

Chapter 5

Good governance and effective state capacities in Peru

Peru should enhance its governance and state capacity to prioritise and effectively implement the policies highlighted in the preceding chapters. Better governance is not an end in itself but a means to achieve the policy objectives needed to boost inclusive development. In particular, tackling corruption should both increase the trust citizens have in their government and build state legitimacy. The governance of the judiciary and legislature should improve, while central government requires better co-ordination and enhanced leadership to drive long-term reforms. Much has been done to integrate the private sector in expenditures and investments, but better management of the process is needed to avoid inefficiencies and unexpected fiscal costs. At the regional level, the allocation of public resources does not contribute to reducing sub-national disparities, and local governments require more capacity to improve their policy making. Although the environmental institutional framework has improved in recent years, implementation of public policies to foster environmental sustainability remains weak.

Peru is a unitary presidential state comprising three branches (legislative, executive and judicial), plus autonomous organs, control institutions and an electoral organisation. The executive branch exercises the government administrative functions of the state and includes all public authorities at sub-national levels (departments, provinces and districts). It is chaired by the President of the Republic. In addition, the Presidency of the Council of Ministers co-ordinates national policies with different ministries, civil society and the private sector to create a participative and transparent framework to boost the processes of modernisation, decentralisation, governance, and social and economic inclusion in Peru.

Peru has adopted key reforms to improve governance and citizens' participation in recent years. At the central government level, its public investment framework (*Sistema Nacional de Inversión Pública*), fiscal framework projections and budgeting process are more effective and transparent. In addition, information technology is better used to enhance transparency, integrity and the efficiency of the procurement. The regulatory and institutional frameworks for public-private partnerships offer better processes to prioritise, implement and monitor private investments. At the sub-national level, the 2002 decentralisation process and subsequent regulations have enhanced local participation, and local responsibility for expenditure. Recent reforms have provided environmental authorities with greater institutional capacity in attempt to boost sustainable green growth.

However, negative perceptions of Peru's institutions among the population remain; these could be tackled through a number of policies. Specifying better the roles of central government institutions will be essential for improving the effectiveness and co-ordination of public policies in order to boost legitimacy and build confidence. A long-term strategic framework comprised of appropriate checks and balances over public expenditures and investments would increase business confidence and improve the way institutions are perceived. Better interactions horizontally – between different ministries and agencies of the central government – and vertically – with departments and provinces – are key to achieving more effective public policies. Furthermore, the current multi-level governance lacks an appropriate methodology for boosting regional development and tackling regional inequalities. One area specifically affected by these institutional weaknesses is the environment.

This chapter discusses four key dimensions needed to improve the effectiveness of public policies in Peru. First, it analyses the role of the central government and, in particular, its capacity to co-ordinate and monitor horizontal policies in Peru. Second, it considers how private-sector involvement in investments is governed and the need for further improvements in procedures related to public-private partnerships, public procurement and Works for Taxes (*Obras por Impuestos*). Third, given the regional socio-economic disparities in Peru, it examines the need to improve the allocation of resources to sub-national authorities and to increase capacity building at local level. Finally, it focuses on the institutional capacity of the environmental sector, which requires effective co-ordination horizontally (across central government), vertically (at multiple levels of governance) and with private actors (mainly legal and illegal mining firms).

A weak institutional framework undermines state legitimacy

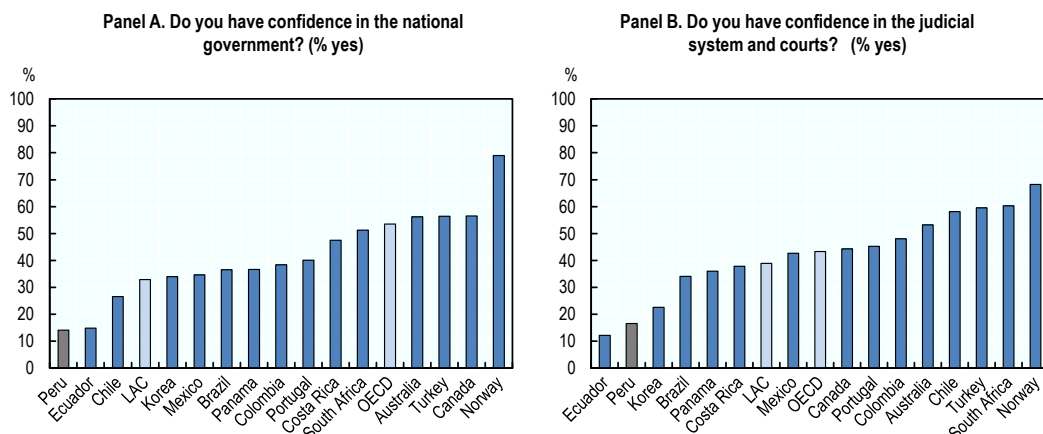
Peru's poor institutional framework is affecting state legitimacy. For instance, corruption is as a distorting factor affecting the quality, composition and productivity of

