



Peru

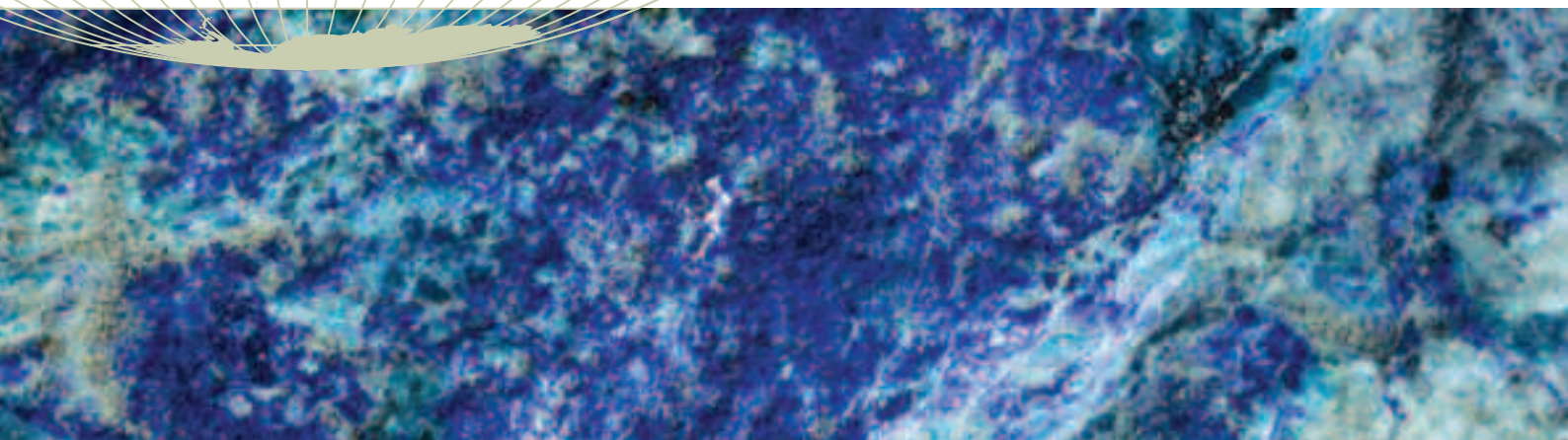
Executive summary

The Challenge of Mineral Wealth:
using resource endowments to foster
sustainable development

October 2006

Spotlight series

08



Peru

A surge of mining investment in Peru since the early 1990s has brought benefits to the national economy. Yet poverty and inequality have remained high, with trickle-down benefits held back partly by incomplete governance reforms. This has in turn intensified social tensions around mining

Government policies towards mining became a hotly-debated political issue in the run-up to Peru's presidential elections in 2006. But at the root of many of the social tensions surrounding the industry are local, rather than national, political dynamics. In particular, it has often proved difficult at the local level around mines in Peru to strike long-lasting compromises between company and community interests.

An example of this is the experience of the Tintaya copper mine, owned by BHP Billiton, an ICMM corporate member¹. Following local criticisms over the environmental and social impacts of the mine, an innovative dialogue process was established between the company, the local communities and a number of NGOs, which led to an agreement by the company to return land to communities and to increase spending on local development, as well as to implement other community-friendly measures. The dialogue had been generally perceived to be a success. Even so, tensions later re-erupted: in 2005, a crowd of over 2,000 protestors broke into the mine, demanding an increase in local development funding from the \$1.5 million originally agreed to \$20 million.

This executive summary provides an overview of the Peru case study – one of four country case studies – of ICMM's² Challenge of Mineral Wealth initiative. An underlying cause of tensions between companies and communities such as at the Tintaya mine, the case study has found, is governance and institutional weaknesses, particularly at the local level. Without public agencies able to act as a trusted mediating and enforcing authority, compromises struck between the various parties are more likely to prove short lived, and conflicts may quickly re-emerge.

