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October 2015

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FISCAL AFFAIRS DEPARTMENT

PERU

FISCAL TRANSPARENCY EVALUATION

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October 2015

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Glossary

BCRP	Central Bank of Peru
CAF	Development Bank of Latin America
CAN	Andean Community
CGR	Annual Financial Statements
CIT	Corporate Income Tax
COFIDE	National Development Bank
COFOG	Classification of Functions of Government
CPMP	Military and Police Pension Fund
DGCP	Accounting Unit of Ministry of Economy and Finance
DL	Legislative Decree
EBU	Extra Budgetary Unit
EITI	Extractive Industries Transparency Initiative
EsSalud	Health Insurance System
ETE	Entities of Enterprise Treatment
FCR	Consolidated Reserve Fund
FDI	Foreign Direct Investment
FEF	Fiscal Stabilization Fund
FOCAM	Camisea Socioeconomic Development Fund
FONAFE	National Fund for Financing State Enterprise Activity
FONCOMUN	Municipal Compensation Fund
FRTL	Fiscal Responsibility and Transparency Law
FSD	Deposit Guarantee Fund
FSR	Financial Stability Report
FTC	Fiscal Transparency Code
FTE	Fiscal Transparency Evaluation
GEOCADMIN	Mining Cadaster
GFSM	Government Financial Statistics Manual
IADB	Inter-American Development Bank
INGEMMET	Mining and Geology Institute
IPSAS	International Public Sector Accounting Standards
ISSAI	International Norms of Supreme Audit Institutions
JICA	Japan International Cooperation Agency
MEF	Ministry of Economy and Finance
MINEM	Ministry of Energy and Mining
Mivivienda	National Housing Fund
MMM	Multiannual Macroeconomic Framework
NFPS	Non-Financial Public Sector
NIA	International Norms of Auditing

NPL	Non-Performing Loan
NPV	Net Present Value
OEFA	Agency for Environmental Assessment and Enforcement
ONP	Office of Pension Administration
OSINERGMIN	Mining and Energy Sector Supervisory Agency
PIA	Opening Institutional Budget
PIM	Modified Institutional Budget
PIT	Personal Income Tax
PMP	Multiannual Budget Plan
PPP	Public Private Partnership
SDDS	Special Data Dissemination Standard
SEDAPAL	State Owned Enterprise Responsible for Water, Sanitation, and Sewage
SENACE	National Service for Environmental Certification
SINAGERD	National System of Disaster Risk Management
SNG	Sub-National Government (Regional and Local Governments)
SNIP	National Framework for Public Investment
SNP	National Pension System (Public)
SOE	State Owned Enterprise
SS	Social Security System
SUNAT	Tax and Customs Revenue Collection Agency
VAR	Vector Autoregression
WEO	World Economic Outlook

Legend for Tables

Practice under Fiscal Transparency Code

LEVEL OF PRACTICE	Not Met	Basic	Good	Advanced

Importance to Fiscal Management

LEVEL OF IMPORTANCE	LEVEL OF PRACTICE		
	High	Medium	Low

Preface

In response to a request from the Minister of Economy and Finance, a mission from the Fiscal Affairs Department (FAD) of the International Monetary Fund (IMF) visited Lima during March 4-19, 2015 to undertake a Fiscal Transparency Evaluation (FTE). The mission also conducted a pilot assessment of current practices in managing resource revenue against the principles set in the new draft pillar of the IMF's Fiscal Transparency Code (FTC) released for public consultation in December 2014. The mission team comprised Geremia Palomba (head), Renaud Duplay, Delphine Moretti, Christine Richmond, and Alpa Shah (all FAD), Felipe Bardella and Armando Zamora (experts). The evaluation was based on information available as of February 2015.

The mission met with Minister of Economy and Finance, Alonso Segura Vasi, Vice Minister of Economy, Giancarlo Gasha Tamashiro, Vice Minister of Finance, Carlos Oliva Neyra, Vice Minister of Mining, Guillermo Shinno Huamaní, and Laura Calderón Regjo, Rossana Polastri Clark, and Jose Valderrama Leon, members of the Study Group of the Ministry of Economy and Finance.

At the Ministry of Economy and Finance, the mission met with César Liendo Vidal, General Director of the Macroeconomic Policy Directorate; Carlos Linares Peñaloza, General Director of the Debt Policy and Treasury Department; Marco Camacho Sandoval, General Director of the Tax Policy Department; Oscar Graham Yamahuchi, General Director of the Financial Market and Public Investment Directorate; Eloy Durán Cervantes, General Director of the Public Investment Department; Jorge Noziglia Chávarri, General Director of the Revenue Management Department; Giancarlo Marchesi Velásquez, General Director of the Private Investment Promotion Department; and, Mr. Oscar Pajuelo Ramirez, General Accountant, their staff, and staff of the Budget Directorate.

The mission also met with staff from the Ministries of Energy and Mining, Justice and Human Rights, Education, and Health, Central Reserve Bank of Peru, National Fund for State Enterprise Activity (FONAFE), Private Investment Promotion Agency (Proinversion), Supervisory Agency for Investment in Energy and Mining (Osinergmin), Agency for Environmental Assessment and Enforcement (OEFA), Perupetro, SUNAT, Superintendence of Banking and Insurance, and Deposit Insurance Fund.

The mission is especially grateful for support and cooperation received from the authorities in the course of the work and especially to Rossana Polastri Clark, Wilder Ramirez and Julio Mejia for their assistance throughout the mission. The mission is also grateful to the IMF Resident Representative Office for the support received and the excellent interpretation of Veronica Gonzales, Claudia Clarkton, and Maria Nelly Cuculiza.

EXECUTIVE SUMMARY

This report assesses Peru's fiscal transparency practices vis-a-vis the IMF's Fiscal Transparency Code, including the new draft pillar on resource revenue management. The new pillar was released for public consultation in December 2014.

Peru's practices meet most of the principles of the IMF's Fiscal Transparency Code at good or advanced level (Table 0.1). Peru provides an extensive set of fiscal information with financial statements covering the entire public sector. There is a comprehensive budget supported by a solid fiscal framework with clear policy objectives embedded in numerical fiscal rules. The country has a clear and comprehensive legal and fiscal regime for the management of resource revenue.

However, there is room for improvement in some areas. A number of items are currently not included in the public sector balance sheet and the coverage of different fiscal reports is not uniform, with information across reports difficult to compare. The practice of automatic incremental changes to the initial budget makes it difficult to connect macro-fiscal objectives set in the fiscal rules with annual and medium-term budget planning. Fiscal risk management is still in its infancy, including the analysis of fiscal risks from the natural resource sector. Looking ahead, the challenge is to implement a full reform agenda that can allow Peru to meet all fiscal transparency practices at good and advanced levels, improving further the country's capacity to manage prudently and transparently its public finances.

Against this overall positive assessment, this evaluation provides a number of findings in each area of the IMF's Code. Specifically:

- ***Fiscal reporting*** meets good or advanced practices against most of the Code's principles. Fiscal reports are prepared frequently and in a timely manner and classify information according to international standards. Financial statements cover both financial and non-financial public sectors and are audited by an independent audit institution. However, taking full advantage of this wealth of data requires addressing a number of issues:
  - Internal consistency checks of reported fiscal data are limited and the quality of data at sub-national government level is not of the highest standards, with several adverse audit opinions.
  - A number of items in the balance sheet and operating statements of financial statements are either not recorded or their values should be reviewed and updated. Preliminary staff estimates of a complete balance sheet for the public sector show that (Table 0.2). In 2013, the public sector presented a negative financial worth of about 34 percent of GDP, mainly concentrated in the central government as debt securities, loans and pension liabilities more than offset the government's large cash deposits. However, significant non-financial assets, including subsoil assets, generated a positive net worth of about

32.6 percent of GDP, 19.3 percent of GDP higher than currently reported in the financial statements.

- ➢ Fiscal reports differ in the definitions of institutional subsectors, making it difficult to compare information across reports.

- ***Fiscal forecasting and budgeting*** practices meet good and advanced standards in most areas. The budget covers the general government, with the exception of some social security institutions and PeruPetro. Medium-term macroeconomic and fiscal projections are detailed and comprehensive. Fiscal policy objectives are embedded in numerical and time-bound fiscal rules. The legal framework sets clear procedures for the preparation, approval and execution of the budget. Moreover, citizen's participation to the budget has improved in recent years. However, translating Peru's credible macro-fiscal framework into annual and medium-term budget planning requires improvements in a number of areas:
  - ➢ The institutional practice of incremental changes to the initial budget weakens the connection between macro-fiscal policy objectives and budget planning.
  - ➢ Medium-term budget planning is still in its early stage of development together with budget controls on multi-year investment spending.
  - ➢ There is no independent evaluation of the government's fiscal performance despite frequent and significant changes to the fiscal forecasts and targets in the past.

- ***Fiscal risk analysis and management*** practices are in their infancy, like in most of the other countries that have undertaken an IMF fiscal transparency evaluation:
  - ➢ The government does not yet produce a comprehensive report that summarizes the various fiscal risks and the possible correlation between these risks. This makes it difficult to assess the relative importance of the various risks and their possible joint realizations.
  - ➢ There is no systemic focus on the evolution of public finances over the long term, despite the significant role played by exhaustible resource revenue.
  - ➢ Fiscal forecasts do not include detailed analysis of the fiscal impact of alternative macroeconomic scenarios and the uncertainty surrounding resource revenue.

- ***Resource revenue management*** practices rely on clear and comprehensive legal and fiscal regimes and open and competitive rights allocation processes that create the basis for an efficient management of the country's natural resource wealth. Compliance with the Extractive Industries Transparency Initiative (EITI) standards provides assurances of integrity in revenue reporting and company compliance with reporting obligations. The government has numerical and measurable objectives for the distribution and use of resource revenue, and publishes information on their use. Practices in managing environmental, social, and operational risks also satisfy basic transparency requirements. However, limited coordination between sector ministries and fiscal policymakers makes it difficult to take full advantage of these strong foundations:

- The practice of automatic increases to the initial budget allocations (through the use of cash balances and other tools) creates a misalignment between budget plans and actual use of resource revenue.
- The lack of independent verification mechanisms for production volumes and prices reduces the effectiveness of auditing activities.
- The fragmentation in the allocation of resources and the use of tools such as off-budget accounts and cash balances hampers the monitoring of the use of resource revenue.

Based on these findings, this evaluation identifies a number of priorities and reform areas that would strengthen the overall management of public finances and fiscal risks, and further improve transparency practices. Addressing these priorities would also enhance the information base for fiscal decision-making. The policy priorities identified in each of the four areas of the Code are the following:

- ***Fiscal reporting***—Strengthening fiscal reporting would require measures to:
  - Improve the coverage of stocks and flows by (i) including in the financial statements some of the main assets and liabilities still not recorded (e.g., subsoil, accounts payable), (ii) rectifying the accounting treatment of some specific items (e.g., pensions, liabilities related to PPPs), and (iii) updating valuation methods (e.g., for pension, infrastructure, building and land);
  - Enhance the comparability of fiscal reports, by harmonizing the institutional coverage and the definition of subsectors across fiscal reports; and
  - Strengthen internal controls and external audit functions and, in particular, (i) undertake internal consistency checks of fiscal data published, and (ii) develop capacities at the comptroller general office.
- ***Budgeting and forecasting***—The priorities in this area are to:
  - Strengthen the annual and medium-term budget planning and, in particular, (i) preserve the stability of fiscal rules often modified in the past; (ii) reduce automatic supplementary appropriations to the initial budget (this would also help bring under better control sub-national governments' budgets), (iii) integrate macro-fiscal planning (developed in the Multiannual Macroeconomic Framework, MMM) and medium-term expenditure planning (developed in the Multiannual Budget Plan, PMP) into a coherent medium-term budget framework;
  - Enhance budget coverage of entities and revenue flows and introduce controls on multi-year spending, in particular, by (i) including in the budget documentation tables bridging the budget and the main macroeconomic fiscal document (MMM) presentations; (ii) recording all revenues, expenditures, and savings of PeruPetro, off-budget accounts, and the Consolidated Reserve Fund (FCR); and (iii) adopting regulations and tools for monitoring the size of multiannual commitments;

  - Improve macro-fiscal forecasts and their reconciliation by reporting and explaining the reasons underlying their deviation from actual outturn; and
  - Enhance independent evaluation by making operational the already legislated independent fiscal council.

- ***Fiscal risk analysis and management***—Priorities to improve the management of fiscal risks include measures to:
  - Disclose risks surrounding fiscal forecasts and the evolution of public finances and, in particular, (i) elaborate on risks related to possible resource revenue scenarios, and (ii) carry out long-term sustainability analysis, including assessing the fiscal value of natural resource reserves;
  - Prepare and publish, at least annually, a fiscal risk statement covering the major specific fiscal risks, including court litigations, loan guarantees, PPPs exposure, environmental disasters, callable capital, and financial sector exposure;
  - Strengthen the reporting of guarantees by publishing the list of government guarantees, including non-financial guarantees for PPP and guarantees currently recorded as debt, their gross exposure, and their probability of being called; and
  - Improve reporting of fiscal risks arising from PPPs, in particular, by (i) making public the methodology for estimating expected revenues and calculating the probability of activation of contingent claims from PPPs, and (ii) consolidating and publishing financial information on PPPs, including gross value of rights and commitments, and expected annual receipts and payments over the life of PPP contracts;

- ***Resource revenue management—***Priorities in this area include measures to:
  - Strengthen the coordination between sector ministries and fiscal authorities, in particular, by (i) developing clear and regular audit procedures for volume measurement and price valuation, particularly in the mining sector, and (ii) integrating volume and price verifications into tax audits;
  - Improve the link between budget plans and use of resource revenue and, in particular, (i) constrain the automatic changes to the initial budget by using natural resources accumulated as cash balances (see above), (ii) register in budget and fiscal reports all flows related to resource revenues, and disclose summary tables of the initial forecasts and subsequent use of natural resources, (iii) report periodically on the use of resource revenue against objectives and revenue earmarking at sub-national level; and
  - Develop further the management of fiscal risks from resource revenue by integrating operational risk analysis and elements of social and environmental risk in fiscal revenue forecasting.

Table 0.1. Peru: Summary Assessment Against the Fiscal Transparency Code

LEVEL OF IMPORTANCE	LEVEL OF PRACTICE			
	1. Fiscal Reporting	2. Fiscal Forecasting and Budgeting	3. Fiscal Risk Analysis And Management	4. Resource Revenue Management
HIGH	1.3. Coverage of Flows	1.3 Medium-Term Budget Framework	1.2 Specific Fiscal Risks	1.4 Assessment and Collection of Resource Revenue
	3.2 Internal Consistency	1.4 Investment Projects	2.2 Asset and Liability Management	4.2 Operational Risks
	4.2 External Audit	4.2 Supplementary Budget	2.4 Public-Private Partnerships	
	4.3 Comparability of Fiscal Data		3.1 Sub-National Governments	
			2.6 Natural Resources	
MEDIUM	1.2 Coverage of Stocks	1.1 Budget Unity	1.1 Macroeconomic Risks	2.1 Disclosure of Natural Resource Rights Holdings
	1.4. Coverage of Tax Expenditures	3.1 Fiscal Policy Objectives	2.3 Guarantees	3.2 Allocation of Resource Revenues
	4.1 Statistical Integrity	4.1 Independent Evaluation	2.5 Financial Sector Exposure	4.1 Social and Environmental Risk
		4.3 Forecast Reconciliation	2.7 Environmental Risks	
LOW	1.1 Coverage of Institutions	1.2 Macroeconomic Forecasts	1.3 Long-Term Fiscal Sustainability	1.1 Legal Framework for Resource Rights
	2.1 Frequency of In-Year Reporting	2.1 Fiscal Legislation	2.1 Budgetary Contingencies	1.2 Allocation of Resource Rights
	2.2 Timeliness of Annual Financial Statements	2.2 Timeliness of Budget Documents	3.2 Public Corporations	1.3 Fiscal Regime for Natural Resources
	3.1 Classification	3.2 Performance Information		2.2 Reporting by Resource Companies
	3.3 Historical revisions	3.3 Public Participation		2.3 Integrity of Resource Revenue Data
				3.1 Resource Revenue Management Objectives
				3.3 Natural Resource Funds (not assessed)

LEGEND	LEVEL OF PRACTICE			
	Not Met	Basic	Good	Advanced

Table 0.2. Peru: Public Sector Financial Overview, 2013
(Percent of GDP)

	Central Government	State Government	Local Government	General Government	Non Financial Corporations	Financial Corporations	Central Bank	Consolidation	Public Sector
Total Transactions									
Operating Balance	**3.4**	**0.7**	**2.3**	**...**	**0.2**	**0.1**	**-0.4**	**-3.9**	**2.4**
Revenue	37.0	4.3	4.9	...	4.9	0.4	0.3	-9.1	42.7
Expense	33.6	3.6	2.6	...	4.6	0.3	0.8	-5.2	40.2
Total Assets	**62.0**	**8.5**	**17.5**	**87.1**	**9.7**	**7.7**	**34.7**	**-19.5**	**119.7**
Non-Financial Assets	38.7	7.3	15.1	61.1	5.6	0.1	0.3	0.0	67.0
o/w: Unreported Subsoil Assets	25.2			25.2					25.2
Financial Assets	23.3	1.1	2.4	26.1	4.1	7.6	34.4	-19.5	52.7
Total Liabilities	**58.2**	**1.0**	**1.4**	**59.9**	**5.2**	**6.7**	**34.9**	**-19.5**	**87.1**
Reported Liabilities	50.5	2.6	1.7	54.0	5.2	6.7	34.9	-19.5	81.2
o/w: Currencies and Dep.	0.0	0.0	0.0	0.0	0.0	5.5	29.7	-14.8	20.5
Debt Securities	14.5	0.0	0.0	14.5	0.0	0.0	4.0	-0.5	18.1
Loans	6.7	0.2	0.2	7.1	1.5	0.6	0.0	-3.3	5.9
Pensions	22.3	0.0	0.0	22.3	0.2	0.0	0.0	0.0	22.5
Unreported Liabilities	5.9	...	...	5.9	...	...	...	...	5.9
Pensions	4.4	...	...	4.4	...	...	...	...	4.4
Accounts Payable	1.5	...	...	1.5	...	...	...	...	1.5
PPP Liabilities (ex certificates CRPAO)	n.d.	...	...	n.d.	...	...	...	...	n.d.
Net Financial Worth	**-34.9**	**0.1**	**1.0**	**-33.8**	**-1.0**	**1.0**	**-0.5**	**0.0**	**-34.4**
Net Worth	**3.8**	**7.5**	**16.0**	**27.3**	**4.5**	**1.0**	**-0.2**	**0.0**	**32.6**

Sources: Staff calculations, Financial Statements 2013, BCRP, Banco la Nación, Mivivienda, Agrobanco, COFIDE, FCR, ONP, EsSalud.

Notes: n.d. no data available; see also notes to Table 1.3.

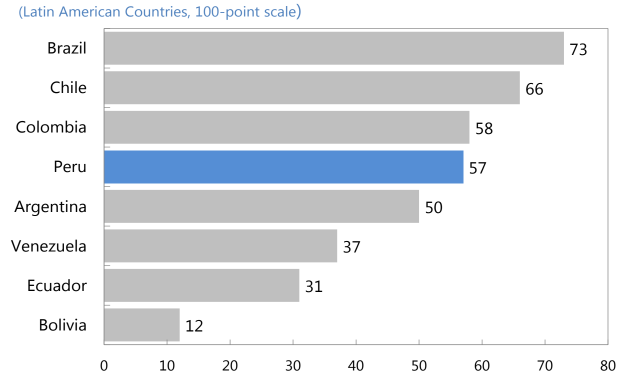
INTRODUCTION

1. **Over the last few years, the Peruvian authorities have significantly improved their macro-fiscal framework and strengthened fiscal transparency arrangements.** In 2013, they adopted a new fiscal responsibility and transparency law (FRTL) that became effective in January 2015. The new law introduces spending rules for each level of government based on a structural balance target to help manage the budget impact of macroeconomic fluctuations, including those from resource revenue. The law also mandates the creation of an independent fiscal council and requires reporting explicit contingent liabilities. In addition, since 2007, the authorities have been rolling out a performance-based budget and, in 2012, began developing a medium-term expenditure framework. These efforts build on past reforms to improve fiscal management, with numerical fiscal rules and reporting obligations dating back to the nineties.

2. **Recent assessments suggest, however, that fiscal transparency in Peru could be further improved.** In 2012, Peru's open budget index was above the average of other Latin American countries, but was lower than neighbors like Brazil, Colombia and Chile, and had declined since 2010. The latest 2009 Public Expenditure and Financial Accountability (PEFA) report identified the absence of a well-developed medium-term expenditure framework and the significant deviations between initial budget and actual spending as key shortcomings of public accountability in the country.

Open Budget Index, 2012

(Latin American Countries, 100-point scale)



Source: Open Budget Survey, 2012.

3. **This report assesses fiscal transparency practices in Peru and pilots the new pillar of the IMF's Fiscal Transparency Code on resource revenue management.** The report relies on publicly available reports (Table 0.3) and focuses on the three pillars of the IMF's 2014 Code: fiscal reporting, budget and forecasting, and fiscal risks analysis and management. It also assesses practices in managing resource revenue against the principles set in the new draft pillar of the Code released for public consultation in December 2014. Resource revenues in Peru are significant. In 2013, the mineral and petroleum sectors accounted for about 12 percent of GDP, around 70 percent of country's exports, and constituted about 10 percent of the non-financial public sector's revenue (40 percent of local governments' revenue). The economic relevance of the sector poses the issue of how transparent is the management of resource revenue in the economy and in public accounts.

4. **This fiscal transparency evaluation (FTE) is organized as follows.** Chapter 1 reviews fiscal reporting practices in Peru. Chapter 2 evaluates the comprehensiveness, orderliness and credibility of budget and forecasting procedures. Chapter 3 assesses government's practices in disclosing, analyzing, and managing risks to public finances. Chapter 4 pilots the new draft pillar of the Code to assess the openness and transparency in managing resource revenue in Peru.

Table 0.3. Peru: Main Fiscal Reports

Report	Coverage			Accounting		Publication		
	Entities	Flows	Stocks	Basis	Class.	By	Freq	Lag
MAIN BUDGETING AND FORECASTING REPORTS								
Multi-annual Budget Plan	CG, GG	Rev, Exp	N/A	Modified Cash	Nat	MEF/DGPP	A	N/A
Budget Law	CG, GG	Rev, Exp	N/A	Modified Cash	Nat	MEF/DGPP	A	N/A
Multiyear Fiscal Plan (Marco Macroeconómico Multianual)	CG, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	Nat	MEF	A	5 months
MAIN IN-YEAR REPORTS								
Debt Reports								
Daily Debt Report (Reporte Diario)	CG	N/A	Securities debt	N/A	N/A	MEF	D	1 day
Statistical Weekly Debt Report (Nota Semanal)	GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	GFSM 86	BCRP/DEF	W	2 weeks
Budget Execution Reports								
Subnational Fiscal Report (Reporte Fiscal Subnacional)	SNG	Rev, Exp	Debt	N/A	N/A	MEF/DGPM ACDF	M	N/C
Budget Execution Report (Reporte de Seguimiento del Preupuesto)	CG, GG, NFPS	Exp	N/A	Modified Cash	Nat	MEF/DGPP	M	4 weeks
Tax Report (Nota Tributaria)	CG	Rev	N/A	Cash	Nat	SUNAT	M	4 weeks
Quarterly Budget Execution Report (Evaluación Presupuestal Financiera)	Budget	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF/DGPP	Q	6 weeks
Other In-Year Reports								
Financial Evaluation of Public Sector (Evaluacion Financiera del Presupuesto del Sector Publico)	NG, SNG, PS	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF	Q	N/C
Multiyear Fiscal Plan Execution Report (Informe de Seguimiento del MMM)	GC, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	N/A	MEF/DGPM ACDF	Every six months	8 weeks
MAIN YEAR-END REPORTS								
Budget Reports, Financial Statements, and Statistics								
Annual Budget Execution Report (Evaluación Global de la Gestión Presupuestaria)	Budget	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF/DGPP	A	5 months
Financial Statements and Budget Execution (Cuenta General de la Republica)	GG, NFPS, PS	Rev, Exp, Fin	Assets, Liabilities	Accrual and Modified Cash	Nat, NICSP 2/	MEF/DGCP	A	8 months
Annual Report on Public Finances (Memoria Anual Finanzas Publicas)	GG, NFSP	Rev, Exp, Fin	Debt, Net Debt	Modified Cash	GFSM 86	BCRP/DEF	A	6 months
Fiscal Rules Report								
Fiscal Rules Monitoring Report (Declaración de Cumplimiento)	CG, GG, NFPS	Rev, Exp, Fin	N/A	N/A	GFSM 1986	MEF	A	5 months
Other Year-End Reports								
Asset and Liability Management Report (Estrategia de Gestion de Activos y Pasivos)	CG	N/A	Financial assets and liabilities	N/A	N/A	MEF	A	N/C
Annual Debt Report (Informe Anual de Deuda)	CG, PS	N/A	Debt	N/A	N/A	MEF	A	8 weeks
Council of Legal Defense of the State Annual report	N/A	N/A	N/A	N/A	N/A	Min. JUS	A	N/C
Pre-electoral Report (Informe Pre Electoral)	CG, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	Nat	MEF	Every 5 years	N/A
Annual Mining Report	MINEM	Mineral Production	Mineral Reserves	N/A	N/A	MINEM	A	N/C
Annual Hydrocarbon Reserves Report	MINEM	N/A	Hydrocar-bon Reserves	N/A	N/A	MINEM	A	N/C
Peru Extractive Industries Transparency Initiative Report	GG, Resource Companies	Revenue, Production	N/A	Cash	N/A	EITI PERU	A	2 year

Source: Authorities, IMF Staff.

Notes: Modified cash: "devengado" for expenditure and "cash" for revenue. N/C: not communicated; N/A: Not applicable; Nat: National budgetary nomenclature; NICSP: national accounting standards based on IPSAS.

FISCAL REPORTING

Fiscal reports in Peru cover the entire public sector, consolidating main stocks and flows, and generally classify information according to international standards. However, different institutional coverage across reports, the lack of information on some balance sheet items, and limited internal consistency, make it difficult to convert this richness of data into a consistent set of fiscal information. Improving fiscal reporting would require enhancing comparability across fiscal reports, widening the coverage of stocks and flows, and strengthening internal consistency and external controls.

5. This chapter assesses the quality of fiscal reporting in Peru against the principles set out in the first pillar of the IMF's Fiscal Transparency Code (FTC). According to the Code, fiscal reports should provide a comprehensive, timely, reliable, comparable, and accessible summary of the government's financial performance and position.[1] In assessing these requirements, the chapter focuses on the following four dimensions:

- Coverage of institutions, stocks and flows;
- Frequency and timeliness of fiscal reports;
- Quality of fiscal reporting (e.g., classification standards, internal consistency); and
- Integrity of fiscal reports (e.g., independence of report compiling and auditing functions).

The assessment is based on a wide set of reports and information publicly available (Table 1.1).

A. Coverage of Fiscal Reports

1.1.1 Coverage of institutions (Advanced)

6. In 2013, the public sector in Peru comprised 2,421 institutional entities that accounted for about 28 percent of GDP by expenditure (Table 1.2). The Accounting Department of the Ministry of Economy and Finance (DGCP) is responsible for compiling and publishing annually the register of public sector institutional units and its subsectors (institutional entities may cover more than a budget unit or *pliego*). In 2013, out of the 2,421 public sector entities, the general government included 2,247 units and public corporations accounted for 173 units (of which, 157 were non-financial corporations of which 25 were under liquidation), plus the central bank. In turn, the general government comprised 256 central government units (including the health insurance system, the military pension scheme, and 3 housing funds), 26 regional government, and 1,965 local government units. Among these numerous local units, a significant number is supposedly not operational, but are not closed.

[1] Fiscal reports comprise budget execution reports, fiscal statistics, and annual financial statements.

Table 1.1. Peru: List of Fiscal Reports

Report	Coverage			Accounting		Publication		
	Entities	Flows	Stocks	Basis	Class	By	Freq	Lag
IN-YEAR REPORTS								
Daily Debt Report (Reporte Diario)	CG	N/A	Securities debt	N/A	N/A	MEF	D	1 day
Weekly Debt Report (Reporte Semanal de Subpastas de Titulos del Tesoro)	CG	N/A	Securities debt	N/A	N/A	MEF	W	1 week
Statistical Weekly Debt Report (Nota Semanal)	GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	GFSM 86	BCRP/DEF	W	2 weeks
Subnational Fiscal Report (Reporte Fiscal Subnacional)	SNG	Rev, Exp	Debt	N/A	N/A	MEF/DGD FAS	M	N/C
Statistical Study Note (Notas de Estudios)	GG, NFPS	Rev, Exp	N/A	Modified Cash	GFSM 86	BCRP/DEF	M	2 weeks
Budget Execution Report (Reporte de Seguimiento del Presupuesto)	CG, GG, NFPS	Exp	N/A	Modified Cash	Nat	MEF/DGP P	M	4 weeks
Tax Report (Nota Tributaria)	CG	Rev	N/A	Cash	Nat	SUNAT	M	4 weeks
Assets Liabilities Report (Reporte de Activos y Pasivos)	CG	N/A	Financial assets and liabilities	N/A	N/A	MEF	Q	8 weeks
Financial Evaluation of Public Sector (Evaluacion Financiera del Presupuesto del Sector Publico)	NG, SNG, PS	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF	Q	N/C
Quarterly Budget Execution Report (Evaluación Presupuestal Financiera)	Budget	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF/DGP P	Q	6 weeks
Multiyear Fiscal Plan Execution Report (Informe de Seguimiento del MMM)	GC, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	N/A	MEF/DGP MACDF	Every six months	8 weeks
YEAR-END REPORTS								
Multiyear Fiscal Plan (Marco Macroeconómico Multianual)	GC, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	Nat	MEF	A	5 months
Annual Report on Public Finances (Memoria Anual Finanzas Publicas)	GG, NFSP	Rev, Exp, Fin	Debt, Net Debt	Modified Cash	GFSM 86	BCRP/DEF	A	6 months
Annual Budget Execution Report (Estadística Anual: Cierre del Presupuesto del Sector Público)	GC, GG	Rev, Exp	N/A	Modified Cash	Nat	MEF/DGP P	A	8 weeks
Annual Budget Execution Report (Evaluación Global de la Gestión Presupuestaria)	Budget	Rev, Exp, Fin	N/A	Modified Cash	Nat	MEF/DGP P	A	5 months
Financial Statements and Budget Execution (Cuenta General de la Republica)	GG, NFPS, PS	Rev, Exp, Fin	Assets, Liabilities	Accrual and Modified Cash	Nat, NICSP	MEF/DGC P	A	8 months
Asset and Liability Management Report (Estrategia de Gestion de Activos y Pasivos)	CG	N/A	Financial assets and liabilities	N/A	N/A	MEF	A	N/C
Annual Debt Report (Informe Anual de Deuda)	CG, PS	N/A	Debt	N/A	N/A	MEF	A	8 weeks
Fiscal Rules Monitoring Report (Declaración de Cumplimiento)	CG, GG, NFPS	Rev, Exp, Fin	N/A	N/A	GFSM 1986	MEF	A	5 months
Pre-electoral Report (Informe Pre Electoral)	CG, GG, NFPS	Rev, Exp, Fin	Debt	Modified Cash	Nat	MEF	Every 5 years	N/A

Source: Authorities, IMF Staff.

Notes: N/C: not communicated; N/A: Not applicable; Nat: National budgetary nomenclature; GG: General government; Mo: Monthly; Qtr: Quarterly; Rev: Revenue; Exp: Expense; Trans: Transactions; Fin: Financial; NFPC: Nonfinancial Public Corporations; SS: Social Security; Ann: Annual; NFIS: national accounting standards based on IPSAS.

