



OECD Territorial Reviews

# PERU 2016

## Policy Highlights



# Notes

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# Introduction

Regional development policies are critically important for Peru. The country has a large land mass and a varied geography which is shaped by a thin coastal region, the Andes mountain range and the Amazon forest in the interior. Coastal regions tend to have better socioeconomic conditions than upland and rainforest regions in the interior of the country. These different areas are not well connected to each other and they deliver different levels of services to their citizens. Further, Lima is the fifth largest urban area in Latin America in terms of population and home to approximately 8.5 million inhabitants, which represents 30% of the national population and close to half of the national economy. Given its large size relative to other Peruvian cities (the second biggest city is less than one-tenth the size of the capital) it is paramount for the national economy for Lima to benefit from its growth potential. Currently its growth is constrained by inadequate transport networks, informal settlements and overcrowding of public infrastructure and services.

Improved regional policies will help Peru in its transition from a commodity-based to a more diversified economy. Productivity is growing but remains low when compared to OECD standards and the country faces challenges in terms of improving infrastructure, reducing informality, and developing new business opportunities. Addressing these challenges requires policies that are designed for the

specific needs of different cities and regions. Although Peru has made advances in regional policies, particularly through its process of decentralisation, more needs to be done.

The National Territorial Review of Peru (2016) examines the performance of regions and cities, and their links to national performance, and identifies policy responses to address the challenges they face. These policy responses include ensuring that the preconditions (such as revenues, capabilities and coordinating mechanisms) are in place for decentralisation to work. In particular, the review recommends to strengthen the regional dimension in order to better integrate and adapt national policies to the needs of Peruvian regions. Lifting the productivity of the country has a lot to do with how Peru's cities can work better. The review also includes recommendations for Peru to develop a comprehensive approach to urban policies, including enhancing linkages with rural areas and identifies how regions can play a stronger role in the government's efforts to diversify the economy. The implementation of these recommendations will require improvements in the statistical system of the country in order to ensure an evidence-based policy making approach. Putting in place these recommendations will help ensure all of Peru's regions maximise their contribution to national wellbeing and prosperity.



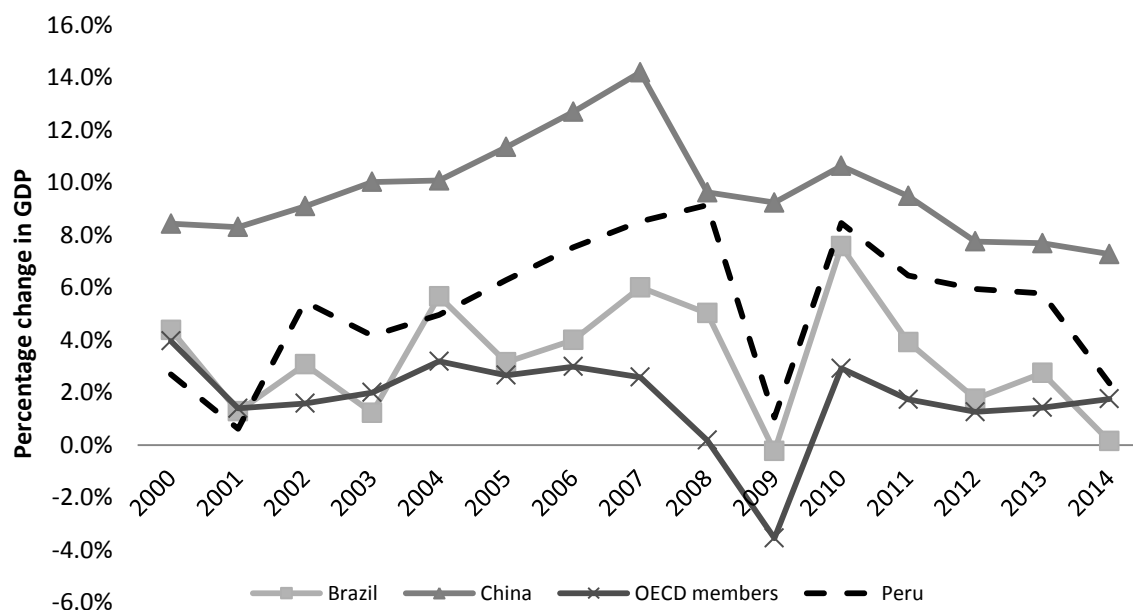
# Assessing national and regional trends in Peru

## Peru's recent growth performance has been impressive but challenges remain

Peru's recent growth performance has been impressive with strong growth and progress in reducing poverty. Since 2000, GDP has averaged 5% annually—much higher than in previous decades. This rate of growth is impressive compared to the OECD average of 2%. Peru's export performance has benefited from rising commodity prices and increased production of key mineral resources. Poverty rates more than halved since 2001 to a level of around 23% in 2014, and extreme poverty rates have fallen from close to 25% to around 5% in the same period.

The Peruvian economy is going through a transition from the commodities boom. The mining sector is dominated by large multinationals, which are globally integrated, and employ less than 1.5% of the labour force. As a result, the benefits to other sectors of the economy in terms of intermediate inputs, and increased household incomes and consumption, are not as significant as its share of GDP and exports. The decline in commodity prices presents downside risks for Peru despite its growth-friendly and sound macroeconomic policies and open economy.

Annual growth GDP growth - Peru compared to OECD average, and select countries.



