WORKING PAPER 300

A Thoroughly Modern Resource Curse? The New Natural Resource Policy Agenda and the Mining Revival in Peru

Javier Arellano-Yanguas

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Summary

The reality of the so-called ‘resource curse’ is now widely accepted. The populations of countries that possess significant natural resources often suffer when these resources are extracted and exported. Attention is turning to ways of mitigating the adverse effects of the ‘curse’. Responsible fiscal policies are required but are in themselves insufficient for overcoming it. International institutions have recently advanced what I term the ‘new natural resource policy agenda’ to deal with the problem. Its core features are (a) decentralisation of government (b) a greater role for direct citizen participation in the allocation of mining revenue; and (c) more cooperation between state agencies and commercial organisations (public-private partnerships). However, the recent history of Peru poses major questions about the effectiveness of this new policy agenda. The government has adopted both conservative fiscal policies and the new policy agenda. Over the last five years the mineral price boom has increased mining revenues markedly, but it has had little impact on poverty. More important, local level conflicts around mining operations have increased, and appear to threaten political instability even more. The problem is that, in a context of weak central state and even weaker local governments, the ‘new natural resource policy agenda’ has partially re-located the resource curse to sub-national levels. Local governments, mining companies and a variety of activist movements are locked into complex relationships that are not easy to negotiate and into conflicts that are not easily resolved. Like its predecessors, this very contemporary manifestation of the resource curse results in poor quality public expenditure and the waste of much of the new resource revenue.

Keywords: mining, resource curse, decentralisation, participation, local government, social movement, conflict.

Javier Arellano-Yanguas is a DPhil researcher at the Institute of Development Studies. He has an interdisciplinary academic background with degrees in development studies, agronomy, and philosophy and religious studies. He has over 15 years' experience in development work with civil society organisations in Spain, Latin America and India. His current research looks at the interaction of local governments, mining companies and social movements at the local level in the Peruvian context. He aims to explain variation in patterns of conflict and cooperation among these actors in different regions of the country.

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Abbreviations and acronyms

ALAC	Association of the Andes of Cajamarca
BCR	Reserves Central Bank
CSR	Corporate Social Responsibility
ECLAC	Economic Commission for Latin America and the Caribbean
EITI	Extractive Industries Transparency Initiative
GNP	Gross National Product
GPC	Grupo Propuesta Ciudadana / Citizens' Proposal Group
IFC	International Financial Corporation
IFI	International Financial Institutions
IMF	International Monetary Fund
INEI	National Institute of Statistics and Information Technology
INEP	National Institute of Statistics and Planning
MEF	Ministry of Economy and Finance
MEM	Ministry of Energy and Mines
MRTA	Tupac-Amaru Revolutionary Movement
NGO	Non-governmental Organisation
SNIP	National System of Public Investment
SNMPE	National Society for Mining, Oil and Energy
SUNAT	National Tax Administration Superintendency
UNDP	United Nations Development Programme

‘Today the mining agenda is the agenda of national development.’

Juan Valdivia – Minister of Energy and Mines

‘Mining is a final and unique opportunity to develop the Peruvian highland regions.’

Raúl Benavides – Business Development Vice-president of Buenaventura

‘Cajamarca has two problems: poverty and mining.’

Member of local NGO

1 Introduction

Evidence accumulated over the last 15 years leaves little room for doubting the existence of a ‘resource curse’. Countries heavily dependent on ‘point resource’ natural resources – geographically concentrated resources like hard-rock minerals, oil and gas – have performed worse, in both economic and political terms, than countries without the ‘benefit’ of such natural endowments (Auty 1993; Ross 1999; Hausmann and Rigobon 2003; Sala-i-Martin and Subramanian 2003; Isham *et al.* 2005; Collier and Hoeffler 2006; Rosser 2006a; Collier and Goderis 2007).

The consensus on the existence of this curse has created the space for discussion on how to mitigate its negative effects (Moore 2003). Academic proposals to improve the public management of natural resources have proliferated (Collier and Hoeffler 2006; Sachs 2007; Ross 2007; Karl 2007; Humphreys, Sachs and Stiglitz 2007). At the same time, international financial institutions, mining business associations and international donors have advanced their own strategies to minimise the negative impact of natural resource exploitation (IIED 2002; EITI 2005; World Bank 2006).

Traditionally, strict public fiscal discipline has been seen as the core measure to mitigate the detrimental effects of the resource curse (Mahon 1992; Auty 1993: 91–109; Auty and Mikesell 1998: 123–137; Hausmann and Rigobon 2003). More recently, international institutions have been advancing a set of ideas that collectively constitute a ‘new natural resource policy agenda’[1] to deal with the resource curse (World Bank 2006: 2–4). Its core features are (a) decentralisation of government; (b) a greater role for direct citizen participation in deciding on how to spend mining revenue; and (c) cooperation between state agencies and commercial organisations (public-private partnerships).[2] These measures, later

1 This agenda has neither been officially established as a clearly defined set of prescriptions, nor is it exclusively recommended for overcoming the resource curse. It amounts to a collection of fashionable measures that have previously been collectively termed ‘radical polycentrism’, understood as power dispersal and suspicion of large political institutions, especially the centralised state (Houtzager 2003: 4–7).

complemented with the Extractive Industries Transparency Initiative (EITI), should help to prevent the pernicious effects of rent-seeking, lack of downward accountability and poor information on the allocation of public resources. This set of proposals appeals both to ideological supporters of market competition and private initiative ('neoliberals') and to enthusiasts for decentralisation and local citizen power ('radical polycentrists') (Houtzager 2003: 7).

While this new agenda has been advanced, the potential for problems and damage has intensified. The increasing demand for commodities from emerging economies and the resultant price boom in oil and minerals have boosted investment in extractive industries (UNCTAD 2007). This new situation enhances the importance that the extractive sector will have for poor countries in the foreseeable future. In the past, commodity booms generated a mirage of wealth in the short-term, but were detrimental to economic growth and political stability in the long-term (Collier and Goderis 2007). Thus, the analysis of the policies currently prescribed to overcome the resource curse becomes crucial for the future of several poor countries.

The recent history of Peru suggests that the 'new natural resource policy agenda' is unlikely to overcome – or even to mitigate – the negative effects of the resource curse. Peru has been one of the most faithful followers of the economic and political prescriptions of the international financial institutions. In the economic field, the previous government led by Alejandro Toledo (2001–2006) implemented disciplined fiscal policies. In the political sphere, Peru has signed up to the Extractive Industries Transparency Initiative, and has fostered decentralisation, participation and public-private partnership as key features of political reform in the period since Fujimori ceased to be President in 2000. The implementation of this agenda has promoted the emergence of local governments, private mining companies and civil society as influential political actors.

At the same time, Peru has become the world's second biggest producer of silver; the third of zinc, cooper and tin; the fourth of lead and molybdenum; and the fifth of gold (MEM 2007a). The recent price boom in minerals has generated extraordinary economic growth, rocketing growth by 8 per cent in 2006 (MEF 2007a), and has fostered further investment in mining.

The Government and the international financial institutions alike express enthusiasm about Peru's prospects for prosperity. The World Bank Director for the Andean region proclaims that Peru will be the 'tiger of the Andes' and forecasts sustainable growth for the next five years (*El Peruano*, 21 June 2007: 8).

Despite Peru's compliance with orthodox prescriptions by international financial institutions, officials in these institutions and government tend to overlook three problems. First, the pace of the poverty reduction fails to meet people's expectations.[3] The broadly publicised macroeconomic prosperity fuels popular expectations of rapid social and broad-based economic improvement. The failure of

2 The paper uses 'public-private partnership' to refer to a greater involvement of companies in the public sphere, mainly through philanthropy and corporate social responsibility. However, the general use of the term is very loose and covers other diverse activities (Richter 2004).

macroeconomic prosperity to meet public expectations eventually reinforces the widespread feeling of social malcontent (Shuldt 2005). Second, the government has failed to diversify the economy as mining gains a bigger share of exports, state revenue and foreign investment [4] (MEF 2007a). Finally, conflicts involving mining companies have multiplied throughout the country. The June 2007 Ombudsperson's Report on Social Conflicts reveals that during the previous year the number of overt conflicts increased from 6 to 35, out of which 21 (60 per cent) were directly related to mining (Defensoría del Pueblo 2007). Social conflicts represent the main threat to mining company operations and, implicitly, to Peru's current economic model. In summary, despite the Peruvian government's compliance with orthodox economic and political prescriptions, the problems of persistent poverty, an increasing mining-based economy, and conflict reveal that Peru faces serious political challenges related to mineral resource exploitation.

Mining companies recognise the existence of these problems. The Fraser Institute's Survey of Mining Companies [5] (Fraser Institute 2007), which represents the mining companies' perspectives, attests that of the 64 countries analysed, Peru ranks first according to the economic potential of its mineral endowment. However, respondents are less optimistic regarding the Peruvian political environment. For instance, the survey places Peru in 44th position according to its 'policy potential' with a clear decline from 15th, 20th and 39th positions in previous years. Peru ranks quite high on tax regime attractiveness and geological database availability. It ranks in the middle regarding environment and labour regulation, infrastructure, and enforcement of current regulations. However, it ranks extremely low for security, political stability, socio-economic agreements and conflicts over land and indigenous issues. Companies' confidence in the Peruvian potential for mining has deteriorated over the last four years, in particular with regard to security, political stability and socio-economic agreements. The mining industry's perception is consistent with the fact that each of the World Bank's six indicators of governance in Peru has also declined in recent years (World Bank 2007).[6]

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3 According to ECLAC (2007: 74–9), from 2001 to 2004, the percentage of the population below the poverty line fell from 54.8 per cent to 51.1 per cent. A new revision of these figures, following a modification of the methodology, claims that the level in 2004 could have been as low as 48.6 per cent and that the figures for 2006 will be 44.5 per cent (INEI 2007: 9). Additionally, the Gini index fell slightly from 0.545 to 0.505 in the period 1999–2004 (ECLAC 2007: 74.79).

4 In 2006, minerals and fuels accounted for 69 per cent of total exports, 26 per cent of internal tax revenue and 56 per cent of foreign investment net inflow. See progress graphs in Appendix I.

5 The Fraser Institute's Annual Survey of Mining Companies was sent to 1,435 exploration, development, and mining consultation companies around the world. The survey represents responses from 322 of those companies.

6 The World Bank uses aggregate indicators built on data provided by a number of survey institutes, think tanks, non-governmental organisations, and international organisations. These indicators have been frequently contested on the basis of (a) the impossibility of reflecting complex processes through quantitative indicators; (b) their use to pursue the World Bank's political agenda. In the Peruvian con text, the analysis of these indicators for recent years accurately reflects the perception of most of the actors directly interviewed. The six World Bank governance indicators and the Peru's variation in its country's percentile rank between 2002 and 2006 are: (i) voice and accountability (percentile 52.9–51); (ii) political stability (21.2–18.8); (iii) government effectiveness (40.8–36); (iv) regulatory quality (57.1–55.6); (v) rule of law (33.8–26.2); and (vi) control of corruption (50.5–45.1).