Table 1.2. Peru: Public Sector Institutional Composition and Finances, 2013 1/
(Percent of GDP)

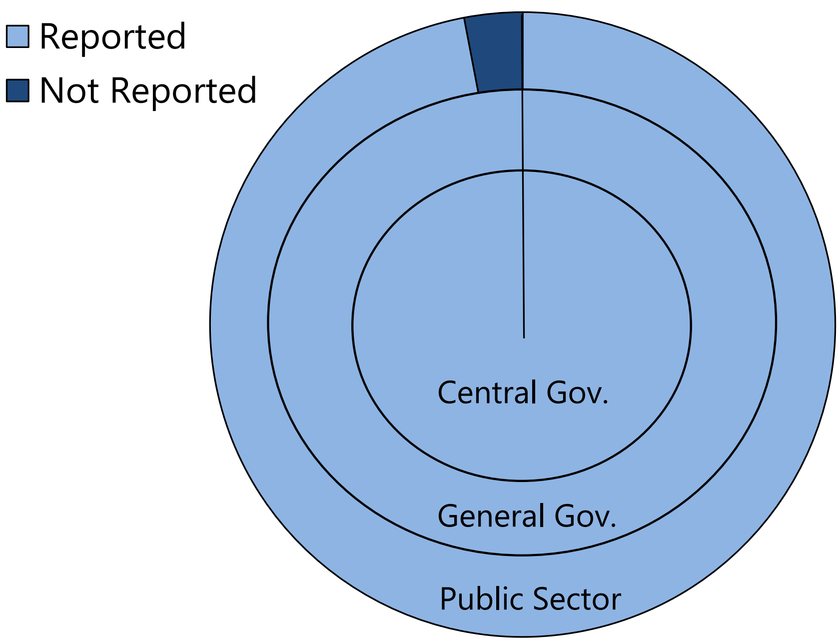
	Number of Entities	Gross Revenue	Inter-PS Transfer	Net Revenue	Net Expenditure	Net Balance
Public Sector	**2421**	**34.2**	**4.6**	**29.6**	**27.8**	**1.9**
General Government	**2247**	**27.7**	**4.3**	**23.4**	**21.6**	**1.9**
Central Government	**256**	**19.5**	**0.1**	**19.4**	**13.2**	**6.3**
Budgetary Central Government	134	16.1	0.1	16	10.2	5.8
Extrabudgetary Units	118	0.2	0	0.2	0.2	0
Mivivienda	1	0	…	0	0	0
Perupetro	1	0.2	0	0.2	0.2	0
ETEs and Soc. Ben.	116	…	…	…	…	…
Social Security	4	3.2	0	3.2	2.8	0.5
ONP	1	1	0	1	1	0.1
FCR	1	0.4	0	0.4	0.2	0.2
CPMP	1	0.3	0	0.3	0.2	0.1
EsSalud	1	1.5	0	1.5	1.4	0.1
State Government	**26**	**3.9**	**3.3**	**0.6**	**4.0**	**-3.4**
State Authorities	26	3.9	3.3	0.6	4.0	-3.4
Local Government	**1965**	**4.3**	**0.9**	**3.4**	**4.4**	**-1.0**
Local Authorities	1965	4.3	0.9	3.4	4.4	-1.0
Non-Financial Corporations	**157**	**5.7**	**0.3**	**5.4**	**5.5**	**0.0**
Petroperu	1	3.5	0.0	3.5	3.6	-0.1
Sedapal	1	0.4	0.1	0.3	0.3	0.0
Electroperu	1	0.2	0.0	0.2	0.2	0.1
Hidrandina	1	0.1	0.0	0.1	0.1	0.0
Seal	1	0.1	0.0	0.1	0.1	0.0
Regional Electricity Companies	13	0.7	0.0	0.7	0.7	0.0
Others	139	0.7	0.2	0.5	0.5	0.0
Financial Corporations	**16**	**0.7**	**0.0**	**0.7**	**0.7**	**-0.1**
Banco de la Nacion	1	0.4	0.0	0.4	0.2	0.1
Agrobanco	1	0.0	0.0	0.0	0.0	0.0
COFIDE	1	0.1	0.0	0.1	0.1	0.0
Cajas Municipales	13	0.2	0.0	0.2	0.4	-0.2
Central Bank	**1**	**0.1**	**0.0**	**0.1**	**0.1**	**0.0**

Source: CGR 2013, FONAFE Budget Execution 2013, Financial Statements 2013: BCRP, Banco de la Nación, Mivivienda, Agrobanco, COFIDE, FCR, ONP, EsSalud, Memoria Anual BCRP 2013.

1/ Subsectors are reclassified following international standards as follows: (i) budgetary central government includes national government as presented in CGR, minus Fondo Consolidado de Reservas (FCR) and Oficina de Normalización Provisional (ONP); (ii) Extrabudgetary units (EBU) include Mivivienda, PeruPetro, and entities of enterprise treatment (ETE); (iii) SS includes EsSalud, FCR, ONP, and the Military Police Pension Fund (CPMP); (iv) state government includes regional governments from the CGR; (v) financial corporations include Banco de la Nación, Agrobanco, COFIDE and Cajas Municipales, CGR does not include Banco de Comercio controlled by CPMP and as such reflected in the CPMP financial statements; (vi) non-financial corporations are as from the CGR 2013, and individual firm data are from FONAFE. Consolidated figures are from the CGR and have been adjusted to account for reclassifications. Net balances are reported as from the budget statement.

7. Financial statements cover the entire public sector while the coverage of other fiscal reports is more limited. Peru is one of the few countries in the world to publish annual financial statements (*Cuenta General de la República,* CGR) that consolidate the entire public sector, including financial and non-financial public entities. In 2013, the general government accounted for about 78 percent of public sector total spending, 60 percent of which was concentrated at the central government level and the remaining 40 percent at the sub-national government (SNG) level. Financial statements serve mainly for accountability purposes and are complemented by other fiscal reports with more limited coverage and used for fiscal monitoring and policy decision purposes. These other reports include fiscal statistics prepared by the central bank (BCRP) and the Ministry of Economy and Finance (MEF) that cover most of the general government in intra-year reports and annually the non-financial public sector (NFPS) (Figure 1.1). They also include the MEF's budget execution reports covering the general government as defined by national legislation, and the annual fiscal rule monitoring report.

Figure 1.1. Peru: Coverage of Public Sector Institutions in Annual Fiscal Statistics (Percent of Expenditure)



Source: IMF staff calculations.

8. Apart from coverage, fiscal reports differ in the definitions of subsectors, in some cases, not following international standards, making it difficult to compare information across reports. Financial statements and budget execution reports follow national legislation and, differently from international standards, exclude from the central government extra-budgetary units (in particular PeruPetro, some social security and housing funds, and the military pension scheme (see Chapter 2).[2] Fiscal statistics follow instead international, although outdated, standards (GFSM 1986). The impact of these classification issues is, however, not large. In 2013, using international standards would have led to reclassify about 1.8 percent of GDP as central government's expenditures. Despite the limited impact, using different definitions of institutional subsectors makes it difficult to compare information across fiscal reports, reducing the utility of the broader fiscal statements for policy decision making. Looking ahead, it would be desirable to align the institutional coverage of all fiscal reports to the most recent international standards, such as GFSM 2014.

1.1.2 Coverage of stocks (Good)

9. The MEF publishes each year the consolidated balance sheet of the public sector. The balance sheet provides detailed information on both financial and non–financial assets and liabilities, as well as net worth of all subsectors (Table 1.3). In 2013, total public sector liabilities amounted to about 81 percent of GDP of which around half were financial liabilities in the form of central government debt and pension liabilities. Assets amounted to 94.5 percent of GDP of which 44.6 percent of GDP were in the form of central government's deposits and central bank's securities. As a result, the public sector reported negative financial worth of 28.5 percent of GDP, mainly concentrated at the central government level and associated with debt securities, loans, and pension liabilities. Significant non-financial assets (infrastructure and equipment) of central and local governments generated a positive net worth of about 13 percent of GDP for the year.

[2] In particular, PeruPetro should be reclassified from the public corporation subsector to the central government as an extrabudgetary unit, because it undertakes mostly non-market activities and its operations are not part of the central government budget (see GFSM 2014, paragraphs 2.82 and 2.88). Specifically, PeruPetro performs promotional and administrative functions, including granting rights to explore and produce petroleum and collecting royalty revenue on behalf of the government. It neither takes commercial interests nor receive production shares in petroleum licenses, apart for four legacy contracts. The role of PeruPetro and issues related to the transparency of resource revenue management are further discussed in Chapter 4.

Table 1.3. Peru: Public Sector Balance Sheet, 2013 1/
(Percent of GDP)

	Budgetary Central Govt	EBU	SS	Consol. Col.	Central Gov.	State Gov.	Local Gov.	Consol. Col.	Consolidated Gen. Gov.	Non-Fin. Corp.	Fin. Corp.	Central Bank	Consol. Col.	Consolidated Public Sector
Assets	**32.1**	**0.9**	**5.5**	**-1.7**	**36.8**	**8.5**	**17.5**	**-0.8**	**61.9**	**9.7**	**7.7**	**34.7**	**-19.5**	**94.5**
Non-financial Assets	12.8	0.0	0.7	...	13.5	7.3	15.1	...	35.9	5.6	0.1	0.3	...	41.8
Financial Assets	19.3	0.9	4.8	-1.7	23.3	1.1	2.4	-0.8	26.1	4.1	7.6	34.4	-19.5	52.7
Monetary gold and SDRs	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	1.5	...	1.5
Currency and deposits	11.8	0.1	2.1	...	14.0	0.2	0.5	...	14.7	1.4	2.3	5.6	-10.0	14.0
Debt Securities	3.0	0.0	0.2	-0.2	3.0	0.0	0.0	...	3.0	0.2	1.8	26.7	-1.1	30.6
Loans	0.0	0.7	0.0	...	0.7	0.0	0.0	...	0.7	0.8	3.4	0.5	-0.5	4.9
Equity	0.0	0.0	0.6	...	0.6	0.0	0.7	...	1.3	0.0	0.0	0.0	-1.0	0.3
Insurance, Pensions	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	0.0	...	0.0
Financial Derivatives	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	0.0	...	0.0
Other receivables	4.6	0.1	1.9	-1.5	5.0	0.9	1.2	-0.8	6.3	1.7	0.2	0.2	-6.9	1.4
Liabilities	**29.6**	**0.6**	**22.0**	**-1.7**	**50.5**	**2.6**	**1.7**	**-0.8**	**54.0**	**5.2**	**6.7**	**34.9**	**-19.5**	**81.2**
Currency and deposits	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	5.5	29.7	-14.8	20.5
Debt Securities	13.6	0.0	1.2	-0.2	14.5	0.0	0.0	...	14.5	0.0	0.0	4.0	-0.5	18.1
Loans	6.4	0.3	0.0	...	6.7	0.2	0.2	...	7.1	1.5	0.6	0.0	-3.3	5.9
Equity	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	0.0	...	0.0
Insurance, Pensions	1.5	0.0	18.9	...	20.4	1.6	0.3	...	22.3	0.2	0.0	0.0	...	22.5
Financial Derivatives	0.0	0.0	0.0	...	0.0	0.0	0.0	...	0.0	0.0	0.0	0.0	...	0.0
Other Payables	8.2	0.3	1.9	-1.5	8.8	0.8	1.2	-0.8	10.1	3.4	0.5	1.1	-0.9	14.3
Net Financial Worth	**-10.3**	**0.3**	**-17.2**	**0.0**	**-27.2**	**-1.4**	**0.7**	**0.0**	**-27.9**	**-1.0**	**1.0**	**-0.5**	**0.0**	**-28.5**
Net Worth	**2.5**	**0.3**	**-16.5**	**0.0**	**-13.7**	**5.9**	**15.7**	**0.0**	**7.9**	**4.5**	**1.0**	**-0.2**	**0.0**	**13.3**

Source: CGR 2013, Financial Statements 2013: BCRP, Banco la Nación, Mivivienda, Agrobanco, COFIDE, FCR, ONP, EsSalud, Extrabudgetary units.

1/ Subsectors are reclassified according international standards and following GFSM 2014, regions are classified as state governments.

10. However, the public sector balance sheet does not fully reflect all government assets and liabilities and their true value (Table 1.4, Figure 1.2). The main differences arise because in the financial statements:

- ***Subsoil assets are not reported*** (25.2 percent of GDP). The subsoil assets have been tentatively evaluated by staff at about S/. 138 billion (see Section 3.2.6).

- ***Tax receivables are only partially reported*** (overall gross value about 20 percent of GDP). In 2013, recorded tax receivables amounted to S/. 49 billion (9 percent of GDP) and were fully depreciated. However, additional tax claims disputed by taxpayers were disclosed as memorandum items and not reported as claims (S/. 52 billion; 9.5 percent of GDP). These claims should be reported in the balance sheet and depreciated based on probability of materialization. More generally, probability analysis, based on past recovery trends should be performed to better assess the actual value of these assets.

- ***Public service pension liabilities are only partially recorded*** (about 11.3 percent of GDP). The balance sheet reports S/. 122 billion in total pensions liabilities covering both part of the civil servants system (so called DL20530) and the National Pension System (SNP) for private and public employees. It also reports additional S/. 62 billion (11.3 percent of GDP) as memorandum items to be incorporated in the liabilities over time. Following GFS standards, all future pension payments related to the civil servants system (DL20530) should be reported as liabilities, while future pension payments related to SNP should be reported as contingent liabilities (Box 1.1). Moreover, the actuarial valuation of these liabilities is dated and an update as well as reclassification of these liabilities are likely to affect significantly the financial net worth.

- ***Accounts payables are not recorded*** (1.5 percent of GDP). The balance sheet does not include payables on the assumption that, by the time the final financial statements are prepared (after March 31st), payments have been fully processed. This leads to systematic under-recording of liabilities.

- ***Loans and debt securities are registered at face value rather than market value.*** The valuation methods to assess loans and debt securities vary across fiscal reports (e.g., face value, amortized costs) and none of these valuation methods are consistent with international standards, which require using market value or nominal value assessment. While most financial liabilities are reported in the balance sheet (an exception arises about PPP, see below), an accounting issue arises about the definition of debt used in other fiscal reports (see Section 3.2.2).

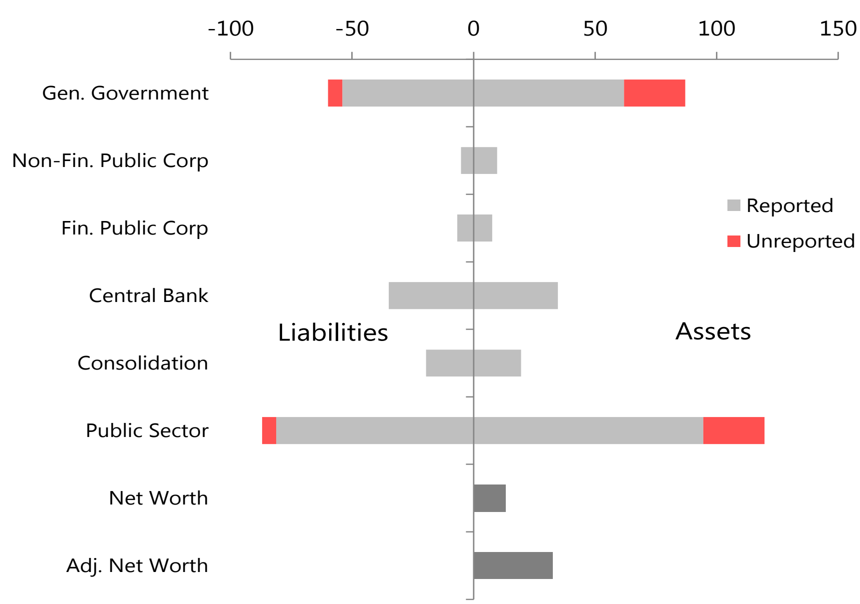
- ***Financial liabilities related to PPPs are likely underreported***. The balance sheet reports about S/. 5 billion in financial liabilities from PPPs. This amount only corresponds to the value of administrative certificates of work completion provided to private contractors (called CRPAO). However, according to international accounting and statistical standards, PPP liabilities should be registered each time the government acquires the related asset (and not only when CRPAO are issued). Indeed, the amount of PPP-related liabilities reported in the balance sheet is small compared to the large pool of projects under PPP contracts, and the estimated value of the potential liabilities is clearly underestimated (see Section 3.2.4).

- ***Other non-financial assets appear significantly underestimated***. Infrastructure and equipment are recorded at historical value and often fully depreciated. This procedure affects particularly the valuation of buildings and structures, many of which have a residual value in the balance sheet of only S/. 1.[3]

Some of these issues are already being addressed. In 2014, regulations were issued to improve the financial instruments valuation methods, a module for recording of buildings and structures was developed, and an inventory process initiated.

11. Taking a more comprehensive view of the public sector balance sheet alters the estimated fiscal position and may potentially change the source and size of fiscal risks. Initial estimates of the true value of the public sector balance sheet put the estimated net worth in 2013 at about 32.6 percent of GDP, 19.3 percent of GDP higher than currently reported. This increase is mainly due to the inclusion of unreported subsoil assets in the balance sheet. Future re-evaluation of some of the main assets and liabilities (e.g., infrastructure, pensions) and assessment of PPP related liabilities could potentially affect the assessment of the main sources and size of fiscal risks.

Figure 1.2. Peru: Public Sector Balance Sheet and Coverage in Fiscal Reports, 2013
(Percent of GDP)



Source: CGR 2013, IMF staff estimates.

[3] Reported concessions and PPP assets amount to S/. 22 billion.

Table 1.4. Peru: Estimated Public Sector Balance Sheet, 2013

GENERAL GOVERNMENT (Consolidated)		**Millions of Soles**	**Percent of GDP**
Reported	Non-Financial Assets	196,169	35.9
	Financial Assets	142,602	26.1
	Liabilities	295,447	54.0
	Net Worth	43,324	7.9
Not Reported	Non-Financial Assets	138,022	25.2
	Subsoil Assets	138,022	25.2
	Financial Assets	-	-
	Tax Receivables	52,000	9.5
	Depreciation of Tax Receivables 1/	52,000	9.5
	Liabilities	32,000	5.9
	Accounts Payables	8,000	1.5
	Public Service Pension Liabilities	24,000	4.4
	PPPs Liabilities (beyond CRPAO) 2/	n.d.	n.d.
	Net Worth (Excluding SNP Pensions) 3/	106,022	19.4
	SNP Pension Liabilities	38,000	6.9
	Net Worth (Including SNP Pensions)	68,022	12.4
Total	Non-Financial Assets	334,191	61.1
	Financial Assets	142,602	26.1
	Liabilities	327,447	59.9
	Net Worth (Excluding SNP Pensions) 3/	149,346	27.3
	SNP Pension Liabilities	38,000	6.9
	Net Worth (Including SNP Pensions)	111,346	20.4
PUBLIC CORPORATIONS (Consolidated)			
Reported	Non-Financial Assets	32,465	5.9
	Financial Assets	145,692	26.6
	Liabilities	148,863	27.2
	Net Worth	29,294	5.4
PUBLIC SECTOR (Consolidated)			
Total	Non-Financial Assets	366,656	67.0
	Financial Assets	288,294	52.7
	Liabilities	476,310	87.1
	Net Worth (Excluding SNP Pensions) 3/	178,640	32.6
	SNP Pension Liabilities	38,000	6.9
	Net Worth (Including SNP Pensions)	140,640	25.7

Source: CGR 2013, FONAFE Budget Execution 2013, Financial Statements 2013: BCRP, Banco de la Nación, Mivivienda, Agrobanco, COFIDE, FCR, ONP, EsSalud, Memoria Anual BCRP 2013, IMF Staff estimates.

1/ Following current practices, unreported additional tax receivables have been fully depreciated with no impact on net worth.

2/ No reliable data are available on PPP related liabilities beyond those registered as CRPAO.

3/ SNP pension scheme is partially reported in the balance sheet, however according to statistical standards this pension scheme should be treated as a contingent liability (see Box 1.1).

Box 1.1. Peru: Overview of Pension Schemes for Public Employees

Pension Schemes for Public Employees in Peru

In Peru, there are three public pension schemes for employees: (i) the National Pension System (SNP), to which public employees are affiliated and private employees can opt for; (ii) the Military Police Pension Fund (CPMP); and (iii) the civil servants system (so called DL20530), closed to new affiliations since 2004. Both the SNP and the DL20530 are administered by the *Oficina de Normalización Provisional* (ONP), a budgetary public entity responsible for collection of contributions and payment of pension benefits. A separate fund runs the military pension scheme.

Statistical Treatment of Pension Schemes

According to GFSM 2014, the statistical treatment of pension schemes in public accounts depends on the nature of the scheme. The nature of the pension scheme depends on whether the scheme is contributory or not, whether it is a defined-benefit or defined-contribution, and whether it is a social security or employment related scheme:

- **Contributory schemes.** The requirement to make payments of social contributions by the protected persons or by other parties on their behalf to obtain entitlement to the benefits indicates the existence of a social insurance scheme.

- **Defined-benefit schemes** are schemes in which the ultimate benefit is calculated by means of a formula embodied in terms of the social insurance scheme. However, the statistical treatment differs depending on the type of beneficiaries: when the beneficiary is the general population, or a large segment of the general population, the scheme would be considered a social security scheme; whereas if individuals, households, or a group of employees are eligible to receive social benefits, the scheme would be considered an employment-related social insurance scheme. Their statistical treatment differs:

  - Under **social security schemes**, the link between benefits and contributions is not considered sufficiently strong to give rise to a financial claim on the part of contributors. As a result, no liabilities are recorded, but an estimate equal to the net implicit obligations for future social security benefits should be presented as a memorandum item to the balance sheet.

  - **Employer-related insurance schemes** are, on the contrary, considered to involve a contractual liability towards employee and registered as liabilities.

Statistical Treatment of Pension Schemes in Peru

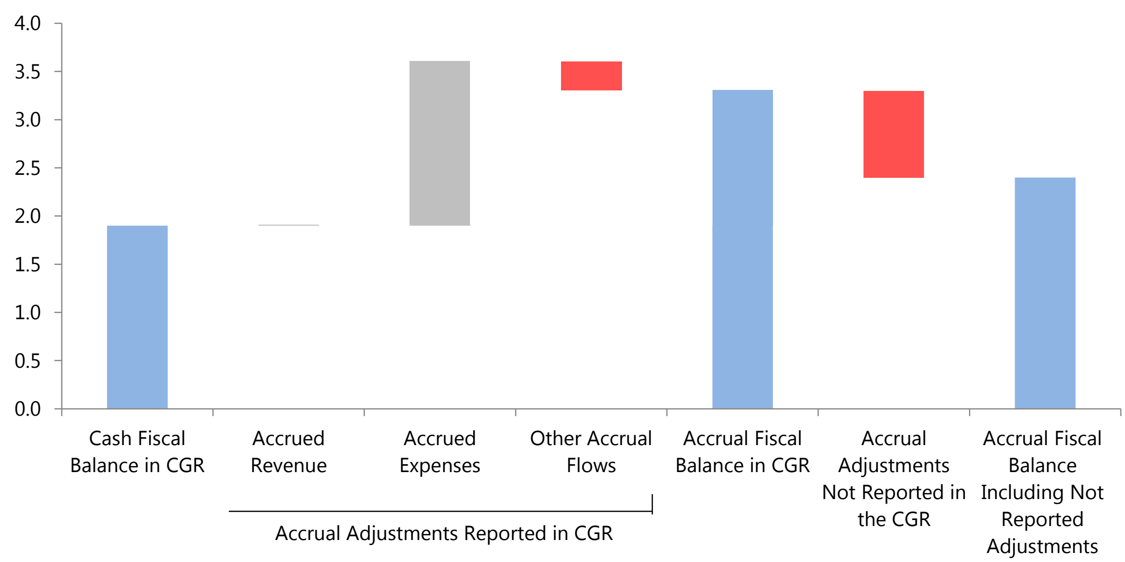
The three pensions systems described above fall into defined-benefit social insurance scheme. All systems rely on transfers from the government to pay benefits, even though SNP and the CPMP have separated institutional funds that accumulate assets overtime. However, while DL20530 and CPMP are employer-related insurance schemes covering only public employees, civil or military, the SNP is a social security scheme that covers large segments of the general population. Therefore, liabilities related to the first two schemes should be treated as liabilities in the balance sheet of the public sector, while SNP's pension liabilities should be treated as contingent liabilities in memorandum items.

1.1.3 Coverage of flows (Basic)

12. Fiscal reports are prepared on a cash and modified cash basis. All annual and intra annual reports present revenue on a cash basis and expenditures on a modified cash basis (*devengado*), i.e., registered when the obligation for payment is recognized.[4] In this respect, fiscal reporting in Peru does not meet the most advance accounting and statistical practices (e.g., IPSAS and GFSM 2014). In particular, the lack of full accrual recording implies that non-cash flows and other economic flows are not fully recorded.

13. Cash to accrual adjustments significantly affect the fiscal balance of the public sector. While CGR's operating statement contains some accrued economic flows (e.g., depreciation of assets and variation of the pension stock), it does not cover a number of flows related to missing items in the balance sheet (e.g., accrued expenses related to accounts payable, change value of debt). Once all accrual adjustments are accounted, the public sector fiscal balance in 2013 would improve from a surplus of 1.9 percent of GDP on a modified cash basis to a surplus of 2.4 percent of GDP (Table 1.5 and Figure 1.3).[5]

Figure 1.3 Peru: Reconciliation of Cash to Accrued Expenditures, 2013
(Percent of GDP)



Source: CGR 2013, authorities, staff estimates.

[4] The Budget Framework Law states that expenditure should be recorded at three stages: *compromisso, devengado, and pagado*.

[5] The computation excludes value and volume changes to liabilities (e.g. impact of exchange rate variation on external debt) and assets (e.g. stocks, inventories, investments).

Table 1.5. Peru: Public Sector Cash to Accrual Adjustments, 2013

	Thousands	Percent of GDP
Cash Fiscal Balance (Excluding Cash Balances from Previous Years) 1/	10,932	1.9
Accrual Adjustments Reported in the CGR		
Expenses		
Acquisition of Non-Financial Assets (+)	36,075	6.6
Net Accrued Pension Liabilities (-)	5,875	-1.1
Depreciation (-)	5,044	-0.9
Litigation Provisions (-)	8,744	-1.6
Other Provisions (-)	7,321	-1.3
Other Adjustments		
BCRP Cash to Accrual (-)	2,310	-0.4
CPMP Cash to Accrual (-)	3,085	-0.6
Corporations Cash to Accrual (+)	757	0.1
Other Identified (-)	1,450	-0.3
Other not Identified (+)	3,848	0.7
Accrual Fiscal Balance 2/	17,783	3.3
Accrual Adjustments Not Rreported in the CGR		
Accounts Payable (-) 3/	4,482	-0.8
Accrual Fiscal Balance	13,301	2.4
Memo item		
NFPS fiscal balance based on fiscal statistics by BCRP	4,832	0.9

Source: CGR 2013 and Staff estimates.

1/ Fiscal balance as presented in the financial statements. Not enough information is available to make adjustments using fiscal statistics.

2/ Fiscal balance as presented in the financial statements, including accrual based items. Financial statements also include fully depreciated revenue of about 11 percent of GDP not reported here that, according to the authorities, refers to tax receivables disputed by taxpayers.

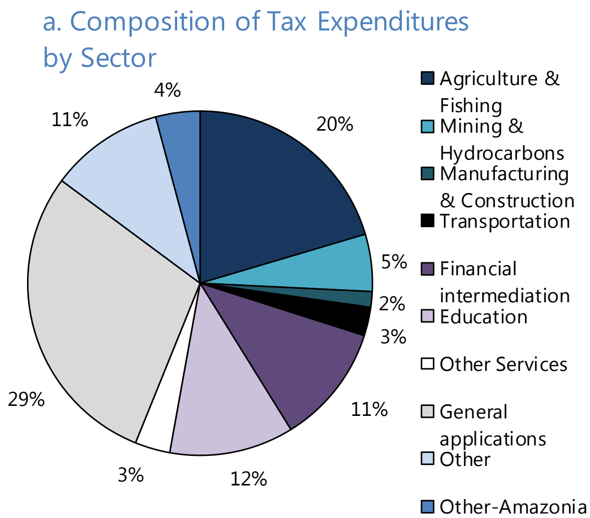
3/ Estimate provided by the authorities.

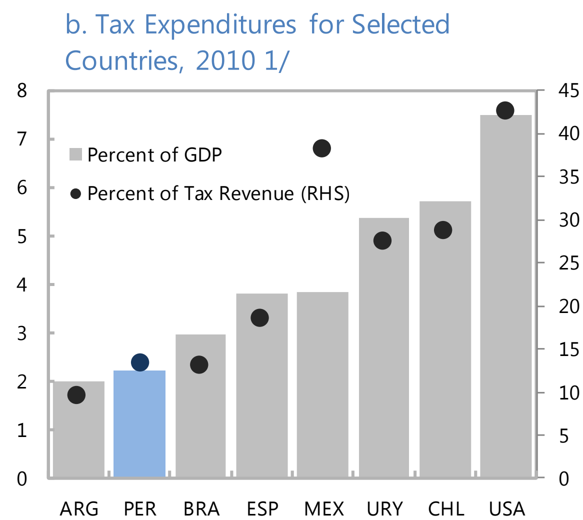
14. Apart from cash-accrual adjustments, some flows across subsectors are not fully reported, leaving substantial transfers across different levels of government undisclosed. Specifically, two sets of transfers are not appropriately registered. First, regional and local governments are authorized to spend against the ordinary revenue of the central government, but this use is not recorded as grants, while the expenditure is reported at sub-national government level. In 2013, these missed transfers amounted to about S/. 17.3 billion for regions (3.2 percent of GDP) and S/. 3.8 billion (0.7 percent of GDP) for local governments. Second, once PeruPetro is reclassified as a central government agency, all revenue it collects and transfers to SNG should be registered, according to international standards, as national government revenue, with a subsequent transfer to SNGs. Instead, they are currently reported as SNG revenue.[6] Overall, in 2013 the amount of transfers to SNGs not appropriately registered was about 4.2 percent of GDP.

1.1.4 Coverage of tax expenditures (Good)

15. The government has been annually publishing estimates of revenue foregone from tax expenditures since 2003 as part of the Multiannual Macroeconomic Framework (MMM). Tax expenditures are defined as any exception to the general tax norm (following the so-called legal approach) and are assessed on a foregone revenue basis. Estimates of revenue losses cover the main tax expenditures of the central government and provide information on losses by tax (e.g., VAT, excise tax, etc.) and expenditure (e.g., credit, deduction, etc.), by geographical area and economic sector (e.g., education, construction, etc.), including for natural resources.[7] Over the past decade, tax expenditures ranged from 1.8 to 2.2 percent. In 2015, estimated revenue losses amount to about 2.2 percent of GDP, lower than in some neighboring countries, and are concentrated in agriculture and fishing, and general tax expenditures that apply mainly to the Amazonia region (Figure 1.4). Tax expenditures in the mining and hydrocarbon sector amount to 0.1 percent of GDP (5 percent of the estimated total).

Figure 1.4. Peru: Tax Expenditures, 2015





Source: MMM (2015-2017), IMF Fiscal Monitor (April 2011).

1/ All estimates are for 2010, except Peru for 2015 estimates are reported. International comparisons of the size of tax expenditure are only indicative as estimation methodologies may vary across countries.

[6] The fiscal statistics prepared by the BCRP and the financial statements provide some information about these flows, however, information is partial and not consistent across reports.

[7] There are no tax expenditures under the personal income tax as the system uses a flat deduction.

