a local team of officials to visit Takoradi port with a very specific remit, viz. to pin down the details of measures taken and opportunities missed in Ghana's development of domestic activity around the construction of the port.

As the construction phase progresses, Tanzania should already be preparing for Phase 2 (Figure 1). This is the central phase, and the one that tends to be at the forefront of people's mind when supply chain issues are discussed. It involves the integration of local companies into the production supply chain where gas comes online. Now this is a huge and complex area, and it is best understood by beginning with some simple considerations.

The first consideration relates to the typical structure of such a supply chain. This will involve, in each of several areas of activity, a lead sub-contractor who will in turn sub-contract to a handful of sub-contractors, each of whom will in turn employ many mid-size firms for specific tasks.

The key tension that must be addressed, as described in section 2 above, lies in bringing in a lead local contractor to spearhead the local content pyramid.

The importance of starting from this picture lies in getting away from the common notion that "we'll have an open tender process to which a large number of local companies can apply." It is crucial to realize from the outset that we are talking in the first instance of a very small number of local firms that can play a leading role in any area of activity – and it is here that a deep understanding of current capabilities of domestic firms on the part of both the Local Content Unit and the Gas Multinational is crucial. The tension that must be addressed is between the tendency for the MNC to assume from the outset that it will operate almost exclusively with foreign lead sub-contractors, assuming that no adequate local capabilities are in place, as against the government's view that the role of lead local subcontractors is essential and achievable. Neither extreme view is tenable: what is true is that capabilities, both those in place now and those that can be enhanced and developed over a 2-year period, are adequate to permit a reasonable degree of integration of local companies: but this will require a carefully managed process, that respects that priorities and concerns of both the MNCs and the government.

4 The Process: Approaches, Objections and Pitfalls

Objections and Responses

The single biggest barrier to the successful integration of local firms into the supply chain is: “Local firms do not exist that can meet our standards of safety. It is essential to our operation that we bring in our customary international subcontractors who understand our operating standards and can meet our requirements”.

Now this is half true. It is indeed the case that certain operations are safety critical. It is also true that there are probably few if any domestic firms that can meet requirements from the outset. It is essential to concede this, if a useful discussion is to ensure. But it is equally important to insist on the other half of the story. Those countries, and companies, that have set out to invest in the building up of capabilities in potential domestic partners, have succeeded in achieving a deep integration of local firms into the supply chain.

5 Achieving the Gains

a. Understanding Local Companies

The first task for the members of a newly formed Local Content Unit (LCU) is to develop a deep understanding of the existing capabilities of the country's firms. In the case of Tanzania, a good point of departure is provided in the *Enterprise Map of Tanzania* volume. This volume sets out, industry by industry, the various clusters of firms engaged within every industry (across agri-business, manufacturing and construction). The first training task for members of the LCU should be to visit a cross-section of suitable firms, in order to understand just how far their current activities have prepared them for possible involvement as suppliers to the new offshore gas industry. These visits can also be used to explore channels of engagement with local firms; to inform local firms of the broad nature of the selection process and screening criteria for applicants to training at the Enterprise Development Unit; and so to communicate both directly and indirectly to the Tanzanian business community the mode of operation of the Local Content Unit.

b. An Enterprise Development Centre

At the heart of any good process for the integration of local firms into the supply chain of multinational oil and gas companies is the Enterprise Development Centre (EDC).

The role of the EDC is to provide training and capability building for local mid-size enterprises that will allow them to become `approved vendors' to the oil and gas multinationals, and to the first tier subcontractors to those multinationals.

The EDC needs to be put in place at a very early stage – essentially, once it is determined that oil and gas will certainly be produced in large volumes. The reason for early action is two-fold. First, the lead time from initiating the formation of the EDC to its commissioning may be well over a year. Second, the typical training period for local firm is 18 months to 2 years. So what does the EDC do? And how does it do it?

