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Local Content Policies In Minerals-Exporting Countries: The Case of Peru

Introduction

The evolution of the mining industry in Peru has been profoundly shaped by the economic and political history of the country. Successive democratic and military regimes undertook measures that influenced the structure and management of natural resources.[1]

The 1990s saw a new political leadership to address the structural weaknesses of the economy, characterised by high unemployment, rising poverty, rampant inflation, chronic balance of payments deficits and unsustainable external debt. A series of structural reforms were initiated to create a more business-friendly environment and open the economy to foreign investors, through the privatisation of state-owned activities, elimination of price controls and most subsidies, reduction of quantitative easing and a unified floating exchange rate. The tax structure was simplified and reformed. Peru's debt was restructured with foreign creditors which helped to increase confidence among potential investors.

A new foreign investment law was introduced in 1991 which guaranteed foreign investors non-discriminatory treatment, free exchange convertibility and unrestricted rights to repatriate capital and profits (GATT, 1994). Peru's investment regime complements its trade regime. In September 1991 Legislative Decree No. 668 established the general framework for domestic and foreign trade, guaranteeing the freedom to engage in domestic and foreign trade as a fundamental condition for Peru's development. It also requires the State to ensure that standards and technical regulations do not constitute an obstacle to the free flow and use of goods and services in external and domestic transactions, and prohibits any type of exclusive right or other monopolistic restriction affecting the production or marketing of goods and services. In this sense, the government went from being an active actor (i.e. its participation along the whole mining value chain from prospecting to marketing) to an investment promoter and regulator. In 2003, the last State-owned operation was privatised. The shift in ownership and the new legal framework contributed to the development of the mining sector by attracting investors from around the world (Bastida et al., 2005).

New reforms in the 2000s were aimed to complete earlier reforms, and in particular to address new challenges, including internal political and social issues that led to mounting conflicts between mining firms and their surrounding communities.[2]

In 2014, the Ministry of Production of Peru launched the Plan for Productive Diversification (PDP), with the aim of generating new engines for economic growth, decreasing dependency on raw material prices, reducing regional productivity gaps, and achieving long-term sustainable growth rates through diversification of the economy. Promotion of clusters and supplier development are seen as two important programmes for achieving those objectives. However, the Ministry of Production does not consider mining as a key driver for diversification.

In 2015, the Ministry of Foreign Trade and Tourism (MINCETUR) launched the National Strategic Export Plan (PENX 2025[3]), that updates the previous plan, in particular adding a competitive

[1] One of the key milestones that influenced mining activities was the enactment of the Mining Code in 1950 establishing rules that were very favourable and flexible to encourage private investment. Following this, investments increased into iron ore, lead, zinc, and other minerals, and exports of metals from 21% of total exports in 1951 to over 40% a decade later (Hudson, 1992). However, following the military coup in 1968, the Velasco Regime nationalised the mines, including the largest copper mining corporation, Cerro de Pasco, reversing the momentum created in the 1950s. This was coupled with restrictive business regulatory frameworks, which resulted in low investments, recurrent losses, stagnating production and decline in labour productivity. Violence and strikes destabilised the mining sector and caused major disruptions in supply chains to the mine (WGC, 2011).

[2] Key reforms included the phasing out of some investment incentives, the integration of Sustainable Development (SD) concepts into the mining legislation, and the imposition of a mining royalty.

approach in order to generate tools for supporting business sectors and promoting the internationalization of Peruvian companies under four fundamental pillars: i) internationalization of companies and market diversification; ii) diversified, competitive and sustainable exportable supply; iii) trade facilitation and efficiency of international logistical chains; and iv) capacity building for internationalization and exporting culture consolidation. Among the sub sectors incorporated in PENX 2025, two of them relate to mining: mining business services and mining equipment supplier.

General economic context

Peru is today one of the best performing economies in Latin America, with an annual GDP growth rate averaging over 5% in the last 15 years,[4] thanks to its solid macroeconomic fundamentals, prudent management of the commodity boom and a sustainable policy reform agenda conducted in the last decades.