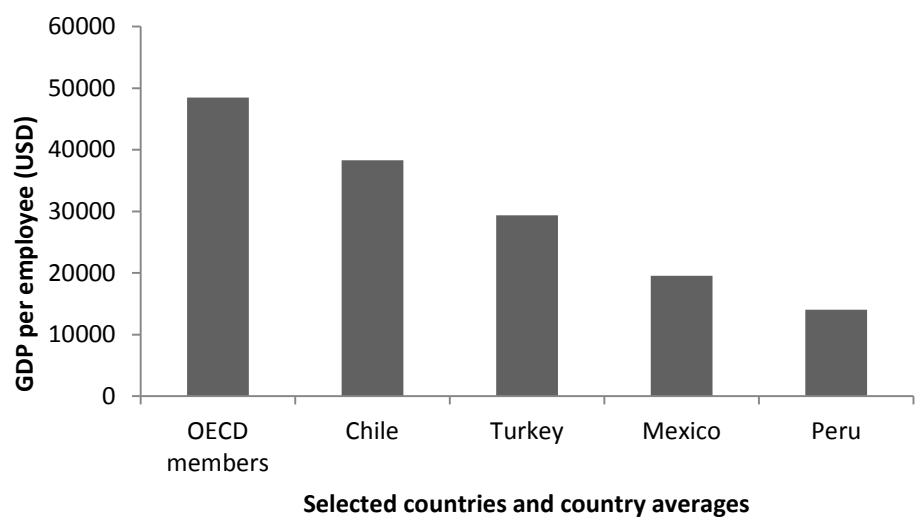
Source: World Bank (2015). World Bank (2015a) GDP at market prices  
<http://data.worldbank.org/indicator/NY.GDP.MKTP.KD/countries?display=graph>.

# Lifting productivity is a paramount challenge

Improving productivity across the economy is a **key challenge**. Despite recent improvements in productivity, Peru’s international level of competitiveness remains low due to its historically low productivity growth. Peru’s labour productivity (USD 14 043) is more than three times lower than the OECD average (USD 48 449), and more than half of the level for Turkey (USD 29 342). There is a large informal sector, at close to 70% of the total employment, which contributes to low levels of productivity. Further, the country needs to

modernise its agricultural sector which currently employs 25.8% of the labour force compared to the OECD average of 5.6%. When considering Peru’s comparatively younger population, there is significant potential for future economic growth. High levels of informality, low levels of skills and innovation, poorly designed and organised cities and under-developed infrastructure are holding Peru back. Unless these issues are addressed Peru will not be able to take advantage of its demographic bonus.

Labour productivity - Peru compared to select averages and countries (2014)



Source: World Bank (2015), GDP per person employed (constant 1990 PPP), <http://data.worldbank.org/indicator/SL.GDP.PCAP.EM.KD>.





# Peru is territorially diverse and can benefit from a place-based approach

**Compared to the OECD, Peru is one of the largest countries containing a very diverse territory.**

Peru is the 19<sup>th</sup> largest country in the world, and only four OECD countries (Canada, the United States, Australia and Mexico) have a larger land mass. Population density is low at only 24 people per sq. km which is similar to relatively low density countries such as Sweden and Chile. The physical geography of the country is shaped by a thin coastal region, the Andes mountains and the Amazon

forest in the interior. Coastal regions tend to have better socioeconomic conditions than uplands and rainforest regions in the interior of the country. These different areas are not well connected to each other and display vastly different levels of public infrastructure and services. Regional economies have different characteristics and display different growth dynamics and will therefore require tailor-made solutions to promote inclusive growth.

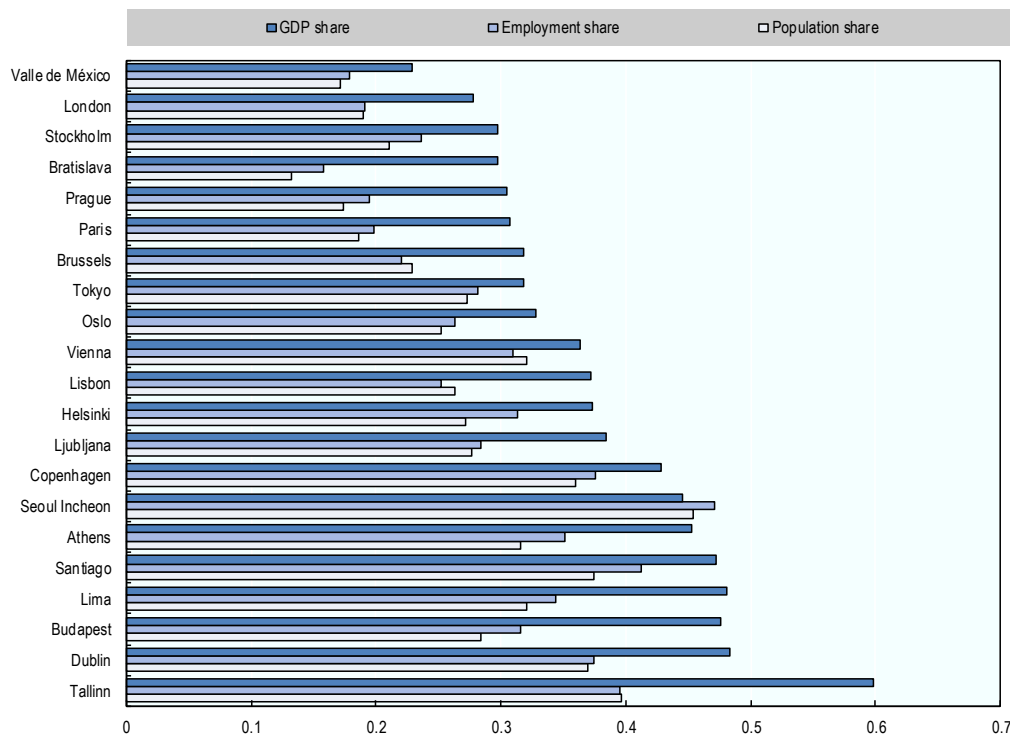
## A key feature of Peru is an over-dominance of Lima making its performance critical to national prosperity

