

SURVEILLANCE of the EXTRACTIVE INDUSTRIES

National
Report
Nº 15
Peru 2012

Lima, June 2012



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Citizen Surveillance Area

GRUPO PROPUESTA CIUDADANA

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National Report N°15 on Surveillance of the Extractive Industries.

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INTRODUCTION



With President Ollanta Humala in office and the Council of Ministers headed by Lerner, some important public policy decisions were made regarding the extractive industries sector (new taxes on mining companies, prior consultation law), but many others have been left behind after the surprising change in the cabinet, due to the pressure exerted by economic power groups and increasing social conflicts. Still, a significant change has been the higher tax revenues the national government will receive with the new taxation measures. However, in return, the government reportedly agreed to put aside other important measures to improve the monitoring and control of environmental impacts as well as policies to manage the growth of extractive industries (such as land use planning).

Regarding the first change, it involved the introduction of three new tax measures that will increase the government's share of windfall profits from mining. These measures were negotiated with mining companies so that their implementation respects the legal order of the sector. On that basis, the government created the "Special Tax on Mining" for companies without legal stability contracts and a "Special Voluntary Contribution from Mining" (called Gravamen Minero) for mining companies with legal stability contracts. Finally, they also passed a law amending the calculation base and rate of mining royalties. Revenues from the first two taxes will go directly to the Central Government.

The government estimates it will collect 3.000 million soles in additional revenues, but there are well supported reasons to believe that these revenues could be lower. Indeed, the Special Tax on Mining and the Special Voluntary Contribution from Mining, which are considered costs for tax purposes, will have a negative effect on income tax payments and will therefore reduce the amount of canon transferred to the regions.

The second change was the enactment of the prior consultation law, whose regulations were approved in April 2012 with observations made by indigenous organizations and rural communities. One of the main objectives of the prior consultation law is to safeguard and respect the rights of indigenous and peasant communities in the decision about the implementation of investment projects whose environmental and social impact is undeniable. With the law and its regulations in place, the biggest challenge ahead for the State, companies and communities lies in the implementation of these measures in a context marked by growing social unrest.

The third change is the government's decision to refurbish the state-owned oil company, Petroperu, in order to enter the exploitation phase in the hydrocarbon sector within a five year period. To do this, Petroperu is seeking strategic partners with whom to invest in oil exploration and exploitation. The management model implemented would be similar to the one used by the Brazilian National Oil Company, Petrobras. Moreover, the oil company will also participate in the construction of the Southern Pipeline Project in partnership with Kuntur (Odebrecht). This changing role of Petroperu is an option that has its opponents, but so far, it is progressing and, if well implemented, it could help reverse the trend of stagnation and even decline in oil production in the Amazon and increase oil revenues for the state.

This is an interesting debate, because while the government argues for the importance of having a modern state owned oil company involved in oil exploitation and in promoting a project of great interest for the development of the southern region, its opponents - interested in privatizing the company - appeal to the discourse of the subsidiary role of the state, according to which it can only develop business activities where the private sector is not present. This is established in Article 60 of the 93 Constitution. However, in most countries of the Latin American region,

public companies are playing an important role in the exploitation of natural resources, the most interesting being those in Chile, Brazil and Colombia.

Social conflicts in 2011 grew rapidly. Among those that achieved the most national coverage we can mention the following: Conga, Tia Maria, Santa Ana and those related to artisanal mining, small scale and illegal mining which take place especially in the jungle of Madre de Dios. The first three conflicts were related local population's rejection of mining projects due to their real or perceived environmental and social impacts. Tia Maria and Santa Ana have been halted by the conflict. However, the conflict that had the most political impact was Conga, which brought down the cabinet headed by Lerner. To date, it remains unresolved and will probably continue this way in the short term, since the sides in conflict have completely opposite points of view, which generates little chance to start a dialogue. The use of repressive measures by the government, that criminalize social protest, is complicating the climate of tension that exists in the conflict zones.

Regarding the conflicts linked to informal mining, we would like to note that these are located in various regions throughout the country. Even though the incidents that received the most media attention have been protests by miners in Madre de Dios and the interdiction of the State (through destruction of dredges and machinery), the protests organized by these miners include many regions of country and display great ability to carry out resistance measures. They also have representatives in Congress. The State has issued measures, on the one hand, to formalize informal mining and, on the other hand, to ban and punish mining activities considered illegal. Given the magnitude, complexity and scope of this activity, the formalization process and the battle against illegal mining will take several years.

We believe that the country must begin to seriously discuss the terms of the modern XXI century mining that President Humala offered and not get caught in the twisted logic of the conflict related to the Conga project. In that sense, we need to discuss and make decisions on: a) the independent environmental authority to end the current scheme of assessment and approval of the Environmental Impact Assessments, which generates distrust in most actors, b) implement the prior consultation law in a coordinated manner, based on consensus, so it can be improved along the way, c) together with the above, enact the Land Use Planning Law to help define the areas where mining activity can and cannot take place; and finally d) the direct social spending and participation of the populations within the project's influence area in the wealth generated.

Surveillance Report 15 on the Extractive Industries provides information and analysis regarding the generation; distribution and use of revenues from mining, oil and gas in the country in 2011. This publication is made possible by the support from the United States Agency for International Development (USAID) and the Revenue Watch Institute. We also thank the work carried out by our regional teams: Cedepas - Norte (Cajamarca and La Libertad), Cipca (Piura), cedep (Ancash, Ica and Moquegua), Cbc (Cusco), Desco (Arequipa) and Spda (Loreto).

I

REVENUE GENERATION IN THE EXTRACTIVE SECTOR

I. REVENUE GENERATION IN THE EXTRACTIVE SECTOR



Since the beginning of 2011, mineral and oil prices kept the speed of growth with which they closed in 2010. However, mineral prices fell in the final months of 2011, basically due to the threat of a crisis in the European Union. This, however, didn't seem to affect the hydrocarbon sector. Despite this threat, 2011 closed with mineral and oil prices, in average, above the ones recorded the previous year. The current crisis in Iran and Uganda threatens to further raise oil prices. On the other hand, China's growth outlook could cause a fall in mineral prices, which would directly affect canon collection.

Although the increase in natural resource prices has been taken in stride by the different stakeholders – State, companies, researchers, etc. – the effect it has had on the extractive sector is undeniable. In 2011, investment in the mining sector was US\$ 4.0 billion¹ and in the next four years, investments are expected to reach up to \$ 53.0 billion² in the mining sector. Although the figures are not as high, the trend of increased growth in investments also took place in the hydrocarbon sector, where until 2005, exploration investment did not exceed US\$ 100 million, but between 2009 and 2011 they reached an average of US\$ 550 million per year³.

This positive scenario is of interest both for companies – because it generates higher profits – as well as for the national government, subnational governments and social organizations since well-designed and efficiently implemented investment projects that seek to improve physical capital and human capital will lay the foundations for sustainable development. It is worth

mentioning that from October 2011, companies began to pay a Special Voluntary Contribution (called Gravamen Minero in Spanish) and a Special Tax on Mining. With these two – together with an amended mining royalty – the government hopes to raise an estimated 3 billion nuevos soles for the central government in 2012.

One factor that has affected mining production is the growing social unrest that has halted projects like the "Tía Maria" mining project in Arequipa, the "Santa Ana" project in Puno, the "Conga" project in Cajamarca and the "Majaz" project in Piura, to mention the most important ones. All this in a context in which the government has neglected important policy measures offered in the campaign, such as the creation of an independent environmental authority for evaluation and approval of environmental impact assessments and a Territorial Management Law. The Prior Consultation Law has been a welcome step, but many concerns have been raised about its norms, which means there are still doubts about whether this measure will reduce social conflict.

In the following section, we will discuss the impact of 2011 – a year marked by a cycle of rising mineral prices – mainly on the fiscal accounts; and we will present scenarios of revenue transfers to subnational governments from the exploitation of natural resources in the coming years. The sectors examined are the mining and hydrocarbon sectors, including oil and natural gas, since over 96% of transfers received by subnational governments from natural resource extraction come from these two sectors⁴.

1 Mining investments exceeded 4,025 million dollars in 2010. Press release, Ministry of Energy and Mines (MINEM: spanish acronym). February 12, 2011. www.minem.gob.pe

2 Statement by the Ministry of Economy, May 15, 2012. http://elcomercio.pe/economia/1414915/noticia-gobierno-busca-concretar-inversiones-mineras-us53000-millones_1

3 Revista 4 - Perupetro. http://www.perupetro.com.pe/revistas/Revista_4/

4 To come up with the percentage mentioned, we have looked at the transfers to subnational governments available in the Economic Transparency Web Portal of the Ministry of Economy and Finance.

A. THE MINING SECTOR

1.1 THE OUTLOOK FOR PRODUCTION AND PRICES

As a result of the economic crisis, demand for minerals was altered and is now mainly focused on store of value assets like gold and silver, and reserve assets like copper. The demand for gold as an asset to hedge against risk (higher inflation) and as an investment asset (in lieu of other financial assets) gained further momentum in 2009 and 2010.

The dollar has continued to depreciate, which has meant that demand for gold as an asset increased. This will be reflected later in the changes in gold spot prices. In the case of silver, the picture was similar to gold. With respect to copper, the positive outlook for global demand during the first months of 2011 was reverted due to financial problems in some European countries and the delayed recovery in U.S. consumption and signs of slower growth shown by China.

The other minerals, more linked to productive activities, such as molybdenum, zinc, lead, iron ore and tin showed

uneven behaviors associated with the slow recovery of the industry worldwide, especially in areas such as the automotive and manufacturing sector.

The national mineral production showed different trends: gold, silver and copper has decreased in 2011 compared to 2010 at rates ranging between 9% and 15%, while minerals like iron and molybdenum have responded positively to the higher international market demand. Meanwhile, production of tin, lead and zinc has fallen sharply (between 20% and 22%) compared to 2010. It is worth recalling that gold production has been declining since 2005, unlike silver and copper, which show a more stable trend (see Table 1.1).

Production of the main minerals that determine the dynamics of the sector, copper and gold, is concentrated in fewer units and more precisely, in a few companies, so changes in their expansion and extraction policies can change the picture of domestic production, and therefore, change the picture of revenue transfers. For example, 80% of copper production is concentrated in the Antamina, Southern and Cerro Verde mining units. Similarly, Minera Yanacocha and Barrick concentrate about 60% of domestic gold production⁵.

Table 1.1
Volume of production of the main minerals, 2001 – 2011
Thousands of tons

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2006/2011	Variation 2011/2010
Copper	722	845	843	1,036	1,010	1,048	1,190	1,268	1,275	1,247	1,112	-7%	-11%
Tin	38	39	40	42	42	38	39	39	38	34	27	-31%	-20%
Iron	3,038	3,056	3,485	4,247	4,565	4,785	5,104	5,161	4,419	6,043	6,274	23%	4%
Molybdenum	9	9	10	14	17	17	17	17	12	17	17	3%	2%
Lead	290	306	309	306	319	313	329	345	302	262	209	-36%	-20%
Zinc	1,057	1,233	1,374	1,209	1,202	1,203	1,444	1,603	1,509	1,471	1,154	-20%	-22%
Gold (MT)	138,522	157,530	172,625	173,224	208,002	202,822	170,128	179,870	182,403	163,400	149,450	-12%	-9%
Silver (MT)	2,571	2,870	2,924	3,060	3,206	3,471	3,494	3,686	3,854	3,637	3,093	-11%	-15%

Source: Ministry of Energy and Mines (MINEM: Spanish acronym)
Production: Grupo Propuesta Ciudadana

5 Let's look back at the conflict between Tacna and Moquegua, where a company decision determined the amounts allocated to each region. For further information see "Surveillance of the Extractive Industries". National Report N° 6, November 2007. Grupo Propuesta Ciudadana.

There are several explanations for the decline in production in recent years. On one hand, the sector needs to continuously open new mines to replace those that are depleted, but this process has been limited in part by the adverse social conflict scenario mining companies are currently facing. In some cases, this has delayed or halted the beginning of new production units⁶. On the other hand, in a context of high prices, companies prefer to exploit lower grade deposits and save the best for the years when prices recede⁷. Finally, some mention that this fall only responds to the regular cycle of any industry that has ups and downs through the years, and mining, since it depends on non-renewable resources, is no stranger to this process. To see the evolution of production of the different kinds of minerals, see Annex 1.

The prices of minerals

The significant impact of the price increase on the profitability of the mining sector⁸, the capital market⁹, tax collection¹⁰ and revenue transfers to regional governments and municipalities¹¹ make this variable and its evolution extremely relevant.

Mineral prices experienced a steady increase since 2003, explained by the rise in demand from countries like

China, U.S. and India, whose economies began a strong process of modernization and large investments. They continued to grow despite initial signs of a crisis in 2007. But this crisis was not due to supply or demand factors, but rather by a strong capital market demand since minerals provided a higher return compared to other financial instruments. Therefore, there was a component of speculation, which we denominated non-commercial positions. Today, the country's main export markets are China, South Korea and Canada.

Mineral prices, therefore, have a real component linked to market volatility and another component linked to speculative investment opportunities. Speculation can affect the short term but in the long term, prices are determined by market dynamics¹². That is, natural resources, minerals and oil, have developed what we can call a double feature: they are both raw materials and financial assets¹³. This new feature of minerals and oil, as discussed below, has made prices go up again even though the economy shows no clear signs of recovery.

Table 1.2 shows average export prices of minerals. We can see that all prices have increased in 2011 compared to 2010 and many of them are even above their 2007 and 2008 levels, when they reached their peak. It is quite clear that the lack of confidence in the dollar has made

6 Mining production falls. Gianfranco Castagnola. Peru21. <http://peru21.pe/impres/ noticia/ produccion-minera-cae/2011-06-04/305480>

7 We should remember that the conflict between Tacna and Moquegua, in June of 2008, is partially explained by the decision made by the mining company, which operates in both regions, to extract the lower grade reserves when prices were high and postpone extraction from higher grade deposits to when prices fell.

8 The increase in prices allowed mining companies to obtain significant profits and, therefore, revenues to fund new projects and expansions. In the beginning of 2010, the Ministry of Energy and Mines (MINEM) announced that mining investments would reach US\$ 5000 during the year.

9 In 2010, the Lima Stock Exchange had the highest return in the world, since it grew 65% triggered mainly by the stocks of junior mining companies. Specifically, mining companies represent close to 60% of the value of all the stocks listed.

10 Close to 15% of the total domestic tax revenues collected by SUNAT came from the mining sector.

11 Between 2005 and 2010, regional governments and municipalities have received over S/. 18.6 billion in canon transfers.

12 "Cristal de Mira". Humberto Campodónico. www.cristaldemira.com. October 3, 2009.

13 *Ibíd.*

Table 1.2
Export prices of minerals, annual average 2001 – 2011

Mineral	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2011/2010
Copper (US\$/lb.)	0.68	0.63	0.72	1.19	1.57	2.77	2.91	2.85	2.13	3.21	3.87	21%
Tin (US\$/lb.)	1.87	1.88	2.44	3.90	3.28	3.95	6.56	8.15	6.11	9.02	11.83	31%
Iron (US\$/TM)	18.88	18.89	17.21	21.45	33.10	38.27	38.86	56.39	43.50	68.17	111.02	63%
Molybdenum (US\$/lb.)	1.75	2.98	4.08	15.91	26.95	21.39	27.42	27.04	9.11	13.32	13.48	1%
Lead (US\$/lb.)	0.36	0.34	0.35	0.67	0.68	0.83	1.15	1.00	0.72	0.92	1.12	22%
Zinc (US\$/lb.)	0.22	0.17	0.20	0.25	0.34	0.82	0.91	0.47	0.39	0.59	0.69	17%
Silver (US\$/oz.tr.)	4.40	4.61	4.87	6.67	7.28	11.46	13.35	14.96	14.19	19.05	33.68	77%
Gold (US\$/oz.tr.)	271.25	314.12	363.47	406.85	445.47	604.58	697.41	873.11	973.63	1,225.29	1,572.67	28%

Source: Peruvian Central Bank (BCRP: Spanish acronym)
 Production: Grupo Propuesta Ciudadana

gold a safe haven, almost an *unequivocal investment*, dragging silver along with it¹⁴. Something similar occurs with copper, driven mainly by purchases by China and the weak dollar.

We compared these annual averages with monthly rates (which can be seen in Annex 2) and found that in the past five years the main products have been consistently above the monthly rates up until 2005. The case of gold and silver is different. They experienced a steadily increasing trend, although in the past year they suffered a small fall compared to other years.

It is noteworthy that, between 2006 and 2007, various forecasts considered that the boom in mineral prices

would continue for the next five years – including a report by the Economic Commission for Latin America (ECLAC) that estimated these prices would last ten years. This caused high expectation around the sector's contribution, which was to become the main source of tax revenues. However, with the price fall in 2008, forecasts were no longer encouraging. Today, with a new price outlook, expectations are more cautious, but estimates still indicate that prices will remain at current levels for a while. The World Bank (Global Commodity Markets)¹⁵ estimates that prices of major minerals will take some years to recover and reach their pre-crisis levels. This suggests that companies will still have good profits, which will result in higher tax revenues.

