Assessment and recommendations

Peru's recent growth performance has been strong but challenges remain.

Peru's recent socio-economic performance has been impressive with strong growth and progress in reducing poverty. Since 2000, gross domestic product (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 have more than halved since 2001, to a level of around 23% in 2014, and extreme poverty rates have also 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 employs 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 would suggest. The decline in commodity prices presents downside risks for Peru. Although its sound macroeconomic policies and open economy will stand it in good stead, the country does face some challenges.

Improving productivity across the economy is a key challenge. Despite recent improvements in productivity, Peru's international competitiveness is impacted by historically slow productivity growth. Peru's total factor productivity has grown at an annual rate of less than 2% over the last two decades, which has not been enough to close the gap with OECD economies. Peru's level of 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 shows particularly low levels of productivity. This includes 25.8% of the labour force employment in agriculture 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.

Addressing this productivity challenge will require a strategic and integrated approach to investing in key enabling factors (skills, innovation, the business environment and infrastructure). The first is challenges associated with human capital and informality. The quality of human capital is not adequate, it is insufficiently developed and not effectively used by firms, and widespread informality in the labour market reduces incentives for firms and individuals to invest in it. The second is the low innovation performance of businesses, universities and other actors within the innovation system. This reduces the scope for diversification and the capacity to participate in higher value activities within global value chains (GVCs). The fourth is poor infrastructure performance, which also reduces competitiveness within GVCs, and the productivity of the non-tradable sector. Peru faces a challenge to design structural policies that can deliver sustained improvements to key enabling factors (skills, innovation, the business environment and infrastructure) in an integrated way.

Peru is territorially diverse and these growth dynamics and challenges are playing out differently across the country.

Compared to OECD countries, Peru would rank as one of the largest countries and is very territorially diverse. It is the 19th largest country in the world, and only 4 OECD countries (Canada, the United States, Australia and Mexico) have a larger land mass. Population density is low at only 24 people per square kilometre, which is similar to relatively low density countries such as Chile and Sweden. The physical geography of the country is shaped by a thin coastal region, the Andes and the Amazon forest in the interior. Coastal regions tend to have better socio-economic conditions than uplands and rainforest regions in the interior of the country. These different areas are not well connected and have vastly different levels of service provision and infrastructure. When assessing regional growth trends in detail, it is apparent that the economic geography of the country is also marked by heterogeneity and difference, which emphasises the importance of taking a place-based approach to policies designed to promote inclusive growth.

A key feature of Peru's economic geography is the over-dominance of the capital Lima, compared with OECD countries. Lima dominates the urban system of Peru with a population of approximately 8.5 million, which represents 30% of the national population and close to half of the national economy. In terms of population, this makes Lima the fifth-largest urban area in Latin America and one of the top 30 metropolitan areas of the world. Arequipa is the second-largest metropolitan area in Peru, and is less than one-tenth of Lima in population size. Lima is the location of 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. Although Lima is performing well compared to other regions, it is not performing that well considering the size of the population and the industry mix. Addressing problems such as over-crowding on the transport network in Lima would have a significant productivity pay-off. There are also significant inter-regional disparities between Lima and the rest of the country, and between coastal areas and the interior, which reflects the weaknesses of other regions, and most likely the underperformance of second-tier cities.

Rural areas make an important contribution to the national economy but are not performing to their potential. Three-quarters of Peru's exports is composed of mining, hydrocarbons and agriculture, and this share of total exports has not shifted significantly in the last 40 years. Although rural areas are rich in resources, the people living there 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 individuals living in urban areas. Moreover, 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 factors such as ineffective strategic spatial planning, poor quality infrastructure and a lack of incentives to facilitate the co-ordination of investment and service delivery at a functional scale.

There is a need to support territorial policies with better evidence.