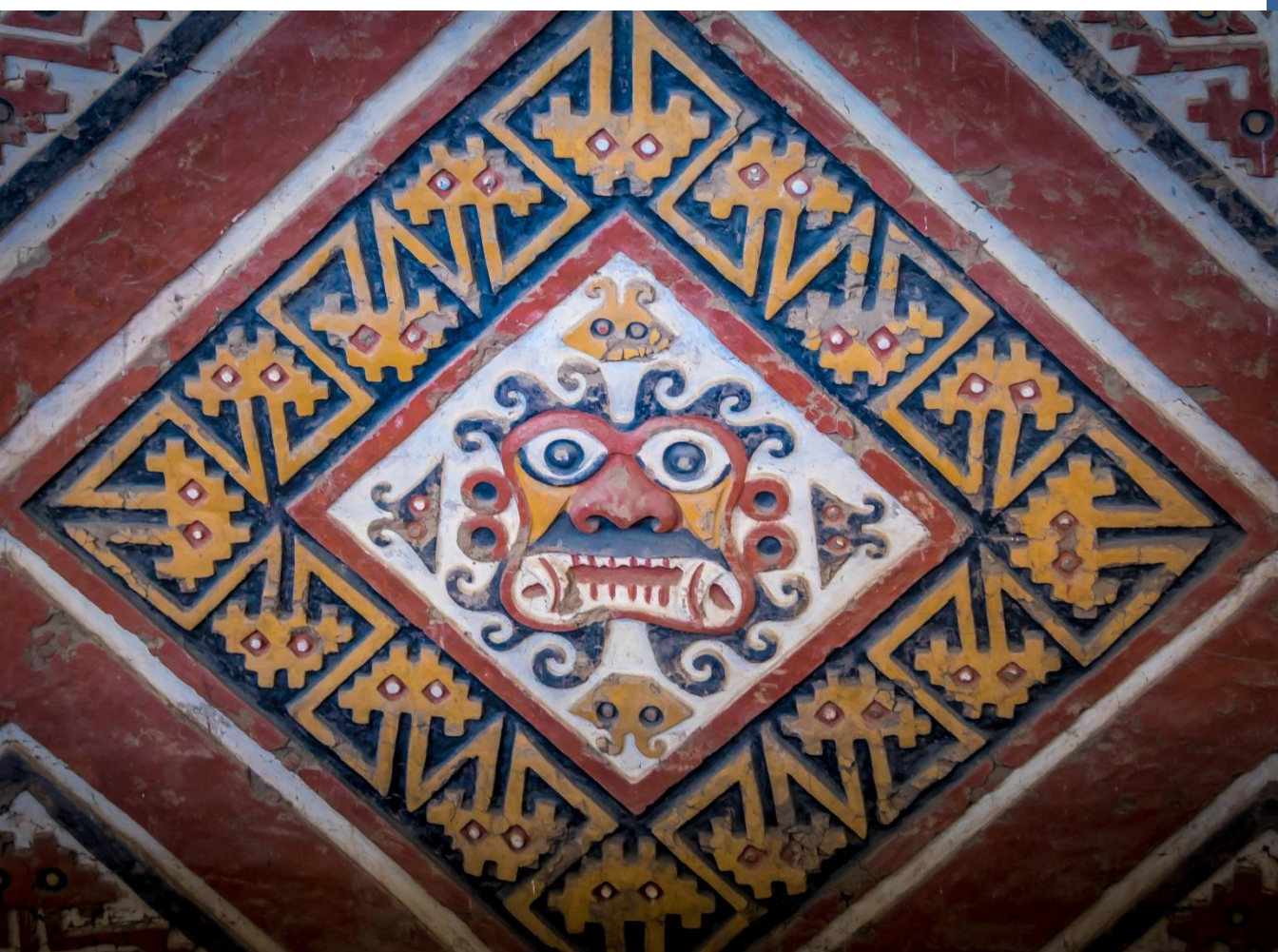
**A key feature of Peru’s economic geography is the over-dominance of the capital Lima, compared with the OECD.** Lima is the fifth largest urban area in Latin America in terms of population and one of the top 30 metropolitan areas of the world. It is home to a population of approximately 8.5 million, which represents 30% of the national population and close to half of the national economy. Arequipa is the second largest metropolitan area in Peru, and is less than one tenth of Lima in population size.

As a result, Peru has a very different urban structure than many OECD countries, mainly due

the lack of second tier cities. Lima hosts the vast majority of Peru’s high value services, manufacturing and transport and logistics, which reflects its role as an international gateway for the country. Given its size relative to other cities and regions in Peru, there is scope for additional agglomeration benefits by addressing problems associated with informal settlements and pressures on the transport network. Inter-regional disparities also reflect the persistence of some underperforming regions, and most likely the lack of capacity of second tier cities to reach their full potential.

**Largest city’s percentage of national population, employment and GDP, 2010**



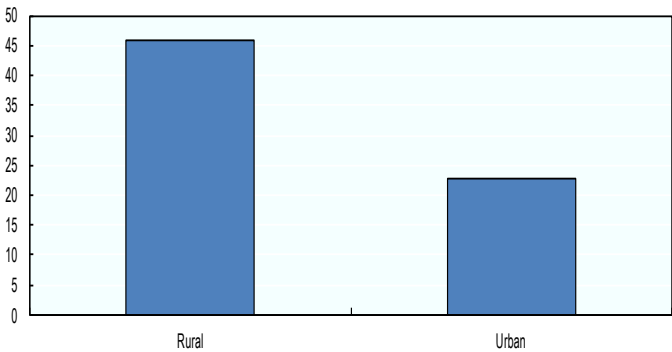


# Rural areas make an important contribution to the national economy but are not performing to their potential.

**Rural areas are rich in resources but face development challenges.** Three quarters of Peru’s exports are composed of mining, hydrocarbons, and agriculture. This share of total exports has not shifted significantly during the last 40 years. Although rural areas are rich in resources, rural dwellers are generally poorer. Nearly half of the individuals in poverty were estimated to live in rural areas, indicating that individuals in rural areas were nearly twice as likely to be poor than their urban counterparts. Moreover, poverty rates are very concentrated in space: about 47% of the poor were living in the region of the *Sierra* which also has a higher proportion of indigenous people. Some of the most important development challenges for Peru are located in rural areas, and better connections with urban settlements will help address them. The linkages between rural and

