



SURVEILLANCE of Extractive Industries

National
Report
Nº 6
Peru 2007

Lima, November 2007



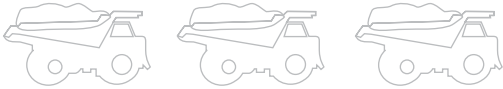
GRUPO
Propuesta
CIUDADANA

With the auspices of:

REVENUE WATCH
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Area of CITIZEN'S SURVEILLANCE



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GRUPO PROPUESTA CIUDADANA / CIVIC GROUP PROPOSAL

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No. 6 National Report on Extractive Industries Surveillance is a publication of Grupo Propuesta Ciudadana and is part of Peru Surveillance System.

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Legal Deposit: 2005-3012

Grupo Propuesta Ciudadana
León de la Fuente 110, Lima 17.

Printed in Peru



This publication was made with the contribution of the Revenue Watch Institute and the services of the Evangelical Churches of Germany for Development (EED).

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The government has put forth a series of measures that will boost the extractive sector investments, in particular mining, which clearly shows a genuine state effort to help this sector. What remains questionable is that the government is only concerned in making mining investment easier, but shows no interest in implementing reforms to strengthen state's management capacity so as to turn revenues generated by mining and hydrocarbons into investment projects that will contribute to local and regional development.

Instead of applying measures to enhance the regulatory framework and the state's capacity to regulate and supervise the compliance of socio-environmental regulations, the government has launched rushed measures-for no apparent reason- such as a proposal for declaring 20 mining projects of national interest, or another that would distribute 35% of the canon (mining royalties) to the families, - from which the companies themselves have tried to stay away. On the other hand, as stated in the report, the company profits are steadily increasing and yet the government is not willing to revise the Voluntary Agreement or demand universal payments of royalties and as a result of which the Peruvian state and Regions continue losing resources

This No. 6 National Report on Extractive Industries Surveillance concerns the first semester of 2007. To revenue generation, distribution and use we have added -in the initial part- a discussion and opinion text about the recent government measures in terms of policies to drive investment in the extractive sector, particularly mining.

We have also included brief texts about issues of interest such as the implementation of Voluntary Contribution to the regions, regulatory changes to improve the application of incoming resources from the *canon*, as well as the measures adopted to decentralize and ease the SNIP / National Public Investment System. Has the investment expenditure rate, produced by these measures, improved? Our reported indicators fail to show significant changes in this aspect.

This No. 6 Extractive Industries Surveillance Report was made possible thanks to the economic support provided by the Revenue Watch Institute and to the effort exerted by CEDEPAS Norte (Cajamarca) CIPCA (Piura), CEDEPAS Norte (La Libertad), CEDEP (Ancash), CBC (Cusco), CEDEP (Ica and Moquegua) and DESCO (Arequipa) regional teams. We would like to thank all these regional public institutions' officers and the officers of the Ministry of Economy and Finance for the information provided.

THE MINING POLICY MEASURES OF THE GOVERNMENT

A bet placed on a model based on the extractive sector.



The measures adopted by the government in terms of the mining policy in recent months show their decision to boost mining investments "at any price" and thus achieve the goal of economic growth – at the rate of 6 or 7% per annum-, which was established in its economic program at 2011 and also to ensure fiscal resources to meet the growing demands of a population that –mostly, does not receive the benefits of economic growth.

The measures to which we refer are: reduction and simplification (D.S. N° 014-2007-EM) of the procedures for the commencement of mining exploration; the signing of a legal stability agreement for the Rio Blanco project (Majaz, Piura); the decision of a "sudden" transfer of the mining *canon* thus creating the image that now the regions have large amounts of resources for investments to reduce poverty levels. These measures were added to a bill declaring of "national interest" 20 mining projects¹ and proposed the distribution of 35% of the *canon* directly to the families living in mining production districts. There is also a proposal that would reduce the area of the Bahuana-Sonene National Park (Madre de Dios) in favor of exploration and exploitation of a hydrocarbon project.

What is the purpose that motivates these decisions by the government? What is the significance of these measures for the economic development and competitiveness in the regions? The article titled "The hortelano dog syndrome" published by President Garcia offers answers to the first question.

A bet placed on extractive industries: An Imposition on or a longing of the regions?

The message sent by the government together with the above measures –and the article quoted– is very clear. Investments in the extractive sector, in particular mining, are a priority for the government. Therefore, these will be implemented regardless if they violate the rights of the people (economic, social, and environmental) that occupy the land where these mineral resources are found. The current high mineral and oil prices –which hovers around the 100 dollars per barrel–, are great incentives for investors due to the high return rate that these projects provide. Hence, foreseeable investments for the period 2007-2010 in the extractive sector will reach figures without precedents: 15 millions of dollars, according to BCRP.

Peru is a country with important mineral and gas resources, but also possesses enormous amounts of biodiversity, nature, history and culture. Although its mining potential is undeniable and more so now when international prices are high offering us an opportunity for development, we should not forget that Peru is also a country where agro export (organic agriculture), tourism in its many forms, craftsmanship, the textile industry, etc., have a great potential in the world

1 Which was filed away in the Congress Commission of Energy and Mines

market that tends to value the products' natural content. Therefore, the course chosen by the government to concentrate its attention on increasing mining and oil investments without any restriction(s)- because according to president Garcia, it is clean and does not contaminate -, seems biased because it pretends to disregard not only the impact of this activity in the development of agriculture in the sierra region and the valleys of the coast- due to the impact on the volume and quality of water resources- but also the right of the regions to decide their own path for development.

In our opinion the main challenge of the country and the regions is to develop competitive advantages focusing on external and internal markets, which generate a more inclusive development, different from the current one, generating great profit, but little employment, which excludes the majority. The decentralization process demands that Regional Governments should contribute to this process by designing their consensual development plans and their competitiveness plans. It is here where the regional social forces - government authorities, businessmen, social organizations- should define, if they have not done so already, the economic activities or productive chains considered strategic for the development of their territory, including mining and hydrocarbons.

To be sustainable, the mining industry cannot nor should it be imposed in an authoritarian manner by the central government- as intended now - with the argument that claims that resources "are for all Peruvians". We believe that it should be promoted taking into account different economic activities in particular livestock and agriculture which are the principal means of living for farmers and their families in the Andes.² The Tambogrande experience gave us a lesson of the conflicts encountered by mining projects in areas with agricultural productive potential; the Majaz Project which attempted to be imposed over local populations, seems like an experience that persists in the same error, both by the companies and the State in its role to enforce procedures provided by law for the commencement of a mining project. On the other hand, projects like Bayovar and Las Bambas initiated with better judgment, offer an interesting possibility. However, in the latter example the intervention of PROINVERSION - responsible for the administration of the Trust Fund- is generating unrest.

The economic model that gives priority to extractive activities also brings along with it other risks with the macroeconomic plan, which is worth to point out clearly. In the first place, it is clear that there is a trend of a growing dependency on tax revenues - albeit temporary- generated by these industries, in particular the mining sector. Secondly, there are emerging signs that the Peruvian economy is acquiring the so called "Dutch disease"³, i.e. plenty dollars⁴ thus producing cheap dollars and affecting competitiveness of non-primary exports, which will cause closure of companies and loss of employment.

2 Agreement 169 with the ILO, ratified by the Peruvian State, in sub item 6.1 establishes that governments should "...a) consult with stakeholder communities, by appropriate means and particularly through its representative institutions, each time legislative or administrative measures are likely to affect them directly..."

3 Campodonico, Humberto, "The Dutch Disease in Peru", La Republica 10-05-2007

4 This abundance is due to a surplus in the trade balance, an increase of remittances by migrants, increase of direct foreign investment and also drug trafficking

At present, extractive industries represent almost 70% of our total exports⁵; at August of this year it represents 32% of internal revenue and 54% of the total income tax collected by SUNAT. The rapid rise in taxes of these industries – that originates in the extraordinary rise of prices of minerals and oil – generates an optical illusion: tax pressure has passed from 13% to 16% of the GDP with no effort by SUNAT, thus the idea of a tax reform has vanished from the public agenda. On the other hand, with little State capacity to solve the management investment expenses, it has created the misleading idea that we live in a fiscal bonanza, up to a point where we cannot even spend all the money available. In the midst of this confusion corporate groups have begun to suggest a reduction of income tax rates, the elimination of the ITF (tax to financial transactions), among others, which to us seem unacceptable. The executive has presented a bill to reduce income tax from 30% to 18% for those companies that decide to re-invest their profits.

Evidence that the non-extractive industrial sector is beginning to suffer the consequences of the economic model are the increasing complaints and criticisms by the National Society of Industries at government policies, which has permitted a sharp fall in the value of the dollar affecting directly their income. But also at the unexpected and improvised government decision to reduce tariffs of 4,200 imported products, among them 42 linked to the wheat, corn, flour, dairy and the sugar chain (from 20% to 9%), with the argument that it will counteract the rise of prices of food increasing in the international market and hence in ours, affecting the popularity of president Garcia. Worst of all is that in an oligopoly market like that of Peru, most likely tariff reductions will not result in lower prices for consumers⁶ and therefore those who are most affected by this measure are agricultural producers already threatened with the signing of the FTA.

The direct distribution of the Canon to the families: A concern for the poor or for mining investments?

To understand the true meaning of this measure we should remember a previous decision of speeding the transfer of the mining canon in one only single quota in the month of June (and not in 12 as before)⁷ supposedly so municipalities and regional governments "have resources like never before in their history to invest in the fight against poverty". But we cannot ignore what everybody knows: the difficulties of these entities to effectively manage these resources. The real intention was to reinforce the image of how much is the mining sector contributing to the benefit of the regions. What was achieved in the practice was to "inundate" with money, municipalities of departments with more mining production (Ancash, Moquegua, and Tacna) and later criticize them for their inability to manage these resources, but doing nothing to provide support to strengthen their technical and institutional capacities⁸.

5 According to BCRP statistical figures, mining and hydrocarbon exports represent 69% of all our exports

6 Campodonico, Humberto, "Tariff reduction: grate victory of liberalism" La Republic 10-16-2007

7 This measure was included in November 2006 when the 2007 Budget Law was passed in Congress.

8 An emblematic example is the San Marcos municipality that managing a 1 million soles budget 3 years ago, today it has 200 million available but as it has difficulty in expenditure this money, it was disqualified.

In June of this year due to this situation Minister Carranza⁹ recognized the inequalities of these transfers of canon resources between the regions and inside them. In addition, he recognized the need to modernize the National System of Public Investment (SNIP) and the System of Contracts and Acquisitions, especially the area of Works in order to have a much more agile system that would help the execution of investments.

However, the decisions made by the government to decentralize and to make the SNIP and the CONSUCODE more flexible are the consequence of improvised measures adopted by the abrupt decisions made by president Garcia¹⁰, which seem not to show positive results. The figures representing investments of the first semester 2007 prove it: regional governments have an advance of 19% of allocated expenditures of the total budget, while in the central government institutions the advance is 25%.

As a consequence of the urge for investments that are not advancing, the standstill of activities of the Majaz project and the increases of socio-environmental conflicts in the areas where mineral resources are exploited¹¹, the government is now planning the direct distribution of 35% of the mining canon to go directly to the families of the area¹² in producer municipalities. In this way, the government argues that, "the intention is to improve the buying capacity in the areas where mining activity operates and thus changing the perception that the profits of mining companies are not reflected in the wellbeing of the country". With this measure the State is giving up its role to lead reforms that will improve the State's management capacity, and so ensure that the revenues generated by mining is converted into projects of local and regional development.

Accelerating the distribution of the canon and giving money to the families are both measures that have the same purpose: the concern of the government to facilitate the path for mining investments, without changing the normative framework that permit the State to share more closely of the revenues and have a better surveillance over the enforcement of environmental regulations. The alleged idea underlying the measure of giving money to the families is so that they will not oppose to the mining activity, which is in part true. However, studies conducted in Peru show that the main cause of mining conflicts is that mining activity affects farmer's rights to access to natural resources, in particular water for agricultural purposes¹³. Therefore; nothing assures that the distribution of money will appease social conflicts.

At first glance, the measure seems to be attractive because it gives people the power to exercise their right to decide the better way to utilize these resources. However, in a society where there is

9 http://www.rpp.com.pe/portada/economia/82735_1.php?font=3

10 We refer for instance to urgent decrees 014 and 015 referred the former to declaring the emergency of investment project execution reducing system demands to a minimum. The latter was a back down in this measure and declaring the reorganization of SNIP

11 According to the last report by the Ombudsman's Office, of 76 identified social conflicts in the entire country, 47% (i.e. 36 conflicts) are "confrontations between the population and the companies that exploit natural resources". Report 43 of September 30, 2007

12 Law modifying the distribution of the Mining Canon

13 Bebbington, A. (2007) "Mining, social movements and peasants' response. A political ecology of territorial transformation" CEPES, IEP.

use and abuse of a patronizing approach a measure like this one, can fall into contaminated terrain. The money received will most likely go to consumption, not to investment; therefore, it will not contributing to foster the effort the people should make or to develop their productive capacities to generate permanent profits. This is regrettable because in the country there are a number of experiences that provide support for income generation capacity of families in rural areas. Moreover, this creates perverse incentives where administration will be extremely complicated for local authorities

On the other hand, this measure is a centralized measure that does not agree with decentralization efforts that the government intends to implement. Firstly, because it violates the autonomy of local governments and tax decentralization, if the Constitution establishes that the canon forms part of municipal income; consequently, its administration belongs to this governmental entity. But, against this mandate, instead of helping to strengthen the capacity of municipalities, the central government is attempting to deprive them of their resources by earmarking them for another end that is not investment, hence also infringing the law. Secondly, the central government makes improvised decisions - like the "sudden" transfer of the canon, affecting municipal performance and later accuses them of not knowing how to effectively spend the transferred resources. And we know that the lack of management of investment resources is a problem affecting all levels of government and this was evident with the ill-advised purchase of police cars, with the delay in executing the Programa Agua Para Todos project (Water for All), and also with the reconstruction process in the South (FORSUR). As a surprise to most, the revision of inequities in the distribution of the canon (between regions and the interior of those who receive it) is an urgent decision that neither Congress nor the Executive want to make.

To summarize the path that the government has chosen is risky, to say the least. The intention is to impose a development alternative based on the exploitation of mineral resources that benefits a small minority in the regions, without judging the negative effects in the local agricultural activity and the competitiveness of other sectors of the economy (through the exchange rate). From a medium and long term view, this plan is risky because it makes us dependent of tax revenues that are not foreseeable and can end up weakening the industrial sector. In the short term it is like the purchase of a "social license" with someone else's money, which is far from the essence of sustainable development.

If the goal is to prove that extractive activities- like mining- contribute to local and regional development, we need measures that will actually boost the capacity of the State (national, regional, and local) to translate revenues received into investment projects that will contribute to improve competitiveness and the living standards of the people. Along these lines and from a medium and long term view, the State should analyze how to optimize these resources.

I. GENERATION OF FISCAL REVENUE IN THE MINING SECTOR AND ITS DISTRIBUTION



In this chapter we will review the tax generated by the exploitation of mining resources and we will analyze the factors by which the departments receive more or less financial resources from such exploitation. Under this idea, we will review price dynamics and volumes of extraction as primary determinants of the economic- financial results of companies, so as to determine the resources that the departments receive. Unlike previous reports in which we focused on unbundling the effects of price and income in relation to the value of production, we will analyze how much the region benefits in comparison with the amount received by the company.

1.1. National overview of production and prices

The mining sector continues to concentrate its energies on three minerals: copper, gold and zinc. Since 2001, these minerals are equivalent to more than $\frac{3}{4}$ of the value of extracted resources, a process that has increased in the last two years. On the other hand, the mining activity accounts for more than half of our exports, reaching almost 60% in the last two years, where 50% corresponds to the above mentioned minerals¹⁴.

In the first semester of 2007, the volumes of extraction of the previously mentioned minerals showed big differences. While zinc rose 28% in comparison to last years' figures, copper rose 9%. Gold production instead fell 24%.

The rise in copper extraction can be explained particularly by greater extraction amounts conducted by Cerro Verde mining company because the exploitation of another area named Cerro Verde II, allowed the company to increase its production threefold during the last two semesters. The rise of zinc can be explained by the priority given to this resource by Antamina, which experienced an extraction increase of 127% between the first semester of 2006 and the first semester of 2007

A different situation is seen with the production of gold. Although, production had increase due to the start of production in Alto Chicama in La Libertad¹⁵, the exhaustion of resources in two units that at one point represented 65% of the national gold production - Yanacocha in Cajamarca and Pierina in Ancash - has reduced the extraction of gold by 24% between the first semester of 2006 as compared to the same period in 2007. It is important to stress that by mid 2009 it is likely that the Pierina mine will close, without any other gold project in mind to counterbalance it.

The remaining metals have maintained a similar production level if we compared the two last semesters, except for molybdenum that

recorded a drop of 22% in the last twelve months due to less volume of mineral available. (See Table 1.1)

Table 1.1

Volume of production: principle metals, 2001-first semester 2007 (thousands of tons).

Mineral	2001	2002	2003	2004	2005	2006	1 st sem. 2006 (A)	1 st sem. 2007 (B)	Variation B/A
Copper	722	845	843	1,036	1,010	1,049	510	554	9%
Tin	38	39	40	42	42	38	20	19	-5%
Iron	3,038	3,056	3,485	4,247	4,565	4,785	2,457	2,585	5%
Molybdenum	9	9	10	14	17	17	8	7	-22%
Lead	290	306	309	306	319	313	150	160	6%
Zinc	1,057	1,233	1,373	1,209	1,202	1,202	572	730	28%
Gold*	139	158	173	173	208	203	105	81	-23%
Silver	2.6	2.9	2.9	3.0	3.1	3.5	1.7	1.7	-2%

* In tons

Source: Ministry of Energy and Mines

Prepared by: Vigila Peru

For their part, the prices that are determined in accordance to the world market⁻¹⁶ continued their increasing trend, but at a slower rate than previous months; this is so in comparison with 2006 when the prices hit their peak of the previous ten years. In 2009 a drop in metal prices is expected with the exception of gold that will however be above the average of the last 5 years.¹⁷ (See Table 1.2)

The estimate is that by 2008 gold will cost more than 700 Dollars per ounce (in 2007 gold was 620 per ounce). The contrary will occur with copper and zinc prices that will lose value in relation to closing prices of 2005 but will

continue above average levels.¹⁸ *What is the cause of this downward correlation of prices?* This is due to an increase in the offer due to commencement of new projects even though these will not cover all of the demand, and to deceleration of growth of the Chinese economy and above all the American economy.

The two variables recently revised that present different behaviors, allow us to calculate the **value of mining production (VMP)**. The VMP estimates the value of extracted mining resources and is a first look to the at performance of the sector. It results by multiplying volumes of extraction by the export price.¹⁹

16 Ore prices are not determined according to costs incurred by companies; these are the result of offer and demand variations in the international market. To this regard, mining companies are "acceptant price".

17 2008-2010 Multi-annual Macroeconomics Framework. Ministry of Economy and Finance, June 2007

18 Report on Inflation. Banco Central de Reserva del Peru. May 2007.

19 Why consider the export price and not the international quote? Because most part of the mining production is sold abroad at this price, called "export price". Most part of these metal sales is done through agreements entered into months in advance, prices agreed based on international quotes. Due to the fact that the last years prices have been constantly increasing, export prices result less than international quotes.

Table 1.2

Evolution of annual average export price of principal metals, 2002-2007 and variation 2007-2006 (Dollars per ton)

Mineral	2002	2003	2004	2005	2006 (A)	2007 1/ (B)	B/A
Copper	1,381	1,591	2,623	3,472	6,112	6,056	-1%
Tin	4,153	5,381	8,602	7,241	8,702	13,546	56%
Iron	19	17	21	33	38	39	2%
Molybdenum	8,312	11,727	36,181	62,756	47,034	54,849	17%
Gold	11,080,324	12,821,013	14,351,465	15,713,484	21,325,963	23,302,616	9%
Silver	162,602	171,660	235,331	256,961	404,123	469,406	16%
Lead	756	769	1,488	1,505	1,824	2,198	21%
Zinc	380	446	562	740	1,812	2,166	20%

1/ average prices at fist semester 2007

Source: Ministry of Energy and Mines

Prepared by: Vigila Peru

During the first semester of 2007, VMP rose to 27, 451 million soles and copper, zinc and gold represented 80% of this amount- with 11.9% increase with respect to the same period in 2006. In recent years the high rise in prices can be explained in large part to increases of the VMP. Looking at chart 1.1 we can see that the VMP (yellow ocher bar) presents strong increases in years that prices had strong rises like what occurred in 2006. If we estimate VMP at 2001 prices (gray bar) we see that prices would have been much more moderate. It is clear that the momentum of the mining sector of recent years can be explained by a strong and also unexpected increase in prices.

It is also important to mention that the rise in prices explains more exactly the increase of the VMP: since 2004 to date it explains more than 80% of this growth, but between the last two semesters it explains the total increase. In other words, the volume of production remains steady and what varies are the prices.

While the amount extracted by the companies was necessarily not what they sold; it is difficult to imagine that companies save reserves under

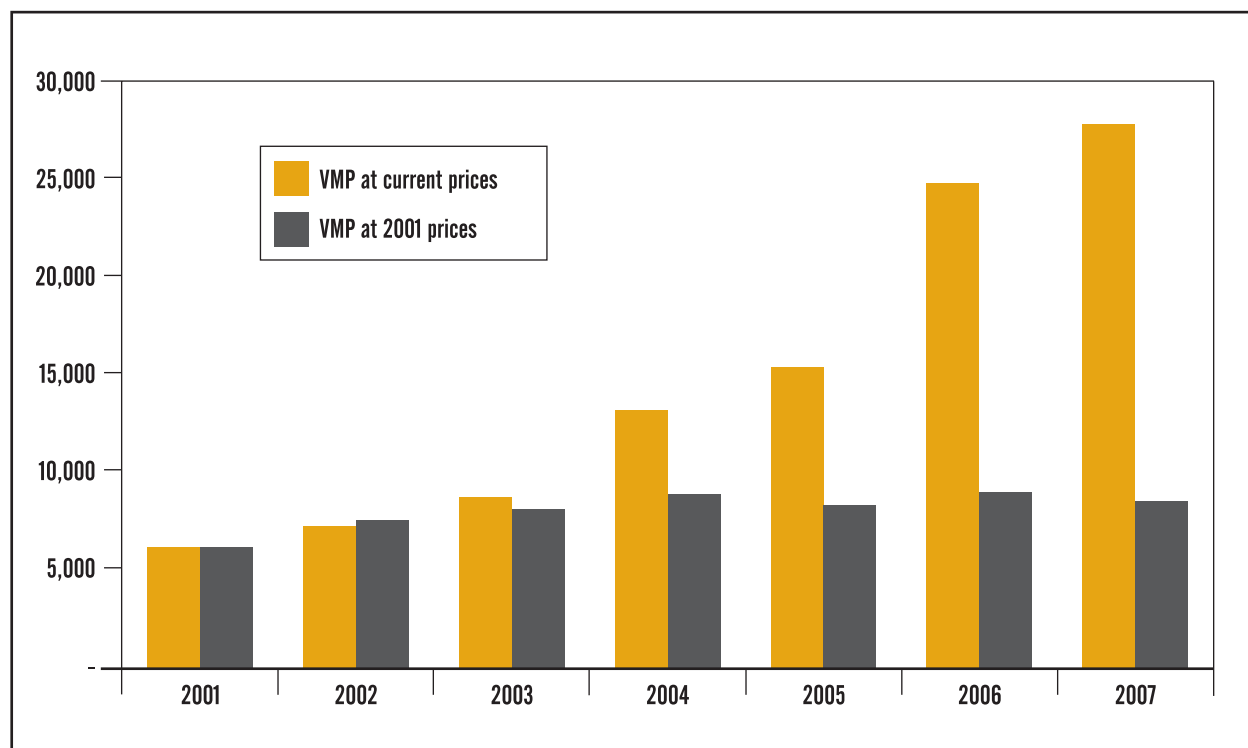
current circumstances, when prices are much higher than previous years. Therefore, VMP offers us an initial look about the performance of the companies in this sector.

The resources extracted- or the value of the extracted resources-, however, is not evenly distributed in the country's territory. At present, mining production is only developed in some departments that benefit from the distribution of the canon which comes from the income tax that companies pay to State.

The first semester of 2007, the VMP is concentrated in seven departments (Ancash, Arequipa, Pasco, Moquegua, La Libertad, Lima and Tacna), representing three fourths of the VMP (Ancash stands out with 22%, the greatest percentage). It is important to highlight that since 2006 the department of Cajamarca is ranked close to the top for its contribution to the VMP. Today, however, it is less important because of difficulties encountered by Yanacocha, the leading company in the department, to expand its operations due to resistance from a significant sector of local population. (See Table 1.3)

Chart 1.1

Evolution of the value of mining production. First semesters, 2001 – 2007
(millions of soles)



Source: Ministry of Energy and Mines; Banco Central de Reserva del Peru
Prepared by: Vigila Peru

Will this structure remain during the coming years? It is estimated that the VMP will remain steady because of the eleven mining companies that concentrate 60% of VMP only two will close from now until 2010. If we observe chart 1.2 we will see the majority of the mineral deposits will continue operating until 2015; including mineral deposits such as Antamina, Cerro Verde, Toquepala and San Rafael that will stay in operation beyond 2020.

However, in the mining sector there are possible projects of investment, and if they become a

reality, they can change the mining scenario of upcoming years. As observed in chart 1.4 the first four are mainly copper mines, similar to Tintaya (Cusco) or Cerro Verde (Arequipa). With an extraction average of 500 tons of copper and under current price, they will represent close to 100 millions of soles in mining canon for departments such as, Apurimac and Junin or Piura that do not receive considerable income from this source. These resources are estimated on the assumption that the projects start their operations.²⁰

20 The quarterly inflation reports issued by Banco Central de Reserva de Peru and the 2008-2011 Multi-annual Macroeconomic Framework highlight the fact that from an investment forecast by the private sector for 2007-2011 something between 10,000 and 12,000 million dollars, half would come from the mining sector.