14 See "Gold fever". Jürgen Schuldt. *La República*, September 30, 2010.

15 http://siteresources.worldbank.org/EXTDECPROSPPECTS/Resources/476882-1253048544063/GDF_Jan2010_GEPweb.pdf

The value of resources extracted

Mineral extraction has shown a declining trend in recent years. In particular, the four main minerals - gold, copper, zinc and silver - show decreased levels of extraction, but at the same time, their prices are the ones that have experienced the greatest increase in the last five years.

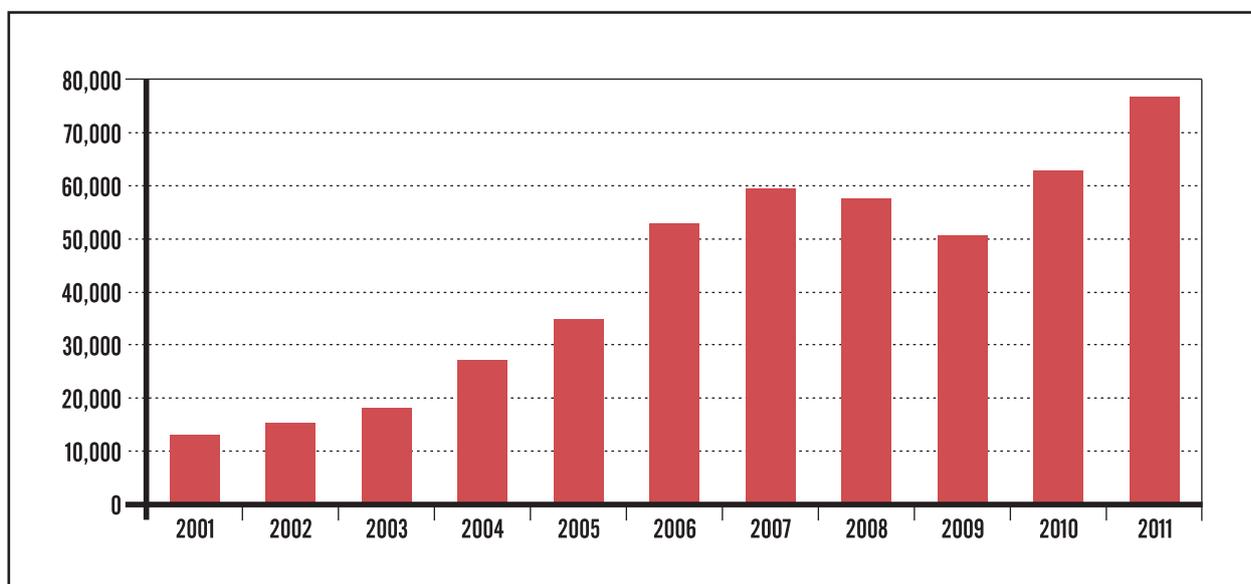
Indeed, the Value of Mineral Production (VMP) – which is obtained by multiplying the monthly export price by the monthly volume of mineral extraction – has grown almost constantly between 2001 and 2011, with a reduction between 2008 and 2009, explained by the fall in prices caused by the global financial crisis. In 2011 the VMP reached S / . 76.73 billion, 22% more than previous year (see Graph 1.1).

Since 2001, the VMP recorded sustained growth rates, largely explained by the increase in prices: from 2003

to 2007, this factor explained on average 80% of the total increase in the VMP. The situation changed considerably in the mid-2008 when the VMP decreased, mainly as a result of falling prices. Soon, however, the production value shows positive growth again: the growth in VMP between 2009 and 2011 is explained largely by higher prices.

Can this indicator be a good approximation to the dynamics of the sector? We think so. Since a lot of the mineral production is oriented to foreign markets, we must observe the dynamics of exports. We found that the VMP and exports have a very similar behavior. That is, in the sample available for the period between 2001 and 2011, mineral exports represent almost 90% of VMP. The difference can be explained by domestic demand and the exchange of minerals between local firms and their parent companies.

Graph 1.1
Value of Mineral Production, 2001 – 2011
Million nuevos soles

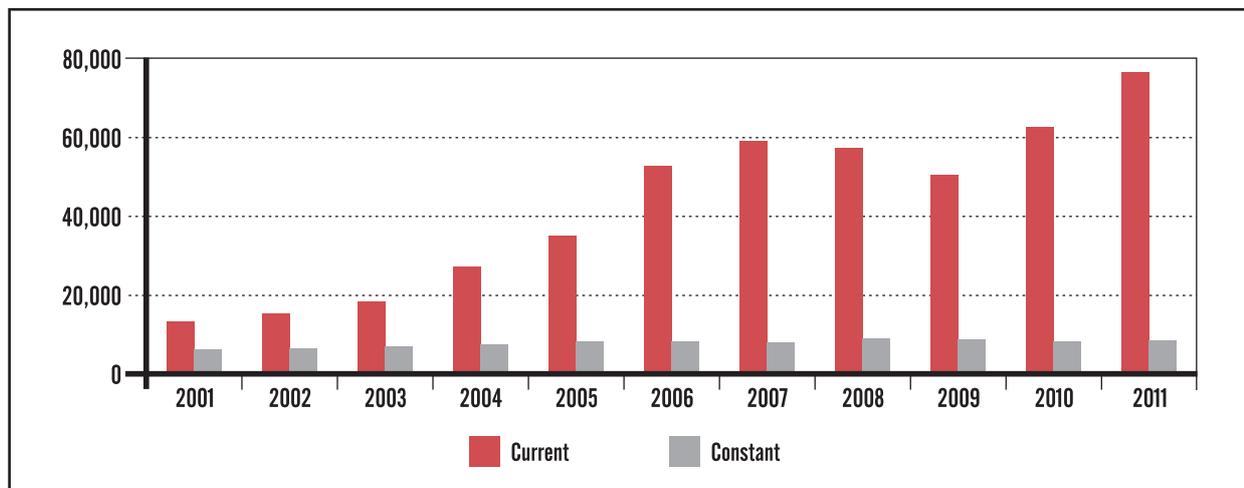


Source: MINEM, BCRP
Productoin: Grupo Propuesta Ciudadana

Graph 1.2

Value of mineral production in current and constant prices, 2001 – 2011

Base year = 1994 (Million nuevos soles)



Source: MINEM, BCRP

Production: Grupo Propuesta Ciudadana

However, what factors explain the increase in value of production? This question is relevant to understand which variables have the most influence on the dynamics of the mining sector. Thus, we look at the value of production at constant prices and at current prices from 1994 to separate the price effect. Looking at the Graph 1.2, we can see the performance of production value when we consider the prices of each year, at current prices, and when we use a base year, in this case 1994, to estimate what would have been the performance of the production value if we only looked at the volume of production. We can see that the bars of the value of production at constant prices have increased very little compared to the ones using current prices. It is therefore clear from this graph that the rise in VMP is primarily due to higher international prices.

To get a first estimate of how much revenues the regions will receive, we need to look at how the value of mineral

production is distributed between regions, although this will not always give accurate results because, as we shall see, this participation is not based on the volume of minerals extracted in a certain region. Instead, it is based on the profitability of each company, which depends on factors such as unit costs, recovery of investments or tax benefits applied. The data in Table 1.3 show that 66% of the VMP in the mining sector is concentrated in six regions: Ancash, Arequipa, Cajamarca, La Libertad, Pasco and Moquegua.

The regions of Arequipa and La Libertad have experienced an increase in their share of the VMP in recent years. In the case of Arequipa, until 2006 their participation was close to 6%, but in 2011, it reached 15%. Something similar happened to La Libertad, whose participation grew from 6% to 9% in the same period. This is explained by the expansion and consolidation of mining units such as Cerro Verde and Alto Chicama, respectively.

Table 1.3
Value of mineral production by region, 2004 – 2011
Million nuevos soles

Region	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2011/2010	2011	
										Particip.	Accumul.
Áncash	5,848	8,019	12,265	12,719	11,231	8,497	10,728	12,397	16%	16%	16%
Arequipa	1,861	2,266	3,455	7,547	8,321	6,749	9,512	11,233	18%	15%	31%
Cajamarca	4,546	5,549	5,806	3,881	5,450	7,741	7,285	8,975	23%	12%	42%
La Libertad	1,042	2,055	4,116	4,400	5,368	5,610	6,026	7,156	19%	9%	52%
Pasco	2,368	2,667	4,988	5,890	4,054	3,190	3,680	5,826	58%	8%	59%
Moquegua	2,662	3,476	4,751	5,158	5,143	3,876	4,987	5,070	2%	7%	66%
Tacna	2,614	3,381	4,646	4,729	3,611	2,620	3,863	4,154	8%	5%	71%
Junín	751	870	2,016	2,336	2,081	1,871	2,530	3,328	32%	4%	76%
Ica	306	503	596	865	1,418	1,151	1,925	3,349	74%	4%	80%
M. de Dios	723	846	1,107	1,262	1,513	1,784	2,374	3,323	40%	4%	84%
Lima	1,670	2,042	3,717	3,987	2,995	1,896	2,833	2,749	-3%	4%	88%
Puno	1,255	1,049	1,250	2,078	2,496	1,955	2,322	2,707	17%	4%	92%
Cusco	1,129	1,339	2,454	2,554	2,094	1,716	2,228	2,758	24%	4%	95%
Ayacucho	43	65	307	479	725	1,032	1,353	1,900	40%	2%	98%
Huancavelica	410	515	930	939	889	756	1,018	1,396	37%	2%	99%
Huánuco	168	222	356	382	285	215	340	408	20%	1%	100%
Apurímac	138	163	253	252	119	36	-	-	-	-	100%
TOTAL	27,536	35,025	53,013	59,458	57,793	50,693	63,003	76,728	22%	100%	

Sources: MINEM, BCRP

Production: Grupo Propuesta Ciudadana

1.2 THE ECONOMIC PERFORMANCE OF COMPANIES

As mentioned in previous reports, company profits depend largely on maintaining the difference between the selling price and the unit cost as wide as possible. As discussed in the previous section, the mineral prices since 2004 recorded a steady growth, with a pause between 2008 and 2009, which resulted in significant profits for mining companies.

Since mid 2008, and as a result of a new international outlook, the mineral prices fell temporarily, which made companies seek to reduce costs as much as possible or outsource¹⁶ those costs through measures such as delaying new operations or cutting back spending on exploration, personnel and direct social spending¹⁷. Therefore, although their profitability – measured by the ratio of net income / equity – fell in 2009 compared to 2008, it is still considered high.

16 Outsourcing the costs means that all the negotiation costs are charged to others so the producer doesn't have to pay them. This allows the owners of the companies to maximize their profits while keeping the prices of their products low.

17 All through 2009 and in the beginning of 2010, workers from various mining units in the country, and even the Mining Federation, announced strikes related to contract renewals and layoffs in the sector.

However, prices throughout 2010 and 2011 showed a recovery after the 2008 crisis, in some cases with record prices, which has resulted again in significant profits for most mining companies¹⁸. The data from the Stock Market Regulatory Agency (SMV: Spanish acronym)¹⁹ shows that companies have achieved, on average, better results in 2011 compared to 2010 with a growth rate of 13% (see Table 1.4). But these results are different among firms. On one side are companies such as Antamina, Volcan and Shougang whose profits have grown substantially and, on the other hand, companies like Xstrata and Minsur whose profits have fallen significantly despite favorable prices. This is an issue

that should be researched further to get a better understanding of these paradoxical results.

On the other hand, by looking at the 20 mining companies listed in the SMV, we find that the ratio of net income / net sales in 2011 averaged 41%, a slight decline compared to the 42% obtained in 2010, but similar to the result recorded in 2007 which is considered the best year in terms of earnings (see Table 1.5). That is, in this group of companies, for each S/. 100 in sales, the company receives S/.41 as net profits on average. This is a high figure, which is interesting for investment.

Table 1.4
Profits of mining companies, 2008 –2011
Million nuevos soles

Company	2008	2009	2010	2011	Variation 2010/2011
Antamina*	2,809	2,839	3,047	4,034	32%
Cerro Verde	2,046	2,108	2,976	2,986	0%
Southern	3,144	2,095	3,413	2,967	-13%
Buenaventura	446	1,769	1,872	2,371	27%
Yanacocha**	1,354	2,132	1,671	1,905	14%
Barrick	1,942	1,876	1,761	1,790	2%
Shougang	416	152	818	1,228	50%
Volcan	513	507	779	1,030	32%
Minsur	921	693	1,060	795	-25%
Gold Fields	0	293	440	580	32%
Milpo	82	180	366	415	13%
Xstrata*	221	283	422	358	-15%
El Brocal	178	239	204	215	6%
Corona	79	84	138	178	29%
Poderosa	44	62	80	100	25%
Santa Luisa	-14	8	22	57	160%
Atacocha	-140	-68	65	57	-12%
Raura	21	20	53	44	-18%
Castrovirreyna	7	1	5	15	206%

18 One of the companies whose profits are not increasing is Cerro Verde, for reasons we have not been able to investigate.

19 http://www.smv.gob.pe/Frm_InformacionFinancieraPorPeriodo.aspx?data=0489922C46775872F740C6D606585123B7F806EA74

Company	2008	2009	2010	2011	Variation 2010/2011
Perubar	-17	-10	18	2	-88%
Los Quenuales	-15	-20	44	0	-100%
Morococha	-16	-38	6	-15	-375%
Argentum	34	0	0	0	0%
Condestable	58	0	0	0	0%
Others	2,691	3,685	5,123	6,492	0%
TOTAL	16,806	18,888	24,381	27,603	13%

Source: SMV

Production: Grupo Propuesta Ciudadana

* The information for these companies has been estimated based on the data from XstrataPlc

** The information for this company has been estimated based on the growth rate of the value of production in 2011.

Table 1.5
Profit and loss statements, 2006 – 2011
Million nuevos soles

	2006	2007	2008	2009	2010	2011
Net sales (NS)	30,252	34,717	32,063	31,592	37,921	33,524
Sales cost	-8,282	-10,348	-11,861	-11,796	-12,174	-13,289
Gross profit	22,097	24,306	19,987	19,425	25,590	20,269
Operating profit	19,110	21,001	15,478	16,385	22,282	17,424
Profit before taxes and worker participation in profits	19,937	22,136	16,893	18,233	23,796	19,105
Worker participation in company profits	-1,499	-1,616	-1,275	-1,368	-1,746	-1,528
Income tax	-4,648	-5,568	-4,268	-4,784	-6,264	-5,263
Net profits (NP)	13,790	14,363	11,085	12,081	15,789	13,809
NP / NS	46%	41%	35%	38%	42%	41%

Source: SMV

Production: Grupo Propuesta Ciudadana

1.3 TAXES AND OTHER CONTRIBUTIONS

We have mentioned that during 2008 and 2009, due to the fall in mineral prices, companies saw their profits reduced. This has affected their tax payment and hence tax collection. However, we also said that since 2009, and especially in 2011, prices recovered. Thus,

according to information from SUNAT²⁰, tax collection from the mining sector reached S/. 11.2 billion. This record number represents a 37% increase compared to 2010. As a result of that, the sector's contribution to domestic tax collection rose from 15% in 2010 to 17% in 2011²¹, a figure that shows a recovery, but is eight points below the level reached in 2007 as shown in Table

20 http://www.sunat.gob.pe/estadisticasestudios/busqueda_actividad_economica.html

21 Domestic taxes make up the revenues for the Public Treasury and those allocated to other entities.

1.6. An additional fact to consider is that the total collection of domestic taxes increased between 2010 and 2011 by S/. 10.1 billion, of which 40% comes from the mining sector.

An interesting fact is that tax collection in 2009 fell sharply due to the financial crisis in 2008, but recovery was immediate. Indeed, in 2010, tax collection had recovered its previous growth rate and in 2012, it will be enhanced by new taxes approved by the government of Ollanta Humala.

The mining sector's contribution to domestic taxes levied by SUNAT²² averaged between 3% and 5% until 2003, but

has grown steadily since then, reaching close to 25% in 2007. In 2011, the mining sector accounted for 17% of all domestic taxes, despite the fact that the amount paid was the highest amount yet. This shows that the tax contribution of other sectors of the economy, such as construction, commerce and hydrocarbons, has grown significantly (see Table 1.6).

