



SPECIAL REPORT

Ministries implementing Works for Taxes in Peru: Light at the end of the tunnel

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1. REGIONS UNDER THE MAGNIFYING GLASS

One of the most serious problems registered in 2014 in Peru was the scarce public investment. It was such the seriousness that it affected an important percentage of the growth rate of the GDP. And even more, investment was particularly low in regions and towns. They ceased to make infrastructure in health care, education, drinking water and sewage systems, roads, telecommunications, police stations, monitoring centres for citizen security, and other more.

This situation of work standstill was explained by the recurrent inefficiency in the management of public resources by local and regional authorities and aggravated by corruption, money laundering and hitman scandals which held the Regional Presidents of Ancash and Cajamarca and other municipal authorities on remand. During 2014, 16 out of 26 regional authorities were accused of corruption and legal proceedings were commenced against them.

In October and December 2014, Peru elected new regional and local authorities who brought along the possibility of raising public investment indicators and awakened the expectations of the population concerning the management of its new authorities which will have to wait until they start using their budgets actively.

In this context, mechanisms of public expenditure and investment acceleration become relevant one year and a half before the mandate comes to an end. Works for Taxes has been a mechanism which has produced surprising results to foster investment in basic infrastructure and has also allowed investment in training components and in technology and equipment implementation, as well as the financing of the maintenance of these works.

Although the mechanism always uses the public revenue -corporate tax, fees derived from the exploitation of resources and mining royalties, as well as other funds from the regional and local government- it shows the efficiency and transparency of the participation of the private sector, when financing a work which will be funded by public income once it is finished. This fosters public investment and complements the direct action of the State.

Nowadays, thanks to this mechanism, companies have agreed to invest more than 1,300 million Peruvian soles. Only in 2014, over 600 million soles were invested mainly in transport, sanitation, education, health and telecommunications.

However, this is not enough given the fact that there is an infrastructure deficit which exceeds 80 billion dollars. The Government, as part of its aim at reactivating the economy, has taken advantage of this

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mechanism changing recently the normative of Works for Taxes in order to allow regional and local governments, as well as health, education, agriculture and irrigation, citizen security and tourism sectors, to use this mechanism. Thanks to all these changes, both sub-national governments and the National Government, together with its respective Ministries, are able to carry out Works for Taxes.

2. LEGAL CHRONOLOGY

Act 29230 was created in May 2008 in order to foster local and regional public investment with the participation of the private sector through the submitting of agreements between companies and regional and local governments.

These private funds which encourage the financing of basic infrastructure investment are deducted after the work is finished from the funds of Fees and Mining Royalties which Regional and Local Governments have as borrowing limit. They already exceed 26 billion soles just for Works for Taxes.

Subsequently, Act 30056 changed various acts to facilitate investment and foster productive development and it modified the original Act of Works for Taxes:

- Public Universities were included. In this way, the company is now allowed to fund and/or to carry out infrastructure projects in

public universities related to equipment, furniture and training.

- The Certificate of Regional and Local Public Investment can be negotiable.
- The funding of the maintenance of works by the company is possible through this mechanism.

In December 2013, in virtue of the Act 30138, the Ministry of Economy and Finance announced new measures for the implementation of the mechanism. These changes improved even more such implementation and offered the possibility of using the funds, different from the fees and managed by the Ministry of Economy and Finance, for the implementation of the mechanism.

In July 2014, new measures established in Act 30230 to reactivate the economy enlarged the funding of Works for Taxes through the transfer of 650 million Peruvian soles to the Promotion of Public Regional and Local Investment Fund (FONIPREL) from the Ministry of Housing and the Ministry of Education. This fund is at the disposal of those regions and municipalities whose incomes from taxes are lower than 2.5 million soles.