According to my findings, the Peruvian case illustrates a new type of resource curse with two novel features. In the context of Peru's weak central state, and even weaker local governments, neither strict public fiscal discipline nor the implementation of the 'natural resources policy agenda' can solve the problems tied to the intensive exploitation of mineral resources. Moreover, a simplistic implementation of the natural resource policy agenda has partially relocated the resource curse to sub-national levels.

Local governments, mining companies and a variety of activist movements are locked into complex relationships that are difficult to negotiate and into conflicts that cannot be easily resolved. Like its predecessors, this very contemporary manifestation of the resource curse results in poor quality public expenditure [7] and in the waste of much of the new resource revenue. The traditional analyses of the resource curse have given insufficient attention to the relevance of local political dynamics and to the actors involved in them. This paper aims to contribute to filling that gap by analysing the Peruvian case.

My analysis concludes that Peru requires capable and stable public institutions in order to overcome the resource curse. Mining operations need robust regulation and enforcement by the state. Sensible allocation of the mining revenue demands accurate information, planning and collaboration between all levels of government. These requisites cannot be fulfilled if the new political agenda becomes an excuse to bypass the necessary steps for strengthening state institutions.

In addition to a literature review, this paper draws on interviews with key political actors, company representatives, civil society activists and scholars (details in Appendix II). In addition to the interviews conducted in the capital, the research included meetings with relevant actors in Cajamarca and Espinar (Cusco), two of the most prominent mining areas in the country. In most cases I do not disclose interviewees' identities in order to protect confidentiality. I name sources only when the information represents official or openly expressed opinions.

This paper is structured in six sections. First, I critically evaluate current knowledge of the resource curse, pointing out that recent research inadequately accounts for political dynamics at the sub-national level (Section 2). Second, I analyse four relevant features of the Peruvian state that provide a context for understanding the repercussions of mining operations in Peru (Section 3). Third, I briefly describe new strategies employed by the mining industry in its relationship with communities and local institutions (Section 4). Fourth, I uncover what the modern resource curse looks like in contemporary Peru, highlighting the emergence of conflict (Section 5) and the dynamics of revenue allocation at the sub-national level (Section 6). Finally, I conclude by summarising my main findings and propose some solutions to Peru's resource curse with potential areas for more research (Section 7).

7 By poor quality public expenditure I mean short-term planning, lack of coordination between different levels, non-integration of national planning, non-alignment to economic diversification.

2 Scope and limitations of resource curse theories

A review of the most relevant literature reveals three clear features of the resource curse:

a) The 'resource curse' is a common label for a collection of different observable negative outcomes that a country in possession of resources may experience: (i) decrease in economic growth (Auty 1993; Sala-i-Martin and Subramanian 2003); (ii) increase in poverty and inequality (Ross 2003; 2007); (iii) hindrance of democracy and reinforcement of authoritarian political systems (Ross 2001); and (iv) outbreak of conflicts and even civil war (Collier and Hoeffler 2005).

b) The so-called 'point source' (geographically concentrated) natural resources correlate more specifically with the generation of economic and social problems than other kinds of geographically diffuse resources. Moreover, there is no proportional relationship between negative outcomes and the quantity of resources exploited. Any increase in resource dependency above a certain level tends to lead to an exponential increase in the likelihood of harmful effects (Sala-i-Martin and Subramanian 2003; Isham *et al.* 2005).

c) Natural resource abundance does not automatically entail negative outcomes. Countries such as Indonesia, Chile, Botswana and Malaysia have managed to avoid the most detrimental effects of the resource curse (Rosser 2006b). Moreover, cursed countries with similar natural resource endowments have experienced different harmful effects. These experiences reinforce the crucial role that governments can play in the transformation of natural wealth into development.

The literature about the resource curse has also some limitations. I point out four of them:

a) Research on the natural resource curse has ignored how historical developments, such as the nature of political systems, international relationships and the functioning of the markets, impact on how states manage their natural resources. The most rigorous studies compare data series that are homogenous for different countries. However, these cross-country data series are only available for the last few decades. This 'historical context' limitation has led to the neglect of the historical development of some of the richest western countries, such as the USA, Australia, the UK and Canada, which have successfully used their natural resources to promote development (Schrank 2007). In the present historical context, characterised by accelerated change, new emergent factors, such as the expansion of democracy, the new ethos of participation, prominence of new actors (NGOs and companies), trade agreements and international standards and regulations (i.e. EITI), could significantly influence the resource curse theory.

b) Recent research fails to sufficiently describe the causal relationship between natural resources and negative outcomes. For example, econometric analysis demonstrates that when mineral exports rise above a certain level, the quality of public institutions may suffer (Sala-i-Martin and Subramanian 2003). However, they reveal nothing about the processes through which institutional weakening happens. A deeper understanding of the resource curse requires the clarification of the causal processes that result in negative outcomes.

c) Cross-country comparative studies must be complemented with analyses of the distinct features of each country's natural resource curse. Research on the natural resource curse has focused on the establishment of general causal links that are valid in a meaningful way for all countries. However, each country has its own particular context that influences the way in which that country's natural resources cause harmful effects (Boschini, Pettersson and Roine 2003). For example the authoritarian regimes of the oil producing countries in the Middle East whose oil is located in the desert neither need to please their citizens to win elections every four years (as it is now the case in most of the Latin American countries) nor have to face the opposition of environmental activists concerned with the protection of forests and water courses. These differences account for distinct ways in which the exploitation of natural resources negatively impacts rich countries. Analysing the specific problems of each country beyond an explanation of general causal links is crucial.

d) The importance of mineral/oil rent has not been sufficiently highlighted. Mineral/oil dependency is usually measured as a proportion of production in relation to GNP, as a percentage of total exports, or as a combination of both. This kind of measure neglects the importance of looking at the rent available after discounting the extraction costs and the average profit made on a standard investment (Collier and Hoeffler 2005). This 'rent-effect' accounts for national differences and, once again, highlights the importance of specific conditions in the exploitation of natural resources.

These four limitations reinforce the variable nature of the natural resource curse and demand a more detailed and in-depth political analysis of the specific resource curse problems and suitable policy prescriptions for each country.

The application of these limitations to the Peruvian situation reveals that the local dimension remains unsatisfactorily examined. Both statistical cross-country analyses based on national data collections and case studies, focusing on political and institutional processes (Shafer 1994; Karl 1997), have neglected the importance of sub-national politics. Only a few studies about (a) regional inequality and conflicts in resource-rich countries (Ross 2004); and (b) fiscal decentralisation (McLure 2003; Ahmad and Mottu 2003) superficially investigated this field.[8]

However, in the context of increasing international emphasis on decentralisation in developing countries, analysis at the sub-national level is crucial if newly emerging forms of the resource curse are to be understood. This Working Paper explores what the resource curse looks like in Peru, taking into account Peru's

8 Ghazvinian (2007)'s recent book explores local perspectives on Africa's oil exploitation in a more journalistic style.

new political context which is marked by the growing importance of sub-national level politics and the emergence of new actors – companies, civil society organisations and sub-national governments – who interact in an evolving political environment.

3 Peru: mineral wealth in the context of a weak state

The Peruvian tradition of mining goes back to the colonial period. For 300 years the Spanish crown's avarice for Peru's gold shaped the relationship between colony and crown. The extractive character of colonial rule governed the exploitation of native resources and peoples by colonial institutions. After independence, British firms in the nineteenth century and American firms in the twentieth century played a major role in exploiting Peru's mineral riches and shaped the nature and policies of the Peruvian state (Dore 1988). The extractive character of the Peruvian mineral-state neither facilitated modern institution-building nor improved the living conditions of the majority of the population. In fact, Peru developed a weak state historically alienated from its people (UNDP 2004: 52–3).

The analysis of four dimensions of state weakness explains how the current mining revival affects the Peruvian political system in terms of: (a) democratic deficits, with poor representation of the population's interests, and political instability; (b) a geographically fractured state with power centralised at the state capital of Lima that neglects remote, underdeveloped regions and their claims to power sharing mechanisms; (c) limited capacities and weak bureaucratic apparatus; and (d) the generation of ad hoc policies. This section focuses on how these weaknesses manifest themselves in dealing with the mineral boom.

3.1 A state marked by democratic deficits and instability

Discrimination of the indigenous and mestizo [9] majority by the white ruling elite characterises Peru's national history. Not surprisingly, Peru developed into one of the most inequitable countries in Latin America. Moreover, the ruling elites crafted the state apparatus to maintain the status quo without developing the features of a modern state.

By 1991 economic bankruptcy and the persistent threat of political violence disproportionately affected poor and indigenous peoples (Manrique 2006: 46). After decades of political instability and economic decline, Alberto Fujimori emerged as the country's saviour. The increasing discredit of the elite political parties created demand for a radical change and Fujimori appeared as the 'brand new' outsider able to break the hegemony of the white ruling class. Peru's people wanted a new brand of leadership, but by electing Fujimori as Peru's president they also got a new brand of regime (Morón and Sanborn 2006: 25).

9 Term used to designate people of mixed European (usually Spanish) and Amerindian ancestry.

Fujimori's regime lasted for ten years. He initially gained popular support by making a mockery of the elite controlled parliament, the judiciary and traditional political parties. Backed by popular support, Fujimori closed parliament, reformed the constitution and initiated an authoritarian regime that promised 'efficient technical' solutions in contrast with the chaos of policies proposed by preceding politicians. His victory over the Shining Path and MRTA guerrilla groups legitimised and reinforced his authoritarian regime. After ten years, widespread corruption and revelations of human rights violations contributed to Fujimori's downfall. However, those ten years deeply scarred Peru's political system in at least three ways: (a) by delegitimising political parties; (b) discrediting institutions; and (c) using mechanisms of direct democracy and participation to bypass political parties.

Fujimori's legacy was an unstable political system: (a) his populist policies did not change the unequal distribution of wealth and power that kept half of the population in poverty; (b) economic deregulation gave business an important leverage over the state (Durand 2005: 251–67); (c) formal democratic institutions lost their credibility; (d) weakened political parties could not stabilise the system; and (e) a new culture of participation and direct democracy opposed representation. This combination of factors fuels political volatility and makes challenges to the system more likely (Revesz 2006; Taylor 2007: 7–9). With regard to mining, unstable politics generates incentives for different actors, such as mining companies and local government, to seek short-term benefits.