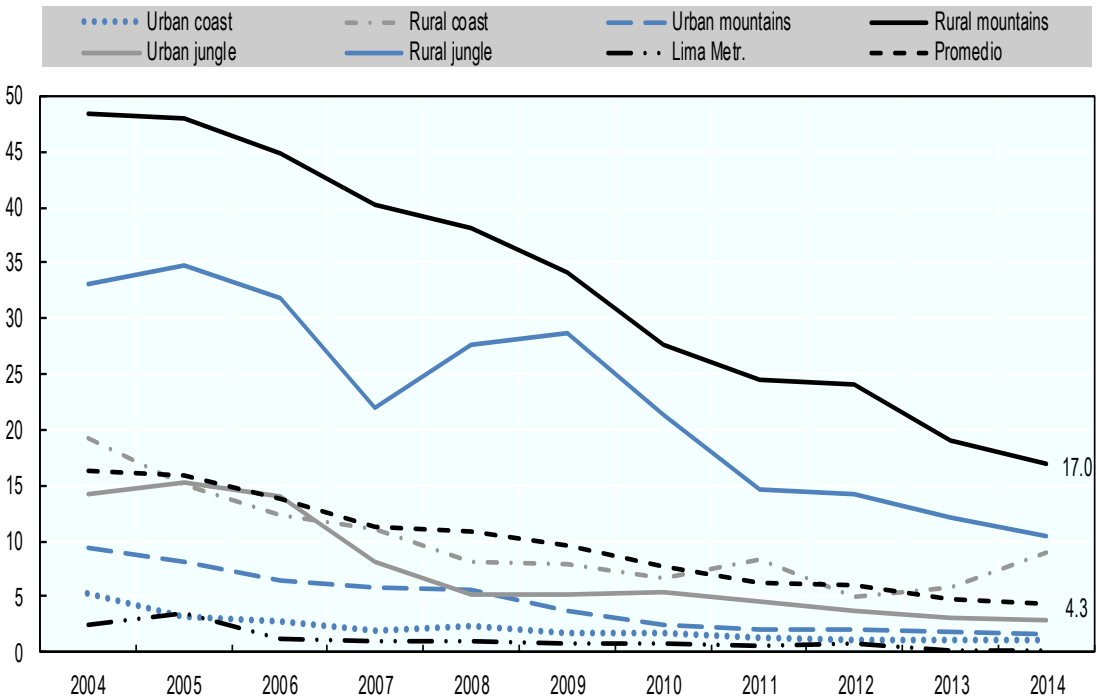
urban areas are weak due to ineffective strategic spatial planning, poor quality of infrastructure, and a lack of incentives to facilitate the coordination of investment and service delivery at the appropriate geographic scale (e.g. functional urban areas).

Percentage of the population living below national poverty lines, 2014



Source: OECD elaboration based on World Bank (2016) data

## Distribution of poverty in a selection of urban and rural areas



INEI 2004, 2014 (Encuesta Nacional de Hogares)







# A framework for action: policy recommendations

An integrated place-based approach to policies will enable Peru to address these challenges

Improving productivity in each region, which in turn will lift national productivity, requires a strategic and integrated approach to investing in the enabling factors of growth (skills, innovation, the business environment and infrastructure). The quality of human capital is not fully developed and effectively used by firms, and widespread informality in the labour market reduces incentives for improvement. The low innovation performance of firms, universities and other actors within the innovation system also needs to be addressed. This reduces the scope for diversification and the capacity to participate in higher value activities within global value chains (GVCs). Poor infrastructure networks reduce competitiveness within GVCs, and the productivity of the non-tradable sector which is mostly in cities where public infrastructure tend to be overcrowded and often suboptimal. Peru faces a challenge to design structural policies that can deliver sustained improvements to key the enabling factors of growth in an integrated way.

Across the OECD, it is increasingly recognised that place-based policies are complementary to structural policies and improve aggregate growth potential. Effective regional policies must focus on increasing the availability of enabling factors to incentivise

endogenous development rather than on transfers or subsidies. Policy complementarities can be effectively leveraged at the regional level where they can be integrated. Place-based approaches allow territorial prioritisation of policies and investments in skills, infrastructure and innovation, based on the different needs of regions to unlock their development potential. Tailoring these policy interventions at a place-based level is also important because of the mutually reinforcing impacts of complementarities between policies (e.g. infrastructure investment alone has little impact on growth unless it is coordinated with investments in human capital and innovation). Such an approach provides a framework for investments to be realised at the critical scale, based on functional areas, and thus avoiding fragmentation. Enabling this place-based approach is dependent upon local and regional governance arrangements that can tailor and adapt policies to local needs and circumstances.

Peru will need to address the following five challenges: i) improve the quality of national statistics and information systems, ii) develop regional policies, iii) urban policies, iv) rural policies; and v) reform the governance of decentralisation



## I) Improvements to the national system of territorial statistics are required

**Peru's way of defining urban and rural areas reduces the effectiveness and efficiency of public policies.** The regional taxonomy for statistical purposes is a very basic (binary) and defines rural in terms of non-urban status. This does not take into account factors such as population density and proximity to urban centres. National ministries and agencies also have different definitions for policy purposes and there is a lack of common platforms to integrate data and its use in policy development. The multiplicity of actors involved in the production of regional statistics results in diversity of standards, concepts, definitions and in several cases, in discrepant statistics. Consolidating territorial statistics and information systems will be instrumental in improving the quality of policy development processes and integrating and adapting the delivery of sectoral policies.