16. Tax expenditure estimates cover the central government only and have no explicit budgetary limit. Tax expenditures do not cover taxes levied by sub-national governments and taxes and fees levied by other government entities (e.g., PeruPetro), although these are expected to be relatively small due to the limited tax capacity of non-central government entities. While no limit exists on the size of tax expenditures, some expenditures are temporary and cannot last more than 6 years. However, VAT and income tax expenditure have no explicit time limit. Introducing explicit controls and budgetary objectives for the size of tax expenditures would bring Peru in line with advanced practices.

B. Frequency and Timeliness

1.2.1 Frequency of in-year reporting (Advanced)

17. Peru produces a wide array of in-year fiscal reports with a high degree of frequency and timeliness. The BCRP publishes monthly and quarterly cash-based fiscal reports covering the general government and the non-financial public sector within two weeks from the end of the month. Monthly cash-based budget expenditure execution reports covering the budgetary national, regional and local units are also regularly published by the MEF within 30 days from the end of the month. Finally, the MEF prepares an MMM execution report every six months and in 2015 will start a quarterly fiscal report as mandated by the new FRTL.

1.2.2 Timeliness of annual financial statements (Good)

18. Peru publishes annual consolidated financial statements for the public sector within nine months of the end of the financial year. DGCP collects annual financial statements from public sector entities by March 31st (three months after the end of the financial year). Financial statements are prepared and submitted for audit by the General Auditor Office by June 20th. After receiving the auditor general report (by August 10th), DGCP sends the audited accounts to congress (by August 15th). At the same time, financial statements are published in the MEF´s website, pending approval by Congress.

C. Quality

1.3.1 Classification (Advanced)

19. Fiscal reports present revenues and expenditures by administrative, economic and functional classifications largely following international standards (Table 1.6). Financial statements present revenue and expenditure according to the economic, administrative and functional classifications and include information on the sources of funds. Budget execution reports contain programmatic information according to COFOG standards. Fiscal statistics published by the BCRP also provide breakdowns by administrative and economic classifications although following the outdated GFSM 1986 standards.

20. A consistent classification appears to be used across different levels of government. Accounting and budgetary entries are recorded in the state information system (SIAF) by all public sector entities, excluding public corporations. Therefore, the charts of accounts and budgetary nomenclatures are similar across most entities within the general government.

Table 1.6. Peru: Classification vs. International Standards

Classification	Purpose	International Standard	Peru General Government
Administrative	Accountability and budget administration.	Specific to each country	National Government (ministries, agencies, national universities, decentralized bodies, public institutions, social entrepreneur entities); Regional Government; Local Government (local authorities, local centers, decentralized bodies, municipal institutes and local communities).
Economic	Control/monitoring of fiscal aggregates, macroeconomic analysis and fiscal reporting.	GFS IFRS/IPSAS	Revenues, expenditures, assets, liabilities and financing flows. Structure consistent with GFSM 1986. Supports IPSAS (cash to accrual).
Functional/ Programmatic	Historic and policy analysis and comparisons; policy formulation and performance accountability.	Classification of Functions of Government (COFOG)	Functional classification consistent with COFOG.
Source of Funds	To identify source of funding, facilitate consolidation, and separately report on all public funds.	Specific to each country	Ordinary revenue, directly collected revenue, credit operations, grants and determined revenue.

Source: Nota Semanal, Nota de Estudios, Memoria Anual (various years), CGR.

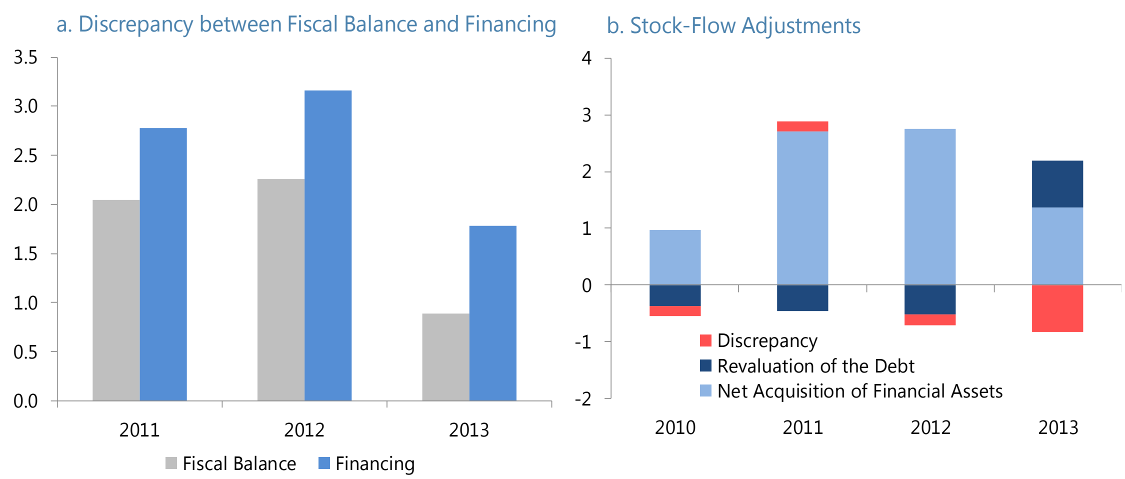
1.3.2 Internal consistency (Basic)

21. **Only limited internal consistency checks and reconciliation of fiscal aggregates required under the FTC are undertaken.** Fiscal statistics by the BCRP show no discrepancy between fiscal balance and financing because any discrepancy is included under domestic financing that acts as a residual item. Reported public debt varies across fiscal reports because of different definitions, making it difficult to reconcile debt issues and debt holding data. Financial statements contain such reconciliation, but rely on the narrow definition of public debt provided by the national legislation that does not meet international standards. No attempt is made to reconcile financing and change in the debt stock.

22. **Despite limited consistency checks, available data suggest that discrepancies are contained.** Staff calculations suggest that over the period 2011-13, the discrepancy between fiscal balance and financing averaged about 0.8 percent of GDP (Figure 1.5a). Over the same period, calculations suggest that stock-flow adjustments averaged about 2 percent of the GDP (Figure 1.5b). The stock-flow adjustment can be seen as the sum of three elements: net acquisition of financial assets, debt adjustment effects, and statistical discrepancies. Staff calculations suggest that the main elements explaining the stock-flow adjustment over the last few years are net acquisition of financial

assets and revaluation of debt with minimal statistical discrepancies, except in 2013, when the discrepancy reached about -1 percent of GDP. Given the range of possible discrepancies, systematically performing internal consistency checks in the future would greatly improve fiscal transparency.

Figure 1.5. Peru: Internal Consistency Reconciliations, 2013
(Percent of GDP)



Source: Memoria Anual BCRP, CGR 2013.
Notes: Change in domestic credit provided by BCRP; Revaluation of the debt is estimated by applying the change in exchange rates to the debt denominated in foreign currencies.

1.3.3 Historical revision (Not met)

23. **There is no systematic publication of revisions to fiscal aggregates in any of the fiscal reports, although ex-post revisions appear not to be significant.** Fiscal statistics are updated as the estimates of fiscal aggregates move from provisional to final following the outcome of the auditing process. However, the final outcomes appear as new figures in the following year's report, without any comparison, explanation or bridging tables reconciling the different vintages. However, over the last few years, annual revisions to the fiscal balance were less than 0.05 percent of GDP.

D. Integrity

1.4.1 Statistical integrity (Good)

24. **Fiscal statistics are produced and disseminated by the BCRP and MEF in line with the IMF's Special Data Dissemination Standard (SDDS) practices.** The statistical methodology used by BCRP and MEF for the compilation of the nonfinancial and financial accounts is the same—GFSM 1986. Statistics have not moved yet to the more recent international standards (GFSM 2014).

25. The Constitution assigns to the BCRP the responsibility to disseminate fiscal statistics. The MEF compiles and also disseminates fiscal statistics. Both BCRP and MEF use SIAF as the main source of data and collaborate to ensure consistency of fiscal statistics. However, no protocol or other regulations appear to exist defining formally any division of tasks and cooperation arrangements between the two institutions.

1.4.2 External audit (Basic)

26. The Comptroller General of the Republic provides independent oversight of public finances. The Comptroller General is an independent body established under the Constitution to audit public entities, with a focus on compliance audits. It undertakes financial audits of fiscal statements in accordance with the International Standards on Auditing (ISA) and International Standards of Supreme Audit Institutions (ISSAI).

27. The Comptroller General provides opinion on the consolidated statements and delegates most of the audits of individual entities' financial statements. The Comptroller General focuses on ensuring that the aggregation of the accounts and eliminations of internal transactions have been correctly performed. While it may directly audit the financial statements of public entities, it outsources to local accounting firms most of the audits of individual entities.

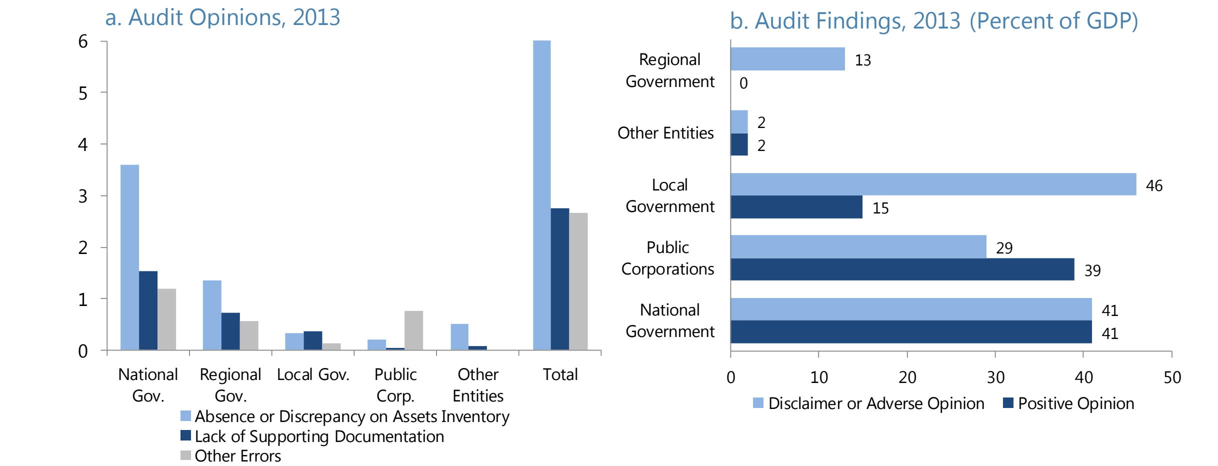
28. The coverage of external audits is large, although it focuses on a limited number of entities. In 2013, audits covered around 230 entities (around 10 percent of public entities), which accounted for about 90 percent of total assets, expenditures, and revenue reported in the financial statements for the public sector. This approach, however, leaves outside the scope of audit a significant number of entities, which may have significant contingent liabilities, although not audited entities appear to be mainly small, and supposedly non-operational, local entities.

29. The audit of the consolidated financial statements in 2013 resulted in a number of disclaimers, particularly at the SNG level (Figure 1.6). The analysis and statistics presented to Congress in 2013 shows that the quality of accounts at the sub-national level is a concern. All audits performed at the regional government level and 75 percent of audits performed at the local government level resulted in qualified or adverse audit opinions. While Congress approval of audits accounts is requested by the constitution, it is not mandatory and financial statements in 2010 and 2013 have not been approved by Congress.

1.4.3 Comparability of fiscal data (Basic)

30. Fiscal reports have only a basic degree of comparability. Annual budget outturn documents are the only fiscal reports prepared on the same basis and institutional coverage, as the budget. They present and compare final outturns (revenue and spending categories) with their forecasts (initial budget and modified budget). The fiscal rule monitoring reports compare fiscal outturns with MMM forecasts, however outturns are not reconciled with fiscal statistics or final accounts.

Figure 1.6. Peru: Audit Findings, 2013



Source: Comptroller General of the Republic.

31. In general, information on fiscal outturns differs across reports, making any reconciliation difficult. For instance, the budget outturns published in the annual budget execution reports differ from the outturns published in the financial statements. Budget reports and financial statements adopt the same recording basis for revenue—even if budget execution data mixes revenue and financing sources of funding—and expenditure but are not homogeneous in terms of coverage of institutions and coverage of flows, making any reconciliation not immediate. The differences are even larger when comparing outturns in budget execution reports and outturns reported in fiscal statistics. In this case, reconciliations would reclassify as central government spending about 1 percent of GDP (i.e., around 8 percent of net expenditure), with a similar discrepancy on the revenue side. The result is that a number of fiscal balances are published in Peru and they differ quite substantially (e.g., in 2013, the NFPS balance was 1.9 percent of GDP in financial statements and 0.9 percent of GDP in fiscal statistics). While no reconciliation between different reports and fiscal balances is undertaken, it would be important to reconcile the different reporting standards.

E. Conclusions and Recommendations

32. Peru's fiscal reporting practices meet good or advanced standards in several areas and provide a richness of fiscal data (Table 1.7). Unlike many other countries, financial statements in Peru provide full institutional coverage of the financial and non-financial public sector, consolidating the main stocks and flows of all subsectors. Fiscal reports are prepared frequently and in a timely manner and generally classify information according to international standard. Fiscal statistics are compiled and disseminated according to international standards and financial statements audited by an independent audit institution. Controls over the reliability and quality appear limited though, with most of the practices meeting only basic requirements or presenting important gaps.

33. Taking full advantage of Peru's richness of fiscal data requires, however, improvements in a number of areas. Despite a wide coverage, a number of items in the balance sheet and operating statements are not recorded (e.g., accounts payable) or evaluated according to best accrual accounting principles (e.g., infrastructure and equipment, PPP liabilities, pensions). While fiscal statistics are compiled according to international standards, the most recent guidelines (GFSM 2014) have not been adopted yet. Despite a general reliability of data, controls on the consistency of fiscal reports are little developed. Moreover, while numerous fiscal reports are published, comparability across reports is limited as the institutional coverage varies across reports. Finally, although financial statements are subject to an independent external audit, audits have limited scope. These shortcomings combined unduly limit the information base that could be used for fiscal-decision making.

34. Strengthening fiscal reporting practices in Peru requires focusing on a number of priorities:

Improve the coverage of stocks and flows and, in particular,

- Include the main missing assets, liabilities, and flows in financial statements and update valuation methods. Specifically, on the assets side, (i) record all tax receivables and develop a methodology based on recovery rates for depreciation; (ii) assess the present value of the main tangible assets (sub-soil, infrastructure, land and buildings). On the liabilities side, (i) record accounts payable; (ii) revise the value of pensions (actuarial valuation) and record their full liability; and (iii) record liabilities related to PPPs in accordance with international standards.

- Over time, adopt GFSM 2014 standards (accrual basis) for fiscal statistics.

Improve the comparability of fiscal reports, and

- Harmonize the institutional coverage and the definition of subsector across the various fiscal reports.

Strengthen internal controls and external audit functions, in particular,

- Undertake and publish internal consistency checks of fiscal data contained in various reports.

- Develop the internal control function and, in particular, develop in-year controls on the quality of fiscal accounts at all levels of government.

- Develop capacities at the comptroller general office, and expand the coverage of the individual financial statements audited.

- Undertake a review of existing public sector entities, and close those that are inactive.

Table 1.7. Peru: Summary Assessment of Fiscal Reporting Practices

	Principle	Assessment	Issue and Importance	Rec
Coverage				
1.1.1	**Coverage of Institutions**	**Advanced:** The CGR consolidates all public entities; however, subsector split is not consistent with international standards.	**Low:** The impact on central government's net worth of reclassifying entities is less than 2 percent of GDP.	
1.1.2	**Coverage of Stocks**	**Good:** Fiscal reports cover most financial and non-financial assets and liabilities.	**Medium:** Estimates of unreported assets and liabilities impact the net worth of around 15 percent of GDP.	Yes
1.1.3	**Coverage of Flows**	**Basic:** Fiscal reports are prepared on a cash and modified cash basis.	**High:** Missed accrued expenditure amount to 8 percent of central government expenditure.	Yes
1.1.4	**Tax Expenditures**	**Good:** Revenue loss is estimated by sector, tax, type of tax expenditure, and geographical area. No legal limit or budgetary objective exists.	**Medium:** Tax expenditures are low, but they do not include expenditures for taxes and fees levied by SNGs and other public entities (e.g., PeruPetro).	
Frequency and timeliness				
1.2.1	**Frequency of in-year Fiscal Reports**	**Advanced:** Monthly reports are published for the General Government and the NFPS.	**Low:** Monthly reports are already published within 30 days.	
1.2.2	**Timeliness of Annual Financial Statements**	**Good:** Audited financial statements are published within 9 months of the end of the financial year.	**Low:** Annual reports could be published within 6 months.	
Quality				
1.3.1	**Classification**	**Advanced**: Administrative, economic, functional and program classifications presented.	**Low:** Classifications are consistent with international standards.	
1.3.2	**Internal Consistency**	**Basic**: Only one reconciliation is published.	**High:** Discrepancy between fiscal balance and financing in 2013 was 0.8 percent of GDP; during 2011-13, stock–flow adjustments averaged about 2 percent of GDP.	Yes
1.3.3	**Historical Consistency**	**Not met**: Revisions to fiscal aggregates are not published.	**Low:** Ex-post revisions are lower than 0.1 percent of GDP.	
Integrity				
1.4.1	**Statistical Integrity**	**Good**: Fiscal statistics are compiled by the central bank and the ministry of finance, in accordance with the GFSM 1986.	**Medium:** Fiscal statistics should migrate to GFSM 2014 standards.	Yes
1.4.2	**External Audit**	**Basic**: The Comptroller General Office publishes an audit report on consolidated fiscal statements.	**High**: All audits performed at regional level, and 75 percent of audits at local level resulted in qualified or adverse audit opinion.	Yes
1.4.3	**Comparability of Fiscal Data**	**Basic:** Budget and fiscal outturns are comparable only in budget documents. Fiscal outturns are not reconciled with statistics and financial statements.	**High:** Discrepancies are around 8 percent of net expenditure.	Yes

FISCAL FORECASTING AND BUDGETING

Peru has a fairly comprehensive budget, formulated within a fiscal framework that has clear policy objectives embedded in numerical fiscal rules. However, different institutional coverage across fiscal documents and an institutional practice of automatic supplementary budgets make it difficult to connect macro-fiscal objectives with annual and medium-term budget planning. Improving forecasting and budgeting practices requires strengthening the link between the budget and medium-term fiscal planning, enhancing reconciliation of different vintages of fiscal forecasts, and making operational the already legislated independent fiscal council.

35. This chapter assesses the quality of fiscal forecasting and budgeting practices relative to the standards set by the IMF's FTC. It focuses on four main areas:

- Comprehensiveness of the budget and associated documentation;
- Orderliness and timeliness of the budget process;
- Policy orientation of budget documentation; and
- Credibility of the fiscal forecasts and budget proposals.

The assessment is based on information publicly available (Table 2.1). A special feature of Peru is the possibility for the public to access the government's online databases containing detailed information on budget execution, investment, and performance information.

Table 2.1. Peru: Fiscal Forecasting and Budget Documents and Online Information

Report	Content	Timing
Fiscal Forecasting and Budget Documents		
Multiannual Budget Plan	Baseline estimates for two years forward	January
Multiannual Macroeconomic Framework (MMM)	Macro fiscal forecasts and fiscal objectives for the NFPS	May
Revised Multiannual Macroeconomic Framework	Noncompulsory update of the macro fiscal framework	End August
Annual budget *exposicion de motivos*	General budget presentation (incl. macro assumptions)	End August
Orientation Guide to the Budget	Non-technical presentation of the budget proposal	September
Budget Law	Approved budget	Early December
Updated Budget Orientation Guide	Updated orientation guide to reflect approved budget	December
Online Information		
Consulta Amigable Portal	Detailed budget authorizations and execution	Daily Update
Banco de Proyectos SNIP	Technical and financial information on investment projects (excl. PPPs)	Daily Update
Resulta Portal	Performance information indicators	Annual Update

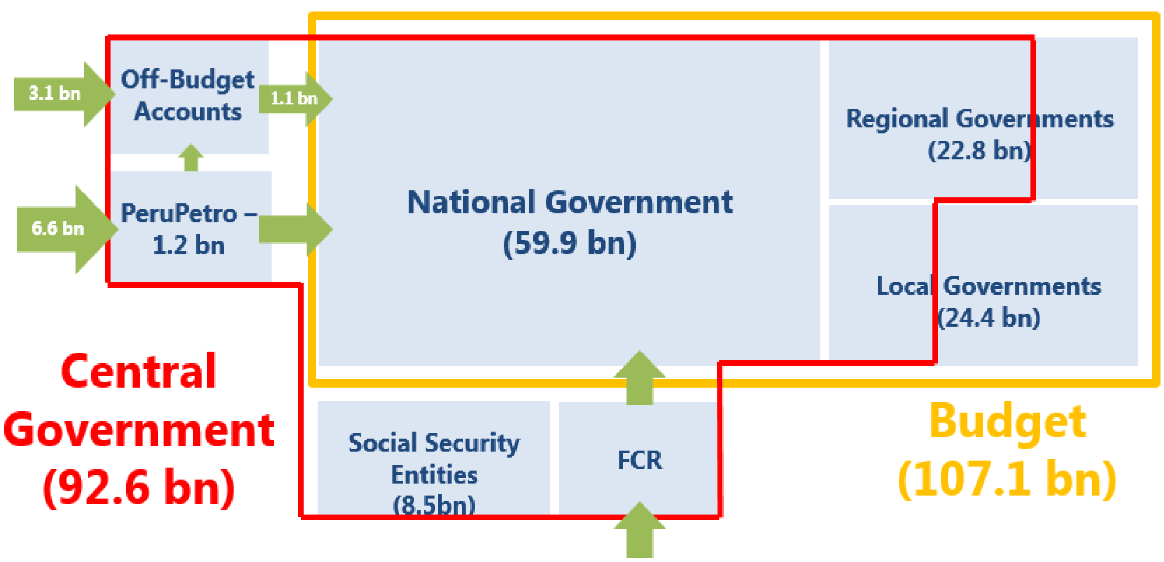
Source: Authorities, IMF Staff

A. Comprehensiveness

2.1.1 Budget unity (Basic)

36. **The annual budget covers revenue, expenditure, and financing of the general government, with the exception of some social security entities and PeruPetro** (Figure 2.1). The annual budget is structured into national, regional, and local governments and all flows of and between the various levels of governments are fully reflected in the budget documentation and budget execution data.[8] However, compared to the internationally accepted definition of central government, the budget does not cover some central government units, specifically a few extra budgetary entities providing social services (notably the health insurance agency, EsSalud), and some smaller entities which support the poor and disabled (Sociedades de Beneficencia Publica). In addition, the budget does not reflect the revenue that PeruPetro retains to cover its costs. As discussed in Chapter 1, following GFS rules, PeruPetro should be considered a central government entity and its own revenue registered as part of the budget. Despite these missing items, the annual budget still covers more than 90 percent of central and general government expenditures.

Figure 2.1. Peru: Institutional Coverage of Budget and Central Government Expenditures, 2013
(in billions of nuevos soles)

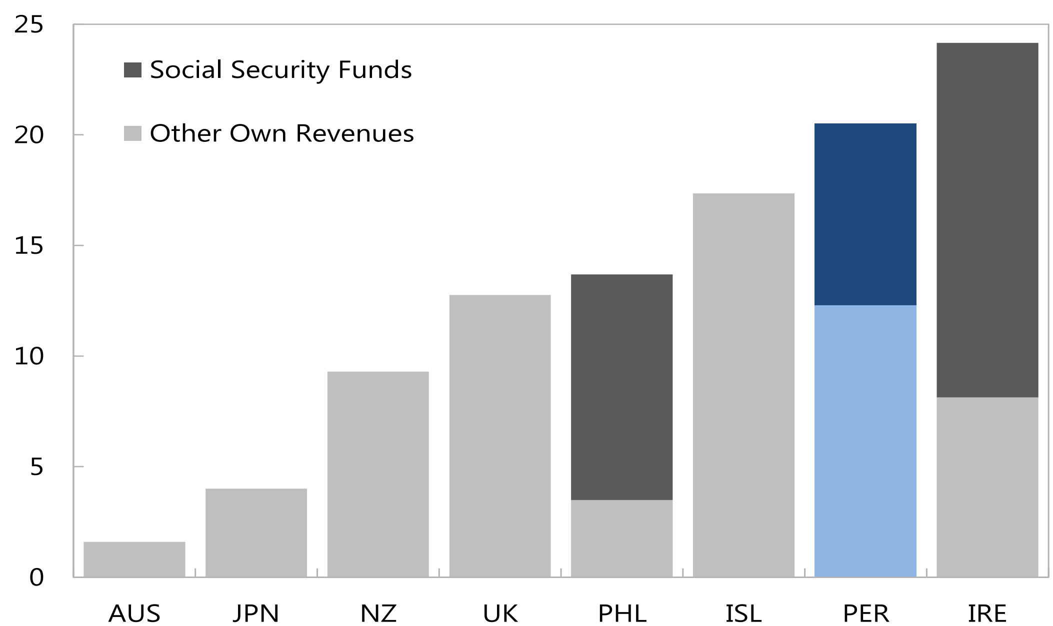


Sources: Budget execution reports, BCRP statistics, staff estimates.
Notes: Figures refer to 2013 direct primary expenditure data. Budget execution data differ from central government statistics due to various transfers among levels of governments. Part of transfers from the national to the regional and local governments are reflected as direct revenue in budget execution reports (e.g., VAT redistribution fund).

[8] While the budget directorate of the MEF (DGPP) prepares the budget for the general government, regional and local governments' individual budgets are prepared directly by sub-national governments.

37. The budget captures well the large size of own revenues in Peru, by presenting all expenditure and revenue on a gross basis, with the exception of some petroleum revenue (those retained by PeruPetro).[9] Budget tables provide a clear distinction between expenditure funded through general revenue and expenditure funded through own source revenue. There are two mechanisms for entities to retain general revenue. First, some ministries and agencies can retain some revenue directly collected. The most significant example is the tax and customs agency (SUNAT) which keeps 2 percent of gross tax collection to cover its costs. This withholding is reflected in the budget by reporting total gross revenue collected and a transfer on the expenditure side. PeruPetro is, however, an exception as the petroleum revenues that it retains to cover its costs are not reflected in the budget (about S./ 1.2 billion, 19 percent of gross petroleum revenue). A second mechanism to retain general revenue is earmarking revenue to specific programs. In this case, expenditure funded with earmarked revenue is also reflected in the budget and clearly identified. All included, in 2013, total expenditure funded with own revenue in Peru represented about 21 percent of central government expenditure, a share which is significant compared to other countries for which data is available (Figure 2.2).

Figure 2.2. Peru: Expenditure Funded with Own Revenue, 2013
(Percent of central government expenditure)



Sources: Budget Execution Report 2013, Staff estimates, national budgets.

[9] Own revenues are defined as revenues that ministries or agencies are automatically authorized to spend. This report refers to own revenues of central government units, including PeruPetro reclassified as such, and excludes sub-national governments' substantial own revenue.

38. The revenue reporting of some off-budget accounts could also be improved. Revenue earmarked to off-budget accounts kept by the Treasury are reflected in the budget only when the resources are appropriated for spending. Over the past three years, the average revenue flow to these accounts amounted to about S/. 2.5 billion of which less than ¾ is annually used (and reflected in the budget), and in 2014 the remaining balance was about S/. 3 billion (0.5 percent of GDP). Although the accounting treatment of these funds does not seem to create an issue in terms of transparency in the use of resources, timeliness of revenue and outstanding balances should be disclosed in budget documentation. This disclosure is particularly important since part of the resources earmarked come from natural resources (see Chapter 4 for a discussion on the allocation of resource revenues). Similar arrangements exist for the *Fondo Consolidado de Reservas* (FCR) which participates in the funding of pensions, and receives resources from ElectroPeru (see Chapter 3).

2.1.2 Macroeconomic forecasts (Advanced)

39. Peru's fiscal and budget documentation provides a clear and comprehensive analysis of the key macroeconomic forecasts underlying the budget and their assumptions. The MMM includes the current and the three year-ahead forecasts of key macroeconomic aggregates, such as real GDP, inflation, exports and imports, commodity prices, and balance of payments along with the last two years outturns. The MMM also contains a detailed discussion on the assumptions underlying the forecasts and presents downside macroeconomic scenarios relevant to Peru. The MMM is generally updated in August (only 2 out of the past 15 MMM reports have not been updated).

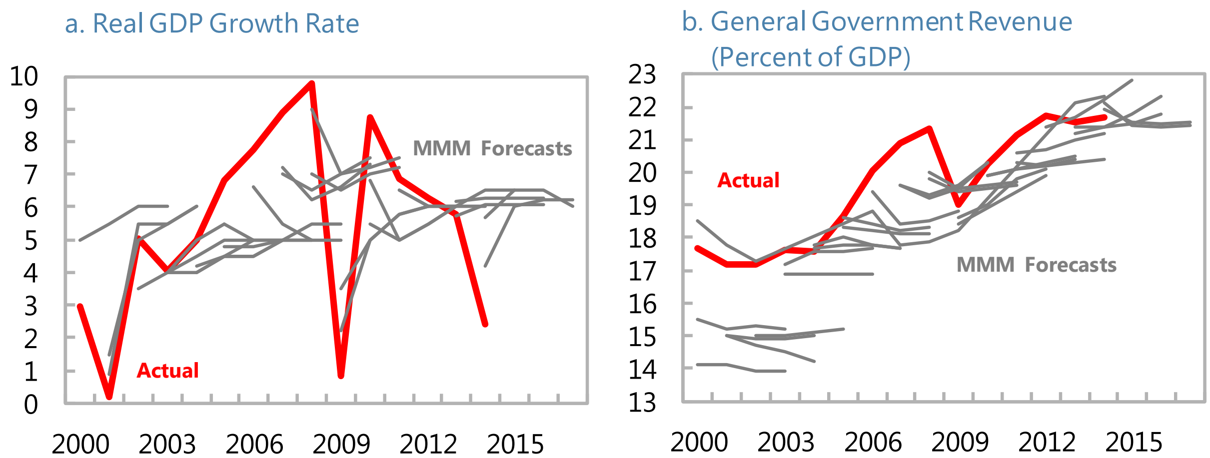
40. While Peru's one year-ahead macroeconomic forecasts are relatively accurate, medium-term forecasts tend to show conservative biases. One-year ahead real GDP forecasts have been relatively accurate when compared to other institutions and general consensus (Table 2.2) and the average deviation over the period 2003-2013 was 0.6 percentage points. However, medium term real GDP projections generally exhibit a more conservative bias (Figure 2.3). The conservative bias in the real GDP projections combines with inflation forecasts that rely on the central bank's mid-range inflation target (systematically under-projecting actual annual inflation) and lead to constantly underestimating nominal outturns. Not surprisingly, revenue forecasts for 2003-2013 also exhibit a conservative bias (about 1.8 percent of GDP lower than outturn). Despite these trends, no document reports reconciliations of macroeconomic forecasts with outturns or discusses the drivers of forecast deviations. Looking ahead, reconciling and discussing deviations between forecasts and outturns could prove helpful in improving forecasts.

Table 2.2. Peru: Real GDP Growth and Revenue Forecasts One-Year Ahead, 2012-2014

	Real GDP (Percent Change)			Revenue (Percent of GDP)		
	2012	2013	2014	2012	2013	2014
Actual	6.3	5.8	2.4	21.7	21.6	21.7
Forecasts						
MEF	6.0	6.0	6.0	20.7	21.7	21.4
BCRP	5.7	6.2	6.2	20.9	21.2	21.3
IMF	5.6	6.0	5.7	20.7	21.6	21.0
Consensus Forecast	5.5	6.3	5.8	…	…	…

Sources: MMM, BCRP Inflation Report, WEO, Consensus Forecast (various years).
Note: BCRP, IMF, and Consensus Forecast are from the month close to the MMM publication date. Revenue refers to general government level. While GDP was rebased in 2014, for comparison purposes with forecasts, actual revenue ratios are presented using non-rebased GDP.