3.2 A state that is geographically fractured

The centralised nature of the Peruvian state conflicts with the country's geographical and cultural diversity. After several attempts to decentralise the state, Fujimori's regime reinforced centralisation. The concentration of wealth in the Peruvian capital of Lima reveals the extreme centralisation reached during the 1990s.

Table 3.1 Centralisation indicators in Peru (1996)

	Lima (metro. area)	**Rest of the country**
Population	31%	69%
GNP	55%	45%
GNP industrial	75%	25%
Private investment	80%	20%
Nº of industries	85%	15%
Fiscal revenues	96%	4%

Source: Dammert (2003: 34).

After the fall of Fujimori in 2000, decentralisation was included as a crucial part of the democratisation process (UNDP 2006: 85–94). In 2002, Alejandro Toledo's government initiated the decentralisation process by employing a three-tier structure of: (a) national institutions; (b) 25 regions/departments;[10] and (c) local governments comprising 195 provinces and 1832 districts.

Despite some advances in the decentralisation of public expenditure, rampant territorial inequalities abound. While Lima's poverty index (percentage of people living below the poverty line) fell from 31 per cent to 24 per cent in 2006, rural poverty stands at 69 per cent, with a meagre reduction of 2 per cent in the same period. Moreover, in rural areas of the Andean and Amazon zones, where most of the extractive companies operate, poverty remains at 77 per cent and 62 per cent respectively, with virtually undetectable improvement. Tellingly, the departments richest in natural resources are among the poorest in the country [11] with Loreto at 66 per cent, Cajamarca at 64 per cent, and Puno at 76 per cent (INEI 2007: 9–10).

Three salient features of Peru's current decentralisation process bear upon the dynamics of natural resources exploitation:

a) Local leaders who have weak connections to national parties dominate regional politics. A bipolar relationship emerges between the capital and provinces, by which local leaders channel popular claims to build their own political agendas, in opposition to that of the national government, with two significant consequences: (i) local leaders sometimes exploit conflicts over mining as a means of gaining popular support (Revesz and Diez 2006); (ii) regional leaders participate little in national politics, thus leaving regional perspectives under-represented.

b) Transferring resources to the sub-national level promotes competition in local and regional elections and the consequent multiplication of candidates fragments local politics. Local and regional governments take office with the endorsement of barely 25 to 30 per cent of the electorate. This lack of popular support accounts for weak governments that rely on clientelism to maintain power (Grompone 2005a: 82–85).

c) Decentralisation went hand in hand with the implementation of schemes guaranteeing popular participation. Consultative boards for fighting poverty, inter-institutional groups for regional and local planning, and participatory budget mechanisms flourished at different levels. The results of popular participation are conflicting and depend on the context and the actors involved. However, rhetorical use of participation is prevalent (Grompone 2005b).

d) There has been very little transfer of political power to the sub-national level. In the case of the mining and oil sectors, all processes for granting

10 Twenty-three departments plus the Metropolitan Government of Lima and the Constitutional Province of Callao.

11 Echave and Torres (2005) show a correlation between mining activity and poverty at departmental level. On the other hand, Barrantes (2005) finds that at the local level the correlation is not so clear.

exploration and exploitation licences, registration licences, maintenance of the land databank and authority for regulation and inspection remain at the national level. This results in decentralised institutions that are void of political power but faced with the discontent of the people day after day.

3.3 A state with very limited capacities

The lack of a competent body of public servants, official aversion to long-term planning and fiscal austerity severely weaken the Peruvian state apparatus. In the 1990's Fujimori, following the prescriptions of the IFIs, implemented a double strategy by: (a) downsizing the public sector; while (b) setting up the tax revenue agency (SUNAT) and specific groups in the Ministry of the Economy as autonomous bodies to manage the crucial pro-market reforms. Fujimori's double strategy resulted in a dual bureaucracy with, on the one hand, a small group of well prepared and well-paid civil servants and, on the other, the rest of the public sector left with low salaries and a remarkable lack of capacity. The next government maintained this dual situation. Most recently, Peru's current president Alan Garcia introduced an urgent decree to reduce the salaries of senior officials and civil servants, provoking the migration of the most capable civil servants to the private sector and further weakening the already weak state.

In 1992 Fujimori's government dismantled the national planning system (INEP), launching an official aversion to long-term planning. Successive governments dismissed state planning as useless or even harmful. In their view, the market best plans for and determines resource allocation. Thus, the government's task is to understand the conditions of properly functioning markets and not to interfere through ideologically driven planning.

Additionally, an obsession with fiscal austerity, even in times of fiscal surplus, reduced public investment to 2.5 per cent of the GNP in 2005, the lowest level in the modern history of Peru. State apparatus adapted its procedures and staff to manage a very modest budget and, consequently, lost its capability to allocate larger public investment in a sensible and efficient way. Recently, when the government of Alan Garcia felt the need to increase public investment to 'sow the minerals' and to 'show mineral goodness', the state apparatus could not respond effectively (*Gestión* 22 June 2007).

3.4 A state that generates *ad hoc* policies

Inconsistency and short-term vision drive Peru's policy making. Public policies are arbitrarily established, volatile, frequently in contradiction with other regulations, barely enforced and easily reversed (Morón and Sanborn 2006: 33–4). The fiscal regulation of mining and the allocation of accrued revenue through the 'canon minero' (a set of rules which redistribute mining revenues collected by the central government to sub-national governments) illustrate two paradigmatic examples of Peru's *ad hoc* policy making.

Fiscal regulation of the mining and oil sectors was established in the early 1990s to attract foreign investment. Although the standard 30 per cent tax on profits applied to mining and oil companies, some concessions were granted to them: (a) companies operating in Peru did not pay royalties [12] for the minerals or oil they extracted; (b) companies did not need to pay tax on profits until they had recovered their initial investments; and (c) when president, Fujimori signed a fiscal stability agreement with extractive companies in which the state renounced its right to introduce changes to fiscal policies without the companies' approval.

After the fall of Fujimori, these pro-mining fiscal policies were challenged from three angles: (a) opposition parties and civil society organisations questioned the Fujimori's legitimacy to sign the fiscal stability agreements as they suspected that these deals were 'oiled' by corruption; (b) the extended time lag between companies' starting operations and paying taxes was regarded as generating potentially explosive conditions for social conflicts; and (c) fiscal policies based on flat-rate taxes failed to appropriately tax activities characterised by highly volatile incomes in the face of a steady increase in international mineral prices. Accordingly, different actors advocated the introduction of a windfall tax.

The presidential candidate Alan Garcia took on these concerns as part of his electoral platform, advocating a review of the government's contracts with mining companies. However, as soon as he took office he backed down and agreed with the mining companies that some palliative measures would be implemented instead of the payment of royalties [13] and windfall taxes. In December 2006, Garcia published the agreement known as the 'mining programme of solidarity with the people.'[14] This programme introduces a voluntary contribution from the mining companies to be spent in the territories where the mines are located. These funds should be managed by a private trust and the companies have the freedom and responsibility for allocating the resources according to a loose set of rules. This agreement between the government and the companies has fuelled popular discontent and presents an image of the government as a defender of mining companies' interests. The government justifies the agreement by arguing that mining companies are already important taxpayers (Figure 3.1) and the agreement is crucial for maintaining a good investment climate.

The mechanism for natural resource revenue allocation is another example of *ad hoc* policy making. In 1976, after the discovery of important oil fields and pressure from regional movements, the central government decided to give 10 per cent of the value of oil production to Loreto, one of the poorest departments in the Amazon region. This kind of transfer from the centre to the producer region was baptised an '*oil canon*'. In 1992 the government created the 'canon minero' and decided that 20 per cent of the income tax paid by mining companies must go to the territory in which the profits are generated. In 2001, parliament approved a law that regulates all these schemes and extends them beyond oil and mining to [15] gas extraction, forestry, hydroelectric generation and fishing, among other

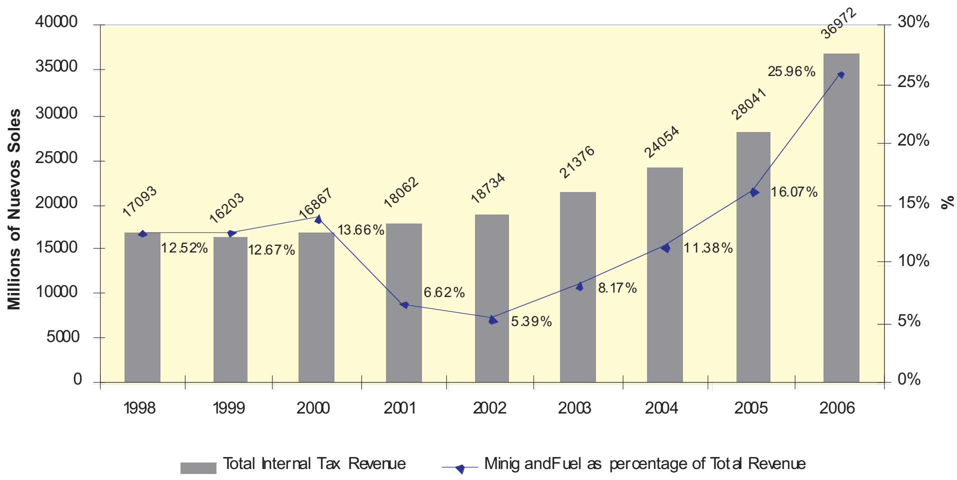
12 Usage-based payments that compensate the coutry for the extraction of its mineral asset.

13 In recent years new mining contracts have included the payment of royalties.

14 The SNMPE (National Society of Mining, Oil and Energy) played a crucial role in the negotiation of the programme. The SNMPE has become the strongest business association in Peru and a key actor in the national political arena.

activities. The new law increases the value of the 'canon minero' from 20 per cent to 50 per cent of the tax on profit paid by mining companies. The way in which this 50 per cent is allocated at regional and local level has been modified in the last few years. The following table summarises the main changes.

Figure 3.1 Mining and fuel as a percentage of internal tax revenue



Sources: MEF (2007a; SUNAT 2007).

Graphic representation: the author.

These regulations create a concentration of revenue transfers at the locality where the natural resources are extracted. Mining companies advocated for the two policy changes of 2004 (see Table 3.2) in a bid to demonstrate the benefits that mining can bring to local communities and calm the growing social unrest around mining activities.

When these new allocation rules were planned, it was estimated that transfers would amount to 451 millions of *Nuevos Soles*.[16] The subsequent rise in oil and mineral prices has increased transfers by tenfold in three years (Figure 3.2), making effective revenue allocation difficult. Furthermore, two other types of transfers complement the 'canon minero.' First, since 2005 some new contracts have required companies to pay royalties that are divided between the regional government (15 per cent), municipalities (80 per cent) and universities (5 per cent) of the zone where the mineral is extracted. Second, some mining companies have generated a significant surplus in the *Fondoempleo* [17] scheme that goes directly to regional governments.