The third category Income Tax (IT), which is the main type of tax paid by mining companies, is also the basis for calculating the transfers of mining canon to the regions. According to SUNAT's report (Nota Tributaria)²³, IT paid by mining companies in 2011 reached S/. 6.3 billion, 30% more compared to 2010, when they paid

Table 1.6
Domestic taxes by economic activity, 2001 – 2011
Million nuevos soles

Sector	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2011/2010
Agriculture	190	215	275	295	305	348	390	394	421	491	567	16%
Commerce	2,062	2,287	2,591	3,056	3,619	4,345	5,354	6,684	7,053	7,731	9,194	19%
Construction	577	536	745	657	840	1,142	1,491	1,820	2,316	2,904	3,557	22%
Hydrocarbons	582	321	655	995	1,380	1,859	1,996	2,304	1,932	2,665	3,924	47%
Manufactures	6,033	6,879	7,169	7,275	7,673	8,397	8,898	9,166	9,740	10,352	11,491	11%
Mining	612	689	1,091	1,741	3,123	7,731	10,761	8,985	4,859	8,132	11,172	37%
Other services	7,886	7,657	8,675	9,788	10,801	12,859	14,359	17,370	18,816	20,805	23,722	14%
Fishing	76	114	138	201	250	243	349	208	247	397	405	2%
TOTAL	18,019	18,698	21,340	24,009	27,991	36,925	43,598	46,932	45,383	53,478	64,033	20%
Mining sector share	3%	4%	5%	7%	11%	21%	25%	19%	11%	15%	17%	

Source: National Tax Agency (SUNAT – Spanish acronym)
Production: Grupo Propuesta Ciudadana

22 According to SUNAT's methodological guide, domestic taxes are made up by Income Tax, Value Added Tax, Excise Tax, New Single Simplified System, Broken up tax debt, Extraordinary Solidarity Tax, Fines, Solidarity Tax for Abandoned Children, Special Tourism Promotion Tax, Tax on State Stocks, Tax on Financial Transactions, Temporary Tax on Net Assets, Tax on Casinos and Gambling, other tax revenues, as well as Municipal Promotion Tax and Car Property Tax.

23 <http://www.sunat.gob.pe/gestionTransparente/notatributaria/index.html>

S/. 4.8 billion. The mining sector accounts for 33% of the total income tax collection. According to the data in Table 1.7, 2011 has seen record numbers in total income tax collection (S/. 19.2 billion), as well as IT from the mining sector (with 6.2 billion) and from others such as commerce (with 2.5 billion) and hydrocarbons (1.5 billion). It is important to note that the information in SUNAT's tax report refers to the amounts collected by SUNAT month to month, without differentiating or determining to which fiscal year these payments belong

to. However, they allow us to appreciate the general tendency of tax collection (see Table 1.7).

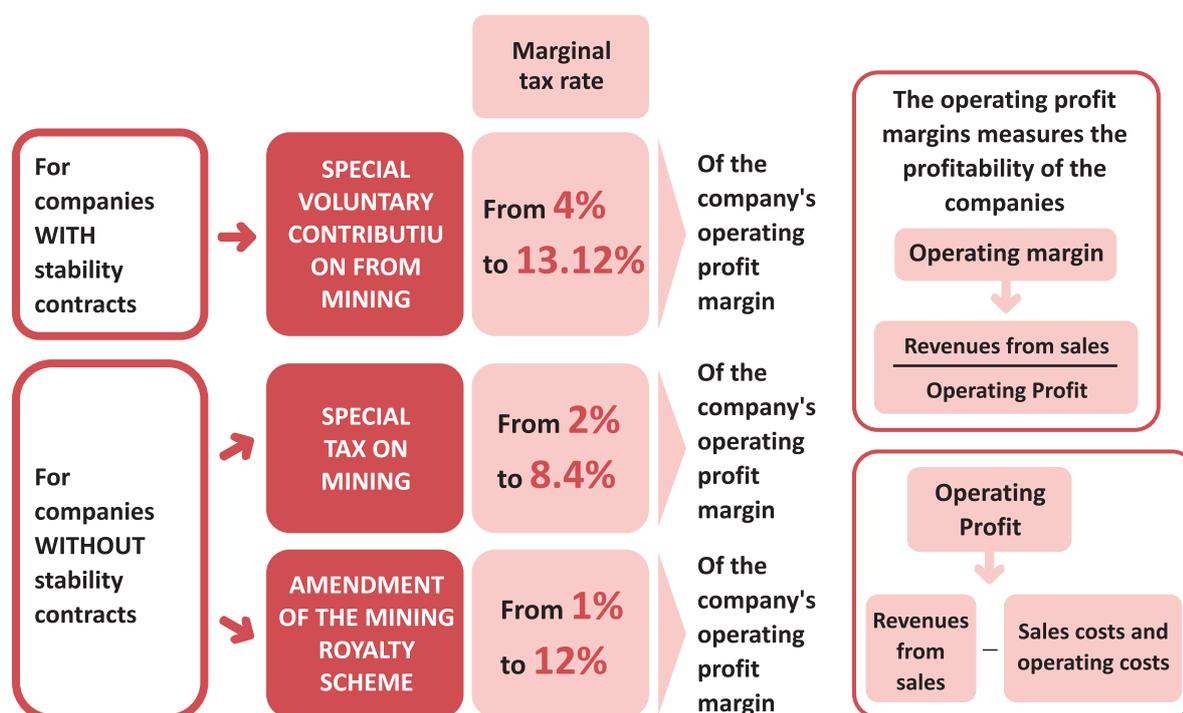
Another aspect to note is that the figure for the income tax collected in 2011 already includes the (negative) impact of both the Special Voluntary Contribution from Mining and the Special Tax on Mining, which, according to the law that creates them, are deducted as costs for the purposes of calculating income tax. What was the impact? This is a pending research topic.

Table 1.7
Income tax by economic activity, 2001 – 2011
Million nuevos soles

Economic activity	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2011/2010
Agriculture	14	15	40	43	28	34	55	38	26	26	50	91%
Commerce	444	518	613	675	775	1,026	1,364	1,898	1,757	1,926	2,479	29%
Construction	92	81	110	142	129	189	232	295	383	507	699	38%
Hydrocarbons	117	29	158	273	366	666	792	921	464	864	1,469	70%
Manufactures	448	609	710	807	878	1,269	1,450	1,856	1,593	1,891	2,495	32%
Mining	129	240	329	586	1,288	4,335	6,439	6,056	2,609	4,831	6,277	30%
Other services	998	1,099	1,754	1,934	1,802	2,394	2,854	3,819	3,820	4,526	5,721	26%
Fishing	10	14	33	35	49	52	73	38	39	80	83	3%
TOTAL	2,253	2,604	3,747	4,496	5,316	9,963	13,258	14,921	10,691	14,652	19,273	32%
Mining sector share	6%	9%	9%	13%	24%	44%	49%	41%	24%	33%	33%	

Source: National Tax Agency (SUNAT – Spanish acronym)
Production: Grupo Propuesta Ciudadana

REVENUES FROM THE NEW TAXES ON MINING



According to SUNAT, the revenues from mining royalties in 2011 reached S/. 840.6 million (this includes the amount collected since October with the new royalty system established in Law N°29789), a 37% increase compared to the S/. 615.3 million collected in 2010. However, if we compare the revenues collected in the IV quarter of 2011 (the new royalty system) with the same quarter in 2010, we can see it is almost the same, even though the value of production in the IV quarter of 2011 was higher than in 2010. Therefore, we can deduce that the amendment in the basis for the calculation of mining royalties has not brought higher revenues to the regions.

Revenues from Mining Royalties 2010-2011 (Million nuevos soles)

Concept	2010				2011			
	I Quarter	II Quarter	III Quarter	IV Quarter	I Quarter	II Quarter	III Quarter	IV Quarter
Mining Royalties	134.8	131.9	161.9	217.2	199.1	170.2	254.5	146.1
Mining Royalties Ley N° 29788	-	-	-	-	-	-	-	70.7
TOTAL	134.8	131.9	161.9	217.2	199.1	170.2	254.5	216.8

Source: SUNAT

Note: In the IV quarter, there are still revenues from the previous mining royalty since the companies are in the process of migrating to the new royalty system.

Production: Grupo Propuesta Ciudadana

On the other hand, since the fourth quarter of 2011, the state began collecting the Special Voluntary Contribution from Mining and the Special Tax on Mining. The Special Voluntary Contribution collected S/. 58.7 million. Additionally, revenues from the Special Tax on Mining amounted to S/. 135.6.

1.4 REVENUES GENERATED

So far we have reviewed the dynamics of the mining sector in terms of volumes, prices, company financial results and, finally, how these variables determine higher or lower tax revenues for the state. Now, based on this information, a question comes up in mineral producing areas: how much of the wealth generated by mining activity returns to the regions? The answer has as a starting point in Article 77 of the Peruvian Constitution, which states: "The respective territorial constituencies are entitled to receive an appropriate share of the total revenues and rents obtained by the State in the exploitation of natural resources in each area. This share is known as canon ". Therefore, a percentage of income taxes the state receives from extractive activities must return to the producing regions.

This is explained more in detail in the Canon Law - Law 27506 - where canon is defined as *the effective and appropriate participation enjoyed by regional and local governments from the total revenues and rents received by the State for the economic exploitation of natural resources*. However, according to the rules of the Canon Law, mining canon is made up of an amount equal to 50% of third category income tax (IT). This is despite the fact that both the Constitution and the Canon Law itself indicate that the canon is an adequate participation of all revenues and rents received by the State in the exploitation of natural resources. The remaining 50% keeps its status of IT and is therefore a part of the national government's general revenues used to finance its expenditures, without specifying the destination. Thus, for the purposes of this report, when say Revenue Generation, we refer only to IT payments declared by mining companies, since this is the basis for mining canon. Still it should be clear that the state collects other taxes from the sector.

It is important to note that the IT payments declared by mining companies is not apparent from the data presented in SUNAT's report shown in Table 1.7, or from data in the company's financial statements obtained from the website of the Value Market Supervising Agency (Superintendencia del Mercado de Valores - SMV). In

the first case, data refers to the revenue collected by the institution every month, without differentiating or determining which productive period it belongs to. In the second case, data recorded shows how much IT the company paid, but without specifying which productive period those payments belong to.

It should be noted that in the SMV's website, we can also access other documents in addition to the financial statements where there is relevant information for a better approach to IT payments reported by mining companies. In the "Notes to the financial statements" and "Analysis and discussion of management" they mention the current IT, which corresponds to the most recent productive period and provides information that is protected by the tax reserve, which is the basis tax assessment. However, it should be noted that both the calculation of the base and the IT, although it is the closest figure we can get, its final estimate is based on SUNAT's calculations. *"The determination of tax liabilities and expenses requires interpretations of applicable tax legislation. The Company seeks professional advice on tax matters before making any decisions on tax matters. Although management believes its estimates are prudent and appropriate, there may be differences of interpretation with the tax administration [SUNAT] that could affect the tax payments in the future"*²⁴.

All in all, this is the closest estimate we can get in the interest of knowing the IT payments by mining companies. In Table 1.8 we recorded 17 mining companies that are listed in the SMV website, which represent 55% of total VMP calculated in the previous section. When the company did not obtain taxable profits, no data is reported.

In general, data from Table 1.8 shows the current income tax payments by companies listed on the Stock Exchange. This shows that in this year there was a fall compared to 2010 even though net profits grew by 7%, according to Table 1.4. However, this growth has not been at all reflected in the current income tax collection, maybe due to the new taxes (Special Voluntary Contribution, Special Tax), the amendment of the royalties and also tax benefits such as the "advanced depreciation" and deferred Income Tax.

24 This paragraph was obtained from the Notes to the Financial Statements from December 31, 2010 and December 31, 2009 of Barrick Misquichilca.

Table 1.8
Current income tax payments, 2010 – 2011
Million nuevos soles

Company	2010	2011	Variation 2011/2010
SouthernPeru	1,452.3	1,298.2	-11%
Minsur	483.4	475.4	-2%
Cerro Verde	1,180.4	1,363.0	15%
Shougang	333.0	599.0	80%
Barrick	843.8	1,101.5	31%
Yanacocha	749.3	-	-
Gold Fields	213.0	300.0	41%
Volcan	196.7	225.8	15%
Milpo	122.9	128.3	4%
Buenaventura	107.4	165.2	54%
Poderosa	101.0	119.5	18%
Raura	25.8	24.1	-7%
El Brocal	80.1	98.7	23%
Corona	58.0	76.0	31%
Santa Luisa	51.8	50.7	-2%
Atacocha	40.8	24.5	-40%
Morococho	8.5	0.0	-100%
TOTAL	6,048.2	6,050.0	0%

Source: Value Market Supervising Agency (SMV – Spanish acronym)
 Production: Grupo Propuesta Ciudadana

In Table 1.8 we can see we are missing the figure for the current tax in 2011 for Yanacocha. This information is not available as this company has withdrawn from the Stock Exchange so it no longer discloses this information for access by civil society. This is one reason why the current tax collection has not changed compared to 2010, since we are comparing figures with one less company. If we were to compare 2010 and 2011 figures excluding Yanacocha, the current income tax would have increased by 14%, almost the same as the increase in Net Profits.

There are some companies whose current IT does not match the variation of their profits, for example, Minsur, whose NP fell by 25%, while the current IT only fell by 2%. Another case Cerro Verde, whose IT increased by

15% while its NP remained unchanged compared to 2010. Finally, another striking case Barrick whose NP rose by 2%, while its IT increased by 31%. These cases may be due to the fact that current IT is also affected by other factors, for example, advanced depreciation, regulation of tax rates from previous years, etc.

B. THE HYDROCARBON SECTOR

Like the mining sector, the hydrocarbon sector has benefited from the upturn in oil prices. The growing demand and modest increase in supply in a context of geopolitical tensions and low global inventories, coupled with a speculative dynamic that dragged most commodities upward, resulted in a record oil price of

US\$ 140 a barrel in mid-June of 2008, which subsequently fell to nearly US\$ 35 a barrel between January and March 2009 and later recovered to over US\$ 70 at the end of 2009. In 2011 oil prices ranged between US\$93 and US\$107 per barrel, bringing the annual average to its highest level since 2008.

It is also important to highlight the momentum given to the hydrocarbon sector by the Camisea project, which extracts natural gas (NG) and Natural Gas Liquids (NGL) from block 88 and 56 in increasing volumes. This chapter discusses the various factors underlying the evolution of the revenues that come from oil exploitation in 2010.

1.5 THE OUTLOOK FOR PRODUCTION AND PRICES

Production of Natural Gas (NG) and Natural Gas Liquids (NGL) between 2004 - beginning of Camisea - and 2011 has increased sevenfold, especially coming production coming

from block 56, which began to produce NGL in September 2008 and NG since February 2010 (see Table 1.9).

Concerning oil extraction, it continues its downward trend. Resource depletion and the lack of success of exploration investments has resulted in a volume of extraction that represents only 56% of what was extracted 15 years ago. By 2011, oil production was 25.3 million barrels, 5% lower than the production in 2010 (see Graph 1.3).

In the case of NGL, the pace of domestic production is marked by the Camisea Project, through blocks 88 and 56. The first extraction began in 2004 and the second in 2008. However, the production of block 88 in 2011 had a 6% fall compared to 2010. Production of NGL from block 56 reached 30.4 million barrels in 2011, 2% less than in 2010, when 30.8 million barrels were extracted.

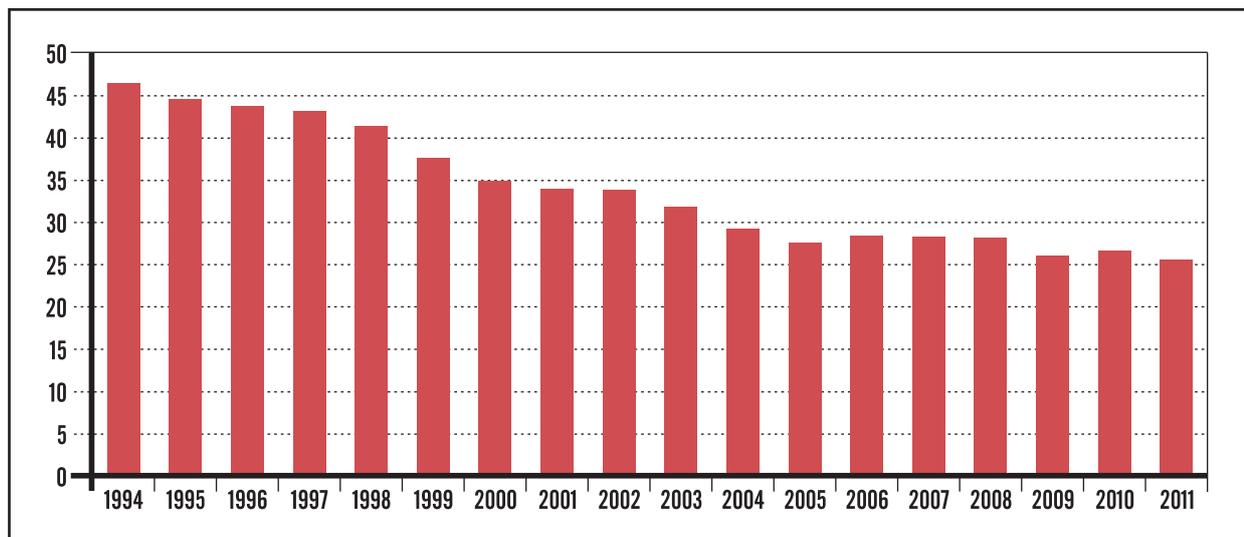
Regarding GN extraction, like the case of the NGL, the dynamics is marked by the Camisea Project. Production

Table 1.9
National hydrocarbon production, 2001 – 2011
Oil – NGL (million barrels) / Natural Gas (million BTU)

Year	Gas	NGL	Oil
2001	13.1	1.4	33.9
2002	15.6	1.5	33.8
2003	18.5	1.5	31.8
2004	30.5	5.2	29.5
2005	54.3	13.1	27.5
2006	63.6	13.9	28.3
2007	96.2	13.4	28.1
2008	122.3	15.9	28.0
2009	125.3	27.1	25.9
2010	255.6	30.8	26.5
2011	401.2	30.4	25.3
Variation 2011/2010	57%	-2%	-5%

Source: Perupetro
Production: Grupo Propuesta Ciudadana

Graph 1.3
National oil production, 1994 – 2011
Million barrels



Source: Perupetro
 Production: Grupo Propuesta Ciudadana

in 2011 reached 401.2 million BTU, 57% more than in 2010 when it reached 255.6 million BTU. This increase is basically due to the start of production in Block 56, which is all destined to the export market. Since February 2010, this block also produces NG.