As a result of the slide in commodity prices and the slowdown of the Chinese economy, growth however decelerated in 2014 to 2.4%. Nonetheless, Peru's economic growth is expected to recover due to an expected increase in mineral production over the next few years despite the weakening of metal prices.

Overall, Peru has an attractive business climate for investors[5] and in 2015, it was ranked as the fourth most attractive emerging economy for investment, behind China, South Korea and Thailand (Bloomberg, 2015). However, there are still challenges to be addressed. Significant progress remains to be made to reduce administrative red tape and the cost of cross border trade.[6] [7]

The largest challenge that the mining industry faces is found on a social and political level. The attitude in Peru towards mining has shifted, with a rising call for participation local communities in mine development. This has reportedly created some fears among international investors and has led to significant delays in permit delivery and project development.

Contribution of the mining sector in Peru

The mining sector has been a historically important political and economic player. Peru is the world's 7th largest mining producer given the diversity of its commodities (PwC, 2013). During colonial times, activities were mainly developed for export, contributing significantly to foreign exchange, fiscal revenues and FDI. Most firms were foreign owned and had developed few linkages with suppliers and markets in the rest of the economy (WGC, 2011).

The mining sector has been one of the main drivers of Peru's recent economic performance. In recent years, the mining industry has generated on average 58% of total exports,[8] 16% of fiscal revenues and 14.4% of GDP, thanks to favourable commodity prices and the sector's competitiveness (Korinek, 2015). The sector has been one of the largest taxpayers in the country in the last decade, contributing to 25% of total government revenues at its peak in 2007 (Korinek, 2015).

Peru has extensive high quality mineral reserves, many of which are still unexploited. It is a regional leader in a number of resources and has a competitive position in the production of a number of metals due to its low direct production costs (labour and energy), high resource grades and competitive shipping costs (McKinsey, 2013). In 2012, Peru was the 3rd global producer of copper, silver, tin, lead and zinc and 5th global producer of gold. The country has a comparative advantage in

3. http://ww2.mincetur.gob.pe/wp-content/uploads/documentos/comercio_exterior/plan_exportador/PENX_FINAL30_1_02.pdf

4 http://databank.worldbank.org/data/reports.aspx?source=2&country=PER

5 In the World Bank's Doing Business 2016 Report, Peru was ranked 50th, which placed the country in 3rd place in Latin America, after Mexico (ranked 38th) and Chile (48th) but far ahead of Brazil (116th) and Argentina (121th).

6 It still takes on average 26 days to start a business compared to half a day in New Zealand for instance.

7 It takes an average of 48 hours to complete compliance procedures to export, estimated to cost USD 50. Procedures to import take longer, on average 72 hours, costing about USD 80 for compliance.

8 Copper accounted for 40% of mining exports, followed by gold (37%), lead (10%), zinc (5%) and iron (3%).

part due to its low cost of production, including energy, which stands at 50% of that of Brazil and 67% of that of Chile, its main competitors in the region (PwC, 2013).

The mining industry is capital intensive and therefore generates fewer jobs than other economic sectors (1.5% of total labour force in 2012, compared to 40% for agriculture for instance). It nevertheless has an important impact due to indirect and induced employment opportunities that result from supply chains and consumption linkages. The ratio of direct to indirect employment is estimated at 1 to 3.2 while the ratio of direct to indirect and induced employment is calculated to be 1 to 9. Therefore, based on this multiplier effect, in 2012, it was estimated that the mining industry accounted for 14% of total employment, direct, indirect and induced combined (McKinsey, 2013).