Table 1.3

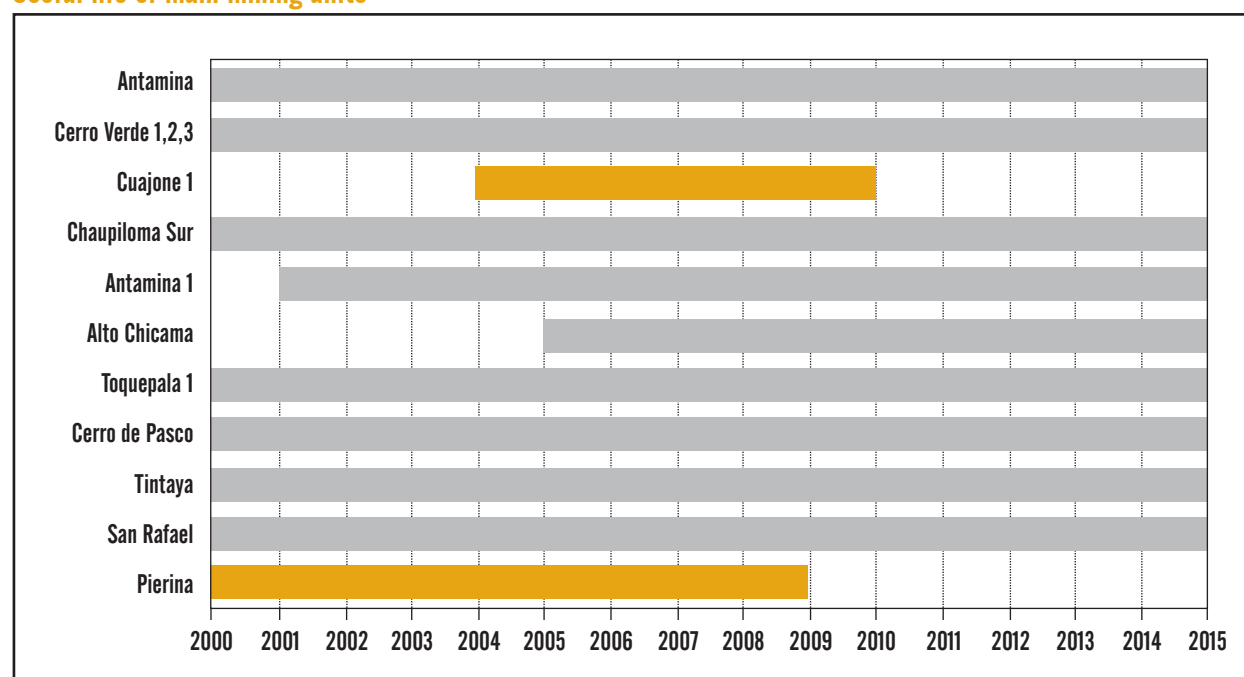
Value of mining production per region and mineral, first semester 2007
(Millions of soles)

Región	Copper	Gold	Zinc	Silver	Molybd.	Lead	Tin	Iron	Total	%	Accumul.
Áncash	3,102	495	1,536	342	406	73	-	-	5,954	22%	22%
Arequipa	2,333	681	25	196	-	15	-	-	3,250	12%	34%
Pasco	121	58	1,561	639	-	602	-	-	2,981	11%	44%
Moquegua	1,751	194	-	79	341	-	-	-	2,365	9%	53%
La Libertad	18	2,024	26	70	-	9	-	-	2,147	8%	61%
Lima	323	17	1,074	450	-	204	-	-	2,069	8%	68%
Tacna	1,575	3	-	44	388	-	-	-	2,009	7%	76%
Cajamarca	-	1,660	-	64	-	-	-	-	1,724	6%	82%
Cusco	1,083	47	-	27	-	-	-	-	1,157	4%	86%
Junín	64	-	622	284	-	103	-	-	1,072	4%	90%
Puno	13	41	17	30	-	10	813	-	924	3%	93%
Madre de Dios	-	607	-	-	-	-	-	-	607	2%	96%
Ica	-	-	-	-	-	-	-	305	305	1%	97%
Huancavelica	34	91	37	99	-	33	-	-	295	1%	98%
Ayacucho	157	24	66	21	-	19	-	-	287	1%	99%
Huánuco	34	-	68	38	-	44	-	-	183	1%	100%
Apurímac	-	36	-	87	-	-	-	-	124	0%	100%
Total	10,609	5,977	5,031	2,469	1,135	1,112	813	305	27,451		

Source: Ministry of Energy and Mines; Banco Central de Reserva de Peru
Prepared by: Vigila Peru

Chart 1.2

Useful life of main mining units



Source: Ministry of Energy and Mines
Prepared by: Vigila Peru

Table 1.4
Main mining projects

Mining Project	Region	Mineral	Investment (millions of dollars)	Useful life (years)	Current State
Las Bambas	Apurímac	Copper	1,500	20	Exploration
Toromocho	Junín	Copper	1,500	21	FS
Minas Conga	Cajamarca	Copper/Gold	1,100	14	EIS
Río Blanco	Piura	Copper	1,000	40	FS
Quellaveco	Moquegua	Copper	1,000	10	FS
La Granja	Cajamarca	Copper/Gold	700	15	Exploration
Michiquillay	Cajamarca	Copper/Gold	700	15	To be privatized
Yanacocha	Cajamarca	Gold	677	10	In execution
Cerro Verde	Arequipa	Copper	560	15	In operation
Fundición de Ilo y Tantahuatay	Moquegua	-	435	20	In execution
Los Chancas	Apurímac	Copper/Molybd	300	10	PS
Cerro Corona	Cajamarca	Copper/Gold	227	15	Construction
Tía María	Arequipa	Copper	150	10	Exploration

Source: Inflation report, Jan. 2007, Banco Central de Reserva

Prepared by: Vigila Peru

FS: feasibility study

EIS: Environmental Impact Study

PS: Prefeasibility study

How high will metal prices rise?
It seems that we will see good prices for a while

Prices of metals had a strong and unexpected increase during the last four years. Some, -such as molybdenum, copper and zinc - more than doubled their price in international markets as a result of strong demand, mainly from the Asian market.

In spite the fact that the forecast of different stock exchange markets mention a reduction in prices in the following months -between 10% and 15% in 3 to 27 months- a recent report by the Economic Commission For Latin America (CEPAL) on this regard²¹ forecasts that prices will not reduce in the next ten years, but that they will maintain in average their current levels.

In any case, projections regarding prices are letting us know that these will not experience drastic reductions in coming months, which means that the favorable scenario will remain in benefit of companies, and departments where mining production is significant, from which they receive important income through canon and royalties.

21 "Scenario of international insertion of Latin America and the Caribbean 2006. Trends 2007"

1.2. Company Results

With the figures on volumes of extraction, prices and values of production recently expressed an important question emerges: *how were things for the mining companies?* Understanding that in certain cases companies extracted the same as previous years and that their costs in relation to operations appear not to vary greatly, it is expected that in the worst cases their profits remain the same as before.

This is what in fact has occurred. According to the National Supervisory Commission of Companies and Securities (Conasev)²², the profits from companies in this sector have passed approximately from 13 000 million soles in 2005 to 23 000 million soles in 2006, which is an increase of 10 000 million soles. As stated above, almost in its totality this increase is the

result of the rise in prices, since the volumes and hence its cost, remained constant. This surplus can be catalogued as "extraordinary profits".

As of the first semester 2007, the economic result of the companies remain favorable, since all companies with the exception of Yanacocha and Compañía de Minas Buenaventura, have seen an average increase of 15% in net earnings between the first semester 2006 and similar period of 2007, even when among these companies this increase varied. (See Table 1.5). For instance; of the mining companies mentioned the large loss for Yanacocha can be explained because their sales were almost reduced in half, due to the reasons previously mentioned. Minas Buenaventura's²³ earnings by participation in other companies showed a reduction by 100 million dollars.

Table 1.5
Net earnings of mining companies
(millions of nuevos soles)

Company	2004	2005	2006	1 st sem. 2006	1 st sem. 2007	Variation 2007/2006
Antamina*	50	2,200	5,120	2,560	3,072	20%
Southern	2,241	3,009	4,161	1,749	2,102	20%
Cerro Verde	299	776	1,452	718	1,194	66%
Minsur	569	488	537	546	1,149	110%
Barrick	568	626	1,371	480	727	52%
Volcan	71	66	759	226	654	189%
Xstrata*	70	300	600	300	360	20%
Los Quenuales	94	122	538	179	280	56%
Yanacocha	1,331	1,770	1,854	1,262	272	-78%
Buenaventura	680	953	1,398	880	163	-81%
Others	1,409	2,509	5,156	2,409	3,058	27%
Total sector	7,382	12,820	22,947	11,310	13,030	15%

* estimated from the value of production

Source: Conasev

Prepared by: Vigila Peru

22 See <www.conasev.gob>.

23 Compañía Buenaventura participates in the shareholding of other companies such as Minera Yanacocha (43% of the shares) and Cerro Verde (18%) among other medium size mining companies.

As the figures show in Table 1.5, company earnings continue being high, in comparison to other years such as 2004 or 2005. This positive performance should be explained by payment of taxes that have been rising, which we will see in the following section.

1.3. Taxes and contributions

The State receives public resources such as taxes without generating any type of return. Hence, it collects different taxes, like the general sales tax, selective consumption tax, income tax, financial transaction tax, and Custom duties, among others.

In recent years, in accordance with a fiscal note by SUNAT,²⁴ revenues from the mining sector rose from 3% of total internal taxes²⁵ in 2001 to

27% of total first semester 2007, therefore, adding importance in the tax structure. Although it is true that the Peruvian economy experiences a cycle of growth, which is reflected in tax receipts, it is particularly the mining sector that represents greatest significance, which is due to favorable prices in this sector. In Table 1.6 we can see an increase in tax receipts from the mining sector of 150% between 2005 and 2006 and eleven fold if compared year 2002 to 2006. This trend is maintained because if we compare the first semester of 2007 and that of 2006, tax receipts of this sector increased 44%.

The income tax paid by mining companies – the basis of transfers to departments – experienced an even greater increase in the last three years than internal taxes. It increased not only in the amount but also in significance: from 2004 to 2006 it multiplied by 7, and during

Table 1.6
Internal taxes per economic activity, 2002-may 2007
(millions of nuevos soles)

Sector	2002	2003	2004	2005	2006	2006 1 st sem.(A)	2007 1 st sem.(B)	Variation B/A
Other services	7,671	8,689	9,808	10,818	12,871	6,784	7,166	6%
Mining	689	1,092	1,742	3,126	7,737	4,224	6,088	44%
Manufacturing	6,887	7,174	7,281	7,683	8,407	3,992	4,578	15%
Trade	2,290	2,597	3,065	3,627	4,349	2,222	2,680	21%
Hydrocarbons	321	656	995	1,381	1,859	1,018	986	-3%
Construction	544	754	666	851	1,157	593	797	34%
Fishing	115	139	202	250	243	174	223	28%
Agriculture	217	276	296	306	349	119	201	68%
Total	18,734	21,376	24,054	28,041	36,972	19,125	22,718	19%
Mining Participation	4%	5%	7%	11%	21%	22%	27%	

Source: Weekly Note, SUNAT
Prepared by: Vigila Peru

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

25 Internal taxes constitute revenues of the Public Treasury and taxes that go to other entities.

the same period it passed from 13% to 44% of the total income tax collected by SUNAT. To the first quarter of this year the figure has not changed, since the mining sector paid 2, 669 millions of soles of Income Tax, 55% more than previous year for the same period, representing 45% of total Income Tax collected. The estimate is that by the end of the year the mining sector will represent 50% of the IT collected. (See Graphic 1.3)

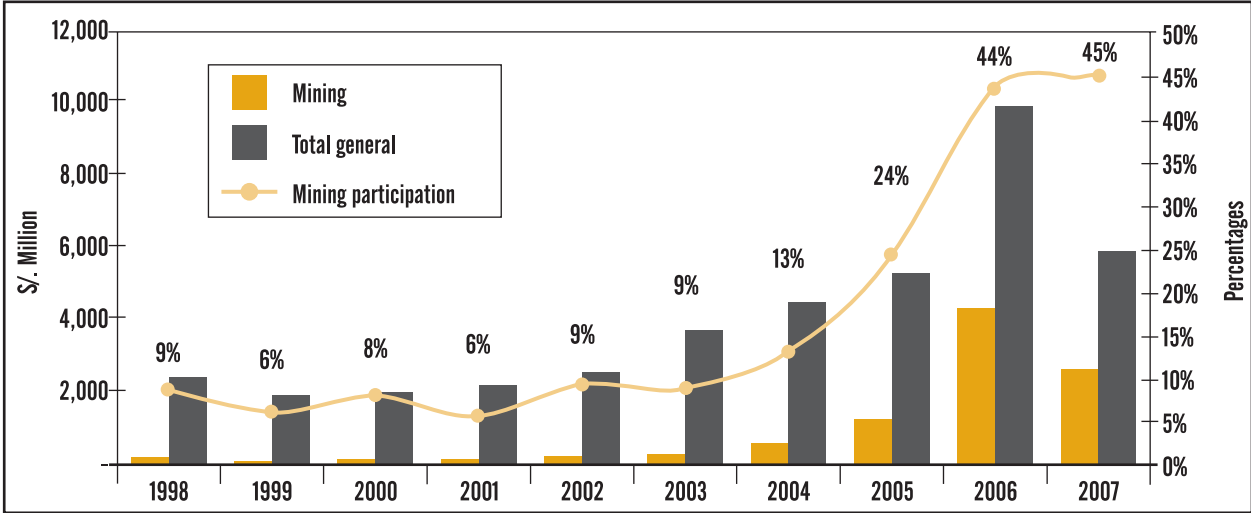
It is important to specify that in accordance with registered figures, the collection of internal taxes and those of the IT (income tax) refer to those taxes paid, not to those declared. In other words, there may be differences between what the companies have declared as tax, what they have to pay and is known as "determined taxes", and what they actually paid at the time of their tax return. The differences are regularized by installments or

are paid globally in April.²⁶. Briefly, from the information presented by SUNAT, it is difficult to know the amount generated by taxes in the different economic sectors in a specific year. This information allows us to see the trend of what is collected.

It is important to mention, as we will see later on, that the mining canon to be transferred is calculated through the determined tax and not the paid tax.

Another contribution of the mining sector provided by law are mining royalties²⁷ that according to SUNAT by the first semester of 2007 were 209.5 millions of soles, 64% more than 2006 during the same, when they reached 127.4 millions of soles. Recalling that royalties are a percentage of the value of the concentrated (mineral) (similar to the VMP estimate), paid by the mining companies as a valuable

Graphic 1.3
Revenue from total income tax and mining sector 1/



1/ only first semester for year 2007
 Source: Weekly Note, SUNAT
 Prepared by: Vigila Peru

26 When a company declares an amount as tax and pays a reduced amount, the difference is regularized with SUNAT and paid later in installments

27 SUNAT is authorized to execute all functions associated to its payment (section 7 of the La won Mining Royalties, Act 28258)

consideration for the use of a non-renewable resource.²⁸

In short, the contribution by the mining sector in terms of taxes and contributions is highly influenced more by favorable prices that determine increasing profits, than by the volume of extraction..

1.4. The generated revenue

In Peru, all economic activities generate revenue that is collected in part by the State through tax collection (taxes and other) and contributions. This revenue collected by the State has different destinations: payroll, purchase of goods and services, investment in development projects, payment of the debt, among others.

We have seen that the income generated by the mining sector increased since 2004, an event that is basically explained due to good prices of minerals and also because certain mining companies had recuperated their investment or did not enjoy anymore of certain tax benefits, a situation that at the time being, reduced tax payments.²⁹

The income generated by the mining sector has a unique treatment, i.e. 50% of the income tax is distributed between the producing departments under the concept of **mining canon**. The

remaining 50% remains in the treasury of the central government. Until 2006, after the year's IT was consolidated, in the coming month of April, the mining canon was distributed to the departments in 12 equal quotas, from June until May of the following year. This method of distribution was changed in 2007 by Congress, so now the canon from IT of year 2006 was transferred in one single quota in June.³⁰

The mining canon distributed to the departments can be monitored through the MEF system of economic transparency. In other words; we can see how much each regional or local government receives and in how these funds are used. One the other hand, no monitoring can be made to the 50% that stays with the central government because it forms part of the total revenues used for other ends.

According to Internet site 'Transparencia Economica'³¹, the revenue of the mining sector generated by the IT in 2006³² was 8,509 millions of soles, almost double the amount generated in 2005 (4,333 millions of soles) and 3.5 more times than that of 2004 (2,317 millions of soles). As previously mentioned, 50% of this revenue constitutes the mining canon and is distributed to the departments. Unlike revenue coming from the IT, mining royalties are transferred in their totality to the region in the following month of its calculation.

28 Mining royalties are paid according to the value of extracted mineral resource: up to 60 million dollars per year, mining companies pay 1%; more than 60 million up to 1 | 20 million dollars, they pay 2%; and for amounts higher than 120 million dollars, they pay 3%.

29 Due to juridical and tax stability agreements and to benefits as a result of these, many mining companies paid very little or paid no income tax because they re-invested their profits, applied accelerated depreciation or a double depreciation of their assets. The result was less revenues for the Treasury.

30 For more reference review <<http://www.participa.peruorg.pe/n-publicaciones.shtml>> the Nota de Informacion y Analisis No. 2 "Problems of canon transfers to regions and municipalities".

31 See <<http://transparencia-economica.mef.gob.pe/>>

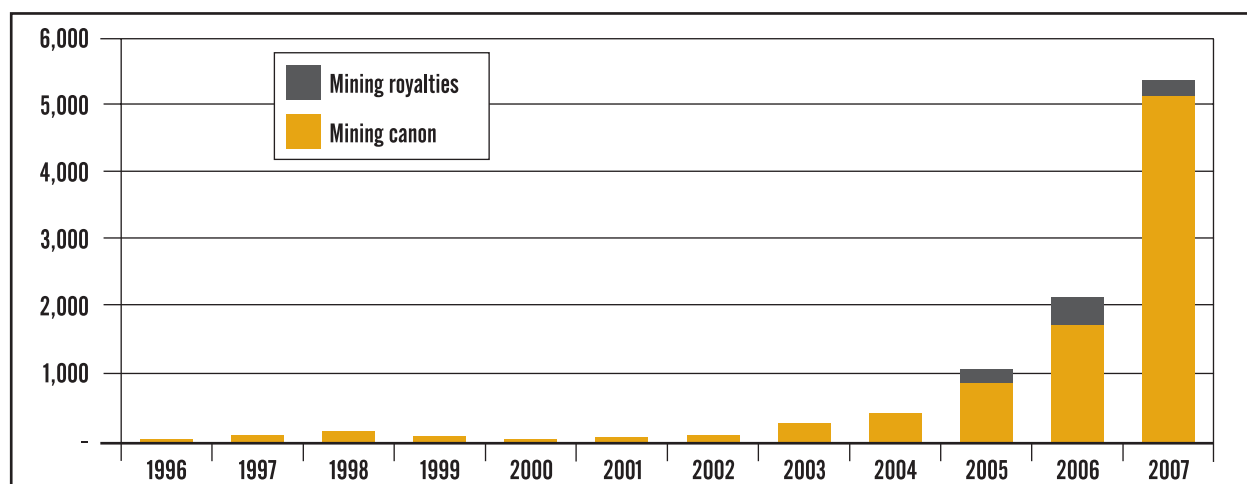
32 To estimate income generated in 2006, one adds the money transferred in June of this year, both to local and regional governments. For past years, add the twelve quotas that refer to these subnational governments for the mining canon and that come from IT.

1.5. Distribution of generated revenue to departments

At the first semester of 2007, 5,157 millions of soles were distributed to the departments as mining canon, almost tripling figures from 2006 (1,746 millions of soles) and almost six fold the amount transferred in 2005 (888 millions of soles). This increase in part is due to an increase of profits, but also to a change in the model of transfer (in one single quota instead of 12) as was

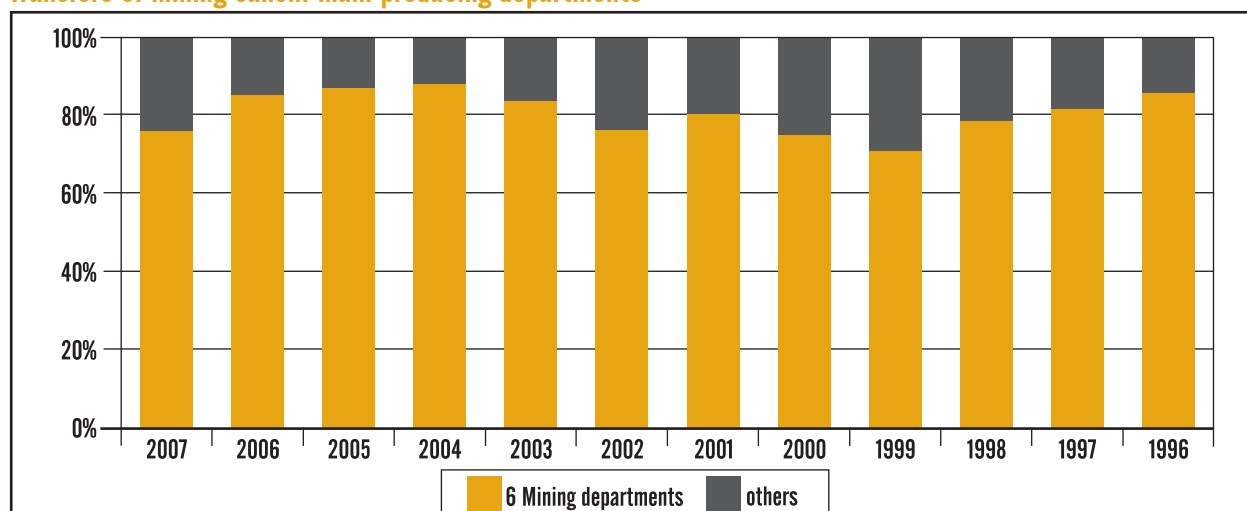
previously mentioned. If the same formula had been maintained -12 quotas- the amount transferred in 2007 would have reached 3,384 millions of soles, in other words, the trend would have been the same of the last three years, in which the amount had almost doubled that of the previous year. Therefore, it is clear that the change in the system had meant an additional increase because the transfer in one single quota included resources that would correspond to 2008 (5 months from January to May). (See graphic 1.4)

Graphic 1.4
Transfers of mining canon and mining royalties - 1996-June 2007
 (millions of soles)



Source: Transparencia Economica
 Prepared by: Vigila Peru

Graphic 1.5
Transfers of mining canon: main producing departments



Source: Transparencia Economica
 Prepared by: Vigila Peru

More resources in extracted value implies more transfers This is not always so: The Moquegua case

As companies extract more resources of a region (in value), it is expected that they will have more profit, and thus, according to law, more money should return to the region by way of the canon.

However, when a company has two mining units in operation but in different zones, the canon distribution is based on the proportion of **exploited minerals**³³, this is understood by the officials of MINEM as the volume of land turned-over that will enter the process of beneficiation (a process to obtain concentrated mineral of greater purity).³⁴

In 2006, of the departments of Moquegua and Tacna, Southern Peru Company obtained a similar amount of concentrated minerals, in volume and value, facts verifiable by the mining royalties, which is a percentage of value of concentrated mineral, which amounted to 107.3 millions of soles for the first and 108.9 millions of soles for the second. However, in June of 2007 when the canon generated in 2006 was distributed in 2006 Moquegua received 362 million soles and Tacna 610 million soles. Why if similar amounts of concentrated ore in terms of value were obtained from those two departments, they ended up receiving each so different transfers?

The reason is that the reserves in Tacna are of less purity than in Moquegua, therefore, to obtain a unit of concentrated copper, it is necessary to turn-over more land in Tacna, and as the canon is calculated in terms of turned-over land, hence Tacna receives more canon.

From the foregoing, there would be the need to revise this criterion used to distribute the mining canon, in a way that the amount transferred is directly related to the value of the concentrated ore obtained from each territory.

As far as mining royalties is concerned, as of the first semester 220 million soles have been transferred i.e. 91% more than in 2006 (115 millions of soles). It is estimated that at year's end the royalties will be close to 600 million soles. The increase of transfers from mining royalties is explained mainly by an increase of prices since these royalties are a percentage of the value of concentrated ore.

The distribution of the mining canon under the same scheme as previous years but with greater amounts, led to the concentration of resources in few departments. The six departments which receive the most (Ancash, Tacna, Cajamarca, Moquegua, Pasco and Puno) concentrated 80%

of the transfers of 2007. If we include La Libertad and Cusco such concentration reached 88%. (See graphic 1.5)

1.6 Distribution of the mining wealth

The discussion on the revenue generated in the mining sector and later transferred to the departments has focused on the fact that "the regions have more resources than ever before", to the point where the regions do not know what to do with them. This statement is true if we compare transfers during the last three years with those of 2005. But, how do these transfers compare to the profits of these companies?

33 Supreme Decree 005-20021-EF. Regulations of the Canon Act, Section 2, Referente Basis of canon.

34 Supreme Decree 157-2002-EF. Regulations of the Mining Royalty Act, Section 2, Definitions.

Throughout this chapter we have seen how the value of the extracted resource has increased, which results in an increase in tax payments, of mining canon and of transfers. When comparing these variables we see that while the departments have more resources available than ever before, the companies obtained very high profits, and in many cases without significantly raising their levels of extraction.

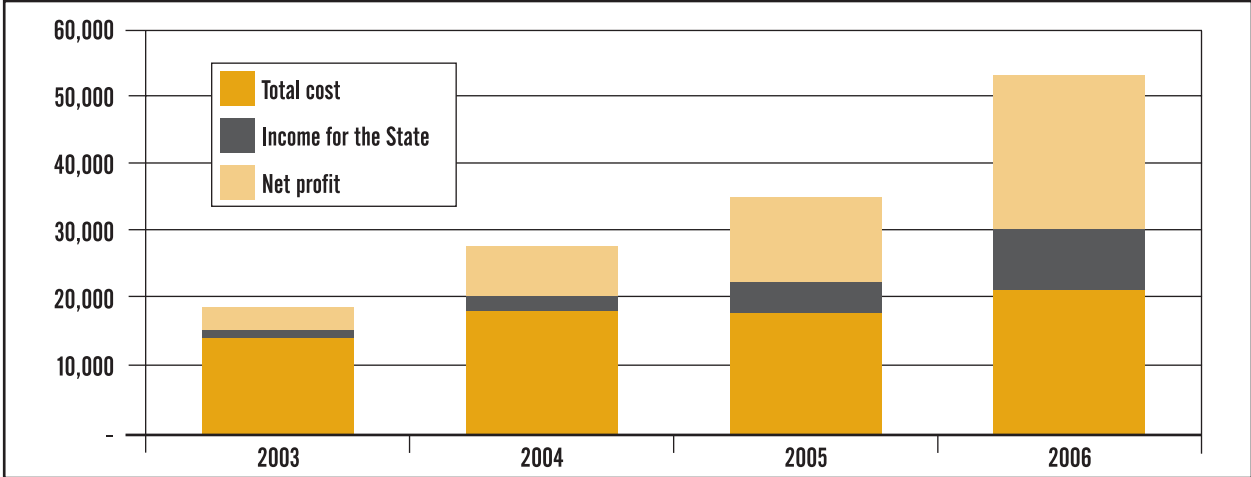
Breaking up the value of production

As mentioned, the value of production helps us estimate the value of the extracted resources. In a situation where prices are very good, this can be a first glance at the sector; and its dynamics is very similar to the sales of mining companies. So if we subtract from the VMP, the net profit of the company and the revenue for the State (which includes 50% from IT that remains with the central government, the mining canon, mining royalties, and the surplus of profit participation by workers), the remaining is the total cost of the company.

So, looking at graphic 1.6 we can see that the total cost maintains a level in accordance with the levels of extraction, where increases were much less than those registered by the prices. In addition, total costs did not experience strong variations, since technology has remained invariant. Instead of that, company profits and State revenues have indeed increased. The net profit that in 2003 represented only an 18% of the VMP, in 2006 represented 43% of the VMP, a ratio very similar to that mentioned earlier with respect to sales. The State revenues also increased, although not in the same proportions if we compare with what remains in the companies: it passed from 6% of the VMP in 2003 to 18% in 2006.

Considered so, the State and the regions have available resources like never before; but mining companies have even higher profits. Therefore, the State cannot give up a greater participation of the income from mining resources, and feel pleased with a voluntary contribution that represents only 5% of the extraordinary profits of the companies.³⁵

Graphic 1.6
Breaking up the value of mining production (million soles)



Source: Ministry of Energy and Mines; Banco Central de Reserva del Peru, Conasev, Transparencia Economica
Prepared by: Vigila Peru

35 For more reference, see in <<http://www.participaperu.org.pe/n-publicaciones.shtml>> Nota de Informacion y analisis No. 5: "Extraordinary profits and voluntary contribution. Who wins, who loses?"

The Voluntary contribution

A year after its announcement, it moves at turtle-pace, and with very little transparency

At the beginning of its administration, the Aprista government negotiated with mining companies an agreement by which the companies committed -in a voluntary, extraordinary and temporary manner - 3.75% of their net profits, for the following 5 years, to the creation of local and regional funds. These contributions will be conditioned to prices of metals above certain limits, and 64.4% is to be discounted in case the company had paid mining royalties. After almost one year of signing this agreement, what is the state of its implementation?

The agreement was entered into in December of 2006 by means of DS 071-2006-EM, under the name Programa Minero de Solidaridad con el Pueblo. The norm states the private nature of the funds, which resources should be put towards nutrition, education, health, capacity building, promotion of productive chains and basic infrastructure, among other areas. The deadline for the creation of the funds is April 30th of each year. In addition, technical coordination commissions will be created and will be in charge of developing the projects. The companies have simple majority in these commissions, what gives them the control of the decisions.

