Evidence and lessons from Latin America

Can rent distribution reduce extractive industries conflict? A focus on the Peruvian case helps highlight how and if these schemes could prove to be effective.

RENT DISTRIBUTION AND EXTRACTIVE INDUSTRY CONFLICTS: THE LATIN AMERICAN APPROACH

SUMMARY

Given the surge in socio-environmental conflicts that extractive industry activity has generated in Latin America, particularly in the last decade, it is only natural that countries in the region have begun to consider how different rent distribution schemes could be used to prevent or mitigate such struggles. By taking a panoramic look at the distribution systems in place across the region, two different distribution logics are identified: distribution for development vs. distribution for compensation. This Brief focuses on the case of Peru, a country struggling with visible and violent conflicts, and examines one particular aspect of their compensatory distribution scheme, the Law of Canon. The Brief presents an overview of the law, and some reflections about the reasons why it seems to not be as effective as was hoped in reducing Peru's conflict. Finally, underlying contextual and enabling factors of Latin American experiences are identified along with lessons learned that may prove useful for countries in other contexts.

RENT DISTRIBUTION AS A SOURCE OF CONFLICT

The expansion of extractive industry activities in the global south has triggered a rise in social and environmental conflicts. The reasons behind these conflicts are varied. One root cause which seems to be present across the world is disagreement over the distribution and use of the significant revenues extractive projects generate.[1] In Nigeria, for instance, when violent social conflict erupted in 2012, the Central Bank Governor publicly attributed the conflict to an [unfair share of oil revenues](). In particular, communities and governments where extractive activity actually takes place typically expect a major share of revenue. In Latin America, this has certainly been the case. In

KEY LESSONS LEARNED

Latin American cases show how rent distribution alone does not diminish conflicts.

To increase the likelihood of success of a particular rent distribution system, compensation mechanisms should be linked with broader development goals and be implemented by decentralised units that have the necessary institutional capacities.

[1] For a broader discussion about the many different causes of such conflicts in Latin America, read the ELLA Guide: Latin American Approaches to Extractive Industry Conflict.

Bolivia, for example, indigenous groups living in extractive industry areas fought for more revenues when natural gas reserves increased to 27 trillion cubic feet (tcf) in 2009.[2]

But if disagreement over distribution is one of the root causes of conflict, does that necessarily mean distribution systems are the answer? Latin American countries have used different distribution mechanisms as a strategy for reducing or preventing conflict, and their experience might help shed light on how these mechanisms could work in other contexts. A point to consider, though, is that systems that give priority to extractive sites still have to meet national-level development expectations, at the same time as trying to prevent conflicts over funds allocation. Overall, the key challenge for governments in Africa, Asia and Latin America is deciding whether to use distribution as strategy for preventing and managing conflicts, and then ensuring it works.

INTRODUCTION TO LATIN AMERICAN RENT DISTRIBUTION: DEVELOPMENT VS. COMPENSATION

Governments in the region have distributed extractive rents in different ways according to different specific goals, such as payment for environmental damages, political compensation or achieving improved development outcomes at the national or local level. In looking across Latin American countries, two different types of strategies for distribution emerge, each linked with two very different objectives.

First, distribution systems may be orientated towards achieving specific development outcomes. In these schemes, extractive rent is allocated to central and local level government units to implement development initiatives in line with governments' development goals, and to support overall planning. Central or regional governments can integrate revenues into their overall national budgets or assign some percentage to specific prioritised sectors. For example, the Chilean government allocates a percentage of extractive revenues to developing the science and technology sector. Development-orientated distribution schemes also occur at the local level, where they focus on supporting local government units' specific development activities and goals.

In contrast, compensation-orientated distribution schemes privilege compensation for the negative impacts of extractive activity over achieving development goals. In Latin America, several governments use compensation criteria to distribute extractive revenues. In Bolivia, Brazil, Colombia and Peru, the regions where extraction takes place receive a larger share of rent revenues than other regions as compensation for the negative environmental and social impacts that extractive activity brings. The compensation logic is used to reward extractive regions, while at the same time aiming to circumvent the emergence of extractive industry opposition over social and environmental concerns.

In most cases, countries use a mix of compensation and development criteria as they design distribution schemes. The Brazilian government, for example, transfers significant funds to the regional governments where oil extraction takes place, with the intention that they use the funds to implement components of their regional development plans. Brazil thus uses compensation criteria to privilege 'producing' regions, but development criteria to ensure that the revenue is spent on achieving development outcomes. The key question, then, is which criteria, if any, predominates.