Legal frameworks in Peru in policy and practice

During the early 2000s, in response to social conflicts, the Peruvian government passed several pieces of legislation that aimed to improve the local development of mining regions. Three regulations are particularly relevant:

a) In 2001, in Law Nº 27506 the Peruvian government revised the Canon Minero to distribute 50% of the corporate income tax paid by mining firms to sub-national government entities from the territory in which minerals are extracted.

b) Under the privatization scheme, Social Trust Funds were created to finance social programmes in the areas close to the concessions. Social Trust Funds receive 50% of the payment made by firms for privatization. Projects supported by the Funds include promoting local entrepreneurs.

c) In 2003, Local Content was introduced in Peruvian legislation for the first time in Decree 042-2003-EM, known as the Commitment to Sustainable Development. This decree includes a list of commitments that all mining firms must adopt when they undertake mining exploration. Mining firms and their contractors commit to preferentially hiring local people as well as providing training. Equally, they must preferentially purchase local and regional goods and services and support entrepreneurs to promote diversification. This decree establishes that firms are required to submit an Annual Consolidated Declaration (DAC for its name in Spanish) on these commitments to the Ministry of Energy and Mines. In addition, local content requirements are part of mining firms' Environment Impact Assessment plans. In addition, the local content clauses of Decree 042-2003-EM were also included in the privatization agreements between mining firms and the government.

Regulatory frameworks

The mining industry in Peru is regulated through relatively straightforward mining laws.[9] The industry is primarily regulated by mining laws and regulations enacted by Peruvian Congress and the executive branch of government (outlined in Box 1). The Mining Law came into effect in 1992, with a particular focus on the need to attract foreign investment in the sector and eliminating of discrimination between domestic and foreign investors. However, since 2000, there has been an increasing emphasis on sustainable development with a number of countervailing laws that have been enacted to that effect (KPMG, 2013). A new mining law was enacted in 2011, essentially aimed at generating more revenue from the sector, with a view to improve the social conditions in the poorest regions.

In accordance with the Mining Law, mining activities (excluding prospecting, commercialisation and storage outside the area of mining operations) can only be carried out under the concession system. Holders of concessions are granted the exclusive and excluding right to carry out a specific mining activity, within a specific geographical area.

[9] The Ministry of Energy and Mines (MINEM) has the authority to regulate mining activities within the Peruvian territory. MINEM also grants mining concessions to local or foreign individuals or legal entities, through a specialized body called the Institute of Geology, Mining and Metallurgy (INGEMMET).

Box 1. Relevant policies and programmes in the mining sector

General Framework

- General Mining Law, Consolidated Text by Supreme Decree N° 014-92-EM
- Prior Consultation Law: 2011
- Canon Minero (revised in 2001 in Law No. 27506)

Investment related rules

- Article 62 of the Constitution (1993) establishes equal rights for domestic and foreign investors who enter in agreement with Government
- Article 19 of Legislative Decree N° 662 (promotion of foreign investment) allows investors unrestricted access to all economic sectors;
- Legislative Decree N° 757 (framework for the development of private investment) relates to the growth of private investment;
- Legislative Decree N° 868 (of November 1996 promotes private investment in public infrastructure and utility works (relevant for mining infrastructure investments) and modifies some articles of General Mining Law, Consolidated Text by Supreme Decree N° 014-92-EM;
- Legislative Decree N°. 708 of November 1991 (relevant for the promotion of investment in mining);
- Legislative Decree N°. 818 of April 1996 (provides incentives for investment in natural resources);
- Supreme Decree N° 018-92-EM (simplified legal procedures to obtain mining rights);
- Supreme Decree N° 042-2003-EM (established prior commitment as a prerequisite for the development of mining activities and additional rules)

Fiscal and trade related rules

- Supreme Decree N° 047-2002 reduces duties paid on capital goods to be used for exploration and production of certain minerals;
- Law N° 27623 returns sales tax on capital goods for the mining sector;
- Supreme Decree No. 15-2004 establishes rules for the decentralized rules of revenues from mining sector;
- Supreme Decree 066-2005 was established to administer CSR in the mineral sector;

A new tax framework was approved in 2011, establishing the fiscal regime for mining

Source: USGS (2012).