physical capital, and undermining the benefits of investment. In this context, corruption can be perceived as a cost to entrepreneurs and to citizens in general. It can affect public investment policies, and challenge private investment by creating a negative business climate for the private sector. More generally, institutions that are perceived as ineffective in achieving their goals, non-transparent in how they act and unaccountable for their results undermine social cohesion, hampers collective action to achieve shared objectives, and reduce the well-being of individuals and communities.


Trust in institutions is a key challenge in Peru

Lack of trust in existing institutions is a crucial concern in Peru. Confidence in institutions is a key pillar of the governance dimension in the OECD well-being framework discussed in Chapter 1. Several institutions in Peru suffer from lack of public confidence. Compared to the benchmark countries (described in Annex 1.A1 of Chapter 1), few citizens in Peru trust in institutions such as the national government and the judicial system (Figure 5.1). Corruption is considered the second most important problem in Peru after delinquency (INEI, 2014). Corruption is perceived to be widespread, with 82% of Peruvians believing it to occur within businesses and 89% throughout the government (Gallup Organisation, 2015). More than 60% of citizens have not complained about cases of corruption because they believe it would be useless or even cause them problems. This perception persists at the sub-national level in some departments. For instance, more than 95% of citizens of Madre de Dios, Apurímac, Huánuco, Callao and Tumbes perceive their governments to lack integrity. In Callao and Tumbes, more than 80% of their citizens report having bribed public servants (CAD, 2013). Building a national and sub-national environment in which people are confident in their government will enhance incentives for entrepreneurship, job creation and well-being of individuals.

Figure 5.1. Confidence in institutions in Peru (2014)



Source: Gallup Organisation (2015), *Gallup World Monitor* (database).

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In recent years, Peru has approved several policies to enhance public administration and reduce corruption (World Bank, 2012). A key reform initiated in the early 2000s helped to enhance public servants' responsibilities and increase sanctions (PCM, 2012). It also improved the quality and professionalism of public administration. The Criminal

Procedure Code, implemented in 2009-10, contributed to enhancing the sector's efficiency and transparency (World Bank, 2012). Institutions offering public services can now share information technology systems. For instance, linking social services ministries and judicial institutions was a step towards better access to justice and boosted anti-corruption policies. Greater transparency and monitoring by the public procurement agency (*Organismo Supervisor de Contrataciones del Estado*, OSCE) strengthened these activities and reduced the possibilities for corruption. A Public Sector Integrity Review is currently being carried out in Peru, within the framework of the OECD Country Programme, to analyse and provide recommendations in further policies to fight against corruption.

Despite certain progress, Peru faces a number of barriers to moving towards transparent and open government to fighting corruption alongside the private sector and civil society. According to meetings with experts from private sector and non-governmental organisations, only a few public institutions are considered to be free of corruption. These include the Ministry of Economy and Finance; the Central Bank of Peru; the Superintendency of banks, insurance companies and pension funds; and the competition authority INDECOPI. Ineffective red tape increases the probability of public servants being bribed to accelerate procedures in Peru (Yamada and Montero, 2011). Although the number of procedures and the time needed to complete them have been reduced, this number remains high compared to OECD and some benchmark countries (Chapter 3). Peru is also facing higher risks from illegal activities, such as drug production and trafficking, which are often facilitated by the bribery of public servants in. This is in particular the case for transportation and control authorities (Pedragio, 2014). For instance, the share of Peruvians who lack confidence in the police has increased from 58% in 2002 to close to 80% in 2013.¹

In that context, strong trust networks are essential to reduce corruption. In social groups where trust is low, as is the case of Peru, there is greater cause for corruption (Yamada and Montero, 2011). In such cases, a vicious circle results in which the incentive for an individual to be corrupt depends on the collective reputation of the group to which they belong (Tirole, 1996). Consequently, it may not be in the interest of individuals to be honest when the institutions they work for have a reputation for being corrupt.