Another important factor to consider is that each distribution system is implemented within the country's particular institutional configuration, going from more centralised models on the one hand to more decentralised models on the other. In the former, most extractive rent remains with the central government, while in the latter most rent is distributed to government units at the regional or local level. In theory, the more distributive the model, the more decentralised the institutional platform.

The table below presents an overview of the different rent distribution models, institutional set-ups related to decentralisation and relative levels of conflict for a selection of Latin American countries.

[2] Vasquez, P. 2010. *Energy and Conflicts: A Growing Concern in Latin America*. Inter-American Dialogue Working Paper 10. Inter-American Dialogue, Inter-American Development Bank, Washington, DC.

Table 1: Distribution Systems, Institutional Set-ups and Conflict in Selected Latin American Countries

Country	Institutional Platform	Ownership of natural resources	Distribution systems based on origin (Compensation)	Level of Conflict
Argentina	Federal	Provincial	None	Medium
Bolivia	Unitary state	People	Percentage of Direct Tax on Hydrocarbons goes to producing Departments	High
Brazil	Federal system	Federal Government	Royalties and excises are shared between the federal level and the producing and bordering states and municipalities	Low
Colombia	Unitary state with regions	State	Substantial part of royalties	Medium
Ecuador	Unitary with regions	State	One dollar per barrel of oil goes to the Amazonian Development Fund	Medium
Peru	Unitary with regions	The Nation	50% of taxes on minerals and royalties on oil and gas and 25% of income tax on oil and gas go the producing municipalities and regions	High
Venezuela	De facto Unitary	State	Small part of royalties goes to states	Medium

Author adaptation of original chart found in: Bosio, G., Jimenez, J.P. 2011 The Intergovernmental Assignment of Revenue from Natural Resources: A Difficult Balance between Centripetal and Centrifugal Tendencies (Preliminary version for comments). Economic Commission for Latin American and the Caribbean (ECLAC), Santiago de Chile.

Conflicts associated with extractive activity are particularly widespread in Peru and Bolivia. Perhaps not surprisingly, these countries have developed two of the most decentralised models privileging use of rents for territorial compensation over centralised development planning. However, the Bolivian compensatory policy is much more integrated within a package of reforms granting increased autonomy from the central government – an autonomy largely demanded by indigenous groups and local political leaders. The most recent Bolivian constitution transformed Bolivia from a uni-national state – like Peru – to a pluri-national one, in which not only sub-national governments but also distinct indigenous populations were recognised as having certain degrees of autonomy. Bolivia's rent distribution scheme was not a separate policy developed to manage distribution on its own, but rather was included as one component of a package of policies giving greater autonomy to newly recognised political units. Interestingly, and in contrast to the Peru model, although Bolivia established a base rate for distribution amounts, there is some discretion in the law, so that some of these autonomous units have actually succeeded in negotiating a better distributive rate than other groups or sub-national governments receive. Often the government engaged in these negotiations as a last-ditch effort to end a particular conflict.

In contrast, Peru, despite having a decentralised system where sub-national governments receive funds and have responsibility for spending them, regional and local governments still have limited decision making power. In short, Peru has administrative decentralisation but limited political decentralisation, with much less autonomy than that granted in Bolivia to sub-national units and groups. The Peruvian Canon system[3] for rent distribution, though obviously related to the country's political context and overall decentralisation model, is still a separate policy put in place specifically to distribute extractive rents for compensation. Thus the Peruvian case we highlight below constitutes the best Latin American example for testing the use of the compensation distribution logic in order to address conflicts.

THE PERUVIAN EXPERIMENT: COMPENSATION REDISTRIBUTION AS CONFLICT MANAGEMENT

The extractive industries contribute significantly to Peru's economy. According to the World Bank, even though total natural resources rents are just 8.2% of GDP, around 50% of national exports are minerals and a big share of fiscal incomes come from this sector, mainly from mining. Furthermore, the importance of extractive industries to the economy has been shown to be increasing. According to the National Society

[3] For additional information about Peru's Canon Law, see the following publications: Toledo, C. 2011. Natural Resource Rents and Redistribution: The Effect of Mining- Based Transfers on Local Populations in Peru. Presentation to the Latin American and Caribbean Environmental Economics Program (LACEEP). University of Berkeley, Berkeley.; Arellano-Yanguas, J. 2008. A Thoroughly Modern Resource Curse? The New Natural Resource Policy Agenda and the Mining Revival in Peru. Working Paper 300. Institute of Development Studies, Sussex.; Avila, G., Baca, E., Quiñonez, N. 2007. No. 6 National Report on Extractive Industries Surveillance. Grupo Propuesta Ciudadana, Lima.