Figure 2.3. Peru: Bias in Macroeconomic Forecasts, 2000-2013

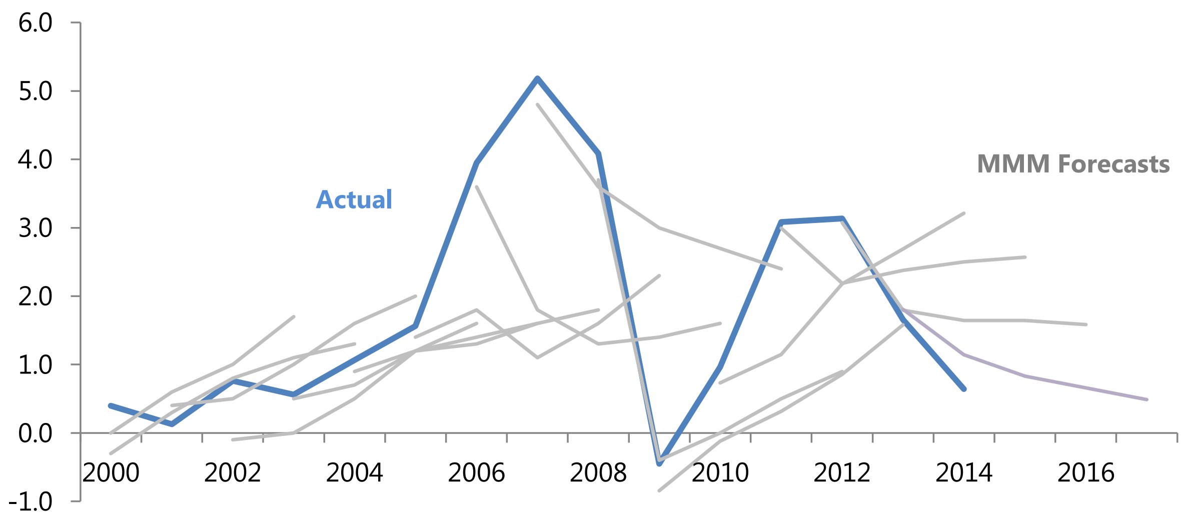


Source: MMM (various years), WEO.

2.1.3 Medium-term budget framework (Basic)

41. The MMM includes medium term projections of aggregate revenue, expenditure, and financing of the general government and the balance of the NFPS. It includes outturns of the two preceding years, an update of the current year and a projection of fiscal aggregates for the next three years. Since 2014, it also includes binding spending ceilings for the national government and the whole of regional and local governments for the next year and projections for the following years. However these ceilings are presented using a classification basis that differs from that adopted in the annual budget (see Chapter 1).

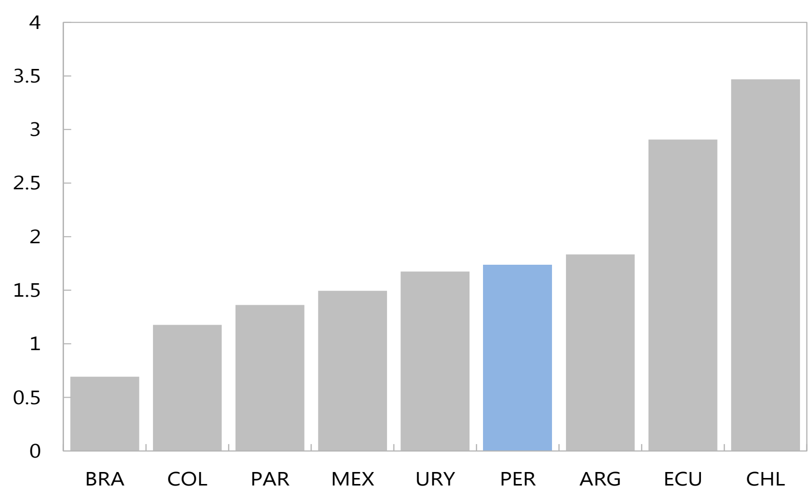
Figure 2.4. Peru: Medium-Term Primary Balance Forecast History, 2000-2013 (Percent of GDP)



Source: MMM (various years), WEO.

42. **The credibility of medium term fiscal projections appears, however, limited.** Medium term projections of the general government primary balance are significantly revised from one MMM to the next and display limited relation to actual outturns (Figure 2.4). Over the decade 2003-2013, the average two-year forward primary balance forecast error was 1.9 percent of GDP. This error may in part reflect macroeconomic forecast errors and partly the fact that the MMM is not informed by a detailed bottom-up analysis of future spending trends (see below). Despite these errors, the volatility of the primary balance in Peru is not higher than in neighboring countries (Figure 2.5).

Figure 2.5. Peru: Average Volatility of Primary Balance in Selected Countries, 2001-2013 (Percent of GDP)

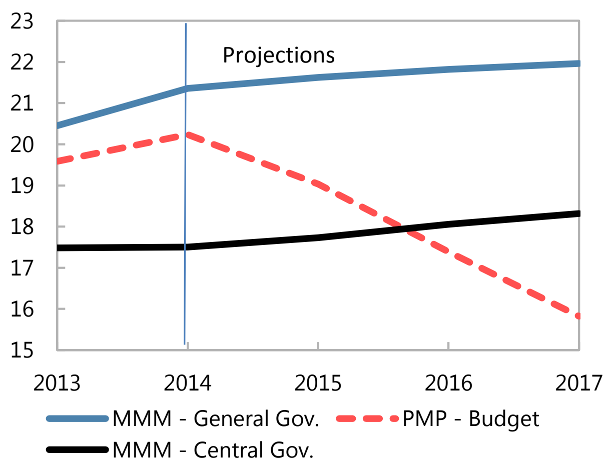


Source: WEO (October 2014).

43. Medium-term macro-fiscal projections and spending ceilings cannot be immediately reconciled with annual and medium-term budget planning. In 2012, the government began developing a medium-term expenditure framework or multiannual budget plan (PMP) published annually at the start of the fiscal year. The plan presents expenditure forecasts over two forward years on a comparable basis with the budget. However, the projections of the MMM and the PMP present a divergent evolution of expenditure because of different underlying assumptions and coverage (Figure 2.6). The MMM reflects a top-down approach based on the constraint set by the fiscal rules and is based on standard international coverage and classification concepts (i.e., GFSM). The PMP reflects a bottom-up approach with conservative estimates based on ongoing policies made by spending units and follows the national budget classification (i.e., exclude some central government entities and funds). As the MMM and the PMP are prepared independently they tend to present a divergent evolution of expenditure. Well functioning medium-term budgeting would require reconciling these top-down and bottom up approaches to perform spending planning in the contest of clear macro-fiscal forecasts and inform more accurately fiscal policy decision making.

Figure 2.6. Peru: Comparability of Medium-Term Expenditure Forecasts

a. Forecasts of Total Primary Expenditure in MMM and PMP (percent of GDP)



b. Forecasts of 2015-17 Expenditure: Economic Classification (percent of 2015 expenditure)

	MMM (Gen. Gov.)	PMP (Budget)
Salaries	+14%	+4%
Goods and Services	+20%	+11%
Transfers (Incl. Pensions)	+11%	0%
Capital Expenditure	+27%	-23%

Sources: Revised 2015-2017 MMM, 2015-2017 PMP

2.1.4 Investment projects (Good)

44. Public investment projects are subject to cost-benefit analysis and their procurement follows competitive tenders. All public investment projects, including at the sub-national level, are subject to the national framework for public investment (SNIP) defined and monitored by the MEF. Feasibility studies, including cost-benefit analysis, and validation of projects by the MEF, are required for all projects with value above S/. 10 million. A dedicated selection process is followed for projects funded through PPPs, with the intervention of a specific government agency, ProInversion (see Chapter 3). Public procurement regulations provide for open and competitive tenders for investment projects above S/. 11,500 with the specific requirements varying based on the size of the project. All information regarding individual projects and procurements processes is available on two web portals administered by the MEF.

45. Despite the increasing size of public investment and recent efforts to boost it further, total obligations under multi-annual projects are not systematically monitored. The budget framework only provides for the recording and monitoring of annual commitments, hence a project can be included in the budget as soon as resources are available to cover its first year costs.[10] Following this practice, over the past ten years, public investment has doubled to 6 percent of GDP and Peru now has higher public investment spending than most neighboring countries (Figure 2.7.a, b). In part, this may reflect a need for more productive investment given the overall low quality of infrastructure in Peru compared to other countries (Figure 2.7.c). Lately, however, the government has taken further steps to unlock investment financing, including with several new financial mechanisms (see Chapter 3), and the size of approved projects, in the past two years, has been significantly higher than the actual investment spending (Figure 2.7.d). At end 2014, overall commitments for capital projects could be as high as S/. 120 billion (20 percent of GDP). These commitments are not fully and systematically monitored and can raise concerns about the sustainability of current investment spending trends. Many countries in this situation have adopted regulations for monitoring the size of multiannual commitments and, in some occasions, modified their budget frameworks to better control multiyear spending (See for example France, Box 2.1). Recently, the government in Peru has taken initial steps to better assess the medium-term fiscal impact of some investment projects.[11]

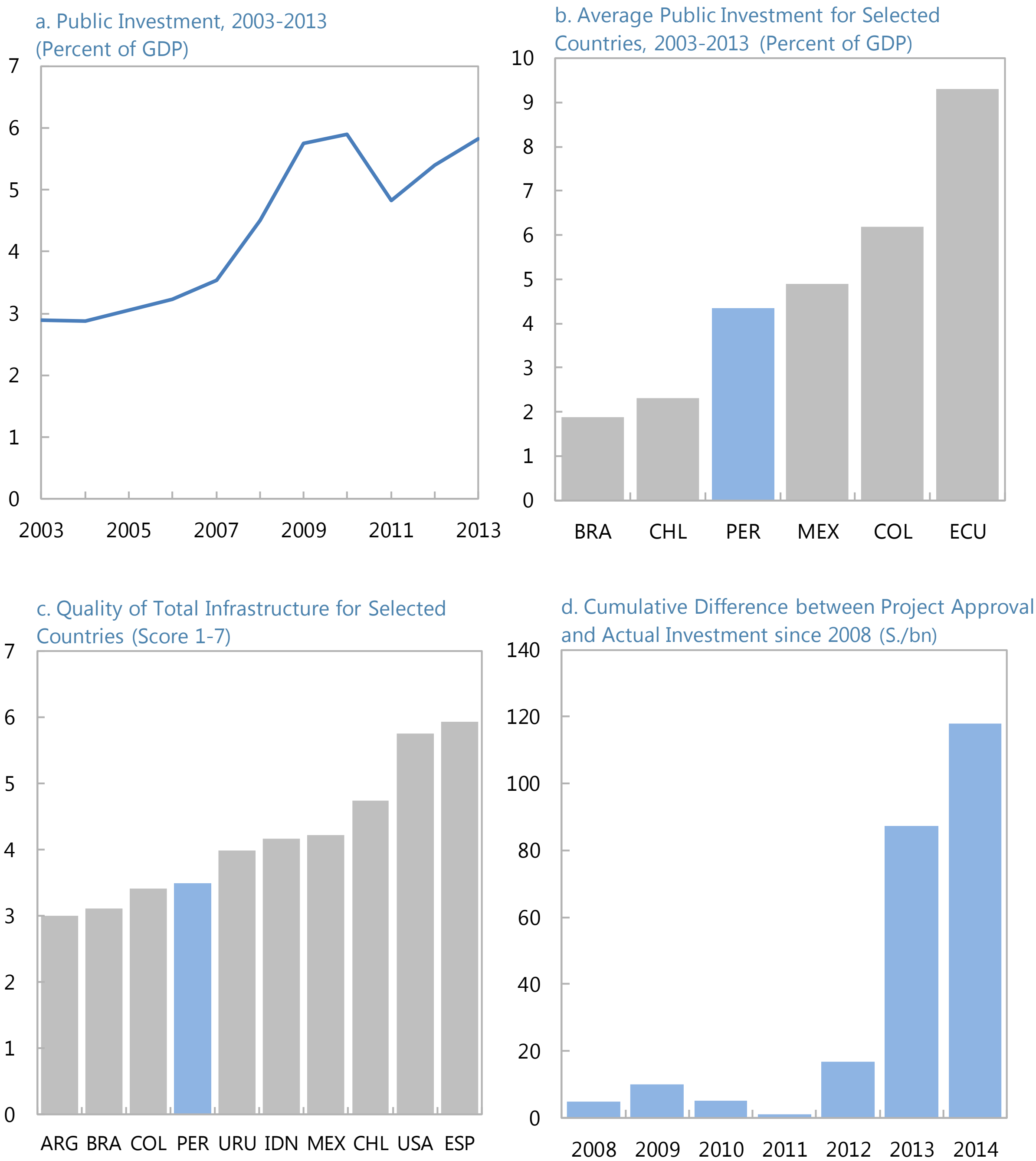
Box 2.1. Multiannual Commitments Controls in France

As part of the comprehensive reform of its budget framework in 2001, France introduced multiannual commitment authorizations (MCA) as a new central feature for monitoring legal commitments and future payments of the government. The budget is now presented both in MCAs and in payment authorizations. The commitment phase of budget execution has moved from an annual basis (as is now the *compromiso* phase in Peru) to a multiannual basis meaning the total cost of a legal commitment into which the government is entering has to be fully recorded against available MCAs. Authority to cover these legal commitments with payments is still provided on an annual basis, and the IT system keeps record of payments made against previously committed MCAs. Annual reports disclose the amount of MCAs to be covered in the future, per program. This information is then used for preparing the baseline estimates of the detailed medium term budget framework.

[10] In addition, the multiannual budget plan (PMP) reports projected spending for the two years after the budget year, covering part of the multiannual costs of projects approved in a given budget (section 2.1.3).

[11] According to a recent regulation, the approval of new PPP projects guaranteed by the government requires an assessment of the fiscal impact of both explicit commitments and contingent liabilities associated to the project.

Figure 2.7. Peru: Selected Public Investment Indicators



Sources: WEO (Fall 2014), Global Competitiveness Index, 2014-15, SNIP, BCRP, IMF staff elaborations.

B. Orderliness

2.2.1 Fiscal Legislation (Advanced)

46. The Constitution, the Budget Framework Law, and Congress Regulations provide a comprehensive and clear legal framework governing the budget timetable and its content. The Constitution (Section 78) requires the government to submit the annual budget to Parliament by end-August, and Congress Regulations grant three months to Congress for approving the budget. Beyond this term, the initial proposal of the Government is automatically adopted. The Budget Framework Act clearly defines the format and content of the supporting documentation to the annual budget proposal.

47. The legislative framework also limits the legislative's power to amend the budget proposal. Members of Congress cannot create or increase public spending (Section 79 of the Constitution). Congress can however reallocate funding although, in practice, reallocations are limited. For the 2015 budget, Congress reallocated less than half a percent of total expenditure.

2.2.2 Timeliness of Budget Documents (Advanced)

48. The annual budget is submitted to Congress by end-August of each year and approved one month before the start of the year. This timing is in line with legal requirements (see Section 2.2.1) and has been systematically respected over the last few years (Table 2.3).

Table 2.3. Peru: Budget Submission and Approval Dates, 2013-2015

	FY 2013	FY 2014	FY 2015
Submission to Parliament	August, 29	August, 29	August, 29
Approval by Parliament	November, 30	November, 29	November, 30
Publication of the Approved Budget	December, 4	December, 2	December, 4

Sources: Authorities, official Gazette.

C. Policy Orientation

2.3.1 Fiscal Policy Objectives (Good)

49. Peru's fiscal policy objectives are clearly stated and embedded in time-bound numerical fiscal rules set by the new FRTL and reported against. Before 2014, the government's fiscal objectives were set by the 1999 FRTL. This law introduced fiscal rules focusing on budget balance targets, spending ceilings and debt limits for the NFPS, and on central and sub-national governments. Since 2005, the rules were regularly reported against with a special report submitted to parliament for the NFPS and the central government while compliance by sub-national governments was not systematically reported. However, rules were often modified and compliance at sub-national government level was poor. Starting in 2015, the government's fiscal objectives are anchored in the new 2013 FRTL. The new law sets spending limits for the general government (used to determine spending ceilings for the national and sub-national governments) anchored in a structural fiscal target for the NFPS, together with debt rules for different levels of government and other more specific rules (Table 2.4).

Table 2.4. Peru: New Fiscal Rules

	NFPS	National Government	SNGs
Budget Balance	Indicative structural deficit less than 1 percent of GDP	…	…
Expenditure	…	Level of primary spending must be consistent with the NFPS structural balance estimated at the start of the budget process, given spending limits for SNGs and projections for other NFPS entities 1/ 2/ Growth rate of wage and pension spending cannot exceed the nominal growth rate of potential GDP	Primary spending growth rate at time t must be below the average revenue growth rate over the previous four years (from t-6)
Debt	Debt ceiling at 30 percent of GDP	….	Debt/average of last four years revenue ratio must be less than 100 percent
Other	…	New permanent spending measures require new permanent revenue sources	Restrictions on external borrowing

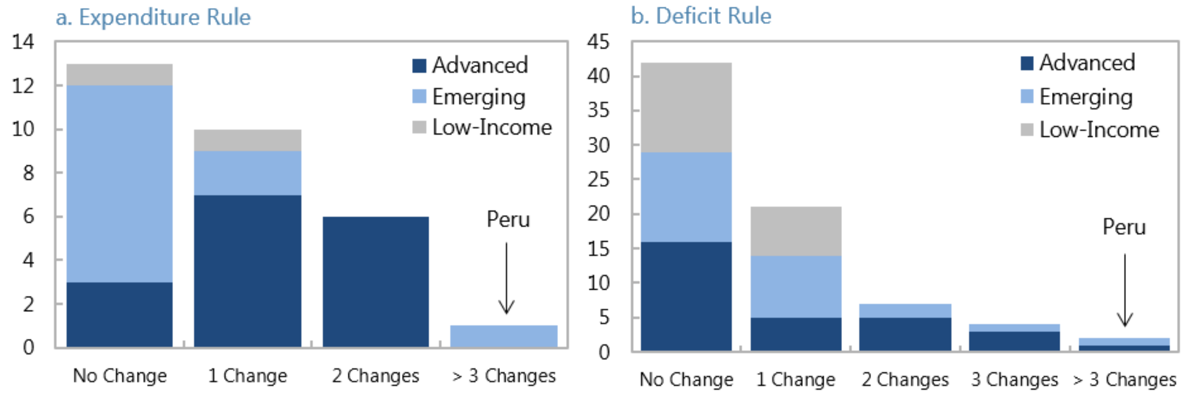
Sources: IMF staff elaborations based on Law 30099.

1/ The limit can rise by up to 0.2 percent of GDP in case of budget under-execution in the previous year. If the expected output gap (positive or negative) is larger than 2 percent, the expenditure limit must adjust, counter cyclically, by up to ¼ of the output gap or 0.5 percent of GDP. When new tax measures yield a permanent change in revenue by 0.3 percent of GDP or more, the expenditure limit changes accordingly.

2/ In the first seven months of an election year, two additional limits apply: (1) budget execution of national government's primary spending cannot exceed 60 percent of the annual budget; and (2) no measures can be taken that increase future current spending or reduce the fiscal space for the future administration.

50. Preserving the stability and securing the compliance with the new fiscal rules is critical for the credibility of the new fiscal framework. In the past, frequent changes to the fiscal rules and a lack of compliance at the sub-national government level have reduced rules effectiveness. Peru has changed its fiscal rules more frequently than its peers (Figure 2.8). Specifically, between 2003 and 2011, the cap on the spending rules was suspended three times and the rules changed four times mainly to relax the ceilings or reduce their coverage. At the same time, compliance with the rules at the sub-national level was poor. In 2010, only 15 percent of regional governments and 3 percent of local governments complied with all fiscal rules. Looking ahead, preserving the stability of the new fiscal rules introduced by the new FRTL is critical for the credibility of the new fiscal framework and would facilitate achieving advanced practices under the FTC.

Figure 2.8. Peru: Frequency of Changes in Fiscal Rules
(Number of Countries)



Source: IMF Fiscal Rules dataset, 2013; Schaechter et al (2012), IMF staff calculations.

2.3.2 Performance information (Advanced)

51. Performance information on the outcomes of major policy areas is regularly disclosed, with some results included in budget documentation. In 2007, the authorities started rolling out a performance-based budget system. More than 240 indicators are produced for monitoring the performance of budget programs, of which three quarters are outcome indicators, the rest being output indicators.[12] Each indicator is selected after a review process conducted by the MEF. All performance indicators are available online (*Resulta*). Since 2013, budget documentation includes forecasts for a selection of the indicators considered most important and compares forecasts with past performance. Looking ahead, this already comprehensive framework should be further integrated with the budget by, for instance, providing a measure of performance of non-program actions and linking future budget allocations with clearly stated performance targets.

2.3.3 Public Participation (Good)

52. Since 2013, the authorities have published an annual orientation guide to the budget. The guide is published alongside the draft budget proposal. The guide provides information on the six areas identified by the Open Budget Index to define a Citizen's Budget.[13] It presents the

[12] Budget expenditures are divided in three categories: programs that give rise to performance outcomes (about 46 percent of total expenditures), actions that result in some form of output (about 10 percent of total expenditures), and expenses that do not result in any outcome or output, such as pensions and debt service (about 44 percent of total spending). Data refer to 2014.

[13] The last Open Budget Index indicates that Peru had no citizen's budget, but its publication in 2012 was prior to the first issue of the annual orientation guide to the budget. The six areas identified by the index are: budget process, revenue collection, priority spending and allocations, sector specific information, contact information for follow up, and economic assumptions.

implications of the budget for a typical citizen but does not provide perspectives from the point of view of different demographic groups.

53. While the central budget process does not provide for formal public participation, a participative budget process exists at regional and local levels. This initiative is not mandatory but is encouraged by the MEF, which provides guidelines for engaging with citizens and selecting projects. An educational guide on this initiative is posted on the MEF website. A web portal allows monitoring of the process, including for citizens who submitted a project.

D. Credibility

2.4.1 Independent Evaluation (Good)

54. The independent Central Bank of Peru regularly provides an assessment of the government's economic and fiscal forecasts. The FTRL requires the MMM and any revised MMM to be submitted for review to the Central Bank, which has 15 days to provide its assessment. The assessment of the Central Bank covers both macroeconomic (GDP and balance of payments) and fiscal projections, discusses consistency of fiscal and monetary policies, and is collated to the MMM. This formal procedure is preceded by regular technical contacts between staff from the MEF and the central bank to discuss macroeconomic assumptions, especially about inflation and exchange rates.

55. The appointment of an independent fiscal council, mandated under the 2013 FRTL, should strengthen the independent evaluation of government's fiscal forecasts and performance. According to the law, the fiscal council should provide opinions on: (i) compliance with and modification of fiscal rules, (ii) economic and fiscal forecasts included in the MMM, (iii) short and medium term developments of fiscal policy, and (iv) methodologies for assessing the structural component of fiscal accounts. At the time of the present evaluation, the authorities expected the implementation decree to create the fiscal council to be published during the current year. Given Peru's performance in budget forecast and a history of revising fiscal targets (see Section 2.3.1), the establishment of an independent fiscal council will be in important institutional feature to improve transparency and fiscal performance.

2.4.2 Supplementary Budget (Not met)

56. The budget framework allows for appropriating additional resources during the course of the fiscal year without the need for supplementary budgets. The Budget Framework Act provides rules to automatically appropriate (and change the initial budget or PIA) various sources of funding:

- Additional retained revenue (*Recursos Directamente Recaudados*) and earmarked revenue (*Recursos Determinados*) can be automatically appropriated, and the unspent balance (*Saldo de Balance*) can be carried over without restriction.

- New loans and transfers can also be appropriated automatically.

- Ordinary revenue (*Recursos Ordinarios*) can only be appropriated with an act of Congress, and carryovers require prior approval by Congress. However additional revenue can also be appropriated via Urgency Decrees, without Congress approval (in 2014, these appropriations amounted to S/. 2.2 bn).

Table 2.5 Peru: Determinants of Budget Over-Execution, 2012-2014
(in millions of nuevos soles)

	2012	2013	2014
Changes to the Initial Budget (PIA)			
Initial Budget	95,535	108,419	118,934
Increase of Appropriations (*Creditos Suplementarios*)	26,846	25,253	25,861
Percent of PIA	*28.1%*	*23.3%*	*21.7%*
Of which: Carry Over of Balance (*Saldo de Balance*)	16,064	16,012	15,794
Appropriation of Additional Resources	10,782	9,242	10,066
Modified Budget (PIM)	122,380	133,672	144,795
Budget Over Execution	7,561	7,354	10,302
Percent of PIA	*7.9%*	*6.8%*	*8.7%*
Ordinary Resources and FCR (pension fund)	1,413	1,221	2,127
Of which: Pensions	1,173	1,122	1,320
Appropriation of Additional Ordinary Resources	591	426	1,175
Uncomplete Use of Contingency Reserve	-350	-327	-369
Own Revenue and Loans	3,384	3,475	5,019
Of which: Natural Resources and Off-Budget Accounts	4,454	1,840	2,633
Retained Revenue, New Loans, Others	-1,070	1,635	2,386
Internal Transfers	2,763	2,658	3,156

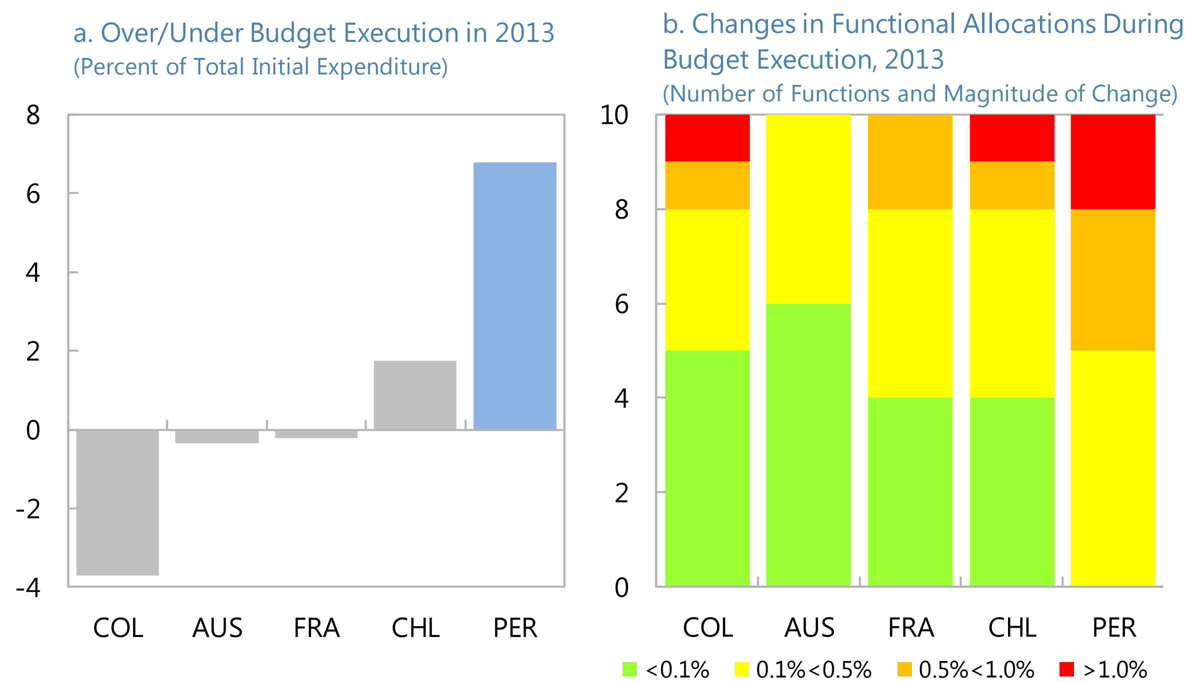
Sources: Authorities, *Consulta Amigable*, IMF staff calculations.

57. **Additional automatic appropriations in the course of the fiscal year lead to significant and systematic over-execution of the initial budget.** The automatic appropriation of new funding described above leads each year to an increase in available appropriations (the modified budget or PIM) of about 20-25 percent and are associated to an over-execution of the initial budget by about 7 percent (Table 2.5). These trends undermine the role of the budget as a credible mechanism to implement government's intended policies. The outcome of these processes is that budget execution in Peru deviates significantly from the initial budget compared to the performance of other countries both in terms of overall amount and the magnitude of the change made to the initial distribution of spending among functions (Figure 2.9).[14]

[14] Only a limited part of budget over-execution can be explained by internal financial and recording arrangements. Specifically, some transfers are recorded as an actual transaction (revenue and expenditure) and have the effect of contributing to budget over-execution outturns. However, these transfers only explain part of the difference in the over-execution recorded in the budget and in the MMM (Figure 2.10).

58. The process of incremental adjustments to the initial budget spending allocations may undermine the compliance with the fiscal rule that sets hard spending ceilings. Under the new fiscal rules, aggregate spending limits are set for each level of government in the MMM and expenditure can only be increased if new structural revenue becomes available (Table 2.4). Hence, a conflict can arise between the ex-ante spending ceilings set under the new fiscal rules and the budget process of increasing budget spending during the year. Depending on the magnitude of adjustments to the PIA finally executed, current budget practices can lead to the violation of the spending ceilings (Figure 2.10).

Figure 2.9. Peru: Budget Execution in Selected Countries



Sources: National Budgets, IMF staff calculations.
Note: Right graph reports budget over/under execution for at the level of ten COFOG functions (left axis). Green and yellow indicate small variations, orange and red indicate large variations.

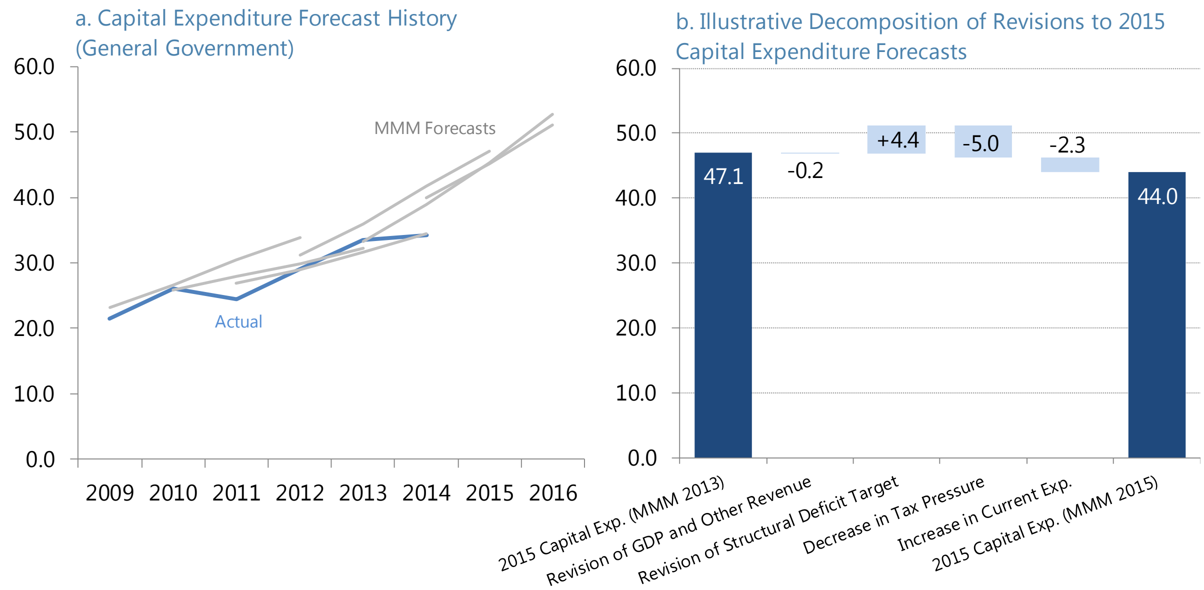
Figure 2.10. Peru: Reconciliation of Budget and MMM Over-Execution of Primary Spending, 2013
(in billions of nuevos soles)

Sources: *Consulta Amigable*, Budget *Exposicion de Motivos*, Fiscal Rules compliance report, IMF staff calculations.

