

# **Unblocking Bottlenecks to Effective Resource Revenue Management in Peru**

Oxfam expert meeting report

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# CONTENTS

Executive Summary.....	2
Introduction and Background.....	3
Key Discussion Points .....	4
Government Decentralization .....	4
Inequalities of Funds Disbursement and Poverty Outcomes .....	4
Quality of Extractive Industries Revenue Investment.....	5
Implementation.....	6
Corruption, Government Accountability, and Transparency .....	7
Public Engagement .....	8
Human Capital and Institutional Capacity .....	9
Nongovernmental Participation.....	10
Opportunities and Solutions.....	11
Annex 1: Meeting Participants .....	12

# EXECUTIVE SUMMARY

Oxfam America is working to examine and address issues that limit progress toward alleviating poverty in countries with large extractive industries (EI). Peru's *canon minero* program requires distribution of substantial EI tax revenues to regional and local governments, yet social gains are inconsistent across the country.

Participants at a June 2014 meeting hosted by Oxfam in Washington, DC discussed the circumstances that impede effective use of *canon* revenue and offered suggestions for potential remedies.

Core impediments identified by the meeting participants include corruption at all levels of Peru's government; misuse of *canon* disbursements at the regional and local level; and uneven institutional capacity to manage revenues in order to achieve equitable and meaningful social benefits.

Participants discussed a broad range of ideas that could help resolve these challenges. Strategies included developing alternative approaches to allocating and spending *canon* disbursements; promoting additional accountability and monitoring mechanisms; building necessary capacity at the individual and organizational levels; encouraging greater citizen engagement in the process; and using the resources of the country's academic institutions.

# INTRODUCTION AND BACKGROUND

This report synthesizes the discussions had during the Expert Meeting on Impediments to Effective Resource Revenue Management in Peru, organized by Oxfam on June 26, 2014. The expert meeting was held under Chatham House rules. Thus, the report documents in bullet form the key points discussed, instead of offering a detailed meeting transcription. We share publicly the proceedings of this rich conversation among experts with the purpose of contributing ideas to the debates on improving resource revenue management for pro-poor development outcomes.

Many developing countries that rely heavily on the extraction of natural resources for revenue do not realize consistent and equitable economic benefits. In Peru, economic growth and exports have risen significantly, and the national rate of poverty has declined. Yet in some regions, including those where mining operations are located, poverty rates are stagnant or increasing.

Under Peru's *canon minero* program, half of all EI tax revenues generated must be distributed in mining-affected areas, ostensibly to promote social and economic benefits. However, the national government does not always allocate these funds in accordance with the formula-based system to regional governments. In addition, regional and local governments often spend *canon* funds on projects that do not make a significant impact on poverty. Funds also are lost to widespread corruption.

Oxfam America is encouraging discussion of issues that limit the potential for resource revenues to decrease poverty and optimize social benefits in EI-dependent countries. A conference convened by Oxfam America in May 2014, in Lima, brought together a range of stakeholders to discuss the country's impediments to effective EI revenue management and to explore potential solutions. Stakeholders included participants from government, civil society organizations, and the corporate sector, among others. Oxfam hosted a follow-up meeting in Washington June 2014 to gather additional perspective on this challenging issue. A list of attendees appears at the end of this report.

Key points raised in the discussion are summarized in the next section.

# KEY DISCUSSION POINTS

## GOVERNMENT DECENTRALIZATION

1. Decentralization of Peru's government is not in itself the problem. Reinstating centralized government is not the solution and may lead to conflict. The fight for decentralization in Peru has been going on for centuries.
2. The problems caused by decentralization must be addressed. However, reforming decentralization has not been a priority and in fact has been blocked in recent years.
3. Under decentralization, economic capacity-building programs shifted to regional governments, which were unable to recruit and train talent to implement the programs. Most programs have been abandoned. In this instance, recentralization may be necessary.
4. Peru's central government will not necessarily manage EI revenues better than do regional governments. For example, some ministries have less capacity than the regional governments. Better approaches to decentralization must be identified.

## INEQUALITIES OF FUNDS DISBURSEMENT AND POVERTY OUTCOMES

5. In response to *canon* disbursement inequalities, the Ministry of Economy and Finance has been making compensatory transfers since 2007. Political considerations hamper further action. Local authorities resist disbursement policy changes, and the congress is hesitant to address the issue without an executive initiative.
6. Falling commodity prices have decreased EI tax revenue, while national economic growth has increased tax revenue. *Canon* funds now have less weight. Modifying *canon* distribution will not solve inequality; the entire government distribution system must be improved. This approach was recommended by a government report, but lack of political will hampers action.
7. Perspectives differ widely about EI's role, specifically whether mining companies are *causing* the inequality or are *aggravating* existing inequality.