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15 The political economy of the generation of funds with specific purposes is well analysed in Barrantes (2007).

16 Over the last years, the *Nuevo Sol* has managed to maintain a stable exchange rate between 3.1 and 3.5 *nuevos soles* per US$.

17 Every year the companies have to share 8 per cent of their net profits with employees, with an upper limit of 18 monthly salaries per year. If there is a surplus it constitutes the *Fondoempleo* fund, part of which has to be invested in employment promotion in the geographical area in which the profit was generated. The rest of the fund is transferred to the regional government to be invested in improvement of local road infrastructure.

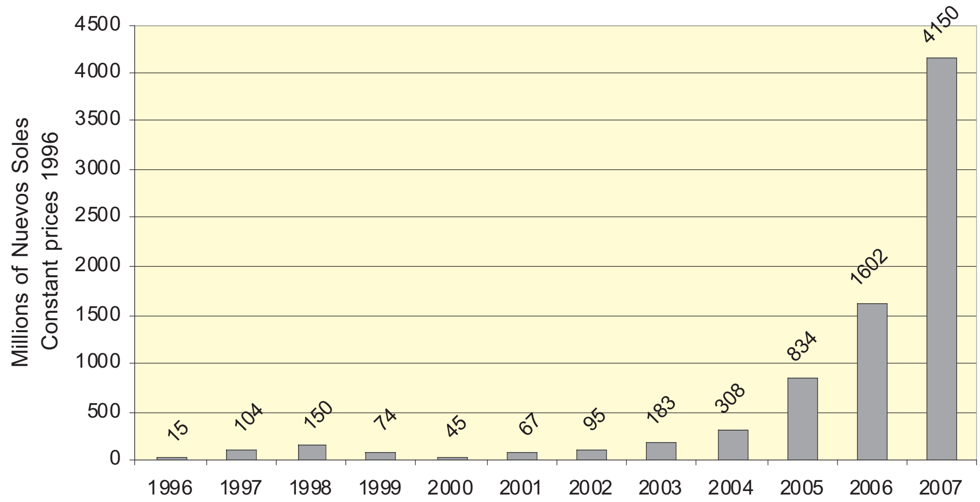
Table 3.2 *Canon* distribution (excepting the *oil canon*)

Distribution June 2002 – May 2004		Distribution July 2004 – December 2004		Distribution since December 2004	
Beneficiary	**%**	**Beneficiary**	**%**	**Beneficiary**	**%**
Regional Government	20	Regional Government + 5% for the public universities of the region	25	Regional Government + 5% for the public universities of the region	25
Municipalities of the province where the resource is extracted	20	District municipality where the resource is extracted	10	District municipality where the resource is extracted	10
		Municipalities of the province where the resource is extracted, excluding the producer district	25	Municipalities of the province where the resource is extracted	25
Municipalities of the department where the resource is extracted	60	Municipalities of the department where the resource is extracted, excluding the producer province	40	Municipalities of the department where the resource is extracted	40

Source: GPC (2007a: 52). Compilation: the author.

These criteria for revenue distribution create the problem of inequality among regions. In 2006, more than 75 per cent of the total ‘canon’ transfers were concentrated in just 8 of 24 regions that account for 25 per cent of the country’s population (Ancash, Cajamarca, Cusco, Loreto, Moquegua, Pasco, Piura y Tacna). Most shockingly, due to the increase of the ‘canon minero’, these eight regions (including their local governments) received more than 61 per cent of the total revenues that the central government transferred during that period (MEF 2007b). At the provincial level, differences become ludicrous. For the same year 2006, while the average of resources available for public investment per head [18] for the whole country was around 375 Nuevos Soles, in Jorge Basadre, a small province in Tacna, the same per capita investment reached a striking 18,700 Nuevos Soles (MEF 2007b). However, mining companies and producer regions strongly opposed attempts in the past few months to change this situation.

Figure 3.2 *Canon minero* and royalty transfers (constant prices of 1996)



Source: MEF (2007b).

Graphic representation: the author.

These four state weaknesses trap local governments, mining companies and activist movements in an insoluble game of competing interests at the sub-national level. Before analysing how these actors interact, it is important to describe the mining industry's new approach to relating with the local environment in which it operates.

4 A new face and a new role for the mining industry?

Over the past ten years, mining companies have tried to present a new and more attractive face to their business. The discourse of the benevolent 'new mining' as opposed to the irresponsible 'old mining' is pervasive. The 'old mining' was characterised by its arrogance towards local people, negative environmental impacts and a lack of concern for the socio-political context in which it operated.

In contrast, 'new mining' is considerate towards local people, is environmentally responsible and makes local development one of its main objectives. This new image is the corporate response to two types of incentives:

a) At the international level in the late 1990s, a set of studies was carried out highlighting the impact of mining on local communities (McMahon and Remy 2001; IIED 2002; Mate 2002). These studies virtually unanimously advocated for a comprehensive reform agenda for the mining industry including:

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18 Taking into account transfers to regional governments, municipalities and the investment directly made by the central government.

(i) greater operational transparency, collaboration with local authorities and civil society, and strengthening cooperation with local governments; (ii) environmental protection; (iii) scrupulous observance of human rights; and (iv) promotion of local development through corporate social responsibility (CSR) initiatives (Mate 2002: 5; World Bank 2003).

b) At the national level, the growing incidence of conflicts between mining companies and local communities appears to be a major issue. Conflicts harm current operations' profits and put the viability of large planned investments at risk.[19] In response to this situation, mining companies, in collaboration with the national government and international institutions, are trying to apply international prescriptions to the Peruvian context (World Bank 2005). As one of the leaders of the national mining industry affirms, *'companies are passing from being defensive regarding environmental conflicts to becoming proactive actors in the development of communities'*.[20]

The government has also reinforced the role of the mining companies as a more active political actor at the local level. There are at least three reasons for this strategy:

a) The central government needs to sustain the flow of investment to the mining sector to achieve its macroeconomic objectives of growth, increase of exports and fiscal balance. However, conflicts threaten investment planning and dis courage the commitment of new companies. Government response has been to present companies as strategic allies in local development as a way to legitimise mining companies' operations. In the words of the current Ministry of Energy and Mines (MEM 2007c: 19 July), the 'mining agenda is today the agenda of national development'.

b) The government and mining companies agreed to set up an alternative voluntary contribution system instead of introducing new taxes, which obliges the government to support the active involvement of mining companies in local development.

c) Local and regional governments do not have the capacity to manage the dramatically increased 'canon minero' transfers to the sub-national level (Figure 3.2) particularly in the absence of a state-driven mechanism to build administrative capacities. The significant lack of capacity forces an unprepared government to trust the mining companies and their managerial expertise to lead regional and local development. Senior mining company managers note that the current prime minister has encouraged them to transfer company capabilities to the public sector by cooperating at the local level.[21]

19 Mining companies plan to invest US$ 11billion between 2007 and 2011. This assumes a twofold increase in the current investment stock and a quantity equivalent to that of the total investment over the period 1992–2006 (MEM 2007b).

20 Personal interview.

21 Personal interviews.

The growing importance of mining companies in local politics and development is matched by the emergence of regional and local governments and civil society organisations as significant political actors. Regional and local governments are theoretically the companies' main counterparts for the promotion of local development. However, the current relationship is so asymmetric that discourses on collaboration and partnership are frequently merely rhetorical devices that disguise mining companies' substantial power over local government. Subordination of local governments by mining companies, political competition for popular acceptance and rivalry between local governments and companies to advance their own developmental agendas are more accurate descriptions of the existing relationship. On the other hand, civil society organisations, far from being a unified actor, comprise a multitude of diverse and sometimes conflicting factions.

The argument put forward in the following sections is that, in the context of weak state capacity, the allocation of public resources is distorted by the unregulated and asymmetric interaction between (a) mining companies promoting their 'new mining' agenda; (b) local governments managing a growing flow of revenue transfers; and (c) civil society asserting popular demands. This distortion is paralleled and reinforced by social conflicts. I will deal in turn with (a) conflicts (Section 5) and (b) the political economics of revenue allocation at the sub-national level (Section 6).

5 Conflicts: from symptoms to causes

Conflicts over mining can be viewed from two complementary perspectives: (a) they are symptomatic of the existence of competing interests, actors' asymmetrical power relations and the state's lack of capability to effectively regulate and arbitrate; and (b) conflicts provide the actors involved in them with incentives to maintain their behaviour even if it has proved to escalate conflicts. Conflicts between Peruvian mining companies and mining communities have been widely documented and analysed (Pascó-Font *et al.* 2001; Echave 2006; Cooperacción 2006; Revesz and Diez 2006; Bebbington 2007). Most of the current conflicts have an environmental component but are actually more complex than just an environmental analysis might suggest.

Environmental and social causes are often tightly interconnected. Not surprisingly, the senior managers of some mining companies try to discredit NGOs and social movements that support popular demands by portraying them as 'watermelons': green on the outside, but red inside. Environmental discourses indeed endorse social demands traditionally advocated by the radical left. Business people correctly identify this link, but their diagnosis neither hides the existence of environmental problems nor diminishes the severity of social problems (World Bank 2005). In fact, the existence of veiled grievances makes it more difficult to reach stable solutions.

This section focuses on why and how social movements emerge that challenge mining companies' operations. In the last part of the section I briefly discuss how conflicts generate negative incentives for mining companies, governments and social movements.

According to Tarrow (1998: 71), popular mobilisation requires that two alternative and complementary conditions arise: (a) new circumstances provide people with the means to escape existing political restrictions; (b) a growing feeling that inaction produces costs that people cannot bear or which outrages their sense of justice and dignity. The presence of mining companies in remote, poor and traditionally marginalised areas of Peru where state apparatus is virtually absent generates both kinds of incentive for popular mobilisation.

First, the presence of large companies gives people the opportunity for face-to-face interaction with a powerful actor. This new situation encourages collective action, as Muñoz, Paredes and Thorp (2006) have shown in Cajamarca and Espinar, two localities that contain intensive mining operations, social conflict, and consequent social mobilisation. The companies' need for the communities' prior consent to mining operations in their territories (the so-called 'social license') gives local people political leverage. They feel that they have a power that they never had before; even if it is the power of refusal, the power of saying 'no' to a powerful company.