By the end of the first semester of 2007, 35 agreements were entered into and 39 local and regional funds were created by an amount totaling 517.9 million soles (see Table 1.8). Still pending is the agreement of six mining companies. In the departments where we do surveillance, the information on the progress of this program is limited. Due to the private nature of this fund; companies are not obliged to provide information requested by local institutions. This information was also not available through the Ministry of Energy and Mines. The little information available is what we describe here.

In Ancash, the most important fund is the Fondo Minero Antamina (regional and local) with 64 million dollars that started operating in May. During the first semester, 20 projects were given priority by a total amount of 13 million dollars; i.e. there is an extra 4 million dollars still under negotiation or waiting for final determination, which results in a total of 17 million dollars. The administration of this fund is entrusted to a Technical Coordination Commission, both local and regional, but it has not been possible to gather more information concerning this fund.

In Arequipa the Minero Cerro Verde Mining Fund is in a standstill because there is no agreement between the company and the local authorities because it is unclear whether or not this fund is separate from the 50 million dollar contribution which was previously agreed (in July 2006) for sanitation plant studies. In the case of the funds of Minas Buenaventura, the company decided to grant the resources to local governments of Carveli and Castilla, and the Regional Government of Arequipa as well.

In Cajamarca, the Yanacocha fund is the only one in existence. The 21 million dollars resources are being administered by the Asocacion Los Andes-Cajamarca. Seven action programs have been given priority (social development, health, road infrastructure, water, tourist development, capacities and productive chains) and twelve projects have been identified.

In Moquegua, the regional and local fund initiated by Southern, amounted to 51.9 million soles, created in December of 2006. The studies and the execution of projects are headed by the Asocacion Civil "Ayuda del Cobre."

In Cusco, the Xstrada Tintaya Fund was signed in March of 2007, and it being commonly referred to as the Convenio Marco de la Provincia de Espinar, of prior existence and which resources amount to 44 million soles

In Ica, it is only known that the agreement was signed in January of 2007. There is no available information in regards to any fund in La Libertad

Briefly, it is worrisome that in the majority of cases information about the implementation of the programs is so restricted, to the point that even the State lacks information. It is known by all that voluntary contribution is only the way that the Aprista government and the companies have found to elude the application of taxes on extraordinary profits and demand universal payment of the royalties. To our understanding these funds are "quasi public"; therefore citizens have the right to inform themselves about the way they are being managed.

Table 1.7

Companies that have entered into voluntary contributions agreements (thousands soles)

	Company	Región	Local Fund	Regional Fund	Total
1	Compañía Minera Antamina S.A.	Áncash	150,936	54,886	205,822
2	Compañía Minera Ares		-	-	-
	U.O. Ares	Arequipa	210	839	1,048
	U.O. Arcata	Arequipa	68	273	342
	U.O. Selene - Explorador	Huancavelica	142	568	710
3	Minera Aurífera Retamas S.A.	La Libertad	192	767	959
4	Compañía Minera Santa Luisa	Áncash	2,905	1,153	4,058
5	Minera Colquisiri S.A.	Lima	883	1,137	2,019
6	Southern Perú Copper Corporation	Tacna/Moquegua	10,382	41,528	51,910
7	Compañía de Minas Buenaventura	Arequipa	319	1,171	1,490
8	Sociedad Minera El Brocal	Pasco	824	3,297	4,122
9	Compañía Minera Raura	Huánuco	219	877	1,097
10	Consortio Minero Horizonte	La Libertad	196	783	978
11	Minera Yanacocha S.R.L.	Cajamarca	51,248	18,636	69,883
12	Aruntani S.A.C.	Moquegua	255	1,018	1,273
13	ARASI S.A.C.	Puno	232	400	632
14	Compañía Minera Caudalosa	Huancavelica	396	144	539
15	Sociedad Minera Cerro Verde	Arequipa	38,821	14,116	52,937
16	Compañía Minera Condestable	Lima	95	382	477
17	CEDEMIN		38	99	137
18	Xstrata Tintaya	Cusco	35,200	9,215	44,415
19	Compañía Minera Argentum	Junín	258	1,031	1,289
20	Pan American Silver-Mina Quiruvilca	La Libertad	341	1,363	1,704
21	Minera Pampa de Cobre	Moquegua	54	217	271
22	Compañía Minera Milpo	Pasco	7,614	2,769	10,383
23	Compañía Minera Atacocha	Pasco	529	2,118	2,647
24	Minera Barrick Misquichilca		-	-	-
	U.O. Pierina	Áncash	8,818	3,207	12,025
	U.O. Alto Chicama	La Libertad	2,587	10,349	12,936
25	Shougang Hierro Perú	Ica	590	2,361	2,951
26	Compañía Minera Poderosa	La Libertad	96	224	320
27	Minera San Simón	La Libertad	58	230	288
28	Minera Doe Run Perú		-	-	-
	U.O. La Oroya	Junín	4,044	1,471	5,515
	U.O. Cobriza	Huancavelica	841	306	1,147
29	Minera Los Quenuales	Lima	14,745	5,147	19,892
30	Minera Perubar	Lima	970	796	1,767
31	Catalina Huanca Sociedad Minera	Ayacucho	Did not generate profits in period 2006		
32	Minera Bateas	Arequipa	Did not generate profits in period 2006		
33	Minsur	Puno	Pending indication of advance contribution		
34	Minera Huallanca	Áncash	Did not generate profits in period 2006		
35	Compañía Minera Castrovirreyna	Huancavelica	Did not generate profits in period 2006		
Sub total			335,107	182,876	
Total			517,984		

Source: Ministry of Energy and Mines
Prepared by: Vigila Peru

II. THE GENERATION OF FISCAL REVENUE AND ITS DISTRIBUTION IN THE HYDROCARBON SECTOR



In this chapter we will analyze the factors that lead to the increase or decrease of revenues generated by the exploitation of hydrocarbon resources, afterwards distributed to producer departments.

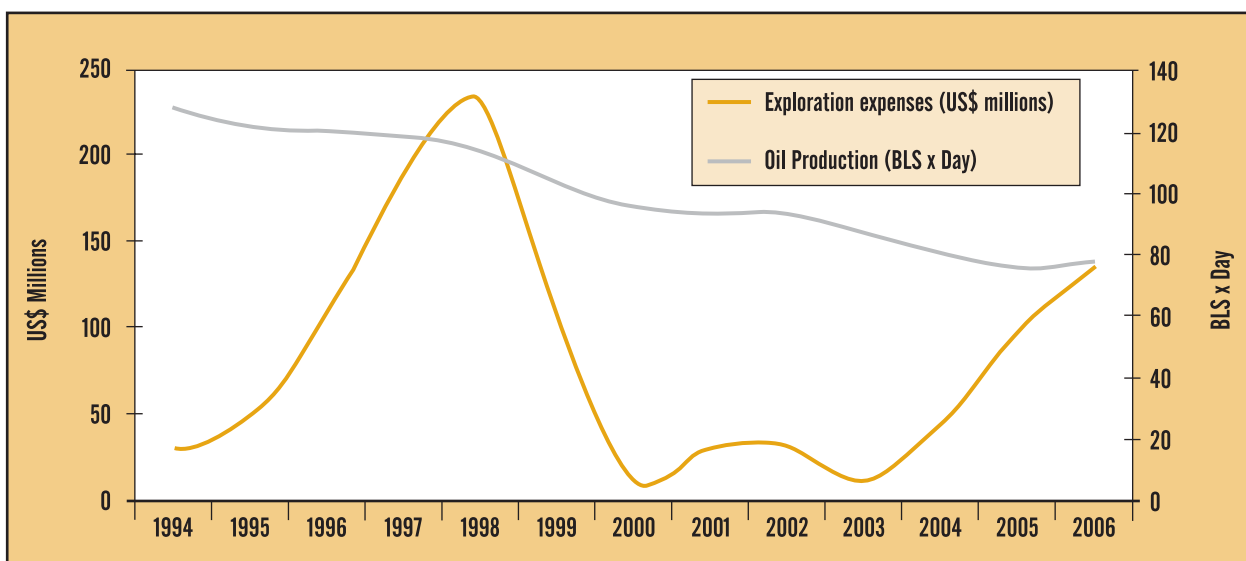
2.1. A National Overview of production and prices

The national production of hydrocarbons, as we have been reporting has decreased progressively as a result of the exhaustion of the wells and little investment in exploration in recent years, which did not produce expected results. This brought about a progressive drop in production since the beginning of the 90's, a trend that was counteracted in part due by the

commencement of the Camisea project in June of 2004 for the production of natural gas (GN) and liquid gas (LGN). In the case of oil, since 10 years ago the trend has been the fall in production, which was stopped in part by the discovery of new oil reserves between June and August of 2006 (See graphic 2.1)

To first semester of 2007 the national production of oil did not register a major variation in respect to the same period of 2006, since it passed from 13.9 million barrels to 14.1 million barrels a 1.2% increase. This can be explained by the small increase in the well productions located in the forest (8y 1 AB) and in the continental platform (Z-2B), also Lot X (Piura) The volume of extraction of the smaller oil wells, in contrast, is decreasing.

Graphic 2.1
Oil production versus exploration expenses



Source: Perupetro
Prepared by: Vigila Peru

On the other hand, LGN's level of production is the same since 2005; however, in recent months it has had many problems due to defects in the LGN³⁶ Camisea ducts which lowered production in various occasions. Thus, production reached 6.5 million MMBTU³⁷ in the first semester of 2007, 1.2% less than the same period in 2006 when it reached 6.58 millions of MMBTU.

With respect to GN's production, it increased considerably due to a greater demand in the industrial sector, domestic and vehicles, because it is a cheaper resource than others.³⁸ It passed from 26.5 millions MMBTUs in the first semester

of 2006 to 42.6 millions MMBTUs in the first semester of 2007, i.e., it rose 61%. The use of GN has extended in Lima, where the number of consumers doubled between June of 2006 and the same month of 2007 from 3,256 to 6,453 users, which elevated the distribution of GN from 3,681 millions cubic feet to 4,489 cubic feet in the same period.

A Regional Look

The production of hydrocarbons is concentrated for many years in Loreto and Piura. From 2004, Cusco became an important producer due to the Camisea project. The importance of the

Table 2.1
Domestic production of hydrocarbon,³⁹ first semesters 2001-2007
Oil-LGN (millions of barrels) / Gas (millions MMBTUs)

Año	Petróleo	LGN	Gas
2001	33.1	1.3	12.6
2002	33.9	1.5	16.1
2003	31.9	1.5	19.8
2004	30.7	4.7	33.0
2005	26.9	13.1	56.1
2006	28.3	13.9	67.8
2006, 1 ^{er} semestre	13.9	6.6	26.5
2007, 1 ^{er} semestre	14.1	6.5	42.6
Variación	1.2%	-1%	61%

Source: Perupetro
Prepared by: Vigila Peru

36 Monthly reports of hydrocarbon production, Ministry of Energy and Mines. See <http://www.minem.gob.pe/hidrocarburos/estad_inicio.asp>.

37 MMBTU: millions of BTU (British Thermal Unit). A BTU represents the amount of energy needed to rise one degree Fahrenheit the temperature of a pound of water in normal atmospheric conditions. A cubic feet of natural gas emits 1,000 BTU in average, although the interval value is between 500 and 1,5000 BTU.

38 A gallon of gasoline of 97 octanes costs an average of 16 soles, while a gallon of natural gas for vehicles (GNV) is 8 soles in average. Another example: for households in Lima, a gallon of gas (that lasts an average of 15 days) costs 32 soles, while the supply of gas for a similar period would cost approx. 6 soles.

39 Perupetro' statistics do not include production of Lot XX, developed by Petrolera Monterrico that stated operating in March 2007 and that extracted 7,853 barrels its first semester, i.e. 0,06% of the total production. This data it reported by the Ministry of Energy and Mines.

geographic location lies on the fact that after extraction and later valuation, a percentage of the latter returns to the region by means of oil and gas canon. This means that to greater resources at greater prices, more transfers. It is important to stress that the difference with the mining canon in comparison with the oil canon does not depend on the financial-economic results of the company but on the value of the resource extracted.

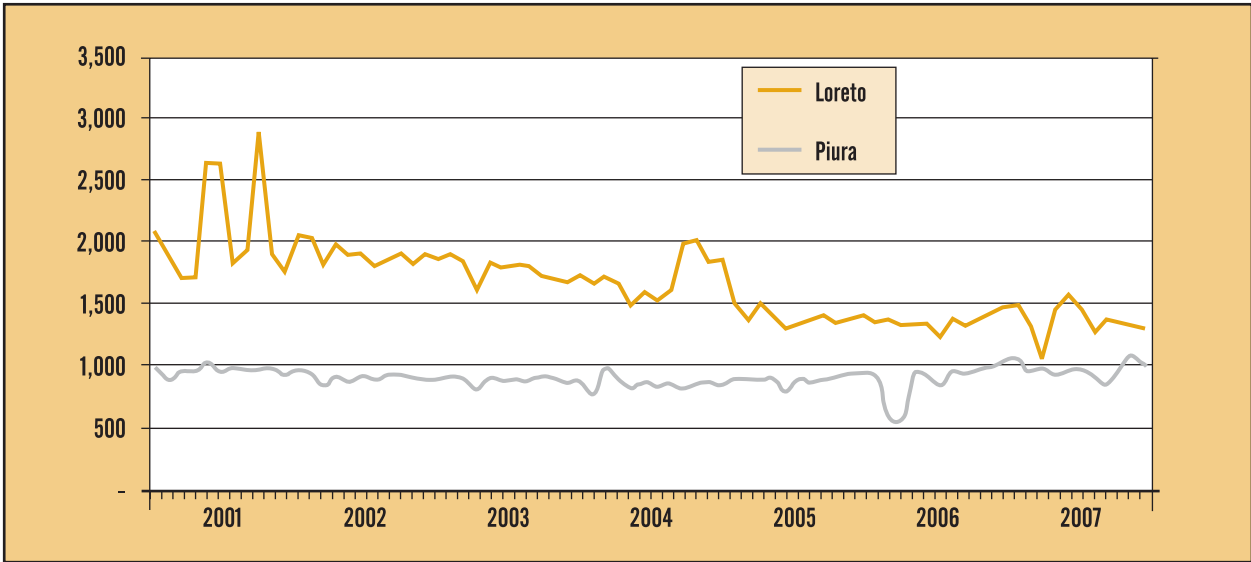
The oil production in Loreto, as was previously mentioned, is reducing as a result of exhaustion of its wells 8 and 1-AB, which production fell more than 30% between 2001 and 2006. As of the first semester of 2007 the production of the department reached 8.20 millions of barrels, similar volume as the same period in 2006 when it reached 8.17 million. It is important to point out that between June and August of 2006, new

oil wells were developed: Shiviayacu 1604D, and Lot 1-AB, and Yanayacu 230314 of Lot 8, which softened the gradual production fall in the department.⁴⁰ As of the first semester of 2007 Loreto generated 58% of domestic production; however in 2000 it had reached 70%.

Another example is Piura where the production has remained steady since 2001 and in fact it has increased in large part due to the San Pedro lot Z-2B and the reconditioning of wells in lot X. Therefore, production passed from 5.70 millions of barrels in the first semester of 2006 to 5.84 millions for the same period in 2007 which represents a slight increase of 2.5%

Finally, the production in Huanuco -lot 31-D, developed by Maple- also represents a steady fall due to the exhaustion of the resource:

Graphic 2.2
Monthly production of oil, 2001-June 2007
(thousands of barrels)



Source: Perupetro
 Prepared by: Vigila Peru

40 The development of these new wells has meant problems with neighboring communities; in the last quarter of 2006, production dropped due to conflicts with them. Production report of Ministry of Energy and Mines, see <http://www.minem.gob.pe/hydrocarbons/estad_inicio.asp>

between 2001 and 2007 it lost 30% of its operating capacity. Its influence remains marginal and only represents 0.1% of the national total. The first semester of 2007 it produced 16.6 thousand barrels, 12.3% less than the same period the previous year when production reached 18.9 thousand barrels.

Briefly, recent discoveries have not been able to reverse the decreasing trend of the production of oil in the last 10 years. However, with respect to official estimates, this scenario will change in the following three years with the exploitation of lot 67 located in the river basin of Marañon, in the region of the Amazon. Then, Peru will become an oil exporter country.⁴¹

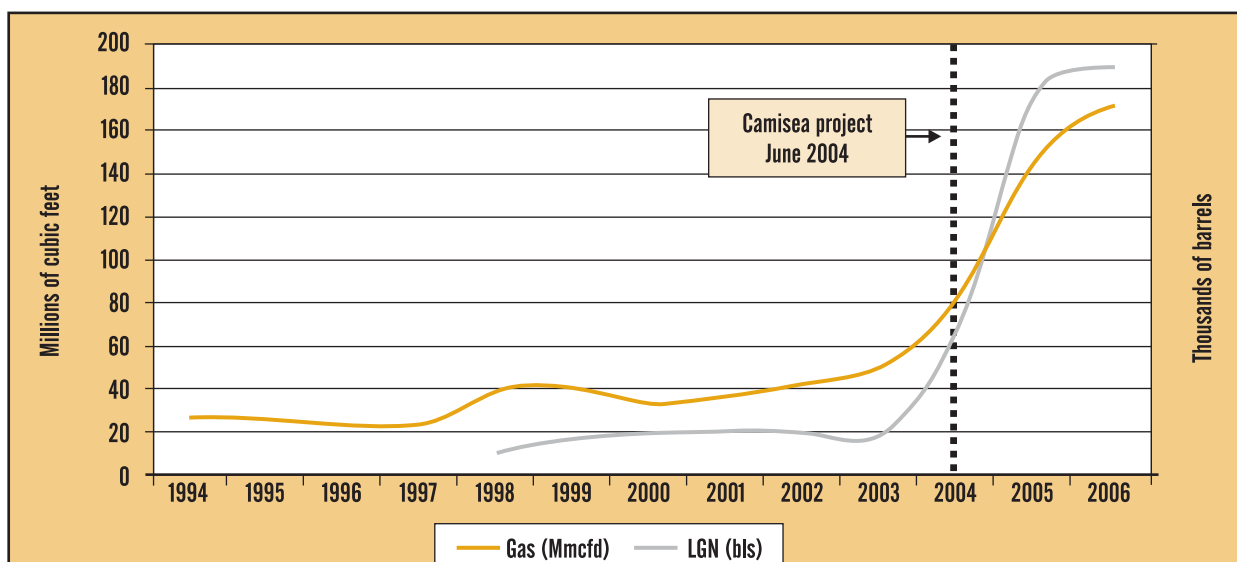
Unlike the oil scenario, production by GN and LGN has been strongly promoted by the

Camisea project. As of the first semester of 2007, Cusco produced 71% of GN of the country and 91% of LGN (See graphic 2.3)

With regard to GN, lot 88, located in Cusco, it increased from 14.6 million of MMBTU in the first semester of 2006 to 30 million MMBTU in the same period of 2007; i.e. a 105% increase. The production of lot 31-C, located in Ucayali, increased from 5.5 million to 6.2 million MMBTU during the last two semesters. Finally, the production of the lots located in Piura remained at the same level in the last two semesters (6.3 million MMBTU).

As to LGN, the production of lot 88 remained steady during the first semesters of 2006 and 2007 (5.9 millions of MMBTU). The production of Ucayali, instead, dropped 11% (from 616 billion MMBTU to 547 billion MMBTU).

Graphic 2.3
Production of natural gas and liquids of natural gas 1994-2006



Source: Perupetro
 Prepared by: Vigila Peru

41 Perupetro official estimates. El Comercio, December 13, 2007.

Main projects in the hydrocarbon sector *To keep in mind*

As previously mentioned, the production of oil in the country is decreasing as compared to what is occurring with the GN and LGN. In terms of production projects, so far there are only two identified projects: Camisea II for GN and LGN and Lot 67 for oil.

According to the last report of Estadística Petrolera 2006 issued by Perupetro in December 2006 there were 42 exploration contracts (34 in the forest and 5 in the continental platform). It is worth pointing out the number, because there were 28 in 2005 and only 14 in 2004.

However, there is a policy on concessions that results dangerous since some are superimposed on natural reserved areas. According to the Observatorio de Actividades Hidrocarburíferas in Peru,⁴² in December of 2003 the area under concession for hydrocarbon activity represented 5% of the Peruvian Amazon territory, and by 2007 instead, this percentage reached 67%. The fact is that many of these zones under concession are superimposed on reserved areas or reserved territory projects which as a consequence caused that in public bidding of nineteen oil lots in July 2007, six did not rise any interest among investment companies due to this situation.

The behavior of the prices

As was mentioned in the foregoing report, the difference in the oil sector (abundant and cheap) and the other of relative scarcity (due to higher world demands) and above all of uncertainty, in an environment of insecurity and conflict in producer areas, has had a direct repercussion in the constant rise of its price that already surpassed the barrier of 70 dollars per barrel.⁴³

Although in each well exists a basket of prices that values the resource extracted in relation to referential international prices, the quality of the resource, transportation and other factors, the value of the baskets of oil have remained the same without significant variations. So, the oil extracted from Huanuco and Loreto downwards results and the oil from Piura increased the price in most of the lots, except in II and Z-2B. (See Table 2.2)

On the other hand, the prices of GN and LGN have displayed different results, in relation to production and demand of each. While the price of LGN has increased from 57.9 to 62.6 dollars a barrel due to demand, GN did not change significantly and was around 1.8 dollars per barrel (MMBTU) in the first semester of 2006 and 1.6 dollars (MMBTU) in the first semester of 2007. It is important to highlight the lowering of the price of GN in the case of Lot 88, where the price reduced by 13.4% if compared to the first semesters of 2007 and 2006, respectively.

The value of production

Unlike the mining sector, where the value of production is an estimated variable, in this case it is calculated in an official manner, since each lot has a "well price" that values the extracted resource.⁴⁴ So, according to figures from the Perupetro, the value of the production of hydrocarbons (VPH) during the first semester

42 See www.observaperu.com.

43 At the closing of this report, the price of oil kept mounting: close to 100 dollars per barrel both in New York and London. This increase is the result of tension in the Middle East region.

44 According to regulations for the application of royalties and retribution in oil contracts (DS 049-93-EM)

Table 2.2

Baskets of prices per lot and resource, first semesters 2006 and 2007

Resource	Region	Lot	2006	2007	Variation
Natural gas (US\$ × MMBTU)	Cusco	88	1.8	1.6	-13.4%
	Ucayali	31-C	3.1	3.4	9.1%
	Piura	I	1.2	1.2	0.0%
		VII/VI	2.0	2.0	0.0%
		X	2.8	2.8	-0.4%
		XIII	7.3	7.7	5.6%
Z-2B	4.8	5.2	7.7%		
LGN (dollars x barrel)	Cusco	88	57.3	62.6	9.3%
	Ucayali	31-C	57.9	61.9	6.7%
Oil (dollars x barrel)	Huánuco	31-D	72.6	71.7	-1.2%
	Loreto	8	62.5	60.3	-3.5%
		1-AB	59.1	56.3	-4.8%
		31-B	72.6	71.7	-1.2%
	Piura	I	66.2	67.7	2.3%
		II	68.4	66.4	-2.9%
		III	68.0	68.5	0.7%
		IV	68.0	68.5	0.7%
		IX	66.2	67.7	2.3%
		V	66.2	67.7	2.3%
		VII/VI	68.0	68.5	0.7%
		X	68.0	68.5	0.7%
		XV	69.2	69.6	0.7%
	Z-2B	71.6	68.7	-4.1%	

Source: Perupetro
Prepared by: Vigila Peru

of 2007 reached 3,746 million soles, 4% less than during the same period in 2006, when it reached 3,915 million soles. El VPH is explained by 92% of oil and LGN whose prices and volumes have not evidenced any major variation, which explains the little variation of the VPH in spite of the fact of a strong increase of volume of GN extracted.

A percentage of VPH goes back to the region through the oil canon and 10% goes to the departments of Loreto, Piura and Huanuco and an additional 2.5% to departments Ucayali and Tumbes as oil overcanon. The region of Cusco receives as gas canon 18.62% of VPH as gas

royalties and 50% of income tax paid by the operator of the project.

So, except for Cusco, the VPH for each region was reduced in the first semester of 2007 which means that the departments have received less for canon. The VPH of Loreto reached 1,457 million soles, 10% less than the same time period in 2006 (1,628 million soles); in Piura it was reduced by 5% when it reached 1,211 million soles, while in 2006 it reached 1,280 million soles. In Huanuco it was reduced by 21% since it reached 3.24 million soles while in 2006 it reached 4.10 million soles. In the case of Cusco the situation was different: it reached 1,075

Table 2.3

Value of hydrocarbon production per region, 2001-first semester 2007
(million soles)

Región	2001	2002	2003	2004	2005	2006	1 st sem. 2006	1 st sem. 2007	Variation %
Loreto	1,406	1,732	1,839	1,857	2,377	2,772	1,465	1,295	-12%
Piura	940	1,017	1,135	1,381	1,838	2,583	1,280	1,211	-5%
Cusco	-	-	-	468	1,736	2,132	1,004	1,075	7%
Ucayali	143	181	223	241	349	351	163	163	0%
Huánuco	4	4	4	5	8	8	4	3	-21%
Total	2,492	2,933	3,200	3,953	6,306	7,846	3,915	3,746	-4%

Source: Perupetro
Prepared by: Vigila Peru

million soles, 7% more than the same period of 2006 when it was in 1,004 million soles. (See Table 2.3)

If we break up the VPH of departments by product, as mentioned earlier, liquid hydrocarbon, oil and LGN represented 92% (65% oil and 27% LGN).

On the other hand, if we look at VPH by lot we find that Lot 88 (the Camisea project), is the one that contributes the most and concentrates 29% of total VPH, followed by: 1-AB and 8, both in Loreto, that contribute 20% and 14%. The lots Z-2B and X, located in Piura contribute each 13% of the total. (See Table 2.4)

2.2 Resources for the State and the regions

In a similar manner to that of the mining sector, the Central Government and the departments benefit from the revenues collected from the exploitation of hydrocarbons. However, as we have mentioned, what goes back to the departments does not depend on economic-financial reports of the companies in the sector, but is a percentage of production value. In other words, under this system there is a capture of the price increase effect in a direct manner.

Tax revenues

As we have seen in the previous chapter, all of the economic sectors contribute resources for the treasury by way of taxes that companies pay for various transactions they make. Thus, the collection of internal taxes from the hydrocarbon sector has been reducing since 1998 as a result of less extraction; a trend that changed progressively since 2003 until now, as a consequence the increase, although it was only in 2006 when production had a slight increase. As of the first semester of 2007 tax collection reached 986 million soles, 3% less than the same period in 2006, it reached 1,018 million soles (See Graphic 2.4).