8. Many incorrectly blame EI for inequalities. Companies operate in an environment where inequality already exists and then exacerbate it by hiring the most capable. Companies should be sensitive to this reality, but they are not able to hire all job applicants.
9. People living near mines benefit economically but may also face environmental concerns. Resource revenue impacts and environmental impacts must be considered separately.
10. Resolving inequality, promoting economic diversification, and driving targeted development may require using a more prescriptive method of distributing the canon.
11. Confusion about the scale of outcomes is a problem. Nationally, poverty has declined, but determining local outcomes is more complicated. Better data collection is needed; some areas are clear success stories, but in other areas there is a lack of agreement on performance. Urban migration issues also play a role on measuring local impact.

## QUALITY OF EI REVENUE INVESTMENT

12. Local governments receiving *canon* revenue may not know how to use it to achieve broad benefits. The money will be spent on infrastructure, and some is used for political gain and corruption. There is a bias toward spending more with *canon* funds, which can lead to low-quality projects that do not support development plans. Processes should be developed to support effective use of *canon* revenue, including better controls that will help prevent accelerated spending.
13. *Canon* revenue is considered the property of the subnational institutions that receive it. By law, the local government has the money, and it cannot be transferred back if unspent. With other government transfers, unspent funds must be returned to the treasury.
14. In local governments, people work in silos, so monitoring is key. Interdepartmental bodies should be set up to monitor resource use and determine where a project is in the cycle, information that is currently unavailable.
15. One problem is a lack of clarity about the use of *canon* funds, i.e., compensation versus development.

## IMPLEMENTATION

16. It is important to examine how to create and implement good EI revenue policies. In Peru, policy design and implementation are different topics. Sometimes reform and design has worked better than implementation and enforcement.
17. Some problems, such as the “human factor,” are deeply engrained and not easily addressed by policy. Mayors who don’t receive funds refuse to do other work. Some prefer to manage the money directly, requesting funds for specific projects. Local and regional governments view transfers as a personal quota. The conflict between national and regional government priorities erodes the implementation process.
18. Under the new tax scheme, communities without EI projects do not receive money, which creates a cycle of poverty. Ninety-nine percent of projects are for infrastructure. There is an urgent need for reform of the spending system, including switching to multiyear projects.
19. The intergovernmental fiscal transfer system must be examined, however existing policies do not need to be judged as good or bad. The main question is the extent to which transfers respond to government policy objectives.
20. Resource-rich regions receive substantial *canon* revenue yet have limited capacity to manage it. It is crucial to develop a structured, disciplined approach to managing revenue over time and achieving key objectives.
21. Boom-and-bust cycles cannot be avoided, but revenue predictability can eliminate the short-term incentive to spend quickly when money is available. A recent law strengthening fiscal transparency included an objective to isolate the public budget from price/revenue volatility and to support a more constant and stable influx of resources.
22. People say they prefer economic development to infrastructure. Experiences in Africa demonstrate that infrastructure projects are effective as long as they don’t limit development and are part of a larger, focused plan.
23. Development roundtables permit greater alignment with participatory budgetary processes. Needs currently exist but *canon* funds will not be received for a few years, so ministries and departments try to fund certain projects identified at the roundtables.
24. *Canon* revenue should be allocated to priorities that target gaps at the local level. It is also important to analyze the results of *canon* expenditures.
25. Investment in education, research, science, and technology should be expanded to decrease *canon* dependence.



26. Peru must improve not only management of *canon* revenue but also allocation of the public budget where gaps exist. The Ministry of the Economy and Finance must try to understand the gaps in each territory.
27. Peru is moving toward a results-based public-private expenditure model, and this approach must be enacted at all levels. Its implementation is complicated. Supervision is critical, particularly for social funds and voluntary contributions. There should be less self-regulation and more proactive state involvement.
28. Rural income and structural poverty must be addressed. Subnational governments provide three-quarters of resources allocated to this issue. National strategies and expenditures are required. The national government must advise local governments about how to implement programs that best support farmers.

## CORRUPTION, GOVERNMENT ACCOUNTABILITY, AND TRANSPARENCY

29. Institutional mechanisms have led to a culture of corruption that penetrates all levels of Peru's government. It is permitted because it benefits a part of society. The problem is not just personal leadership but also institutional leadership; in fact, quality leadership is missing at all levels, partly due to the political system. People will not speak up about corruption for fear of political fallout.
30. Monitoring should be improved from top to bottom as well as within civil society; it should use tools including the judiciary, checks and balances, and the controller's office.
31. Subnational implementation of the Extractive Industries Transparency Initiative (EITI) is an interesting step on the path to greater transparency. Decentralizing EITI to the regions and promoting a process to generate and use information might spur discussion among regional leaders that leads to more effective use of *canon* revenue.
32. Significant transparency exists in Peru, both on the web and with EITI. The next step is determining how to use information to drive results. Combined with an active civil society, the potential exists to channel information as an effective tool for engagement on all levels.

33. The work of companies and CSOs has resulted in two regional governments' greater transparency, which in turn demonstrates that such efforts yield tangible results.

