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A thoroughly modern resource curse: The new natural resource policy agenda and the mining revival in Peru

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Recent experience from Peru shows how standard remedies for mitigating the resource curse can backfire when they take insufficient account of local context and political dynamics.

Introduction

It is widely recognised that government dependence on revenue from "point source" natural resources has a negative impact on political and economic development. Problems of managing the resource curse in Peru have intensified in recent years, with a boom in mining investments located in some of the poorest, most neglected parts of the country. Peru has adopted orthodox policy prescriptions advocated by the IFIs and others, including disciplined fiscal policies, adoption of the EITI, decentralisation of government, increased citizen participation in the allocation of mining revenue, and public-private partnerships between state agencies and mining companies. However the outcomes have been disappointing: continued poor quality of public expenditure, persistent poverty (and failure to meet popular expectations), increased conflict, and failure to diversify the economy. This Working Paper explains how, given the particular local context and political dynamics operating in Peru, the problems of the resource curse have in part been relocated to subnational levels.

A Weak State

A combination of factors including the extractive character of colonial rule, exploitative postcolonial relationships with mining companies, and more recent political history have resulted in a weak but highly centralised state, with huge levels of inequality, and discrimination against the indigenous and mestizo majority. The Fujimori legacy further discredited democratic institutions, weakened political parties, and fuelled political instability. Regional inequalities persist despite recent decentralisation policies which have transferred resources to subnational authorities, but without adequate power to deal with rising popular discontent. Local politics is highly competitive and fragmented, and the state has limited capacity to allocate and manage public investment.

Ad Hoc Government Policies

Government fiscal policies towards mining companies, in particular concessions that allow them to make voluntary contributions to local development in lieu of paying royalties and windfall taxes, have fuelled popular discontent and calls for greater public control over natural resources. Arrangements whereby 50% of the tax on profits paid by mining companies goes to the territory in which the profits are generated (the 'canon minero') have added to problems at local level. Government and mining interests support the system as a way of demonstrating that mining and development go hand in hand. But it distorts allocation decisions, exacerbated in the last few years by huge increases in profits and therefore transfers to mining areas, which local governments lack the capacity to manage.

New Political Actors

Mining companies are emerging as new political actors at the local level, promoting a "new mining agenda" which advocates environmentally and socially responsible policies. They are seeking to use their own development funds to resolve local conflicts, and their financial and political leverage to influence public policy decisions. This brings them into (unequal) competition with weak local governments.

The presence of mining companies is giving rise to new sources of local conflict (for example over the environmental impact of open-pit mining), and new political actors (local communities have leverage because companies require their consent to operate). Social movements are using environmental discourse to bring together groups with a wide range of social and economic interests and grievances, making them unsuited to coordinating public participation in constructive negotiations. Weak state capacity for environmental regulation and widespread public suspicion of its collusion with mining companies erodes its legitimacy and capacity to play a role in conflict resolution.

A New Resource Curse?

Deficiencies in systems for allocating revenue at subnational levels already result in poor coordination between national, regional and local levels, while decentralized participatory budgets have produced excessive fragmentation, lack of technical rigour and ineffective monitoring. These problems are compounded in mining areas by huge increases in money from 'canon minero' transfers (up to ten or twelvefold increases in the space of 2-3 years in some cases); competition from parallel, uncoordinated spending by mining companies from their own funds; attempts by mining companies to influence participatory budgeting processes; and pressure from both government and companies on local authorities to spend quickly. The results are poor quality spending that does not generate sustainable economic growth, growing long-term inequalities between regions, the undermining of local authority capacity and legitimacy, increasing conflict and weakened government ability to deal with it.

Implications for Policymakers

Local governments, mining companies and a variety of activist movements are locked into dysfunctional relationships and conflicts that are not easily resolved. There are no simple solutions, but the following could help strengthen state legitimacy and capacity, and reduce causes of conflict:

- introduce windfall taxes or more progressive, profit based taxes on mining companies, as well as royalty payments;
- create an independent environmental enforcement agency;
- improve the process of granting mining concessions by central government, with more participation by local authorities;
- strengthen the capacity of local institutions to manage public spending including participatory budgeting processes;
- restrict mining companies to a more limited social role. By-passing public institutions may yield positive benefits in the short term, but places companies at the forefront of public demands, thus triggering conflicts; and undermines the capacity and legitimacy of public institutions.

For international development practitioners, the lesson is to take much better account of local political context before advocating policy prescriptions.