A weak judiciary is powerless in the fight against corruption

The ineffectiveness in courts and in the judiciary system is also increasing corruption in Peru. Higher workloads are causing delays to judicial procedures, providing greater incentive for litigants to engage in corruption activities (Rose-Ackerman, 2007; Salazar and Ramos, 2007). Low levels of education and low wages also render judges prone to corruption (Sánchez Urribarrí, 2008; Hammergren, 2007). Widespread inefficiencies and corruption in the judiciary affect economic activity. In particular, the ineffectiveness of the legal system, and the low probability of being either detected or punished, have an impact on corruption (Andvig and Moene, 1990).

There are several institutions in Peru to fight against corruption. These institutions include the Attorney General (*Ministerio Público*), the General Comptroller and the Prosecutor against Corruption (*Procuraduría Pública Especializada en Delitos de Corrupción*). The Attorney General is responsible for conducting investigations and judicial actions in defence of public interests. The transparency and efficiency of this institution are affected by a lack of experts and the fact that several provincial prosecutors are appointed discretionally. In addition, corruption cases at the highest level have

reinforced its lack of legitimacy.² The General Comptroller is the ruling body of the National Control System, in charge of supervising and auditing the proper use of the goods and resources of the state. Ineffectiveness in this institution results from a lack of prevention and dissuasion of public servants, as well as from the poor internal control mechanisms within other public administrations (Panfichi and Alvarado, 2011). The Prosecutor against Corruption lacks an institutional framework to prioritise corruption cases, and is short of specialised human resources due to its restricted budget (Simon and Caro, 2012). Peru needs a better balance between punishment and effective decision processes for public servants to create appropriate incentives for their activities.

The legislative branch and the decentralisation process fail to impose adequate accountability on the executive

The legislative branch does not contribute enough to the fight against corruption. In addition to its law-making power, the legislature has the power of political control and supervision. In practical terms, it has the power to investigate cases of public interest, including cases of corruption. Similar to other countries in Latin America, the checks and balances the legislature provides over the decisions of the executive remain limited (Dayton-Johnson et al., 2011). This implies that it is not necessarily in the interests of individual congressmen to increase their supervision over the executive, limiting the quality of the control they can exert (Panfichi and Alvarado, 2011). This results in a lack of efficiency among the parliamentary commissions in charge to investigate public cases. Furthermore, citizens consider Congress the most corrupt institution in Peru.³

Corruption remains a key challenge at sub-national level. In the 1990s, before the decentralisation process began, weak control institutions and a centralised executive without checks and balances affected corruption in Peru (Morris and Blake, 2009). The decentralisation process initiated in 2002 has not achieved its objective of bringing accountability closer to citizens. The judicial system has not improved as much as desired, and Peru is lagging behind other countries in the region in strengthening the rule of law at the sub-national level. Corruption cases persist at local levels and in administrations that interact directly with citizens. Around 65% of corruption incidences happen at the level of regional governments (Arbizu, 2014). Better management of public resources at the sub-national level is fundamental to enhancing transparency of public institutions in Peru (see section below on sub-national policies).