Generated Resources

The State, in addition to revenues from tax collection in the sector, receives income as royalties collected for the extraction of resources. Through Perupetro, the State enters into exploration and development agreements and sets forth the conditions for extraction and payment for the resource. These contracts can take two forms:

- a) a **license contract** when the State transfers to companies the right of property on the

Table 2.4

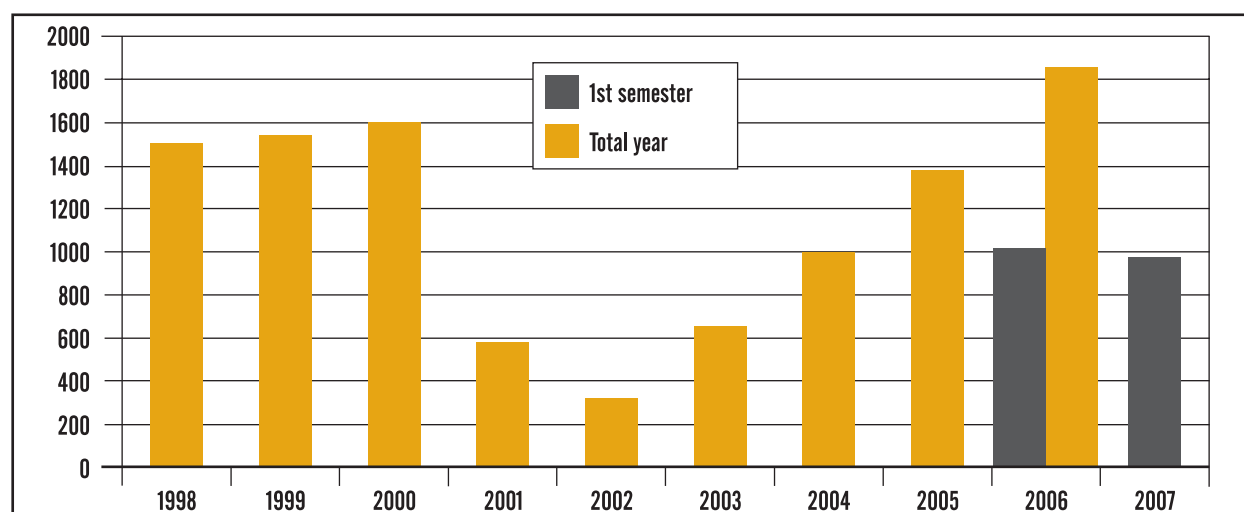
Value of hydrocarbon production, first semesters per region, 2001-first semester 2007
(million soles)

Region	Lot	2006				2007			
		Gas	LGN	Oil	Total	Gas	LGN	Oil	Total
Cusco	88	74.2	929.6	-	1,003.8	144.3	930.7	-	1,075.0
Huánuco	31-D	-	-	4.1	4.1	-	-	3.2	3.2
Loreto	8	-	-	578.1	578.1	-	-	515.5	515.5
	1-AB	-	-	872.1	872.1	-	-	767.1	767.1
	31-B	-	-	14.9	14.9	-	-	12.2	12.2
Piura	I	2.1	-	29.6	31.8	2.5	-	27.4	29.8
	II	-	-	21.0	21.0	-	-	17.8	17.8
	III	-	-	35.3	35.3	-	-	30.9	30.9
	IV	-	-	40.5	40.5	-	-	47.0	47.0
	IX	-	-	10.0	10.0	-	-	9.4	9.4
	V	-	-	4.8	4.8	-	-	5.4	5.4
	VII	-	-	-	-	-	-	-	-
	VII/VI	2.8	-	117.5	120.3	2.5	-	100.7	103.2
	X	15.3	-	475.4	490.7	14.6	-	455.6	470.2
	XIII	7.0	-	0.0	7.1	7.7	-	-	7.7
	XIV	-	-	-	-	-	-	-	-
	XV	-	-	0.7	0.7	-	-	0.6	0.6
	Z-2B	48.0	-	469.3	517.3	44.2	-	444.4	488.6
Ucayali	31-C	54.7	108.2	-	162.9	65.3	97.4	-	162.7
Total		204.2	1,037.7	2,673.5	3,915.4	281.1	1,028.1	2,437.1	3,746.3

Source: Perupetro
Prepared by: Vigila Peru

Graphic 2.4

Internal revenue, hydrocarbon sector, 1998-first semester 2007
(million soles)



Source: National Superintendence of Tax Administration
Prepared by: Vigila Peru

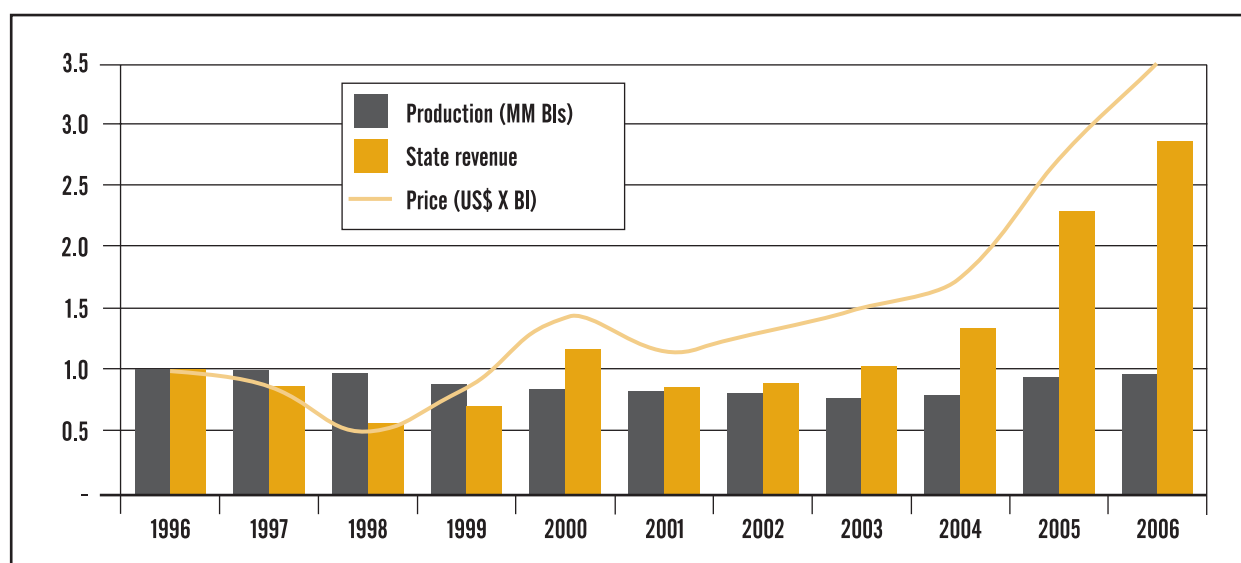
extracted product for which the companies pay royalties; and

- b) **a service contract** when the company receives a retribution based on production, after the product is sold by the State and associated costs of transport and commercialization is deducted. The difference- the resources that remain with the State- are known as "royalty equivalent".

The royalty (or royalty equivalent) stipulated in the contracts is a percentage of the valuation of controlled hydrocarbons production,⁴⁵ in other words, the VPH. The determination of this royalty is not a standard but varies according to the contract; besides, it is estimated by different methodologies.⁴⁶

Because a royalty is a percentage of VPH, and at its turn this is affected by the variation of production volumes and prices, royalties are also influenced by these variations. Revenues from royalties that generated the sector have been increasing since 2002 due to the increase of the price of hydrocarbons. This can be seen in Graphic 2.5: beginning in 1996, we see how in spite the decrease in the volume of production of hydrocarbon liquids (which were 92% of VPH) State revenues increased in direct relation with price dynamics. Like this, for example from 2002 until the slight recuperation of production in 2006; export prices (that behave according with world trend) have multiplied by 3 and State revenues multiplied by 3.5.

Graphic 2.5
Comparison between hydrocarbon production rates, State revenue and export price, 1996-2006
Base year: 1996



Source: Estadística Petrolera 2006
 Prepared by: Vigila Peru

45 DS 049-93-EM, Regulations for the application of royalties and retribution in oil contracts, section 3.

46 There are four methodologies to determine royalties: factor R, accumulated production per mine with price adjustment, by scales of production and by economic result.

At the end of the first semester of 2007, the royalties -including equivalents-reached 358.1 million dollars. It is estimated that by the end of 2007 these will reach 720 million dollars, i.e. an amount similar to that of year 2006 (732 million dollars). If compared to VPH, the royalty is on average 30% of it, even though among the contracts there are differences, given that in each there is a specific way how to calculate the royalty.

Unlike the mining sector, where income tax paid by the companies is distributed in equal proportion -50% to the regions (mining canon) and 50% to Treasury-, in the hydrocarbon sector what is distributed to the regions (oil canon) is equivalent to a percentage of the VPH of each lot. Therefore, as we saw beforehand, the oil canon represents 12.5% of the VPH; of this percentage, 10% goes to the regions of the lots

in Piura, Loreto and Huanuco as oil canon, and 2.5% to Tumbes and Ucayali as compensation for extractive activity, a percentage that is known as "oil overcanon".

Only for Lot 88 (Camisea project) located in Cusco, the operator pays the State 37.24% as royalties. The gas canon is made by 50% of paid royalties and 50% by income tax paid by the operator.

The canon as percentage of the VPH in the first semester of 2007, reached 168.3 million dollars (534.7 million soles), 2.5% less than the same period in 2006 (548 million soles). The canon during first semester of 2007 represented 47% of royalties paid and what remains for the Central Government is the difference, i.e. 189.8 million dollars. It is important to mention that the royalties include the amount that

Table 2.5
Royalties and canon by lot, first semester 2007 (million dollars)

Lot	Región	Contract	Royalties (A)	Canon (B)	VPH (C)	A/C	B/C
Z-2B	Piura	Servicios	23.5	19.3	154.0	15%	13%
88	Cusco	Licencia	126.2	63.1	338.9	37%	19%
1-AB	Loreto	Licencia	81.8	30.2	241.8	34%	12%
8	Loreto	Licencia	41.5	20.3	162.5	26%	13%
X	Piura	Licencia	39.2	18.5	148.2	26%	13%
31-C	Loreto	Licencia	17.3	6.4	51.3	34%	13%
VII/VI	Piura	Licencia	7.4	4.1	32.5	23%	13%
I	Piura	Servicios	2.6	1.2	9.4	28%	12%
IV	Piura	Licencia	6.6	1.9	14.8	45%	13%
III	Piura	Licencia	4.3	1.2	9.7	44%	13%
II	Piura	Licencia	2.8	0.7	5.6	50%	13%
31B/D	Loreto/Huánuco	Licencia	2.3	0.6	4.9	47%	12%
IX	Piura	Servicios	1.7	0.4	3	57%	13%
V	Piura	Servicios	0.6	0.2	1.7	33%	13%
XIII	Piura	Licencia	0.4	0.3	2.4	18%	13%
XV	Piura	Licencia	0.1	0	0.2	41%	13%
Total			358.1	168.3	1,180.90	30%	14%

Source: National Superintendence of Tax Administration
Prepared by: Vigila Peru

corresponds for canon, therefore as is seen in Table 2.5, while the royalties collected by the State are on average 30% of the VPH, the canon transferred is on average 14% of the same.

On the other hand, the regions where the Camisea project ducts pass by, are compensated from the Fondo de Desarrollo Socioeconomico de Camisea (FOCAM), which is constituted by 25% of the royalties received by the Central Government. This fund benefits Ayacucho, Huancavelica, Ica and Ucayali⁴⁷ and Lima.Provinces.⁴⁸ According to the Website of Transparencia Economica,⁴⁹ at the end of the first semester of 2007 the FOCAM reached 54.2 million soles, 8% less than the same period in 2006 (59.4 million soles).

It is also important to highlight that as of this year, more precisely from February on, as another part of the gas canon, 50% of the income tax paid by the operator of the Camisea project has begun to be transferred, which is transferred solely to Cusco. In the first semester this transfer reached 113.8 million soles.

Briefly, revenues generated by the hydrocarbon activity reached 1, 366 million soles (approximately 429.5 million dollars). Of this

amount, 702 million soles remained in the departments from where resources were extracted, and 663.2 million soles were to the treasury of the central government. If we compare the income generated and the VPH, that as we recall reached 1,180.9 million soles, we see that the former represented 36.4% of the later.

2.3 The distribution within the departments

Of the 702 million soles transferred to the departments, 396.9 million soles (56%) were distributed to local governments- districts or provinces- . Regional governments received 271.4 million soles (39%) and the remaining 34.5 million soles were distributed to public educational institutions. It is worth to note that from the resources that the regional Cusco government receives as gas canon- Cusco has to transfer one fifth (20%) to public universities of the region (See Table 2.6).

The departments that receive more resources through transfers during the first semester of 2007 were Cusco (314 million soles), Loreto (134.1 million soles) and Piura (121.1 million soles).

47 As a result of its claims, the department of Ucayali has access to 2.5% of the portion received by the Central Government as compensation for the impact in part of its territory in the border with Cusco by the Camisea Project activities.

48 In the case of Lima, Metropolitan Lima and public universities are excluded.

49 See <<http://transparencia-economica.mef.gob.pe>>

Table 2.6
Transfers to departments for canon and FOCAM associated to hydrocarbons, first semester 2007
 (million soles)

Region	Local Governments			Regional Governments			Educational Institutions			Total		
	Gas canon	Oil canon	FOCAM	Total	Gas canon	Oil canon	FOCAM	Total	Oil canon		FOCAM	Total
Cusco	178.6	-	-	178.6	135.4	-	-	135.4	-	-	-	314.0
Loreto	-	53.7	-	53.7	-	69.8	-	69.8	10.7	-	10.7	134.1
Piura	-	84.7	-	84.7	-	24.2	-	24.2	12.1	-	12.1	121.1
Ucayali	-	23.8	7.9	31.6	-	21.3	1.2	22.5	3.8	0.4	4.1	58.3
Tumbes	-	21.2	-	21.2	-	6.1	-	6.1	3.0	-	3.0	30.3
Ayacucho	-	-	8.4	8.4	-	-	4.8	4.8	-	1.6	1.6	14.9
Lima	-	-	6.8	6.8	-	-	2.9	2.9	-	1.0	1.0	10.6
Ica	-	-	5.8	5.8	-	-	2.9	2.9	-	1.0	1.0	9.6
Huancavelica	-	-	5.7	5.7	-	-	2.9	2.9	-	1.0	1.0	9.5
Huánuco	-	0.3	-	0.3	-	-	-	-	-	-	-	0.3
Total	178.6	183.6	34.7	396.9	135.4	121.3	14.6	271.4	29.6	4.8	34.5	702.7

Source: Transparencia Economica; Perupetro
 Prepared by: Vigila Peru

III. USES OF THE REVENUE FROM THE EXTRACTIVE INDUSTRIES



This chapter is divided in three parts: the first addresses the amendments to the legal framework related to the use of the canon; in the second part is the estimates the amounts of the revenues from the extractive industries transferred to the regions; and finally, the third part, describes and analyzes the uses of this revenue, by of regional governments and public universities of the regions as well, where we perform surveillance.

3.1. Changes in the legal framework in respect to the use of the canon

a) Normative changes in respect to the use of the canon in regional and local governments in the first semester of 2007

Pursuant to Act 27506 the Canon Act (Section 6 clause 6.2), "the resources that regional and local governments receive on account of canon shall be used exclusively to fund or co-fund infrastructure or projects or Works that should have regional or local impact, respectively, for which an account is established for this purpose".

Under Act 28927, the 2007 Public Budget Act, local and regional governments were authorized to use up to 20% of canon, overcanon and royalty resources for the maintenance of infrastructure generated by projects that have a regional and local impact, as well as the costs that demanded the selection processes for the execution of public investments projects. . As well, up to 5% can be used to finance the elaboration of public investment project profiles. The difference with respect to 2006 is that 5% was part of the 20%; and for year 2007,

it is 5% of the total amount. This last change is due to the problems (meant to say lack of resources) experienced by sub-national governments in designing projects and for their future bids.

In accordance to the Act of Indebtedness of the Public Sector for 2007, Act 28928, regional and local governments are authorized to use resources from the canon, the over-canon and the mining royalties for the creation of trusts that will be used in paying obligations stemmed from indebtedness operations that such governments may enter into with the endorsement of the national government, or that the latter may transfer them through a transfer of resources agreement, for payment of firm and contingent obligations that said governments may agree in the framework of private investment promotion processes.

Also, sub item 9.1 of this same Act, provides that regional and government locals are authorized to constitute Trusts, from the resources from mining royalties they are entitled to: the Fondo de Desarrollo Socioeconomico de Camisea (FOCAM), the Regional Compensation Fund (FONCOR), the canon and over-canon, in order to create Trusts to be used for the following activities:

- i) Pay service debt derived from operations of indebtedness which these governments have agreed to with the endorsement of the national government, or that the latter has agreed and transferred through a transfer of resources agreement, when the resources derived from indebtedness have been used to fund public investments projects;

ii) The payment financial obligations, firm and contingent by regional and local governments in a framework of private investment promotion and concessions that have the endorsement of the national government; and

iii) The administrative expenses derived by the creation of trusts.

Act 29001 (April 16, 2007) authorizes the regional and municipal governments of the zones declared under emergency by DS 014-2007-PCM and DS 021-2007-PCM to use a maximum of 50% of the revenues of April from canon, the over-canon and the mining royalties, regulated by law 28258, to execute immediate actions to assist the populations affected by natural disasters (frost or hail). The zones declared under emergency were: Huancavelica, Junin, Ayacucho, Apurimac and Puno. The raise of salaries, bonuses or others payments of a permanent nature were restricted, under responsibility.

As of May 10th 2007, under a Decree of Urgency 013-2007, authorization was given for this fiscal year of 2007 for regional governments to hire teachers with incoming resources of the canon and over-canon. But this decree contradicts regulations on the use of the canon, and poses certain questions: why use canon resources to pay teachers when this resource is a temporary income and when this expenditure is considered a current and permanent expenditure? This expenditure is normally funded with so-called ordinary permanent resources by the Central government; and probably, based on this no regional government accepted to implement

this measure with the exception of Cusco.⁵⁰ On the contrary, the regional president of Loreto, Yvan Vasquez Valera,⁵¹ rejected this idea because he believed that the "was not the appropriate way" to solve the education problem of his jurisdiction.

b) Normative changes with regard the use of canon in public universities in the first semester of 2007

For 2007, Act 28927 of the Public Budget eliminated the restriction for national universities to spend resources of the canon only in infrastructure and equipment. Instead, they were authorized to: "carry out research that may promote economic and productive development of the regions using the contribution received from the canon, over-canon and royalties".

However, this change of rules is insufficient for national universities of the regions to conceive and develop research projects in science and technology that will contribute to regional development. How do we ensure that these research projects (agriculture, livestock, industrial and others) will respond to the real need for innovation and technological change of productive sector or of the municipalities and regional government? This is the basic question that the amendment provided by the Act is not focusing on.

In this context, a strategy that can yield good results is to link research supply with companies and regional institutions demands. On the other hand, to design and develop quality research it would be good to encourage strategic alliances between public universities of the regions and

50 The regional vice president of Cusco, Mario Ochoa Vargas, stated that they have initiated this measure and thanks to this decree they can use part of the gas canon in contracts of 1,180 teachers for their jurisdiction, which will benefit near 40 thousand students that are not having classes

51 See <http://www.cnr.org.pe/seccionvigilancia_noticia.php?id=48>

institutions such as the Consejo Nacional de Ciencia y Tecnología (National Council of Science and Technology), certain corporate interests and universities with more experience in scientific investigation and technology.

Briefly, the canon legal framework in force has become more flexible. Furthermore, other than infrastructure projects, there is the possibility to start up projects according to necessities and priorities of the population. For example, it is possible to complete public investment projects for training and technical agricultural assistance, improvement of irrigation techniques, technical assistance in relation to stock raising, improving meat products, milk products, the pasture and genetics, among others,⁵² similarly projects that improve health service and health. However, to our knowledge, the factor that continues to limit financing in these types of projects is that the regional governments and the municipalities do not have many specialists to design and develop effective projects of this nature.

3.2 Canon, overcanon and royalties transfers to the regions, 2007

The resources that benefit the regions for having any extractive activity in their territory, pursuant to law are six types of canon (mining, oil, gas, forestry, hydro energetic and fishery) the mining royalties and the Fondo de

Desarrollo de Camisea (Camisea Development Fund). All these concepts represent the canon, over-canon and royalties (CSCR).

According to the web site of Transparencia Economica of the MEF, in the first semester of 2007 under this concept a total of 6,175 million soles was transferred, of which 5,157 million soles corresponded to the mining canon. It is important to clarify that a transfer for mining canon refers to:

- a) the transfers from January to May of 2007 for 902,6 million soles, an amount on account of canon generated during the fiscal year of 2005⁵³ and
- b) The "sudden"⁵⁴ transfers of mining canon in June 2007 (4, 254 million soles) provided by the 2007 Act, which corresponds to the canon generated in 2006. It should be made clear, as a result of a change of rules, , there will be no more transfers of mining canon until June of 2008; of the 4, 254 million soles "suddenly" transferred, 1, 772 million soles (42% in total) corresponds to transfers of the months of January to May of 2008.

Under a more conservative way of transfer of oil canon (691 million soles for 2007) and gas canon, and also of FOCAM⁵⁵ (716 million soles for all 2007), assuming that the transfers of the second semester remain the same as those of the first, the total foreseeable canon amount

52 See <http://7www.mef.gob.pe/DNEP/capacitacion/transf_canon.pdf>

53 Under the former scheme, the canon was distributed in twelve monthly installments, between June 2006 and May 2007.

54 The Ministry of Economy and Finance through Ministerial Resolution 321-2007-EF/15 (June 8, 2007), approved the distribution rates of the mining canon for year 2006 that amounted to 4,254 million soles (50% of income tax), amount that pursuant to the Budget Act for fiscal year 2007, was transferred to local and regional governments in June, in one sole quota.

55 The oil cannon and the gas cannon from royalties of Lot 88 depend on the production value and international prices of hydrocarbons. In a growing economy and with rising international prices, we assume that cannon for this activity will be higher the second semester compared to the first semester.

that the regions will receive in 2007 will be close to 7, 100 million soles, a historic figure as we will see.

We observe a trend during the last four years (2004-2007) during which transfer of resources due to the extraction of natural resources increased speedily. The figures increased more than three fold, if we compare 2004 and 2006 (from 1,083.5 million soles to 3, 540.4 million soles). Comparing 2004 transfers with the figures forecasted for 2007, we see that the canon transferred could be multiplied six fold.

What sector contributed more towards the Canon, over-canon and Royalties?

As we saw in the previous chapters the canon concentrated primarily on two extractive activities: mining and hydrocarbon. For the first semester of 2007, the mining activity contributed 87% of the transfers, followed by hydrocarbon with 11% (See Graphic 3.1)

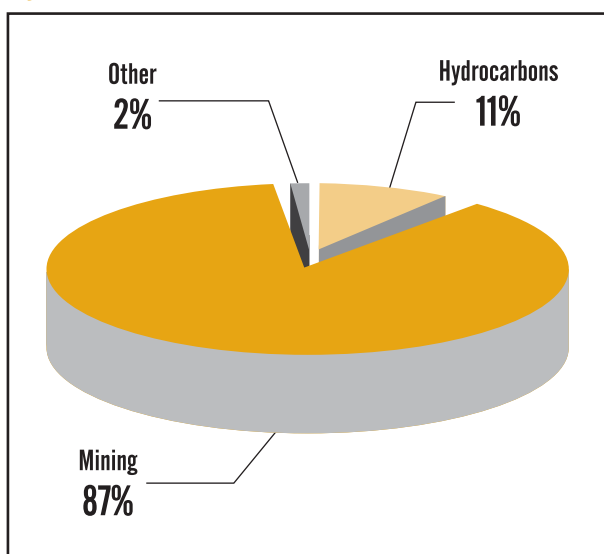
As we stated, the extractive activity - and in particular mining- has been increasing its

influence during recent years. Thus, its contribution has passed from 42% in 2004 to 79% in 2007 (considering the forecasted figure). This is so, due to the consolidation of mining investments and increase of ore prices; the "sudden" transfer of the mining canon stresses this trend in 2007.

The most important contribution is the mining canon with 83.5%. The oil canon follows with 5.6% and the gas canon with 4.9% (3.1% coming from the gas canon is generated by royalties of Lot 88 and 1.8% of the gas canon is from income tax); and mining royalties, with 3.6%. (See Table 3.1).

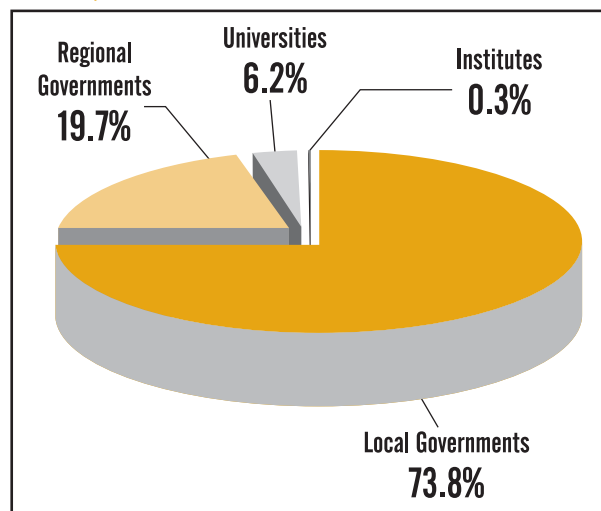
With regard the participation of the different levels of government in the CSCR, we can point out that the end of the first semester of 2007, the local governments have, according to law, the greatest participation (73.8%), followed by regional governments (19.7%) and finally the educational entities, i.e., universities and institutes (6.5%). In regards to institutes, these participate only of the transfer of oil canon and over-canon (See Graphic 3.2).

Graphic 3.1 C
Composition of source of canon, over-canon and royalties, first semester 2007



Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

Graphic 3.2
Distribution of source of canon, over-canon and royalties, first semester 2007 (percentages)
Total: 6,175.9 million soles



Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

Table 3.1

Resources transferred from source Canon, Over-canon and Royalties according to activities of origin, first semester 2007
(million soles)

Activity	Type of resource	Amount transferred	
Hydrocarbons	Gas canon - royalties	190.1	704
	Gas canon - Income tax	113.8	
	FOCAM	54.0	
	Oil Canon and over-canon	345.5	
Mining	Mining canon	5,157.0	5,377
	Mining royalties	220.3	
Others	Forest canon	4.5	95
	Hydro energetic canon	59.0	
	Fishing canon - right to fish	7.0	
	Fishing canon - Income tax	24.0	
Total general		6,175.9	6,176

Source: National Decentralization Council and Perupetro
Prepared by: Vigila Peru

As far as the distribution of resources by department, we verify that the concentration has been greater in the year of 2007. As a matter of fact, five regions concentrate more than 68% of the transfers (during the period of 2004-2006, this same number of regions concentrated 55%). In this process, what has varied is the ranking of the benefited departments: Ancash moved from seventh position to the first and Tacna from fourth to second.