**Defining functional urban areas will be a key part of delivering more effective urban policies and improving urban-rural linkages.** These territorial definitions are based on political boundaries and administrative units. The usage of these boundaries must be coupled with functional boundaries in order to avoid an arbitrary definition of a territory that often does not correspond to patterns of life, job markets and business flows. For example, the administrative boundaries of a city often do not capture the economic flows and interactions which constitute its functional area. The mismatch between functional and administrative boundaries can result in difficulties in coordinating policies from

different administrative units and lead to sub-optimal outcomes. Currently there are no statistical or administrative geographies that correspond to the concept of functional region or labour market area. The analysis of functional urban areas in Peru would support the development of better policies for urban and rural areas.

**Adopting the OECD regional typology to Peru will help facilitate international comparability.** To help improve the system of territorial statistics and improve international comparability, the OECD regional typology should be applied to Peru. For the purpose of comparability with the OECD territorial grid the following classifications are recommended:

- Territorial level 2 (TL2) can be properly represented by 25 departments (*departamentos*); these include 24 departments, as such, plus the Constitutional Province of Callao (*Provincia Constitucional del Callao*), to which the State recognized a special status, reflected also in most of the statistical reporting.
- Territorial level 3 (TL3) can be properly represented by 195 provinces (not included the Constitutional Province of Callao).
- Below TL3, the building block of the regional typology is the community level, which in this case is the municipal level.

### *Recommendation to improve statistical definitions and the system of territorial statistics*

→ Develop harmonised statistical definitions of urban and rural areas by:

- Undertaking a stocktake of existing regional definitions across national ministries and develop harmonized statistical definitions for urban and rural areas.
- Advancing rural definitions to take into account the physical geography of the country (coastal, highlands, and rainforest), areas of strong interaction with urban centers, population density/ size, and accessibility/ remoteness.
- Advancing urban definitions with journey to work and travel time data which enables the creation of an agreed definition of functional urban areas within the system of national statistics.
- Developing indicators aligned with the OECD regional typology to allow for international comparability.

→ Expand the system of territorial statistics by:

- Developing a framework and set of indicators for measuring multi-dimensional wellbeing at a regional level that aligns with the OECD Better Life Index.
- Incorporating the measurement of GDP at the scale of regions and functional urban areas into Peru's national accounts.
- Developing an agreed set of environmental and land use indicators at the regional level, which would include the INEI linking existing datasets into a single data portal to improve access.

## II) Peru will need to strengthen its regional policy approach to unlock the growth potential of its regions

**Sectoral and innovation policies are primarily designed in a top-down way and Peru therefore has some way to go in shifting toward a place-based approach.** Over the past two decades, Peru has demonstrated a commitment to sound macroeconomic policies which have enabled the growth and diversification of exports. Peru's industry and innovation policies, which are primarily design and executed at a national level, have focused on further diversifying the economy and increasing the complexity of the country's export basket. Capabilities have been built within national ministries to design and deliver these policies, and constituencies have been built with private and public sector stakeholders around these core ideas. However, these policies are still primarily designed around industry sectors at a national level (with some exceptions such as the *Policy Strategy for Territorial Innovation*).

**Peru has a planning and institutional architecture that can provide the foundation for implementing a place-based approach.** Over the last decade the Peruvian Government has invested in improving its strategic planning capabilities. In 2008, the SINAPLAN (National Strategic Planning System) and its National Strategic Planning Centre (CEPLAN) as its governing and guiding body were created. The National Strategic Development Plan (PEDN in Spanish) establishes a policy framework to guide

development policies, which incorporates economic, social, and environmental considerations. CEPLAN has also established a hierarchy which links national development planning to sectoral and territorial plans. Concerted Regional Development Plans (PDRC) provide a framework for guiding development policies at a regional level. They are prepared by the regional governments, using an 8-year planning horizon.

**There is not sufficient vertical or horizontal coordination to implement this approach, particularly concerning the fiscal framework.** Mechanisms to ensure whole of government participation in the policy and investment cycle at a subnational level are lacking. These planning frameworks are also not clearly linked to, or conditional upon the allocation of resources (e.g. fiscal transfers). CEPLAN has a monitoring and evaluating role in regards to these subnational planning frameworks. However, it is in an advisory capacity and focuses on the degree of alignment between national, sectoral and strategic spatial planning frameworks, and the articulation between objectives, indicators and targets within each plan. There does not appear to be clear incentives to develop better quality plans, or to ensure coordination across the planning cycle. In addition, there is significant variation in capabilities between regional governments, and a lack of consistency and depth in measures to build these capabilities.

### ***Recommendations to implement a better approach to regional policies including by strengthening regional institutional capacity***

➔ Consider the establishment of more effective institutional support capacity that can facilitate a partnership based approach to regional development between departments and the national government. Two strategic options to achieve this outcome are: (i) deconcentrated agencies of the PCM and MEF working in partnership at a macro-regional scale; and, (ii) regional development agencies (RDA) that are constituted as a partnership between departments and the national governments. These options would need to be evaluated in terms of cost efficiency and effectiveness in relation to the following functions:

- Developing the skills and technical capacity of regional governments (departments) in areas such as policy development and evaluation, strategic planning, procurement, and project/programme delivery.
- Providing support to departments and municipal governments to better integrate strategic plans with fiscal frameworks and investment strategies.
- Communicating strategic priorities of the departments to the national government, identifying opportunities for strategic alignment between departments, and ensuring these priorities inform the national budget and planning cycle.
- Ensuring that national policies and priorities are considered and reflected in departmental planning.
- Integrating investments and program delivery at a regional and macro-regional scale, including improved coordination across national ministries.
- Evaluating and monitoring departmental and municipal level planning to ensure plans are effective and aligned with the national system of strategic planning.