Finally, on the 16th November 2014, the Ministry of Economy and Finance announced new measures to promote economic growth and investment which were adopted in the Congress under the Act 30264 which

“The list with prioritized projects will be published only when the MEF provides its formal opinion on the Budget of the Ministry that is applying”

introduces more attractive changes for the private company:

- Entities of the National Government are allowed, within their competence and through the procedures of the Act 29230 (Works for Taxes Act), to carry out projects of public investment which are feasible in the National Public Investment System (SNIP). Some of the matters concerning these projects are health, education, tourism, agriculture and irrigation, as well as public welfare and safety, including its maintenance.
- Such financing will be executed against ordinary resources of each sector which shall be taken into account in their institutional budgets.

3. NEW INCENTIVES TO IMPLEMENT WORKS FOR TAXES FROM THE NATIONAL GOVERNMENT

On the 23rd of January 2015, two months after the announcement of the Act, a record time for the implementation of laws in Peru, Regulation of the Act 30264, which allows National Government’s entities (Ministry of Health, Ministry of the Interior, Ministry of Education, Ministry of Agriculture and Irrigation, Ministry of Foreign Trade and Tourism) to directly implement the mechanism of Works for Taxes charged to their annual budget was implemented.

The main powers of the new Regulation are summarised as follows:

Ministries’ identification and priorities about the Works for Taxes Bank of Projects

- The Ministry authorised to implement Works for Taxes, in virtue of the act published in November 2014 and its Regulation, shall pass through ministerial resolution the list of projects which are intended to be accomplished.
- The list with prioritized projects will be published only when the MEF provides its formal opinion on the Budget of the Ministry that is applying.
- Projects must be feasible in the SNIP and must include components of applied research and/or technologic innovation.

Companies’ identification and prioritizing proposal of Works for Taxes projects

- The private sector will be able to present its projects to the Ministries approved by law, so they can be included in the entity’s prioritized list.
- In order to do that, it shall send a letter to the owner of the public entity (minister or vice-minister, or whoever they delegate to), in which they express their intention of developing an investment Project, which shall contain what follows:

“The Public Entity, in no more than fifteen days after receiving the proposal, will notify the Private Company in case such proposal is relevant to them, as it meets the policy and intentions of the Sector”

- » Proposer’s name or corporate name, specifying the Individual Taxpayer Registry, registered address and legal representative, as well as a copy of the power of attorney related to such representative.
- » Details concerning the project that the proposer intends to develop, as well as an estimate of the costs of the investment, the estimated time of execution and the reasons why this project should be supported.
- The Ministry will pass the project’s proposal whose details are set forth in the letter sent, always taking into account the Budget granted by the MEF.
- The Public Entity, in no more than fifteen days after receiving the proposal, will notify the Private Company in case such proposal is relevant to them, as it meets the policy and intentions of the Sector.
- Once it has been notified, the Company can start considering if it is worth investing in it according to its conformity with the normative of the SNIP.
- Individual Taxpayer Registry, registered address and legal representative, as well as a copy of the power of attorney related to such representative.
- Proposal of study of pre-investment elaborated according to the technical normative, methods and criteria of SNIP.
- Guarantee for the work’s costs.

Finally, during the identification and prioritizing phase, the Company and the Entity must be aware of not letting a prioritized proposal coincide, wholly nor partially, with projects which are being drawn up now, projects already prioritized according to the act and the present regulation, nor projects being already accomplished by any other subdivision.

Summons, organization and execution of the selection process until the work is awarded

- A Special Committee will be established in the Ministry which decides to finance a work using taxes. It will have three representatives from such Ministry.
- This Committee will be in charge of summoning, organizing and elaborating the basis for the selection process of the Company as of the hiring of the Company responsible for supervising the work. Moreover, it will

Once this study has been concluded, the Company must present the following information to the Ministry:

- Proposer’s name or corporate name, specifying the

elaborate a previous report for the Comptrollership Office as to implement the selection criteria until the Project has been assigned to the private Company.