The EDC needs to have two divisions: a 'business' division and a 'technical' division. The role of the business division is to bring local mid-size firms up to speed in financial reporting, health and safety management, process management, procurement and sales, and related areas. The importance of the business division needs emphasis: in the early stages of the work of the EDC, this division is likely to have substantially more firms to deal with than the technical division. Its work is fundamental in equipping local mid-size firms to qualify for 'approved vendor' status. But its importance goes beyond this: local firms that achieve the standards required by the EDC for 'approved vendor status' will have graduated to a level where they will be well-equipped to do business with any multinational companies (MNCs) based in Tanzania, outside the oil and gas sector. In other words, what is worth emphasising here is the general nature of the skills involved. In contrast to the 'technical' division, whose work is more narrowly focussed on the oil and gas sector, the work of the business division is concerned with general business practices.

The importance of the work of the technical section is obvious, but it is less obvious why the work of the business division is crucial. What needs to be at the centre of thinking in this respect is that there is always a substantial gap between the practices that serve a midsize firm operating in a familiar local environment, and the practices that are standard in the international business community. It is not that this gap is a particularly difficult one to bridge, but rather that it takes time to carry out the necessary changes in procedures and practices at various levels in the company – and this is where the work of the EDC is of central importance.

So how does the business division actually carry out its task? There are two models, which can both play a role, operating in parallel. The first model involves a group of professional staff based at the EDC's premises, who give one or two day courses to personnel from participant firms. The second model is one in which a single professional from the EDC or appointed through the EDC is seconded to a single participant company for a period of several months, and who works with the management of the firm to put in place the required changes.

The 'technical' division of the EDC works to the same model, with two potential modes of operation: 'in-house courses' and 'secondment of (technical) personnel'. For the technical section, however, the client firms are of course split into a number of groups depending on their areas of interest. There may be half a dozen such groups, ranging across a wide area, from 'engineering services' at one end of the spectrum, to 'hygiene in the food delivery systems' at the other end. The setting up of these separate technical areas, and the provision of qualified technical staff to lead the operations of each unit, is one of the first tasks of the newly established EDC.

So how do local firms become attached to the EDC? The answer is, that the most efficient and effective way forward is to proceed in two stages. In the first, the LCU is pro-active in drawing up a list of potential candidate firms, and recruiting them to the EDC. In the second, an 'open door' is offered to any (existing or newly-formed) local firms to apply for places at the EDC. Achieving efficiency and transparency in this process is important, an issue to which we return in Section 6 below.

c. Partners in the Process

One of the earliest ministerial decisions will relate to the choice of partners to be used in the setting up of the Enterprise Development Centre. Here, it is likely that the partners will include one or more private sector firms, as well as one or more international agencies. For example, in the case of Ghana, one likely lead partner is the African Development Bank via the Fund for Africa Private Sector Development (FAPA). Another likely lead partner is the Ernst and Whinney company, which is a member of Invest in Africa, via its Cape Town-based Africa Business Section. FAPA's potential role is worth emphasising, as it is now building up considerable experience in the relevant area through, for example, its recent pilot scheme with 700 SMEs in Zambia. The modus operandi of Ernst and Whinney is also worth noting, in that it is focussed or the 'secondment' model, in which an E&W employee spends a lengthy period within a candidate local firm.

d. Shadowing Schemes

In a shadowing scheme, qualified local individuals are recruited to positions within the multinational oil and gas company. Their duties involve working alongside ('shadowing') a specific regular employee of the company for a period of one or more years. The aim to this exercise is to 'learn the job by seeing it done'.

Schemes of this kind have to be managed with great care if they are to be successful, but the rewards from putting a well-designed scheme in place can be enormous.

The Do's and Don'ts of shadowing schemes are summarized in Box 1. Here, we look at how to put a scheme in place.

The process begins with a dialogue between the LCU (or another government agency) with the MCN involved. The organization and financing of the scheme need to be negotiated. If this is to be handled well, there needs to be a realistic shared view of the broad parameters of the scheme: how many shadowing positions should be created? For people with what kind of initial technical background? In what areas of activity?