This increasing production of NG and NGL has been generating gradual changes in the country's energy matrix. Indeed, before the beginning of the Camisea Project, oil explained 70% of the Peruvian energy market, renewable energy (mainly hydroelectric power) was 24% and NG and NGL together represented only 7%. Currently, 56% comes from oil, 27% from renewable energy and 17% from NG and NGL. The goal of the government's current energy policy is to achieve a scenario where each energy source supplies roughly the same portion of the Peruvian market²⁵. It is likely that the recovery of reserves from Block 88 for domestic consumption will allow the acceleration of mass consumption of natural gas in the country.

Regional production of hydrocarbons

As in mining, oil producing regions receive a share of the revenues from extraction, which is transferred to them as oil canon, sobrecanon and gas canon. That is, more extraction and higher prices mean more revenues for the regions. Below we will discuss the production dynamics in each region (see Table 1.10).

Loreto: This region is mainly an oil producer, but extraction has been falling gradually. In 2010, production was 45% less than in 2001. In 2005, the perforation of new oil wells stabilized extraction, but it began to fall again in 2008 due to the depletion of resources. In 2011, the falling trend has not stopped: oil extraction was 10.2 million barrels, a 10% reduction compared to 2010. The region represents 40% of the country's total oil production today, a percentage well below the 66% it represented in 2001.

25 Taken from the presentation of the vice minister of Mines, Pedro Gamio, "Towards a new energy matrix", available in MINEM's web page, 2008.

Piura: Piura is also a region with oil resources, although it presents a different picture to that of Loreto. The beginning of the operations in block XIII and Z1 between 2006 and 2008 and the consolidation of the production in block III since 2008 has increased production from 11 million barrels per year between 2001 and 2006 to 15 million barrels in 2010. In 2011, 13.7 million barrels were extracted and the region provides 54% of all domestic oil production. In 2001 this contribution was only 32%.

There are some small oil wells in Ucayali, Tumbes and Huánuco, which allows these regions to get some resources from oil canon. The first two regions also get a share of the revenue from oil extraction in Loreto and Piura, respectively, through the *sobre canon*, an issue we will address below.

In general, domestic oil production is lower than the one recorded at the beginning of the last decade, as seen in Figure 1.3. The beginning of operations in block 67 in Loreto²⁶ - estimated for 2011 but postponed until 2013 - would more than double the national production and triple the output of this region, which will result in more revenues for the central government and also for Loreto.

We should note that the contracts for some blocks expire in the coming years, but given that the Government, through the state owned company Petroperu, is considering beginning to extract oil itself, so the government may decide not to renew these contracts. Therefore, it is likely that in the next two years, production will fall some more in these blocks located in Piura (III, IV, VII-VI) and Loreto (1-AB).

Cusco: This is where the Camisea Project is located and NG and NGL are extracted. In block 88 the extraction began in June 2004. Then in September 2008, they began extracting NGL from block 56 and in February 2010 NG for export. In 2011, extraction of NG has been 411.7 million BTU, 65% more than in 2010. Regarding NGL, the extraction was 29 million barrels, 1% less than in 2010. It should be noted that while the Camisea Project is often described as the country's real chance to change the energy matrix, its current financial importance lies in the NGL, because its price is tied to international oil price, therefore the revenue from the Camisea Project is highly influenced by variations of that price²⁷ (see Table 1.10).

26 On April 28, 2009, the government declared this block of "national interest" (SD 044-2009-EM).

27 See: "Camisea: la carne son los líquidos". Humberto Campodónico. www.cristaldemira.com

Table 1.10
Regional hydrocarbon production, 2011
Oil – NGL (million barrels) and natural gas (million BTU)

Region	Block	2010			2011		
		Gas	NGL	Oil	Gas	NGL	Oil
Cusco	56	104.57	12.19	-	231.75	12.77	-
	88	143.82	17.29	-	179.97	16.25	-
Loreto	8	-	-	4.27	-	-	3.64
	1-AB	-	-	6.83	-	-	6.44
	31-B	-	-	0.09	-	-	0.08
	31-E	-	-	0.04	-	-	0.03
Piura	I	1.97	-	0.36	2.02	-	0.38
	II	0.06	-	0.21	0.35	-	0.18
	III	-	-	1.10	-	-	1.20
	IV	-	-	0.36	-	-	0.31
	IX	-	-	0.09	-	-	0.08
	V	-	-	0.07	-	-	0.06
	VII_VI	0.96	-	1.19	1.13	-	1.11
	X	5.10	-	4.78	5.66	-	4.92
	XIII	0.24	-	1.41	0.35	-	1.50
	XV	-	-	0.01	-	-	0.04
	Z-2B	4.82	-	4.15	4.72	0.43	3.95
	Z-6	-	-	-	-	-	-
Tumbes	XX	-	-	0.02	-	-	0.02
	Z-1	-	-	1.38	-	-	1.38
Ucayali	31-C	9.74	0.91	-	6.41	0.90	-
Huánuco	31-D	-	-	0.05	-	-	0.05
TOTAL		271.29	30.39	26.39	432.37	30.35	25.38

Source: Perupetro
Production: Grupo Propuesta Ciudadana

Between now and 2016 there are six oil blocks whose contracts are close to their expiration date. Five are located in the northwest (Piura) and one in the jungle (Loreto).

Company	Block	Location	Date of signature and expiration		Type of Contract
			Signature	Expiration	
Interoil Perú S.A.	IV	Coast	04.03.93	03.03.2013	License 20 years
Interoil Perú S.A.	III	Coast	05.03.93	04.03.2013	License 20 years
UNIPETRO ABC	IX	Coast	17.06.93	16.06.2013	Service 20 years
SAPET	VII/ VI	Coast	22.10.93	24.08.2015	License 21 years and 276 days
Pluspetrol Norte S.A.	1 AB	Northern Jungle	30.08.85	29.08.2015	License 30 years
Petrolera Monterrico	II	Coast	05.01.96	04.01.2016	License 20 years

In addition to the upcoming expiration of the contracts of those blocks, an additional feature is that they show a fall in production volume, which is partly explained by the lack of investments to increase production and / or reserves, because the operators don't have time to recover those investment. This means that, most likely, production will continue to decline in the coming years, until 2016.

The behavior of prices

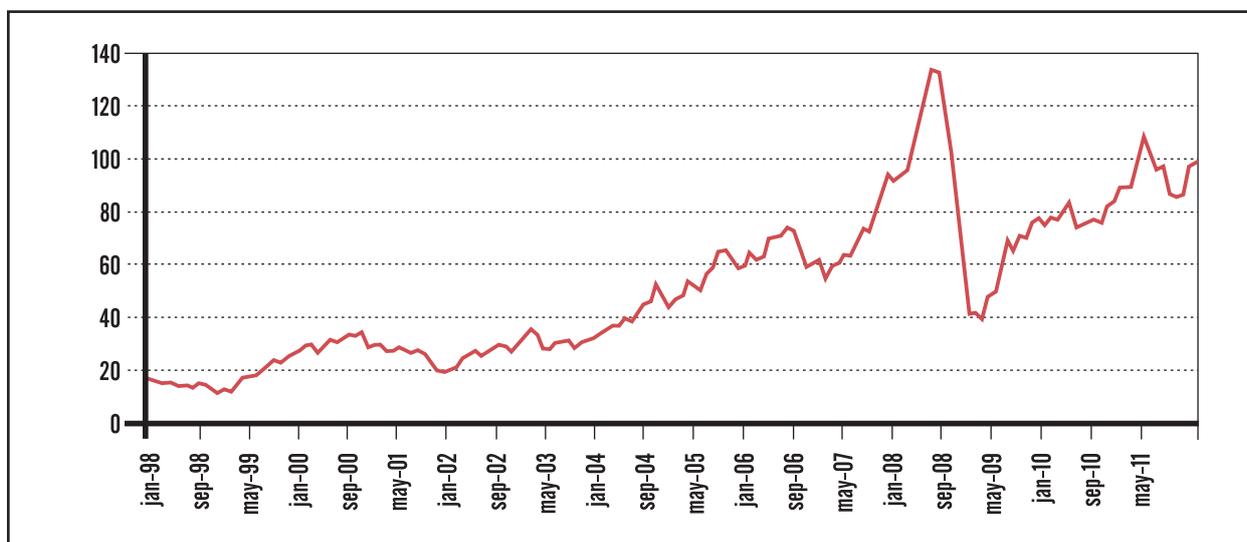
Oil companies pay a royalty to the Peruvian State for the extraction and marketing of the resource. This payment is based on the volume extracted, valued according to a basket of different products (different types of crude oil) that reflects the international price,

adjusted according to its quality²⁸, transportation or other factors²⁹.

In previous reports we have talked about the increase in international oil prices, which responded to the relative scarcity in the world market and uncertainty in a context of insecurity and conflict in producing areas of the Middle East.

As a result of the financial crisis, expectations of future demand and the deterioration of the speculative trend caused oil prices to fall to levels similar to those in early 2005, ie US\$ 35 and US\$ 40 a barrel between November 2008 and March 2009. Since then, prices have recovered due to some signs of improvement, especially due to the performance of the U.S. economy. In the course of 2011 oil price was between US\$ 89 and US\$ 100 a barrel (see Graph 1.4).

Graph 1.4
Monthly oil export prices, 1998 – 2011
US Dollars per barrel



Source: Perupetro
 Production: Grupo Propuesta Ciudadana

28 There are different types of oil according to its density: extra heavy, heavy, medium, light and superlight. Lighter oil has the largest demand in the market and at the same time, the highest prices since both the cost of extracting and refining are lower than those for heavier oil.

29 "Camisea: the real meat is the liquids". Humberto Campodónico. www.cristaldemira.com

1.6 VALUE OF PRODUCTION

A first look at the dynamics of the hydrocarbon sector gives us the Value of Production of Hydrocarbons (VHP), but unlike the case of mining, where the production value is an estimate constructed on the basis of two other variables – that come from two different information sources – the VHP is a variable calculated by Perupetro officially, because the transfers are associated with resource extraction – oil and gas canon – and are estimated as a percentage of VHP.

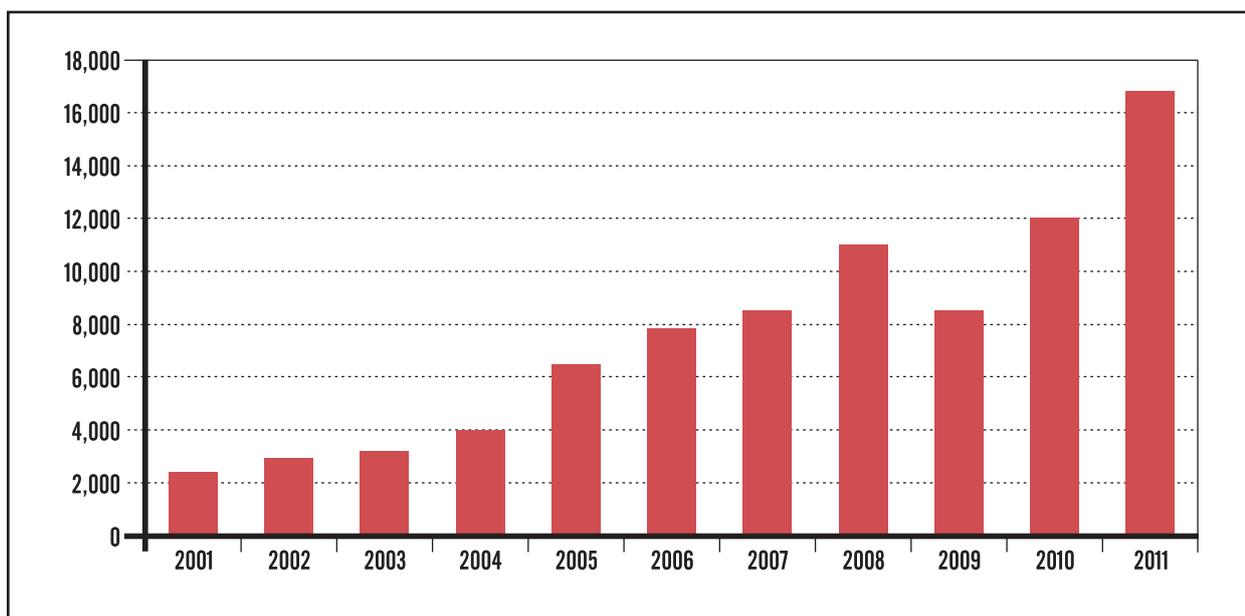
Thus, according to data from Perupetro, in 2011, VHP – which is obtained by multiplying the volume of resource extracted by the value of a basket allocated to each block – amounted to S/. 16.8 billion (US\$ 6.1 billion), 40% more than in 2010 when it reached S/. 12.1 billion (US\$ 4.3 billion). This VHP measures the value of resources extracted, so that, the higher the amount of hydrocarbons

produced or the higher the price, the producing region will receive more revenues through the canon.

In Graph 1.5 we see the behavior of the VHP, which is largely explained by the production of oil and NGL. Both products account for almost 90% of VHP and, as mentioned, both products depend on changes in the international price of oil. Just by looking at the downward trend of production (Graph 1.3) with the increasing trend of VPH we can clearly see the important role played by international prices.

As noted above, a percentage of VPH is transferred back to the producing regions through the mechanism called oil and gas canon. Oil canon is made up of 10% VHP and is transferred to producing regions. Later, an additional 2.5% of VHP was established and denominated oil sobrecanon³⁰. The gas canon for Cusco is made up of 50% of the royalties paid by the project operator and

Graph 1.5
Value of Hydrocarbon Production, 2001- 2011
Million nuevos soles



Source: Perupetro
Production: Grupo Propuesta Ciudadana

30 Sobrecanon was created specifically for two regions: Ucayali and Tumbes. In 1976, 10% of the value of the oil production in Loreto was allocated to the region as canon for a ten year period. In 1981 the period was extended until the oil run out. But when the Ucayali region was created, breaking up a part of Loreto, it lost its oil canon. Therefore, the 1982 Budget Law created Sobrecanon, which is 2.5% of the value of oil production. In 1983, after the "El Niño" phenomenon, 10% of the value of oil and gas production that took place in Tumbes and Piura were allocated to the regions, until these resources run out. Law N° 23871 enacted in June 14, 1984 included an additional 2.5% to create the Sobrecanon for Tumbes. Later, small amount of oil also began to be extracted from Tumbes and Ucayali, so Piura and Loreto also receive Sobrecanon.

Table 1.11
Value of hydrocarbon production by region, 2001 - 2011
Million nuevos soles and percentage

Region	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Variation 2011-2010
Cusco	-	-	-	468	1,722	2,131	2,504	3,209	3,633	5,963	8,926	50%
Piura	940	1,017	1,135	1,381	1,993	2,585	2,811	3,892	2,657	3,292	4,431	35%
Loreto	1,309	1,732	1,839	1,857	2,377	2,774	2,845	3,241	1,699	2,177	2,745	26%
Tumbes	-	-	-	-	-	-	-	203	177	312	412	32%
Ucayali	138	181	223	241	349	351	364	421	321	307	301	-2%
Huánuco	4	4	4	5	8	8	8	11	7	11	15	37%
TOTAL	2,390	2,933	3,200	3,953	6,448	7,849	8,531	10,978	8,493	12,062	16,830	40%

Source: Perupetro
 Production: Grupo Propuesta Ciudadana

50% of the third category income tax paid by the same operator³¹.

Table 1.11 shows the evolution of the value of oil production by region. It is clear that start and consolidation of the Camisea Project explains why VHP has almost quadrupled between 2004 and 2011. The fall in international oil prices in 2009 caused a decline in VHP, which recovered through 2010. In 2011, VHP has grown by 40% compared the previous year. The VHP in Cusco, where Camisea is located, had the greatest territorial increase due to the strong growth in production volume and also higher prices.

In sum, the national oil extraction continues to decline while national NGL production has remained almost constant and Natural Gas has almost doubled in Cusco. Despite this modest production performance, the VHP in 2011 increased 42% compared to 2010, which is explained in 53% by the rise of international oil prices and 47% by growth in the volume of production.