*Recommendations to implement a better approach to regional policies including by strengthening regional institutional capacity (cont.)*

➔ Improve the quality and effectiveness of Concerted Regional Development Plans by:

- Ensuring that within the next 2 years that all Departments have an endorsed Concerted Regional Development Plan.
- Supporting the Regional Government in gathering input and advice from national ministries during the formulation of the Concerted Regional Development Plan (coordinated by the deconcentrated agency or RDA model).
- Mandating a formal review of the implementation of Concerted Regional Development Plans every 3 years, synchronised with other regions, and which is publicly available (coordinated by the deconcentrated agency or RDA model).
- Mandating publicly available annual reporting on progress in implementing the Concerted Regional Development Plan by the Regional Governor (which also includes a summary of the activities and achievements of the Regional Coordination Councils).
- Strengthening the economic analysis within these plans, for example, incorporating further analysis of the industry and business structure within regions at the scale of functional economic areas (including at a macro-regional scale), including how regional businesses are integrated with GVCs, and the identification of key bottlenecks and growth opportunities at these scales.
- Creating opportunities for policy makers at a departmental level to learn from each other and good practices nationally and internationally (e.g. through targeted training, and a bi-annual conference on regional planning and investment).

➔ Better integrate regional planning with the fiscal framework by:

- Introducing competitive based funding programmes that are designed to encourage innovation, infrastructure and skills initiatives at a regional level. Ensure that the criteria for prioritising funding includes demonstrating alignment with Concerted Regional Development Plans, the integration of investment between national ministries, and co-contributions from regions, different municipalities, business and other actors.
- Tasking the Ministry of Economy and Finance (MEF, through the RDA or deconcentrated agency) to work in partnership with departments to identify and prioritise medium-term (three to five years) capital investment programmes in the regional PDRCs to deliver on strategic priorities in the territory (derived from the national and subnational plans and programmes). Through the RDA, the MEF should also contribute to the development of these investment programmes.
- Including the annual report on progress in implementing the Concerted Regional Development Plan in the department's budget, demonstrating alignment with budget initiatives.





### III) A framework for urban policy has been established; however, it needs to provide stronger policy direction with clear mechanisms for implementation

To diversify the economy and lift productivity, Lima and secondary cities will need to be better connected and more inclusive. With Lima playing such a dominant role in the economy, the productivity and wellbeing of the city is a national policy issue. Considering its size relative to other regions in Peru, there is scope to generate additional agglomeration benefits and to lift the productivity of Lima. More can also be done to foster a system of cities by increasing connectivity, and improving integration with rural areas. To realise these benefits it is increasingly recognized across the OECD that national governments should play a more proactive role in urban policy. Effective urban policy requires clear differentiation and alignment between the roles of different levels of government, and mechanisms to coordinate 'city shaping' land use, infrastructure and environmental policies. As urban policy tends involve trade-offs between different policy options, citizen engagement is also important to the design and implementation of policies at a metropolitan and local scale.

**Leadership from the centre of government is required to deliver effective urban policies.** The National Urban Development Plan (NUDP) (2006-2015) was developed by the Ministry of Housing, Construction, and Sanitation, and provides a platform to better coordinate policies to support better urban development outcomes. However, the NUDP has not accomplished its goal of serving as guide and catalyst for the development of Peruvian cities. Peru's urban policy is primarily focused on social policy issues and needs to complement this with a focus on the economic performance of cities. Linkages with implementation also need to be strengthened. This includes strengthening the system of land use regulation, and integrating strategic spatial planning with public investment. Leadership from the PCM and MEF is required to achieve these outcomes.

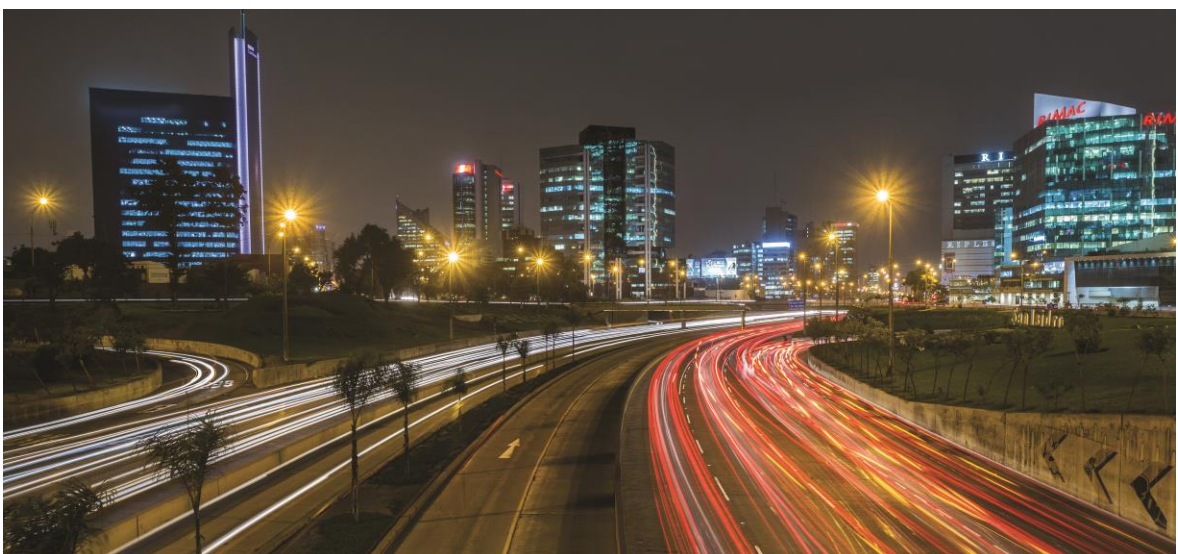
**Urban policies need to be better integrated with fiscal frameworks.** Mechanisms to link urban policies with resource allocation at a national level are lacking, which means that the NUDP has not unlocked the investment required to support urban development objectives. Importantly, this is also about ensuring that investments are delivered at the right time, in the right location, and in the right sequence (e.g. the coordinated delivery of economic and social infrastructure to support the development of new urban areas). This is not occurring consistently because urban policy objectives are not considered systematically by line Ministries or the MEF in terms how decisions are made programs and investments.