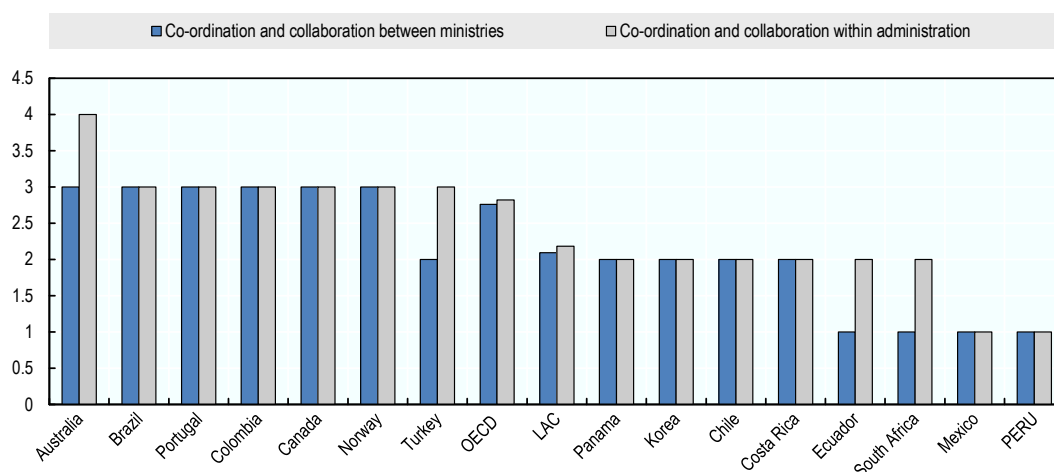
Poor co-ordination and implementation of public policies hamper central government

In all countries, the centre of government (CoG) should play a key role in ensuring the quality, co-ordination and monitoring of public policies at the executive level. The CoG is the body or group of bodies that provides direct advice to the head of the government and ministers. More precisely, it supports quality decision making by the head of government, provides cross-government policy co-ordination and monitoring of the government policy implementation. Apart from their traditional role of serving the executive from an administrative perspective, CoGs are now playing a more active role in policy development and co-ordination across OECD countries. The extended definition of the CoG does not only include the presidency or its equivalent, but also comprises key strategic partners, such as the ministry of finance or the ministry of planning. Depending on a country's particular institutional makeup, several actors can play an important role in CoG co-ordination. Additionally, central agencies responsible for coherent human

resources policies, e-government policies and regulatory policies across different departments can also contribute to reinforcing cross-government co-ordination.⁴


Peru lags behind benchmark countries in the co-ordination of public policies. One flaw in Peru's centre of government set-up is the lack of co-ordination of public policies in the country. Despite efforts to increase dialogue among different institutions in recent years, the lack of collaboration and co-ordination among ministries and within the administration is an obstacle to effective policy making and implementation (Figure 5.2). This poor performance compared to benchmark countries can be explained by a number of factors, such as weakness in the prioritisation and implementation phases for policies involving several ministries. This includes environmental policies (see section below), and other key policies considered in previous chapters (e.g. skills and education in Chapter 2, and innovation and infrastructure in Chapter 3).

Figure 5.2. Perceptions of co-ordination among public institutions, 2012



Note: 0 represents very little co-ordination and 4 strong co-ordination. The Institutional Profiles Database provides an original measure of countries' institutional characteristics through composite indicators built from perception data. The perception data were gathered through a survey completed by country/regional Economic Services (*Services économiques*) of the French Ministry for the Economy and Finance and the *Agence Française de Développement's* offices.

Source: IPD (2012), "2012 governance data", *Institutional Profiles Database*, www.cepii.fr/institutions/EN/ipd.asp.

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The centre of government in Peru faces challenges related to leadership, co-ordination and long-term implementation of policies. It is composed of the Presidency of the Council of Ministers (PCM) including the National Centre for Strategic Planning (CEPLAN), and the Ministry of Economy and Finance. To increase the effectiveness of public policies to reduce inequalities and boost productivity, CoGs need to offer vision, leadership and innovation. In Peru, this is especially difficult as the country faces high levels of political and public-sector fragmentation. In addition, the lack of enforcement of a National Development Plan in the long term puts pressure on the strategic policy-making capacity of the state and its service delivery capacity. In that context, there is a lack of co-ordination of public policies in the medium and long term. In the period 2000-15, there were 20 different Presidents of the Council of Ministers, representing close to 6 appointments per presidential mandate. This high turnover is primarily explained by political and corruption scandals (even those originating outside the PCM).

It affects the stability and legitimacy needed to move forward with reform, and to reinforce the PCM's strategic role in supporting the quality and co-ordination of the decision-making process. In addition, although CEPLAN has the technical capacity to undertake research and analysis, little is done at the executive level to promote the adoption and implementation of these studies. Indeed, the president of CEPLAN's governing board is not a member of the Council of Ministers, and CEPLAN does not have the capacity to take the lead in adopting or executing specific projects.