## PUBLIC ENGAGEMENT

34. When decentralization began, mechanisms were established to engage public opinion and support accountability. These mechanisms have weakened over time. They must be strengthened and redeployed through a bottom-up process.
35. Peruvians have the right to monitor their government. A national-level message asserting this right must be communicated; this would be an incentive to decrease corruption.
36. Local governments do provide some transparency. It is possible to go online and see how municipalities spend funds, however, few people are aware of this. The information and infrastructure are in place, but people must be informed that the tool exists and taught how to use it.
37. One enhancement to the government's budget communication tool would be providing information on percentages of both budgetary execution and fulfillment of goals.
38. Educating citizens about transparency issues is admirable, but there is not enough capacity to disseminate the information effectively.
39. Peruvians think more transparency brings less corruption, which isn't accurate. Despite considerable access to information, the corruption level is still high. Corruption in Peru is organized in a complex dynamic stemming from the democratic system; there must be checks and balances.
40. In El Salvador, some provinces with low participation in the budgetary process get their needs met, yet some places with high participation have many unmet needs. In districts where the public and civil society are better organized, there is less corruption. Institutional reforms from the top and organic reforms from civil society are both necessary.

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## HUMAN CAPITAL AND INSTITUTIONAL CAPACITY

41. According to the Ministry of Economy and Finance, only 3 percent of civil servants have certified capacities. Regional mandates are ineffective, because the regions want to control hiring.
42. Brain drain is a problem. Skilled people have a strong incentive to move elsewhere for higher-paying jobs. This is a chicken-or-egg problem: Should salaries be increased first, to attract talented staff, or should capacity be built first?
43. Strategies to retain people after developing their capacity, such as incentives and higher compensation, must be explored in order to improve management of revenue and projects. Perhaps more local development initiatives will be an incentive for skilled people to stay in place.
44. Organizational reform is also key to building capacity. For example, 80 percent of local governments do not use certified professionals, because officials bring friends and relatives into key positions. Employing people with appropriate capacity should be mandatory.
45. Capacity building should address different concepts for public investment, focusing on how things are done and applying simple tools. People responsible for spending *canon* revenue require investment management capacity, from planning to execution and monitoring.
46. The International Finance Corporation program in Peru demonstrated the need to differentiate staff experience levels for capacity training. People at advanced levels of government have considerable experience, but the municipal-level problems are overwhelming. Significant money has been spent on capacity building with limited results.
47. National interest in capacity building is limited. Addressing revenue management bottlenecks is the short-term view; nobody wants to invest in the long term. Consensus for long-term investment in solving the capacity gap must be developed.
48. Civil society can work with local government to build capacity, but in the electoral phase, reforms and changes are not made, because power groups in local governments resist change and transfers of power.
49. Combining the roles of advocacy and capacity building is difficult and can lead to government distrust.

50. Many labor opportunities have gone to men, despite the fact that many women hold leadership positions in some regions. Any capacity training should include a gender focus.

## NONGOVERNMENTAL PARTICIPATION

51. Universities are autonomous and should work on developing tools to support better EI revenue management. A mechanism is required to ensure that universities can access sufficient funds or partner with other universities to improve the quality of research.

52. University officials feel that incorporating the *canon* into salaries does not support clear evaluation of who is doing the work and who is not. EI revenues should fund research, not salaries.

53. Universities in Lima have limited capacity for high-quality research, and institutions outside of Lima have even less. High expectations for research do not reflect reality. In addition, mid-level organizations should be considered for training.

54. The role of monitoring and evaluation to support better EI revenue management commonly go to private consultants but could be transferred to other institutions. This presents an opportunity for universities and technical institutions.

55. Establishing mechanisms to encourage cooperation among different groups may be useful. Ideas include an “observatory” where companies, NGOs, and communities can collectively review and evaluate development progress, and a center that brings together the academic, government, and private sectors to address unanswered questions, such as sustainability after a mining company exits an area.

56. Engaging different sectors is necessary, but not to absolve the state of its responsibility to the community. Looking to companies as the solution is a problem; the inclination to privatize public spending is risky.

# OPPORTUNITIES AND POTENTIAL SOLUTIONS

- Promote results-based policy-making and budgeting
- Provide stabilization funds to encourage greater medium- and long-term spending
- Conduct systematic evaluations of intergovernmental transfers
- Build local capacity to improve use and management of funds
- Clarify roles and responsibilities of all parties in revenue management and development planning and require accountability
- Create development plans aligned with a broader national plan and coordinated across actors
- Define national and regional development objectives
- Identify lessons from positive cases (e.g., San Martin, Arequipa)
- Consider the role of development roundtables for greater coordination across actors in planning, execution, and monitoring
- Encourage greater investment at a national level in science and technology
- Educate public on information available and how to use it strategically

# ANNEX 1: MEETING PARTICIPANTS

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