Article 63 of the 1993 Constitution stipulates that foreign investors have the same rights as national investors (Baker and McKenzie, 2013), with one restriction, namely, foreigners are not allowed to acquire or possess mines, lands, forests, water, fuels and energy sources within 50 miles of the border, unless an exception is declared by Supreme Decree based on a public necessity cause or because of national interest.

In April 2012, the Government passed a “Prior Consultation Law”, requiring prior consultation of Indigenous communities before any infrastructure or mining or energy projects can be developed in their areas.

Labour market regulations

Regulations governing the labour market are defined in 2010 Labour Procedure Law in addition to what is required under various other regulations, such as the Law of productivity and labour competitiveness, the procedural labour law, the law on collective labour relations, the law on days of work, hours, and overtime; the regulations on safety and health in the workplace; and other sector-specific legislation and ratified international conventions. All employment agreements must be registered with the Ministry of Labour.

With respect to recruitment of foreign workers, not more than 20% of an employer’s local workforce may consist of foreign employees. Additionally, wages paid to foreign employees may not exceed 30% of total payroll cost. Such limits can be waived for professionals and specialized technicians or management personnel of a new entrepreneurial activity or in case of a business reconversion.

All mining firms and their contractors are obliged to promote local hiring according with the Commitment to Sustainable Development legislation. However, this norm leaves this commitment very vague in that it does not set up percentage requirements nor penalties or incentives for complying with or not fulfilling this obligation. Consequently, each firm has its own interpretation of local and its own policy for local hiring.

Regulations regarding production

The Mining Law requires holders of mining concession to meet a minimum annual production target no later than the expiration of the sixth year.[10] If the target is not reached, the holder of the mining concession is obliged to pay a non-production penalty or credit a minimum investment.[11] Failure to pay the validity fee or the non-production penalty for two consecutive years can lead to the forfeiture and cancellation of the mining concession.

The Commitment to Sustainable Development legislation introduced a requirement for mining firms and their contractors to preferably buy local products and services. These obligations have also been included in privatization contracts.

Table 1. Summary of LCPs applicable in Peru

Type of Requirements	Details of requirements	Applicability in Peru	Relevant legal framework
Preferential employment	Compulsory requirement to employ % of local labour	Foreign employees should not exceed 20% of total personnel. Wages paid to foreign employees should not exceed 30% of total payroll cost.	Recruitment of Foreign Workers Law
	Permits or licensing requirements	All mining firms must commit to prioritizing local hiring and to buying local goods and services prior to getting a concession	Commitment to Sustainable Development Decree
Foreign ownership		Only restriction: foreign firms cannot acquire or possess concessions, within 50 miles of the border unless an exception is declared by Supreme Decree based on a public necessity cause or because of national interest	Constitution
Production requirements	Minimum annual production target	Concessions holders are required to meet a minimum annual production target. If the minimum target is not reached, a penalty equivalent to 10% of the corresponding minimum annual production per year is applicable. Cancellation of the mining concession in case of failure to pay the validity fee or non-production penalty during two consecutive years.	Mining Law
Reporting and justification	Mining firms to report and justify hiring foreign labour or sourcing inputs from abroad	Mining firms to report progress on local hiring and local purchases annually	Annex IV of the Annual Consolidated Declaration (DAC)
		Extractives industry Social Trust Funds to report quarterly	Ministry of Energy and Mines
		Employment agreements must be registered	Ministry of Labour
Prior consultations	Prior consultations with Indigenous communities before development of activities	Law requires prior consultation with Indigenous communities before the development of any project. The communities have the right to object to the development of the activity	Prior Consultation Law

[10] The target is equivalent to one Tax Unit (S/.3 700) per year and per hectare for metallic mining concessions and to 10% of one tax unit (approximately S/.370) per year and per hectare for non-metallic mining concessions. The minimum annual production target must be reached the first semester of the 11th year following the year on which the mining concession was granted (Baker & McKenzie, 2013).