1.7 REVENUES FOR THE STATE AND THE REGIONS

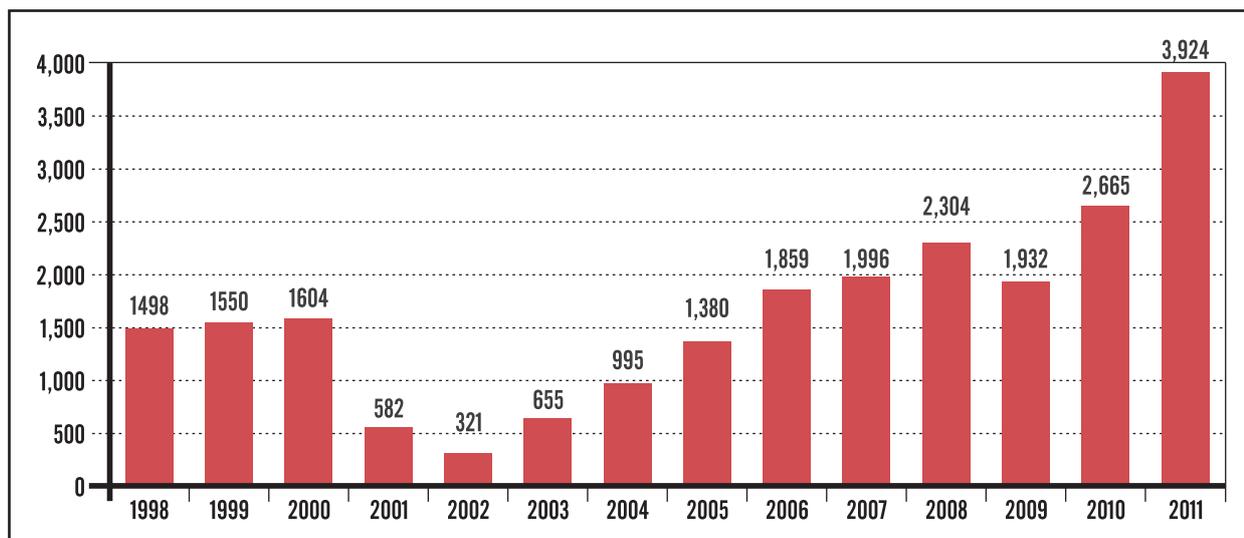
Unlike the mining sector, where revenue transfers to the regions depends on the economic and financial results of companies, in the hydrocarbon sector, regions receive a percentage of production value, thus benefiting more directly from the effect of the increase in prices or volumes of extraction.

Tax collection

The economic dynamics of the hydrocarbon sector in 2011 has allowed the National Treasury to capture significant resources. Revenues from domestic taxes in the sector reached S/. 3.9 billion in 2011, 47% more than in 2010 when it reached S/. 2.7 billion. As seen in Graph 1.6, this is the most significant increase in the last ten years. These revenues are not transferred to the producing areas, but rather remain in the treasury of

31 Royalties paid by the consortium in charge of the Camisea Project, under the leadership of Pluspetrol, are 37.24% of the VHP; therefore, the royalties that return to Cusco are 18.62% of the VHP.

Graph 1.6
Domestic taxes, hydrocarbon sector, 1998 – 2011
Million nuevos soles



Source: SUNAT
 Production: Grupo Propuesta Ciudadana

the central government, but, with the approval in 2011 of the oil canon Equalization Law, which takes effect in 2012, regions oil will also receive 50% of the income tax paid by oil companies to the state³².

Revenue generation

As in the mining sector, the state collects taxes and royalties on the extraction of resources such as oil, NGL or NG. Through Perupetro, it signs exploration and exploitation contracts with companies, establishing the conditions on extraction and payments. These contracts are one of two types:

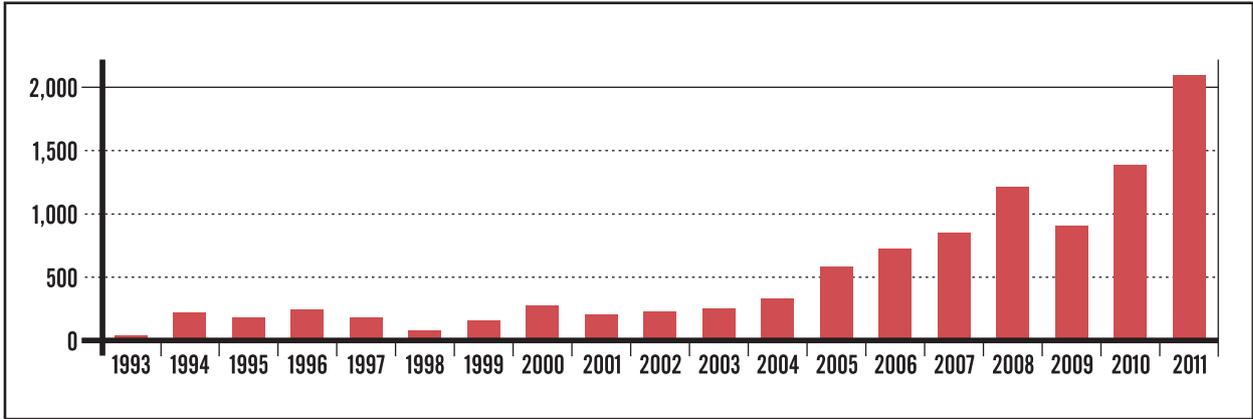
License contracts: The state transfers to the companies the right to the property of the product extracted, for which they pay a royalty.

Service contracts: Companies receive a retribution based on production, after the product is sold by the State and deducting costs associated to transport and marketing. The difference, which the State keeps, is called "equivalent royalty".

The royalty or equivalent royalty, both set in the contracts, are a percentage of the value of production of hydrocarbons, ie: VHP. The determination of this royalty is not standardized, but varies according to the contract and is also estimated using different methodologies. There are four of them: R factor, cumulative production by reservoir with price adjustments, production scales and economic performance. It is important to note that, after the state collects the royalties or equivalent royalties, it transfers oil canon to the regions, which is an amount equal to a percentage of the VHP. That is, the percentage distributed

32 The equalization refers to the decision to include oil producing regions in the canon system applied to the mining regions and to Cusco in the case of natural gas.

Graph 1.7
Rvenues from service and license contracts, 1993 –2011
Million dollars



Source: SUNAT
 Production: Grupo Propuesta Ciudadana

as oil canon is deducted from the amount of royalties collected by the state. In 2011, royalties (including equivalent royalty) totaled US\$ 2.1 billion, an estimated increase of 51% compared to 2010, when these revenues were US\$ 1.4 billion. See Graph 1.7.

It is important to mention that the data on royalties and royalty equivalents is shown by Perupetro on its website in dollars³³. Furthermore, they are presented in a table that gives the figures on all the state revenues. Therefore the comparison of information on royalties, VHP and canon are in dollars.

If we compare royalties –State revenues – with VHP, the former represent on average 34.1% of the latter. There are differences across blocks because, as mentioned above, each has a different contract that sets caps to the amount of royalties to be charged. Unlike the mining sector, where IT paid by companies is shared equally (50% of IT going to the regions as mining canon and the remaining 50% remains in the central government), in the hydrocarbon sector regions perceive an amount equal to a percentage of VHP set for each block, which is deducted from the royalty charged by the state. See Table 1.12.

33 For further details see: http://www.perupetro.com.pe/wps/wcm/connect/perupetro/site/informacionRelevante/Estadisticas/Cont_IngresoFisco

Table 1.12
Royalties and canon by block, 2011
Million dollars and percentage

Contract	Block	VHP (A)	Royalty (B)	Canon (C)	B/A	C/A	C/B
License	II	206	106	26	51.20%	12.50%	24.40%
License	III	1,294	641	162	49.50%	12.50%	25.20%
License	IV	335	164	42	48.90%	12.50%	25.60%
License	VII_VI	1,223	177	153	14.50%	12.50%	86.40%
License	X	5,595	2,381	699	42.60%	12.50%	29.40%
License	XIII	1,651	526	206	31.80%	12.50%	39.30%
License	XV	43	17	5	40.10%	12.50%	31.20%
License	XX	17	4	2	21.10%	12.50%	59.20%
License	31B Y 31D	139	56	16	40.50%	11.50%	28.40%
License	31-C	1,097	561	137	51.20%	12.50%	24.40%
License	31-E	35	5	4	15.00%	12.50%	83.30%
License	1-AB	6,236	1,861	780	29.80%	12.50%	41.90%
License	8	3,652	931	457	25.50%	12.50%	49.00%
License	56	17,159	6,736	6,688	39.30%	39.00%	99.30%
License	88	15,401	5,741	5,735	37.30%	37.20%	99.90%
License	Z-1	1,485	75	186	5.00%	12.50%	248.60%
License	Z-6	3	1	0	25.00%	12.50%	50.00%
Service	I	444	90	56	20.20%	12.50%	61.80%
Service	IX	90	68	11	75.30%	12.50%	16.60%
Service	V	61	22	8	37.00%	12.50%	33.80%
Service	Z-2B	5,213	794	541	15.20%	10.40%	68.10%
TOTAL		61,377	20,955	15,913	34.10%	26%	76%

Source: Perupetro
 Production: Grupo Propuesta Ciudadana

Since 2012, the oil canon for all oil-producing regions has been amended by Law No. 29693, and is now made up by: 15% of production value plus 50% of income tax paid by oil companies.

A rough estimate of the income taxes collected that could be collected is shown in the table below, by region. We have assumed that the IT will be 6% of production value, using the growth rate of the period between 2006 and 2011.

Region	VHP 2011 (S/.)	Growth rate 2006-2011	VHP 2012* (S/.)	IT (6%)	Canon
Huanuco	15,075	14%	17,217	1,033	517
Loreto	2,745,279	0%	2,739,554	164,373	82,187
Piura	4,546,263	13%	5,153,074	309,184	154,592
TOTAL	7,306,616	7%	7,817,401	469,044	234,522

*Forecast developed with the growth rate for 2006-2011



DISTRIBUTION OF REVENUES AND AVAILABLE RESOURCES

II. DISTRIBUTION OF REVENUES AND AVAILABLE RESOURCES



So far we have estimated how much revenue is generated, both in the mining and oil sector. In this section, we will describe how much of that revenue is distributed to the regions, according to the existing legal framework, and how much these transfers to the regions were in 2011, including the leftover resources from 2010³⁴.

2.1 DISTRIBUTION OF REVENUES

The revenue generated by both the mining and hydrocarbons sector, which are transferred to the regions is called mining canon (50% of the IT paid by mining companies), oil canon (12.5% of VHP) and gas canon (50 % IT and 50% of royalties paid by the Camisea Consortium). There are two additional transfers: mining royalties and FOCAM. The first is defined as a compensation for mining resources extracted and the second as compensation to the territories through which the pipeline that carries natural gas Camisea goes through.

Thus, transfers from extractive activities to the regions –including municipalities and regional governments–

amounted to S/. 8.4 billion by December 2011, in addition to interest generated³⁵. This amount is 35% higher than the S/. 6.2 million they received in 2010 (see Table 2.1). This year, like previous years, the most important revenues are, in the first place, those from mining - canon and royalties - which account for over 60% of all transfers to the regions with a total amount exceeding S/. 5 billion; then those that come from hydrocarbons – gas, oil, FOCAM – which together account for 45% of total transfers, over S/. 3 billion.

We should keep in mind that the Ministry of Economy and Finance's Transparency Web Portal discloses all transfers made by the national government to the different entities within the state. There are two categories of transfers: licensed and accredited. The former are those initially planned, while the latter are the ones actually made. For this section and the next, we will use accredited transfers, since those are calculated on the basis of rates established by the Canon Law. The licensed transfers are related to the programming of these resources within the budget. Therefore, data presented in the first two chapters may differ from those in Chapter 3, although the differences are not significant.

34 These revenues come from the result of the previous years, which will fund spending in the current period. They are made up by the difference between the revenue received and the spending during the fiscal year. It also includes refunds from payments carried out and charged to periods of spending that have already closed. (Source: Glossary, MEF)

35 We should remember that the MEF unilaterally decided in 2008 to centralize canon revenues to a single account under its own control; to do so it enacted a Directorial Resolution N° 013-2008-EF/ 77.15, which established a procedure to progressively centralize the funds in Budget Item 18 called Canon, Sobrecanon, Royalties, Customs and Participations (from now on referred to as "canon") into one Single Account of the National Management Office of the Public Treasury, and also Directorial Resolution N° 014-2008-EF/77.15, which amends the provisions of R.D. N° 013- 2008-EF/77.15. This mechanism allows those revenues to generate interests.

Table 2.1**Accredited transfers from extractive activities by level of government to December 2011****Million nuevos soles**

Type of Canon	Local	Regional	Total	Participation
Mining	3,181	1,092	4,273	51%
Gas	1,333	442	1,775	21%
Oil	546	313	859	10%
Mining Royalty	705	143	848	10%
FOCAM	313	135	448	5%
Hydro Energy	101	43	144	2%
Fisheries	25	14	39	0%
Forestry	0.1	0.1	0.1	0%
TOTAL	6,204	2,183	8,387	100%

Source: Economic Transparency Web Portal

Production: Grupo Propuesta Ciudadana

In the following paragraphs, we will see the distribution of canon to the regions. The data in Table 2.2 show that Cusco and Ancash are receiving the largest amounts of canon and royalties – 25% and 10%, respectively. Cusco has benefited from the strong increase in the production of the Camisea project. Both regions represent 35% of total transfers for extractive activities. In order of importance, they are followed by La Libertad, Cajamarca, and Arequipa, with transfers above S/. 500 million. The five regions mentioned concentrate about 50% of all funds transferred through canon and royalties.

We should consider that, for budgetary purposes, the funds transferred to municipalities and regional governments as a share of extractive revenues are

included in item 18 entitled "Canon, Sobrecanon, Royalties, Customs and Participations", which also includes other types of revenues from non-extractive activities (FONIPREL, FORSUR, TRUSTS, Incentive Plan, Modernization Program). These revenues - shown in Table 2.3 - amount to S /. 2.86 billion, which meant in December 2011, the total amount of transfers for item 18, is S /. 10.8 billion.

The inclusion of these revenues unrelated to the extractive sector in Item 18 has complicated citizen monitoring of canon revenues, which creates a problem for transparency, since it is misleading to unskilled users. We therefore emphasize that to properly manage the data on extractive revenue; we need to exclude the other resources shown in Table 2.3.

Table 2.2
Accredited transfers from extractive activities by region, 2011
Million nuevos soles

Region	Type of Canon						Mining Royalty	FOCAM	Total
	Mining	Gas	Oil	Hydro Energy	Fisheries	Forestry			
Amazonas	0.13	-	-	0.00	0.00	0.00	0.00	-	0.1
Áncash	767.92	-	-	15.31	14.13	0.00	4.50	-	801.9
Apurímac	2.08	-	-	0.00	0.00	0.00	0.55	-	2.6
Arequipa	677.13	-	-	2.76	1.37	0.00	53.70	-	735.0
Ayacucho	58.54	-	-	-	-	0.00	23.44	107.31	189.3
Cajamarca	463.55	-	-	3.73	-	0.01	76.58	-	543.9
Callao	0.00	-	-	-	4.46	-	-	-	4.5
Cusco	175.09	1,775.14	-	4.04	-	0.00	34.33	-	1,988.6
Huancavelica	8.88	-	-	66.26	-	0.00	18.40	76.69	170.2
Huánuco	4.40	-	1.60	-	-	0.01	2.12	-	8.1
Ica	204.89	-	-	-	6.07	0.00	24.57	84.64	320.2
Junín	80.53	-	-	9.08	-	0.01	44.04	-	133.7
La Libertad	468.71	-	-	-	1.84	0.00	53.34	-	523.9
Lambayeque	0.51	-	-	-	-	0.00	0.11	-	0.6
Lima	106.03	-	-	24.99	7.14	0.00	59.16	96.40	293.7
Loreto	-	-	79.95	-	-	0.03	0.00	-	80.0
Madre de Dios	0.13	-	-	-	-	0.01	-	-	0.1
Moquegua	399.51	-	-	-	1.16	0.00	88.92	-	489.6
Lima Metropolitana	2.17	-	-	0.87	-	0.00	-	-	3.0
Pasco	185.20	-	-	9.34	-	0.00	64.56	-	259.1
Piura	0.13	-	318.21	1.09	28.35	0.00	0.14	-	347.9
Puno	311.12	-	-	4.67	-	0.00	65.28	-	381.1
San Martín	0.64	-	-	-	-	0.01	0.06	-	0.7
Tacna	345.47	-	-	1.44	0.08	0.00	91.62	-	438.6
Tumbes	-	-	98.00	0.00	0.05	0.00	-	-	98.1
Ucayali	-	-	48.16	0.00	-	0.03	-	83.35	131.5
TOTAL	4,262.77	1,775.14	545.92	143.57	64.65	0.13	705.40	448.39	7,945.96