According to the case study, institutional and governance problems also help explain why – in spite of the considerable economic benefits brought by mining investment in Peru – poverty and other social problems often remain acute. If these problems could be overcome, the case study argues, larger socio-economic benefits could be delivered from mining, social tensions mitigated, and operational risks reduced. Importantly, the research of the Challenge of Mineral Wealth initiative was not just overseen by an independent advisory group: the Peru case study was itself reviewed by the government of Peru. "The study is particularly helpful in pinpointing key issues and aspects that deserve special attention", Peru's Minister of Mines and

Energy, Glodomiro Sánchez Mejía, wrote in a letter to ICMM in March 2006.

Wealth and poverty of the nation

Focusing first on the national-level impacts of mining, there is little doubt that these have been positive in economic terms. Between 1992 and 2004 domestic and international mining companies in Peru made total investments of about US\$9.8 billion. This investment surge was triggered by significant policy changes towards the sector. With the start of the Fujimori Presidency in the early 1990s the underlying philosophy for governing the economy took a complete U-turn. Following a previous period of state dominance of the mining sector, private sector involvement, especially foreign direct investment, was actively encouraged and state-owned mining assets were privatized. Regulatory changes provided legal and fiscal stability for companies.

Some basic figures can be used to illustrate mining's recent economic contribution to Peru. Mining and metals exports now comprise roughly half the country's merchandised exports, according to government figures. In 2004 mining contributed about 6.9 % of GDP (the figure for 2003 was 6.8%). While direct and indirect employment from mining relative to the economically active population is small (in total about 3.5%), this is due to the capital intensive nature of the industry. Broader indirect effects, however, are believed to be large. Of the \$1.5 billion of inputs delivered to the industry, an estimated two-thirds are supplied from within Peru (this includes imported goods delivered by Peruvian suppliers). In 2003 the mining sector paid for about 4% of government's actual spending and contributed slightly more than 5% to government's total tax intake (making the sector one of the largest overall taxpayers in the country).

Contrary to the theory of the 'resource curse', there is no evidence that mining has detracted from broader economic development in Peru. In fact, its resurgence has coincided with a period of greater economic stability. Liberal economic policies have led to a relatively stable exchange rate, decreased inflation and official reserves at comfortable levels. Over the past 15 years, the macro-economy has been well understood and competently managed. Within this improved policy framework, mining has clearly played a kick-starting role in boosting a previously ailing economy.

Unfortunately, however, this positive macroeconomic picture has not been mirrored by improvements in many social indicators. An exception to this is that over the period from the 1960s to 2002 three key social indicators - infant mortality, life expectancy and literacy rates - have generally improved. Nonetheless the 2004 Report on Human Development for Peru from the United Nations Development Programme finds that the country has been unable to reduce social inequality and very significant disparities in income and regional development. More than half of Peru's population continues to live in poverty and nearly a quarter lives in extreme poverty, with the problem often particularly acute for rural, indigenous communities. In this respect, Peru differs from the other case studies: in Chile and Ghana, for example, poverty levels have fallen as mining investment has increased. Peru also retains one of the most unequal patterns of income distribution in Latin America.

¹ The International Council on Mining and Metals. Also please note that in 2006 BHP Billiton agreed the sale of Tintaya to Xstrata, another ICMM member.

² The project was also conducted in collaboration with UNCTAD and the World Bank.

Within mining areas in Peru, moreover, it is difficult to pinpoint any particular regional effects of the industry's activities on poverty reduction. Available data shows no clear patterns. One important development whose effects are only beginning to play out, however, is that since 2002, 50% of corporate income tax collected from mining companies is redistributed to regions, municipalities and districts where mines are located (the figure was previously 20%). This mechanism – the *Canon Minero* – allows these sub-national state bodies more independent expenditure decisions. Although the *Canon Minero* transfers in 2003 constituted only a small proportion of total actual government spending, they can be highly significant at the local and regional level, and have recently risen dramatically (see Figure 1). The rules for redistribution of the transfers have been changed three times in the past four years, reflecting the highly controversial nature of the criteria. While increased transfers to mining areas should in theory improve local poverty reduction (an issue discussed again later in this executive summary), many of the changes are simply too recent to show up in the data.