- Once the process is published, the Company has 10 days to present its willingness to the summoning Ministry.
- In the case of being it the only applicant (as usual in such a selection process), the Company will be directly awarded, the deadlines will be abridged and the contract will be awarded the next day after verification and evaluation of the technical proposal.

Delegation of competences of both regional and local governments for the drawing up and execution of Works for Taxes by the National Government.

In the case of projects in which only regional or local governments are involved, the Regulation points out that they are allowed to submit agreements according to

the SNIP normative and the Decentralization Act.

4. WORKS FOR TAXES PRIORITY IN HEALTH AND EDUCATION

While the reactivation measures (Act and its Regulation) which give autonomy to Ministries to execute works for taxes directly were being specified, these sectors, without wasting time, started working in parallel in the elaboration of project portfolios of public investment, giving priority to the infrastructure deficit in each geographic area; the state of that infrastructure; the existence of a feasible Public Investment Project (PIP), that is, approved by the National Public Investment System (SNIP); and the amount of money for investment; among other criteria.

In the case of the Ministry of Education (Minedu), under the leadership of the Minister Jaime Saavedra, a group of professionals was formed in order to get this project portfolio off the ground and start a process of

SUMMARY OF THE PROJECT PORTFOLIO OF THE MINISTRY OF EDUCATION IN WORKS FOR TAXES 2015

FORMULATION UNIT	GROUPS OF SCHOOLS	INVESTMENT PER GROUP (MILLION SOLES)	TOTAL INVESTMENT (MILLION SOLES)
District Municipality	51	16.4	836.4
Provincial Municipality	15	20.0	300.00
Regional Governments	12	16.5	198.0
Total	78		1,334.4 (more than US\$400 millions)

Source: Website of the Ministry of Education, Lima-Peru (Minedu).

“Companies have started paying attention to the new project portfolio of the Ministry of Education for 2015 for Works for Taxes”

promoting these projects to be funded through Works for Taxes. For this reason, the technical team in charge of Works for Taxes priorities in Education has made use of the available data in the School Census 2013 and in the Educational Infrastructure Census 2013.

The result of this effort has been especially positive to change the image of the sector from a passive and careless one to a sector that gives importance to the educational infrastructure deficit and treats it with urgency in terms of service quality.

Companies have started paying attention to the new project portfolio of the Ministry of Education for 2015 for Works for Taxes. At the end of 2014, the Regional Governments of Junín, Ica and Ayacucho assigned 24 schools to the Credit Bank of Peru which will invest more than 60 million soles (more than 20 million dollars) in replacing the current infrastructure and maintaining it in the short-term with its income tax and with

the financial counterpart of the mining taxes of these regions.

For this year 2015, with the Regulation passed in January, the Ministry of Education is ready to situate its project portfolio directly in the priorities of the private companies which shape Works for Taxes. The amount of money that the Ministry wants to invest directly this year in Works for Taxes exceeds 1,300 million soles (more than 400 million dollars) at a national level, expecting to assign 78 groups of schools at regional, provincial and district levels.

From the total amount, the Ministry of Education hopes to invest at least 250 million soles (around 78 million dollars) in Works for Taxes effectively.

The fact that Ministries can be direct investors of Works for Taxes brings advantages and facilities to the company, as it reduces the costs of managing a project with local authorities and its Regional and Municipal Councils; it avoids the confrontation

PROJECT PORTFOLIO OF THE MINISTRY OF HEALTH IN PUBLIC-PRIVATE PARTNERSHIP AND WORKS FOR TAXES 2015

RESULTS	PROGRESSES 2014	GOAL 2015	CATEGORY	TOTAL ESTIMATED INVESTMENT (MILLION SOLES)
Investment in provincial hospitals	3 hospitals being refurbished 24 hospitals elaborating a technical profile	12 hospitals finished in Lima: 8 in San Juan de Lurigancho, 2 in Huancavelica and 2 in Madre de Dios 24 hospitals under construction	Works for Taxes	600.0 (around US\$200 millions)

Source: Website of the Ministry of Health.

between questioned authorities with a low level of commitment and the mechanism; it generates important impacts on investment decisions as the company has greater confidence in the fact that the sector is acting according to national public policies interests, instead of personal and political interests; among other advantages.