Second, mining operations have a great potential to cause social unrest (World Bank 2005: 100–15). There are five reasons for that:

a) Official discourse on the strategic importance of mineral wealth raises popular expectations and generates incentives for poor people to demand their share. However, open-pit mines neither generate enough employment to match popular expectations nor develop strong links with other sectors of the economy (Kuramoto 1999).

b) The arrogant behaviour of managers, miners and other mining actors generates a sense of grievance among the population.

c) Companies compete with people for the control of scarce natural resources, mainly land and water, which are considered crucial assets by rural inhabitants.

d) Mining is perceived as a polluting activity that affects water resources, produces emissions that contaminate the air, and adversely affects public health.

e) There is a long time lag between the start of a mining operation and the generation of revenue that can benefit the population.

The sum total of these factors generates incentives for collective action. However, the transformation of these opportunities into actual social mobilisation needs the agency of actors who will name grievances, connect them to other grievances and construct frameworks of meaning which act as catalysts (Tarrow 1998: 110).

Social movements around mining use an environmental discourse to frame their claims and to gain legitimacy. Two factors explain this tendency. First, domestically, the authoritarian regime of Fujimori, the violence of Shining Path and the discredit of political parties made it unpopular to make demands using political left-wing discourse. Environmentalism became an accepted framework within which to pose popular demands in a context where other political expressions were repressed or delegitimised. Second, international institutions and NGOs sympathetically supported popular environmental struggles.

The flexibility of this environmental framework and its lack of hardline ideology have made it possible for different groups to come together under the same banner without feeling that any particular group has hijacked the movement. In the process, the interaction of the particular agendas of these different groups transforms the original meaning of the concepts that they use. Thus, environment is no longer exclusively related to pollution, management of natural resources or biodiversity. The term has been opened up to include dignity and justice, popular control over territory, respect for human rights and sustainable development as essential elements.

This 'loose-fitting' environmental framework, in turn, facilitates a flexible form of organisation based on pre-existing traditional structures, such as churches, rondas campesinas,[22] NGOs, and peasants' committees, that interact according to the local context and the specific demands by indigenous forms of popular struggle. This organisation's flexible structure has an advantage in mobilising communities but, at the same time, is very unsuited to coordinating public participation in constructive negotiations (Revesz and Diez 2006: 69).

Over the last three years, the number of open conflicts has increased and state response has been to deal with them one by one (Revesz and Diez 2006: 78). Although local issues trigger conflicts, there are general underlying conditions that underpin conflicts.

a) The state has a weak regulatory and enforcement capacity (World Bank 2005, Executive Summary), typified by poor environmental regulation and monitoring. The Ministry of Energy and Mines (MEM) is simultaneously responsible for: (i) promoting investment in new mining operations; (ii) granting mining concessions; (iii) reviewing and approving the environmental evaluations that allow mining companies to move into exploration; and (iv) approving environmental impact assessments prepared by companies to enter into the exploitation phase. From an institutional design perspective, the MEM's divergent responsibilities present a conflict of interest (Bebbington 2007). Problems are even more acute with implementation: (i) company capacity surpasses the competence of the ministry to control it [23] and; (ii) highly centralised regulation, decision making and monitoring of large mines in Lima results in decisions that are taken with limited knowledge of realities 'on the ground'. Finally, although there is some mechanism for the participation of local communities in the evaluation process, the reality is that the timing and the

22 Traditional rural organisations which were set up to prevent cattle-rustling. Later they started to play an important role in settling disputes among villagers and providing security to the population. In some areas they were crucial in the fight against the Shining Path guerrilla.

23 One member of an international company affirms that the MEM spent around US$ 2,000 to examine an environmental impact assessment on which the interested company invested around US $4 million.

complexity of evaluation procedures inhibit communities from intervening effectively in the process.

b) Fiscal policies (particularly companies' opposition to paying royalties and windfall taxes) have rallied an emergent nationalism that demands greater public control over the country's natural resources. It is no coincidence that Ollanta Humala, the left-leaning nationalist candidate, won the mining regions' vote in the last presidential elections. Despite Humala's clear popularity in the mining regions, both the government and the companies have ignored the growing nationalism and agreed to the controversial 'mining programme of solidarity with the people', popularly baptised 'mining alms'.

The result is widespread public suspicion of collusion between Peru's government and mining companies that erodes the authority and legitimacy of the state. This has two negative consequences: (a) this perception of deceitful collusion makes people feel that open conflict is the only way to claim (what they consider to be) their rights; and (b) once conflict arises, the state is unable to fulfil its role as arbitrator between the people and the companies. The state increasingly opts out of conflict resolution – described as the problem of the vanishing state – leaving the companies and the local communities on their own (Revesz and Diez 2006).

Simultaneously, conflicts generate incentives for actors to behave in ways that tend to generate more problems. For example, mining conflicts have put the decentralisation process under pressure before it has been properly planned and implemented. Both the government and the companies use fiscal decentralisation, the 'canon minero', to mitigate conflicts and demonstrate that mining goes hand in hand with development. This implicit objective distorts the allocation of resources at the local level where weak local governments are badly equipped to deal with competing demands, timing and procedural constrictions, and popular demands. The next section analyses how mining companies, regional and local governments and civil society interact once monetary transfers through the 'canon minero' dramatically increase.

6 The political economy of revenue allocation at the sub-national level

Peru's rural mining regions test the capability of the 'new mining' and the 'new natural resources policy agenda' to transform mineral wealth into development.

Peru has a political system characterised by growing decentralisation, greater public participation and a positive approach to collaboration between public institutions and the business community. Moreover, the mining companies operating in Peru are, at least in rhetoric, committed to good practices. However, positive outcomes are unlikely in light of the current political mechanisms for revenue allocation. The current revenue allocation process tends to generate low quality public spending, undermine the legitimacy of public institutions and exacerbate the pattern of mining dependency.

The cases of Cajamarca and Espinar (Cusco) illustrate the problems with revenue allocation. Mines in both places share some features, common to most new mines, that influence the ways in which they interact with their localities: (a) they are owned by important and powerful international companies;[24] (b) they are open-pit mines, which have a big impact on the environment; (c) they use sophisticated technology and, consequently, are capital-intensive; (d) they are located in mountainous areas of the Andean region deeply scarred by poverty and traditionally neglected by Lima. The dynamics that these mines generate also have remarkable similarities, albeit each with some specific features that will be pointed out in turn.

6.1 The scenarios

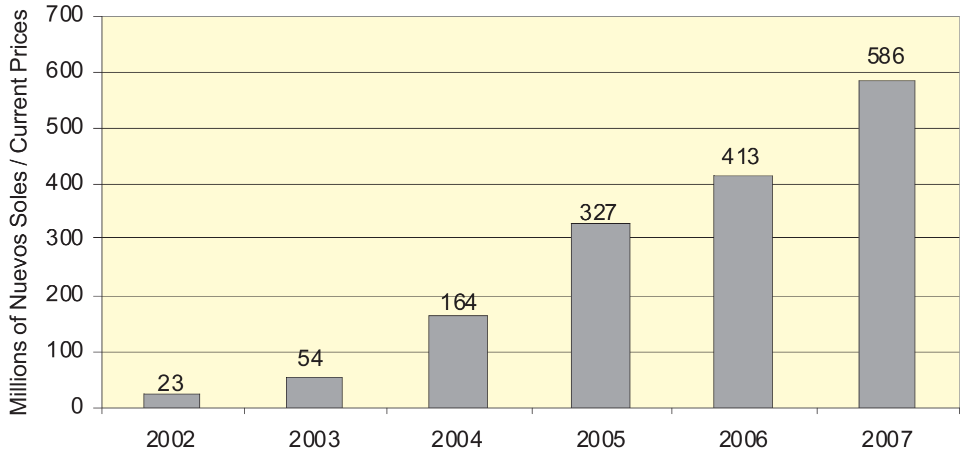
In the department of Cajamarca, the Yanacocha Company [25] operates the largest gold mine in Latin America. Yanacocha began mining in 1993 and is considered to be at the forefront of the 'new mining'. The owners present the participation of the International Financial Corporation (IFC) as a guarantee of good practice. Yanacocha has had a profound impact on life in the region, the most visible effect being its growing economic importance. In terms of production, mining represented more than 40 per cent of regional GNP in 2006 (BCRP 2007). 'Canon minero' transfers have increased ninefold in the last four years (Figure 6.1) and supply more than 80 per cent of the resources available for public investment in the region (GPC 2007a: 63).

The impact is even greater in the province of Cajamarca and the two districts of Baños del Inca and La Encañada, where the mine is located. In these cases there has been a tenfold increase in transfers (Figure 6.2). In relative terms, in 2007 the 'canon minero' transfers per capita were 560 Nuevos Soles (S/.) for Cajamarca, 1371 S/. for Baños del Inca and 1876 S/. for La Encañada. The importance of these figures emerges when they are contrasted with the estimated family income per head in these districts in 2005, being 2919 S/. (19 per cent of family income per head), 2549 S/. (54 per cent of family income per head), and 2384 S/ (79 per cent of family income per head) (UNDP 2006: 252). However, alongside its economic impact, Yanacocha´s operation has been plagued by significant social conflicts between the company and local communities (Pascó-Font *et al.* 2001; Revesz and Diez 2006).

24 It is worth noticing that exploration operations are frequently undertaken by junior companies with limited capital. These companies aim to sell the profitable operations to bigger companies, which own the resources and technology for the exploitation phase (Glave and Kuramoto 2002: 2). However, the initial interaction of the junior companies with the local communities has often determined the conflictual nature of the relationship for the future.

25 Yanacocha is a joint venture between Newmont (USA), which holds 51.35 per cent ownership interest, Buenaventura (Peru) owning 43.65 per cent and the International Finance Corporation (IFC), an arm of the World Bank, which holds the remaining 5 per cent.

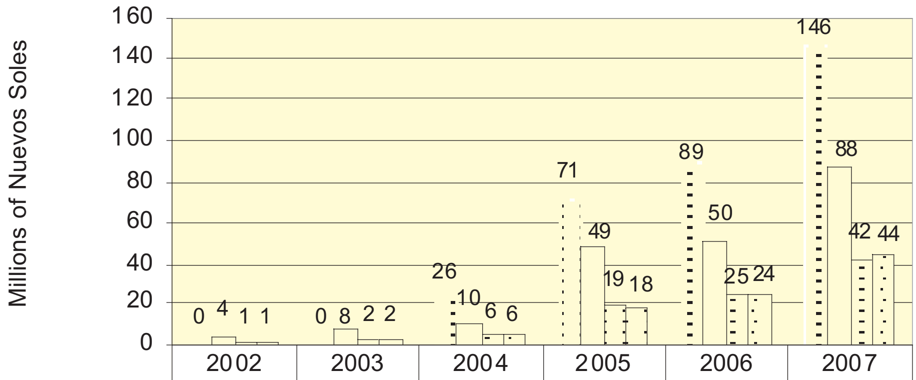
Figure 6.1 Evolution of ‘canon minero’ transfers to the Cajamarca Region



Sources: MEF (2007b; GPC 2007a).