Source: Economic Transparency Web Portal
 Production: Grupo Propuesta Ciudadana

Table 2.3
Accredited transfers from Item 18 "Canon, Sobrecanon, Royalties, Customs and Participations". By region, 2011.
Million nuevos soles

Region	Canon					Mining Royalty	FOCAM	COFIDE and others	FIDEICO	FONIPREL	FORSUR	Incentive Plan to improve Municipal Management	Municipal Modernization Program	Customs	Law N° 15686 and its norms	Surplus from transfers	Total
	Mining	Gas	Oil	Hydro Energy	Fisheries												
Amazonas	0.13	-	-	-	-	0.00	-	11.93	8.81	0.54	-	19.36	6.97	-	-	0.59	48.34
Ancash	767.92	-	-	15.31	14.13	0.00	-	-	11.47	3.57	-	32.28	21.49	1.89	21.55	210.30	1,105.27
Apurímac	2.08	-	-	-	-	0.65	-	-	24.81	17.51	-	18.33	7.69	-	-	0.21	71.28
Arequipa	677.13	-	-	2.76	1.37	0.00	-	-	33.31	0.74	-	24.76	20.99	9.48	-	0.34	834.53
Ayacucho	58.54	-	-	-	-	0.00	107.31	0.10	-	45.88	-	25.83	9.61	-	-	1.17	276.34
Cajamarca	463.55	-	-	3.73	-	0.01	-	0.34	4.59	12.93	-	60.84	23.53	-	-	-	660.73
Callao	0.00	-	-	-	4.46	-	-	-	35.42	-	-	14.77	20.00	346.79	-	19.24	440.69
Cusco	175.09	1,775.14	-	4.04	-	0.00	76.69	0.25	31.51	7.46	-	44.09	21.51	0.00	-	0.01	2,099.93
Huancavelica	8.88	-	-	66.26	-	0.00	-	0.02	22.27	3.28	7.65	22.00	7.21	-	-	-	236.25
Huánuco	4.40	-	1.60	-	-	0.01	-	0.18	47.98	44.89	-	34.60	12.88	-	-	-	149.04
Ica	204.89	-	-	-	6.07	0.00	84.64	-	35.71	2.60	28.32	16.94	9.67	3.58	-	2.17	423.86
Junín	80.53	-	-	9.08	-	0.01	-	0.52	31.82	27.04	-	46.80	24.59	-	-	-	280.83
La Libertad	468.71	-	-	-	1.84	0.00	-	-	27.54	0.13	-	39.29	25.43	3.06	-	-	629.69
Lambayeque	0.51	-	-	-	-	0.00	-	-	66.79	0.55	-	35.32	17.30	0.00	-	-	120.60
Lima	106.03	-	-	24.99	7.14	0.00	96.40	-	11.64	4.66	0.50	118.14	156.20	0.00	-	-	596.03
Lima Metro.	2.17	-	-	0.87	-	0.00	-	-	-	-	-	-	-	-	-	-	3.28
Loreto	-	-	79.95	-	-	0.03	-	0.05	4.30	0.04	-	34.42	14.08	3.27	-	1.24	137.38
Madre de Dios	0.13	-	-	-	-	0.01	-	10.69	13.07	0.78	-	3.51	1.72	0.04	-	-	29.95
Moquegua	399.51	-	-	-	1.16	0.00	-	-	14.31	0.41	-	2.82	2.66	2.74	-	-	529.39
Pasco	185.20	-	-	9.34	-	0.00	-	0.12	39.23	4.68	-	11.19	4.65	-	-	-	331.57
Piura	0.13	-	318.21	1.09	2.89	0.00	-	0.02	5.54	19.06	-	53.59	34.82	10.74	-	-	446.26
Puno	311.12	-	-	4.67	-	0.00	-	0.13	0.00	12.67	-	44.03	20.44	1.71	-	0.40	472.81
San Martín	0.64	-	-	-	-	0.01	-	-	21.17	9.50	-	40.07	18.13	0.01	-	-	89.60
Tacna	345.47	-	-	1.44	0.08	0.00	-	-	1.71	-	-	8.10	6.09	8.14	-	-	480.32
Tumbes	-	-	98.00	-	0.05	0.00	-	-	19.71	-	-	7.80	3.42	1.14	-	-	130.12
Ucayali	-	-	48.16	-	-	0.03	83.35	-	16.59	3.53	-	18.12	8.91	0.02	-	-	178.69
TOTAL	4,262.77	1,775.14	545.92	143.57	39.19	0.13	848.26	24.34	529.30	222.44	36.47	777.00	500.00	392.63	21.55	235.66	10,802.76

Source: Economic Transparency Web Portal Production: Grupo Propuesta Ciudadana

2.2 AVAILABLE RESOURCES

We consider it important to estimate the concept of available resources within budget item 18 because, as a result of the strong growth in revenues, regional governments and municipalities are unable to spend the entire budget and important remainders are being left unspent from the previous year, which are then added to the budget the following year. This significantly modifies the Opening Budget figure approved in Congress. Therefore, the available resources are the result of adding the remaining resources from the previous year's balance to the regular budget, as shown in Table 2.4.

The remainder from the previous year's balance in item 18 amounted to S/.11.14 billion in 2011, of which 97.5% belongs to the municipalities and only 2.5% to regional governments. This fact seems strange, because while all local governments together show a greater remainder from the previous year than regional governments, the difference was not so large³⁶: In 2009 and 2010, regional governments had approximately 32% of the total remainder from the previous year of all subnational governments. So how is it that in 2011 the regional governments would have only 2.5% the remainder of all subnational governments? One reason for this is that some regional governments – which have high revenues – don't include in their budget the entire amount of resources they have, probably because they know they cannot spend them all during the year.

Let's see two examples to illustrate this. In the region of Ancash, the remainder from the previous year in 2010 was S/. 1.4 billion, of which 33% (or S/.466 million) belonged to the regional government. Therefore, it is peculiar that in 2011, this regional government reported a remainder from the previous year of zero even though canon transfers were quite

similar these two years (see Table 2.4 and Surveillance Report 13, p. 38). The other case is that of Cusco, where in 2010, the remainder from the previous year was S/. 553 million, of which S/. 365 million (34%) belonged to the regional government. However, in 2011 the regional government reported a remainder from the previous year of only 15 million nuevos soles this year, even though canon transfers in 2011 were substantially higher than the previous year.

These observations have two implications. First, they show us that the amount of available resources in table 2.4 does not include the resources available to regional governments which they don't include in the budget. Second, we show that we are facing a transparency problem because information on canon revenues which is not included in the budget, but is available to regional governments is not publicly accessible. Therefore, the public opinion of the regions has no way of knowing how much money the regional government really has, a situation that may allow some actors to use information to their own advantage. An example of this occurred in the case of the Cajamarca Regional Government earlier this year, when the national government and the media claimed, in the context of a conflict over the Conga project, that this regional government had "over 500 million soles in unused funds." Unfortunately it was not possible to access that information to verify the veracity of the allegations.

That said, the figures in table 2.4 should be taken with caution. Available resources in item 18 reached S/. 20.4 billion in December 2011, of which S/.17.2 belong to municipalities and S/.3.2 to regional governments, although, as mentioned before, this includes other revenues that, as shown in Table 2.3, are not related to the extractive industries, including the FONIPREL, the Regional Trust Fund, the Incentive Plan for Improvement of Municipal Management and others.

36 Surveillance Report on the Extractive Industries N°13 (2011) page 38.

Table 2.4

Available resources in Item 18 "Canon, Sobrecanon, Royalties, Customs and Participations"
by region in 2011
Million nuevos soles

Region	Local				Regional				Total (A+B)
	Canon, sobrecanon, royalties and FOCAM	Other Transfers	Surplus	Total (A)	Canon, sobrecanon, royalties and FOCAM	Other Transfers	Surplus	Total (B)	
Amazonas	0.0	22.2	38.8	61.1	0.0	27.9	0.0	27.9	89.0
Áncash	583.3	28.8	1,136.2	1,748.3	297.7	9.4	0.0	307.1	2,055.4
Apurímac	1.6	35.0	66.5	103.1	1.6	32.8	5.7	40.1	143.2
Arequipa	410.2	32.0	887.2	1,329.4	192.7	31.6	0.0	224.3	1,553.6
Ayacucho	100.5	80.9	298.6	480.1	39.4	11.3	0.0	50.8	530.8
Cajamarca	322.7	52.7	707.8	1,083.1	278.9	12.4	157.5	448.9	1,532.0
Callao	1.6	157.8	205.1	364.5	0.0	224.9	0.0	224.9	589.5
Cusco	1,204.3	55.5	1,881.0	3,140.9	376.6	31.2	14.9	422.6	3,563.5
Huancavelica	104.9	50.2	235.5	390.7	35.2	38.4	0.0	73.7	464.4
Huánuco	4.0	58.1	130.0	192.1	1.3	48.3	0.0	49.6	241.6
Ica	151.3	64.5	392.2	608.0	34.1	40.0	0.0	74.1	682.1
Junín	91.1	62.5	301.5	455.0	40.5	40.7	0.0	81.3	536.3
La Libertad	361.4	33.9	668.2	1,063.4	89.0	29.4	0.0	118.4	1,181.8
Lambayeque	0.2	35.6	66.3	102.1	0.0	68.0	0.0	68.1	170.2
Lima	194.1	202.1	695.0	1,091.2	42.0	22.4	0.0	64.4	1,155.6
Loreto	75.4	43.2	157.1	275.7	215.4	5.1	78.4	298.9	574.6
Madre de Dios	0.1	5.1	6.7	11.9	0.0	11.8	0.0	11.8	23.7
Lima Metro.	0.0	0.0		0.0	4.3	0.0	0.0	4.3	4.3
Moquegua	262.7	6.0	559.7	828.4	101.9	14.6	0.0	116.5	944.9
Pasco	152.1	10.2	314.8	477.1	49.6	38.1	0.0	87.6	564.8
Piura	282.6	89.6	572.5	944.6	58.2	10.9	0.0	69.1	1,013.7
Puno	262.5	70.5	444.5	777.5	60.9	5.8	0.0	66.7	844.2
San Martín	0.3	40.8	86.2	127.3	18.5	21.6	31.1	71.2	198.5
Tacna	337.1	15.2	682.7	1,035.0	53.9	2.6	0.0	56.5	1,091.6
Tumbes	77.4	6.1	125.9	209.4	47.5	28.4	0.0	75.9	285.3
Ucayali	96.6	32.9	189.5	318.9	48.9	16.3	0.0	65.1	384.1
GENERAL TOTAL	5,078.0	1,291.4	10,849.5	17,218.8	2,088.3	823.9	287.6	3,199.8	20,418.6

Source: Economic Transparency Web Portal
Production: Grupo Propuesta Ciudadana



USE OF REVENUES FROM THE EXTRACTIVE INDUSTRIES

III. USE OF REVENUES FROM THE EXTRACTIVE INDUSTRIES



In the previous chapter, we have discussed the revenues from extractive activities, the amounts transferred and the available resources in sub-national governments (SNGs) (transfers + remainder from previous year). The budgeting process for SNGs consists of developing the Opening Budget (PIA) using the budgetary "ceilings" provided by the Ministry of Finance (MEF), which are based on the forecasts in the Multiannual Macroeconomic Framework. Afterwards these budgets are debated in Congress; the budget is approved in late November and begins to run since January 2011.

However, since the first months of the year, there are amendments made to the opening budget of subnational governments which results in the Amended Budget (PIM). The first substantial change occurs with the inclusion of the remainder from the previous year, but also other resources. In some cases, these changes often double or more than double the investment budget for municipalities and regional governments.

One aspect that we pointed out earlier is that budget item 18 includes revenues that don't come from extractive activities, namely Trust Funds, FONIPREL, Municipal Incentive Plan, among others. Canon revenues, which come from the extractive industries, are the most important revenues in this item and represent 90% of transfers for regional governments, as well as 68% of transfers to local governments.

3.1 REGULATORY CHANGES CONCERNING THE USE OF CANON IN 2011

During the 2011 fiscal year there were important regulatory changes that took place with the departure of Alan Garcia and the arrival of Ollanta Humala to the presidency.

Emergency Decree N°012-2011 – issued on March 31, 2011 and was valid until June 10, 2011 – suspended the right to make any new hires or begin new investment projects in all three levels of government until July 28. The reason for this measure issued by the Ministry of Economy and Finance was to prevent risks of inflationary pressures they perceived and thus meet the fiscal targets.

REMURPE –the network of local governments – made a statement³⁷ on May 11, where they pointed out that that for the MEF, this decree did not apply to local governments in terms of restraining their spending, since postponing the transfer of funds from the "Incentive Plan" does not alter the maximum amount set for each entity. The revenue transfers from the national government to local governments guarantee the progress and completion of investment projects, according to Report No. 087-2011-EF/76.20 of the MEF. However, REMURPE states that they cannot carry out transfers for new projects that already have contracts or agreements. Furthermore, local governments cannot access new additional credits to implement new projects.

ED N° 012-2011 remained in place until June 10, 2011 for local and regional governments as well as the central government.

The public sector Budget Law for the 2011 fiscal year – Law N° 29626 states the following:

- It authorizes transfers made by regional governments to public universities according to paragraph 6.2 of Article 6 of Law N° 27506 (Canon Law), and its amendments.

37 Public statement on E.D N° 012-2011 (May 11, 2011) <http://remurpe.org.pe/inicio/noticias/513-pronunciamiento-sobre-el-du-012-2011->

- It authorizes the Moquegua Regional Government to use up to eight million seven hundred and nine nuevos soles to repay its debts.
- It authorizes the National University of San Cristobal in Huamanga and the National University of Huancavelica to use revenues from canon, sobrecanon and mining royalties for construction, rehabilitation and repair of infrastructure and the necessary equipment.
- It authorizes the National University of the Peruvian Amazon (UNAP) to carry out domestic borrowing operations with the National Bank (Banco de la Nacion) – using oil canon as a guarantee - to fund public investment projects to expand the university's infrastructure. To this end, it requires prior approval from the Ministry of Economy and Finance.
- It extends the validity of the of the thirteenth final provision of Law N° 29289 , Public Sector Budget Law for the 2009 fiscal year, which regulates the use of revenues from canon, sobrecanon and mining royalties by regional governments and local governments:
 - o Use up to 20% of the revenues from canon, sobrecanon and mining royalties in current spending exclusively destined to maintenance of regional and local investment projects, prioritizing basic infrastructure.
 - o Allocate 5% of revenues from canon, sobrecanon and mining royalties to fund the development of public investment project profiles within the framework of the Consensus-based Development Plans.
 - o Regional and local governments can use the revenues from canon, sobrecanon and mining royalties in funding or co-funding public investment projects that include interventions to provide public services, infrastructure for police stations, medical centers, hospitals, schools and jails, that generate benefits for the

community and are framed within the competencies of the level of government; or co-fund public investment projects that are the competency of other levels of government, which are implemented by the latter in road infrastructure. These projects cannot include, under any circumstance, interventions for business purposes or that could be developed by the private sector.

- It establishes the validity of Emergency Decree N°051-2009 until December 31, 2011. Regional and local governments may sign cooperation agreements to co-finance public investment projects that include infrastructure projects with revenues from canon, sobrecanon and mining royalties. These agreements shall be signed between regional governments or between them and other public entities belonging to different levels of government. Investment projects referred to in the preceding paragraph may be related to security and national defense.

3.2 USE OF CANON REVENUES IN THE REGIONAL GOVERNMENTS

3.2.1 Programming the budget by source of funding

In 2011, regional governments had a total revised budget of S/. 21 billion, 5.3% higher than the one in 2010, which was S/.19.9 billion. The main source of funding for regional governments is Ordinary Resources which were 65% of the total budget in 2011. The second source of funding is revenues from budget item 18: Canon, Sobrecanon, Customs and Participations, which amounted to S/. 4.4 billion, 21% of the total budget (see Table 3.1).

The opening budget for regional governments that comes from Canon (Item 18) grew in their component linked to the extractive activities. However, the aggregate amount fell compared to 2010, mainly due to the fall in other transfers which are FONIPREL and Regional Trusts, as shown in Table 3.1.

Table 3.1

Amended Budget of the RG by source/item of funding 2010 - 2011
In percentage and million nuevos soles

Source/Item	2010		2011	
	PIM	Participation	PIM	Participation
Ordinary Resources	11,828	59%	13,740	65%
Directly collected resources	653	3%	673	3%
Donations and transfers	2,049	10%	1,880	9%
Item 18: Canon, Sobrecanon, Royalties, Customs and Participations	5,087	26%	4,409	21%
a) Transfers from extractive activities	1,704		2,088	
b) Other transfers	1,875		824	
c) Remainder from previous year's balance	1,508		1,496	
Resources from official borrowing operations	308	2%	288	1%
TOTAL	19,927	100%	20,988	100%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

First, transfers related to extractive activities included in Item 18 add up to S/. 2.1 billion, 22% higher than the previous year. In contrast, other resources not related to the extractive industries fell by S/.1.9 billion in 2010, reaching S/.824 million in 2011. As is known, since late 2008 and even more in 2009, the central government began to transfer new resources to regional government, namely FONIPREL, Trusts and Regional Shares of FORSUR (for Lima), including them within budget item 18.