A less ambiguous message, on the other hand, comes from analyzing the direct and immediate economic impacts of individual mines in Peru: the case study involved a detailed examination, for example, of the country's largest operational copper and zinc mine, the Antamina mine in the Andean region of Ancash, which has clearly made some significant economic contributions. Owned by a consortium of BHP Billiton, Mitsubishi, Teck Cominco and Falconbridge, and with operations begun in 2001, the mine has an expected lifespan of around 20 years.

The company operating Antamina – La Compañía Minera Antamina – has set out a number of explicit sustainable development goals including, for example, the provision of 100% access to basic services such as water and electricity for communities in the area of impact, and 100% increase

in per capita income also in the area of impact. The mine's social investment budget for 2005 was around \$7.5m, with the local population involved in the design and implementation of projects. More significantly the mine contributed some \$662m to the Peruvian economy in 2005, the case study calculated, including taxes paid, goods procured, either locally or nationally, and jobs created (a total of around 9,000 – 12,000 jobs are estimated to have been created by or depend, directly or indirectly, on Antamina).

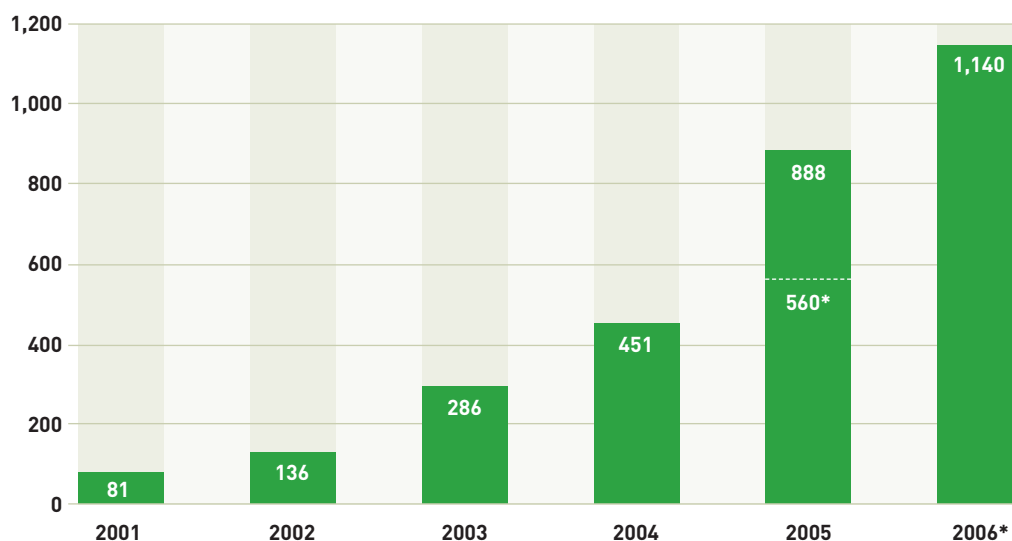
Digging for the cause

So what explains this overall situation in which mining has brought national economic benefits, in which mining companies are contributing economically as a result of their individual operations, yet in which poverty and other social outcomes remain in need of urgent attention?

Without doubt there is room for improvement in the way companies manage their broader socio-economic impacts. With regard to Antamina, for example, the case study indicated that that the company could have improved the way in which it consulted with communities – in particular, early indications of employment for local people raised expectations which have yet to be fully met (in spite of the company's local employment initiatives.) There is also a need to integrate the company's efforts into coherent local or regional government development plans.

However, this is arguably only an aspect of the problem, with governance issues playing a deeper role. Certainly, Peru's performance on those governance indicators conventionally measured by the World Bank has been weak. Recent changes have led to more participation and trust of society in the political process and have improved political rights. However, real improvements in the workings of the public service and administration and the legal system have remained outstanding.