In contrast, the 5 regions that receive fewer transfers continue being the same and their positions have not changed: Madre de Dios, Callao,⁵⁶ San Martin, Amazonas and

Lambayeque shared only 0.02% of the total, each with less than 800 thousand soles (See Map 3.1)

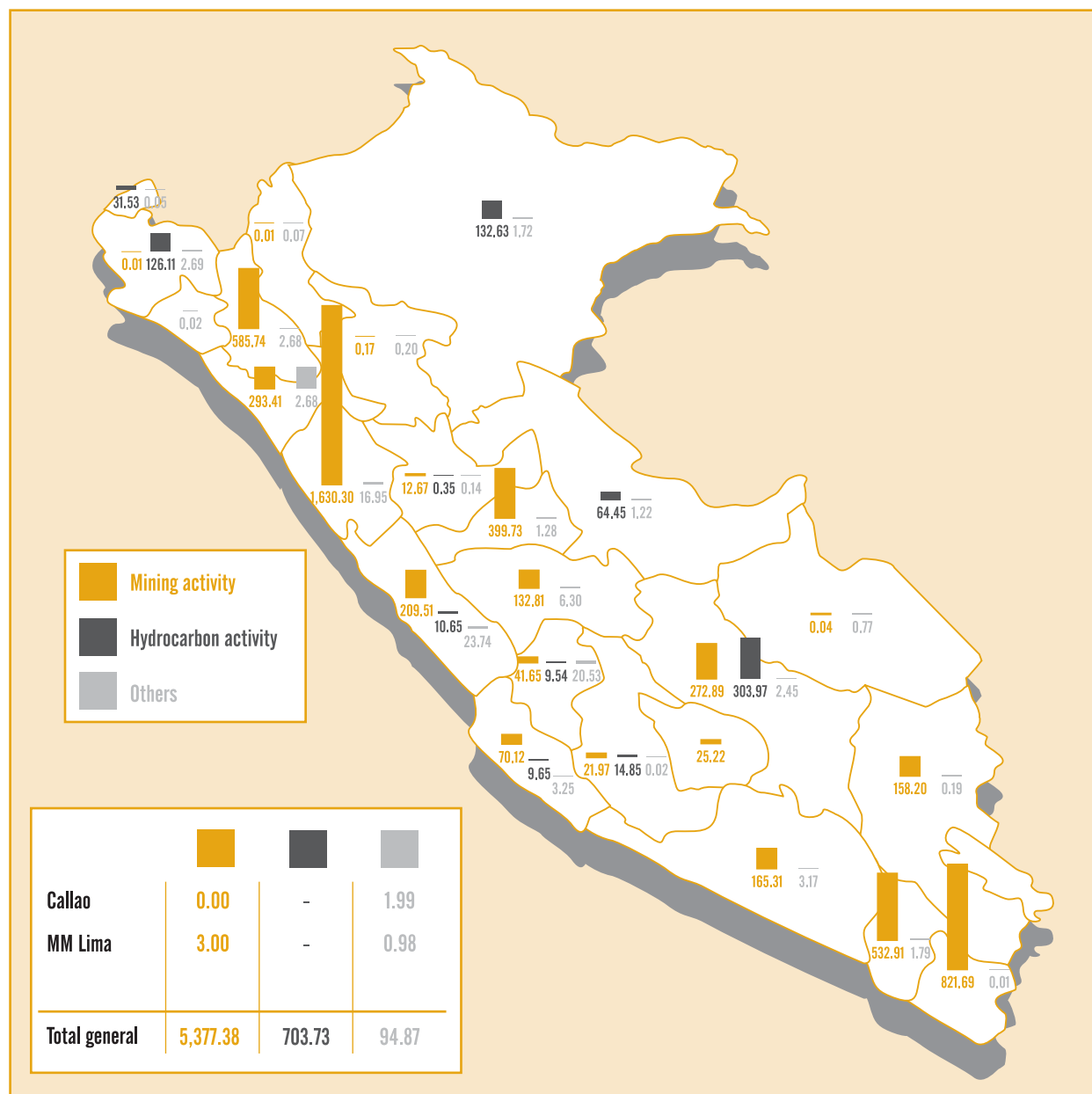
It is important to point out, as was seen in chapter 1, that the inequities⁵⁷ in the distribution of the canon are given not only between departments, but also within the producer departments that receive more resources. We believe then that the current canon distribution scheme is not sustainable anymore; it should be revised and amended; first to correct interdepartmental inequities and then inequities between producer and non-producer departments.

56 In the case of Callao, the situation is different if revenues from custom duties are taken into account, implying very interesting figures.

57 In the case of Callao, the situation is different if revenues from custom duties are taken into account, implying very interesting figures.

Map 3.1

Transfers of Canon, Over-canon and Royalties to departments, to June 2007 (million soles)



Source: National Decentralization Council and Perupetro
Prepared by: Vigila Peru

3.3 The use of canon in the regions

In this section we will analyze the use of canon resources in regional governments and public universities at the end of the first semester of 2007. Additionally, based on the information provided by the MEF, we are adding a table on

the use of the canon in 2006 by main municipalities that have been receiving canon in our areas of surveillance.

It is important to mention that in the development of this sub item we will put greater emphasis in the departments where Vigila Peru

carries out surveillance actions of extractive industries (Arequipa, Ancash, Cajamarca, Cusco, Ica, Libertad, Moquegua and Piura).

3.3.1. In the regional governments⁵⁸

In order to perform a better evaluation of the use of canon by regional governments, this part has been divided in four: in the first one, we will review the canon expenditure program; then we will address the importance of canon in scheduled investments, then we will examine the execution of the investments; and finally we will review regional government projects

A. Canon Expenditure Program, at June 2007

When we talk about the Canon-2007 we are referring to source 18 according to the structure used by MEF, named: Canon, Over-canon, Royalties, Custom Duties Revenues, and Participations.⁵⁹ It is important to recall that this source is constituted by the resources of the six types of canon, mining royalties, FOCAM, Custom duties revenues and participations.

As we previously mentioned, the law provides that canon funds should be used in investment projects, up to 20% for maintenance of Works and tenders and 5% for studies. Therefore, regional governments can budget for: capital expenditure (investments, financial investments and other capital expenditures), and to a lesser degree, running expenses (purchase of goods and payment of services, personnel payments and obligations, among others).

For this analysis we are using the Presupuesto Institucional Modificado / the Modified Institutional Budget (PIM) which is the updated budget⁶⁰ of the entity or agency. Of the 1, 871 million soles budgeted with the 2007 canon, 86% were used for capital expenditure and 14% for running expenses (See Table 3.2).

Table 3.2
Distribution of PIM-canon per type of expenditure, as of June 2007
(million soles and percentages)

Category	Amount	Participation
Running expenses	263.2	14%
Capital expenditures	1,608.2	86%
Total	1,871.5	100%

Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

If we observe the trend, we can say that comparing 2004 with 2007 the PIM of the Canon source of regional governments has multiplied four fold: it passed from 447 million soles (2004) to 1, 871 million soles (2007).

The participation of running expenses has increased considerably: from 8% in 2004 to 14% in 2007 (from 69 million soles to 263 million soles), a situation that is explained due to maintenance costs of infrastructure that is permitted by law, which implies expenses in purchasing goods and services. Furthermore, it is necessary to bear in mind that by 2007 customs duty revenues were added to the Canon source that authorizes its use in running expenses and contribute more than 141 million soles to this item.

58 The 26 entities refer to 25 regional governments and Metropolitan Municipality of Lima

59 According to guidelines of the public budget, for 2006 there were two sources: 01 Cannon, over-canon, royalties and participations and 03-Participation in custom duty revenues. For 2007, according to 2007 Budget Act, two mores sources have been added. This action makes difficult surveillance of use of revenues solely from extractive industries when they are mixed with other resources.

60 Conceptually it results by adding to Presupuesto Institucional de Apertura (PIA) the budgetary amendments made during the year. This budgetary amendments are of various types and some are authorized by the head of the entity himself (in the case of the canon, for instance, only his authorization is needed).

In regards to the 2007 PIM-canon, we see that 78% of running expenses (equivalent to 205 million soles) is concentrated in four regions, of which the Regional Government of Callao receives 141 million soles; Loreto,⁶¹ 40 million soles and Moquegua 22 million soles. In the case of Callao, a large percentage corresponds to customs duty revenues, an important source for this region.

In regards to capital expenditures, canon is programmed for use in public investment, financial investments projects and other capital expenditures. As it can be seen in chart 3.3, for 2007 investments represent 87% of the budget, followed by other capital expenditures, that represents 11% and financial investments⁶² (2%).

In the period 2004-2007 there is a slight fall in investments share: from 93% in 2004 to 87% in

2007. But in absolute terms investments have increased from 380 million soles to 1,397 million soles.

Variations of investment budget financed with canon in regional governments, 2007

The canon modified budget for regional government investments as of June 2007 has substantial changes⁶³ (58%) with regard to the initial budget, with more than 500 million soles increase. The existence of budget amendments, which is more usual each time, is a characteristic of the national budget of the last 3 years, and it stems from the fact that income provisions (always conservative) by the MEF are largely surpassed by revenues actually collected by the treasury, allowing budgetary supplements through "supplementary credits". This practice fostered by the MEF has meant poor quality budgetary planning, which underestimates budget ceiling limits causing budget unforeseen amendments that institutions cannot absorb. In the case of reference, it is impossible to imagine that governments and municipalities can incorporate this amount – so big as sudden- that the "sudden" transfer of the mining canon caused. Therefore, it is important that the MEF revise not only its transfer projection methodology, but also the budget as a whole.

The increase in the budget due to canon has not been of the same magnitude for all the regional governments. For example, those that are experiencing increases in absolute terms are

Table 3.3
Distribution of PIM-canon, over-canon and royalties in capital expenditures, 2007
(million soles and percentages)

Category	Amount	Participation
Investments	1,397.2	87%
Financial investments	28.6	2%
Other capital expenditures 1/	182.3	11%
Total	1,608.2	100%

1/ mainly transfers to public universities of those regional governments that receive mining, gas, fishing, hydro energetic and forestry canon.

Source: Ministry of Economy and Finance

Prepared by: Vigila Peru

61 In the case of Loreto, Ucayali and Huanuco up to 20% of the oil canon and over-canon can be used for running expenses. In Piura and Tumbes, 100% is for investment expenses.

62 Refers only to the Loreto Regional Government, and agricultural and fishing training support projects

63 The "sudden" canon transfer effect is not relevant in reported budgetary amendments, first because this transfer was made in June, and second because a number of regional governments have not incorporated these resources to their budget. Therefore, the PIM (June)-PIA differences will probably be more than 500 million soles.

Cusco (gas and mining region), Tacna (mining region), Ancash (mining region), San Martín⁶⁴ and Cajamarca (mining region) in more than 40 million soles each. See following Table 3.4.

Table 3.4

Variations in budget of investments from canon in regional governments, to June 2007
(million soles and percentages)

Regional Government	PIA 2007 (a)	PIM- April	PIM - June (b)	Variations	
				Absolute (b-a)	Percentage (b-a)/a
Cusco	94.91	126.29	179.24	84.33	89%
Tacna	89.88	89.88	147.66	57.77	64%
Áncash	118.63	166.43	168.19	49.57	42%
Moquegua	83.34	145.16	132.89	49.55	59%
San Martín	47.36	93.34	93.34	45.98	97%
Cajamarca	78.15	94.73	119.19	41.04	53%
Callao	37.27	59.42	59.41	22.14	59%
Lima	19.39	39.8	41.11	21.72	112%
Pasco	18.83	38.91	38.91	20.08	107%
Loreto	89.93	108.78	108.92	18.99	21%
Piura	47.56	69.37	66.24	18.68	39%
Puno	23.4	39.8	39.8	16.41	70%
Tumbes	13.97	30.02	30.02	16.05	115%
Ica	14.58	24.61	24.61	10.03	69%
La Libertad	19.19	28.65	28.65	9.46	49%
Huancavelica	16.51	16.51	24.02	7.52	46%
Ayacucho	10.03	17.35	17.49	7.46	74%
Ucayali	36.25	42.24	42.95	6.7	18%
Junín	6.34	12.6	12.6	6.26	99%
MM de Lima	2.92	4.15	3.97	1.04	36%
Huánuco	0.74	1.55	1.55	0.81	109%
Amazonas	0.02	0.02	0.04	0.02	78%
Lambayeque	0.01	0.02	0.02	0.01	90%
Apurímac	1.52	1.5	1.5	-0.02	-1%
Arequipa	14.89	14.89	14.69	-0.2	-1%
Madre de Dios	0.2	0.2	0.2	00	0%
Total general	885.81	1,266.22	1,397.22	511.40	58%

Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

The Regional Government of San Martín received in 2006 compensation for the elimination of incentives and tax exemptions, an allocation of resources (more than 46 million soles) named "participations/shares" (by law this resource forms part of Canon source). These resources are regulated by Supreme Decree 154-2005-EF. The relevant provisions of the rule explain that resources to be transferred to the regional government of San Martín, will not be less than 45 million soles per

64 Does not have a significant extractive activity but is entitled due to elimination of tax exemptions

year; and will be deposited and managed through a Trust, of which the trustor will be the Regional Government and will be earmarked to projects determined by the law as well as to the maintenance of prioritized infrastructure.

By this concept, by 2007, 47 million soles have been budgeted (in the opening budget) for the execution of rehabilitation projects and improvement of the highway Tarapoto-Azpusana branch (asphalt and the supervision of the work), as well as the interconnection of the Interconnected National Electrical System through the lines of transmission of Tocache-Bellavista or Cacic-Moyabamba. Furthermore, the Regional Government has a remaining of the balance (2006) of more than 46 million soles that added to the budget of 2007, means a total modified budget of 93 million soles to invest.

Do regional governments budget all they have available from canon?

To respond to this question we need to know how much money do regional governments have

available by the canon, adding i) canon⁶⁵ transfers as of June 2007 (deducting 20% that is transferred by law to public universities of respective region); and ii) the balance of fiscal year 2006.

It is important to point out that to compare canon transfers and the remaining balance of canon of 2007 with previous years, we do not consider the Custom duties that are incorporated to the Canon in 2007.

As is observed in chart 3.5, the canon available in regional governments increased four times and passed from 399 million soles in 2004 to 1, 798 million soles in June of 2007 (of this amount 354 million soles correspond to the period from June to May when canon was "suddenly" transferred in advance). Furthermore, there is a tendency of a significant increase of remaining balance. This shows that as a whole, regional governments have presented problems in the execution of incoming growing resources by the canon. See map 3.2

Table 3.5
Amount available from canon in regional governments,* 2004-June 2007
(million of nuevos soles)

	2004	2005	2006	2007
Canon transfer	301	540	821	1,202**
Remaining balance	99	164	326	596
Amount available by canon***	399	704	1,147	1,798

* we have deducted transfers that regional governments have to make to public universities of the region, as provided by the Canon Act.

** Amount transferred as of June 2007

*** does not take into account interest generated in previous year since amount was deposited in Banco de la Nacion.

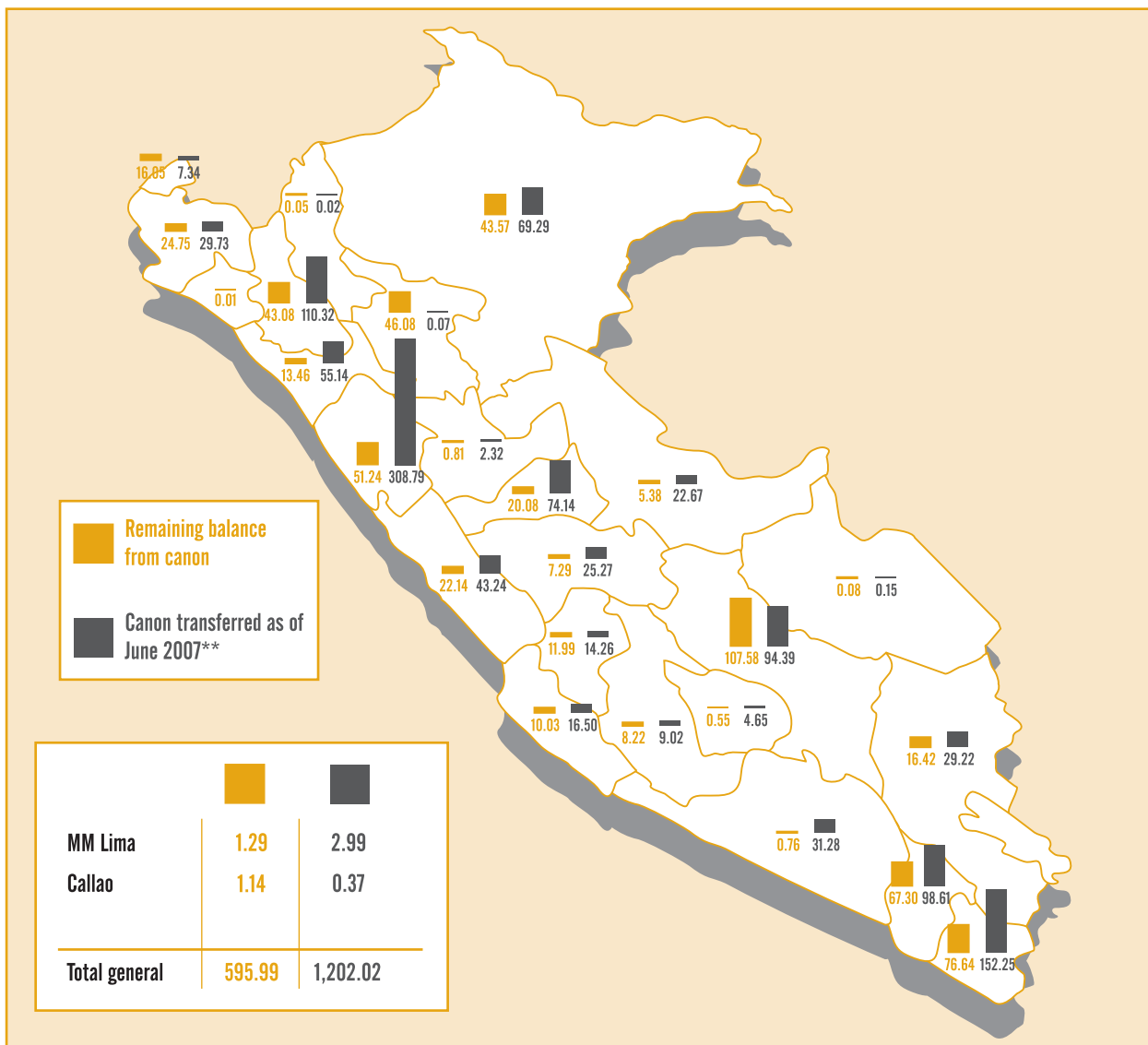
Source: Ministry of Economy and Finance

Prepared by: Vigila Peru

65 The six types of canon, mining royalties and FOCAM.

Map 3.2

Amount available from Canon, Over canon and Royalties* in regional governments, as of June 2007 (million of soles)



* not included resource by Custom duties, incorporated to source of Canon in 2007

** we have deducted transfers that regional governments have to make to public universities of the region, as provided by the Canon Act.

Source: Ministry of Economy and Finance

Prepared by: Vigila Peru

Finally, as we see in graphic 3.3, comparing the amount available with budgeted amount we see that regional governments of Ancash, Tacna, Cusco, Moquegua, Cajamarca Pasco and La Libertad, did not budget all the money from canon at their disposal. The money not budgeted is respectively, 192 million soles, 81 million soles, 33 million soles, 34 million soles, 55 million soles

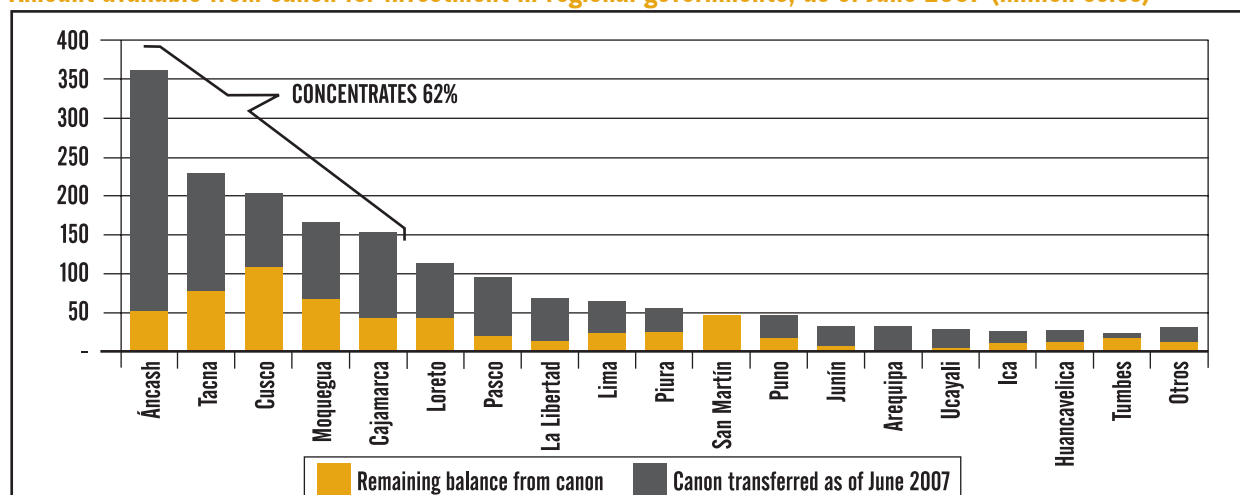
and 40 million soles. It is important to note that these amounts are very similar to transfers that correspond to the Jan-May period of 2008 included in the "sudden" transfers.⁶⁶

This situation -not budgeting all of the money that is available from canon resources- is most likely the results that regional governments

66 We estimate that transfers for the Jan-May period for regional governments of Ancash, Tacna, Cusco, Moquegua, Cajamarca, Pasco and La Libertad are, respectively, 116 million soles, 50 million soles, 19 million soles, 30 million soles, 35 million soles, 27 million soles and 20 million soles.

Graphic 3.3

Amount available from canon for investment in regional governments, as of June 2007 (million soles)



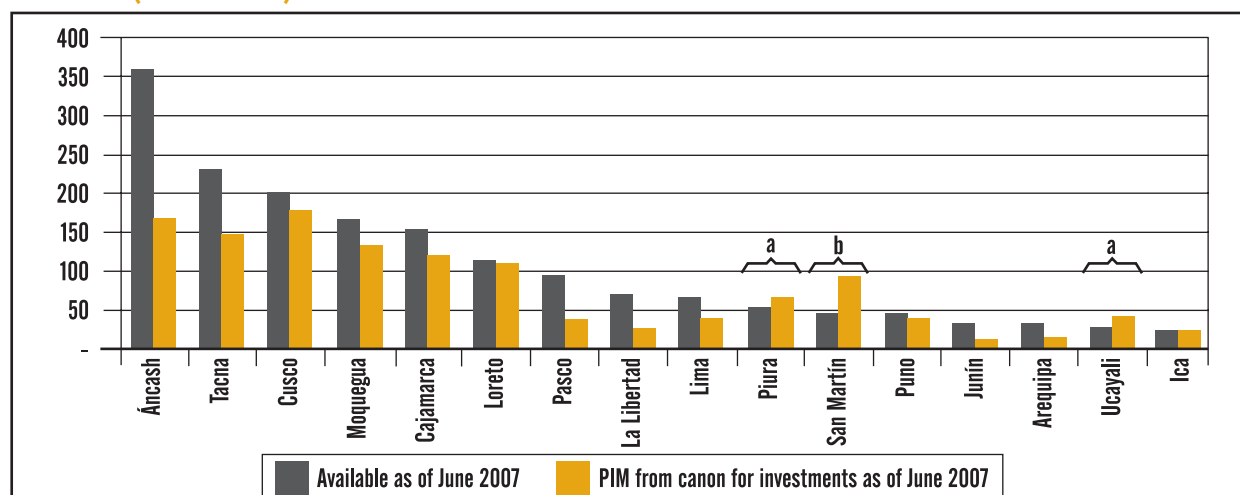
Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

consider that due to various reasons they would not be able to spend it during the year: because they do not have viable projects, because the money arrived suddenly and in great quantity or due to difficulties associated to the management of investment projects under the framework of the rules established by the Sistema Nacional de Inversion Publica (SNIP - National System of Public Investment), the Consejo Superior Contrataciones and Adquisiciones del Estado (Consucode - the National Council of Contracts and Procurement) among others.

Furthermore, there are cases in which the budgeted canon is more than what is actually available, which does not mean that governments are planning to spend funds that are not available to them. This situation occurs in two types of regions: i) where the canon comes from oil, and therefore, there are transfers pending from the second semester (see graphic 3.4 case a); and ii) in San Martín where the difference is due to the fact that the available canon does not include transfers from the compensation due to the elimination of tax exemptions (see case b in the same graphic).

Graphic 3.4

Comparison between available canon and the PIM from canon for investments in regional governments, as of June 2007 (million soles)



Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

B Contribution from the canon to investment of regional governments, 2007

Between 2004 and 2007 there are no big changes in the funding structure of regional governments investments⁶⁷ and canon continues being the principal source. Especially, for 2007 the canon share was around 43%;

followed by Ordinary Resources⁶⁸ and Donations and Transfers. But as we indicated, between 2004 and 2007 the budgeted canon increased threefold: from 446 million soles (2004) to 1,397 million soles (2007). In addition, since 2005 the source Donations was incorporated to transfers by means of the Fondoempleo surplus.⁶⁹ See chart 3.6

Table 3.6
Investment Financing in regional governments, PIM 2004-2006
(percentage and million soles)

	2004	2005	2006	2007
Ordinary resources	42%	36%	28%	35%
Canon, Over-canon, royalties, participation and Custom duties revenues*	43%	45%	44%	43%
Resources directly collected	5%	5%	4%	3%
Official resources from external credits	2%	4%	4%	3%
Donations and transfers	9%	10%	20%	15%
Total	100%	100%	100%	100%
	1,047.41	1,442.48	2,580.35	3,237.00

Source: MEF (Ministry of Economy and Finance)

Prepared by: Vigila Peru

Note: *to be able to compare the Canon source with amounts of previous years, we added the Custom Duties revenues for those years.

It is important to point out that from extractive activities the regional governments – in addition to canon- receive important transfers from surplus of workers participation in company profits (see Reporte 5). In the case of Moquegua, the Compañía Minera Southern Peru, pursuant to provisions set forth by Legislative Decree 892 and Supreme Decree 009-98-TR, transferred to the Regional Government 80 million soles that will be entirely invested in the construction of a highway Moquegua-Omate-Arequipa, the inter Andean integration highway, that will connect towns in the coast and the mountains of Moquegua.

67 Figures from Modified Institutional Budget (PIM) for those years. For year 2007, the PIM is taken from the month of June 2007.

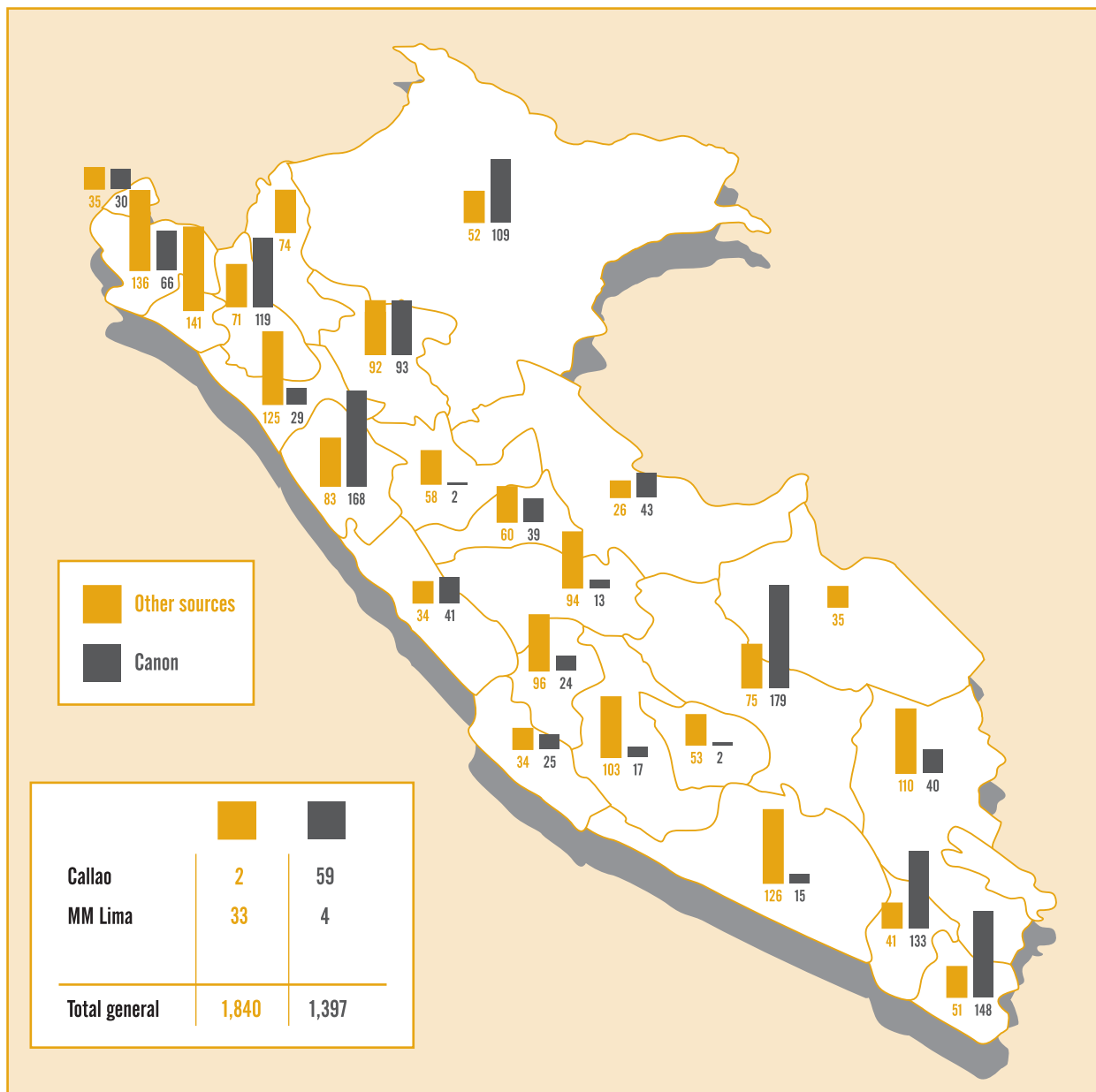
68 Made of two sources: the Regional Compensation Fund (FONCOR) and Ordinary Resources for regional governments.