2.4.3 Forecast reconciliation (Not met)

59. The MMM provides relatively limited information and discussion about the sources of often substantial revisions to successive fiscal medium term forecasts. The MMM compares revised aggregate fiscal forecasts with latest forecasts, but only offers generic reasons for the differences between those forecasts, even if they may involve at times significant revisions to specific spending items, such as investment (Figure 2.11). The only exception has been the 2015-2017 revised MMM. The inclusion of reconciliation tables breaking down the relative impact of different factors underlying the revisions would help improve the credibility of the government forecasts.

Figure 2.11. Peru: Revisions to Capital Expenditure Forecasts
(in billions of nuevos Soles)



Source: MMMs, IMF staff calculations.
Note: For calculations, figure b assumes that capital expenditure is the only adjustment variable in the MMM revision process.

E. Conclusions and Recommendations

60. Peru's fiscal forecasting and budgeting practices meet good or advanced standards in most areas. The budget has a wide coverage and covers the whole of general government, with the exception of PeruPetro and some social security institutions. Medium-term macroeconomic and fiscal projections are detailed and comprehensive, despite a conservative bias and frequent revisions. Fiscal policy objectives are embedded in clear, although complex, fiscal rules. The legal framework clearly sets the rules for the preparation, approval and execution of the budget, as well as the legislative power to amend budget proposals.

61. Translating Peru's credible macro-fiscal framework into advanced annual and medium-term budget practices requires, however, improvements in a number of important areas. Fiscal policy objectives are clearly stated, but the connection between these objectives and budget planning is not transparent due to the different institutional coverage between fiscal rules and the budget and because of the institutional practice of automatic incremental changes to the initial budget. In addition, despite well-developed macro-fiscal forecasts, the medium term budget framework remains to be developed. Moreover, while fiscal forecasts are generally reliable, they are at times subject to significant changes that are not explained.

62. Strengthening fiscal forecasting and budgeting practices in Peru requires focusing on the following policy priorities:

Enhance budget presentation, coverage, and controls on multi-year spending, in particular:

- Include in the budget documentation tables bridging the budget and the MMM presentations and some discussion on how to reconcile budget forecasts (revenue and expenditure) with the fiscal forecasts presented in the revised MMM.

- Disclose in the budget documentation forward looking financial information for institutions not included in the budget (EsSalud, etc.), and discuss their financial links with the budget.

- Record all revenues, expenditure, and savings of PeruPetro, FCR, and off-budget accounts and clarify the mechanisms for transferring appropriations between spending entities.

- Adopt regulations and tools for monitoring and controlling the size of multiannual commitments and disclose their size in budget reports.

Strengthen annual and medium-term budget planning, and:

- Revise the budget framework to reduce automatic supplementary appropriations and facilitate compliance with fiscal rules.

- Integrate the MMM and the PMP into a medium term budget framework to guide the preparation of the annual budget.

- Preserve the stability of the fiscal rules, and adopt enforcement mechanisms.

Improve macro-fiscal forecasts and forecast reconciliation, in particular:

- Report and discuss the reasons underlying any deviations in macroeconomic forecast from actual outturn.

- Explain in the MMM the different determinants underlying revisions of fiscal forecasts.

Enhance independent evaluation:

- Make operational the already legislated independent fiscal council.

Table 2.6. Peru: Summary Assessment of Fiscal Forecasting and Budgeting Practices				
	Principle	**Assessment**	**Issue, importance**	**Rec**
Comprehensiveness				
2.1.1	**Budget Unity**	**Basic.** Budget covers most of general government expenditure, but misses operations of PeruPetro and some social security funds.	**Medium.** Own revenues funded about 21 percent of central government expenditure, mostly covered in the budget.	
2.1.2	**Macroeconomic Forecasts**	**Advanced.** MMM provides forecasts of key macroeconomic variables and underlying assumptions.	**Low.** One-year ahead GDP forecasts are credible, while medium term projections exhibit a conservative bias.	
2.1.3	**Medium-Term Budget Framework**	**Basic.** The MMM includes medium term projections for the general government that are not comparable with the annual budget.	**High.** Inconsistencies between MMM and PMP are significant.	Yes
2.1.4	**Investment Projects**	**Good.** Public investment projects are subject to a formal review process and contracted via open and competitive tender.	**High.** Multiannual commitments in investment spending amount to 20 percent of GDP.	Yes
Orderliness				
2.2.1	**Fiscal Legislation**	**Advanced.** Legal framework is clear and comprehensive.	**Low.** Budget is approved by the legislature with limited modification (less than 0.5 percent of expenditure gets reallocated).	
2.2.2	**Timeliness of Budget Documents**	**Advanced.** Budget systematically submitted by end-August and approved by end November.	**Low**. Official calendar is regularly observed.	
Policy Orientation				
2.3.1	**Fiscal Policy Objectives**	**Good.** Government's fiscal objectives are clearly defined and embedded in numerical fiscal rules.	**Medium.** Numerical fiscal rules have been subject to frequent changes.	Yes
2.3.2	**Performance Information**	**Advanced.** Budget documentation includes performance indicators on outcomes.	**Low.** Performance indicators only cover 56 percent of spending.	
2.3.3	**Public Participation**	**Good**. A budget orientation guide is annually published and a participative budget scheme is in place for sub-national governments.	**Low.** Peru is at the median ranking of the World Bank's Voice and Accountability indicator.	
Credibility				
2.4.1	**Independent Evaluation**	**Good.** The central bank provides an independent assessment of the MMM's macroeconomic and fiscal projections.	**Medium.** Past performance against (constantly revised) fiscal targets is poor.	Yes
2.4.2	**Supplementary Budget**	**Not met.** Total expenditure is increased throughout the year via decrees.	**High.** Actual total primary expenditure is on average 7 percent above initial budget	Yes
2.4.3	**Forecast Reconciliation**	**Not met.** The MMM provides no discussion of the determinants of revisions of macro-fiscal projections of different MMM vintages.	**Medium.** Revisions of forecasts are regular and relatively significant.	Yes

FISCAL RISK ANALYSIS AND MANAGEMENT

Fiscal risk management in Peru is, in some respects, in its infancy. Some risks are reported regularly, while others on a more ad hoc basis or not reported. Overall, there is not yet a comprehensive vision of fiscal risks and often single specific fiscal risks are not assessed thoroughly. However, the implementation of the new FRTL that mandates the disclosure of specific fiscal risks is likely to result in Peru adopting more advanced risk management practices.

63. This chapter assesses the government's analysis, reporting, and management practices of fiscal risks in Peru relative to the principles set out in the IMF's FTC. Following the Code, the chapter focuses on three dimensions:

- Disclosure and analysis of fiscal risks;
- Management of fiscal risks emanating from specific sources (e.g., government guarantees, public-private partnerships, financial sector); and
- Risks arising from fiscal decision-making between central government, sub-national governments, and public corporations.

The assessment relies on information on various fiscal risks available in a number of different public documents (Table 3.1).

Table 3.1. Peru: Selected Reports Describing Fiscal Risks

Report	Fiscal Risk Discussed	Author	Frequency
Multiannual Macroeconomic Framework	Macroeconomic, long-term risks, PPPs, debt, environmental, contingencies	MEF	Annual
Pre-electoral Report	Environmental, contingencies	MEF	Every 5 years
Budget Execution Report	Sub-national government	MEF	Monthly
Sub-national Fiscal Report	Sub-national government	MEF	Monthly
Financial Evaluation of Public Sector	Sub-national government	MEF	Quarterly
Debt Report	Debt, guarantees, PPPs	MEF	Annual
Asset and Liability Management Report	Liabilities, assets of the central government	MEF	Annual
Strategy for Asset and Liability Management	Liabilities, assets	MEF	Annual
Deposit Insurance Fund (FSD) Report	Deposit guarantee	FSD	Annual
Report on Financial Stability	Financial sector	BCRP	Semi-annual
Council of Legal Defense of the State Annual Report	Litigations	Ministry of Justice	Annual

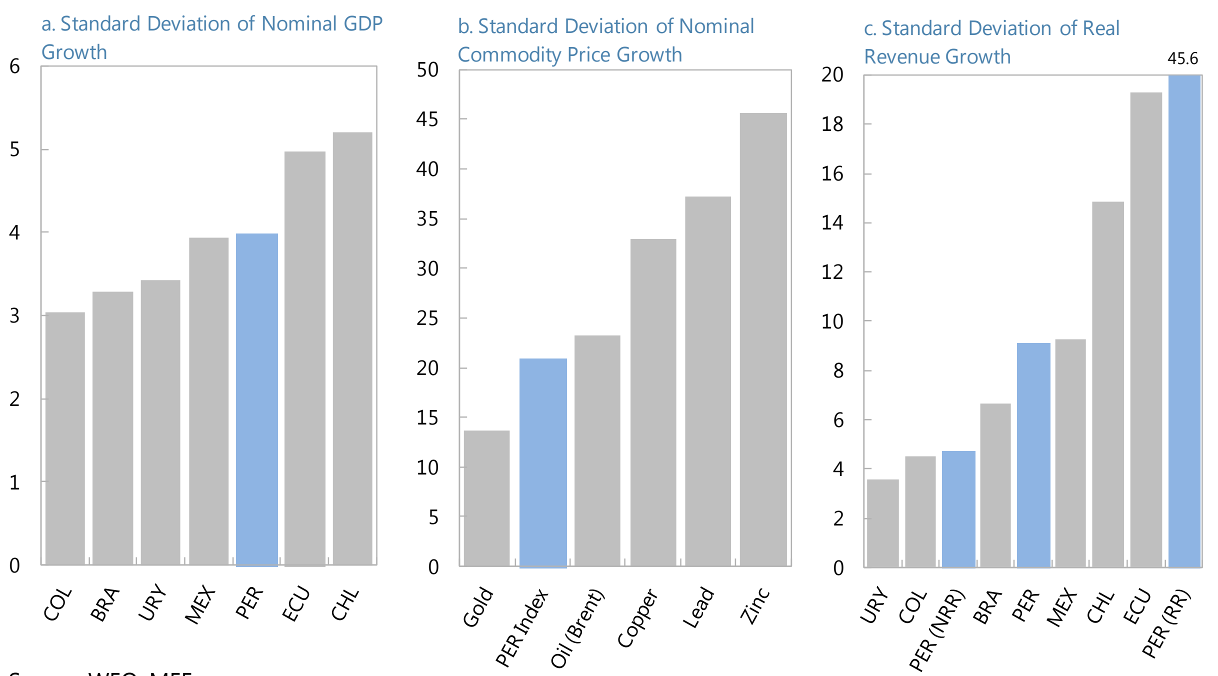
Source: Authorities, IMF Staff.

A. Disclosure and Analysis

3.1.1 Macroeconomic risks (Basic)

64. Peru is exposed to substantial macroeconomic volatility, which in turn poses sizeable budget risks. Over the last decade, Peru's nominal GDP growth volatility was higher than in most of neighboring countries and commodity prices, which affect about 10 percent of general government revenue, also exhibited significant volatility (Figure 3.1). These elements have contributed to the high volatility of real revenue growth experienced over the past decade.[15]

Figure 3.1. Peru: Indicators of Macro-Fiscal Risk, 2003-2013



Source: WEO, MEF.

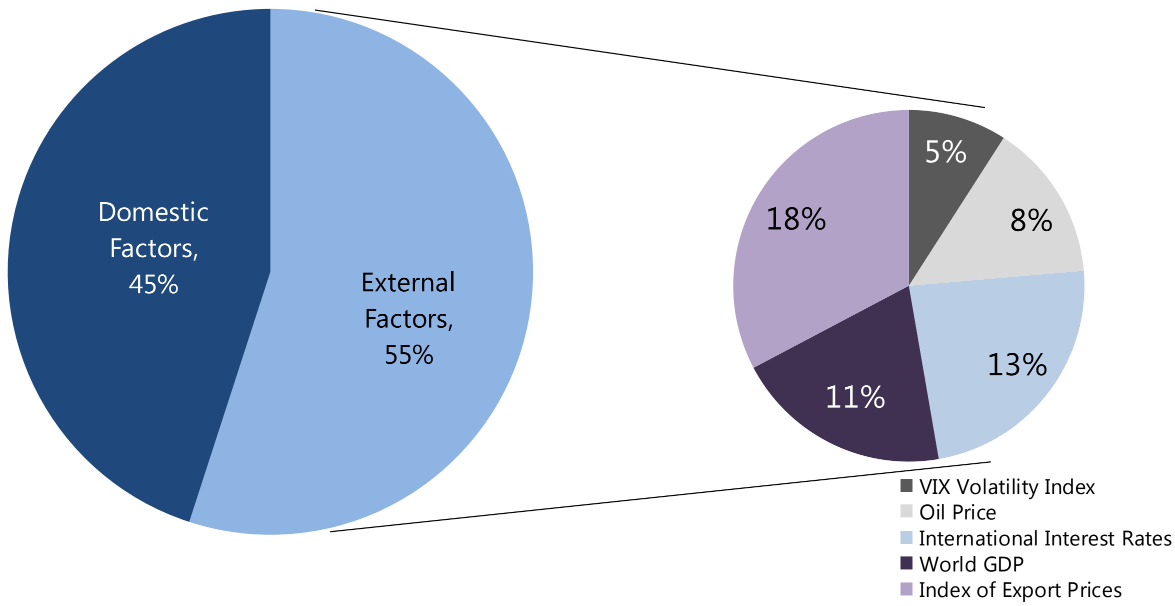
Note: NRR: non-resource revenue; RR: resource revenue; PER Index: price index of Peru's main mineral exports as defined by MEF.

65. The annual MMM presents sensitivity analysis of fiscal forecasts to macroeconomic assumptions and very limited discussion on alternative macroeconomic and fiscal scenarios. For example, the 2015-2017 MMM examines the factors contributing to the volatility of growth over the last 20 years, showing that the majority (55 percent) can be explained by external factors, in particular export prices and oil prices (Figure 3.2). Using this analysis, the report identifies three alternative macroeconomic scenarios based on an assessment of the greatest risks facing the Peruvian economy related to both external and domestic factors (i.e., developments in China and

[15] During the 2004-2013 decade, on average, the standard deviation of real resource revenue growth was 45.6 percent compared to a standard deviation for non-resource revenue growth of only 4.7 percent. The volatility of resource revenue is a concern for local governments which derive around 40 percent of total revenue from natural resources.

the US and a domestic shock of El Niño). The MMM then considers the impact on the main macroeconomic indicators of each scenario over a three-year horizon, however, it only presents the fiscal implications at an aggregate level focusing on the fiscal balance, expenditure, and public debt and does not examine the channels through which each scenario affects public finances.[16]

Figure 3.2. Peru: Determinants of GDP Volatility

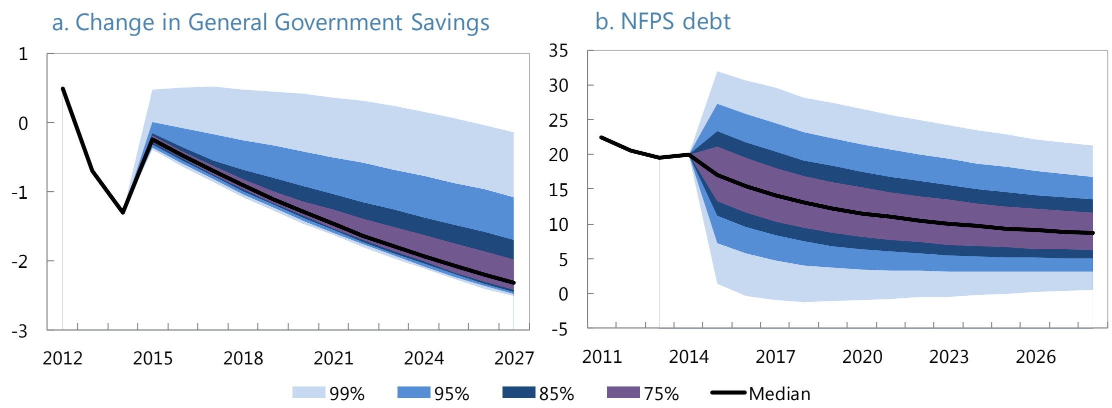


Source: MMM (2014).

66. The MMM analysis could be expanded to include a more detailed presentation of the fiscal outcomes associated with macroeconomic stress scenarios and stochastic analysis. The MMM could discuss the channels through which the macroeconomic scenarios are expected to impact the main spending and revenue items of the budget. Further, the analysis could be disaggregated by level of government, given that about 40 percent of NFPS spending is undertaken by local and regional governments and the risk associated with resource revenue streams is concentrated in relatively few sub-national governments. Given the recent adoption of a structural fiscal target, the analysis could also include random shocks to fiscal outcomes based on their historical distribution. Figure 3.3 provides an example of a possible stochastic macro-risk sensitivity analysis. The charts present the path for savings and public debt under possible stochastic scenarios using the current structural deficit target of 1 percent of GDP. The analysis suggests that under this deficit target, there is a 15 percent probability that the debt-to-GDP ratio is higher than its starting level (21 percent of GDP) within the next 3 years, and there is no likely scenario under which savings (in percent of GDP) would rise.

[16] An exception was the 2012-2014 MMM that included fiscal tables presenting the Central Government revenue and NFPS impact under an alternative stress scenario.

Figure 3.3. Peru: Probability Distribution of Fiscal Outcomes
(Percent of GDP)



Source: IMF staff estimates.

3.1.2 Specific fiscal risks (Not met)

67. **The government is exposed to a wide variety of fiscal risks arising from sources that are not always easily incorporated into macroeconomic analysis or even quantifiable.** Some of these fiscal risks are current and others refer to longer-term possible events (Table 3.2). Current specific fiscal risks include contingent liabilities from legal proceedings against the state (as of end-2013, there were 109,860 ongoing domestic legal proceedings against the State),[17] PPPs, and guarantees. They also include less easily quantifiable risks arising from natural disasters and exposure to the financial sector. Longer-term risks include aging and health related costs. While not strictly speaking a contingent liability, the costs of providing pensions and healthcare to an aging population can pose pressures to public finances over the medium to long term.

68. **Although information on some specific risks is available, no summary report discusses on a regular basis the range of specific fiscal risks to which the government is exposed.** Specific fiscal risks are separately reported in various documents. The annual MMM regularly reports information on firm commitments and contingent liabilities from PPPs for the upcoming three years, and the annual debt report presents some information on financial guarantees and PPP exposure. On a more ad hoc basis, the pre-electoral Report (2011) and the 2012-2014 MMM compiled some information on PPPs, litigation, and select guarantees. However, these reports use different definitions and evaluation methods and results are rarely comparable. Although risk analyses are not public, most of these risks are followed and assessed internally on a regular basis.

69. **In light of the wide range of specific fiscal risks the country is exposed to, regular summary reporting on risks facing the government is critical for fiscal analysis.** The implementation of the 2013 FRTL is likely to improve reporting and management of fiscal risks.

[17] See Ministry of Justice, Council of Legal Defense of the State Annual Report, 2013.

According to the law, the government should produce a report on explicit contingent liabilities in 2015. Over time, the authorities also plan to incorporate an analysis of some specific fiscal risks in the MMM.[18]

Table 3.2. Peru: Selected Fiscal Risks 1/

	S/. Million	US$ million	Percent of GDP (2014)	Year	Notes
Total	183,584		31.9		
Legal	51,135		8.9		
National Courts	30,547		5.3	2013	2, 3
International Courts	16,336		2.8	2012	3, 4
International Investor Dispute Arbitration	4,252	1,500	0.7	2015	4, 5, 6
Guarantees	20,957		3.6		
Loan Guarantees (Avales)	15,881	5,603	2.8	2013, 2014	4, 7, 8, 9
ONP Bonds	5,075	1,791	0.9	2013	10, 11
Public Private Partnerships	15,467		2.7	2014	
Financial	3,507	1,237	0.6	2014	10, 12, 20
Non-Financial	11,960	4,219	2.1	2014	10, 12, 21
Deposit Guarantee	68,522	24,175	11.9	2014	13
Other	27,503		4.8		
Natural Disasters	3,705		0.6	2015	12, 14
Debt of SOEs and SNGs (excl. explicit guarantees)	15,546		2.7	2014	4, 7, 15
Contingent Obligations to International Organizations	8,251		1.4	2013	4, 12
Memorandum Items:					
Longer-Term Fiscal Risks	382,540		66.5		
Pensions	193,234		33.6	2007, 2013	10, 16, 17, 18
Health	189,307		32.9	2014-2050	3, 19

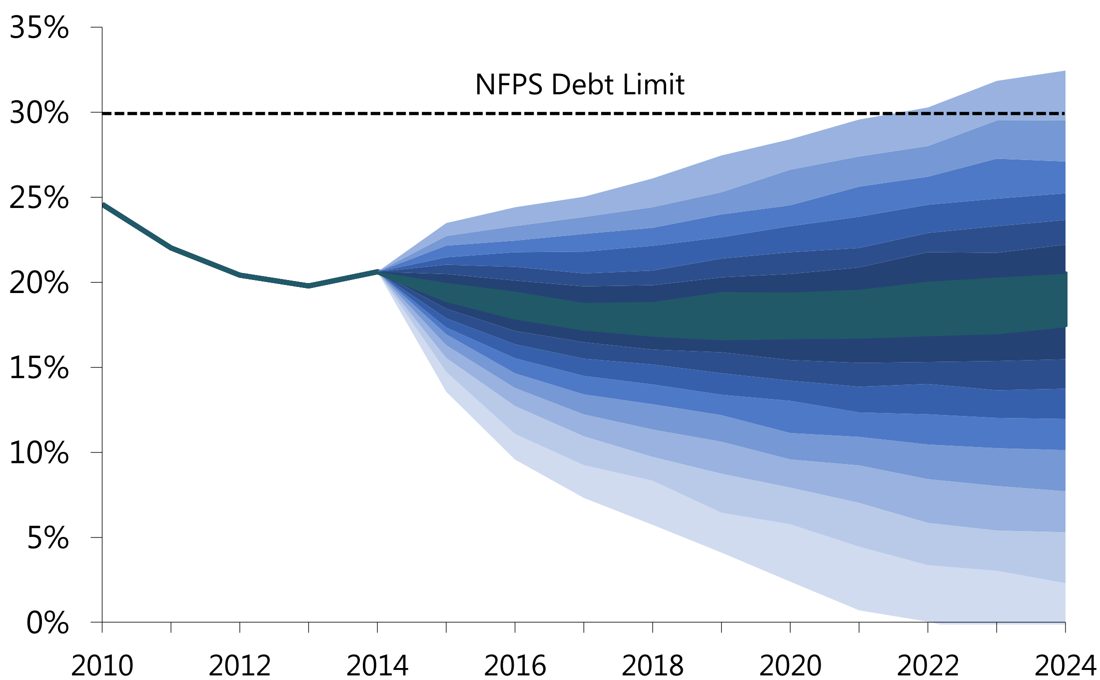
Sources: IMF staff estimates, IMF Fiscal Monitor (2014), MEF.
1/ Since no international standard exists for risk methodologies, risks are reported at face value (except where explicitly noted) although they have different probabilities of materializing. This approach tends to overestimate the value of each single risk and produce unlikely payout scenarios. 2/ Recognized after initial court ruling, Ministry of Justice, Council of Legal defense of the State Report, 2013. 3/ IMF staff estimates. 4/ Original currency in part US$. 5/ Staff estimates using information gathered from discussion with the authorities. 6/ Nominal value of outstanding cases. 7/ MEF, Debt of Regional and Local Governments, Table 5. 8/ PetroPeru maximum amount permitted under Law 30130. 9/ Includes *convenios de traspasos de recursos*. For details, see Section 3.2.3 and Table 3.5. 10/ Original currency US$. 11/ MEF annual Debt Report. 12/ BCRP, MEF, and other sources. 13/ Total value of deposits implicitly covered; Fondo de Seguro de Depósitos. 14/ In the event of an earthquake, it corresponds to the maximum probable loss on state assets for a 1000-year return period (seismic event with a 0.1 percent probability of occurrence). 15/ Debt of Public Enterprises. 16/ PV calculation associated with Law 28991, Supreme Decree 011-74-TR. 17/ Actuarial calculation by ONP. 18/ Data from CGR 2013 as calculated by CPMP. 19/ Estimate of NPV of healthcare spending change from IMF Fiscal Monitor (Fall 2014). 20/ Total financial guarantee. 21/ Total non-financial guarantee.

[18] In June 2015, the authorities published the first report on explicit contingent liabilities of the NFPS.

3.1.3 Long-term fiscal sustainability (Not met)

70. **Information on the long-term sustainability of fiscal policy is limited to the analysis of public debt trends.** The MMM presents a 10-year debt sustainability analysis along with the underlying macroeconomic assumptions, but no long term forecasts of other fiscal aggregates are published. The discussion on public debt includes a stochastic sustainability analysis using a vector autoregressive (VAR) model to assess the probability that the fiscal debt rule will be met at the end of the forecast horizon. However, the analysis does not consider fiscal risks such as those stemming from natural disasters, litigation losses, or realization of other contingent liabilities. According to their latest analysis, the authorities conclude that there is a 94 percent probability of not breaching the debt rule (Figure 3.4).

Figure 3.4. Peru: Long-term Fiscal Sustainability Analysis
(Percent of GDP)

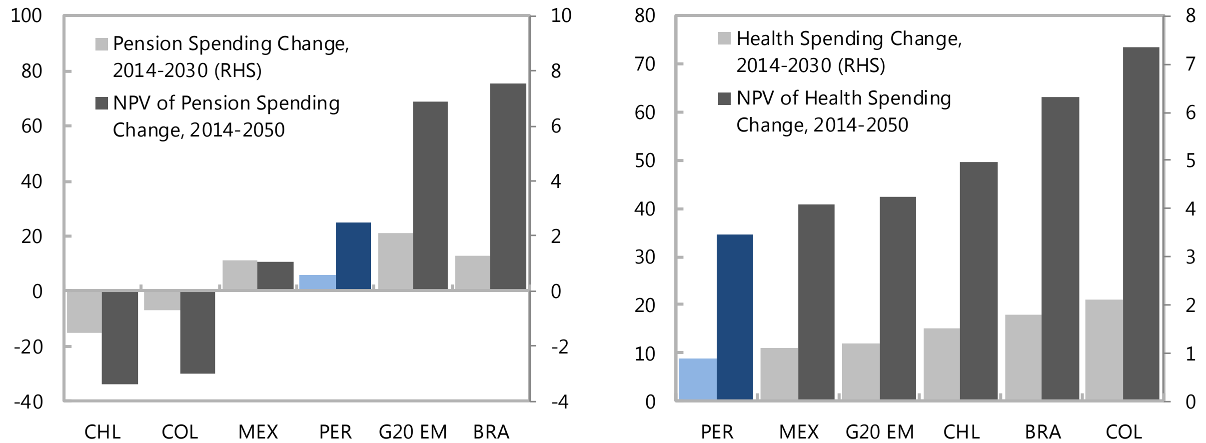


Source: MEF.

71. **The long-term sustainability analysis does not include pension and health spending projections although these expenses can be expected to rise over time and to pose new risks.** The Office of Pension Administration (ONP) and the MEF publish projections of public pension liabilities annually. There is a recognized imbalance in the system given the low contribution density (number of contribution months/number of potentially active months), the relatively low contribution rate (about 13 percent of labor income), and the high ratio between the contribution and benefit (benefits are received for 40 years on average, but employees only pay contributions for 25 years). Staff estimates that pension spending could increase by around 25 percent of GDP in NPV terms by 2050 (Figure 3.5), a larger increase than for some of Peru's peers. Health spending

estimates are not available in Peru, but staff calculations show that health spending costs could increase by almost 35 percent of GDP in NPV terms by 2050 (Figure 3.5). Moreover, despite Peru's currently low debt levels, with part of the budget relying on revenue from exhaustible resources, it is important to assess risks to Peru's public finances over the long term.

Figure 3.5. Peru: Long-Term Sustainability of Pension and Health Spending for Selected Countries
(Percent of GDP)



Source: IMF Fiscal Monitor (Fall 2014), IMF staff calculations for Peru pension projections.
Notes: For NPV calculations, a discount rate of 1 percent a year is used in excess of GDP growth.

B. Risk Management

3.2.1 Budget contingencies (Advanced)

72. The annual budget includes a contingency reserve and its in-year use is regularly reported. The contingency reserve consists of three elements: (i) a mandatory provision for unforeseeable events, such as natural disasters (1 percent of ordinary revenues); and two non-mandatory provisions for (ii) payroll policy and (iii) policy decisions under consideration but not finalized at the time of budget submission. The average overall reserve over the last five year was about 3½ percent of initial total budget spending. The contingency reserve can only be accessed through a Supreme Decree, which transfers the required amount to the appropriate budget line. Its use is fully disclosed, operation by operation, in the quarterly financial evaluation of budget execution. Over the past four years, the contingency reserve has not been fully exhausted during budget execution.

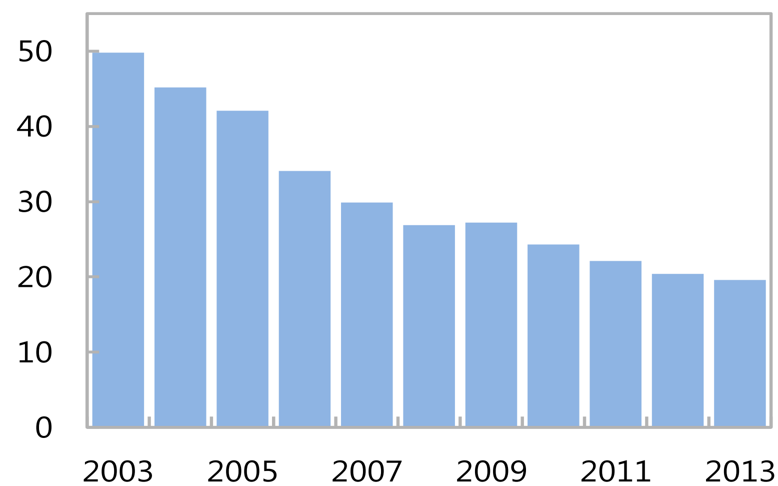
3.2.2 Asset and liability management (Good)

73. The government produces an estimate of the public sector balance sheet, which includes most conventional assets and liabilities. In 2013, liabilities were about 81 percent of GDP and financial and nonfinancial assets around 94.5 percent of GDP (Section 1.1.2). Over the last decade, financial liabilities have decreased, driven by a significant decline in public debt from about

47 of GDP in 2002 to around 20 percent of GDP in 2013 (Figure 3.6), contributing to an improvement in the net financial worth of the public sector.

74. Government borrowing is authorized by Congress that sets annual ceilings, and the MEF periodically reports cost and risk management indicators related to public debt. The public debt law states that all public sector borrowing has to be authorized by congress, and the annual debt law establishes limits on the new debt that public sector entities can subscribe during the year, including guarantees. The 2013 FRTL also sets debt rules for both the whole NFPS and SNGs. In addition, a legislative decree sets a limit on the stock of commitments related to PPPs (see section 3.2.4). Annual and quarterly public debt reports provide information on the NFPS debt structure and annual operations, as well as indicators of liquidity, interest rate, and exchange rate risk exposure. An accounting issue arises about the definition of public debt adopted in Peru though. According to the debt law, debt excludes Treasury bills and commitments related to PPPs, but includes guarantees.[19] Adjusting for these items would possibly bring total public debt above 20 of GDP once liabilities related to PPPs not reported in financial statements are accounted for (Table 3.3 and Chapter 1).

Figure 3.6. Peru: NFPS Gross Debt, 2003-2013
(Percent of GDP)



Source: MEF Annual Debt Report (2013), BCRP, WEO, IMF staff estimates.