[11] The penalty is equivalent to 10% of the corresponding minimum annual production per year and per hectare until the year on which the holder reaches such production, provided it occurs before the 15th year as from the granting of the mining concession.

Linkages with the wider economy

Unlike in Brazil, the mining industry is largely owned by foreign firms. When they started their operations, most core supplies were imported, and to a large extent, professional and technical labour were foreign. Today, Peru has built its capabilities in certain technical fields although its skills levels continue to improve. For instance, Peru has reached maturity in areas such as the management of engineering firms; most major mining firms can obtain high-quality engineering services locally at highly competitive rates. The learning curve for local firms was enhanced by joint projects with large engineering, procurement, construction and management (EPCM) players. It has also carved its niche in certain types of construction services required for the safety of the mining industry (such as modern scaffolding systems), which also serves other economic sectors, in particular related to infrastructure. As a result, local firms have learned to compete internationally. Firms continue to have recourse to foreign consultants in the industry for support on specific technical aspects.

Unlike Brazil, Peru does not have a large industrial base, which was a disadvantage when developing mining-related manufacturing firms. However, some international firms have settled in Peru to facilitate the sales of specialised plants and machinery or to manufacture their own machines and components in order to provide tailor-made services to the mining industry. The remoteness of mining sites and the need to design some equipment to respond the specific mine requirements in Peru provided opportunities for local suppliers.[12]

A study conducted by *Instituto Peruano de Economía* (IPE) claimed that 60% of the supply chain in Peruvian mining was of Peruvian origin, including some fairly sophisticated pieces of engineering equipment (ICMM, 2013).

Despite abundant and trainable labour, skilled labour shortage is a serious challenge in certain fields in Peru (McKinsey, 2013). In 2013, it was said to have reached a critical level in part due to the limited graduate turnover from mining schools. Peru faced deficits in three categories of skills: (i) general skills that compete with other economic sectors such as infrastructure and construction facing similar growth as the mining sector; (ii) technical and operational skills with specific competencies in mining and (iii) professional skills, which are in high demand globally.

Box 2. Gold mining and supply chain in Peru

In Peru, the four largest gold mining firms are Barrick Gold, Gold Fields, Newmont and Buenaventura. A recent study conducted by the World Gold Council, indicated that the four mines' total procurement from national suppliers (including local agents of international firms) averaged 90% of their expenditure from 2007 to 2010, at times exceeding twice the total taxes paid by these mines. Capital expenditure through national suppliers was estimated to be between 25% and 40% of total expenditure. Expenditure on services supplied by local communities was between 15% and 20%.

The report however does not give the breakdown of the purchases to ascertain how much of the expenditure actually stayed in Peru or how much of the value added was created by local businesses. For example, most heavy equipment is imported given the complexity of firms' requirements. Yet much of the installation and ongoing maintenance work for this equipment, requiring highly skilled labour, is carried out by Peruvians.

Despite the capital-intensive nature of the industry, the World Gold Council study indicated that the four mining firms provided about 4 000 direct jobs per year from 2005 to 2014, which created another estimated 4 000 indirect jobs during the same period. Although this is small in relation to total employment creation in the country it is nevertheless significant for local communities.

Source: World Gold Council (2012).

[12] For example, truck bodies must be designed specifically to suit each operation, taking into consideration the density of the material, the capacity, the specific mine requirements or limitations and the cost.

Strategic partnerships

During the last decade, many mining firms have put in place suppliers' development programmes to foster the expansion of local suppliers to meet their input needs. In general, these include supplier recruitment for specific inputs and the development or training and support at various levels. Although official statistics on local entrepreneurs created by mining supplier programmes are not available, it is estimated that these programmes have benefitted at least to 3 000 SMEs (Balcazar, 2015). Examples of products and services which have been established by local suppliers in partnership with mining industries include provision of environmental and construction services, transport and construction services, operation and maintenance of water supplies in remote areas and supply of safety apparel and garments.