National policies are based on different ways of defining regions and using evidence about social, economic and environmental conditions, which reduces the effectiveness and efficiency of public policies. Peru's regions are diverse, and each region has different sources of and potential for growth. There are significant differences in socio-economic conditions between coastal, highland and jungle areas and these places are not well connected. However, Peru's regional taxonomy for statistical purposes does not capture this diversity and is a very basic (binary) one, which defines rural in terms of non-urban status. This definition does not include factors such as population density or proximity to urban centres. National ministries and agencies also have different definitions of urban and rural areas 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 does bring disadvantages, such as an arbitrary definition of a territory that often does not correspond to patterns of life, job markets or 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 co-ordinating 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 is applied to the case of 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 recognised 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 report is identified with the term of district and district municipality. Throughout this report, the terms local governments and municipal governments

will be used to identify both provincial municipality and district municipality (if not otherwise indicated).

Recommendations to improve statistical definitions and the system of territorial statistics

1. Develop harmonised statistical definitions of urban and rural areas by:

- undertaking a stocktaking of existing regional definitions across national ministries and develop harmonised 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 centres, population density/size and accessibility/remoteness
- advancing urban definitions with journey to work and travel time data which enable 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.

2. Expand the system of territorial statistics by:

- developing a framework and set of indicators for measuring multi-dimensional well-being 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 National Institute of Statistics and Informatics (Instituto Nacional de Estadística e Informática, INEI) linking existing datasets into a single data portal to improve access.

Peru will need to strengthen its approach regional policy to unlock the growth potential of its regions.

Across the OECD it is increasingly recognised that place-based policies are complementary to structural policies and improving aggregate growth potential. There are strong differences in the economic performance between regions and these differences tend to persist over time due to regional factors. These factors can be influenced by integrated and tailored investments in "enabling factors" such as skills, infrastructure and innovation that are designed to unlock regional growth potential. Tailoring these policy interventions at a place-based level is important because of the mutually reinforcing impacts of complementarities between policies (e.g. infrastructure investment alone has little impact on growth unless it is co-ordinated with investments in human capital and innovation). 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 still has some way to go in shifting toward this place-based approach as sectoral and innovation policies are still primarily designed in a top-down way. Over the past two decades Peru has demonstrated a commitment to sound macroeconomic policies which has enabled the growth and diversification of exports. Peru's industry and innovation policies, which are primarily designed 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 key 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 already 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 eight-year planning horizon.

However, there is insufficient vertical and horizontal co-ordination to implement this approach, particularly concerning the fiscal framework. Mechanisms to ensure whole-of-government participation are lacking in the policy and investment cycle at a subnational level. These planning frameworks are also not clearly linked to, or conditional upon, the allocation of resources (e.g. fiscal transfers). CEPLAN does have a monitoring and evaluating role in regards to these subnational planning frameworks. However, it is in an advisory capacity and focuses upon in the degree of alignment between national, sectoral and strategic spatial planning frameworks, and the articulation between objectives, indicators and targets within each plan. There do not appear to be clear incentives to develop better quality plans or to ensure co-ordination 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

3. Consider the establishment of more effective and strategic institutional support capacity to facilitate a partnership-based approach to regional development between departments and the national government. Two strategic options to achieve this outcome are: 1) deconcentrated agencies of the Presidency of the Council of Ministers (PCM) and Ministry of Economy and Finance (MEF) that can work in partnership at a macro-regional level; and 2) regional development agencies (RDA) that are constituted as a partnership between departments and the national government:

- 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

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

- ensuring that national policies and priorities are considered and reflected in departmental planning
- co-ordinating investments and programme delivery at a regional and inter-regional scale
- evaluating and monitoring departmental and municipal level planning to ensure plans are effective and aligned with the national system of strategic planning.

4. Improve the quality and effectiveness of concerted regional development plans (PDRC) by:

- ensuring that within the next two years that all departments have an endorsed PDRC
- 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 PDRCs every three years, synchronised with other regions, and which is publicly available (co-ordinated by the deconcentrated agency or RDA model)
- mandating publicly available annual reporting on progress in implementing the PDRC by the regional governor (which also includes a summary of the activities and achievements of the regional co-ordination 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).

5. 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 PDRCs, 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 PDRC in the department’s budget and plans, demonstrating alignment with budget instruments.

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 well-being 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 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 recognised 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 co-ordinate "city shaping" land-use, infrastructure and environmental policies. As urban policy tends to 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) (2006-15) was developed by the Ministry of Housing, Construction and Sanitation, and provides a platform to better co-ordinate 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 co-ordinated 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 on programmes and investments.