75. The risks surrounding the central government's financial assets and liabilities are disclosed and analyzed in the assets and liabilities management reports and strategy. Quarterly asset and liability management reports (and annual debt reports) provide information on the asset and liability structure and the operations of the central government, as well as present and discuss indicators of liquidity, interest rate, exchange rate, and concentration risks. The Strategy for

[19] According to GFSM 2001, if the PPP asset is regarded as a government asset, the impact on the fiscal deficit and debt are similar to the case of a publicly financed investment project.

Global Asset and Liability Management, updated annually, defines the objectives and the implementation strategy in managing financial assets and liabilities. The objectives include maximizing assets return (with particular emphasis on financial reserves), expanding the role of Treasury bonds, and developing the domestic financial market. The implementation strategy includes the management of market and balance-sheet risks. In addition, it discusses liquidity risk management; the counter-cyclical position to confront interest rate risks; and the diversification of exchange rates risks. Finally, the strategy also analyses the relationship between assets and liabilities and, in particular, the net exposure to currency risks.

Table 3.3. Peru: Definitions of NFPS Gross Debt, 2013

	S/. Million	Percent of GDP
a. Gross Public Debt Reported in MEF Annual Debt Report	**98,761**	**18.1**
External Debt for public sector	52,503	9.6
Domestic Debt for central government	46,258	8.5
Treasury Bonds	35,866	6.6
ONP Bonds (guarantees)	6,305	1.2
Loans from Banco de la Nacion and others	4,087	0.7
b. Gross Public Debt Reported in Central Bank Fiscal Statistics	**107,044**	**19.6**
Adjustments to public debt reported by MEF		
National government payables and Treasury bills	9,335	1.7
External debt for the financial sector (coverage discrepancy)	(1,052)	-0.2
c. Proposed corrections to Fiscal Statistics	**(294)**	**-0.1**
Reintegration of external debt for the public sector	1,052	0.2
Exclusions of ONP Bonds (guarantees)	(6,305)	-1.2
Financial liabilities related to PPPs reported in financial statements 1/	4,959	0.9
Financial liabilities related to PPPs not reported in financial statements 2/	n.d.	n.d.
d. Total public sector excluding Central Bank (b+c)	**106,750**	**19.5**

Source: MEF, BCRP, staff estimates.

1/ Liabilities registered in the balance sheet refer to CRPAO (see Chapter 1).

2/ Liabilities not registered in the balance sheet refer to loans associated to PPPs for which an asset has acquired, but no loan has be recorded beyond CRPAO. According to international accounting and statistical standards (IPSAS32, GFSM2014), when the government becomes the economic owner of an asset under a PPP, a loan should be recorded to cover the acquisition of that asset. The authorities provide no estimate of such liabilities despite the large number of past PPP contracts and current PPP commitments of about 19 percent of GDP (see Section 3.2.4).

76. There is no strategy to manage most of the non-financial assets recorded in the balance sheet as well as assets not owned by the central government. Most of the non-financial assets are not included in the government's assets and liabilities management strategy, which for instance does not cover land holdings, buildings, infrastructure assets, as well as financial assets and liabilities of social security and insurance funds, and SNGs (Table 3.4).

Table 3.4. Peru: Main Assets and Liabilities Not Covered by the Asset and Liability Management Strategy, 2013

	S/. Million	Percent of GDP
Assets	389,583	71.2
Sub-soil assets	138,022	25.2
Land and buildings	228,634	41.8
Equity investments (social security, and sub-national governments)	7,291	1.3
Other financial assets (social security, and sub-national governments)	15,636	2.9
Liabilities	4,959	0.9
Financial liabilities related to PPPs 1/	4,959	0.9

Source: CGR, FONAFE, IMF staff estimates.
1/ Includes only PPP liabilities reported in the financial statements.

3.2.3 Guarantees (Basic)

77. Various reports present information on guarantees; however, they use different definitions and do not provide a unified view of the government's overall gross exposure. The annual debt report provides the gross value of loan guarantees and ONP bonds guaranteeing minimum pensions classified as debt (amounting to about one percent of GDP in 2013). The report also provides information on exposure to PPPs. However, until 2014, the report disclosed the combined net present value of firm commitments (*compromisos firmes*) and contingent liabilities (the latter adjusted for the realization of risks) net of expected revenue.[20] The MMM also reports PPP exposure, but provides information on nominal commitments and contingent liabilities (assessed at gross value) for only three years ahead. Information on loan guarantees (not included in the definition of debt) is not systematically provided, and the latest information was presented in the 2012-2014 MMM. Finally, there is no information on guarantees issued by SNGs and SOEs (although, they do not appear to have issued any guarantees) and on possible implicit guarantees such as, for example, the deposit insurance scheme.

78. The government's gross exposure to guarantees is potentially large, but not particularly high by international norms. A preliminary assessment suggests that the overall exposure to guarantees in 2014 amounted to about 18 percent of GDP.[21] This exposure includes guarantees for loans and minimum pensions, gross value exposure for financial and non-financial

[20] In May 2015, the authorities issued the 2014 annual debt report providing for the first time separate information on firm commitments and contingent liabilities from PPPs; the report does not present an overall picture of government's guarantees though.

[21] In absence of generally accepted methodologies to ascertain the probability of a given risk factor, the approach followed in FTEs is to disclose the potential impact of guarantees at face value, even if the probability of the event may be extremely low as, for example, in the case of potential calls on deposit guarantee schemes. Admittedly, this approach tends to overestimate total exposures.

contingent liabilities related to PPPs, and possible implicit exposures (Table 3.5).[22] The overall gross exposure of the government to guarantees appears in line with what was assessed in FTEs undertaken in other countries (Figure 3.7).

Table 3.5. Peru: Government Guarantees, 2014

	US$ Million	Percent of GDP
Total Explicit and Implicit Guarantees	36,979	18.2
a. Explicit Guarantees	12,851	6.3
Loan Guarantee (Avales) 1/	5,603	2.8
ONP Bonds	1,791	0.9
Non Financial Guarantees to PPPs	4,219	2.1
Financial Guarantees to PPPs 2/	1,237	0.6
b. Implicit Guarantees	24,129	11.9
Bank Deposits Guarantee Scheme	24,129	11.9

Source: MEF, IMF staff estimates.

1/ Includes guarantees to PetroPeru (US$1 billion) and to the Municipality of Lima, as well as *convenios de traspasos de recursos*. These latter are registered in the balance sheet of the NFPS, but carry counterparty risks for the central government as debt is expected to be served by the beneficiary entity.

2/ Includes 0.4 percent of GDP in guarantees expected in 2015.

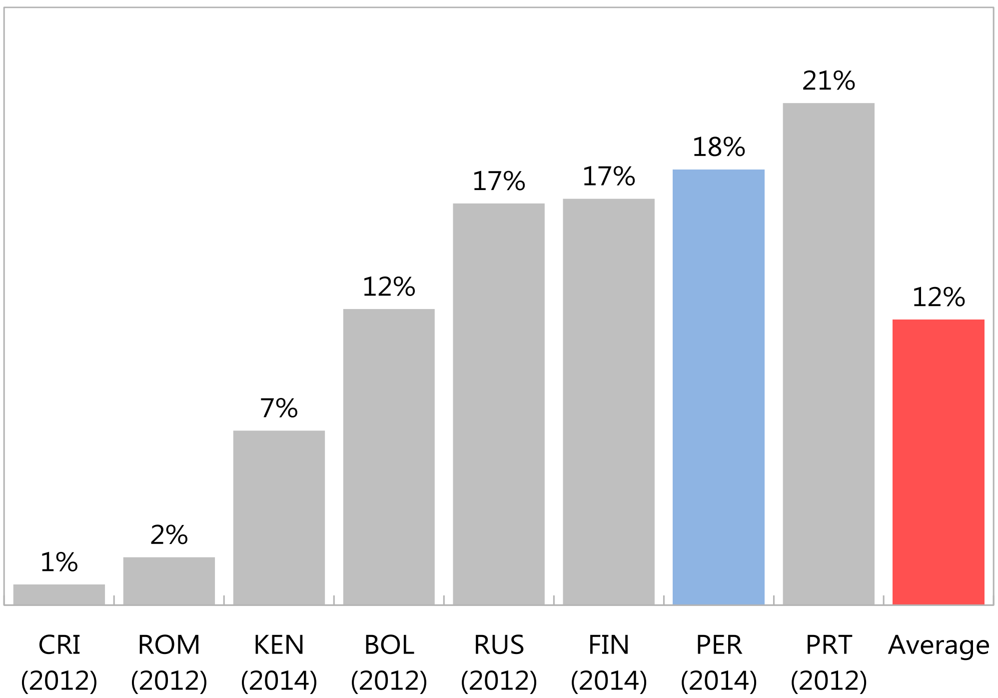
79. There are legal limits on granting different types of guarantees although they are not always binding. The annual debt law sets a limit on new loan guarantees (*avales*) and financial guarantees to PPPs as part of the annual debt issuance limit and the granting of guarantees by any public entity has to be authorized by the MEF within this limit. However, *ad hoc* laws can authorize loan guarantees above this annual limit in the course of the year, as was recently the case with the guarantee granted to Petroperu (about ½ percent of GDP). In addition, the PPP law sets a limit on the NPV stock of firm commitments and contingent liabilities related to PPPs of 12 percent of GDP.[23] However, this limit applies to exposures net of expected revenue and with contingent liabilities adjusted for realization risks. Non-financial guarantees related to PPPs (e.g., for minimum revenue) are not subject to any explicit limit.

[22] According to the PPP legislation, financial guarantees for PPPs provide guarantee for loans and bonds issued in the context of PPP projects; non-financial guarantees are issued to the private sector to reduce the risk profile of the project (e.g. for minimum revenue guarantees).

[23] The ceiling of 12 percent of GDP can be reviewed every three years by the government with the obligation to inform Parliament of any change.

80. The authorities have initiated reforms to improve the assessment and reporting of guarantees. The FRTL mandates a report on explicit contingent liabilities, and the MEF has been working to improve assessment methodologies for contingent liabilities.[24] Given the size of the overall potential exposure and plans for large infrastructure projects which may call for new PPPs, it will be important for the authorities to provide a unified vision of the total exposure to guarantees with binding limits and address the classification, assessment, and reporting issues discussed above.

Figure 3.7. Peru: Government Guarantees in Selected Countries
(Percent of GDP)



Source: FTE (various), IMF staff estimates.

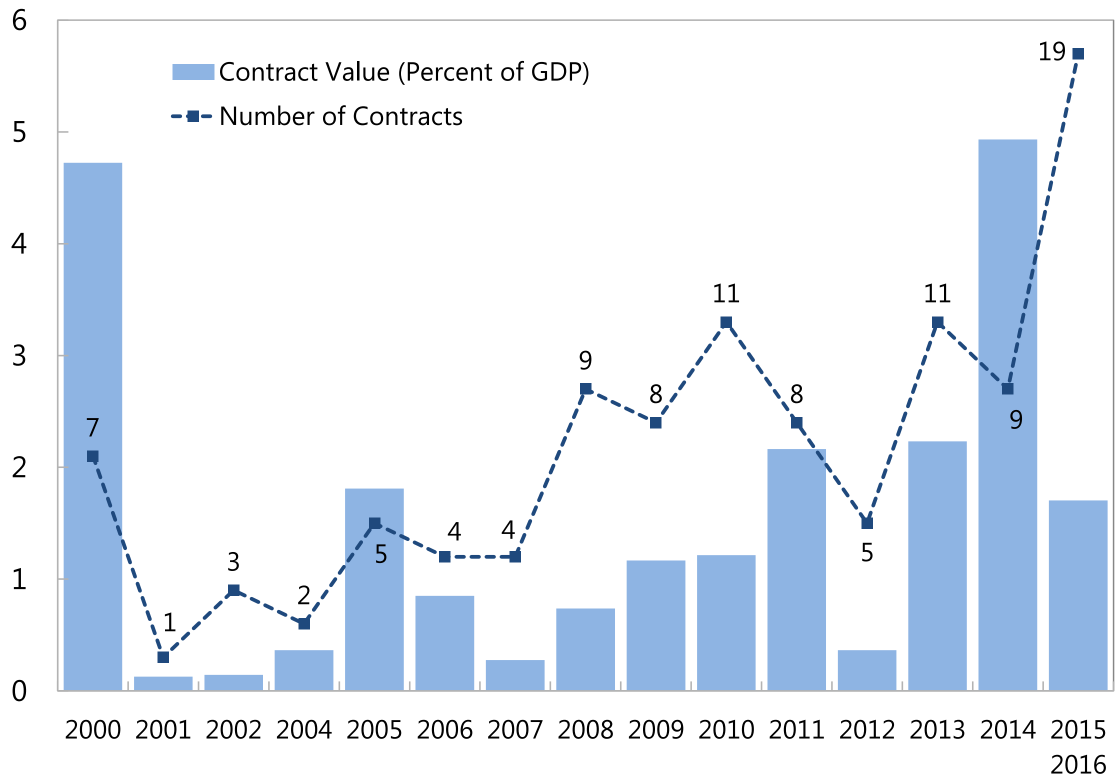
Notes: Russia data include the bank deposits guarantee scheme; Portugal's guarantees are reported for central government only.

3.2.4 Public-private partnerships (Basic)

81. PPPs are a significant source of fiscal risks in Peru. Since 2000, there have been 106 PPP contracts awarded with cumulative investments of about 15 percent of GDP (US$28 billion). PPP investment will increase further in the coming years as 20 projects started in 2013-2014 and additional 19 projects are scheduled to be awarded in 2015 and 2016 with a total investment of about 6½ percent of GDP (Figure 3.8).

[24] In June 2015, the MEF published the first report on explicit contingent liabilities of the NFPS.

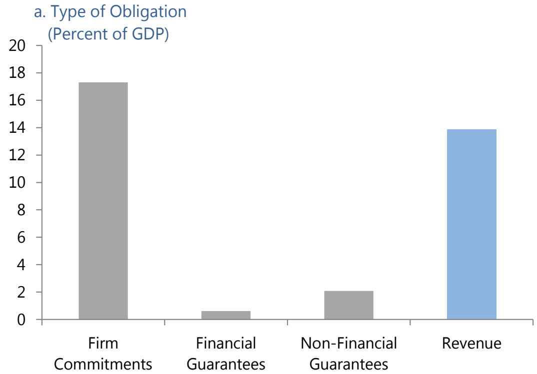
Figure 3.8. Peru: Value of PPPs Contracts, 2000-2016



Source: Proinversion, IMF staff estimates.
Note: When contract value of projects scheduled for 2015 and 2016 was not available, it was estimated using the average value of contracts for previous years.

82. The government's reported commitments likely underestimate the underlying risks arising from PPPs. The government estimates the NPV of public commitments related to PPPs at about 4 percent of GDP. This amount underestimates the underlying risks from PPPs because it assigns a probability of activation risk of contingent claims that does not consider all possible risks (e.g., risks related to land acquisition) and is calculated net of expected revenue, which in turn may suffer from a significant optimistic bias. In 2014, the overall nominal gross value of the government's firm and contingent commitments was around 20 percent of GDP, highlighting the possibility that significant fiscal pressures may arise in the future from PPPs (Figure 3.9).

Figure 3.9. Peru: Nominal Value of Rights and Obligations of the Government under PPPs, 2014



b. Type of Contract 1/

	Percent of GDP	US$ (Millions)
Commitments	19.4	39,329
Firm Commitments	16.7	33,872
Co-Financed Contracts 2/	11.1	22,522
Self-Sustainable Contracts	5.6	11,350
Financial Guarantees 3/	0.6	1,237
Non-Financial Guarantees	2.1	4,219
Revenue	13.9	28,153

Source: MEF, IMF staff calculations.
1/ The Peruvian legislation distinguishes between self-sustainable and co-financed PPP contracts. Contracts are self-sustainable if they have no government financial guarantee and the probability of activation of any non-financial guarantee is less than 10 percent. PPP contracts are co-financed if they involve a financial guarantee or non-financial guarantees with a probability of activation above 10 percent.
2/ Following the authorities' accounting treatment, co-financed PPP contracts exclude items classified as financial guarantees (0.6 percent of GDP).
3/ Includes 0.4 percent of GDP in guarantees expected in 2015.

83. **In an attempt to accelerate local public investment, the government has recently developed a new private-public participation scheme, which carries new fiscal risks.** Under the new scheme, called *Obras por Impuestos,* a private company has ten years to fund and undertake a regional or local public investment project, and can deduct the corresponding costs from its income tax, payable to the national government.[25] Regional and local governments are then expected to reimburse the national government for the amounts deducted from income taxes against their own revenue. This scheme exposes the national government to a revenue risk if the sub-national government is not able to pay back (e.g., because of high resource revenue volatility). Moreover, the government does not report on the gross exposure for reimbursements due by SNGs that as of end-2014 involved more than 150 contracts with an estimated value of about 0.3 percent of GDP.

84. **While there is a legal limit on the total amount of PPP commitments, no information is available on the financial performance of PPP contracts and government's receipts.** A legal ceiling of 12 percent of GDP is set on the present value of the stock of firm and contingent commitments related to PPPs, net of contractual revenues. However, detailed financial information on single projects is scarce and fragmented, making it difficult to have a complete picture of the risk exposure arising from PPPs. Looking ahead, the large and increasing exposure to PPP risks suggests the need to further improve the risk assessment and information available both for public and policy-decision making purposes.

[25] The right to deduct the investment amount from the future income tax due is formalized in a certificate referred as *Certificado de Inversión Pública Regional y Local (*CIPRL).

3.2.5 Financial sector exposure (Good)

85. The general government has limited direct exposure to the financial sector through five financial institutions as well as a number of municipal cajas. State-controlled financial institutions accounted for about 13 percent of total banking assets as of September 2014 (less than 0.1 percent of GDP) and about 10 percent of the sector loans.[26]

86. The deposit guarantee fund (FSD) is financed by contributions from the financial sector but is implicitly guaranteed by the government. The fund provides insurance for individual deposits up to S/. 94,182 in eligible banks. As of December 2014, the FSD was estimated to cover more than 20.8 million accounts with a potential insurance liability of about 12 percent of GDP. At the end of December 2014, the FSD balance stood at 0.4 percent of GDP, less than 5 percent of insured deposits and below an international benchmark of about 20-40 percent.[27] While the government does not guarantee the fund, the FSD can borrow from the government as needed, giving rise to a potential liability for the government.

87. There has been no government support to the financial sector since 2001 and current financial sector risks appear contained by large buffers. The closure of three banks between November 2000 and April 2001 resulted in the FSD borrowing from the Treasury to meet its obligations. More recently, the failure of a minor municipality credit entity required no government support. As of December 2014, non-performing loans in the financial system stood at 4 percent (including restructured and refinanced loans) with municipal and rural cajas' NPLs being much higher, reflecting the risk associated with their microcredit lending (Table 3.6). However, the financial system has large buffers to contain vulnerabilities, with a capital adequacy ratio of about 14 percent, and a liquidity ratio of about 23.5 percent of local currency. Dollarization of financial assets, while down sharply from levels witnessed in the early 2000s remains a key structural risk for the sector.

[26] The main state-controlled financial institution is Banco de la Nación, accounting for around 8 percent of total banking assets. The authorities do not consider Banco de Comercio a public financial institution, even though it is run by the Military Pension Fund, which according to GFSM makes it an entity to be classified as part of the General Government.

[27] Set at the First Annual Conference of the International Association of Deposit Insurers (IADI) in Basel, Switzerland, May 2002.

Table 3.6. Recent Indicators of Financial Stability in the Banking Sector in Latin America

Country	Time	Capital		Asset Quality	Liquidity			Profitability
		Tier 1 Capital Ratio	Capital Adequacy Ratio	Gross NPL Ratio	Customer Deposits to Total Loans	Liquid Assets Ratio	Liquid Assets to Short-Term Liabilities	Return on Assets
Peru	2014 Q4	10.6	14.2	4.0	89.6	23.5	39.4	1.9
Brazil	2014 Q3	13.1	16.5	2.9	118.6	12.6	192.8	1.3
Chile	2014 Sep	9.9	…	2.1	…	12.8	…	1.6
Colombia	2014 Dec	11.7	…	2.9	91.6	8.1	12.9	2.9
Ecuador	2011 Dec	16.1	…	3.2	127.0	22.1	36.4	2.0
Mexico	2013 Dec	13.4	15.8	3.2	88.6	36.0	47.7	2.1
Uruguay	2013	14.2	15.6	1.3	161.8	41.9	57.8	1.6

Source: IMF FSI Database.

88. The authorities regularly assess financial sector stability, although government risk exposure is only indirectly assessed by the BCRP. The BCRP's semiannual Financial Stability Report (FSR) includes a thorough assessment of recent developments in the financial sector — including Banco de la Nación and municipal cajas, and of risks to financial stability, although with limited reporting of fiscal liabilities and risks. The report presents aggregate results of annual bank stress tests, including macro stress scenarios based on those presented in the MMM and BCRP's Inflation Report, and separately reports aggregate results for the municipal cajas. However, the government does not disclose any analysis of its total fiscal exposure to the financial sector and the risks around this exposure.

3.2.6 Natural resources (Basic)

89. Mineral and petroleum production is an important source of government revenue, but also creates significant fiscal risks. The volatility of resource revenue affects short- and medium-term fiscal projections. Reliance on exhaustible natural resources raises longer-term sustainability risks as well. As mineral and hydrocarbon reserves are depleted, Peru will eventually need to find alternative sources of revenue, in particular for local governments, which have a high dependence on natural resource revenue (Sections 3.3.1 and 4.4.2), or reduce the level of public expenditure.

90. Information on the volume of resource assets is periodically published, but no information is available on the value of Peru's subsoil assets and long-term resource revenue. Physical volume reserve estimates are published annually, but there is no official estimate of the fiscal value of these reserves. Looking at flows, PeruPetro and MINEM regularly report on the historical volume and value of commodity production and fiscal resource revenues are part of fiscal reports, but there is no comprehensive public information on medium to long-term projections of commodity production and resource revenue.

91. Staff calculations tentatively estimate the net present value of government revenues from subsoil assets in 2013 at around 25 percent of GDP (S./ 138 billion). This estimate relies on available data on total proven and probable reserves of Peruvian oil, gas, and mineral commodities.[28] Given the limited data available on current projects and planned developments, the estimation is based on assumptions regarding the development of proven and probable reserves, future production profiles, extraction costs and constant real prices, using historical trends on overall government take in each commodity group (Box 3.1).

Box 3.1. Peru: Sub-Soil Assets and Revenue Resource Valuation: Methodology and Assumptions

Government's subsoil assets are estimated as the net present value (NPV) of future fiscal revenues arising from the extraction of mineral and petroleum reserves. For illustrative purposes, the estimate relies on an aggregate approach that uses existing data on mineral and hydrocarbon reserves, and a set of assumptions regarding production rates and costs, together with an assumption of constant real prices for each commodity. These data and assumptions are used to project the future cash flows from extracting existing reserves. The stream of future government resource revenue is then obtained by calculating the share of revenue flows going to the government under the current fiscal regime discounted to obtain the NPV of the government's share of subsoil assets.

The estimation of future fiscal resource revenue requires a number of assumptions on key variables:

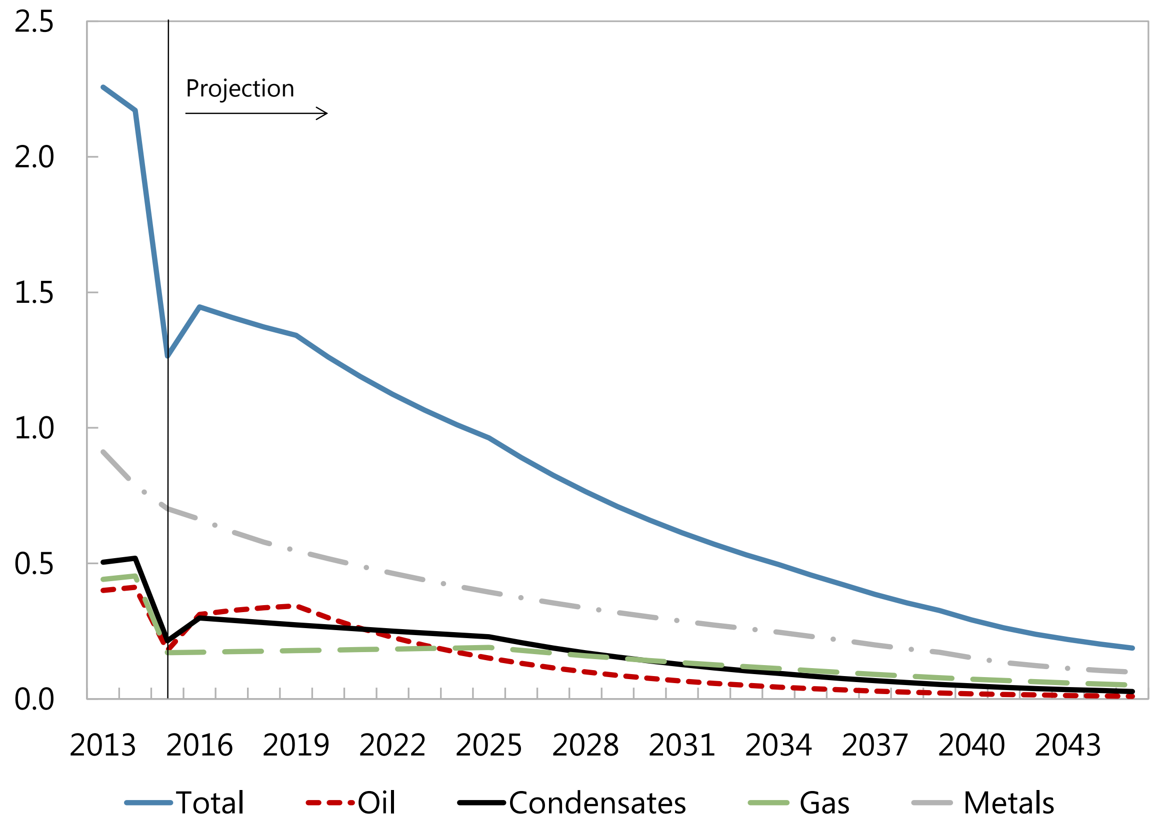
- **Asset recognition:** The estimate covers proven (developed and undeveloped) and probable reserves for minerals (copper, gold, zinc, silver, lead, iron ore, tin and molybdenum) and petroleum (oil, gas and condensates) sectors. Reserve estimates rely on published data by MINEM and PeruPetro. For each of these reserve categories, assumptions were made about the proportion that would be extracted over time (e.g., 100 percent for proven reserves, 80 percent for probable reserves, and 50 percent for possible reserves of oil and gas).
- **Production:** Production rates were estimated based on historical production levels, an assumed period of exhaustion for the production of current reserves (either 30 years or until exhaustion of current reserves). Production costs and sale prices for each commodity were set at a long-term level averaging recent trends, and assuming constant real prices over time.
- **Fiscal regime:** Fiscal regimes were approximated by estimating an average effective tax rate reflecting contract fiscal terms and historical statistics for each commodity group.
- **Discount Rate:** Nominal revenues were discounted at a 6.5 percent rate to obtain the NPV of the government share of subsoil assets. The discounting rate reflects the assumed long term nominal GDP growth rate for Peru.

This valuation reflects a simple methodology to estimate government's sub-soil assets and revenue flows; in practice, an exhaustive commercial valuation of mineral and petroleum assets should be undertaken. Such valuation should ideally be undertaken at a mine or field level for large operations; government's future revenue should be estimated by contract and project and not based on aggregate historical trends; each input variable should be verified to the extent possible and be subject of wide consultation and consensus within the government (see IMF Guide on Resource Revenue Transparency, 2007).

[28] Commodities include copper, gold, zinc, lead, iron, tin, and molybdenum and data sources are the Annual Mining Report (2013), *Libro Annual de Reservas de Hidrocarburos* (2013) and Perupetro,

92. Illustrative thirty-year projections suggest that fiscal revenues from natural resources will fall steadily as a share of GDP. Under the baseline scenario of constant real prices, resource revenues are projected to fall from 2.2 percent of GDP in recent years to around 0.2 percent of GDP over the next 30 years (Figure 3.10). This decline is mainly driven by a decline in production, particularly of petroleum products. While such estimates are inherently uncertain, this analysis provides a clear trend and is particularly important for the long-term sustainability of public finances given other trends in age-related spending (see section 3.1.3) and the large infrastructure gap, which are likely to create further pressures on public finances.

Figure 3.10. Peru: Natural Resource Revenue under Alternative Long-Term Scenarios
(Percent of GDP)

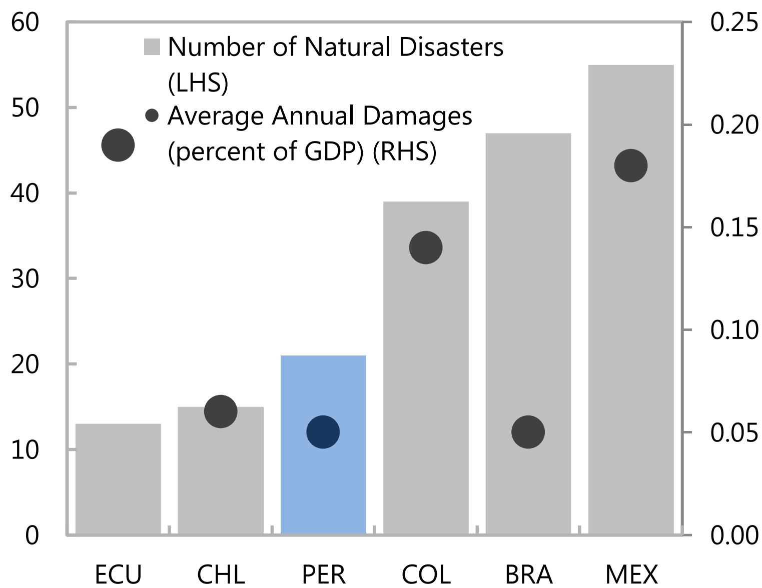


Source: IMF staff estimates.
Revenue includes corporate income tax, royalties, mining tax lien, and special mining tax.

3.2.7 Environmental risks (Basic)

93. Peru is prone to various types of natural disasters. Between 1993 and 2012, Peru was hit by 21 natural disasters (International Disaster Database, EM-DAT), including both climate related phenomena (droughts, floods, mudslides, etc.) and geophysical events (earthquakes, volcanic eruptions, etc.) at an annual estimated direct fiscal cost of 0.05 percent of GDP (Figure 3.11).[29] Peru is particularly vulnerable to severe episodes of El Niño that in 1982-1983 and 1997-1998 are estimated to have caused about 11½ and 6 percent of GDP worth of damages, respectively. It is also exposed to seismic activity with a value of infrastructure exposed to seismic disasters of about US$450 billion.[30] Peru also faces risks arising from climate change. An analysis by the Andean Community (CAN) estimates that GDP in 2025 will be 4.3 percentage points lower due to the effect of climate change, while a BCRP analysis estimates that climate change could generate a loss of 6 percentage points of potential GDP.[31]

Figure 3.11. Peru: Fiscal Costs of Natural Disasters in Select Countries, 2003-2012



Source: EM-DAT, World Development Report (2014).

94. The government reports and discusses its fiscal exposure to severe El Niño episodes although it does not examine the exposure to other natural disasters or environmental risks. The 2015-2017 MMM considered the macroeconomic and fiscal consequences arising from a severe El Niño episode, suggesting that the debt and deficit would increase slightly compared to the baseline.

[29] World Bank. 2014. World Development Report.

[30] Informe Preelectoral Administración 2006-2011; IADB. Peru: Program to Reduce the Vulnerability of the State to Disasters III, Loan Proposal. June 2014.

[31] Informe Preelectoral Administración 2006-2011; CAN 2008, El Cambio Climatico no Tiene Fronteras: Impacto del Cambio Climatico en la Comunidad Andina; Vargas, P. 2009, El Cambio Climatico y Sus Efectos en el Peru, BCRP Working Paper No. 2009-14.