The remainder from the previous year's balance in item 18 is another additional important component of the amended budget and come from the unspent resources from the previous year. The remainder from the previous year included in the 2011 budget amounts to S/. 1.5 billion, and most of it belongs to regional governments with significant revenue from mining canon, oil canon or gas canon. The most outstanding cases are Cusco, Ancash, La Libertad, Arequipa, Cajamarca and La Libertad.

In 2011, the funding source that increased the most was item 18, whose budget rose from S/. 2 billion in the beginning of this year to S/. 4.4 billion by the end of the year.

We should mention that the source of funding denominated Donations and Transfers, which represents 9% of the total budget (S/. 1.9 billion), also includes revenues from the extractive industries. There come from the so called "Fondoempleo surplus", which comes from the 8% participation of net company profits that workers receive. This participation cannot exceed 18 additional wages a year and the excess amount is allocated to the Fondoempleo to finance training and employment promotion projects in the producing regions, with a maximum of 2,200 tax units. In cases where after making these deductions there is still surplus, companies must transfer the excess to the regional governments to finance infrastructure projects. These transfers are included in the budget item called Donations and Transfers (see Table 3.2). The condition for the existence of the Fondoempleo surplus is for the company's profits to be very large, like Antamina in Ancash and others.

In some regions such as Ancash, Cajamarca, Moquegua and Arequipa, where mining companies (Antamina, Yanacocha, Southern, and Cerro Verde) have generated huge profits in recent years, the Fondoempleo surplus had reached high amounts, especially for the Ancash regional government, but the exact figure is not publicly

Table 3.2**Changes in the budget (PIM - PIA) of the RGs, by source of funding, 2010 - 2011****Million nuevos soles and percentage**

Source/Item	2010			2011			Variation PIM 2011/2010	
	PIA	PIM	Difference	PIA	PIM	Difference	Amount	%
Ordinary resources	10,902	11,828	926	11,206	13,740	2,534	1,912	16%
Directly collected revenues	449	653	205	466	673	207	19	3%
Donations and transfers	0	2,049	2,049	0	1,880	1,880	-170	-8%
Canon, Sobrecanon, Royalties, Customs and Participations	1,362	5,087	3,725	1,988	4,409	2,420	-679	-13%
Resources from official borrowing operations	294	308	15	180	288	108	-21	-7%
TOTAL	13,007	19,927	6,920	13,839	20,988	7,149	1,062	0

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

available, neither from the regional government nor the Ministry of Economy.

In sum, the main source of funding for regional governments are "ordinary resources", followed by revenues included in item 18 which are very important in regions where exploitation of natural resources is significant. However, the inclusion of revenues that are not necessarily related to the extractive industries in this Item make it difficult to track, as discussed below.

3.2.2 Investment budget programming in the RG, by source of funding

35.5% of the total budget managed by the regional governments in 2011 – which amounted to S/. 21 billion – corresponds to investment (S/. 7.5 billion). The main source of funding for this investment budget is Item 18, which represents 45% of the investment budget and the main source of funding are transfers for extractive industries.

Table 3.3**Investment budgets in regional governments, by source of funding, 2011****Million nuevos soles**

Item	PIA	PIM	Participation (%)		Variation (PIM/PIA)	
			PIA	PIM	Amount	%
Canon, Sobrecanon, customs and participations	1,481	3,320	48%	45%	1,840	124%
Ordinary resources	1,373	2,329	44%	31%	956	70%
Donations and transfers	0	1,378	0%	19%	1,378	-
Resources from official borrowing operations	180	288	6%	4%	108	60%
Directly collected revenues	63	129	2%	2%	66	105%
TOTAL	3,096	7,445	100%	100%	4,348	140%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

As seen in Table 3.3, the revenues in Item 18 have increased the most. The difference between the PIA and PIM is S/ 1.8 billion, a 124% increase over the PIA, which is explained by the inclusion of the remainder from the previous year and new revenues for regional governments.

In general, we can see that the revenues that come from the extractive activities make up an important part of the budget of the regional governments, especially those who receive canon. Thus, in the main producing areas

such as Pasco, Cusco, Moquegua and Tacna, revenues in Item 18 explain over 65% of the total investment budget of the regional government (see Table 3.4). However, regarding the observations we made about the data in Table 2.4, it is likely due to the exclusion of some canon revenues from the amended budget, the real importance of this revenues is underestimated in some cases. One example is the Ancash regional government, where revenues from Item 18 only represent 29% of the investment budget.

Table 3.4
Relevance of canon (Item 18) in regional governments' budget - 2011
Million nuevos soles

Region	PIM Item 18 (A)	PIM TOTAL (B)	Percentage A/B
Amazonas	60	224	27%
Áncash	314	1,067	29%
Apurímac	79	286	28%
Arequipa	164	389	42%
Ayacucho	90	220	41%
Cajamarca	353	608	58%
Cusco	330	389	85%
Huancavelica	83	251	33%
Huánuco	86	254	34%
Ica	135	192	70%
Junín	91	189	48%
La Libertad	140	288	48%
Lambayeque	76	161	47%
Loreto	164	437	38%
Madre de Dios	39	132	30%
Moquegua	101	131	77%
Pasco	140	204	68%
Piura	126	312	40%
Puno	162	380	43%
San Martín	74	292	25%
Tacna	148	255	58%
Tumbes	82	213	38%
Ucayali	99	154	64%
Lima	77	167	46%
Callao	107	167	64%
Lima Metro.º	2	84	2%
TOTAL	3,320	7,445	45%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

3.2.3 Regional governments amended investment budget (PIM), by function

What is the destiny of the investment budget in the regional government? This is the question we address below. According to the data in Table 3.5, the majority are directed to projects in four functions: health and sanitation (29%), transport (28.8%), education, culture and sports (15.6%) and agriculture (12.9%). These four together account for 86.3%, and this picture has not changed significantly over the past two years. Therefore, we can conclude that many of the revenues from the extractive industries are targeted to sectors where there

are serious gaps in social and economic infrastructure in the regions. What has probably changed little is the fact that the vast majority of these projects are infrastructure in health, education, transport and agriculture.

The issue of the destiny and effectiveness of resource management in a year marked by social conflicts, such as Conga, has been in the center of the media attention, and they have disseminated information which has often been inaccurate and distorted. For instance, they said that regional governments or municipalities have huge amounts of canon revenues that remain unspent because

Table 3.5
Investment budgets in the Regional Governments by functions, 2009 - 2011.
Million nuevos soles

Function	2009	2010	2011	Participation 2011
Health and sanitation	1,379.0	2,357.9	2,155.4	29.0%
Transport	2,643.2	2,433.6	2,142.9	28.8%
Education	995.2	1,156.8	1,164.6	15.6%
Agriculture	1,106.1	1,024.1	957.5	12.9%
Planning Management and contingency reserve	376.1	325.5	279.1	3.7%
Energy	199.2	267.2	250.8	3.4%
Culture and sports	92.7	121.4	128.3	1.7%
Public order and security	102.6	137.2	125.5	1.7%
Environment	93.9	109.4	88.1	1.2%
Tourism	72.5	45.8	48.5	0.7%
Social protection	57.7	55.8	29.3	0.4%
Housing and urban development	40.4	36.6	28.7	0.4%
Fishing	32.9	27.9	14.4	0.2%
Justice	8.1	5.3	9.8	0.1%
Commerce	9.3	6.1	6.9	0.1%
Mining	9.7	7.0	6.2	0.1%
Work	3.8	2.5	2.6	0.0%
Communications	5.6	1.1	2.5	0.0%
Industry	9.5	6.2	2.1	0.0%
Defense and National Security	16.6	7.6	1.4	0.0%
Social prevision	0.2	0.0	0.1	0.0%
Foreign relations	0.3	0.0	-	-
TOTAL	7,254.6	8,135.1	7,444.5	
Transp., Health and Sanit., Educ. y Agric. (THSEA)	6,123.6	6,972.4	6,420.3	
Participation THSEA	84.4%	85.7%	86.2%	

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

they do not know how to use them or are using for unnecessary projects. While the unexpected arrival of revenues and the rush to spend them has led to oversized or non-priority projects, the fact is that, in light of the figures, over four fifths of the revenues in recent years have been used to fund roads, education, health and agriculture. The bottom line is not the speed of spending, but the lack of information about the quality of investment projects and on the quality of public spending.

3.2.4 Progress on the expenditure of investments budgets in regional governments

By December 2011, the regional governments' investment budget was S/.7.4 billion, an amount well above the opening budget of S/. 3.1 billion. While the magnitude of the changes has declined compared to the previous year, these are still large and are a factor that makes management very difficult in a context in which regional governments have inadequate revenues for recurrent expenditures compared to the money available for investments.

To measure the performance of regional governments in spending the investment budget, we use three indicators: the first measures the effectiveness of spending using the opening budget (accrued spending/PIA), the second measures how the effectiveness of spending using the amended budget (accrued spending/PIM) and the third measures the growth in investment spending between 2007 and 2011. To analyze these three indicators, we present Table 3.6.

A first conclusion from looking at the first indicator is that, on average, regional governments implemented 156% of their PIA, but looking in detail, there are three regional governments (Amazonas, Ica and Lima-Metropolitan area) that have spent less than their PIA, which is indicative of little effectiveness. At the other extreme there are regional governments that spent much more than their opening budget (Ancash, Arequipa, Pasco, Junin).

The second conclusion based on the second indicator is that, on average, regional governments spent 65% of their amended budget, an improvement compared to

the previous year, when they reached 61%. The difference with the results of the first indicator is explained by the large scale of changes in the budgets that lead to paradoxical situations, such as the following: the Ancash RG spent 663% of its PIA and only 61% of the PIM. Meanwhile, the Lambayeque RG spent 123% of its PIA and 83% of the PIM. Which of the two is most effective? To try to answer this question we must evaluate the data considering both the size of the budget that regional governments manage, as well as the evolution of their spending in the last four years (see Table 3.6)

The data in the table show the regional governments classified into four groups. In the first group are two regional governments which have investment budgets above S/. 500 million: Ancash and Cajamarca. Although Cajamarca made more progress in its spending (75%) the total spending remains low and also the growth of investment spending (49% annual average) is less than that of Ancash (51% annual average). However, both recorded a growth rate higher than the average of 23%.

In the second group there are five regional governments that manage budgets between S/. 300 and S/. 500 million. Of those five, the ones with the best spending performance are Loreto and Arequipa, while Puno shows a low efficiency since it only spent 31% of its amended budget. Data from the third indicator gives better results to Arequipa and Loreto (see Table 3.6).

In the third group there are ten regional governments with investment budgets between S/. 200 and S/. 300 million. According to the indicator, two regional governments stand out: San Martín and Huánuco. To these two we should add Tumbes, with a high growth rate (45%) of spending in the last four years. At the other extreme, the Tacna RG shows low efficiency, followed by Apurímac.

The fourth and last group includes nine regional governments with budgets below S/. 200 million. Most of the regional governments in this group achieved a level of progress above the average of 65%. Among them, we highlight the performance of Ucayali, Lambayeque and Junín. However, if we consider the third indicator, the ones that stand out are Ica, Lima (Metropolitan area) and Callao.

Table 3.6**Progress in the expenditure of the investment budget of regional governments, 2011****Million nuevos soles and percentages**

Ranking according to PIM	Region	PIA (A)	PIM (B)	Expenditure (C)	Progress %		Growth rate 2007-2011 (Annual average)
					C/A	C/B	
More than 500	Áncash	98	1,067	649	663%	61%	51%
	Cajamarca	250	608	454	182%	75%	49%
300-500	Loreto	219	437	346	158%	79%	43%
	Arequipa	151	389	343	227%	88%	26%
	Cusco	244	389	244	100%	63%	16%
	Puno	104	380	116	112%	31%	6%
	Piura	186	312	196	105%	63%	6%
200-300	San Martín	163	292	262	161%	90%	24%
	La Libertad	132	288	161	122%	56%	9%
	Apurímac	92	286	113	122%	39%	18%
	Tacna	61	255	73	120%	29%	0%
	Huánuco	127	254	194	152%	76%	33%
	Huancavelica	113	251	164	144%	65%	17%
	Amazonas	144	224	143	99%	64%	11%
	Ayacucho	104	220	139	135%	64%	5%
	Tumbes	84	213	136	162%	64%	45%
	Pasco	58	204	116	200%	57%	15%
Less than 200	Ica	123	192	117	95%	61%	46%
	Junín	76	189	159	209%	84%	34%
	Callao	78	167	122	156%	73%	42%
	Lima (provinces)	82	167	119	145%	71%	39%
	Lambayeque	109	161	133	123%	83%	0%
	Ucayali	108	154	137	127%	89%	36%
	Madre de Dios	87	132	98	112%	74%	32%
	Moquegua	79	131	87	111%	67%	5%
	Lima (Metropolitan area)	22	84	11	50%	13%	-31%
TOTAL		3,096	7,445	4,833	156%	65%	23%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

So that readers can see in more detail the progress of expenditure of investment budgets between 2007 and 2011, we present a summary in Table 3.7. The most salient results are the following: the Ancash RG increased its investment spending by 424% in this period. Cajamarca's situation is very similar, while the investment spending of the Lambayeque RG remained unchanged in the last four years. Finally, the spending

of the Metropolitan area of Lima in 2011 is the lowest of the last four years (see Table 3.7).

In summary, with the information about the performance in investment spending using all three indicators, we can conclude that:

Table 3.7**Expenditure of the investment budgets in regional governments, 2007 - 2011**

Million nuevos soles and percentages

Regional Government	2007	2008	2009	2010	2011	Annual variation in spending				
						2007-2008	2008-2009	2009-2010	2010-2011	2007-2011
Amazonas	93	106	144	117	143	14%	35%	-18%	22%	53%
Áncash	124	133	285	529	649	7%	115%	86%	23%	424%
Apurímac	58	77	71	136	113	33%	-8%	91%	-17%	94%
Arequipa	136	182	302	286	343	34%	65%	-5%	20%	152%
Ayacucho	115	97	124	183	139	-15%	27%	48%	-24%	22%
Cajamarca	92	67	165	265	454	-27%	147%	61%	71%	392%
Cusco	137	227	304	281	244	66%	34%	-8%	-13%	78%
Huancavelica	88	131	112	159	164	49%	-14%	42%	3%	87%
Huánuco	62	68	73	106	194	10%	7%	44%	83%	213%
Ica	26	54	57	106	117	109%	5%	88%	10%	351%
Junín	49	108	155	127	159	119%	44%	-18%	25%	223%
La Libertad	116	195	182	202	161	68%	-6%	11%	-20%	39%
Lambayeque	132	176	153	100	133	34%	-13%	-35%	34%	1%
Loreto	82	54	113	315	346	-34%	107%	180%	10%	323%
M. de Dios	32	47	80	138	98	45%	72%	72%	-29%	205%
Moquegua	72	79	184	155	87	10%	132%	-16%	-44%	21%
Pasco	67	78	169	78	116	16%	116%	-54%	48%	73%
Piura	153	150	201	329	196	-2%	33%	64%	-41%	28%
Puno	92	89	190	185	116	-4%	114%	-3%	-37%	26%
San Martín	112	231	219	222	262	106%	-5%	1%	18%	134%
Tacna	74	89	136	126	73	20%	300%	-8%	-42%	-2%
Tumbes	31	52	79	110	136	68%	51%	39%	24%	338%
Ucayali	40	81	121	142	137	101%	50%	18%	-4%	242%
Lima	32	71	113	150	119	124%	60%	33%	-21%	277%
Callao	30	54	94	132	122	82%	74%	40%	-8%	309%
Lima Metro.	48	45	139	273	11	-7%	211%	96%	-96%	-77%
TOTAL	2,093	2,741	3,965	4,953	4,833	31%	45%	25%	-2%	131%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

- a) In the group of RGs with the highest budgets, the Ancash, Arequipa, Cajamarca and Loreto RGs stand out due to their high effectiveness in spending.
- b) In the middle level budget group, the San Martín and Huánuco RGs have the highest effectiveness considering indicators two and three.
- c) In the last group, the Ucayali, Junín and Madre de Dios RGs stand out.
- d) The RGs with the lowest effectiveness in investment spending were Tacna, Puno and the Metropolitan area of Lima.
- We need to clarify that greater effectiveness in spending does not necessarily imply greater efficiency in spending or a better quality of investment projects. An example is the case of Loreto, whose regional government shows good effectiveness in spending thanks to a sewer project implemented by hiring a contractor. However, there are

strong objections to the quality of the sewage infrastructure that come from both the professional associations and the citizens who suffer the consequences.

What is the behavior of investment spending in regional governments disaggregated by functions?

Most of the investment budget is focused on five functions: transportation, sanitation, education, agriculture and health. These functions have a total spending of S/. 4.8 billion. The functions with the highest spending have been the sanitation, agriculture, planning, energy and education. See Table 3.8.