The answers to these questions turn on the availability of Tanzanian citizens with appropriate education and training. This is an area where a preliminary examination of the stock of Tanzanian engineering graduates, both those working within the country and those currently working abroad, needs to be undertaken as a matter of urgency.

In order to provide a feel for the likely scale of a well-designed shadowing operation, it is useful to look at the Ghanaian experience (Box 1). Ghana was particularly fortunate in having a substantial number of very able engineering graduates, many employed in engineering firms in other countries, who could be attracted into its shadowing scheme. The Ghanaian scheme, which took place with Tullow Oil, involved 80 Ghanaian 'shadows'. This is a very large scheme, and it would be ambitious for Tanzania to aim at this many shadows, given the likely availability of suitable candidates.

Where should the 'shadows' be placed? They should in all cases be placed in the 'majors', not among sub-contractors. Among the majors, some will be more amenable than others operating a scheme. Moreover, the mix of backgrounds among Tanzanian recruits will make some kinds of role within a firm more suitable than others. So it is sensible to think of sharing the shadowing scheme across two, or even three, MNCs.

The Benefits of Shadowing Schemes

The benefits of a successful shadowing scheme are very substantial, and they are of two kinds. The first is that individual Tanzanians can build a career within the industry, not just with their original 'host' MNC, but in any firm within or outside Tanzania. But the second benefit is that ex-shadows have proved, in other countries, to be highly entrepreneurial in setting up new sub-contracting companies of their own that feed into the industry supply chain (Box 2)

Box 1.Shadowing Schemes: DOs and DON'Ts

Shadowing Schemes are one of the most powerful devices in the Local Content agenda. Yet such schemes can easily go wrong, and a huge opportunity is then missed. What are the rules to follow in order to get good results?

Rule 1: Act Early: Get Tanzanian shadows in place from the very outset, prior to going offshore.

Rule 2: Hands off recruiting. Let the multinational operator control the recruitment of young Tanzanian engineers. Do not allow the process to be 'politicised'. Allow it to be a business decision.

Rule 3: Do not involve subcontractors: they are not interested and will not be committed. Focus on the majors.

Of these 3 rules, Rule 1 is the most urgent: An example of excellent practice is provided by Tullow Oil in Ghana: even prior to Tullow's 'undersea' team of 80 people leaving London for Ghana, each one of these 80 people already had a Ghanaian shadow in place.

So who pays the bill? Running a shadow scheme is costly. The oil and gas multinationals do not want to pay, after negotiations are complete, for such activities, so it must be built into the contract from the outset. Only in rare cases will it be possible to obtain support from this source in the absence of an advance contractual undertaking.

Box 2.Shadows and Spin-offs: A Columbian Tale

The most striking example of a successful shadowing scheme comes from Columbia, where various engineers originally engaged as shadows formed new small firms that entered the industry's supply chain, displacing former international suppliers. Example of this are:

- The newly formed Columbian firm Equipo took over plant maintenance from the UK based multinational Wood Group. The individuals who set up Equipo had all been shadows within the Wood Group. Some 85-90% of Equipo's employees are domestic citizens.
- The PTS company is involved in the highly technical area of 'Well Testing'. It took over an operation that had previously been outsourced to the multinational leader, Haliburton. Again, the founders of PTS were domestic nationals who had been trained by Haliburton during the period when it was responsible for Well Testing.

e. **Education and Training**

One of the most important elements in a good plan lies in meshing the training and education of young Tanzanian engineers who can find positions of responsibility in the offshore gas industry. Different countries, and different multinationals, have approached this problem in different ways. One common element in good plans, however, stands out: it is vital to build, at the earliest possible stage, a partnership between one or more faculties of engineering at Tanzanian universities, with Petroleum Engineering departments at leading international universities. Such partnership would typically involve a handful of foreign academics spending a year or more at a Tanzanian university, working with local faculty to develop new courses and put degree programs in place that can be self-sustaining in the medium term. In other words, it is crucial to develop local expertise that will be a long run asset to Tanzania's university system.