As for the Health sector, the Ministry of Health has elaborated a portfolio of almost three thousand hospitals to be executed as Works for Taxes.

For 2015, and approved by Law to carry out Works for Taxes directly, 12 hospitals out of the total amount of projects are intended to be refurbished. These hospitals are located in provinces and will be finished this year.

The newness of this portfolio, as in the case of Education, is that the construction of these 12 hospitals will not just attract investment in infrastructure and equipment, but also for the maintenance for a period of time varying between five and ten years, according to the Ministry of Health.

It is worth noting that, in the case of Public Security sector, the Ministry of Interior (Mininter) published in the last Annual Executives Conference (CADE) its project portfolio for Public-Private Partnership and Works for Taxes. Among the projects we can find the investment in infrastructure and equipment for police stations, remote surveillance centres, training centres for non-commissioned officers of the police and border surveillance posts.

PROJECT PORTFOLIO OF THE MINISTRY OF INTERIOR IN WORKS FOR TAXES

INVESTMENT PROJECTS	NUMBER	TOTAL ESTIMATED INVESTMENT (MILLION SOLES)
Police Stations	127	156.3
Specialized Units	12	13.6
Border Surveillance Post	9	14.6
Criminalistics Units	3	40.0
Fixed Units	4	85.6
Technical Schools (Lima)	3	93.4
Mobile Units	5	120.7
Technical Schools (National)	6	159.6
Total	169	683.8 (more than US\$200 millions)

Source: Presentation of the Ministry of Interior in the Annual Executives Conference (CADE), November 2014.

“This increases the incentives for companies to use the mechanism in a context in which regional and local authorities have lost their prestige due to corruption accusations, money laundering and even murder”

In the case of police station, the largest investment would be concentrated in Loreto, with 32 police stations and almost 50 million soles, followed by Huánuco and Pasco.

5. FINAL CONCLUSIONS: CHALLENGES AND OPPORTUNITIES

The adoption of the Regulation, that allows health, education, citizen security, agriculture and irrigation, and tourism sectors directly apply the mechanism of Works for Taxes, is very good news for the company that now will be able to ally with the Government in using this mechanism.

This increases the incentives for companies to use the mechanism in a context in which regional and local authorities have lost their prestige due to corruption accusations, money laundering and even murder.

Furthermore, it is very beneficial for sectors to manage the process of Works for Taxes because it is easier to submit formal agreements. On the other hand, priorities concerning investment projects are considered according to the public policy of each sector and the basic public services deficit located in areas suffering poverty.

Sectors which have been benefited from this regulation of facilitating the use of their investment funds to be channelled through the mechanism Works for Taxes have already a prioritized project portfolio countrywide to be executed by this category. Health and Education stand out as they have initiated since 2014 a vigorous project portfolio promotion policy participating in forums and business meetings. In these forums the project portfolio is presented with all the total estimated investment and the selected geographic regions to carry out our projects. It is a proactive effort to put an end to the deficit and to repay the debt that the State has with many Peruvians, especially those from lower classes.

However, the efficient use of the regulation by the State and by companies is very challenging:

A MODERN HOSPITAL FOR SANTIAGO DE CHUCO: THE ALLIANCE BARRICK-BBVA IN WORKS FOR TAXES



One of the few and most recent experiences in Works for Taxes in the matter of Health is the one carried out in Alliance with BBVA-Banco Continental. It consisted in the substitution of the César Vallejo Hospital in the province of Santiago de Chuco, La Libertad, in northern Peru.