69 See Reporte Nacional de Vigilancia of Industrias Extractivas No. 5, Grupo Propuesta Ciudadana, June 2007

As expected, the canon contribution to the investment budget varies from region to region. Taking the figures of the 2007 modified budget (as of June), in ten regional governments-of the 26 existing entities- the canon finances more

than 50% of the investments. A group of six (Cusco, Ancash, Tacna, Cajamarca, Moquegua and Loreto) stand out for having budgets over 100 million soles for investments, a historic figure, as shown in map 3.3.

Map 3.3
Canon Contribution to regional government investments, PIM 2007
 (million soles)



Source: MEF (Ministry of Economy and Finance)
 Prepared by: Vigila Peru

C. the Advance in the budget execution of investments as of June 2007

In this section we will use the indicator of advance in the execution of investments that is calculated by dividing the amount of realized expenses (allocation phase) and the modified budget. This is an indicator of "the expenditure efficiency", which measures how much was advanced in the execution of investment expenditure that was budgeted for the fiscal year.

In view that in only 10 regional governments, the canon finances more than 50% of the investments, the analysis of the advance in the execution of investments should consider the total investments, without distinguishing the source of finance.

The first semester of 2007, the regional governments show an advance expenditure of 19% of the total budget, while among the central government institutions the indicator is 25% (see Appendix 1). In other words, the difference is

not substantial. These figures reflect that so far, there are no clear signs that the expenditure capacity of the State has gotten any better, in both central and regional levels (look at chart 3.7).

Similarly, if we compare the first semester of 2006 and the same period of 2007, we see that the regional governments increased their investment expenditure by almost 50% (203 million soles), and the central government just by 2% (19 million soles).⁷⁰

According to the investment budgetary framework, there is need to consider that the amounts have increased dramatically in regional governments, more than the central government. As is seen, between 2004 and 2007 the investment PIM of the RG was over 3, 237 million soles, which is more than threefold its investment budget of 2004. The central government, instead, increased investments by 35% only, which was the amount planned for investments in 2004. But even so, its expenditure capacity is not much better than the regional governments.

Table 3.7

Advance in the execution of investments in regional governments and central government, 2004-2007 (in million soles and percentages)

	Regional Governments			Central Government		
	PIM (a)	Execution (b)	Advance Execution (b/a)	PIM (a)	Execution (b)	Advance execution b/a
2004	1,047	758.71	72%	3,611	2,733.00	76%
2005	1,443	994.14	69%	4,072	3,141.00	77%
2006	2,572	1,445.57	56%	4,416	2,918.00	66%
As of the first semester 2006 and first semester 2007						
2006	2,572	418.76	16%	4,416	1,215.82	28%
2007	3,237	621.90	19%	4,857	1,234.99	25%

Source: MEF (Ministry of Economy and Finance)
Prepared by: Vigila Peru

70 If we take into account period Jan-Oct 2006 and similar period in 2007, we see that the regional governments increased investment expenditure by almost 47% (451 million soles) while the central government just by 11% (227 million soles)

In absolute terms and in percentage of the GDP, the investments are indeed increasing: they have passed from 6 billion soles and 2.8% of the GDP in 2004 to more than 13 billion soles and 4% of the GDP in 2007. These increases are nevertheless insufficient considering the large deficit of services in the country: the MEF⁷¹ has calculated that the public service deficit for the citizens in the education and health sector reached 1,394 billion dollars; in transportation, 4,205 billion dollars; in electricity, 4,042 billion dollars, which totals 10,570 billion dollars.

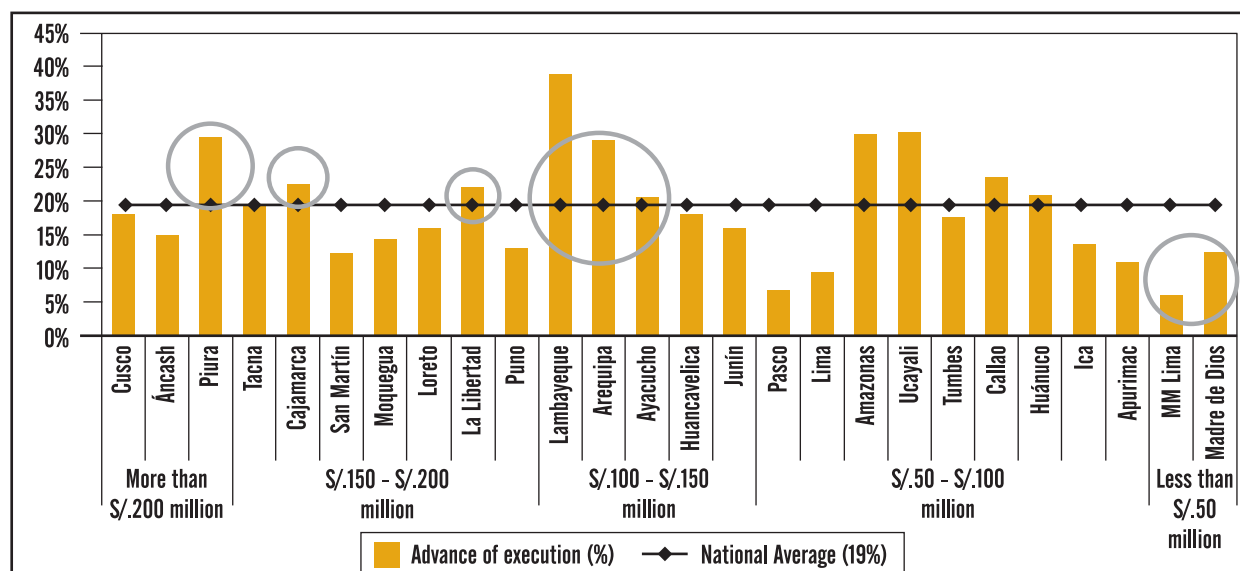
Of the group of regional governments with important resources in investments (more than 150 million soles) Piura, Cajamarca and La Libertad stand out because they have executed over 20% (See graphic 3.5). Similarly, among the regional governments with smaller budgets (between 100 million and 150 million soles)

Lambayeque, Arequipa and Ayacucho stand out (See the same graphic). In contrast, the Regional Government Program of Lima Metropolitan Municipality (PGRMML) and Madre de Dios, although they have a smaller budget for investment (less than 50 million soles) present the smallest advance of execution (See the same graphic). See Appendix 2.

In this report we should consider the known problems concerning the difficulties to execute investments and consider that 23 out of the 25 regional governments⁷² have new administrations as of January of 2007. These new administrations, as usual, have incorporated new officers that have required time to learn about public management, and also have had to review- and often reorganize- prioritized projects, budgeted by the previous administration.

Graphic 3.5

Advance in the budgetary execution of regional government investments, as of June 2007 (percentages)



Source: MEF (Ministry of Economy and Finance)

Prepared by: Vigila Peru

Note: the PIM was taken as of June 2007 and the execution is in the accrued phase.

71 See <<http://www.mef.gob.pe/DGPM/docs/docint/pres/SNIPbpg.pdf>>.

72 Except for the Government of Piura and Lambayeque that were re-elected.

Some measures to improve expenditure capacity

The first semester of 2007 was noted because diverse political actors recognized that the delay of the execution of investments is a problem that affects the entire public administration. Measures were adopted to reorganize the SNIP and loosen the rules of CONSUCODE, but so far -as the figures of the advance of execution show (in the three levels of government) we are not seeing any improvement in the speed of investment expenditure.

The case of the Sistema Nacional de Inversion Publica (SNIP), we should highlight the creation of a restructuring commission to improve it, in response to pressure exerted by some regional presidents early in 2007. This commission has been plural: participated the Under Secretary of Economy, the Director General of SNIP, the mayor of Moquegua, the Chief of Planning of MTC, the technical teams of Preinversion and the Fondo Nacional de Fomento de la Actividad Empresarial (FONAFE) and the president of RG of San Martin in representation of the recently created Asamblea Nacional de Gobiernos Regionales (ANGR).

Among the number of changes to be noted is the increase of the maximum amounts of the minimum required level of studies. Other improvements are the redefinition of the concept of replacement, i.e. the purchase of furniture and equipment for up to 300 thousand soles would not be economically evaluated and the possibility that the FONAFE's financially self-sustained projects be evaluated with criteria of private profitability and not social profitability.

Also, there was progress in the decentralization of the SNIP. Now the Oficinas de Programacion e Inversiones / Investment Programming Office (OPI) of the regional and local governments have the authority to declare the viability of their projects and to authorize the creation of programs and conglomerates (before the project group had to be authorized by the MEF).

In respect to the reform of Consucode, unfortunately so far they have not advanced much; one clear example are the two failures in the tenders to acquire police cars. In view of this, the president of the republic Alan Garcia, requested the intervention and the aid from the Programa de las Naciones Unidas para el Desarrollo (PNUD) and the Banco Interamericano de Desarrollo (BID) so that they can be put in charge of purchases and bids of the state for one or two years. We think that this proposal is short effect only, not resolving deep problems; and furthermore, there is evidence that this kind of systems is not quite transparent.

Finally, we should point out that in certain regional governments (like in Cajamarca, San Martin, and Junin) they are preparing reform initiatives of public management to adjust their organization to new challenges imposed by decentralization in terms of consensual planning, budget participation, and transparent public management, in order to improve their performance.

Mechanisms to better use the canon resources

To optimize the use of the incoming funds from the natural resources, the international experience provides financial mechanisms of diverse types that the regional and municipal governments can evaluate their application. Among them, we can mention the following:

- *Stabilization Funds*, in which the aim is the reduction in the impact of volatile revenue associated to non-renewable resources. These funds accumulate and de-accumulate wealth when the revenues are higher or lower than certain established limit, in order to isolate the effect of the variations in the prices of the resource. Thus, we have the case of the Corporacion Nacional del Cobre de Chile that has built a scheme of stabilization to avoid the adverse fluctuations in the price of copper.
- *Equity or Savings Funds* that have as an objective the accumulation of the wealth so that future generations can benefit from the revenues derived from the exploitation of natural resources in the present. There are many international experiences of this type, like the Alberto Savings Fund, the Norwegian Oil Fund and the Alaska Fund, among others.
- *Financing Funds* that have the goal to serve as a guarantee for financing sources, that can constitute as a source of security for short, medium or long term indebtedness operations, with the guarantee of resources generated from revenues from the exploitation of natural resources (for example the Kuwait Fund).

D. Public investment projects in regional governments

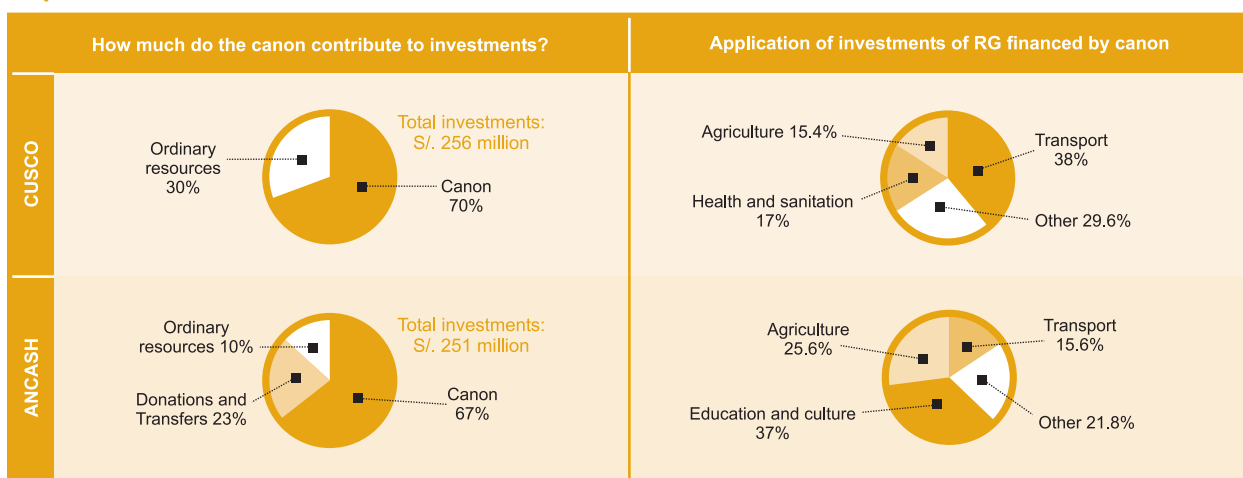
governments of the area under our scope of surveillance.

Types of Projects Programmed by regional governments based on canon resources

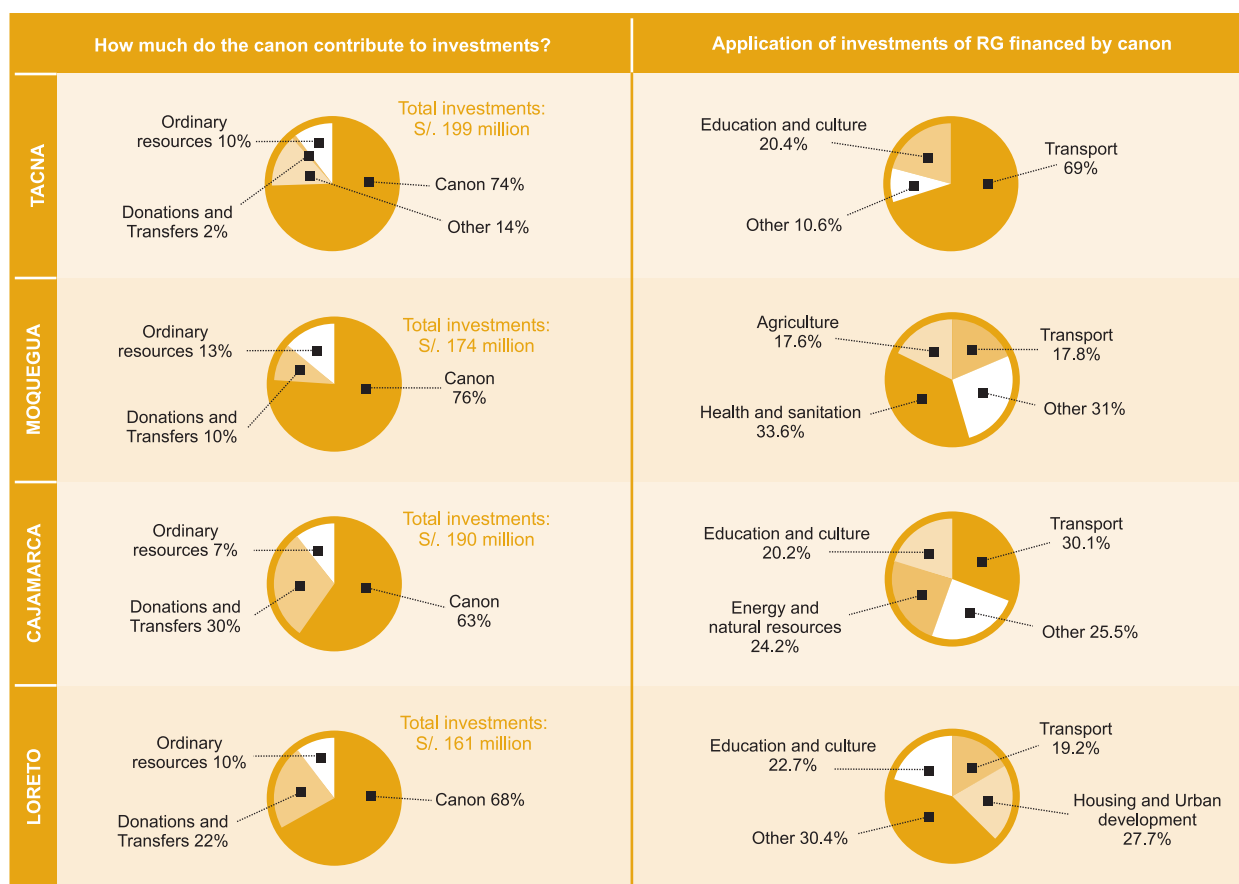
In the first place, we will present the information using the classifier for expenditure per function for the main RG financed by canon. Then, we will review the main projects of the regional

For the first semester of 2007, considering 26 regional governments⁷³ (entities), three are the functions (transport, education, health and sanitation) that continue concentrating more than 69% of the financed investments from the canon. But when we review in detail each regional government, these present

Graphic 3.6



73 In the case of the main local governments of our regions where we conduct surveillance, see Appendix 3.



peculiarities, as shown in our review of the six principal (RG) receiving canon in graphic 3.6.

culture; Moquegua and Ica, health; Loreto, housing and urban development.

The Regional governments of Cusco, Tacna, Cajamarca, Callao, Ucayali, La Libertad and Arequipa have transport as the principal purpose of financed investments from canon resources; Ancash and Piura, education and

For the sake of information, the following chart 3.8, shows the project with more execution as of the first semester 2007, financed by the canon source and total sources in the regional governments where we do surveillance.

Table 3.8
Main project executed at the end of semester 2007 by regional governments according to source

Regional Government	According to canon source	According to total sources
Áncash	Improvement of roads in central urban sectors, old Coischco and industrial zone of the city of Coischco, totally financed with canon for 1.73 million soles	The same project financed with canon
Arequipa	Improvement of the streets of traditional town of La Pampa, Socabaya in Arequipa, totally financed with canon, for 101 thousand soles	Operation and maintenance of the agrarian function that belongs totally to the Special Project Majes.Siguas for 5.15 million soles
Cajamarca	Electrification of Huarango for 1.56 million soles, totally financed with canon.	Rehabilitation and improvement of highway Cajamarca-Celendin-Balzas (9.2 million soles)

Regional Government	According to canon source	According to total sources
Cusco	Improvement of the highway Cusco-Paruro, totally financed with canon resources for 3.39 million soles (a 17% advance)	Sambor irrigation, at the end of the first semester 2007 had committed expenses for 5.1 million soles (7% from canon)
Ica	Health infrastructure, for 62 thousand soles totally financed with canon resources	Socio-economic investment that at the end of the first semester committed expenses for 849 thousand soles
La Libertad	Implementation of the North Macro regional Headquarters of INEN (National Institute of Tumor related diseases) for 357 thousand soles, 100% canon financed	Project management (11 million soles)
Moquegua	Pre-investment studies for 1.8 million soles, 86% financed with canon resources	The same project financed with canon resources
Piura	Project management for 11.6 million soles, 69% canon financed	The same project financed with canon.

The declaration of viability of the projects in regional governments

As we see in Table 3.9 eight regional governments (The Amazon, Cajamarca, Huanuco, Ica, Lambayeque, Piura, Puno and Tumbes) present a better performance in terms of the amount of the projects with a declaration of viability, that have successfully surpassed 66% (amount of the projects approved the first semester of 2007 as compared to 2006), for which it is expected that at year's end this ratio will exceed 100%.

According to the amounts of the projects with viability in relation of the last 18 months, the regional governments with an important

portfolio of projects are Cusco (310 million soles), Junin (231 million soles) and Puno (224 million soles). The regional governments of Callao and Madre de Dios, instead, only count as viable projects for a value of 44 million soles and 27 million soles respectively.

Similarly, 94% of investment projects that achieved viability in the first semester of 2007, involve amounts for less than 3.5 million soles; and only 1%, amounts over 8 million soles. On the other hand, 54% of the total amount of public investment projects declared viable in this period corresponds to projects of less than 3.5 million soles and 26% to projects of more than 8 million soles (see Table 3.10).

Table 3.9

Total cost of public investment projects with viability presented by regional governments, 2006-first semester 2007 (million soles and percentages)

	2006 (million soles)	I semester 2007 (million soles)	b/a
	Total cost (a)	Total cost (b)	
Amazonas	89	58	66%
Áncash	145	44	30%
Apurímac	57	26	46%
Arequipa	112	9	8%
Ayacucho	127	46	36%
Cajamarca	69	102	148%
Callao	44	-	0%
Cusco	266	44	16%
Huancavelica	112	27	24%
Huánuco	34	53	158%
Ica	26	41	155%
Junín	195	36	18%
La Libertad	122	19	16%
Lambayeque	40	31	78%
Lima	71	14	19%
Lima Metropolitana	39	14	35%
Loreto	79	13	16%
Madre de Dios	23	4	19%
Moquegua	135	33	25%
Pasco	46	11	23%
Piura	86	94	109%
Puno	90	133	148%
San Martín	154	17	11%
Tacna	87	4	5%
Tumbes	37	22	59%
Ucayali	96	42	44%
Total	2,380	937	39%

Source: MEF Bank of Projects

Prepared by: Vigila Peru

Note: the highlighted boxes represent ratios over 50%

Table 3.10

Proyectos viables de los gobiernos regionales según rangos de inversión al primer semestre del 2007

Type	Units	Rank of cost of public investment project (in million soles)				Total
		less than S/. 1	S/. 1 - S/. 3.5	S/. 3.5 - S/. 8	Over S/. 8	
Amounts	Million soles	127	376	189	246	937
	In percentages	14%	40%	20%	26%	100%
Number of projects	Number	406	219	35	8	668
	In percentages	61%	33%	5%	1%	100%

Source: MEF Bank of Projects

Prepared by: Vigila Peru

There is a certain decrease in the tendency to draw up projects of smaller amounts by regional governments. In other words, it passed from 77% to 61% of projects that obtained viability for less than 1 million soles; in 2006 and first semester of 2007 (See appendix 4).

During the first semester of 2007 only six regional governments (Ancash, Ica, Junin, Piura, Puno and Ucayali) were capable of having viable projects for amounts over 8 million soles. On the other hand, regional governments of Lambayeque, Lima and Tacna concentrated more than 80% of the public investment projects for amounts less than one million soles.

Also, for the last eighteen months, most of the projects that have obtained viability are of smaller size and consequently their impact is local instead of regional. The regional governments of Arequipa, Cajamarca, Lambayeque, Lima, Loreto, Madre de Dios, Puno and Tumbes concentrated more than 80% of the projects for amounts less than one million soles.

It is evident that this first semester (2007), the regional governments have produced less viable projects, possibly because to the "rearrangements" by new authorities and officers (the first semester they obtained 39% of viable amounts as compared to 2006). For this reason it is important to continue with the improvement of technical and institutional capacities for the formulation and evaluation of projects. In our opinion, one of the areas where there are deficits is in non-conventional investments projects to address problems such as; education, health and nutrition, which most probably do not require large sums, but should be technically and conceptually well conceived. Furthermore, we believe these projects should

respond to management-by-results approach that should be based on an integrated outlook of planning and budget and the articulation of actions and actors for the attainment of results.

3.3.2. Purpose and use of canon, over-canon and Royalties in public universities

According to the legal mandate (Act 28562) for 2006 the canon resources that were received by universities should be used in investment projects in scientific and technological research, understood as infrastructure and equipment for this end. The use of these funds for the payroll, remunerations or similar was prohibited. In 2007 this prohibition was lifted (2007 Budget Act 28927) and the universities were authorized to use the canon and royalties in research projects that promote the economic and productive development of the region, not only in infrastructure.

It is an opportunity and a challenge for the university community to watch over so that in their institutions research is developed that respond to the needs of the regional productive system and so contribute to regional development.

According to Table 3.11, we can point out that against what was expected most universities (six out of eight) have reduced their research budget. The most visible cases are the universities of Cajamarca, del Santa and Universidad Santiago Antunez de Mayolo. It brings to attention especially the case of Ancash, where the transfers by canon grew strongly in 2007. It is probable that this is due to the fact that the Regional Government has not yet completed transfers to the universities.

Table 3.11
Modified budget of investment of public universities, 2006 and 2007
(thousand soles)

Department	National University	PIM investments 2006	PIM investments 2007*	Variations 2007-2006
Arequipa	San Agustín	5,226	11,710	6,484
La Libertad	Trujillo	8,613	14,525	5,912
Ica	San Luis Gonzaga de Ica	5,452	4,099	- 1,353
Piura	Piura	20,339	19,279	- 1,060
Cusco	San Antonio Abad del Cusco	29,603	28,283	- 1,320
Áncash	Santa	12,526	0,460	- 12,066
Áncash	Santiago Antúnez de Mayolo	36,274	29,498	- 6,776
Cajamarca	Cajamarca	44,239	4,861	- 39,378
Total general		162,272	112,719	

Source: MEF Ministry of Economy and Finance

Prepared by: Vigila Peru

(*) PIM is as of June 2007. The figures are of investments from all sources.

On the other hand, why do six universities had their budgets reduced? It is probable that public university authorities, even when they had at their disposal more resources from extractive revenues⁷⁴ to invest, they did not budget all the money due to the same problems faced by the government to execute their investments.

After these clarifications we proceed to compare the amounts that universities have at their disposal from canon transfers with the amounts they budgeted to spend in investments. For our analysis we calculated two types of available amounts: the "theoretical" and the "real". The theoretical is obtained by assuming that the respective regional government complied with depositing the five percentage points, according to law, plus the remaining balance of the previous year of the university. The real amount is the amount actually transferred by

the regional government to the university, plus their remaining balance of the previous year.

As seen in Table 3.12, on the one hand, the public universities have at their disposal more incoming resources to invest from extractive revenues (Canon and Donations and Transfers) than had been programmed so far; but, on the other hand, the regional governments related to these eight universities are failing to complete the transfer of more than 181 million soles, in accordance with what they received in the first semester of 2007.

Furthermore, in Ancash, the Regional Government is short of transferring more than 40 million soles to each public university in the region, in accordance with what it received in the first semester of 2007. Similarly, along the same lines, the Regional Government of Cajamarca is short of transferring more than 36 million soles; and in Cusco, more than 31 million soles.

74 In the case of public universities, these benefit from extractive revenues through two financing sources: the canon, over-canon and royalties and the Donation and transfer source.

Table 3.12**PIM investments (only extractive revenues) and amount available in public universities, first semester 2007 (thousand soles)**

Department	Public University	PIM investments from extractive revenues (a)	"Real" amount available from extractive revenues (c)	"Theoretical" amount available from extractive revenues (b)	Not transferred by reg. gov. to public university
Arequipa	San Agustín	6,966	8,947	17,294	8,347
La Libertad	Trujillo	2,449	4,495	20,263	15,768
Ica	San Luis Gonzaga de Ica	385	2,353	6,705	4,352
Piura	Piura	18,318	19,258	19,391	133
Cusco	San Antonio Abad del Cusco	24,359	45,403	76,973	31,570
Áncash	Santa	16	22,661	65,022	42,361
Áncash	Santiago Antúnez de Mayolo	2,424	16,605	58,966	42,361
Cajamarca	Cajamarca	73	38,254	75,022	36,768
Total general		54,989	157,977	339,636	181,659

- (a) The 2007 investments modified budget (as of June) includes the sources that university income is registered from extractive activity: Donations and Transfers and Canon and Over-canon.
- (b) The amount that "theoretically" should be in public university accounts in the event regional governments had transferred promptly the revenues received from mining, gas, hydro-energetic, fishing and forestry canon. In addition, the accounts include transfers from oil canon, mining royalties and FOCAM that the Central Government deposits directly to universities. Also, included to the remaining balance of 2006 are Donations and Transfers, and Canon and Over-canon sources.
- (c) The "real" amount in public university accounts from actual transfers of related regional government and Central Government and their remaining balance from Donations and Transfers and Canon and Over-canon sources.