The funding of this kind of venture is often possible via donor financing. The British Council, and its counterparts in other countries, has in the past played a key role in such initiatives. The multinational gas companies can be contributors in two equally important ways: in contributing to the costs, and in providing teachers for specialist modules. So a complex partnership needs to be put in place – and since this kind of venture takes a couple of years to mature, initiating this kind of activity should be seen as a matter of urgency in Tanzania now.

6 Practicalities: Achieving both Transparency and Effectiveness in the company recruitment process

One of the most important considerations in the process of involving local firms in the multinationals' supply chains relates to finding a way to achieve both transparency and effectiveness in the recruitment process.

The 'transparency' issue is easily understood. Many countries that have discovered new sources of oil and gas have been told by international organizations that the recruitment of local companies into the multinationals' supply chain must be open and fair. Now this is a valid concern: the problems of nepotism and potential corruption must not be overlooked. Yet the advocates of such processes are too often inadequately informed of the level and dispersion of local industrial capabilities, and wrongly imagine that there are many similar local candidates that might compete to be included. This is rarely the case – and the problem is how to maintain transparency and fairness in an environment where the number of suitably qualified local candidates is initially low.

To be specific: In Tanzania, just as in Ghana or Zambia, the number of well-functioning mid-size or larger firms in steel fabrication can be counted on the fingers of one hand. If firms of this kind are to be recruited, then a process needs to be put in place that recognizes the paucity of candidates.

To combine transparency and efficiency, the line of attack that has been developed internationally goes as follows:

1. The multinational firm, in consultation with government, selects one local firm as a lead or first-tier supplier in a given area of operations. In the engineering area, for example, there is often just one local firm with the breadth and depth of local expertise to fill this role.
2. The 'lead local contractor' then proceeds to bring mid-size local firms into the supply chain by employing them as sub-contractors. Initially, there will be few suitable candidates. But by introducing the requirement of achieving 'Approved Vendor Status' through involvement in training at the Enterprise Development Unit, a larger number of local firms can be brought into play.
3. One a local firms has achieved 'Approved Vendor Status', it enters an open and competitive tendering process, with the 'lead local supplier' as the principal.
4. This means that the key step in regard to transparency becomes the recruitment of local firms to the Enterprise Development Centre. Here, the best process is one that (a) allows any local firm to apply, and (b) specifies in advance a set of objective relevant criteria that will be used in selecting applicants for training. For example, in the engineering area, a set of criteria can be set out, which are 'relevant but not all essential'. One such criterion, for example, might be 'proven commercial success in large scale metal fabrication'. This criterion would weed out a quite small number of local firms that would be able to enter the very large and lucrative business of supplying 'tank farms' (sets of very large cylindrical steel tanks). The point of this example is to show what kind of requirement constitutes an 'objective relevant criterion'. There are many such criteria that can be pre-specified, and there can be different lists for different sectors (for example, firms from the food and drink

sector aiming to build up catering businesses would face requirements relevant to hygiene and to established distribution and storage channels).

The general principle, however, is simple: make application open to all, but apply pre-stated, objective, relevant criteria in selection.

7 Decisions and Actions: First Steps

The above description of the process of setting up a Local Content Unit (LCU) and an associated Enterprise Development Centre (EDC) is, of course, just an outline scheme. Practical experience, as the process unfolds, will lead to many specific decisions that will mould Tanzania's own approach to these challenges. But what is clear is that it is now important to take some initial steps:

1. Form a Local LCU with an initial staff of about 10 highly able and motivated members. Some 6 or so will be drawn from the relevant ministries. Another two will be local professionals with relevant experience in the private sector and/or relevant technical expertise. Finally, there should be two members from abroad, who have experience of negotiating local content with oil and gas multinationals in their own countries. (Section 1 above)
2. The Expert Group and the Minister, together with the head of the newly-formed LCU, will need to approach potential partners that will work with the LCU to establish an EDC. (Section 5c).
3. A premises will need to be found for the LCU and EDC, and a decision will be needed as to whether there should be two bases, one in the capital and one in the port area.
4. The members of the LCU should immediately embark on a programme of visits to Tanzanian firms in order both to build up knowledge within the LCU of the current capabilities of local firms, and in order to acquaint local firms with the planned work of the LCU and the EDC.