SPOTLIGHT ON DISTRIBUTION IN PERU

In addition to canon, a few other aspects of Peru's distribution system are worth mentioning. Royalties play a role in compensation, and are kept within producing regions. The amounts coming from royalties, however, are much less significant than Canon funds. Some other revenue sources, often not even tracked by the central government, also stay within producing regions. For instance, some companies donate resources to affected areas through mechanisms called 'social funds', as a form of Corporate Social Responsibility. After taking Canon, royalties and these other private sector flows into account, the central government actually only recieves about 46% of total national extractive rents.[5]

The funds allocated to the Central Government are not designated to go to any particular sector, but rather are allocated on a yearly basis according to priorities set in the yearly budget. Therefore, the government can use these funds to achieve its development goals, even though there is no single clear mechanism through which this would happen. Instead, the central government's use of extractive rents to generate improved development outcomes depends on how it effectively uses its budget overall.

of Mining, Oil and Energy (SNMPE), mining investments rose from US$ 828 million in 2004 to over US$ 4 billion in 2010.

At the same time that extractive industry is expanding, conflicts are also increasing, as Figure 1 shows. Most Peruvian mines are located in the Andean highlands, in areas where the poorest Peruvian citizens live. Areas where mining takes place typically lack infrastructure, like quality roads, and local governments have weak institutional capabilities. Furthermore, mining brings direct impacts on the livelihoods of those who live close by, though this and related problems are not usually properly addressed. As a corollary, conflicts arise as the means through which communities can complain about what is happening and force the government to recognise their right to participate in decision making and give consent.[4]

In the 1990s, Peru's General Mining Law (*Ley General de Minería*) set incentives to attract extractive investments, but did not include a focus on how to distribute those resources. It was only in 2001 that the government decided to compensate affected local communities through cash transfers by establishing the Canon Law.

The Canon Law dictates that 50% of income taxes collected from extractive industries is kept for use at the central level, with the other 50% transferred to producer regions.[6] The transfer the regions receive must then be distributed to different levels of government and agencies within the region according to pre-set percentages, even though these percentages, as well as the government units designated to receive the funds, have changed over time (see Table 2).

Once the regional government receives its transfer from the central government, it keeps a percentage of the transfer for itself, then distributes the rest to sub-national units within the national territory. The transfers to the region as a whole benefit all local governments units, regardless of whether they have extractive industries or not. Then extra transfers are made to the specific provinces and

Table 2: Mining Canon Distribution at the Regional Level

Government Unit or Agency Receiving Transfer	Year of Canon Implementation			
	2001	2001-2003	2003-2005	2005-present
Districts where mining takes place	40%	-	10%	10%
Provinces where mining takes place		20%	25%	25%
Region as a whole	60%	60%	40%	40%
Regional Government	-	20%	25%	15%
Regional Universities	-	-	-	10%
Total Amount Received by the region from central government transfer (50% of total national rents)	**100%**	**100%**	**100%**	**100%**

Own Elaboration.
Source: Barrantes, R., Zarate, P., Durand, A. (eds). 2005 *'Te Quiero pero No': Mineria, Desarrollo y Poblaciones Locales* (*'I Want You But No': Mining, Development and Local Populations*). Instituto de Estudios Peruanos (IEP), Oxfam, Lima.

[4] For more information about strategies being used to strengthen extractive industry consultation, read the ELLA Brief: Managing Conflict Through Consultation: Latin America's Experience.
[5] Daniel, P., Ossowsky, R. 2006. *Receitas do Petróleo e Política Fisca (Oil Rent and Fiscal Policy)*. Workshop on Management of Oil Rents. Luanda, Angola, May 2006.
[6] Peru's decentralisation scheme divides the country into 25 regions. Each region is then divided up into provinces, and each province is divided into districts.

districts where mining takes place. This actually means that districts where mining takes place actually get more than 10% of the regional transfer since they benefit from their own transfer plus the transfer to the region as a whole.

The story of how the Canon Law was established and has been adjusted over time helps shed light on the Peruvian government's compensation goals. The narrative begins in 2001, when conflict at the Tambogrande Mine in northern Peru was billowing out of control. Several people died during massive protests against the project, which was set in a mainly agricultural zone. The conflict sparked a national-level compensation debate, and in 2001, the Law of Canon was born.

Just a few months after it was established, the Canon Law was modified to reflect the regional governments' new roles as a result of Peru's newly rolled-out decentralisation scheme (column 2001-2003 in Table 3). With this change, half of the money that previously went straight to the mining province was now allowed to be kept by the Regional Government.