Source: MEF Ministry of Economy and Finance

Prepared by: Vigila Peru

Advance in the execution of investments

For the 2007 investment budget, the revenues from extractive industries have contributed more than 48% of the total amount in eight

universities observed. Furthermore, in universities like Piura and San Antonio Abad the canon financed more than 85% of the budgeted investments. See the following Table 3.13.

Table 3.13**Contribution from extractive revenues to university investments, 2007 PIM (June) (million soles and percentages)**

	PIM (all sources) investments	Contribution from extractive revenues
U. N. San Antonio Abad del Cusco	28.28	86%
U. N. de Trujillo	14.52	17%
U. N. de San Agustín	11.71	59%
U. N. San Luis Gonzaga de Ica	4.09	9%
U. N. de Piura	19.27	95%
U. N. de Cajamarca	4.86	1%
U. N. Santiago Antúnez de Mayolo	29.49	8%
U. N. del Santa	0.46	3%
Total	112.71	49%

Source: MEF Bank of

Prepared by: Vigila Peru

Note: PIM investments that contribute to extractive revenues is close to the Canon and Donations and Transfer source.

In respect to the advance of the budgetary execution of investments (coming from all sources) as of the first semester 2007, the eight universities together, have a financial advance of 28%, higher than the central government (25%) and also the regional governments. But it calls to attention that the Universidad del Santa has not used their resources programmed for investments, because although it represents the smallest investment budget (460 thousand soles) it has not spent anything so far.

From this group, the universities San Antonio Abad del Cusco and that of Piura present the largest budgeted amounts in investment (more than 19 million soles) and the greatest advances in the execution of investments. In contrast, the Universidad Antunez de Mayolo (also with more than 29 million soles) represents one of the smallest advances in the execution of investments (3%). See chart 3.14.

Table 3.14
Advance in the budgetary execution of investments in universities as of the first semester 2007 (percentages)

	In regard total investments
U. N. San Antonio Abad del Cusco	39%
U. N. de Trujillo	7%
U. N. de San Agustín	31%
U. N. San Luis Gonzaga de Ica	34%
U. N. de Piura	58%
U. N. de Cajamarca	50%
U. N. Santiago Antúnez de Mayolo	3%
U. N. del Santa	0%
Total general	28%

Source: Ministry of Economy and Finance

Prepared by: Vigila Peru

Notes:

PIM and execution (allocation) of investments contributed by extractive revenues is close to the Canon and Donations and Transfer source.

We believe that the problems in the execution of investments have their origin in the same factors already identified for the regional government and central government (selection process and SNIP, among others already seen). Additionally, the Ministry of Economy and Finance stipulated the viability of investment projects for year 2007 in the case of universities had to be run by the Oficina de Programacion e Inversiones/Investment Programming Office (OPI) of the Asamblea Nacional de Rectores/ National Assembly of University Presidents (ANR), with the objective of watching over the quality of projects and to speed up viability declaration of the same. But in the practice, this measure proved to be a mistake; because of delays in the evaluation and execution of projects. In June of 2007 this situation was corrected, and returned to the university's OPI, the faculty to declare the viability of the projects.

Finally, at the end of the first semester of 2007, the universities of Cusco, Piura and Cajamarca notably improved their financial execution of their investment (advances of more than 39%). To the contrary, the Universidad del Santa that presented the greatest execution advance in 2006 (88% in respect to the 10 million programmed for investment), in the first semester, had a lower execution advance.

IV. TRANSPARENCY AND ACCESS TO INFORMATION



The Transparency and Access to the Public Information Act 27806 (2002), regulates the right for all citizens to gain access to public information, be it through internet web sites or through letters sent to related civil servants. Under this framework, we will see what has been the behavior of public institutions, with regard the request of information filed.

Finally, even when the extractive companies are not bound by the Transparency Act to provide information, based on their good corporate practices and social responsibility, we have requested them information concerning the regions.

4.1. In the public sector

The provision of information regarding the use of resources from extractive industries

The Ministry of Economy and Finance (MEF) stands out by its web site Economic Transparency⁷⁵ where we find the following applications: Sistema Integrado de Administracion Financiera⁷⁶/Integrated System of Financial Administration (SIAF-SP) National and Regional Government; SIAF Consulta Amigable/Friendly Inquiry; Transfers to National, Regional and Local Governments; among others (See graphic 4.1).

In the application SIAF Consulta Amigable we find information concerning the financial

expenditure execution. In what is money spent? Where does the finance come from? In what type of projects is the canon sources and other sources invested in? But this application only shows a partial view at the expenditure management, because the information concerning the modified budget is not available, neither is the physical targets associated with financial expenses. Also non-available is information concerning income budget, or an the advance of revenues of the income of the different entities or agencies.

Similarly, it is important to point out the urgency to make public the information of SIAF for local governments. Since 2005 it was announced its public access, but unfortunately as of today this has not been put into practice. Municipalities with more budget should be integrated to this SIAF-GL, among them those that receive large amounts from the canon. This would help local social organizations to have access to this information, exercise their right to look after the local management and contribute in improving their performance.

Furthermore, in the web site of Transparencia Economica we can find the application Transfers to National, Regional and Local Governments⁷⁷ where information is available concerning central government transfers to sub-national governments from different resources (mining, oil, gas canon, Foncomun and others). The information that is presented is detailed by type of resource, month, entity, and others. It is

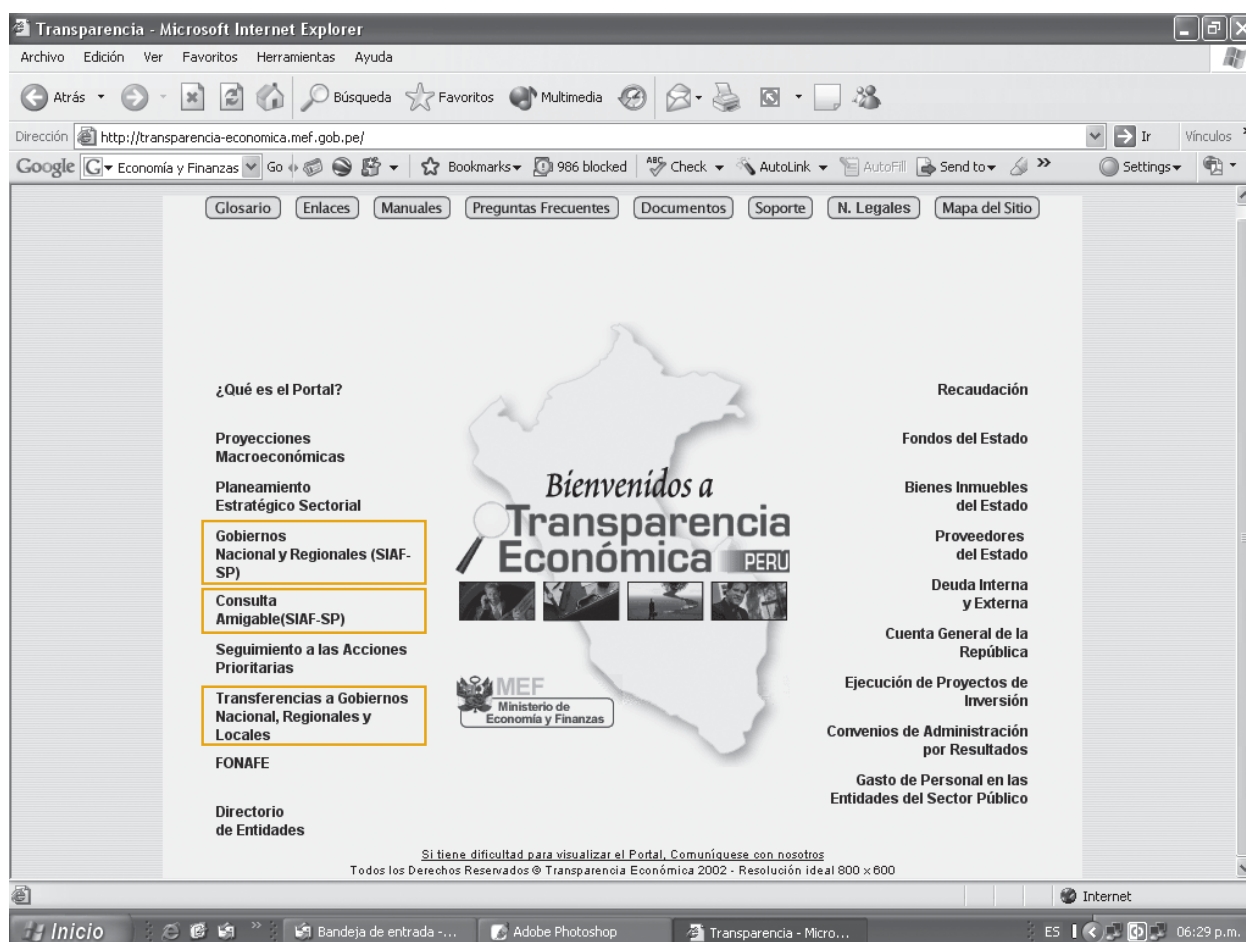
75 <http://transparencia-economica.mef.gob.pe/>

76 <http://ofi.mef.gob.pe/transparencia/default.aspx>

77 <http://ofi.mef.gob.pe/transferencias/gl/default.aspx>

Graphic 4.1

Web site of Transparencia Económica of the Ministry of Economy and Finance



important to note that this application is not free from mistakes; for example, for the present year (2007), it maintained the source "01" (Canon, Over-canon, Royalties and Participation), even when according to the 2007 Budget Act this did not exist. The Act combined source 01 and 03 (Participation in Custom Duties revenues) that became source 18 (Canon, Overcanon, Royalties, Custom Duties revenues and Participations). Another problem that we detected in this transfer application of the MEF is the delay in the transfer from the gas canon to Cusco, made up of income tax payment (50%) by Camisea,

corresponding to 2005. The transference was regularized in the months from February to May of this year (2007).

Finally, we should underline the improvement in the application of the Bank of Projects of the SNIP.⁷⁸ In the first semester, the window of presentation was modified in order to facilitate the search for information.⁷⁹ But this purpose is half fulfilled due to difficult handling (a user manual should be attached to this new presentation for a better understanding). It calls our attention that the

78 <http://ofi.mef.gob.pe/WebPortal/ConsultaBancoProy.aspx>

79 The information provided includes: name of the projects presented for evaluation, such as amount of the project, stage of evaluation in which they are, who is presenting it, who is in charge of assessing viability, the professional in charge of the Work (if that is the case), time foreseen for the execution, among other.

application to convert the SNIP code of a project into a code of the Dirección Nacional de Presupuesto Público/National Bureau of Public Budget (DNPP) is no longer on-line. This limitation makes project monitoring more difficult, from the pre inversion phase to the execution of the same.

The behavior of the Regional Public Entities with regard the request for information

To obtain the necessary information to prepare the surveillance reports, the regional teams of Vigila Peru, filed applications requesting information pursuant to Transparency and Access to Public Information Act.⁸⁰ In this section we inform about the attention that these applications received; for which we classify the answers in five categories: a) Delivery of complete information and within legal time term (CP); b) Complete delivery passed the legal time term (CF); c) Incomplete delivery within legal time term (IP); d) Incomplete delivery passed the legal time term (IF); e) No delivery of information (NE).

The behavior of the public institutions to which we requested information (regional governments, regional bureaus of mines and energy, national universities and municipalities, among others) is very heterogeneous, as can be seen in Table 4.1.

The information that we requested to all the regional governments referred to investment programs (with data about sources of financing, modified budget, execution advance of the physical and financial targets, and whether it

was an annual or multiannual project). Only the regional government of Cajamarca delivered complete information within legal time term, maintaining their good performance in terms of access to information. Unfortunately, the regional government of Moquegua has worsened in relation to the previous report, because for this report, it did not provide the information requested. Also, the regional governments of Arequipa and Ica refused to deliver information not complying with the Transparency and Access to Information Act.

In terms of the local governments,⁸¹ the municipalities that stand out are the provincial municipality of Arequipa (improved in respect to the previous report) and the one of Cajamarca (maintains its good practices) that provided complete information within the legal time term. On the contrary, in Nazca and Marcona (both in Ica), as well as Espinar (in Cusco), performance worsened with regard to report N° 5, when they delivered complete information, although passed the legal time term. The municipalities of Paucarpata (Arequipa), Huaraz and Independencia (Ancash), Espinar (Cusco), Quiruvilca (La Libertad) and Talara (Piura) refused to provide the information requested, not complying with the Transparency Act.

In public universities⁸², the scenario has not been encouraging at all. Only the National University of Trujillo provided complete information within the legal time term. On the other hand, the universities of Santa (Ancash) and San Antonio Abad (Cusco) refused to provide information.

80 The Act provides that «the Public Administration entity, before which an application requesting information has been filed, should provide it within a seven (07) day term, a term that can be postponed exceptionally for five (05) additional working days when circumstances make it difficult to gather the information requested. In this case, the entity has to notify in writing, before the deadline, the reasons why it needs to make use of the time extension, otherwise the request will be considered rejected» (Section 11.b of Act 27927)

81 The information requested is the same than that of regional governments.

82 We have requested their investment programs.

From the eight regions under surveillance, five regional bureaus in the mining and energy sector did not provide information (Arequipa, Cusco, La Libertad, Piura and Moquegua). Similarly, in the headquarter offices of Ica and Moquegua their performance has worsened in respect to the previous report, when they provided complete information within the legal time term. For this report, they provided incomplete information passed the legal time

term (Ica) or they did not provide information (Moquegua).

The Defensoria del Pueblo/Ombudsman Offices of Ancash, Cusco, La Libertad and Piura did not provide the information requested (record of events of tension in the region due to extractive activity), which calls our attention being this one of the promoter entities of transparency practices and access to information.

Table 4.1

Attention to applications requesting information filed with public entities in the regions, 2006

Name of the public institution	Arequipa	Áncash	Cajamarca	Cusco	Ica	La Libertad	Piura	Moquegua
Dirección Regional de Energía y Minas-DREM	NE	IF	IF	NE	IF	NE	NE	NE
Defensoría del Pueblo	CF	NE	IF	NE		NE	NE	IP
Municipalidad 1	CP	NE	CP	NE	IF	NE	NE	NE
Municipalidad 2	NE	NE		IF	IF	IF	IF	
Gobierno Regional	NE	CF	CP	CF	NE	CF	CF	NE
PERUPETRO				CF			CF	
Superintendencia Nacional de Administración Tributaria-SUNAT	CF	NE	NE	NE		NE	CF	
Dirección Regional de Trabajo						IF		NE
Universidad Nacional 1	CF	NE	NE	NE	NE	CF	CF	
Universidad Nacional 2		NE						

Source: Regional Reports of Surveillance of Extractive Industries No. 5

Prepared by: Vigila Peru

(CP) Delivery of complete information and within legal time term

(CF) Complete delivery passed the legal time term

(IP) Incomplete delivery within legal time term

(IF) Incomplete delivery passed the legal time term

(NE).No delivery of information

Note: the dark boxes show entities that were not requested information because there was no need for the regional report

Municipalities to which we requested information								
Municipalities	Arequipa	Áncash	Cajamarca	Cusco	Ica	La Libertad	Piura	Moquegua
Municipality 1	Arequipa	Huaraz	Cajamarca	Espinar	Nazca	Quiruvilca	Talara	Mariscal Nieto
Municipality 2	Paucarpata	Independencia		Echarate	Marcona	Santiago de Chuco	La Brea	

Note: the dark boxes show entities that were not requested information because there was no need for the regional report

Public Universities to which we requested information								
Public Universities	Arequipa	Áncash	Cajamarca	Cusco	Ica	La Libertad	Piura	Moquegua
National University 1	San Agustín de Arequipa	Santiago Antúñez de Mayolo	Nacional de Cajamarca	San Antonio Abad del Cusco	San Luis Gonzaga de Ica	Nacional de Trujillo	Nacional de Piura	
National University 2		Del Santa						

Note: the dark boxes show public universities that were not requested information because there was no need for the regional report

4.2 The Behavior of Extractive Companies

Results of applications requesting information

Relying on their practices of social responsibilities and transparency, in each region, we filed applications requesting information to the extractive companies about topics such as 2006 income tax payment⁸³, its actions and investments in social responsibility projects and its mechanisms to relate with the impacted communities due to its activities. We also requested information about the advances of the so-called voluntary contribution, though;

none of the companies provided this type of information.

The practice in Yanacocha concerning provision of information is outstanding (through the Asociación los Andes de Cajamarca), even though, in an incomplete manner. Also, in comparison with the previous report, when Petrobras Energía Peru S. A. provided complete information, this time did not provide requested information. Unfortunately, the rest of the main companies located in areas where we do citizen surveillance maintain their refusal to provide information, as it is shown in Table 4.2.

83 There is an initiative, such as the Extractive Industries Transparency Initiative (EITI in English), that the following: "we are determined to promote high levels of transparency and accountability in public, the government activities and the economic activity" and "we believe that the disclosure regarding payments in a certain country should cover all the companies dealing with extractive industries that develop operations in that country".

Table 4.2**Attention to applications requesting information filed with extractive companies, 2006**

Region	Type of attention*		
	Provided information	Provided incomplete information	Did not provide information
Arequipa			Sociedad Minera Cerro Verde S.A.A./ Cía. de Minas Buenaventura S.A.A./ Cía. Minera Ares SAC.
Áncash			Cía. Antamina /Cía. Mra. Barrick Misquichilca.
Cajamarca		Yanacocha	Mra. Golfield
Cusco			Xstrata Tintaya / Pluspetrol
Ica			Shougang Hierro Perú S.A.A.
La Libertad			Minera Barrick Misquichilca S.A.- Mina Lagunas Norte
Piura			Petro Tech Peruana SAC. Petrobrás Energía Perú S.A.
Moquegua			Southern Perú Copper Corporation / Aruntani SAC.

Source: Regional Reports of Surveillance of Extractive Industries No. 5

Prepared by: Vigila Peru

Note: * Pursuant to law, they are not bound to provide information.

V. CONCLUSIONS AND RECOMMENDATIONS



7.1. CONCLUSIONS

Generation of revenues in the mining sector

1. The economic momentum of the mining sector shown in the last three years is maintained in the present, with the difference of a deceleration of the growth rate during the first semester of 2007. The value of mining production (VMP) increased by 16% with respect to the same period in 2006, a figure that we consider high, even when it is below the average of the last three years: 46%. This smaller rate is explained because prices grew in a slower rate than previous years, and for the strong drop in the extraction volumes of gold by Yanacocha mining.
2. Considering the useful life of the mining units in exploitation, it is possible to affirm that the extraction of minerals observed in the last two years will maintain similar levels until 2010. Mining production will be concentrated in five departments (Ancash, Arequipa, Pasco, Moquegua and Tacna); consequently, these regions will receive more transfers by the mining canon and royalties. However, there are projects waiting in file that if carried out will modify the referred productive scenario and thus the canon transfers associated with this.
3. In 2006, almost half of the net profits of mining companies were *extraordinary profits*, called so because they originate due to a strong increase in prices. By 2007, the forecast is that this scenario will not change: during the first semester, the mining company profits reached 13,000 million soles, in comparison with 11,300 million during the same time period in 2006, and the year's forecast is close to 26,000 million soles, a figure higher than the 22,000 million that the companies obtained in 2006.
4. The contribution of the mining sector to the treasury is each time greater in absolute and relative terms, which is starting to produce a dangerous reliance on fiscal revenues with respect to the mining sector, whose earnings are vulnerable to the changes in the world market. The end of the first semester of this year, 27% of internal taxes and 45% of income tax collected by SUNAT came from the mining sector. It is important to recall that in 2002 they amounted to 4% and 9% respectively.
5. As of the first semester of 2007, the transfers by the mining canon reached 5,157 billion soles, almost threefold what was transferred in 2006 and six fold what was transferred in 2005. This time the transfer was made in one only quota and not in twelve as before. Accordingly, the next transfer of mining canon to the regions will be completed in June 2008. The main effect of this decision has been to make available more resources that certain regions and municipalities have in their bank accounts, because with existent institutional capacities it is impossible to program the

execution of these resources in the present year.

6. This great amount of resources is generating a growing inequality between regions and municipalities of the country. The six regions that receive more resources (Ancash, Tacna, Cajamarca, Moquegua, Pasco and Puno) concentrate 80% of the transfers made in 2007; and if we include La Libertad and Cusco, this total reaches 88%. This situation is produced because the mining production is concentrated in few regions and because, pursuant to law, the mining canon benefit only the producer regions.
7. The consolidated figures concerning profits, taxes and production cost of the mining sector permit to conclude that in 2006 the profit sharing of companies in the total value of wealth generated reached the highest level of the last 4 years, 43%, when in 2003 it bordered 18%. Therefore, the Peruvian State cannot waive its right to share of a greater amount of this extraordinary income from mining resources, as other states in the world are doing. The voluntary contribution negotiated by the current administration is by all means disadvantageous for the country - representing 5 % of the extraordinary profits that the companies obtained in 2006 -, for which it should be revised and modified.
8. In terms of the implementation of the voluntary contribution, at the end of the first semester 2007, there were 35 signed agreements and 39 local and regional funds had created for a total amount of 517.9 million soles. Agreements with six mining companies are still pending. Due to the "private" nature that the government accepted to grant these funds, the information that can be gathered about their creation and implementation is very limited. The scarce data available indicates that only in Antamina (Ancash) and

Yanacocha (Cajamarca), the funds count already with a pool of identified projects; in other regions the advance is very limited.

9. In the country there is no official source that informs about the revenue generated in the mining sector and that may allow monitoring from its inception, what is possible to do in the hydrocarbon sector, where citizens can obtain information of prices, volumes of extraction, value of production and canon.

Generation of the revenues in the Hydrocarbon Sector

1. In the case of oil and liquids of natural gas (LGN), up to the first semester 2007 the productive dynamic of the sector was maintained without major variation with regard to the same period in 2006: 1.2% and -1%, respectively. The discovery of new oil wells has only stopped the decreasing tendency of the extraction of these two products. In the case of natural gas (GN), the increase of the first semester of 2007 with regard to the same period in 2006 was by 61%, associated to a high increase in industrial, domestic demand and that of vehicles.
2. The basket of price reference of hydrocarbon prices up to the first semester 2007 did not present big variations with regard to the same period in 2006. This has led to 4% set back in the value of the hydrocarbon production; although the fall in Huanuco and Loreto was 12 % and 21%, respectively. This led to the reduction in these regions, of transfers by canon - calculated as a percentage of the total production value-.
3. The oil canon experienced a decrease that is associated with the set back in production. So, the canon totaled 534.7 million soles, a figure 2.5% less than the one obtained in a similar period in 2006,

when it reached 548 million soles. The FOCAM also decreased 9%, because 54.1 million soles were transferred in the first semester, when in the same period in 2006 reached 59.4 million soles.

4. Of the 702 million soles transferred by canon (oil and gas) and FOCAM in the first semester of 2007, the regions that received more resources were Cusco (314 million soles), Loreto (134.1 million soles) and Piura (121.1 million soles).

Canon Use

1. For 2007, by law 28927 (the 2007 Public Budget Act), regional and local governments were authorized to allocate up to 20% of the incoming canon resources, over-canon and royalties to the maintenance of infrastructure generated by regional and local projects, and to expenses demanded by selection processes for the execution of public investment projects. Also, they were authorized to allocate up to 5% to finance the preparation of profiles of public investment projects.
2. Similarly, the 28927 Act eliminated a restriction imposed on national universities that limited spending canon resources only in infrastructure and equipment, and authorized them to "[...] with the contribution they received from canon, over-canon and royalties to carry out research that promote the economic and productive development of the regions".
3. With the Urgency Decree 013-2007 (May 10, 2007) regional governments were authorized for the fiscal year 2007, the hiring of teachers with canon and over-canon resources. But this decree, apart from contradicting the canon Act, poses the risk

of using canon resources – which is a temporary income- to pay for teachers, which is a payment of a permanent nature that should be financed with stable ordinary resources.

4. As of the first semester 2007, according to the web site Transparencia Economica of the Ministry of Economy and Finance, by way of canon (the six types), and mining and gas royalties a total of 6,175 million soles have been transferred to the regional governments, municipalities, universities and institutes, of which 83% (5,157 million) correspond to the mining canon, which is an indicator of the significance acquired by this sector in canon transfers.
5. Concerning sub-national governments' share of revenues from canon, over-canon and royalties, we found that as of the first semester of 2007, local governments had the greatest share (73.8%); then, regional governments (19.7%); and finally, the educational entities, i.e. universities and institutes (6.5%). In the case of institutes, they only participated in the transfers of oil canon and over-canon.
6. With regard the distribution of the canon resources by departments, we verified that as a result of the mining canon being transferred in only one quote, the concentration has been stressed. In fact, five departments concentrate 68% of the transfers (in the period 2004 – 2006 five regions concentrated 55%). In this process what has varied is the ranking of benefited regions: Ancash advanced from the seventh position to the first one and Tacna from fourth to second. On the other hand, the five regions that received less transfers continue being the same and their share has not changed: Madre de Dios, Callao,⁸⁴ San Martin, Amazonas and Lambayeque share

84 In Callao the situation varies if Custom Duties are taken into account, which involve significant figures.

only 0.02% of the total, each with less than 800 thousand soles.

7. Comparing available resources by canon with the budgeted ones, as of June 30th, there are amounts not included in the modified budget of 2007 corresponding to regional government. In the case of Ancash, Tacna, Cusco, Moquegua, Cajamarca, Pasco and La Libertad (with 192 million, 81 million, 23 million, 33 million, 34 million, 55 million and 40 million soles, respectively), these amounts are very similar to the resources from mining canon corresponding to the period January–May 2008, included in the "sudden" transfers that government completed in June; therefore. Therefore, it should not be a surprise that these resources exist.
8. As expected, the canon contribution to the investment budget of the regional governments varies from region to region. Taking the figures of the modified budget 2007 (up to June), in ten regional governments – from the 26 existing entities– the canon finances more than 50% of investments. A group of six regional governments (Cusco, Ancash, Tacna, Cajamarca and Loreto) stand out by having the greatest budgets (between 100 and 180 million soles) from canon for investments.
9. As of the first semester 2007, the regional governments show an advance of the allocated expenditure of 19% of the total budget for investments. Among the central government institutions, the indicator is 25%. As seen, the differences are not substantial. These figures reflect that there are no clear signs of improvement in the capacity of state expenditure, both in the regional and the central level, as a result of reorganization measures of the Sistema Nacional de Inversion Publica and flexibility of the rules by CONSUCODE.
10. With regard the destiny of the canon resources as of the first semester 2007 and considering the ten regional governments with greater amounts of canon budgets, three functions continue concentrating more than 69% of the financed investments with the mentioned resources: (transportation, education, culture, health and sanitation)
11. In the regional governments the tendency to draw projects involving small amounts prevails: 94% of investments projects that attained viability in the first semester of 2007 involve amounts of less than 3.5 million soles, and only 1.2% have budgeted amounts superior to 8 million soles.
12. With regard the investments of the eight public universities (within the geographic area of our study), we can point out that they have more resources available to invest than those programmed at the end of June 2007. Additionally, the regional governments still have not transferred to them 181 million soles, amount that belongs to them for the canon that the regions received in the first semester of 2007.
13. Concerning the advance in the budgetary execution of investments (all sources) as of the first semester of 2007, the eight universities together had a financial advance of 28%, higher than the central government's (25%) and that of regional governments. In this group, the universities San Antonio Abad of Cusco and that of Piura present the highest budget amounts for investment (more than 19 million soles) and the greatest execution advance. On the other hand, the university Santiago Antunez de Mayolo (with more than 29 million soles) presents one of the lowest execution advances of investments (3%).