**More effective mechanisms are required to better coordinate and align urban policies at a subnational level.** There is a well-developed urban planning framework at a provincial and district level. However, it has not been implemented consistency across the country. These inconsistencies in implementation reinforce the point that there are not effective mechanisms in place to coordinate and align the various actors involved in urban policy. It also indicates differences in capacity between different provinces and district municipalities, and a lack of effective monitoring and evaluation of performance at regional and national levels. Even larger districts and provinces, which are likely to be better resourced, have low rates of implementation for key planning instruments. The regional level is largely absent from urban policy which reduces the scope for coordination and alignment between districts and municipalities and the national level.



## *Recommendations to develop a comprehensive approach to urban policies*

- ➔ The Peruvian Government should develop a comprehensive approach to urban policy which builds upon the lessons of the NUDP)2006-2015, and encompasses the following elements:
  - Clear policy objectives and indicators, which are outcomes-based, and monitored and evaluated.
  - Leadership of the PCM and MEF to ensure coordination in urban policies across national ministries (in particular Housing, construction and sanitation, Transport and communications, Environment, and Production).
  - Incentives and technical assistance for provincial and district municipalities to implement planning instruments and systems for land management (land use zoning, development approvals, and cadastre).
  - Enforcement of laws to protect public land and property rights, which is currently lacking.
  - The incorporation of strategic spatial planning into the fiscal framework (for example funding proposals for infrastructure should be required to demonstrate alignment with strategic spatial plans).
  - Incentives to encourage the matching and coordination of policies at the scale of functional urban areas.
  - An articulation of how cities can contribute to national strategies to lift productivity and promote economic diversification, and an identification of the economic roles and functions of cities within Peru's urban system.
- ➔ In parallel with this work, the Government should also work with key stakeholders to identify options for improving the governance of land use and infrastructure for functional urban areas.
  - This includes ensuring each city has an endorsed strategic spatial plan, and there is a coordinated process for linking this with investment decisions about infrastructure at a subnational and national level.
  - The Government should prioritise reforms for the metropolitan region of Lima, which will then provide lessons for improving planning and governance arrangements in intermediate cities.



#### *IV) Linking programs to address poverty with initiatives to promote economic development under a common rural policy framework would help rural areas maximize their assets and address development challenges*

The OECD's New Rural Policy can provide a framework to enable Peru's rural areas to maximise their assets and address development challenges. Capitalising on rural assets, including oil, minerals, and agricultural products has been critical to Peru's strong economic performance over the past two decades. Rural areas also face development challenges with higher levels of poverty, less skills, and lower quality infrastructure. OECD countries are increasingly implementing integrated approaches to address these kinds of challenges, maximise assets and opportunities, and to support rural areas to unlock new growth opportunities. In this context, innovative governance structures and policy instruments have been implemented in many OECD countries to strengthen coordination and to exploit the varied development potential of rural areas. The OECD has labelled this as the "Rural Policy 3.0" which includes a focus on integrated investments, urban-rural partnerships, and building capacity at the local level.

The current approach to rural policy is largely sectoral and focuses on poverty alleviation. Addressing poverty has been a policy focus of successive national governments in Peru. The Ministry of Development and Social Inclusion, and the Ministry of Agriculture play major roles in rural development policy. There are also a number of other national Ministries – such as Transport and Communications, and Health – which have developed rural specific policies. A large number of different social programs have evolved which provide transfers to poorer households, and invest in public services and basic infrastructure. There are comparatively less resources dedicated to economic development programs. Subsidies to agriculture were removed in the 1980s, and support focuses on extension services and the development and diffusion of irrigation technologies. Since the 1990s there has also been significant investment in the road network, which has benefited rural producers, and helped to reduce rural poverty.

There is a disconnect between these programs to alleviate poverty and policies to promote rural economic development. Peru's social programmes are largely detached from the country's competitiveness agenda focusing on the creation of employment and income generating opportunities. The Ministry of Economy and Finance and the Ministry of Production do not, for example, actively participate in efforts to address poverty and promote local economic development in rural areas. The same disconnect is evident at the subnational level and in NGOs and citizens organization the engagement of the business community is minimal. For instance, *Juntos* (and the large pool of information the programme collects about households and communities) may operate in coordination with a pro-growth programme, or better a policy, that empowers people and creates employment and business opportunities that reduces their dependence on the conditional cash transfer system.

To realise this outcome, governance arrangements for rural policy will need to be improved. Mirroring the situation in cities, rural regions would benefit from the creation of stronger regional governments that can coordinate investment and the delivery of public services. These include rural-urban partnerships that help adjacent communities interact and that facilitate the delivery services and public goods at the right territorial scale. In fact, the lack of an intermediate government level that can coordinate different streams of national policies is a key challenge in Peru that particularly affects the capacity of the public sector to promote the sustainable development of the country. An effective coordination body will also be needed at a national level, coupled with a clear vision and political leadership. For this reason, and given the importance of rural development in the country, the PCM and MEF should play a more proactive role in the national rural development agenda to facilitate a genuinely whole of government approach.



### *Recommendations to implement a pro-growth rural development agenda*

➔ The development of a pro-growth rural agenda can be achieved in the following ways:

- Ensuring that the vision, objectives and priorities for rural development have a strong focus on productivity and diversification and are included in relevant policies across government (the PCM and MEF should work in partnership to ensure buy-in and commitment from different national ministries to this policy agenda).
- Prioritising the development of initiatives which are designed to enhance productivity and diversification opportunities for rural communities (e.g. mining, agriculture, fisheries, and tourism).
- Adapting existing social programs such as Juntos and better link clients with opportunities for skills development, employment and entrepreneurship (this will provide a platform to make further inroads into poverty reduction, and reduce reliance on transfers over time).
- Strengthening the role of regions in the planning and coordination of rural development initiatives by ensuring Concerted Regional Development Plans include a strong focus on rural economic development.