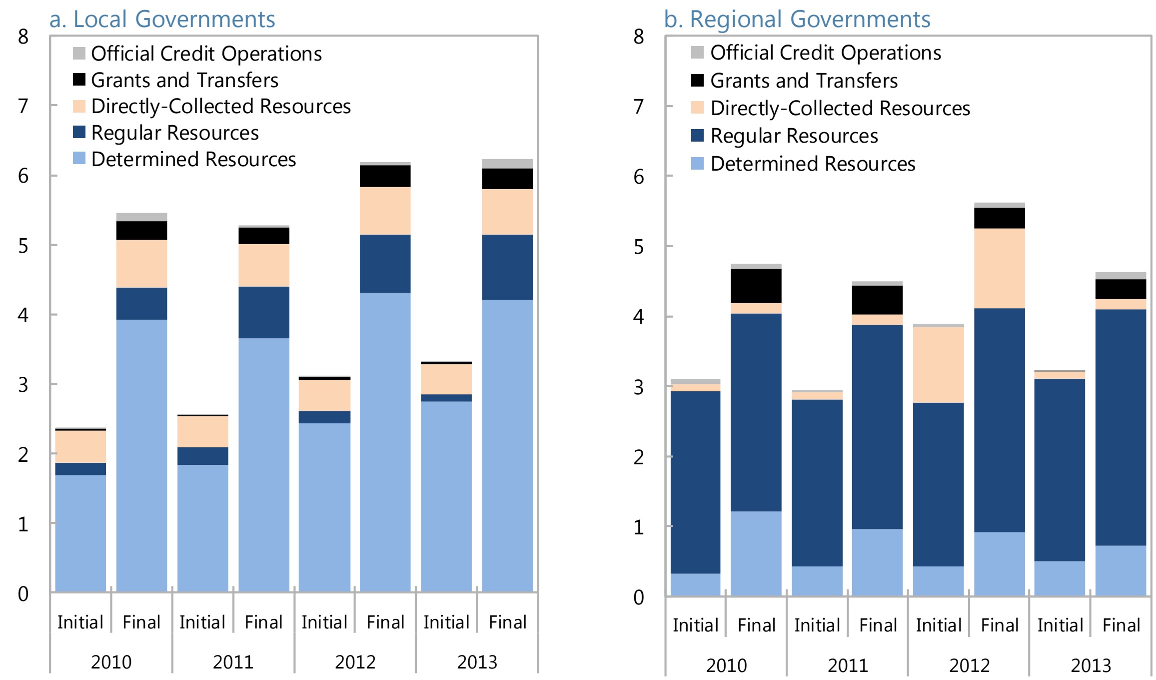
95. However, the authorities have recently taken steps to mitigate some of the operational and fiscal risks arising from natural disasters. The National System of Disaster Risk Management (SINAGERD) was established in 2011 and a disaster risk management national policy was recently approved. A recent 2015 ministerial resolution requires government entities to evaluate risks and analyze their impact as well as to develop and implement business continuity plans, and efforts are underway within the MEF to quantify the potential cost associated with rare events. In addition, the annual budget includes a mandatory contingency reserve for unforeseen events such as natural disasters and an additional budget contingency can be activated for regional disasters exceeding regional government capabilities. Moreover, the Fiscal Stabilization Fund (FEF) can be drawn on in the event of a national emergency. Finally, more recently, the government has contracted long-term contingency credit lines with the Inter-American Development Bank (IADB), the Development Bank of Latin America (CAF), the Japan International Cooperation Agency (JICA), and the World Bank to be activated in the event of a natural disaster. Going forward, a more comprehensive risk assessment, and disclosure of the results, possibly on the basis of Peru's historical experience, is warranted.

C. Fiscal Coordination

3.3.1 Sub-national governments (Advanced)

96. Sub-national governments (SNG) in Peru are large and pose important fiscal risks. In 2013, SNGs accounted for more than 40 percent of general government primary spending. While their debt is low (about 2 percent of GDP in 2013), they face substantial revenue risks due to their high dependence on volatile revenues earmarked from natural resources. SNGs also pose important budget risks. They carry over significant cash balances (see Chapter 2) which they incorporate into their budget through large supplementary budgets that averaged about 100 (50) percent of local (regional) governments' initial budget allocations during the recent years, leading to significant different between the initial budget and final spending outturns (Figure 3.12). This means that their initial budget does not provide a credible forecast of their intended expenditure over the fiscal year.

Figure 3.12. Peru: Sub-National Governments Initial Budget and Outturns, 2010-2013
(In millions of nuevos soles)



Source: MEF.

97. Extensive information on sub-national government finances is available across several documents. While the MMM has little information on SNGs' medium term projections,[32] primary spending and investment execution are reported monthly, and more detailed fiscal performance is reported quarterly and annually. Regional and municipal debt stocks are also published on a monthly basis, while the outturns of municipal enterprises are reported annually.[33] Assessments of whether regions or local governments have complied with their fiscal rules have been, however, only irregularly disclosed.

98. Sub-national governments are subject to both debt and spending rules although they do not have a strong compliance record. Since 2014, SNGs must adhere to new fiscal rules limiting debt and expenditure growth; moreover, any new medium and long-term borrowing requires central government authorization.[34] In reality, compliance with the myriad of past fiscal rules has been spotty. For example, in 2010, only 15 percent of regional governments and 3 percent of local government complied with all fiscal rules. Increasing the likelihood of adhering to the new

[32] General government fiscal operations are not disaggregated by level of government, although beginning in 2015, spending limits to comply with under the 2013 FRTL are reported.

[33] Municipal enterprises' results are published in the *Evaluación Global de la Gestion Presupuestaria*.

[34] Previously, SNGs were subject to a myriad of fiscal rules aimed at limiting debt, debt service, expenditure growth, and the deficit.

fiscal rules will require control on the use of supplementary budgets, timely verification of budget execution, and enforcement of corrective measures.

3.3.2 Public corporations (Basic)

99. As in other countries, also in Peru the liabilities of public corporations are a typical source of fiscal risks for the government. As of December 2013, the liabilities of public corporations amounted to about 12 percent of GDP. Most of these liabilities are accounted for by just a few companies. The financial situation of the public corporations appeared, however, to be strong with positive net profits both at the consolidated level and individually for the largest corporations (Figure 3.13).

100. The budget provides information on transfers to public corporations, while information on other direct and indirect support to corporations is not publicly available. Budget information covers transfers to both national and local public companies that, over the last four years, averaged about 0.5 percent of GDP (mostly to SEDAPAL and Eletroperu to finance social projects, and to municipal and regional firms). Transfers also occur from public corporations to the government (Figure 3.14). For instance, PeruPetro, Banco de la Nación, and AgroBanco transfer profits to the MEF, and ElectroPeru's profits are earmarked to the FCR, a fund managed by ONP. Transfers also occur among public corporations but they are not publicly reported. For example, the central government's holding company, FONAFE, systematically transfers profits from companies in surplus to companies in deficits as equity contributions and provide loans to finance companies in need of liquidity.[35] As a result, the overall picture of direct and indirect transfers to public corporations as well as the amounts received by each single entity is not publicly available.

101. There is no estimate of quasi-fiscal activities undertaken by public corporations. While occasionally mentioned in companies' and fiscal reports, public corporations' quasi-fiscal activities are not systematically identified nor evaluated. Examples of public policy activities carried by the public corporations include social projects undertaken by local public corporations in the housing sector and collection of revenue (e.g., PeruPetro collects natural resources royalties on behalf of the government).

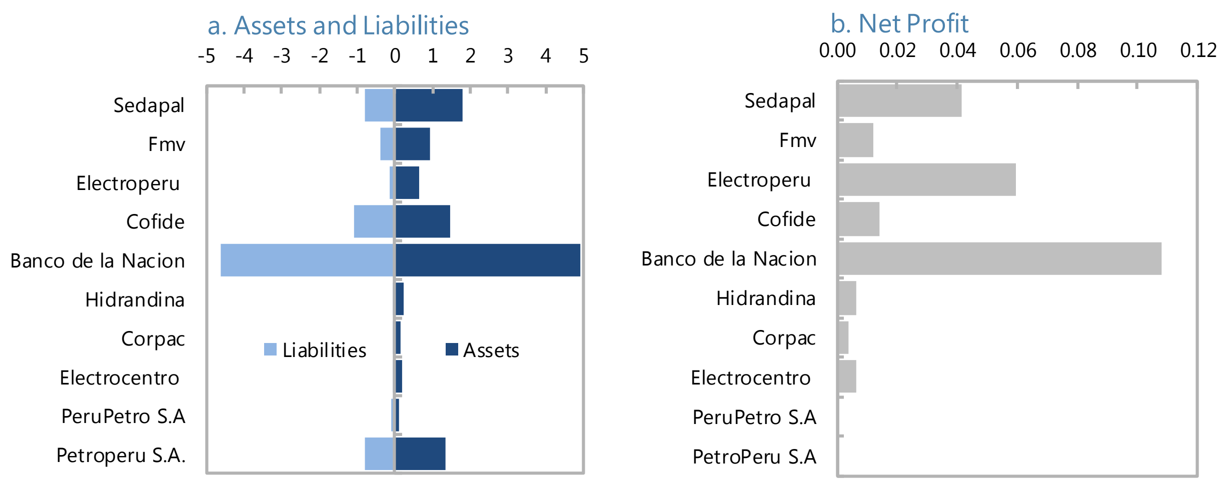
102. The financial performance of single public corporations is monitored and publicly reported, but there is no detailed analysis of the sector as a whole. FONAFE's management reports detail the missions, operations, and financial situation of the 34 public corporations under its umbrella. PetroPeru publishes its own management reports and financial statements.[36] Budget execution of regional and municipal public corporations is reported in the budget execution report

[35] FONAFE acts as a public holding company for most of government's firms, with the exception of a few corporations under the supervision of MEF (i.e., PetroPeru) and line ministries. The amount of annual transfers from FONAFE appears limited and estimated at about S/. 0.5 billion (about 0.1 percent of GDP).

[36] The most recent financial statements by PetroPeru available on online date 2012.

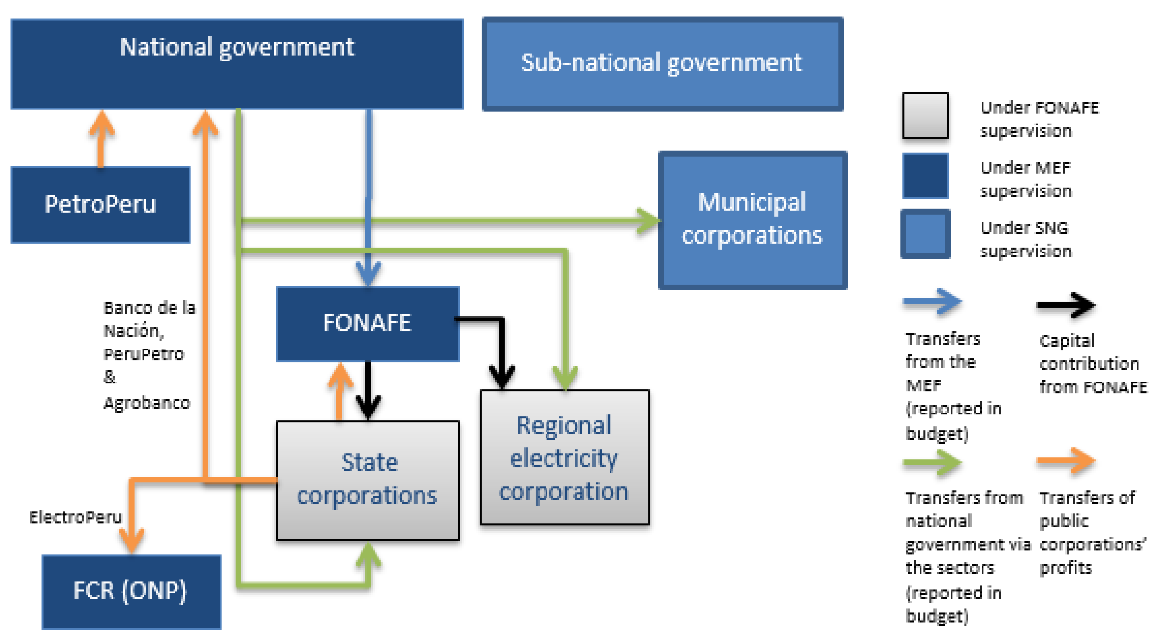
of the MEF and by the CGR. An analysis of the overall performance of the state's public corporations is only provided in the MMM, but at a very aggregate level (i.e., total profit/loss).

Figure 3.13. Peru: Balance Sheet and Net Profits of the Largest Public Corporations, 2013 (Percent of GDP)



Source: FONAFE (2013), and PetroPeru (2012).

Figure 3.14. Peru: Overview of Public Corporations and Government Main Direct Transfers



Source: IMF Staff, Peruvian authorities.

D. Conclusions and Recommendations

103. While public debt is low and financial reserves large, Peru faces significant and diverse fiscal risks. GDP growth and government revenue are relatively volatile, making medium-term fiscal forecasting challenging. Risks from volatile resource revenues are particularly concentrated in some sub-national governments. The public pension system presents structural imbalances and health spending is expected to increase significantly over the next decades. Legal proceedings, PPP exposures and guarantees appear large and the country is exposed to significant risks from natural disasters.

104. The assessment suggests that fiscal risk analysis and management practices in Peru generally meet basic practices, with better standards only achieved in a few areas (Table 3.7). Peru rates high on budget contingencies and reporting on SNGs' finances. The country also has a clear asset and liability management strategy and significant buffers in the financial sector. However, fiscal risks analysis appears to be mostly in its infancy in other areas covered by the IMF's Fiscal Transparency Code with most of the practices meeting basic requirements or presenting important gaps, particularly in reporting and managing specific fiscal risks and performing long-term fiscal sustainability analysis.

105. The analysis and management of fiscal risks remains diffuse across different institutions and there is scope for improvement in a number of important areas. The government produces credible, although conservative, fiscal forecasts, but it does not present much analysis of the fiscal impact of alternative macroeconomic scenarios, the uncertainty surrounding the forecasts of resource revenue, and the evolution of public finances over the long term. Moreover, although information is available on many specific fiscal risks, the government does not yet produce a comprehensive report that summarizes the various risks and the possible correlation between the risks. This makes it difficult to assess the relative importance of the various risks and their possible joint realizations. Finally, although good information is available on the finances of public corporations, there is no detailed report on the overall financial performance of the public corporation sector, the transfers between the sector and the government and within the sector, and any quasi-fiscal activities carried out by these companies.

106. To strengthen the government's fiscal risk management practices requires focusing on the following priorities:

Disclose risks surrounding fiscal forecasts and the evolution of public finances, in particular,

- Expand the analysis of the fiscal impact of macroeconomic shocks and provide information (e.g., with fan charts) on the uncertainty surrounding the forecast of the main fiscal aggregates (e.g., overall balance, debt, savings); elaborate and publish resource revenue forecasts under different price and extraction scenarios.

- Periodically analyze and report on long-term risks to Peru's public finances (e.g., health, pensions, long-term resource revenue) and publish official estimates of the fiscal value of natural resource reserves.

Disclose specific fiscal risks, by

- Preparing and publishing, at least annually, a fiscal risk statement covering the major specific fiscal risks. The statement should discuss and, where possible, quantify specific risks and management policies, covering risks associated for example with court litigations, loan guarantees, PPPs, environmental disasters, callable capital, financial sector exposure, and SNGs.

Strengthen the reporting of guarantees by, in particular,

- Taking stock of total guarantee exposure and publishing the list of government guarantees (including non-financial guarantees for PPPs and guarantees currently recorded as part of debt), their gross exposure, and probability of being called.

Improve reporting of fiscal risks arising from PPPs, by

- Consolidating and publishing detailed financial information on PPPs, including gross value of rights and commitments of the government under PPP contracts, and expected annual receipts and payments over the life of the contracts; and

- Making public the methodology for estimating expected revenues and for calculating the probability of activation of contingent claims from PPPs.

Reduce risks from SNGs by

- Minimizing the use of automatic adjustments to the initial budget, and enforcing corrective measures and sanctions for SNGs not in compliance with fiscal rules.

Table 3.7. Peru: Summary Assessment for Fiscal Risks Practices				
	Principle	**Assessment**	**Issue and Importance**	**Rec**
Risk Disclosure and Analysis				
3.1.1	**Macroeconomic Risks**	**Basic:** Limited fiscal analysis and discussion relating to macroeconomic scenarios is presented.	**Medium:** Volatility of resources revenue makes the budget subject to a high uncertainty.	Yes
3.1.2	**Specific Fiscal Risks**	**Not met:** Information on some specific risks is published on ad hoc basis. There is no single report providing an overview.	**High:** Specific fiscal risks could amount to about 32 percent of GDP.	Yes
3.1.3	**Long-Term Fiscal Sustainability**	**Not met:** Only 10-year debt sustainability projections are published.	**Low**: Pension spending could increase by 25 percent of GDP in NPV terms by 2050	
Risk Management				
3.2.1	**Budgetary Contingencies**	**Advanced**: A contingency reserve with access criteria is legally provided. Detailed use is reported quarterly.	**Low**: Annual reserve has not been exhausted over the past four years.	
3.2.2	**Asset and Liability Management**	**Good:** Public debt operations are subject to annual approval with a ceiling and there is a central government's asset and liability management strategy.	**High:** Assets and liabilities not included in the government management strategy amount to around 71 percent of GDP.	
3.2.3	**Guarantees**	**Basic:** New financial guarantees are subject to annual approval and limit.	**Medium:** The gross exposure of the government to explicit and implicit guarantees is 18 percent of GDP.	Yes
3.2.4	**Public-Private Partnerships**	**Basic:** The net value of obligations is reported. However, information is scattered, not reconcilable across reports, and gross exposures not published.	**High:** The gross value of commitments amount to about 20 percent of GDP. The PPP portfolio is increasing rapidly.	Yes
3.2.5	**Financial Sector Exposure**	**Good**: The authorities publish financial stability reports and conduct stress tests (not published). Deposit insurance scheme is implicitly guaranteed by the government.	**Medium**: Banking sector appears to be well capitalized but recently a municipal credit entity failed. Dollarization of financial assets is a key risk.	
3.2.6	**Natural Resources**	**Basic:** Estimates of volume of natural resource assets are published as well as the value and volume of historical commodity production.	**High:** Resource revenue accounts for about 13 percent of general government revenue (40 percent for local governments).	Yes
3.2.7	**Environmental Risks**	**Basic:** Fiscal reports analyze the effect of extreme episodes of El Nino, but not other natural disasters or environmental threats.	**Medium:** Fiscal costs of natural disasters averaged 0.05 percent of GDP annually in 1993–2012.	
Fiscal Coordination				
3.3.1	**Sub-national Governments**	**Advanced**: Fiscal reports are published monthly, quarterly and annually. Fiscal rules set for debt, expenditure growth, and borrowing.	**High:** SNGs are responsible for 40 percent of public spending and have a poor record of adhering to rules.	Yes
3.3.2	**Public Corporations**	**Basic:** Direct transfers from the budget are disclosed, but quasi-fiscal activities are not clearly identified or cost	**Low:** Budget transfers average about 0.5 percent of GDP.	

RESOURCE REVENUE MANAGEMENT

Peru has a clear and comprehensive legal and fiscal framework, follows open and competitive rights allocation processes, and performs effective reporting of resource revenue. However, limited coordination between sector ministries and fiscal policymakers, a relative fragmentation in the process of allocating resources, and the institutional practice of automatic supplementary budgets reduce the capacity of fiscal authorities to manage resource revenue effectively. Improving the management of resource revenues requires: integrating tax and sector audits, reducing discrepancies between budget plans and actual use of resource revenues, and enhancing fiscal risks analysis and reporting on their use.

107. The mineral and petroleum sectors play a major role in the Peruvian economy and in the financing of the public sector (Figure 4.1). Peru is among the major world producers of copper, zinc, and gold and has sizable reserves of oil and gas. In 2013, the mineral and petroleum sectors accounted for about 12 percent of total GDP and 68 percent of the country's exports. Investment in these sectors was also the main driver of the recent surge in the country's FDI. Revenues from natural resources are also critical for the government budget, accounting on average for about 13 percent of total government revenue over the last decade (and 40 percent of local governments' revenue), not far from the performance of some of the most resource-rich countries in the region.[37]

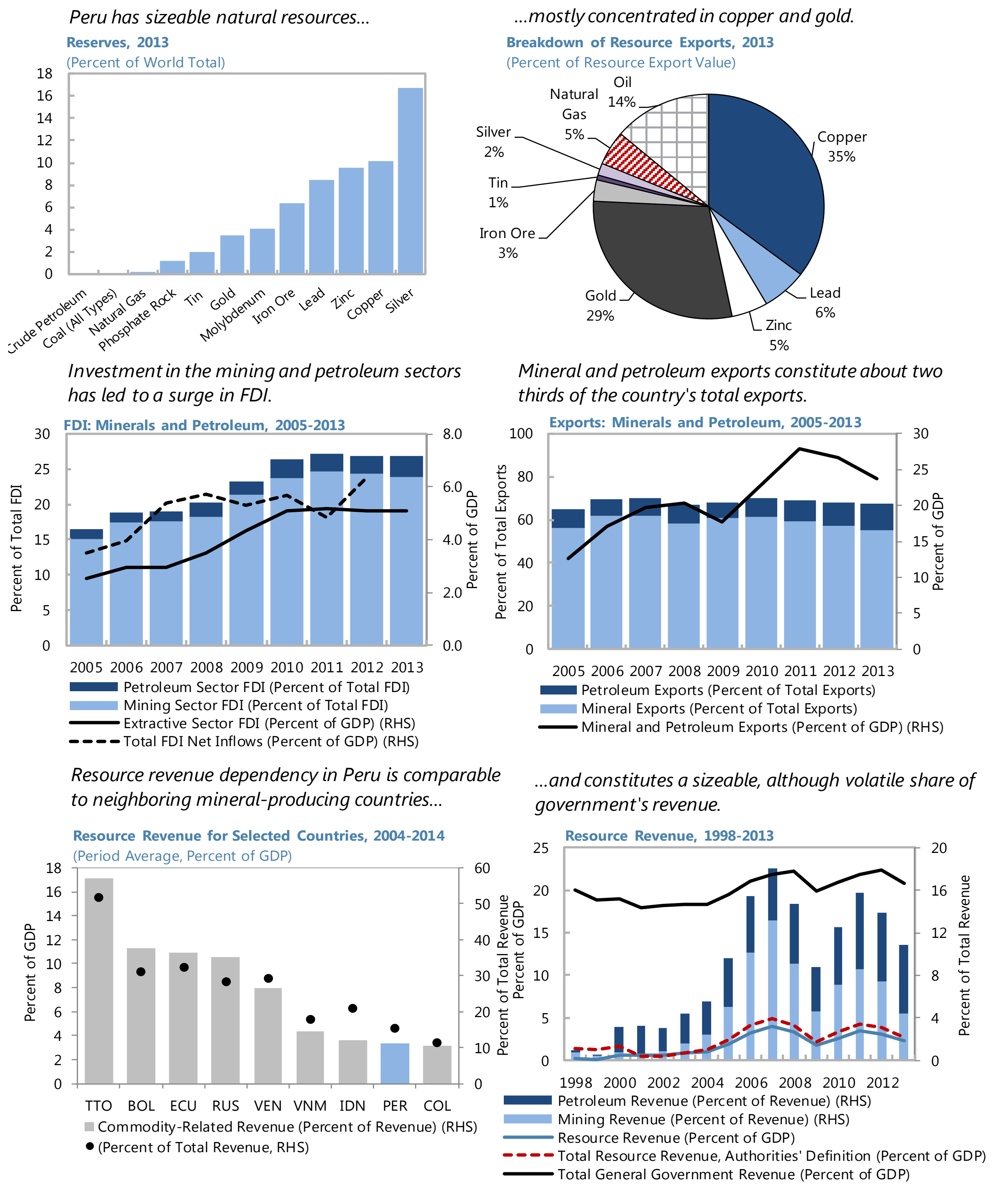
108. The economic importance of resource revenues in Peru raises important transparency considerations. Transparent rights allocation processes and clear legal and fiscal frameworks are important to both secure revenue benefits to the country and to maintain investor confidence. For the government, the assessment and collection of resource revenues pose specific challenges in terms of commodity valuation and volume measurement that hinge on the clarity and rigor of tax administration and audit procedures. Countries like Peru with significant earmarking of resource revenues to local communities require careful forecasting and budgeting procedures to deal with revenue volatility, along with accurate planning and reporting to ensure the efficient use of resources.

109. This chapter assesses fiscal transparency in managing resource revenue in Peru against the principles set in the new draft pillar of the IMF's FTC. According to the new pillar released for public consultation in December 2014, natural resource revenues should be collected, managed, and disbursed in an open, transparent, and sustainable manner. In assessing these requirements, this chapter looks at the entire resource revenue management process and focuses on the four dimensions identified under the Code:

- Openness and transparency of the legal and fiscal regimes;
- Comprehensiveness, timeliness and reliability of fiscal reporting;
- Fiscal forecasting and budgeting of government's resource revenues; and
- Analysis and management of sector-specific fiscal risks.

[37] In this report, resource revenues are narrowly defined to include taxes on profits (income tax, special mining tax and mining lien) and royalties (royalties on petroleum, gas, and minerals) payable by natural resource corporations.

Figure 4.1. Peru: Contributions of Mineral and Petroleum Sectors



Source: BCRP, EIA, IMF staff estimates, IENI, MINEM, ProInversion, SUNAT, USGS, WCA.

A. Legal and Fiscal Regime

"Natural resources should be governed by a comprehensive legal framework, with open and transparent procedures for granting exploration rights, and clear rules governing resource revenue generation and collection." (IMF's Fiscal Transparency Code, draft new pillar)

4.1.1 Legal framework for natural resources (Advanced)

110. Peru has a comprehensive legal framework that clearly defines rights, obligations and responsibilities for all stages of the development process of natural resources (Table 4.1). Under the Constitution, the state owns all natural resources. A legal framework of laws, regulations, licenses and license contracts (through which the terms of the license are agreed) determines the conditions for granting rights to the private sector and for the use of resources. The legal framework of the mining and the petroleum sectors differ in some respects.

- ***Mining sector.*** Peru has a licensing system for granting mining rights, without distinguishing between exploration and extraction phases.[38] Under this system, rights holders are entitled to extract and sell the resources in a given area, subject to the conditions set in the legal framework. Licenses are categorized into large, medium, small-scale and artisanal mining.

- ***Petroleum sector.*** The legal framework for the petroleum sector is also a licensing system, although with a sole concessionaire. The law grants exclusive rights to petroleum extracted to PeruPetro S.A., a state owned entity. In turn, PeruPetro enters into license contracts with private investors; these contracts set out the conditions for exploration and extraction and transfer the rights on extracted petroleum to the licensee. Although under a licensing system, these contracts are governed by private commercial law.

111. All relevant laws, regulations, licenses and license contracts are public and easily accessible. The Ministry of Energy and Mining (MINEM) publishes on its website all mining and petroleum sector legislation and regulations, and fiscal legislation is available on the MEF's website. The supervisory agency for the mining sector (OSINERGMIN) and PeruPetro also make available all applicable legislation regulations on their websites. Current mining licenses are published in the mining cadaster (GEOCAMIN) and petroleum license contracts are available on the website of PeruPetro.

112. The legal framework also guarantees a clear allocation of institutional responsibilities among government bodies. A question may arise with respect to the role of PeruPetro. This is a state-owned enterprise that performs promotional and administrative functions, including entering into resource contracts and collecting revenue on behalf of the government. However, the company neither takes participating interests nor receives production shares in the contracts, apart from four

[38] In the Peruvian legislation, the Spanish term *concesión* is used to describe the arrangement by which the holder is granted the right to explore and extract resources, rather than conceding rights to resources in the ground. In this respect, despite the name, the system is license based. These systems are at times known as modern concession.

legacy services contracts dating from PeruPetro´s creation. Hence, the typical conflicts of interest inherent where state-owned enterprises participate in the resource sector do not appear to arise with respect to PeruPetro.

Table 4.1. Peru: Legal Framework for the Resource Industry

	Constitution	Laws	Regulations	License/Contracts
Foundations of Resource Rights Allocation				
Ownership over Resource Rights	√			
Authorization to Grant Rights		√		
Process for Rights Allocation		√	√	
Qualification Requirements for Rights Allocation		√ (Mining)	√ (Petroleum)	
Terms and Conditions of Resource Development				
Coverage of Stages (i.e., Exploration, Development, etc.)		√ (Mining)	√ (Petroleum)	√
Investor Obligations (e.g., Technical, Environmental, Social, Reporting, etc.) :		√	√	√
Assurances to Investors		√		√
Dispute Resolution		√		√

Source: Peru legal framework and Staff elaboration.

4.1.2 Allocation of resource rights (Advanced)

113. **Peru has broadly open and competitive processes for granting natural resource rights with the specific rules and procedures varying across sectors.** The variation of rules and procedures in allocating rights across sectors is common practice to account for the different features of each sector.

- ***Mining.*** In the mining sector, mineral rights are granted according to the "first come, first served" method, with provisions for an auction in case of simultaneous claims.

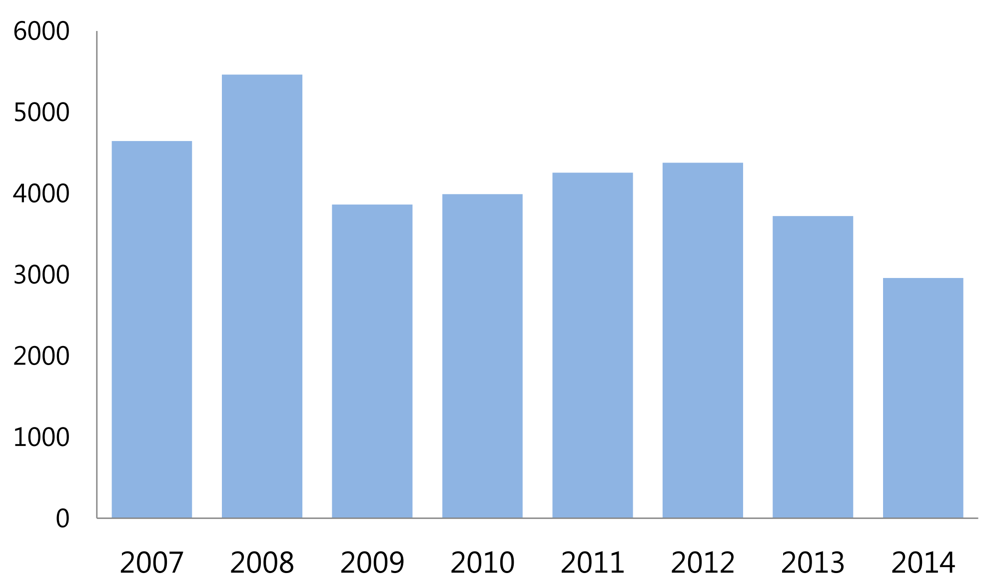
- ***Petroleum.*** Under the system regulating the petroleum sector, license contracts can be concluded either after a bidding process or by direct negotiations. In 2007, however, PeruPetro decided to grant rights only through competitive bidding rounds.

The choice of these allocation methods seems in general appropriate to guarantee open and competitive allocation processes given the characteristics of each sector. Competitive bidding systems work best where there are potential rents to be realized and geological information is plentiful and available. In this case, risks to bidders are lower and multiple bidders can be attracted. Therefore, open tenders, with bidding for initial exploration rights are quite common in the petroleum industry, but less so in the mining industry, where first come first served methods appear to fit better in line with international practices. However, Peru has a very mature mining sector and there appears to be scope for abandoned mines capable of redevelopment to be reserved and open to bidding.