Graphic representation: the author.

Figure 6.2 Evolution of ‘canon minero’ transfers to mining districts in Cajamarca



	2002	2003	2004	2005	2006	2007
■ Regional Government	0	0	26	71	89	146
■ Provincial Government	4	8	10	49	50	88
■ La Encañada District	1	2	6	19	25	42
■ Baños del Inca District	1	2	6	18	24	44

Sources: MEF (2007b).

Graphic representation: the author.

The expansion of mining activities in the region is another important factor when analysing the problems generated by revenue allocation. In addition to Yanacocha´s expansion to nearby sites, some of the largest future operations planned for the country will be located in Cajamarca: Cerro Corona (Minera Gold Fields), la Granja (Rio Tinto), la Zanja (Buenaventura), Rio Blanco (Zijin Mining Group) and Michiquillay (Anglo American Services).

These companies have already agreed US$ 3.5 billion worth of investments in the region over the next five years (MEM 2007b). However, some of these operations are highly controversial and have led to violent conflicts, as was the case in the Rio Blanco project. Rio Blanco is on the border between Cajamarca and Piura, in an area of high environmental value. There, Majaz, a subsidiary of the English Montericco Metals [26] has started exploring operations against the expressed opinion of the inhabitants.[27] To tackle conflict increase and formulate a joint strategy, the different mining companies with interests in the department have formed the 'North Group' with a mission to promote regional development. They have drawn up a comprehensive plan that focuses on road infrastructure, electricity and telecommunications (Grupo Norte 2006).

Finally, Yanacocha and the other companies operating in the region have earmarked a large amount of money to support community initiatives. In 2005 Yanacocha donated US$ 23.4 million for community projects. Over the next five years, Yanacocha has promised to give US$ 45 million to the 'mining programme of solidarity with the people'. A trust under the control of the company will manage this contribution with the participation of some local people.

Espinar is a small municipality in Cusco where the Tintaya mine is situated. Tintaya was initially a state-owned company. After its privatisation, it has had a succession of different owners (Billiton, BHP), including Xstrata, which bought it last year. Tintaya's impact on the local environment is remarkable and the increase of resources that flow to local governments is even more dramatic than in Cajamarca. In the three-year period from 2005 to 2007, its 'canon minero' transfers have multiplied twelvefold, a 1,100 per cent increase (Figure 6.3).

Like Yanacocha, Tintaya's history has been marked by conflicts, sometimes violent ones. To overcome this historical cycle of conflict, in 2004 Tintaya agreed with local authorities to generate a fund to promote local development, the 'Acuerdo Marco Fund' (this fund is seen as the precursor to the newly established 'mining programme of solidarity with the people', which mining companies and government recently agreed upon). In 2007, the 'Acuerdo Marco Fund' amounted to US$ 11 million for investment in the districts of Espinar province. Theoretically, the company and the municipality jointly manage this fund by means of an *ad hoc* committee. 'Canon minero' resources and the 'Acuerdo Marco' account for more than 90 per cent of public investment in Espinar.[28]

6.2 General mechanisms for allocating resources

More than 96 per cent of regional and local government budgets comprise financial transfers from the central government (GPC 2007b: 25). The central office sends resources directly to each sub-national government's bank account.

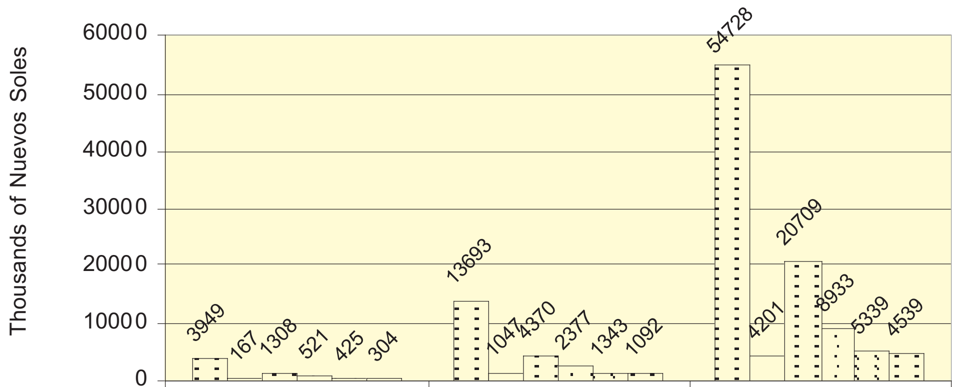
26 In April 2007 the Chinese Zijin Consortium acquired Monterrico Metals.

27 A complete account of the evolution of this conflict with relevant additional information about mining in Peru can be found in Bebbington (2007).

28 Interviews in the Municipality of Espinar.

Accordingly, local governments bypass the regional government when managing their budgets, resulting in the lack of mutual accountability between regional and local levels.

Figure 6.3 Evolution of 'canon minero' transfers to mining districts in Espinar



	2005	2006	2007
■ Province of Espinar	3949	13693	54728
■ Alto Pichigua	167	1047	4201
■ Coporaque	1308	4370	20709
■ Pallpata	521	2377	8933
■ Pichigua	425	1343	5339
■ Suyckutambo	304	1092	4539

Source: MEF (2007b).

Graphic representation: the author.

Once the resources are available at the local level, allocation is strictly regulated. The system is structured around three complementary devices that should inform the process of public investment: (a) a participatory development strategy; (b) an institutional strategic plan; and (c) a participatory budget. This subsection analyses how these three devices are designed and points out some general shortcomings of this system of allocation.

Every sub-national government is supposed to generate a development strategy for its territory. Regulations encourage local governments to develop these strategies in consultation with the relevant local actors. The development strategy should be the foundation for the institutional strategic plan and the allocation of resources. However, in practice, this process has dangerous limitations:

a) The lack of planning, at a national level, to frame the sub-national planning processes disconnects local development from the implementation of national policies and from other territories´ strategies. The result is a patchwork of juxtaposed strategies without synergy. At the national level, there are four agencies responsible for investment in (i) rural electricity; (ii) rural roads; (iii) telecommunications; (iv) water and sanitation. Each has its own planning instruments, its own criteria for the distribution of funds among territories, and even its own definition of rural areas (Peltier-Thiberge 2006: 294). These agencies operate independently of regional and local governments, which, in turn, overlap with national activities by investing a significant proportion of their resources in electricity, roads and water and sanitation.

b) There is no institutionalised coordination between regional and local planning. As a result, different strategies coexist in the same territory. Some regional governments are already aware of this problem and have started to work with local authorities to reach collaborative agreements on a project-by-project basis. However, the experience of Cajamarca shows that implementation on a large-scale basis is constrained because the transaction costs of this procedure are so high. Thus, only 6 out of 232 projects prioritised in the regional participatory budgeting process of Cajamarca for 2006 have a regional impact. The other 226 are merely small projects restricted to the local level (CEDEPAS 2007: 35–6).

c) The high staff turnover in sub-national governments results in an inconsistent development strategy. Official blueprints are merely colourful decorations for the office walls of new incumbents. In the absence of a professional civil service, more than 80 per cent of sub-national government staff are replaced [29] after each election. New officials and staff neither have the political interest nor the knowledge of the previous processes to make sensible use of the strategies designed by former government administrations.

A participatory budget is the other key device for allocating resources for local investment. In 2002 the parliament approved a law (Nº 27680) that enforces participatory budgeting as compulsory public policy for all sub-national governments.

The objectives of this measure were: (a) to reinforce democracy and good governance by means of civil society participation; (b) to promote private investment through the participation of business in the budgetary process; (c) to improve the quality of public spending; (d) to foster downward accountability; (e) to encourage the contribution of the population to projects that benefit them (Shack 2006: 69–70).

Theoretically, within the framework of regional and local development strategies, government officials, representatives of local governments and local communities, members of civil society and, in a few instances, business people, review the problems and opportunities in the territory and adjust the criteria for prioritising projects. After this process, a technical committee analyses the economic and technical viability of different proposals. Finally, the regional president or municipal mayor presents the technical analysis to the participants who, after deliberation, approve prioritised projects (Shack 2006: 72–3).

Nevertheless, central office is not completely absent from the process. All projects accepted through the participatory budget process have to be examined and approved by the National System of Public Investment (SNIP). The SNIP is a

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29 Figures for Cajamarca Regional Government and Municipality.

technical body whose mission is to guarantee the technical feasibility and economic and social profitability of public investment. At the beginning of 2007, some of the SNIP's functions were transferred to the regional level to make the approval procedure quicker and more flexible.

After four years of participatory budgets, the analysis of the national experience reveals some shortcomings with the participatory budget process (Shack 2006: 78): (a) investment is excessively fragmented between competing popular interests making it impossible to focus resources on strategic projects; (b) a lack of technical rigour at the local level leads the SNIP to reject a high proportion of proposed projects; (c) lack of coordination between development strategies and participatory budgeting and between local and regional levels; (d) limited representation of the participants; and (e) a lack of effective mechanisms to monitor and control the agreements. As the next subsection reveals, these deficiencies multiply in mining regions that receive large influxes of money.

6.3 The dynamic or resources allocation in mining regions

Regional and local governments in the mining regions have to manage an unexpected and substantial amount of money for public investment. Four factors condition their performance: (a) the volatility of 'canon minero' transfers; (b) a lack of technical expertise to implement large and complex programmes; (c) legal requirements that impose strict procedures for resource allocation; (d) a growing pressure from mining companies and the central government to spend all the available financial resources quickly. Over the past year, the need to spend money quickly has turned out to be a major issue.

Mining companies and the central government accuse the sub-national governments of being incapable of effectively investing revenues. This allegation stems from different motives. Companies are trying to shift the burden of responsibility for conflict resolution onto the local authorities, blaming local authorities for poor outcomes. Additionally, they are attempting to gain popular support for their involvement in local development by criticising local government's development efforts. In turn, central government is trying to disassociate itself from the dismal development record by placing blame on local authorities. Moreover, the central government strategically downplays the performance of regional governments in a competition for political legitimacy.

Beyond their efforts to assist the population, regional and local authorities aspire to popularity and maintaining power. In an environment of fragmented politics in which regional presidents and mayors assume power with little popular support, investment allocation becomes the main tool with which to gain legitimacy (Schady 1999). The participatory budget process has consequently become a forum where local communities, municipalities (in the case of the regional budget) and some popular organisations set out their proposals for small local infrastructure projects.

The result is a blanket distribution of resources to all districts and communities within the mining provinces, regardless of their real needs and, in the case of districts, of the amount of resources they receive directly from central office. This thin distribution promotes the implementation of a myriad of tiny projects with little impact in terms of structural development.

Mining companies' activities further distort the allocation of resources. Companies legitimise their involvement at the local level through different discourses, ranging from theoretical approaches regarding public-private partnership to a more functional attitude that regards the companies as substitutes for a capable public sector.