## *V) Reforms that strengthen subnational governments and encourage a partnership based approach to regional development policies are required ...*

**Making decentralisation work is central to improving social, economic and environmental outcomes at a regional level.** Peru's regions face diverse challenges and opportunities, and public policies need to be tailored to effectively address them. Improving coordination between levels of government and improving subnational capacities will enable this place-based approach. Since 2002, Peru has undergone a decentralisation process driven both by democratic and economic and regional development objectives. This process has sought to bring democracy closer to the people, enhance accountability while at the same time improve the provision of public goods and reduce regional disparities. Peru has made strong advances in terms of political decentralisation, with the election of regional governments and transfer of significant responsibilities to the subnational level.

**Roles and responsibilities are not clear and subnational governments lack the skills and capabilities to carry them out effectively.** The current decentralisation process was initiated in 2002, and based the division of responsibilities between levels of government on the principle of subsidiarity. However, in practice there is an overlap in roles and responsibilities across governments. In addition, these responsibilities were transferred simultaneously to all regions independently of an assessment of their capacities to carry them out. The national government has not devolved responsibilities related to resource allocation, and subnational governments (particularly regions) do not have an adequate tax base. As a result there is a systemic problem in relation to lack of accountability for outcomes at a subnational level. The national government seeks to overcome this issue by directly delivering services at a regional and local level, and placing tight controls on the expenditure decisions of subnational governments.

**Coordination rather than fragmentation is the problem facing public administration in Peru.** Peru displays levels of regional and municipal size above the OECD average (both in terms of area and population). However, over 60 new municipalities have been created over the past 6 years, which is a potential risk and requires closer consideration. Without effective coordinating mechanisms various risks can emerge between levels of government such as gaps between responsibilities and fiscal

capacity, the lack of capacities to deliver services, and policies that are designed without consideration of synergies and overlaps between sectoral areas. Mechanisms that address these risks such as mutually agreed contracts and agreements, the monitoring of nationally agreed standards and regulations for service delivery, and coordinating committees and partnerships are lacking or not effectively operationalised in the Peruvian context.

**Subnational governments, particularly at the regional level, do not have the fiscal space to effectively tailor and adapt policies and resources to regional and local circumstances.** The vast majority of taxes (87%) are collected by the national government and if resources are allocated to the subnational level they are tightly controlled. Subnational governments have become increasingly dependent on central government transfers, particularly on "ordinary resources" which constituted 78% of regional revenues and 22% of municipal revenues in 2014. Most of these resources are transferred from the central government for particular projects and programmes, and the capacity for regional governments to modify them is limited. Subnational governments in those cases are confined to a role of executing national policy directions and resource allocation decisions. In this sense they act more as deconcentrated agencies of the central government than as subnational governments in a decentralised system.

**The revenue system from natural resources is contributing to a problem of fragmentation of investment at a subnational level.** An increase in revenue from natural resources (the *canon*) in recent years has increased imbalances in expenditures between local municipalities and regions. *Canon* transfers are strongly concentrated with six regions receiving 77.7% of the overall transfer between 2002 and 2014. Three-quarters of this revenue is allocated to the municipal level with the remaining 25% allocated to the regional level. In this period, the level of transfers from the *canon* increased significantly, from 164 million PEN to 7.1 billion PEN. Together with the lack of effective co-ordination mechanisms, the transfer system contributes to the problem of fragmentation of public investment at a subnational level.

## Recommendations to make decentralisation work by strengthening subnational governments and encouraging a partnership based approach to public investment

→ Develop more effective partnerships between level of government to deliver better policy outcomes by:

- Strengthening the role of the Inter-governmental Coordination Council including by re-focusing its role on policy coordination between the national and regional governments, and streamlining its agenda on a small number of mutually agreed policy issues.
- Strengthening governance arrangements that facilitate policy and investment coordination between levels of government at the scale of functional urban areas, and macro-regions.
- Developing a coherent strategy to build the skills and capabilities of subnational governments, which is linked to an accreditation system for increasing responsibilities (including applying the national law on Civil Service reform to the local and regional level).
- Putting in place an asymmetric approach to decentralisation, particularly for metropolitan areas, which would allow for the flexibility to better match responsibilities with resources and capabilities.
- Clarifying the criteria for the creation/amalgamation of new municipalities (including consideration of factors such as fiscal sustainability, efficiency and effectiveness of services, service catchments), and establishing a more transparent and consultative process which includes a public statement providing the evidence and rationale for these decisions.
- Creating a taskforce with a mix of technical skills and capabilities (strategic planning, public finance, procurement, project management and evaluation), which can be applied in a flexible way to address critical gaps in skills and capabilities at a subnational level.

→ Develop a coherent package of actions to enable better public investment outcomes at a subnational level by:

- Strengthening support for subnational governments to apply results-based budgeting, which is integrated with local and regional concerted development plans.
- Incorporating multi-year (3-5 year) capital investment and service delivery plans into the fiscal framework at a regional level and making national transfers conditional upon them (the PCM/MEF should also ensure coordinated input from across national ministries to these plans).
- Developing a system of public reporting of service delivery performance at a subnational level, which is transparent, user friendly, and enables comparisons between jurisdictions.

→ Designing and implementing an integrated reform to subnational finances which includes the following features:

- Increasing the proportion of investment funds (such as the canon) which are allocated to the regional level, and reducing the proportion allocated to the provincial and district levels in order to increase the overall effectiveness of public investment at a subnational level by generating increased economies of scale and the scope for policy complementarities.
- Creating a stability fund managed by an independent board appointed by the Government, which would help balancing the cyclical nature of the royalties system (the canon in Spanish).
- Strengthening equalisation mechanisms to help compensate for inequalities between subnational governments that are exacerbated by the canon.
- Improving tax administration at a subnational level by pooling administrative capacity at a regional level enabling regions to better collect taxes on behalf of municipalities.
- Providing subnational governments with the mandate and capacity to mobilise their own revenues (e.g. property tax at a municipal level) which would help stabilise public finances, while providing clearer accountability for outcomes.





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