114. Rights allocation systems in both mining and petroleum sectors rely on pre-defined qualification criteria and require independent verification and disclosure of final awards. Although systems differ across the two sectors, they guarantee both openness and transparency of the allocation processes.

- ***Mining sector.*** Requirements for obtaining a mining license are determined by law and the application and granting process for the primary mining title are simple, clear and defined in the mining law. To obtain a mining license, the law requires that the area is free of restrictions and that the applicant is clearly identified, able to carry out the proposed activities, and pays application and license fees. The application process is managed by INGEMMET, the mining and geology institute. The terms and conditions, rights and obligations of licenses are not subject to any discretionary adjustments or negotiation. Applications are publicly disclosed and processed in the order as they are filed. The successful awards are disclosed to the public in the mining cadaster (GEOCATMIN), which is available on line.[39] Over the last few years, on average about 4,000 licenses a year were awarded (Figure 4.2), and at end-2013, there were 42,147 mining licenses outstanding and 8,701 applications in process.

Figure 4.2. Peru: Number of Mining Licenses Awarded, 2007-2014



Source: INGEMMET.

[39] License holders may enter into contracts of operation with third parties. These contracts should comply with specific conditions established by the Mining Law, including the obligation to register the contract in the official registry of public documents (Oficina de Registros Públicos).

- ***Petroleum sector.*** PeruPetro awards license contracts through clear tender processes and pre-qualification criteria. Pre-qualification criteria for operating companies are published in advance, together with bid procedures and the contractual terms and conditions up for public offer. The bidding parameters are simple and objective and the reception of bids is public. The results of the bidding process are public and contestable by interested parties. The opening of bids and the determination of awards are certified by a public notary and by the Auditor General Office at PeruPetro. Since 2007, PeruPetro has conducted 6 licensing rounds following these practices (Table 4.2).

Table 4.2. Peru: Results of Petroleum Licensing Rounds, 2007-2015

Bid Rounds	2007	2008	2010	2013	2014	2015
Bid Documentation Published	Results, minutes of award ceremony	Full, includes license contract	Full, includes license contract	Full up to suspension, includes license contract	Full, includes license contract	Full up to date, includes license contract
Number of Participants	18	19	7	…	1	…
Number of Blocks Awarded/Offered	13/19	17/22	14/25	--/9 (Suspended)	2/2	--/7 (Still open)

Source: PeruPetro.

4.1.3 Fiscal regime for natural resources (Advanced)

115. **The Peruvian legal framework clearly defines the fiscal regimes applying to natural resource sectors, including restrictions for modifying tax provisions through license contracts.** The mining and hydrocarbons laws, mineral royalty legislation and the general tax legislation define a system of corporate income tax (CIT) and royalty regime for both the mining and petroleum industries. In the mining sector, additional profit-related taxes were introduced in 2011 in the form of the Special Mining Tax and the Mining Lien. No additional tax provisions exist apart from those set in the laws. However, in the petroleum sector, PeruPetro issues license contracts that define royalty rates and their calculation methods (Table 4.3). As a result, royalty provisions have varied with bid rounds.[40]

116. **Fiscal stability assurances are granted under the mining, hydrocarbons and foreign investment laws, creating project-specific fiscal regimes in the sectors.** In the petroleum sector, tax stability is provided throughout the life of the contract. Under the mining law, tax stability is provided for 10 or 15 years depending on investment size and capacity. In both cases, stability

[40] Two exceptions exist to this general tax treatment. First, for the Camisea gas and condensates project, the law also sets domestic gas supply obligations. Second, a different tax treatment applies to four petroleum service contracts dating back to 1993 and 1996 and managed by PetroPeru. These are a historical legacy of an older tax petroleum regime and as such they are not considered in this report, which focuses on the current tax system. In 2014, revenue from these contracts amounted to about 5 percent of hydrocarbon revenue. Sales under these service contracts occur under negotiated contracts with buyers and the terms of sale are not made public. However, PetroPeru has published revenue from these contracts on its website since 2004.

covers tax rates and methods to calculate tax bases and comes with a CIT rate surcharge of 2 percentage points. Legislation on foreign investment provides additional stability arrangements covering the withholding tax rate applied to dividends distributed to investors. In the mining sector, the presence of stability assurances, combined with the recent changes to the general royalty system, has effectively created different fiscal regimes across projects. While SUNAT publishes a list of the companies for which the pre- and post-2011 royalty regimes apply, the complexity created by the stability assurances makes the understanding of individual project fiscal regimes difficult to the ordinary public. A citizen's guide could be considered to allow greater accessibility to this information, particularly relevant to those communities entitled to a share of revenue from projects in their respective territories.

Table 4.3. Peru: Fiscal Regimes in the Mining and Petroleum Sectors

General	
Corporate Income Tax	Standard rate applies
Additional Corporate Income Tax	Additional 2 percent to the standard rate applies for contract with stability assurances and for petroleum risk service contracts.
Mining Sector Specific	
Royalty (Law 28258)	Applicable to mining companies with stability contracts pre-2011
Modified Royalty (Law 29788)	Applicable to mining companies with stability contracts signed after 2011 and to companies without stability contracts
Special Mining Tax	Applicable to mining companies without stability contracts pre- 2011
Mining Lien	Applicable to mining companies with stability contracts pre- 2011
Petroleum Sector Specific	
Royalty	Tax base calculation method and royalty rates vary across contracts as a consequence of bid rounds.

Source: Peru legal framework and staff elaboration.

4.1.4 Assessment and collection of resource revenues (Good)

117. The legal framework clearly defines the rights and obligations of taxpayers in the resource sectors and of the revenue-collecting authorities. Collection of resource revenue is split among SUNAT and PeruPetro. SUNAT collects income taxes in all sectors, as well as mining royalties and PeruPetro collects petroleum royalties. Taxpayers assess due taxes through self-assessments which are subject to audit by SUNAT. SUNAT has the power to amend the taxpayer's declarations and taxpayers have the right of defense through a regulated administrative process. SUNAT publishes guidance notes to clarify calculation methods and compliance with different elements of the mining fiscal regime.

118. The authorities conduct tax audits and verifications of production and transaction prices of resource companies, although they appear limited in scope. According to the authorities, SUNAT conducts periodic tax audits of major mining and petroleum producers mainly focusing on consistency of commercial documentation and accounting standards, although no detailed information is available on the scope and timing of these audits. The scope of tax audits is greatly limited by difficulties in verifying production volumes, costs, and transaction prices, particularly in the mining sector. In performing its audits, SUNAT can request technical support from MINEM. Yet MINEM has only begun in 2014 to conduct pilot production audits (about 14 audits have been conducted to date), and detailed rules to assess mineral volumes and value are not yet in place. Hence, the sector fully relies on a system of self-assessment, as there is no systematic method to verify production volumes and qualities. Issues are less urgent in the petroleum sector where PeruPetro, jointly with contractors, measures the daily volumes of production and the license contract prescribes the creation of a reference price basket for each quality of oil or gas extracted. In both cases, however, there appears to be little coordination between the auditing activities by SUNAT, MINEM and PeruPetro, greatly reducing the scope of any tax audit. Moreover, no information is publicly available about audits.

119. Strengthening the assessment process of resource revenue would improve the transparency of revenue collection in Peru. One way to deliver such improvement is to integrate volume and price verifications into tax audits by strengthening the collaboration between SUNAT, MINEM and PeruPetro. An alternative could be the introduction of formal and regular volume audits, regulated by a comprehensive technical guide on the determination of ore grades, in the case of mining, and for the calibration of measuring equipment in the case of petroleum. The preliminary results of the 14 pilot reviews conducted by MINEM in the mining industry suggest that the benefits of a better verification process could be significant. According to the authorities, some of the reviews pointed out possible underreporting of volumes and led to the opening of formal reconciliation processes.

B. Fiscal Reporting

"Governments and resource companies should provide comprehensive, timely, and reliable reports on holdings of natural resource rights, on extraction and trading activities, and on payments and collections of resource revenue." (IMF's Fiscal Transparency Code, draft new pillar)

4.2.1. Disclosure of natural resource rights holdings (Good)

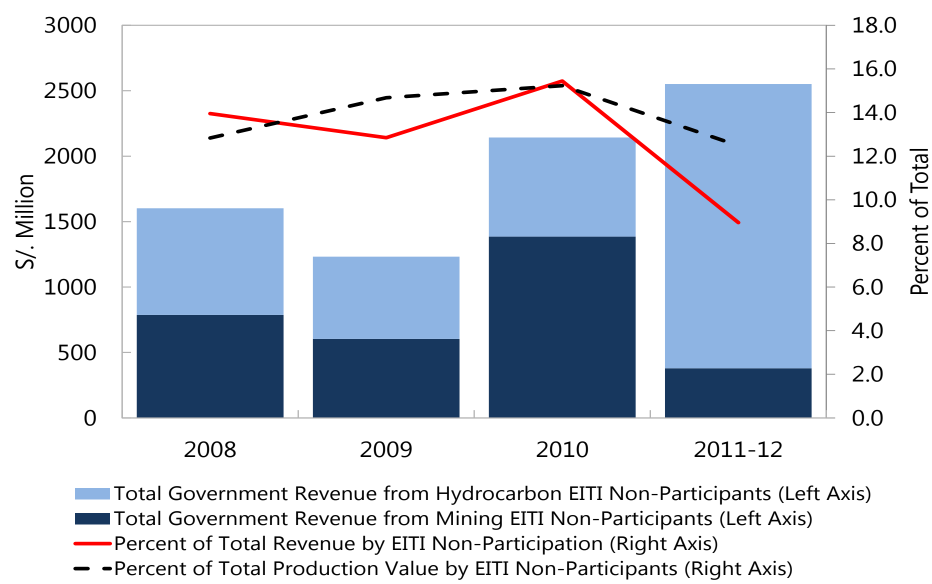
120. The government maintains, publishes and updates a register of all natural resource rights holders. The online mining cadaster held by INGEMMET provides the status and text of mining licenses and is updated daily. PeruPetro publishes on its website copies of all petroleum license contracts.

121. There are no formal requirements to disclose beneficial ownership of mining or petroleum licenses. In addition to inherent transparency considerations, knowledge of beneficial owners (and the chain of intermediaries connecting the beneficial owner and license holder) would allow the government to better monitor and enforce tax liabilities related to indirect transfers of rights, with the benefit of enhancing tax administration and collection of resource revenue.

4.2.2 Reporting by resource companies (Advanced)[41]

122. Most of the resource companies operating in Peru publicly report company-level tax payments on a voluntary basis under the Extractive Industries Transparency Initiative (EITI). [42] Peru has adopted the EITI standard for government revenues from resource extraction activities. Reporting of revenues is at a company level, on a cash basis and includes corporate income tax, royalties, special mining taxes and validity rights fees. The value of commodity production is also reported. Company and government information on tax payments and commodity production has been published since 2004. While EITI is a voluntary initiative, participation has been steadily increasing. In 2012, companies adhering to the EITI standards covered 88 percent of total production value and 91 percent of total tax collections, leaving a small percentage unreported (Figure 4.3). The next EITI report is due in April 2015 and will reflect the 2013 EITI standards, including project level reporting.

Figure 4.3. Peru: Tax Payments Not Reported under the EITI Process, 2008-2012



Source: EITI.

[41] The Code requires an assessment of reporting by domestically domiciled or listed resource companies with international extraction activities. While there is no legislation in Peru mandating project-level reporting on worldwide extraction activity for these companies the extent of worldwide operations undertaken by Peruvian mining companies is limited. Hence, this aspect of reporting by resource companies is not addressed in this FTE.

[42] The EITI is a global standard to promote open and accountable management of a country's oil, gas and mineral resources. Countries implementing the EITI disclose information on tax payments, licenses, contracts, production and other key elements around resource extraction following the EITI reporting standard. The standard is implemented by governments, in collaboration with companies and civil society and all information is regularly published and certified for compliance in country's EITI Reports.

4.2.3 Integrity of resource revenue data (Advanced)

123. Peru has achieved EITI compliance since 2012, showing minor reconciliation errors between government's tax receipts of resource revenue and companies' tax payments. Since 2009, companies' tax payment of royalties, CIT and special mining taxes have been reconciled exactly with government's tax records (Table 4.4). The only discrepancy is in the payment and collection of validity rights fee, which in 2012 constituted less than one percent of total resource revenue.

Table 4.4. Peru: Reconciliation Errors Under EITI Reporting Process, 2008-2012 (in millions of nuevos soles) 1/

		2007	2008	2009	2010	2011	2012
Total Revenue	Difference	7.3	5.1	4.3	5.7	8.8	9.1
	% Difference	0.1	0.0	0.0	0.0	0.1	0.1
Mining and Hydrocarbon (Royalties and CIT)	Difference	1.5	0.1	0.1	0.0	0.0	0.0
	% Difference	0.1	0.0	0.0	0.0	0.0	0.0
Land Fees	Difference	5.8	5.0	4.3	5.6	8.7	9.1
	% Difference	29.8	21.9	19.0	22.9	24.0	27.3
Special Mining Tax	Difference	...	...	...	...	0.1	0.0
	% Difference	...	...	...	...	0.1	0.0
Tax Lien	Difference	...	...	...	...	0.0	0.0
	% Difference	...	...	...	...	0.0	0.0

Source: EITI and IMF staff estimates.
1/ The reconciliation error is defined as the sum of the absolute values of individual company level reconciliation errors.

C. Fiscal Forecasting and Budgeting

"Budget documentation should provide a clear statement of the government's resource revenue management objectives, and report on the allocation of resource revenues for public spending and saving." (IMF's Fiscal Transparency Code, draft new pillar)

4.3.1 Resource revenue management objectives (Good)

124. Peru's annual and medium term fiscal policy objectives for the use of resource revenue are clearly stated and embedded in time-bound numerical fiscal rules. As discussed in chapter 3, effective in 2015, Peru has adopted a new fiscal rule that aims, among others objectives, to insulate the budget from the volatility of resource revenue. The new rule sets spending limits for the general government anchored in a structural fiscal target. The structural fiscal target is based on annual forecasts of structural revenues, which in turn are composed of resource and non-resource revenues. Structural resource revenue projections are calculated using a published methodology that relies on a narrow definition of revenue (i.e., taxes on profits and royalties payable by natural resource corporations) and long-term historical commodity prices trends. However, as structural revenue includes both resource and non-resource revenues, the system does not allow for separate identification of the amount of natural resource revenues spent and saved in any given year (i.e., below/above structural revenue). The new rule also includes a legal requirement to publish compliance reports.

125. Structural resource revenues are allocated to different levels of government and for SNGs revenue are earmarked for public investment and maintenance spending (Table 4.5). The exact distribution of revenues at sub-national government level depends, among other factors, on the location of the natural resource exploitation activity. As a result, resource revenues are unequally distributed across SNGs. For example, during the period 2007-11, resource revenue in the twenty municipalities that received most (least) accounted, on average, for about 79 percent (0.01 percent) of their total revenue. The legal framework also specifies that SNGs can only use this revenue to finance public investment (80 percent) and maintenance spending (20 percent), with some transfers to regions earmarked for universities. Part of the royalties from the Camisea gas project are also earmarked for the *Fondo de Desarrollo Socioeconómico de Camisea* (FOCAM) and the *Fondo Para Las Fuerzas Armadas y Policia Nacional.*

126. The government reports on the use of SNGs' earmarked natural resources, however, the practice of supplementary budgets blurs the link between budget plans and actual execution. The distribution of natural resources across SNGs is reported in budget documents and fiscal reports. However, the breakdown of how these revenues are spent is only available through the MEF's budget execution portal (*consulta amigable*). Moreover, earmarked revenue of SNGs not spent in a given year flows to their saving accounts as cash balance (*saldo de balance*). The use of these balances is usually incorporated in supplementary budgets in the following years, creating a systematic mismatch between original budget plans and actual use of resources revenue (see Chapter 2). Clearer and detailed information on the use of earmarked resource revenues and full budgeting of cash balance early in the year would improve transparency in the use of resource revenue at sub-national level.[43]

[43] The next EITI exercise will pilot a detailed report on the use of resource revenues in two regions. Coordination with the EITI process and the budget reporting system in this pilot would be a useful step in providing accessible information to the public on the expenditure of natural resource revenues.

Table 4.5. Peru: Allocation Rules for Resource Revenue to SNG

	Gas Canon	Oil Canon 1/	Mining Canon	Mineral Royalties	FOCAM	FOCAM-Uyacali	Fondo de Fuerzas Armadas 2/
Composition/Zone of Influence	50 Percent CIT and Royalties	50 Percent of CIT and 18.75 Percent of Production	50 Percent of CIT	100 Percent of Royalties	25 Percent of Block 88 and Block 56 Royalties	2.5 Percent of Oil and Gas Royalties	30 Percent of Block 88 and 40 Percent of Block 56
District	10%	40%	10%	20%	15%		n.a
Province	25%		25%	20%	30%		n.a
Municipal Departments	40%		40%	40%	15%	83% (various)	n.a
Regional Government	20%	52%	20%	15%	30%	13%	n.a
Department Universities	5%	8%	5%	5%	10%	4%	n.a
Designated Use	80 percent investment, 20 percent maintenance spending				Investment, maintenance, environmental and ecological training		Modernization and purchase of equipment

Source: MEF.
1/ The oil canon is governed by different rules for the areas of Loreto, Ucayali, Piura, Tumbes, and Huánuco.
2/ These funds are distributed between the military, marine, air force and police.

4.3.2 Allocation of resource revenues (Not met)

127. Spending and saving of resource revenues is not fully recorded in the government budget. As mentioned in chapter 2, there are two instances where budget recording could be improved, in this case affecting resource revenue. First, flows into and out of off-budget accounts, and in particular the Armed Forces Fund, which includes a portion of gas royalties from the Camisea project, are only registered when the expenditure occurs and not when revenue are actually transferred. This means that saving of this revenue is not clearly reported. Secondly, PeruPetro retains a portion of the petroleum royalties it collects on behalf of the government to cover its own operating costs. While these costs and revenue are reflected in the financial statements of PeruPetro, they are not reflected in budget documentation. These amounts may be significant. In 2013, PeruPetro reported S/. 1.2 billion in operating costs (See 2.1.1), approximately 9 percent of total resource revenue. In the same year, the Armed Forces Fund retained US$113 million in petroleum revenues that were not reported in the budget, approximately 2.5 percent of total resource revenue for the year. This issue reflects the relative fragmentation of the allocation framework, which could be more clearly presented in budget documentation.

128. Borrowing against future revenues, including resource revenue, is authorized by law and disclosed in budget documentation. Sub-national governments have borrowed against their future streams of earmarked resource revenues. In particular, borrowing from the MEF undertaken through, for example, an agreement of resources transfers (*Convenio de Traspaso de Recursos*) gives the central government (the lender) the right to future resource revenues of the SNGs (the borrower). This debt is included in the annual debt ceiling and has to be approved by the Auditor General's office. In the case of external debt, the central government borrows on behalf of (or acts as a guarantor for) the SNGs and the loan is usually repaid out of earmarked revenues before they are transferred to the SNGs. An example of such a loan is the recent World Bank loan subscribed by the central government on behalf of the Las Bambas region and guaranteed by future revenues of a large mining project in the area.[44] All borrowing is recorded in the debt register and transfers and repayments of all debt are reflected in the budget.

4.3.3. Natural resource funds (Not Assessed)

129. Peru has no natural resource fund. While Peru has a fiscal stabilization fund for the national government (FEF), this fund does not constitute a natural resource fund. The FEF is endowed with unspent ordinary revenue (*recursos ordinarios*) of the national government (which includes 50 percent of the income tax paid by natural resource companies), 10 percent of privatization proceeds and of concessional fees. The FEF can be used in the case ordinary revenues of the national government (90 percent of which are not resource related) fall by more than 0.3 percent of GDP below previous year revenues or in case of national emergencies and international crises. While inflows and outflows from the funds are reported, there is no possibility to separate general revenue from resource revenue (if any) going into the fund. For these reasons the principle is not assessed.

D. Fiscal Risk Analysis and Management

"Governments should disclose, analyze, and manage social, environmental and operational risks associated with natural resource exploitation." (IMF's Fiscal Transparency Code, draft new pillar)

4.4.1 Social and environmental risk (Good)[45]

130. Mining and petroleum operators are required to present environmental impact assessments (EIA) and report regularly on their performance and other relevant events. In addition to the assessment of environmental effects of mineral and petroleum operations, the EIAs are required to include details of community consultations and social issues as an integral part of the environmental licensing and reporting processes. Peru is a signatory of the 1989 Convention 169 of the International Labor Organization that mandates and regulates consultations with aboriginal and indigenous communities before natural resources projects take place on their territories. The application of the convention in Peru has evolved into a well-regulated process of consultations with local communities before mineral exploration and any extraction activities take place.

131. The government conducts and publishes regular audits on company compliance with technical regulations, and safety and environmental rules and regulations.[46] Public audiences and information workshops are mandatory before environmental certifications are issued as a pre-requisite to start mining or petroleum activities. The environmental assessment and licensing

[44] The 'Obras por Impuestos' scheme plays a similar function (See Chapter 3).

[45] Staff considers government's current reporting on environmental and social risks sufficient to meet good practices even if it does not include an explicit assessment of fiscal risks.

[46] These functions are performed by OSINERGMIN and the Agency for Environmental Assessment and Enforcement (OEFA) and starting in 2015 by the National Service for Environmental Certification (SENACE).

documents are published in the online environmental evaluation system of MINEM (SEAL). Between 2004 and 2013, 279 environmental studies for mining activities were authorized.

132. While there is extensive reporting of environmental and social risks, little consideration is given to the fiscal risks associated with the social and environmental impact of resource activities. The fiscal implications of risk analyses performed under the mandatory EIAs and Operational Safety and Risk reviews are not assessed. Therefore, such risks are not reflected in the relevant risk analysis and mitigation section of budget documents. However, these risks can be significant. For example, the start of production of the Camisea project, currently generating in excess of US$1 billion per year in government revenue, had to be delayed 20 years after its discovery due to environmental and social concerns. More recently, in 2011, the Conga mining project, with an estimated potential to generate about US$2.7 billion of government revenue was suspended after violent community protests. Looking ahead, assessing the fiscal risks from the environmental and social impact of extractive resource would improve budget planning and the risk assessment of public finances.

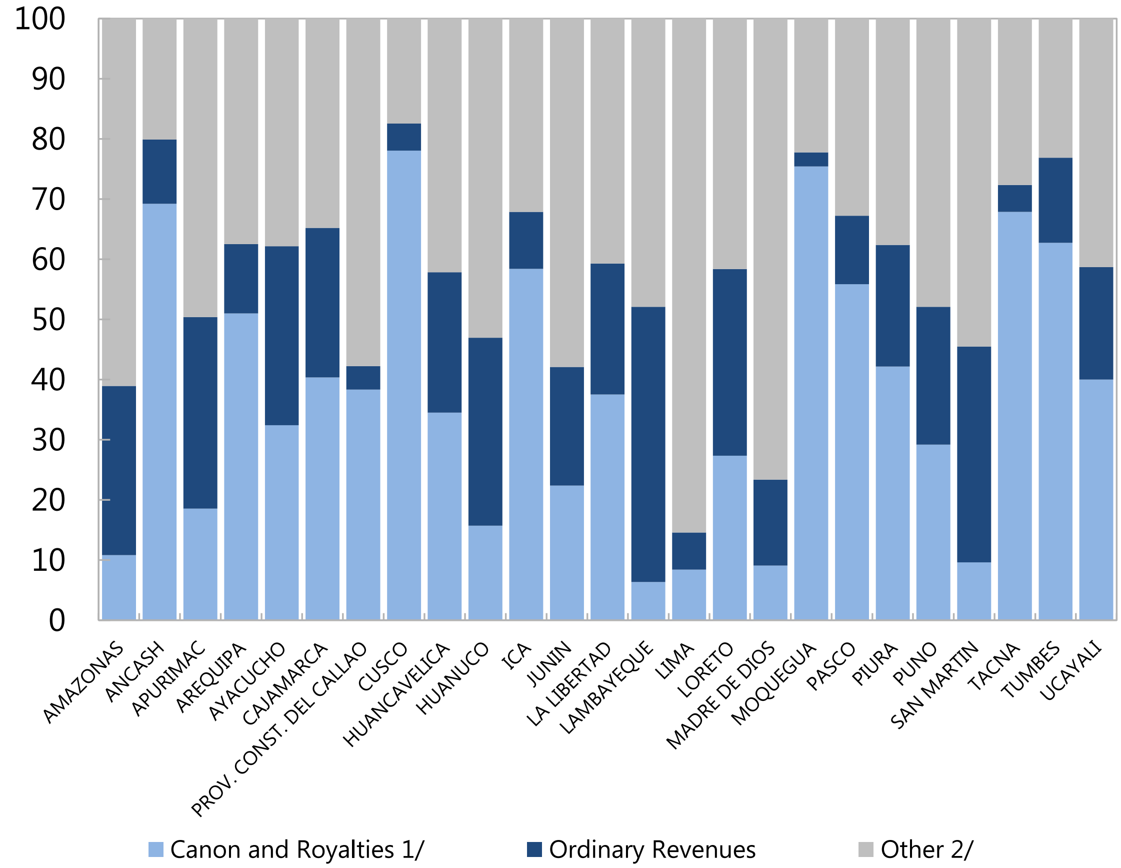
4.4.2 Operational risk (Basic)

133. The government regularly reports on the status of resource extraction projects and, in some cases, on planned activities. MINEM publishes an annual statistical report which provides details and on the status of major current mining projects, as well planned activities. The mining cadaster allows public access to information on exploration and development activity and is updated daily. Similarly, PeruPetro publishes daily production data for each petroleum block on its website, and a detailed annual report of historical activity, but provides limited details about planned activities.

134. Fiscal forecasts account for future production plans, but both sectoral and fiscal reports provide little information on risks to production and their impact on fiscal revenues. The MMM includes a discussion of production estimates and new projects underpinning resource revenue projections. It also provides a brief description of the main sources of production growth in the hydrocarbons sector. However, the implications of these assumptions on resource revenue forecasts are not explained in detail and there is no discussion of the main risks to production and resource revenue from operational and other disruptions.

135. Strengthening the analysis of production and revenue risks is particularly important, including for SNGs. Peru's resource revenues appear to depend on a small number of large projects, exposing government finances to project specific disruptions. In the mining sector, for example, in 2013, 89 percent of copper production came from the top 4 mining companies representing 5 mining operations, and revenue forecasts in the mining sector appear to be contingent on the successful commencement or expansion of only 7 megaprojects. Similarly, in 2013, 68 percent of hydrocarbons royalties came from the Camisea gas and condensates. Delays or disruptions in these projects could therefore significantly impact resource revenue forecasts, making the analysis of fiscal risk from these events particularly important. Risks are especially large for local governments located in regions of high resource extraction activities and more reliant on resource revenues (Figure 4.4).

Figure 4.4. Peru: Composition of Local Government Revenue by Region, 2013



Source: Consulta Amigable
1/ Includes customs duties and transfers.
2/ Includes municipal taxes, credit, transfers and revenues from FONCOMUN.

E. Conclusions and Recommendations

136. Peru has in place very strong transparency arrangements across the resource revenue management chain and most of the practices meet good and advanced standards. A clear and comprehensive legal and fiscal framework, along with open and competitive rights allocation processes, provides a strong starting point for the efficient management of the country's natural resource wealth. Compliance with EITI standards provides assurances of integrity in revenue reporting as well as developing a custom for company compliance with reporting obligations. The government has numerical and measurable objectives for the distribution and use of resource revenue, and publishes information on their use through the budget. Practices in managing environmental and social as well as operational risks satisfy basic transparency requirements.

137. Translating these strong foundations into advanced fiscal practices in managing resource revenue requires, however, improvements in a number of important areas (Table 4.6). While rights and obligations of revenue authorities and taxpayers are clear, the lack of independent verification mechanisms for production volumes and prices reduce the effectiveness of auditing activities. Despite clear fiscal policy objectives, the use of budgeting tools such as cash balances creates a misalignment between initial budget plans and actual use of resource revenue. Moreover, practices to manage the revenue risks from operational, social and environmental issues are still in their infancy. Overall, there is ample room to enhance the coordination between sector ministries and fiscal policymakers and administrators. Better coordination would enhance revenue collection and improve fiscal risk analysis and management.

138. Strengthening resource management practices in Peru requires focusing on a number of policy priorities:

Strengthen the coordination between sector ministries and fiscal authorities, and

- Develop clear and regular audit procedures for volume measurement and price valuation, particularly in the mining sector.
- Integrate volume and price verifications into tax audits and improve the collaboration between SUNAT, MINEM and PeruPetro.

Improve the link between budget plans and use of resource revenue and information flows by

- Constraining the use of natural resources from cash balances not originally committed in the initial budget;
- Registering in the budget and fiscal reports all flows related to resource revenues, including transfers to the Armed Forces Fund and PeruPetro's revenue, and include summary tables in budget documentation to report on the allocation of resources; and
- Reporting periodically on the use of resource revenue against objectives and revenue earmarking at sub-national level.

Develop further the management of fiscal risks from resource revenue, and

- Integrate operational risk analysis and elements of social and environmental risk in fiscal revenue forecasting.

Table 4.6. Peru: Summary Assessment of Resource Revenue Management Practices

	Principle	Assessment	Issues and Importance	
Legal and Fiscal Regime				
4.1.1	**Legal Framework for Resource Rights**	**Advanced:** The legal framework is clear and readily accessible.	**Low:** Peru ranks 3rd in Latin America for policy perception in the 2013 Fraser Institute survey.	
4.1.2	**Allocation of Resource Rights**	**Advanced:** Methods used to grant concessions and licenses are open and competitive, with granting of rights publicly disclosed.	**Low:** The current allocation methods have led to no significant litigation instances.	
4.1.3	**Fiscal Regime for Natural Resources**	**Advanced:** The legal framework fully defines the fiscal regime and the scope for contractual variations.	**Low:** The current framework has facilitated FDI in the sector.	
4.1.4	**Assessment and Collection of Resource Revenues**	**Basic:** Rights and obligations of taxpayers and the revenue authorities are clearly defined in the law.	**High:** Limited tax audits and verifications of production and prices of resource companies.	Yes
Fiscal Reporting				
4.2.1	**Disclosure of Natural Resource Rights Holdings**	**Good:** The mining cadaster and copies of awarded petroleum license contract are available online.	**Medium:** 100 percent of extraction activity is undertaken by the private sector.	
4.2.2	**Reporting by Resource Companies**	**Advanced**: Peru adheres to EITI standards.	**Low:** EITI participants account for about 90 percent of total production value.	
4.2.3	**Integrity of Resource Revenue Data**	**Advanced**: Peru has achieved EITI compliance.	**Low:** Reconciliation error about 0.1 percent of total resource revenue.	
Fiscal Forecasting and Budgeting				
4.3.1	**Resource Revenue Management Objectives**	**Good**: Policy objectives for the use of resource revenue embedded in numerical fiscal rules.	**Low**: Detailed information on the use of earmarked resource revenues only available in *consulta amigable*.	
4.3.2	**Allocation of Resource Revenues**	**Not Met**: Some resource revenue, saving, and expenditures are not reported in the budget.	**Medium:** In 2013, 11.5 percent of resource revenues were not reflected in the budget.	Yes
4.3.3	**Natural Resource Funds**	**Not Evaluated:** No natural resource fund exists in Peru.	**Not Evaluated**.	
Fiscal Risk Analysis and Management				
4.4.1	**Social and Environmental Risk**	**Basic**: Obligations for environmental and social impact analysis exists, but no fiscal risk analysis.	**Medium:** History of long delays and disruptions in large extraction projects.	Yes
4.4.2	**Operational Risks**	**Basic**: Government reports on natural resource project status and planned activity, without quantifying operational and fiscal revenue risks.	**High**: 90 percent of copper production comes from only 5 projects.	Yes