The companies swing between two paradoxical positions and corresponding strategies. On the one hand, they complain bitterly about the local communities asking them for services that the state should provide. This approach is a useful way of downplaying company responsibility for resolving local conflicts. On the other hand, when the companies decide to play a more active role in local development, they position themselves as the recipients of and respondents to popular demand (and anger). Most companies ultimately choose the latter strategy. Beyond the rhetoric on their commitment to local development, there appear to be two main reasons for this option: (a) they urgently need to resolve current conflicts and prevent future conflicts that threaten mining operations; and (b) in some cases, need to set up the basic infrastructure that will facilitate investment in future operations.

To achieve their goals, the companies have two different strategies that they combine depending on the context: (a) they use their resources to gain popularity and transform their support of local development into a marketing strategy; and (b) they use their own resources and their political leverage to influence the way in which public resources are allocated.

All companies widely use the first strategy, clearly demonstrating their understanding of CSR. Most of the companies' CSR activities are concentrated on supporting local development projects in the areas of education, health, nutrition, irrigation, local roads and small business promotion.

In Espinar, Tintaya implements its support to the community in three ways. First, it funds projects through 'Tintaya Trust', a charity directly managed by the company. Second, the company helps the local communities and district municipalities to prepare projects for submission to the participatory budget. In this way, communities closer to the mine get a technical advantage in budget preparation and allocation. Third, although in theory the 'Acuerdo Marco Fund' is supposed to be managed jointly between the provincial municipality and the company, in practice, the company and the 'Tintaya Trust' control the fund and implement most of the approved projects.

The participatory budget mechanism and the 'Acuerdo Marco Fund' use similar procedures for accessing public funds. Local communities and other local organisations can submit their proposals to both schemes. However, the 'Acuerdo Marco Fund' has the advantage of being more flexible. The result is that both arrangements run in parallel and there is no room for coordination or cooperation. The mining companies, in their interest, concentrate resources in the communities that are closest to the mine. Mining companies' power erodes the legitimacy of public authorities, which cannot compete with the company in terms of flexibility, capacity to hire skilled professionals and political leverage at the national level to obtain advantages for mining communities.

Tintaya's experience represents the traditional approach in which an individual mining company uses the rhetoric of promoting local development to gain local support through clientelism, offering local communities with infrastructure development, marginal jobs and other benefits in exchange for a peaceful coexistence. Yanacocha, in Cajamarca, uses similar strategies and supports a large number of local projects directly or by means of ALAC, its 'charity'. The new arrangement to channel funds into the 'mining programme of solidarity with the people' is likely to exacerbate this pattern. However, the substantial economic prospects for future mining operations in Cajamarca have forced the companies to initiate a new strategy.

The formation of the 'North Group' represents this new approach that attempts to influence the planning of regional development. According to various regional analysts, the 'North Group' is the only actor that has a clear agenda for the future of the region. This agenda aims to make the short and medium-term progress of newly planned mining operations feasible.

The agenda comprises two different lines of implementation: (a) local people need to feel a significant improvement in their living conditions in order to reduce conflicts; and (b) the region needs better road infrastructure and a reliable electricity supply to facilitate exploitation. The promotion of this agenda presupposes greater company involvement in determining public policy. Mining companies plan to use their political leverage and growing capacity to determine the allocation of investments through the 'mining programme of solidarity with the people'. For example, they propose allocating money to match public budgets for road projects and use their leverage to promote the involvement of the World Bank in important infrastructure projects in the region.

6.4 Outcomes

Not withstanding the novelty of the current revenue allocation system, investment at the local level is resulting in some clear effects:

a) Public investment is concentrated in certain regions and – within these regions – in the communities that are closest to the mines. This concentration in a limited area does not generate sustainable economic growth and in the long-term will generate horizontal inequalities.

b) The pressure to invest revenue as quickly as possible and to distribute resources according to 'electoral' criteria downplays technical rigour and generates unplanned and uncoordinated spending.

c) The presence of significant private investment to promote development projects at the local level tends to diminish the potential efficiency and synergy of a more coordinated operation. This public-private competition, instead of reinforcing public capacity, erodes the legitimacy of the local authorities.

d) Undermining of public authorities, both at national and local levels, is likely to exacerbate conflicts and to reduce the government's ability to deal with conflict in a constructive way.

e) The new strategy of some mining companies to promote the industry's involvement in setting the development agenda is likely to increase Peru's economic dependency on mineral exploitation.

7 Conclusions

The analysis of the recent revival of the mining industry in Peru reveals a new form of resource curse characterised by two unique features: (a) the deep involvement of new actors (mining companies, sub-national governments and civil society organisations); and (b) the emergence of the local level as the crucial political arena where these stakeholders interact.

The most notorious symptom of this new form of resource curse is the growing incidence of conflicts related to mining operations. The environmental face of these conflicts hides a more complex set of reasons and grievances that account for upsurges in violence that are related to (a) social unrest generated by the geographical coexistence of large mining operations with rampant poverty; (b) the state's limited ability to enforce mining regulation; and (c) the public perception of collusion between the government and the mining companies. However, conflicts do not stem from these factors alone. Once conflicts arise, they themselves become the cause of further problems. Companies' attempts to mitigate conflicts and show the developmental potential of the mining industry lead them to interact with local actors in a dysfunctional way by: (a) fostering clientelism; (b) promoting quick spending that reduces the quality of public investment; and (c) trying to usurp the state. The result is a vicious circle in which popular frustration generates conflicts that in turn reinforce the conditions for new conflicts.

This perverse dynamic manifests despite Peru's faithful compliance to rigorous fiscal policies and to the 'new natural resources policy agenda'. In the context of weak public institutions, the state's simplistic adoption of the new resource agenda is used by the mining companies to advance their own interests at the local level, distorting the original aim of the reforms. The way in which participatory budgeting devices are used to allocate the resources of the 'canon minero' clearly exemplifies this distortion of reforms. This capture of a theoretically progressive agenda hampers the generation of a more representative political system. As a result, mining companies suffer the ill-effects of their short-sighted strategy in the form of the growing incidence of conflicts that threaten the social viability of their operations. At the same time, the process reinforces the resource curse and impedes the transformation of mineral wealth into improved living standards for Peru's people.

The solutions are far from simple. At the national level, it is crucial for the state to gain legitimacy in the eyes of its citizens and regulate and defend their interests. For example, in terms of fiscal policy, the introduction of windfall taxes or a more progressive profit-based tax system and the widespread use of royalty payments would likely generate a more stable political environment by: (a) reinforcing the regulatory role and legitimacy of the government; (b) improving mining companies' public image; and (c) disarming the more radical discourses on nationalisation of natural resources. Although mining companies reject these kinds of measures, they face a trade-off between maximising the short-term profits of their current investments and generating an appropriate environment for future operations. In the environmental field, the creation of an independent environmental enforcement agency could legitimise the state in the eyes of its citizens and introduce more accurate regulatory instruments (Poveda and Sánchez-Triana 2006: 486).

Also at the national level, the central government should improve the process of granting mining concessions. The process of granting licenses for exploration and exploitation of mineral deposits is highly centralised. Participation of local authorities in the process would help take local socio-political variables into account and manage relations with local communities more carefully.

At the sub-national level, the concurrence of the decentralisation process with the growing importance of mining operations and revenue creates a challenging scenario for both sub-national governments and mining companies. Regional and local governments, for the most part, are aware of the need to improve their management capacities in order to enhance public services. On the flip side, mining companies are conscious of their asymmetrical power relations with local government. However they do not realise that this power makes people suspicious of their real intentions and places them at the forefront of popular discontent. Strengthening public institutions would help to generate a political environment less prone to conflict and more efficient in managing public spending. Some possible measures along these lines are: (a) strengthening the capability of local institutions; (b) generating regional 'stabilisation funds'; (c) improving participatory budgeting processes; and (d) maintaining the private and limited social role of the mining companies.

Although an in-depth discussion of these measures is beyond the scope of this paper, it is worth emphasising that mining companies should be very careful not to usurp the state. Conflicts, pressure to set up new mining operations and the weakness of public institutions encourage mining companies to play a more state-like role. However their growing tendency to take over state activities ultimately generates more problems [30] because (a) it erodes the legitimacy of public institutions, which lose their regulatory and arbitration capacity; and (b) it places the companies at the forefront of public demands, thus triggering conflicts. Bypassing public institutions can yield positive results in the short-term but it will generate more instability in the long-term.

This paper represents a preliminary approach to understanding a new form of resource curse. The complexity of the dynamics that account for this curse merits further research. Of the different issues that new studies should address, it is worth mentioning: (a) a deeper analysis of the new actors (mining companies, sub-national governments and civil society organisations) and the influence of

30 In the African context some authors advocate this kind of substitutive role (Kaplan 2007).

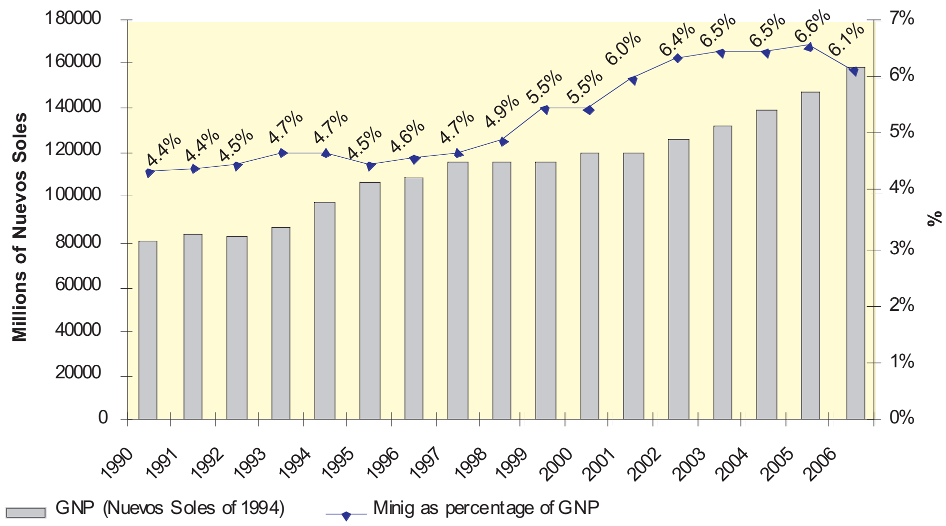
variations within each group; (b) disparities between different countries and regions that could be attributed to the behaviour of key actors; (c) the environmental impact of mining operations; and (d) the effects of social mobilisation and collective action.