Table 3.8

Progress in the expenditure of investment budgets in regional governments, by function in 2011
Million nuevos soles and percentages

Function	PIA	PIM	Accrued expenditures (G)	Progress in spending (G/PIM)
Transport	668.8	2,142.9	1,302.6	61%
Sanitation	485.7	1,240.5	912.7	74%
Education	380.7	1,164.6	733.7	63%
Agriculture	577.2	957.5	690.7	72%
Health	497.9	914.9	479.7	52%
Planning, management and contingency reserve	191.7	279.1	212.7	76%
Energy	99.6	250.8	191.7	76%
Public order and security	11.7	125.5	84.3	67%
Culture and Sports	43.5	128.3	76.0	59%
Environment	54.3	88.1	59.4	67%
Tourism	21.5	48.5	28.2	58%
Social protection	17.6	29.3	18.8	64%
Housing and urban development	15.6	28.7	15.0	52%
Fishing	10.0	14.4	10.0	70%
Mining	1.1	6.2	5.4	86%
Commerce	1.4	6.9	5.3	77%
Industry	10.3	2.1	1.5	73%
Justice	0.0	9.8	1.5	15%
Communications	2.9	2.5	1.3	53%
Defense and national security	2.6	1.4	1.3	93%
Work	0.9	2.6	1.1	40%
Social prevision	1.6	0.1	0.1	100%
TOTAL	3,096	7,445	4,833	65%

Source: MEF - SIAF

Production: Grupo Propuesta Ciudadana

CONCLUSIONS AND RECOMMENDATIONS



CONCLUSIONS

Revenue generation in the mining sector

1. In 2011, production of the main minerals (gold, silver, iron and copper) remained stagnant. However, the value of mineral production increased by 22% compared to 2010, from S/. 63.0 billion to S/. 76.7 billion. This increase is mainly explained by higher international prices.
2. Mining companies' net profits continued to grow, due to rising international prices and also to the measures implemented to optimize their production costs. The Stock Market Regulatory Agency (SMV – Spanish acronym) estimates that mining companies' profits in 2011 increased by 13% compared to 2010. The profitability of companies also performed well, so the ratio of Net Profit/Net Sales was 41%, quite similar to 2010. All of which indicates that 2011 was a very good year for the mining business.
3. Domestic tax collection in 2011 increased by 20% compared to the previous year, while the taxes paid by the mining sector increased by 37%, according to the information provided by SUNAT. The main tax paid by the mining sector, Income Tax, grew by 30%.
4. As a result of the regulatory changes taken on in 2011, royalty payments (Law Nº 29788) are now based on operating profits. Revenues collected in the fourth quarter of 2011 from this concept were S/. 216.8 million, a figure which is very similar to the same period of 2011 (S/. 217.2 million). This shows that the amendment in the base for mining royalty payments has not generated higher revenues.

Revenue generation in the hydrocarbon sector

5. National oil production in 2011 fell by 5% compared to 2010. This is due to depletion in oil blocks that have already been exploited for many years.
6. National production of natural gas liquids (NGL) in 2011 fell by 2% compared to 2010. In contrast, natural gas (NG) production increased by 57% in 2011 mainly due to the beginning of extraction from block 56 which is destined for the export market.
7. The Value of Hydrocarbon Production (VHP) in 2011 was S/. 16.8 billion, 40% more than in 2010. This is mainly explained by the higher natural gas production, as well as the rise in prices. The price of oil continued to rise, getting close to US\$ 90 and US\$ 100 per barrel, which were a lot higher than in 2010.
8. In 2011, the royalties collected by the State totaled US\$ 2.1 billion, 51% more compared to 2010 when it was US\$ 1.4 billion. This increase is due in large part, as indicated above, to the increased production of natural gas in block 56 of the Camisea project.
9. The Oil Canon Equalization Law enacted in 2011 will take effect in 2012. With this measure, oil canon increases from 10% to 15% of oil production, while sobrecanon increases from 2.5% to 3.75% of oil production. In addition, producing regions will also receive 50% of income tax paid by oil companies. With these amendments, revenues to Loreto, Tumbes and Piura will be increased.

Use of revenues

10. Accredited canon transfers to the regions (regional government + local government) amounted to S/. 8.4 billion in 2011. This amount is 35% higher than the one recorded in 2010, when it was S/. 6.2 billion. These revenues from mining and gas canon account for 72% of total transfers from the extractive industries.
11. Four of the twenty-four regions concentrate more than 50% of the funds transferred from the extractive industries. In order of importance, these are: Cusco, Ancash, Arequipa and Cajamarca. As a result of the increased production in the Camisea project, Cusco has received 25% of total transfers in 2011.
12. The Opening Budget (PIA) of item 18 of the regional governments in 2011 amounted to S/. 2.0 billion. After the amendments (Amended Budget - PIM), it reached S/. 4.4 billion, ie: an increase of 121% between PIA and PIM.
13. In 2011, the progress in expenditure of investment budgets in regional governments was 65% on average, resulting in an unspent budget of S/. 2.6 billion. However, it is known that the performance of regional governments in expenditure is heterogeneous. The ones that had a better performance are the regional governments of Arequipa, Cajamarca and La Libertad, while those with the worst performance were Lima – metropolitan areas, Tacna and Puno.
14. The orientation of investment spending by function in regional governments has not changed significantly in recent years. Over 85% of the resources fund projects of Transportation, Education, Health and Sanitation and Agriculture. The functions with the highest budget are health and sanitation, followed by transport. Together, these two functions account for 57% of the total.
15. The leftover resources from item 18 (canon and sobrecanon, royalties, customs and participations) in 2011 amounted to S/.11.1 billion, of which 97.5% correspond to municipalities and only 2.5% to regional governments. However, this low percentage of regional governments represents a sharp change compared to 2010, when the leftover resources amounted to S/. 15.9 billion, of which 32% belonged to regional governments and 68% to local governments. This change is due to the fact that some regional governments do not include in their budget the total amount of resources they have available.
16. In Item 18 (canon and sobrecanon, royalties, customs and participations), the main source of revenues for regional governments, the Ministry of Economy and Finance has included transfers that are not related to the exploitation of natural resources, which has made it virtually impossible to track the use of canon and mining royalties. The result is an impaired budget transparency.
17. In 2011 there was a fall in investment spending by subnational governments compared to 2010, especially in municipalities. One factor behind this decline is the introduction of Emergency Decree 012 that halted the implementation of investment projects for at least two months. This was challenged by local governments, regional governments and civil society, achieving its repeal.

RECOMMENDATIONS

1. The Ministry of Finance and the National Congress should assess whether the new taxes applied to mining are generating additional revenues equivalent to S/. 3.0 billion, as well as the impact of these measures on income tax payments and thus on the canon transfers to the regions.
2. The National Congress and the Executive power should demand more transparency on the resources available which are not included in regional government budgets and come from the extractive industries.
3. The problems associated to canon distribution in the regions should be discussed and resolved in the framework of a new Fiscal Decentralization Law, following the proposal by the National Assembly of Regional Governments and the Network of Rural Municipalities of Peru.
4. In the short term, the Executive power should present the proposal offered several months ago to improve canon distribution within the regions.
5. The Ministry of Economy and Finance should make a distinction between the transfers from the exploitation of natural resources (which were originally the only ones included in item 18), and other revenues such as FONIPREL, FORSUR, Incentive Plan, Modernization Plan, as well as those revenues that could come in the future, but have nothing to do with the extractive industries.



Annex 1

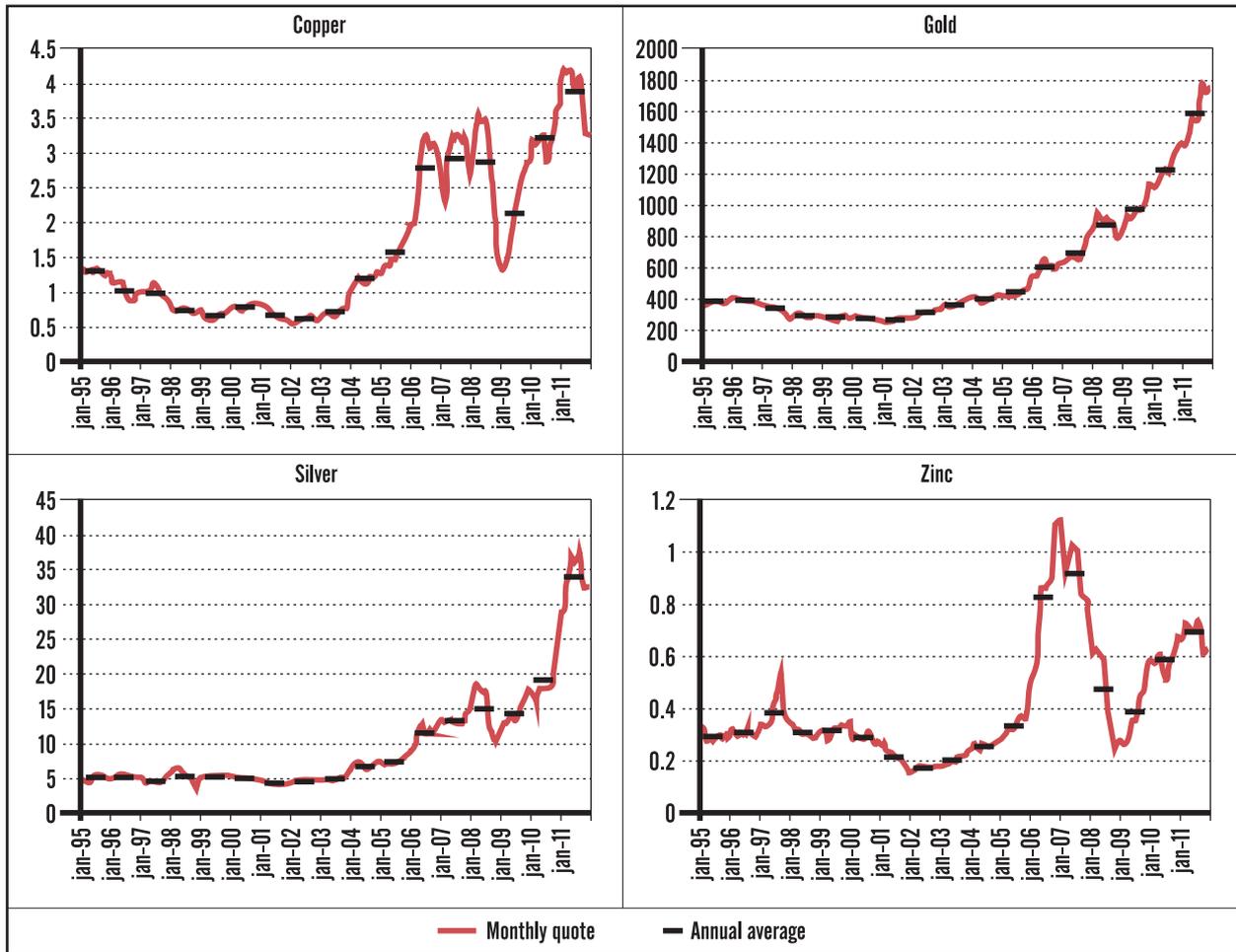
Volume of production of the main minerals
1990 - 2010

Year	Copper	Tin	Iron	Molybdenum	Gold	Silver	Lead	Zinc
	FMT	FMT	FMT	FMT	Kg	Kg	FMT	FMT
1990	323,412	4,812	2,181,321	4,179	20,179	1,927,534	209,722	598,193
1991	382,277	6,568	2,460,338	3,094	22,606	1,926,611	217,864	638,064
1992	379,128	10,044	1,976,664	5,629	24,242	1,667,711	214,007	626,179
1993	381,250	14,310	3,474,378	4,777	30,318	1,670,815	224,695	668,094
1994	365,663	20,680	4,636,628	4,631	47,800	1,768,199	235,042	690,017
1995	409,693	22,662	3,948,199	3,411	57,744	1,928,853	237,597	692,290
1996	485,595	26,842	2,915,692	3,667	64,886	1,976,536	248,929	760,353
1997	506,498	27,953	3,171,312	4,262	77,940	2,090,311	262,466	867,691
1998	483,338	25,907	3,282,118	4,344	94,214	2,024,570	257,713	868,757
1999	536,387	30,618	2,715,392	5,470	128,486	2,231,390	271,782	899,524
2000	553,924	37,410	2,812,785	7,193	132,585	2,437,706	270,576	910,303
2001	722,355	38,182	3,038,401	9,499	138,522	2,571,114	289,546	1,056,629
2002	844,553	38,815	3,056,055	8,613	157,530	2,869,639	305,651	1,232,997
2003	842,605	40,202	3,484,900	9,590	172,625	2,923,686	309,164	1,373,792
2004	1,035,574	41,613	4,247,174	14,246	173,224	3,059,962	306,211	1,209,006
2005	1,009,899	42,145	4,564,989	17,325	208,002	3,205,673	319,368	1,201,671
2006	1,048,472	38,470	4,784,601	17,209	202,822	3,470,661	313,332	1,203,364
2007	1,190,281	39,019	5,103,597	16,787	170,128	3,493,909	329,154	1,444,354
2008	1,267,867	39,037	5,160,707	16,721	179,870	3,685,931	345,109	1,602,597
2009	1,274,725	37,503	4,418,768	12,295	182,403	3,854,019	302,412	1,509,129
2010	1,247,126	33,848	6,042,644	16,963	163,400	3,637,412	261,902	1,470,510
2011	1,235,138	29,266	7,010,938	17,952	163,164	3,392,792	230,002	1,255,879
Growth rate 1990 - 2011	282%	508%	221%	330%	709%	76%	10%	110%
Growth rate 2005 - 2011	22%	-31%	54%	4%	-22%	6%	-28%	5%
Growth rate 2008 - 2011	-3%	-25%	36%	7%	-9%	-8%	-33%	-22%

Source: Ministry of Energy and Mines (MINEM-Spanish acronym)

Annex 2

Export prices of minerals, annual and monthly average, 1995 – 2011



Source: Peruvian Central Bank (BCRP-Spanish acronym)
 Production: Grupo Propuesta Ciudadana

ANNEX 3

Tax revenues collected by the Consolidated Central Government and SUNAT

Million nuevos soles

1998 – 2011

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
CONSOLIDATED CENTRAL GOVERNMENT REVENUES	23,677	23,822	26,317	26,633	27,603	31,132	34,954	39,924	51,154	58,253	65,596	60,274	73,146
REVENUES COLLECTED BY SUNAT (1+2+3)	25,384	25,670	28,835	29,775	30,438	34,179	38,444	44,012	55,506	64,320	72,760	67,600	81,081
1. Tax revenues collected by SUNAT (a+b)	24,331	24,288	25,601	26,475	27,083	30,640	34,657	39,673	50,179	58,459	65,487	59,952	72,409
a. Tax revenues collected by SUNAT - Domestic	16,052	16,138	16,818	18,019	18,698	21,340	24,009	27,990	36,925	43,598	46,932	45,383	53,478
<i>Agriculture</i>	138	137	148	190	215	275	295	305	348	390	394	421	491
<i>Fishing</i>	59	49	83	76	114	138	201	250	243	349	208	247	397
<i>Mining</i>	591	495	699	612	689	1,091	1,741	3,123	7,731	10,761	8,985	4,859	8,132
<i>Hydrocarbons</i>	1,477	1,547	1,604	582	321	655	995	1,380	1,859	1,996	2,304	1,932	2,665
<i>Manufactures</i>	4,730	4,669	4,750	6,033	6,879	7,169	7,275	7,673	8,397	8,898	9,166	9,740	10,352
<i>Other Services</i>	6,174	6,445	6,733	7,886	7,657	8,675	9,788	10,801	12,859	14,359	17,370	18,816	20,805
<i>Construction</i>	728	690	683	577	536	745	657	840	1,142	1,491	1,820	2,316	2,904
<i>Commerce</i>	2,155	2,106	2,118	2,062	2,287	2,591	3,056	3,619	4,345	5,354	6,684	7,053	7,731
b. Tax revenues collected by SUNAT - Customs	8,280	8,150	8,782	8,456	8,385	9,300	10,649	11,682	13,254	14,861	18,556	14,569	18,931
2. Social contributions	-	1,314	3,184	3,255	3,319	3,502	3,741	4,023	4,879	5,245	6,768	7,244	7,957
3. Non tax revenues (c+d)	1,052	68	51	44	36	37	46	316	449	615	505	403	715
c. Mining royalties	-	-	-	-	-	-	-	266	401	526	455	338	646
d. Other non tax revenues 4/	1,052	68	51	44	36	37	46	50	48	89	50	65	70

Participation of the mining sector in revenues collected by SUNAT	2.4%	2.0%	2.7%	2.3%	2.5%	3.6%	5.0%	7.9%	15.4%	18.4%	13.7%	8.1%	11.2%
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Participation of the mining sector in domestic tax revenues	3.7%	3.1%	4.2%	3.4%	3.7%	5.1%	7.3%	11.2%	20.9%	24.7%	19.1%	10.7%	15.2%
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Source: SUNAT – Weekly report

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