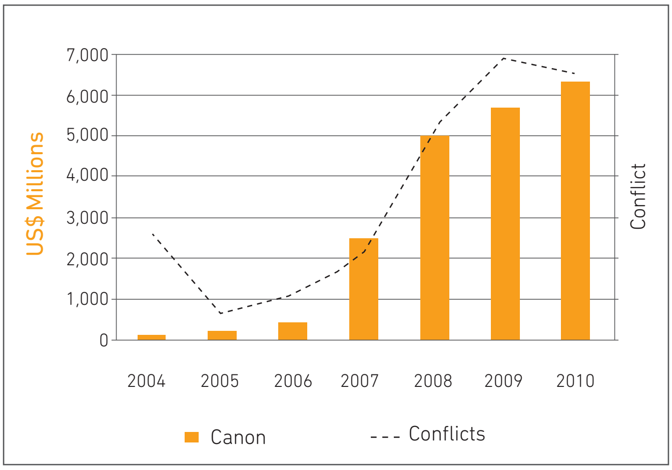
Over time, the law was modified as a reaction to different extractive industry conflicts, further underscoring the assumption that the government's goal for the canon distribution scheme was to manage conflict. In 2003, the Tambogrande conflict escalated again over an upcoming decision about whether or not the mine should be closed. Ultimately the Tambogrande project was never implemented, and the national government believed the opposition was due to local people not receiving enough direct benefits from extractive industries. The government decided to modify the Law again to be even more distributive, giving mining districts and provinces a greater share of the transfers (column 2003-2005 in Table 3).

Finally, the most recent change to Canon happened in 2005 in the face of extremely violent conflict in the Majaz mine (column 2005-present in Table 3). The clash between the company, the government and local inhabitants included allegations of torture of protesters, and the taking of the BHP Tintaya mine. In this last legal modification, 10% of the canon transfer to the regions was allocated to regional universities as a strategy for enhancing regional development.

HAS CANON SUCCEEDED IN REDUCING CONFLICT?

The analysis of Peru's canon ditribution demonstrates how it privileges compensation over development. The canon fund transfers seem to have been designed as an answer to public pressure in order to reduce conflicts and make new extractive projects acceptable. However, conflicts associated with extractive industries in Peru have not decreased, but rather increased, as Figure 1 shows.

Figure 1: Mining Investments, Canon and Conflicts in Peru



Own Elaboration.
Sources: Data from the Defensoria del Pueblo (Peruvian Ombudsman); Peruvian Ministry of Economy and Finances (MEF); Peruvian Central Bank (BCRP)

What are some explanations for why Peru's compensation-distribution strategy seems to be failing at reducing the country's conflict? Some authors argue that the government's distribution strategy actually deteriorates the decision making context needed to promote development amongst sub-national governments. In the face of increasing rent availability, competition for controlling these rents also increases. The context deteriorates into a polarised political game that generates short-term policies instead of promoting long-term local development processes. Moreover, conflicts begin to be seen as a way to achieve a better bargaining position. In other words, local communities see conflicts as the mechanism by which they can secure more resources.[7] This perception is underscored by the fact that each canon modification

[7] Arellano, J. 2011. *¿Minería sin Fronteras? Conflicto y Desarrollo en las Regiones Mineras del Perú* (*Mining without Borders? Conflict and Development in the Mining regions of Peru*). UARM, IEP, PUCP, Lima.
[8] Sinnott, E., De La Torre, A., Nash, J. 2010. Institutions and the Resource Curse or Blessing. In: Sinnott, E., De La Torre, A., Nash, J. 2010. *Natural Resources in Latin America and the Caribbean: Beyond Booms and Busts?*. World Bank, Washington, DC.

came about as a government reaction to a specific conflict.

Finally, researchers have noted that political processes that help build institutions can be corrupted by volatile rents such as those from extractive industries.[8] If these rents undermine already weak institutions, there is less possibility for supporting long-term growth, thereby decreasing probabilities for better long-term development outcomes.

Another set of reasons that explains the failures in the distribution scheme has to do with limitations in how the transfers are spent. In most cases, sufficient funds are transferred to give local governments enough resources to invest in achieving development outcomes. However, in order to use those resources, sub-national governments have to first fulfil central-level government requirements, such as detailing the importance of the project they are planning, before they can use the funds. This bureaucratic mechanism was established to prevent local governments with limited capacity from spending canon on unproductive investments. This seems to be a warranted fear, as regional and local governments have often used the money to increase current accounts spending, like in the *Plan Piloto* case discussed below (see text box). At the same time, even when the central government set an exception that 20% of extractive rents can be spent on infrastructure projects, this has not necessarily solved the problem. Local governments still struggle to improve their expenditure performance in terms of quantity and quality investments.