The scope of this further research could have significance beyond Peruvian governance. Taking into account that (a) the Peruvian political model is common to other developing countries, and (b) that company strategy must be understood within the framework of new global guidelines for the mining industry,[31] subsequent analysis of this new form of the resource curse could be relevant for other countries in the future.

31 For example, a recent analysis of corporate partnerships and community development in the Nigerian oil industry can be found in Idemudia (2007).

Appendix I Economic figures of Peru

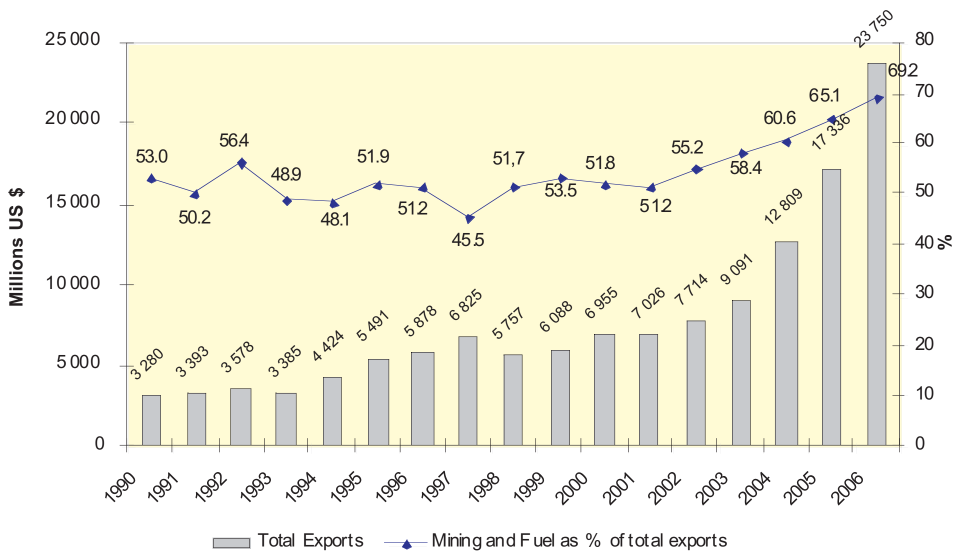
GNP and percentage of mining



Source: MEF (2007a).

Graphic representation: the author.

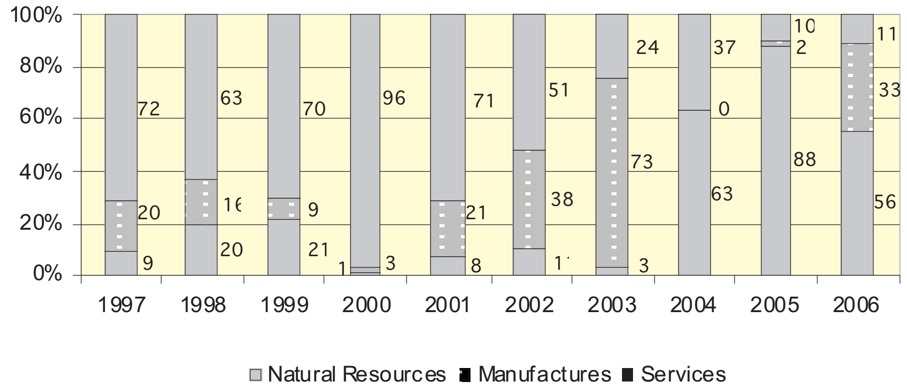
Total exports/mining and fuel as percentage of exports



Source: MEF (2007a).

Graphic representation: the author.

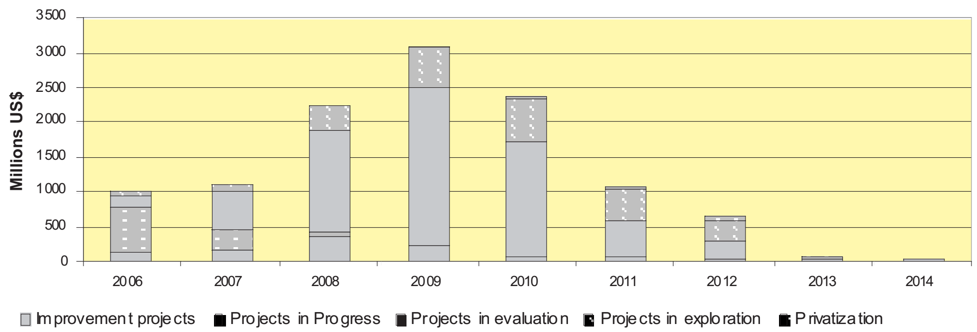
FDI annual inflows according to main sectors



Source: ECLAC (2007).

Graphic representation: the author.

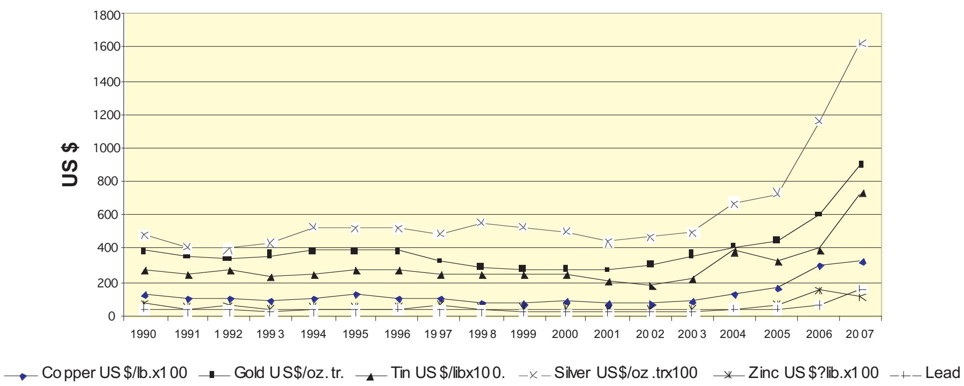
Mining investment planning 2006–2014



Source: MEM (2007a).

Graphic representation: the author.

Mineral prices



Source: MEF (2007a).

Graphic representation: the author.

Appendix II Interviewees

Name	Personal profile	Date	Place
1. Álvarez, David	President of the Unified Front for the Defence of the Interests of the Espinar Province (FUNDIE).	14 June 2007	Cooper-acción/ Espinar
2. Aroca, Javier	Responsible for extractive industries' issues of Oxfam America in Peru.	20 June 2007	Oxfam America
3. Aroni Quispe, Teodoro	Manager of Municipal Planning	14 June 2007	Municipality / Espinar
4. Baldera, Gonzalo	Manager Assistant for Development of the Regional Government of Cajamarca	18 June 2007	Regional Govern-ment/ Cajamarca
5. Benavides, Raúl	Busines Development Vice-president of Buenaventura	11 June 2007	Buenaven-tura / Lima
6. Burneo, Kurt	Lecturer of Economy at the UPCP; former Director of the Central Reserves Bank (BCR) and of the National Bank (BN); Former Vice-minister of Economy and Finance	22 June 2007	PUPC
7. Campodónico, Humberto	San Marcos University Lecturer; he worked in the National Institute of Planning and in ECLAC; he writes regularly in newspapers.	11 June 2007	Larcomar / Lima
8. Chirme, María	Current president of CORICAMI	15 June 2007	Private house / Espinar
9. Cordoba, Francisco	Founder of CORICAMI; promoter of the agreement between the Tintaya Company and the communities	15 June 2007	Private house / Espinar
10. De Echave, José	Director of Cooperacción	11 June 2007	Cooper-acción / Lima
11. Díaz Canseco, Javier	Former member of the Parliament (1981–2006). Presidential candidate of the Socialist Party	12 June 2007	Café News / Lima
12. Diaz, Javier	CEDEPAS	18 June 2007	CEDEPAS / Cajamarca

13. Escalante, Juan Carlos	Support Manager of Newmont Explorations	11 June 2007	Newmont / Lima
14. Gonzales, Alex Martín	CEDEPAS	19 June 2007	CEDEPAS / Cajamarca
15. Huilca, Leoncio	Technical Secretary of the ‘Acuerdo Marco’ Management Committee.	14 June 2007	Municipality of Espinar
16. Iguiñiz, Javier	Director of the Economics Department of the Pontifical Catholic University of Peru (PUPC)	8 June 2007	PUCP / Lima
17. Labó, Ricardo	Manager Support of External Affaires (Rio Tinto)	20 June 2007	Rio Tinto
18. López, Silesio	Political science lecturer at PUPC; former director of the National Library	12 June 2007	PUPC / Lima
19. Manuel Grave	Researcher of GRADE; specialist in mining issues	20 June 2007	GRADE
20. Mendoza, Waldo	Lecturer of Economy at the UPCP; former Vice-minister of Economy and Finance.	22 June 2007	PUPC
21. Muñoz, Ismael	Political science lecturer at PUPC	12 June 2007	PUPC / Lima
22. Quiñones, Nilton	Reseacher in Propuesta Ciudadana	11 June 2007	Propuesta Ciudana / Lima
23. Romero Neira, Fernando	Manager of Regional Planning and Budgeting	16 June 2007	Regional Govern-ment / Cusco
24. Roncal, Nery Alejandro	CEDEPAS	18 June 2007	CEDEPAS / Cajamarca
25. Rosemberg, Cristina	Research assistant of GRADE	20 June 2007	GRADE
26. Sáenz Vargas, Leilo	Manager of the Municipality of Cajamarca	19 June 2007	Municipality of Cajamarca
27. Samaniego, Victor	Personal adviser of the Regional President	13 June 2007	Regional Govern-ment / Cusco
28. Sánchez, Pablo	Sub-director of GRUFIDES	19 June 2007	CEDEPAS / Cajamarca

29. Sánchez, Sergio	Advisor for Natural Resources Management of the Regional Government of Cajamarca	18 June 2007	Regional Govern-ment / Cajamarca
30. Sánchez, Walter	Sub-director of Promotion and Mining Development / Energy and Mines Ministry (MEM)	12 June 2007	MEM / Lima
31. Shuldt, Jürgen	Researcher and lecturer of the Pacific University (UP)	21 June 2007	UP
32. Tanaka, Martín	Director of the Institute of Peruvian Studies (IEP)	21 June 2007	IEP
33. Valdivia Jordán, Mauro	Director of Mining and Environment at the regional office of the MEM (Cusco)	13 June 2007	Regional Govern-ment / Cusco
34. Vigo, Violeta	Executive Director of ALAC	19 June 2007	ALAC / Cajamarca
35. Villa, Andrés	Member of SER (Rural Educative Services)	18 June 2007	SER / Cajamarca
36. Villarán, Fernando	Consultant; former Labour Minister (2001–2005); president of the Commission for the design of the CEPLAN	20 June 2007	SASE
37. xxx	President of the Suero-Icam Community	14 June 2006	Cooper-acción / Espinar

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