Box 3. Three examples of suppliers development programmes

Barrick Gold, one of the largest gold mining firms in Peru, has set up a Lean Supplier Program to assist its suppliers and contractors to identify opportunities to improve performance in specific areas, namely: safety, environment, social responsibility, continuous improvement, timely delivery, invoicing and inventory control. The firm set up internal policies and procedures to increase safety and environmental standards to ensure sustainable production practices. Suppliers are trained to meet those standards and successful ones receive an ISO 14001 certification, which recognizes their capabilities to respond to the requirements of the firm.

In 2012, **Antamina**, the largest producer of copper and zinc in Peru, started a programme named Developing Suppliers of Excellence for the Mining Industry of Peru. The objectives were two fold, namely to improve the productivity of the mining firm and to develop the capacity of suppliers to provide increasingly complex services for the industry and, potentially, for other industries as well. The Programme had an interesting model, which consisted of putting the challenge to local suppliers to identify and find innovative solutions and approaches to resolve High Value Challenges, i.e. existing operational problems, inefficiencies or anomalies faced by mining operations. The firm offered interested and capable suppliers the opportunity to co-design these solutions, which led to the development of cooperative relationships therefore changing the nature of engagement with suppliers from a purely transactional one. Following a process of strategy selection, the Logistics and Operations Departments then offered the opportunity to chosen suppliers to test their solutions before awarding contracts.

Gold Fields La Cima's Cerro Corona mine in Hualgayoc, Cajamarca, continues to work on improving sources of supply and to support the efforts of contractors and local suppliers to build capacity. As the first results of the Providers Strengthening Program underway are being reviewed, it is expected that the Contractor Assessment Program will be expanded, incorporating 75% of the main contractors of the operation. So far, 60 local enterprises are certified to be compliant with standards of efficiency and security, which enables them to offer their services to Cerro Corona directly or indirectly through specialized contractors. Gold Fields La Cima has also promoted training for local providers and is currently working with two merchant associations that encompass 35 suppliers. Working groups established with employers in the area of direct influence promote constant communication and seek additional opportunities for cooperation and capacity building.

Sources: WGC (2012); Antamina, Supplier of Excellence Report (http://www.antamina.com/en/sobre-antamina/quienes-somos/iniciativas-de-excelencia/proveedores-de-excelencia/); http://expoferia.peru2021.org/2015/stands/gold_fields/descargas/Brochure_Responsabilidad_Social.pdf

Main properties

Peru has gone a long way to becoming a significant player in the mining sector. Since the 1990s, its open business environment has facilitated the entry of significant foreign investments, in particular in its copper and gold sector.

Peru does not have specific local content targets although mining firms agree to prioritize local hiring and procurement and report on their progress. There are, however, local employment quotas that apply to all firms: not more than 20% of jobs and 30% of total payroll can be accorded to non-Peruvians.

Although not always considered among local content initiatives, Peru implements minimum production requirements of mining firms in order to continue to hold concessions. Although this is implemented in order to stimulate production in the sector, such requirements ensure a minimum level of economic activity in the mining area; outcome therefore is to ensure a minimum level of local engagement. Mining concessions holders are required to meet a minimum annual production target. If that minimum target is not reached, they are subject to a penalty equivalent to 10% of the minimum annual production in that year. Failure to pay the non-production penalty during two consecutive years results in the cancellation of the mining concession.

Mining firms active in Peru have implemented suppliers' development programmes similar to those in place in other countries in the region such as Brazil and Chile.[13] These programmes particularly leverage the proximity to highly competitive firms and allow capacity upgrading in accordance with the needs of those firms. In particular, processes in which suppliers are invited to offer solutions to recurrent problems and suppliers training programmes in which they increase their skills and obtain new certifications have benefits for both local suppliers and large mining firms. These programmes foster technological spillovers that can bring innovative techniques and methods and can transform the buyer-supplier transaction into a cooperative relationship.

More Information

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[13] See previous chapter on Brazil, and Korinek (2013).