I remarked, at the outset of this lecture, that my focus would be on practical steps towards implementation of policy, rather than on the wide range of high level policy issues. It will be clear from what I have said that my focus is a narrow one. But the specific issues that I have chosen to focus on are both important and urgent, and the gains made by Tanzania from its Offshore Gas industry will depend to a substantial degree on the effectiveness with which these issues are addressed.

APPRECIATION FROM GILMAN RUTIHINDA'S FAMILY

Delivered by Mr. Rolland Rutihinda

Governor of the Bank of Tanzania Professor Benno Ndulu

Honourable Guest Speaker Professor John Sutton of the London School of Economics

Distinguished guests, ladies and gentlemen

Good afternoon to you all.

Firstly I would like to introduce you all to my lovely mother Mrs Josephine Rutihinda

I am honoured to say this humble speech on behalf of my absent brother and sister, Godwin and Renatta Rutihinda

21 years is a long time. 21 years our father has been gone. But even after 21 years he has not been forgotten.

As I look around I am extremely pleased to see so many family members, friends and old colleagues of my father attending this event. I feel enormous pride in the respect, love and honour you have all shown him in appearing here today even though it is 21 years after he passed. You have not forgotten. For that my family and I are truly grateful to all of you.

My memories of him are few. For anyone who has felt the heartache of losing a family member, spouse or parent it is always important to recognize the contribution that person has brought into their lives through those memories. Each one of these memories are special and unique in fuelling us each and every day to aspire to be the best version of ourselves in every way. His time in office was short but he left a mark that has been unforgettable to those who knew him and even to those who were unaware that his actions may have had a positive effect on their lives. For that is one of the side effects of service to your country and government. But here today it is a great pleasure to see his work being recognized.

They say that when we are born God makes us all ordinary. But that every single day ordinary people do extraordinary things. I believe that my father was an ordinary man who managed to do extraordinary things and that legacy that he has left behind is why we are here today to pay homage to that legacy and respect his memory.

For me personally it inspires me to one day touch the lives of the people around me so I may also be honoured and leave a legacy as great as he has. Our family is also extremely humbled as we know that an event like this is not a common occurrence for anyone who has ever lost a loved one. We are aware that this is something that is special and to our host the Bank of Tanzania, we have tremendous gratitude in carrying on his memory in such a manner.

Thank you from the bottom of our hearts.

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APPENDIX II: LIST OF THE PREVIOUS GILMAN RUTIHINDA MEMORIAL LECTURES

Date	Presenter	Institution	Theme/Topic
June 20, 1995	Prof. Tim Congdon	Managing Director, London Street Research Ltd – London	The Role of Central Banking in Economic Development
July 1, 1997	Prof. Benno Ndulu	Executive Director, African Economic Research Consortium: Nairobi – Kenya	The Challenges to the Transition to low Inflation Economy
June 18, 1999	Dr. Mathew Martin	Director, Debt Relief International – London	How Africa can Finance its Development?
July 10, 2000	Prof. Jeffrey D. Sachs	Director, Centre for International Development, Harvard University, Boston – USA	The Highly Indebted Poor Countries (HIPC) Initiative and Strategy for Tanzania's Economic Development
August 26, 2008	Ter – Minassian	Director, Fiscal Division, IMF – Washington DC	Creating Sustainable Fiscal Space for Infrastructure: The case of Tanzania
August 12, 2011	Prof. Patric Hanoham	Governor, The Central Bank of Ireland	Managing and Mitigating Effects of Global Financial Crisis: Lessons for

			Peripheral Countries
June 10, 2014	Prof. John Sutton	London School of Economics	Gains from the Natural Gas: Local Content and Tanzania's Industrial Development