Figure 1: Canon Minero Transfers 2001–2006 (Million Nuevo Soles)



* Budget as approved at the beginning of the fiscal year Source: MEF; Elaboración: CAD Ciudadanos al Día
Source: Ciudadanos-al-Día (2006) (updated)

This document is one of a series of publications produced by ICMM under its Resource Endowment initiative, which aims to better understand how large scale mining activity in low and middle income countries impacts the socio-economic development of host countries. This action-research project is being done together with UNCTAD and the World Bank Group, with broad stakeholder engagement. For the latest information on the initiative, including details of publications, activities and partners visit www.icmm.com

The International Council on Mining and Metals (ICMM) is a CEO-led organization comprising many of the world's leading mining and metals companies as well as regional, national and commodity associations, all of which are committed to improving their sustainable development performance and to the responsible production of the mineral and metal resources society needs.

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More specifically, the main factor that has constrained mining from making much greater contributions, the case study argues, is that national-level macroeconomic and structural reforms (which set the stage for the surge in mining investment from the 1990s) have not always been matched by equal improvements in institutional capacity and in political-administrative processes at the regional and local level. This is particularly important given the higher levels of funding now flowing to sub-national state bodies under the *Canon Minero*.

Evidence from the case study pointed, for example, to a lack of organizational capacity on the part of local governments to manage the impacts of mining. Proactive arrangements are needed where local and regional governments have very weak political-administrative capacities. Public agencies would be better able to serve the development needs of communities and deliver basic social services if there were strengthened approaches to strategic planning, more effective public expenditure programs and better monitoring of results.

Such improvements are needed to ensure the *Canon Minero* funds actually deliver commensurate advances in living conditions. The transfers certainly represent a significant opportunity for development (for example, they often far exceed companies' own social investment budgets), but unless spent effectively, they may turn out to be a mixed blessing. A related danger is that because *Canon Minero* funds must be spent on capital projects (described eloquently in the case study by one interviewee as "anything that involves cement"), as opposed to say capacity-building programs, spending plans will not sufficiently take account of cost implications for future years.

Similar problems beset efforts to build local supply chains and to foster economic diversification in mining regions: the case study found that, whatever the particular company approaches in this area, institutional and governance arrangements supporting this remain weak. If the policy objective is to encourage new poles of private sector development (which are naturally localized in the case of mining) this again will depend on building competent local and regional authorities which have reasonable endowments of financial resources (either through their own tax revenue base or predictable and reliable central government transfers) and also of human resources and general administrative capacity.

Finally, governance weaknesses also appear to underlie many of the social tensions surrounding mining in Peru. With local and regional government bodies often struggling to provide basic public services, such as healthcare, water or electricity, communities often turn instead to companies for such goods (which reinforces what might be described as a paternalistic, rather than sustainable development, model for mining). In many instances the firms have responded positively and provided additional resources. But communities still often perceive such corporate social investments as insufficient. Though often understandable given the pressing nature of local needs, such expectations may persist irrespective of amounts spent, and the fact the companies have neither the capacity nor the mandate for such a governmental role.

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With public agencies lacking the capacity to mediate and enforce agreements between companies and communities, meanwhile, companies have often chosen to negotiate directly with communities over their additional local contributions. These arrangements have in turn sometimes led to a bidding process in which agreements reached in the short run have proved unstable in the long run. It is precisely this dynamic that appears to be at the heart of the recent tensions at the Tintaya mine mentioned at the start of this note, as well as at other mining projects in Peru.

The Peru case study³ highlights, in short, the critical importance of improved governance and institutional arrangements for translating the financial resources brought by mining into more effective development – as well as for reducing the social tensions it may trigger. This is easier said than done of course, and is likely to require increased partnerships between companies, governments, communities and other key stakeholders. Please see Spotlight series 03, 'Ways Forward', for a summary of the practical recommendations derived from all four of the case studies in this respect. This note also describes how ICMM plans to take forward its own work in this area.

³ The full case study (as well as the other three country case studies) will be published by UNCTAD following Government review.

ICMM would like to thank all the individuals, governments and organizations that contributed to the study, full details of which are included in the main report. In particular, ICMM appreciates the cooperation and support of: the Government of Peru, including various ministries and semi-autonomous agencies; and Compañía Minera Antamina S.A management in Lima, Huarmey and at the mine (and in particular Steven Botts and Gerald Wolfe).