Transparency and Access to Information

1. The behavior of regional public entities concerning applications requesting information is heterogeneous. Among the regional governments, only Cajamarca has provided complete information and within the legal time term, maintaining its good performance in access to information with regard the previous report. The regional government of Moquegua, did not provide the information requested and its performance worsened. The regional governments of Arequipa and Ica refused to provide information.
2. In regards the local governments, it is important to highlight the performance of the provincial municipalities of Arequipa and Cajamarca, that provided complete information and within the legal time term.
3. In the public universities the scenario is not encouraging: only the National University of Trujillo provided complete information within the legal time term. Finally, it calls our attention that the offices of the Defensoria del Pueblo/Ombudsman Office of the regions Ancash, La Libertad, Cusco and Piura have not provided the information requested.
4. Most extractive companies did not respond to our applications requesting information presented in the regions. The exception is Yanacocha that through their Asociacion los Andes de Cajamarca, continues providing requested information; even if in an incomplete manner. It has been proved once again with few exceptions that extractive companies talk about transparency that in fact do not practice.

7.2 RECOMMENDATIONS

1. Now that the government is prioritizing mining investments, it is essential to increase transparency regarding the production value, as well as the tax and non tax payments that the companies make, in an individual way. This information should be provided by the Ministry of Energy and Mines or Economy. Along these lines, we express our concern for the impasse of the Extractive Industries Transparency Initiative (EITI) Peru - that responds to a commitment of the Peruvian State with global EITI-, whose aim is precisely to increase the transparency referred to payments made by the companies to the States.
2. The Ministry of Energy and Mines, and related mining companies, should develop a database on prioritized projects as an expression of transparency and social responsibility that they proclaim, executed under the framework the Programa Mine-ro de Solidaridad con el Pueblo/ Mining Program of Solidarity with the People (Voluntary Contribution). Hence, in each region and in the country, citizens can inform themselves about their advance and exercise their right of surveillance they are entitled to. Let us recall that this fund originated from a negotiation between the central government and the mining companies, eluding the application of a tax on extraordinary profits.
3. The current scheme of canon distribution is not sustainable anymore and should be revised bearing in mind that, in first place, it is necessary to reduce the inequality in the distribution that is observed in the interior of the producer departments. Then, we should think in the creation of a compensation fund that will benefit the departments that do not receive from the canon and that have high rates of poverty.
4. To optimize the use of incoming canon resources and royalties through the creation of investments funds (trusts) that will allow the regional governments and municipalities that receive important revenues of this nature, stabilized the flow of their future income, finance significant projects and also make intergenerational transfers of earnings.
5. To improve the capacity of the State to manage investments is a priority that should be led by the national government, in alliance with regional and local governments; specially, with those that receive greater canon transfers. For this purpose, the State should start by implementing the Centro de Planteamiento Estratégico/Center for Strategic Planning (CEPLAN), an endeavor that the Executive Power maintains paralyzed, although this agency has its budget.
6. To establish, through an Act by Congress, that the Ministry of Economy and Finance should transfer canon resources directly to the universities, without regional governments acting as intermediaries.



Appendix 1

Execution of Investment in the Central Government

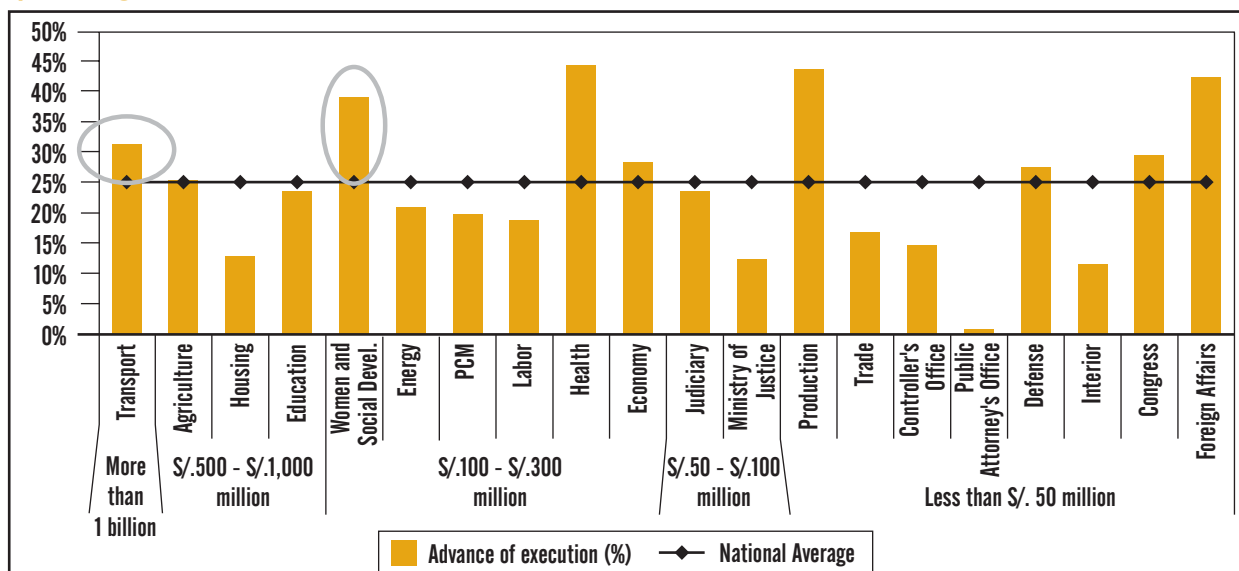
For the purpose of our analysis, we have considered convenient to group the sectors according to the amounts of investment. This is because demands are different when planning investments less than 50 million soles than investments over 200 million soles. Similarly, it is different to present an advance of execution of 90% in respect to one million

soles than having to do it in respect to 100 million soles.

The sector of central government with the greatest advance of execution in investments is transportation⁸⁵, see Graphic 3.5. This advance is mainly due to the Ministry of Transport and Communications (MTC) and specifically to the executor unit Provias Nacionales, that presented an execution of 31% of the budgeted figure for investments. In addition, this Ministry has the highest budget for investments: 1,341 million soles.

Graphic 1

Advance in the budgetary execution in investments in national government sectors, as of June 2007 (percentages)



Source: MEF (Ministry of Economy and Finance)

Prepared by: Vigila Peru

Note: the PIM was taken as of June 2007 and the execution is in the accrued phase.

85 This sector presents three entities: The Train Huancayo-Huancavelica administration, INICTEL and the Ministry of Transport and Communications.

What is the reason for the good budgetary performance of this executor unit? As a hypothesis, we can say that it is a result of important projects of Provias Nacional that continue in progress since last year; and therefore, are in a stage ahead from the pre-investment phase (planning and evaluation); and in addition, it has a consolidated team and

procedures for the execution of investments. On the other hand, Provias Descentralizado (another executive unit of MTC) faces problems in the execution of their investments because many of their projects are under evaluation, and the entities in charge planning and evaluation are the regional governments.

**Table 1. Central Government Investments, 2007
(in million soles and percentages)**

Ranks	Entities	PIA 2007 (a)	PIM April 2007 (b)	PIM June 2007 (c)	Exec. Allocation June 2007(d)	b/a	c/b	c/a	Advance (d/c)
Mas de 1,000 millones	Total 36. Transport & Communications	1,022.06	1,268.95	1,341.61	414.44	124%	106%	131%	31%
500-1,000 millones	Total 13. Agriculture	574.47	606.35	683.54	174.28	106%	113%	119%	25%
	Total 37. Housing, Construction and Sanitation	942.61	905.25	680.29	84.54	96%	75%	72%	12%
100-300 millones	Total 10. Education	452.74	584.62	635.85	148.44	129%	109%	140%	23%
	Total 39. Women & Social Devel.	275.30	283.40	301.43	118.04	103%	106%	109%	39%
	Total 16. Energy and Mines	341.33	271.80	297.27	61.27	80%	109%	87%	21%
	Total 01. Presidency Council of Ministers	147.71	152.64	199.62	39.79	103%	131%	135%	20%
50-100 millones	Total 12. Labor and Promotion of employment	178.35	139.33	172.83	31.83	78%	124%	97%	18%
	Total 11. Health	33.69	155.44	166.73	74.16	461%	107%	495%	44%
	Total 09. Economy and Finance	94.12	102.17	105.95	29.70	109%	104%	113%	28%
Menos de 50 millones	Total 04. The Judiciary	25.46	50.22	57.94	13.47	197%	115%	228%	23%
	Total 06. Ministry of Justice	24.88	28.95	53.17	6.36	116%	184%	214%	12%
	Total 38. Production	14.19	41.64	45.30	19.65	293%	109%	319%	43%
	Total 35. World Trade and Tourism	36.56	33.20	32.87	5.49	91%	99%	90%	17%
Total general	Total 19. Controller's Office	20.23	22.82	22.82	3.27	113%	100%	113%	14%
	Total 22. Public Attorney's office	3.14	3.14	17.64	0.09	100%	561%	561%	1%
	Total 26. Defense	7.61	12.61	15.03	4.10	166%	119%	197%	27%
	Total 07. Interior	6.26	8.25	12.44	1.39	132%	151%	199%	11%
	Total 28. Congress	10.86	11.45	11.45	3.39	105%	100%	105%	30%
	Total 08. Foreign Affairs	1.32	1.32	3.06	1.29	100%	232%	232%	42%
Total general		4,212.90	4,683.57	4,856.84	1,234.99	111%	104%	115%	25%

Note: the advance in execution is as of June 2007
Source: Ministry of Economy and Finance. Own preparation

APPENDIX 2. Regional government Investments, 2007 (in million soles and percentages)

Ranks	Entities	PIA 2007 (a)	PIM April 2007 (b)	PIM June 2007 (c)	Exec. Allocation June 2007(d)	b/a	c/b	c/a	Advance (d/c)
Mas de 200	Cusco	160.89	204.35	254.42	45.04	127%	125%	158%	18%
	Áncash	124.09	248.83	251.17	37.21	201%	101%	202%	15%
	Piura	101.48	149.69	202.49	59.74	148%	135%	200%	30%
150-200	Tacna	120.56	122.81	199.08	37.49	102%	162%	165%	19%
	Cajamarca	83.63	121.10	190.05	42.61	145%	157%	227%	22%
	San Martín	93.40	176.75	185.00	22.89	189%	105%	198%	12%
	Moquegua	105.04	186.76	174.10	24.48	178%	93%	166%	14%
	Loreto	93.98	157.72	160.75	25.78	168%	102%	171%	16%
	La Libertad	87.15	146.42	154.09	34.07	168%	105%	177%	22%
	Puno	52.63	99.74	150.05	19.34	189%	150%	285%	13%
	Lambayeque	113.52	135.30	140.98	54.72	119%	104%	124%	39%
	Arequipa	79.53	113.43	140.31	40.52	143%	124%	176%	29%
	Ayacucho	37.06	87.51	120.61	24.76	236%	138%	325%	21%
100-150	Huancavelica	70.16	106.14	120.37	21.31	151%	113%	172%	18%
	Junín	58.23	101.79	106.50	17.13	175%	105%	183%	16%
	Pasco	41.68	71.06	98.98	6.78	170%	139%	237%	7%
	Lima	31.94	59.84	74.84	6.83	187%	125%	234%	9%
	Amazonas	41.90	47.64	74.47	22.05	114%	156%	178%	30%
50-100	Ucayali	45.78	62.45	68.72	20.66	136%	110%	150%	30%
	Tumbes	30.19	52.45	64.80	11.34	174%	124%	215%	17%
	Callao	38.33	61.00	61.01	14.41	159%	100%	159%	24%
	Huánuco	31.59	39.06	59.23	12.41	124%	152%	187%	21%
	Ica	35.26	58.74	58.86	7.96	167%	100%	167%	14%
	Apurímac	21.71	25.28	54.25	5.85	116%	215%	250%	11%
	MM Lima	34.84	36.66	36.48	2.22	105%	100%	105%	6%
Menos de 50	Madre de Dios	15.91	17.60	35.39	4.31	111%	201%	222%	12%
Total general		1,750.51	2,690.12	3,237.00	621.90	154%	120%	185%	19%

Note: the advance in execution is as of June 2007

Source: Ministry of Economy and Finance. Own preparation

Appendix 3

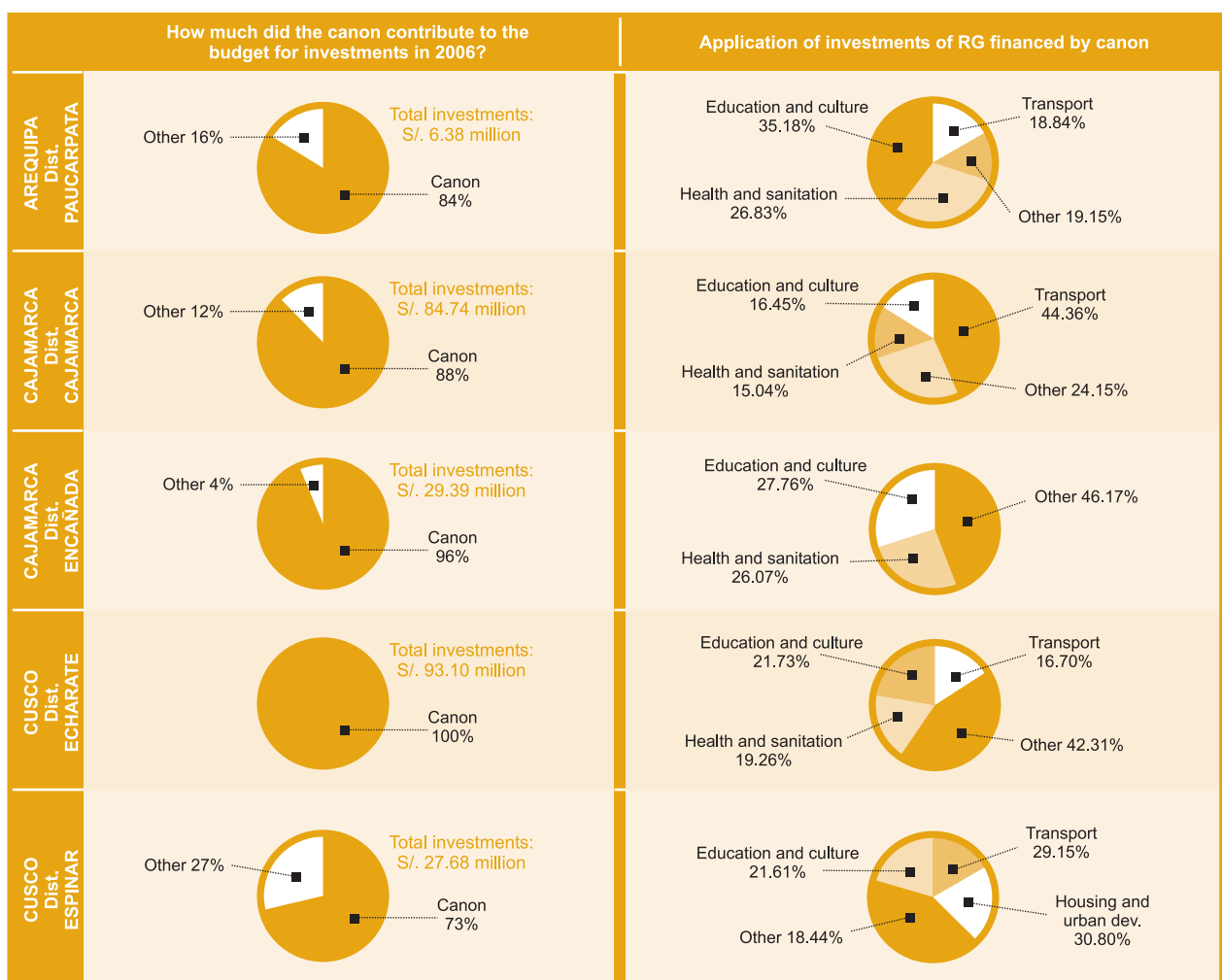
Use of Canon Resources in the Local Governments

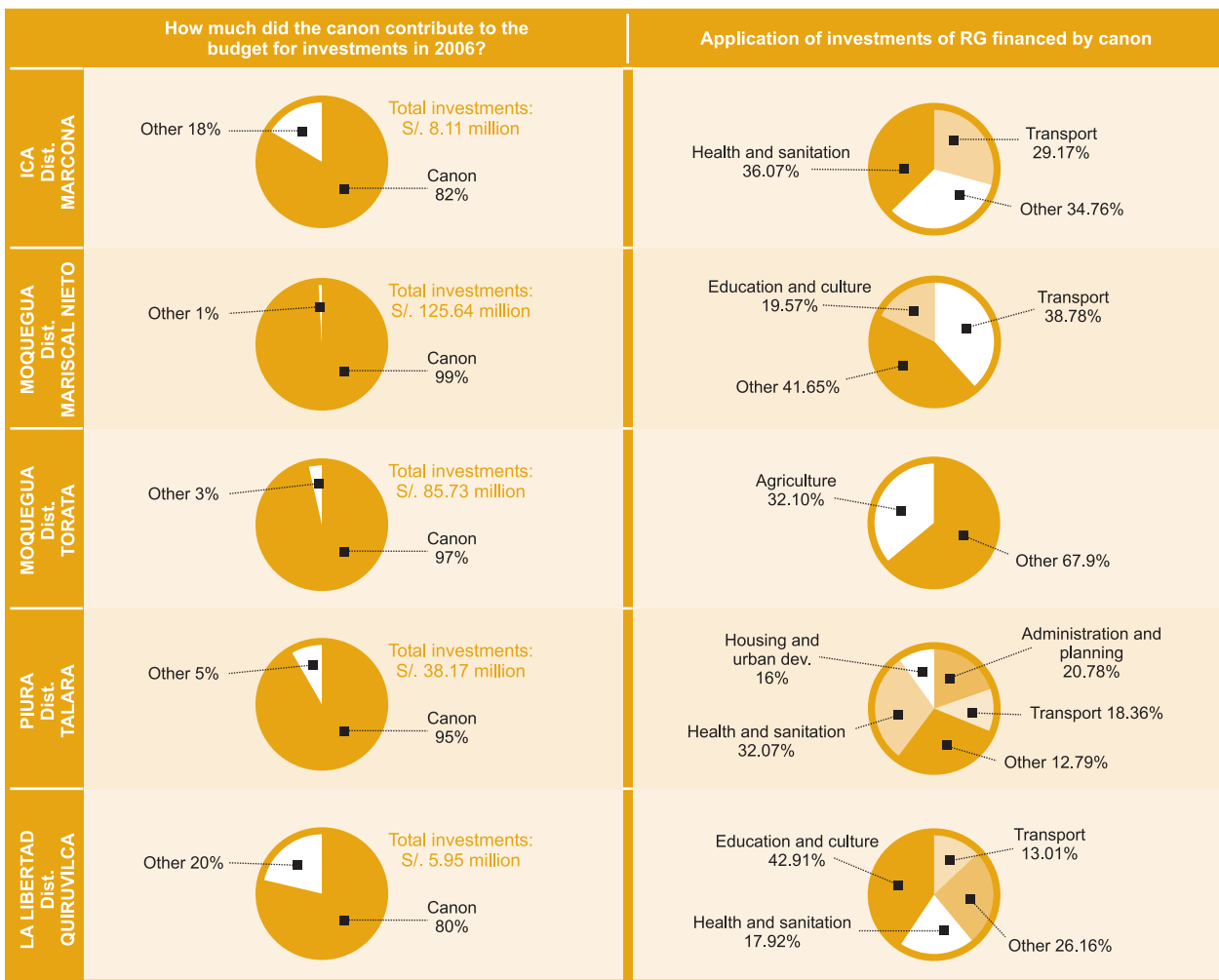
Type of projects financed by local government with the canon resources

In the ten municipalities that receive more canon in the seven regions of study, we observed that the canon finances more than 80% of investments (information provided by the Ministry of Economy and Finance for 2006). It is important to point out that the MEF through the SIAF-GL did not present a register of investments of San Marcos municipalities (in Ancash).

In this group the municipalities of Cajamarca (in Cajamarca), Echarate (Cusco), and Mariscal Nieto and Torata (both in Moquegua) stand out, having budgeted more than 80 million soles in investments. On the other hand, it calls our attention that both the regional government of Piura and the municipality of Talara designated 20% of its investment expenditure for administration and planning.

In conclusion, we noted that the municipalities studied earmarked canon resources, mostly for projects in education, health and transport





Advance of Canon Execution in Investments (local governments under study, 2006)

With regard to the canon, over-canon, royalties source and participation; according to the Bulletin of Fiscal Transparency of February 2007 (MEF), the advance of financial execution increased from 57% in 2005 to 66% in 2006. This has been so even when the transfers and the Modified Institutional Budget (PIM) of the municipalities had been increasing.

The municipalities that stand out in the execution of investments are La Encañada (Cajamarca), Paucarpata (Arequipa) and Talara (Piura), which present the greatest advances in the execution, higher than the national average (66%). It calls our attention that municipalities like Mariscal Nieto (Moquegua), Echarate (in Cusco) and Torata (in Moquegua) have spent more than 40 million soles, more than what was spent in the same period (2006) by regional governments like Tacna (that spent 38 million of 81 million soles) and Ancash (28 million of 70 million soles).

Table 3.12**Advance of budgetary execution 2006 of canon in investment of local governments
(million soles and percentages)**

Department	Districts	PIM 2006	Execution 2006	Advance
Moquegua	Mariscal Nieto	125.64	64.48	52%
Cusco	Echarate	93.10	44.36	48%
Moquegua	Torata	85.73	44.80	54%
Cajamarca	Cajamarca	84.74	38.69	52%
Piura	Talara	38.17	28.76	79%
Cajamarca	Encañada	29.39	26.77	94%
Cusco	Espinar	27.68	10.54	52%
Ica	Marcona	8.11	3.00	45%
Arequipa	Paucarpata	6.38	4.65	87%
La Libertad	Quiruvilca	4.76	2.81	59%

Source: Ministry of Economy and Finance
Prepared by: Vigila Peru

Which have been the main projects executed in 2006, with canon resources

- District municipality of Paucarpata (Arequipa): the construction of the stadium, for a total of 765 thousand soles.
- Provincial municipality of Cajamara (Cajamara): pavement of roads, for 12.2 million soles.
- Provincial municipality of Espinar (Cusco): the construction of schools, for 4.1 million soles.
- District municipality of La Encañada (Cajamarca): construction of schools, for 4.1 million soles
- District Municipality of Echarate (Cusco): construction of potable water supply and drainage systems, for 5.9 million soles
- District municipality of Marcona (Ica): construction of street roads and sidewalks, for 865 thousand soles.
- Provincial municipality of Mariscal Nieto (Moquegua): construction of urban roads. In 2006 8 million soles were allocated and the financial execution was 89%, as part of the municipality's commitment, in a joint project with other local governments.
- District Municipality of Torata (Moquegua): improvement of irrigation canals, for 4.6 million soles.
- District Municipality of Talara (Piura): coverage expansion of solid waste collection services in the district of Pariñas, for 2.7 million soles.
- District Municipality of Quiruvilca (La Libertad): improvement of roadways, for 591 thousand soles.

Appendix 4 Viable projects of regional governments according to investment ranks, 2004-2006

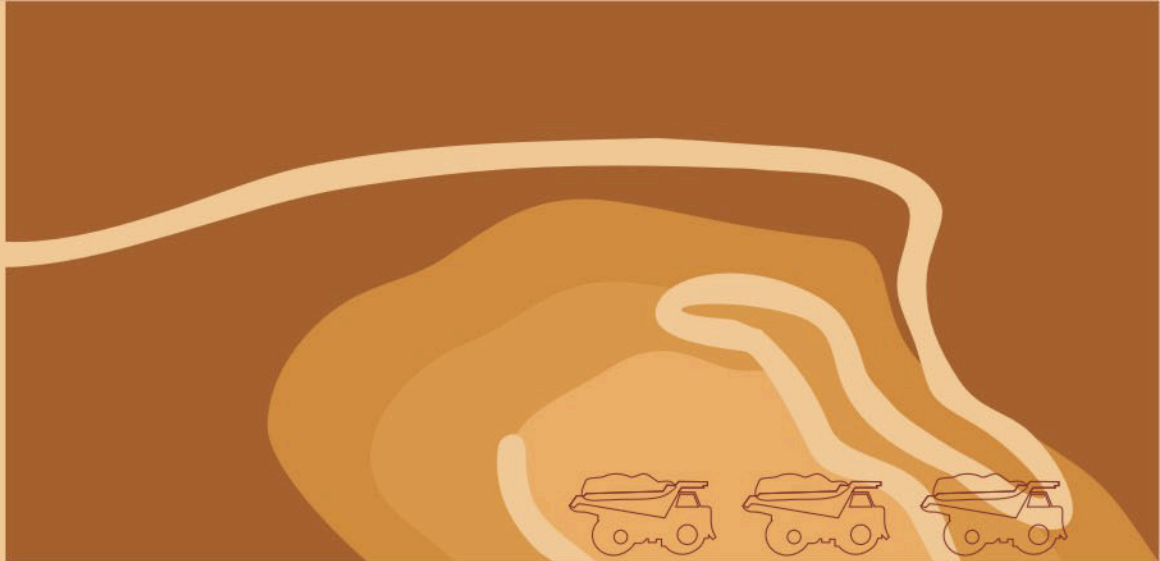
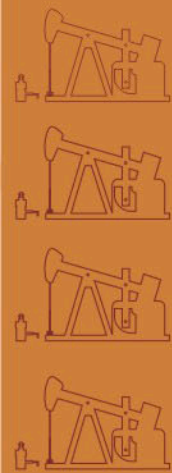
Entities	2006				I semester 2007				The last 18 months			
	Less than S/. 1 million	S/. 1 - S/. 3.5 millions	S/. 3.5 - S/. 8 millions	Higher than S/. 8 millions	Less than S/. 1 million	S/. 1 - S/. 3.5 millions	S/. 3.5 - S/. 8 millions	Higher than S/. 8 millions	Less than S/. 1 million	S/. 1 - S/. 3.5 millions	S/. 3.5 - S/. 8 millions	Higher than S/. 8 millions
	Amazonas	81	19		1	34	13	5		115	32	5
Ancash	136	40	6		9	15		1	145	55	6	1
Apurímac	61	21			8	12			69	33	-	-
Arequipa	186	27	6		6	4			192	31	6	-
Ayacucho	67	46	2		14	17	3		81	63	5	-
Cajamarca	149	18			70	33	2		219	51	2	-
Callao	11	9	4						11	9	4	-
Cusco	198	65	9	2	36	9	4		234	74	13	2
Huancavelica	85	38		1	21	9	1		106	47	1	1
Huánuco	35	11	1		3	26	2		38	37	3	-
Ica	36	4	2		20	8	1	1	56	12	3	1
Junín	112	42	3	4	16	6	2	1	128	48	5	5
La Libertad	42	14		1	7	7	1		49	21	1	1
Lambayeque	84	11			50	11			134	22	-	-
Lima	99	21			19	2	1		118	23	1	-
Lima Metropolitana	37	14			12	6			49	20	-	-
Loreto	91	10	6	1	7	2	1		98	12	7	1
Madre de Dios	41	7			4	2			45	9	-	-
Moquegua	33	26	7	2	3	11	2		36	37	9	2
Pasco	36	15		1	11	3			47	18	-	1
Piura	120	31			17	9	6	3	137	40	6	3
Puno	256	11	7	1	1	1		1	257	12	7	2
San Martín	67	33	3	1	12	3	1		79	36	4	1
Tacna	51	35	1		6	1			57	36	1	-
Tumbes	57	9	1		13	5	2		70	14	3	-
Ucayali	69	17	1	1	7	4	1	1	76	21	2	2
Total general	2,240	594	59	16	406	219	35	8	2,646	813	94	24
	77%	20%	2%	1%	61%	33%	5%	1%	74%	23%	3%	1%
			100%			100%					100%	

Source: Bank of Projects of the Ministry of Economy and Finance

Prepared by: Vigila Peru

Note: Public investment projects correspond to those presented by regional governments

REPORTE NACIONAL N° 6
DE VIGILANCIA DE LAS INDUSTRIAS EXTRACTIVAS
se terminó de imprimir en noviembre de 2007
en los talleres de LETTERA GRÁFICA



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