Urban policies are not co-ordinated or aligned at a subnational level. There is a well-developed urban planning framework at a provincial and district level; however, it has not been implemented consistently across the country. These inconsistencies in implementation reinforce the point that there are not effective mechanisms in place to co-ordinate 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 co-ordination and alignment between districts and municipalities and the national level.

Recommendations to develop a comprehensive approach to urban policies

6. The Peruvian government should develop a comprehensive approach to urban policy which builds upon the lessons of the National Urban Development Plan (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 co-ordination 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 co-ordination 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.

7. In parallel to 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 urban plans, and that there is a co-ordinated 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.

Linking programmes to address poverty with initiatives to promote economic development under a common rural policy framework would help rural areas maximise their assets and address development challenges.

The OECD's New Rural Policy can provide a framework for better enabling Peru's rural areas to maximise their assets and address development challenges. Peru's strong national economic performance that has characterised the past two decades depends on capitalising on rural assets, including oil, minerals and agricultural products. 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 support rural areas to unlock new growth opportunities. In this context, innovative governance structures have been created in many OECD countries to strengthen co-ordination across sectors and across levels of government; and innovative policy instruments aimed at identifying and exploiting the varied development potential of rural areas. The OECD has labelled this as the "New 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 and irrigation 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 programmes 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 programmes. 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 programmes to alleviate poverty and policies to promote rural economic development. Peru's social programmes are largely detached from the country's competitive agenda, focusing instead 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 non-governmental organisations (NGOs) and citizens' organisations the engagement of the business community is minimal. For instance, *Juntos* (and the large pool of information the programme collects about households and communities) could operate in co-ordination with a pro-growth programme, or better a policy, that empowers people and helps to create in the right conditions that would allow them to leave 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 co-ordinate investment and the delivery of public services. These include rural-urban partnerships that help adjacent communities interact and that facilitate the delivery of services and public goods at the right territorial scale. In fact, the lack of an intermediate government level that co-ordinates 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 co-ordination body will also be needed at the 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 the 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

8. 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 centre of government – the Presidency of the Council of Ministers and the Ministry of Economy and Finance – 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 programmes such as *Juntos* and better linking 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 co-ordination of rural development initiatives by ensuring concerted regional development plans include a strong focus on rural economic development.

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 co-ordination 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. The process 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 the 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, which was initiated in 2002, based the division of responsibilities between levels of government on the principle of subsidiarity. However, in practice there is an overlap of 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 levels, and placing tight controls of expenditure decisions on subnational governments.

Co-ordination rather than fragmentation is the problem facing the 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 co-ordination 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 co-ordinating committees and partnerships are lacking or not effectively operationalised in the Peruvian context.

The transfer system is unequal and subnational governments 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 resources that are allocated to the subnational level are tightly controlled. For example, subnational governments are heavily dependent upon 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. 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

9. Develop more effective partnerships between levels of government to deliver better policy outcomes by:

- strengthening the role of the Inter-governmental Coordination Council including by refocusing its role on policy co-ordination 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 co-ordination between levels of government at the scale of functional urban areas, and macro-regional scale

Recommendations to make decentralisation work by strengthening subnational governments and encouraging a partnership-based approach to public investment (*continued*)

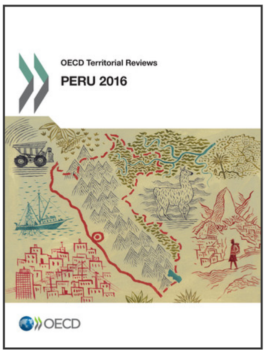
- developing a coherent strategy to build the skills and capabilities of subnational governments, which is linked to an accreditation system for increasing responsibilities (including applying the national Law on Civil Service Reform to the local and regional levels)
- putting in place an asymmetric 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 task force 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.

10. 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 (three-to five-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 co-ordinated 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.

11. 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, would help balance the cyclical nature of the royalties system (the *canon* in Spanish)
- strengthening equalisation mechanisms to help compensate for inequalities between regions that are exacerbated by the *canon*
- improving tax administration at a subnational level by pooling administrative capacity at a regional level, enabling regions to 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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