This hospital is in charge of assisting people from the eight districts that form the province of Santiago de Chuco (approximately 58,320 inhabitants). The actual infrastructure of the César Vallejo Hospital (HCV) is precarious, built during the 70's with prefabricated materials such as wooden and iron panels. Some units were built afterwards but it still cannot function as a modern hospital

With an investment of more than 36 million soles (more than 11 million dollars), thanks to Works for Taxes, Barrick and BBVA were awarded in 2014 for the construction of this hospital. The Project aims at an increase of the quality and the coverage of its services by permanent assistance (24 hours, 7 days per week) concerning general medicine, surgery, obstetrics and gynaecology and paediatrics, always with professionals. Specialised monitoring in the HCV will benefit the population to a large extent as there will be no need to go to Trujillo, the capital of the region. In the next 10 years, 795,340 cases are estimated to be successfully assisted.

“Works for Taxes is an alternative mechanism that promotes progress”

- Each sector must promote more intensively projects related to Works for Taxes. Ministers and senior management teams’ work is crucial in order to make progress at a faster rate.
- Decisions of public and private investment have been affected by the one year and a half period that remains until Government’s management ends. This could slow down or even put an end to the investment compromises in Works for Taxes and Public-Private Partnership which would be expecting a change in management. This situation gets worse due to the political problems in terms of governmental instability.
- As any new process, the one initiated with the adaptation of the Regulation will require civil servants and government bodies to have a more technical knowledge, compared to the one of the Ministries, of promoting projects of Works for Taxes which have not been executed by sectors yet.
- It will be crucial for 2015 and 2016 to estimate the funds which are going to be invested in Works for Taxes. This will guarantee that the financial counterpart for the company will be covered and the Ministry of Economy and Finance will approve public investment.
- Although the project portfolio should be carried out by the Government, many projects are executed by subnational governments, that is, by Regional and Local Governments. The Regulation considers this situation and allows sectors to submit agreements in which local and regional governments delegate power to them.
- Finally, even though Works for Taxes mechanism is producing surprising results and State policies continue to be attractive enough for companies to join this initiative, this is not less important than other functions which governmental bodies need to execute concerning works, goods and services. The provision of basic services through public administration cannot be replaced, nevertheless it can walk hand in hand with the private sector’s resources in order to execute projects and hire. In spite of that, it is a clear need to introduce updated and efficient practices in order to manage public investment, with simplified and transparent rules staff recruitment and training of honourable civil servants and authorities. Meanwhile, Works for Taxes is an alternative mechanism that promotes progress and illustrates the possible Alliance between the public and the private sector.

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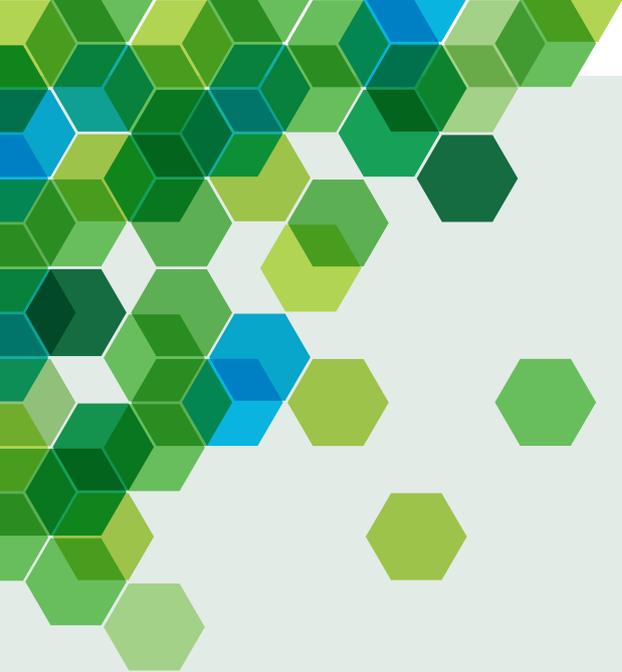
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