Unfortunately, these bureaucratic challenges combined with local governments' low capacity to spend the incredibly high amounts they were suddenly receiving from canon mean that a low proportion of funds are actually spent. The Peruvian Ministry of Economy, through its Integrated Financial Management System (SIAF), reported that between 2004 and 2011, only 5.3% of Canon was spent.

Even if governments of extractive industries areas are receiving compensation funds, then, the fact they are not being spent well - if they are spent at all - means residents are unlikley to feel they have been compensated. Overall, when transfers are not enhancing development, then frustrations, and the conflicts they cause, actually get worse.

CANON FOR COMPENSATION? A NEW JOB AGENCY NAMED 'PLAN PILOTO'

Unfulfilled employment expectations are a main source of conflict in mining sites in Peru. Since large-scale extractive industry companies are generally unable to absorb local labour demand, tensions arise. This was the case in the Antamina mine in the San Marcos district of Peru's Andean highlands, where the government decided to make an exception to the rules for using canon. The government allowed a local municipality to use its assigned canon share to hire local residents by creating a special heading in the budget called 'Infrastructure Maintenance' as part of the *Plan Piloto* employment programme. The job typically entailed sitting next to a road or verifying if a depot is still in the same place as the day before, and the only requirement for getting the job was being a resident of San Marcos. Incredibly, the salary was more than four times what inhabitants would earn for working on their land.

This case offers a perfect example of how canon funds, though staying within the affected region, are not necessarily being used to enhance development. The San Marcos example thus offers another explanation for why Peru's compensation scheme does not seem to be making much progress in reducing conflict.

Source: Inchaustegui, C. 2010. *Connections between FDI, Natural Resources Access and Local Development: The Case of Antamina mine, Peru. Are We Following the Correct Path?* University of Bergen, Bergen.

CONTEXTUAL FACTORS

KEY CONCLUSIONS FROM THE LATIN AMERICAN APPROACH

The Peru case highlights the complicated nature of distribution as a conflict management strategy. The central government transferred canon funds to sub-national governments seemingly without a clear development plan, demonstrating that their main concern was not development per se, but conflict mitigation. Furthermore, decisions about how to implement canon were often made in the heat of a conflict, perhaps reflecting reactionary decision making rather than carefully considered policy making. Distribution therefore lilley addressed the symptoms of conflict rather than its causes.

A first key enabling factor for successfully using distribution schemes seems to be institutional capacity. The Peruvian decentralisation process began just a decade ago and is still being modified and adjusted. Regional governments still need to consolidate their institutional structures and enhance their technical capacities. In smaller political-territorial units such as provinces and districts, capacities are even more limited. As a result, most provinces and districts that receive significant revenue shares have resorted to hiring private and external consultants to try to manage canon funds. Unfortunately, this has not resulted in improvements in their administrative performance.

Overall, then, this case shows that distributive schemes need clear expenditure plans and institutional capacities, though these were absent in Peru. The compensation-driven system might work if it is closely linked with regional development plans and based on strong institutional regional capacities, as is seen in Brazil. Otherwise, more centralised systems, such as in Chile, might work best.

Finally, the different degrees of environmental and social impacts of extractive industries due to specific demographic and physical conditions create different levels of conflict that require different types of strategies. In Peru, rural communities live near almost all most mining sites in the highlands, while indigenous communities live in fragile ecosystems close to gas and oil operations in the Peruvian Amazon. These communities compete with extractive companies for common resources such as land and water and are directly affected by negative environmental impacts. In this context, conflicts are more likely to appear. On the contrary, the main extractive oil operations in Brazil are located off-shore, while most mining operations in Chile are located in areas with low population density, meaning conflicts in these countries are less common and less visible.

LESSONS LEARNED

1. Rent distribution on its own does not seem to be effective in diminishing conflicts. Instead, it is necessary to enhance development in communities surrounding extractive activities in order to truly compensate them. The quality of spending therefore matters.

2. To be effective in diminishing conflicts, rent distribution needs an adequate institutional framework within which it can be implemented. Without strong institutions, rent distribution can lead to even more conflict and actually undermine the basis for further long-term development.

3. Though compensation itself is an important goal, its strength lies in being directly linked to achieving broader development objectives. It might not matter how much a municipality can get from extractive activities, without a consensus-based plan for what it should try to achieve with its funds.

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