Peru also displays little capacity for strategic foresight to improve evidenced-based decision making. Strategic foresight refers to a long-term period (exceeding ten years) including planning scenarios. Development plans prepared by different ministries overlap and sometimes show lack of co-ordination. For instance, in the past few years, the executive has released numerous national plans, such as the Productive Diversification National Plan (from the Ministry of Production), the National Strategic Development Plan (CEPLAN) and the National Strategic Export Plan (Ministry of Trade). A key challenge for Peru will be to create a National Development Plan, defined at the CoG, discussed with different public and private actors, and integrated with the public investment framework. A single plan could facilitate the legitimacy of a long-term agenda, while the current multiplicity of plans reduce the coherence within the executive and may affect their overall credibility with civil society and the private sector. Furthermore, these plans are not approved by Congress and are not necessarily linked with the Multi-Annual Investment Plan defined by the executive.

There have been significant improvements in the Public National Investment System at the Ministry of Economy and Finance (MEF) but they need to be better co-ordinated with other public institutions. There is today greater fiscal transparency in the short and medium term thanks to the Multi-Annual Macroeconomic Framework and the Multi-Annual Budget Plan (Chapter 4). In addition, public investment projects are subject to cost-benefit analyses and their procurement follows competitive tenders. Recent improvements in the information available and technologies used for tracking public investment are increasing investment transparency. All direct public investment projects are subject to the national framework for public investment (*Sistema Nacional de Inversion Pública*, SNIP), defined and monitored by the MEF. All projects costing more than PEN 10 million must have feasibility studies, including cost-benefit analyses, and the express approval of the project by the MEF.

The OECD Country Programme with Peru undertakes detailed analyses and considers recommendations on the functioning of the public governance and the regulatory framework in Peru. Better public governance and regulatory practices are fundamental to Peru's development agenda. In that context, the OECD Country Programme includes the Public Governance Review, the Review of Regulatory Reform Policies and the implementation of best international practices in Regulatory Impact Analysis. These studies support Peru to develop and implement good governance and regulatory practices, and to achieve better social, economic and environmental objectives.

Private-sector involvement brings benefits but also governance challenges

In order to avoid unexpected fiscal costs and to enhance the effectiveness of its public policies, Peru has improved the regulatory and institutional framework for private-sector involvement in recent years. However, challenges remain in three areas of private-sector involvement: 1) public-private partnerships; 2) *Obras por Impuestos* or Works for Taxes; and 3) public procurement.

Despite impressive improvements, regulation of public-private partnerships could still be more effective

Faced with growing demand for infrastructure to promote economic development and guarantee further fiscal sustainability, Peru has used private participation to help finance projects. The private sector can provide expertise, innovation, lower costs and higher quality; a competitive auction process can result in the selection of the most efficient operator as well as the optimal price, given that competition takes place before firms commit to invest (Guasch, 2004). Since the 1990s public-private partnerships and concession contracts have been widely used to develop major infrastructure projects in Peru. Government officials adopted this approach with the aim of consolidating public finances after the profound economic crisis of the 1980s (Chapter 1).

The framework for private-sector involvement is improving

Overall, the legal framework for concessions in Peru is relatively clear and comprehensive, offering incentives to attract both local and international private investors. Since 1991 the executive introduced the regulation of private initiatives for investment and the participation of public entities such as ministries and sub-national authorities in the pre-implementation evaluation, design and approval of projects (Decrees Nos. 662 and 757).

The legislation on public-private partnerships in Peru has improved as institutional knowledge has grown, supported by international and domestic training and assistance. The 1996 Public Works Concession Law, followed by the 2008 Regional and Local Public Investment with Private Participation Law, introduced more flexibility to the contract structure, improved the project cycle for concessions and simplified the means by which the government can attract investment.

From 2014 Peru has addressed the barriers to creating more sustainable public-private partnerships in infrastructure (Law No. 30167). This has demonstrated growing political support for these projects. It improved the framework for such partnerships, creating a national register of contracts. It also made it possible to present private initiatives directly to ProInversión, the national agency responsible for private investment promotion, and opened the development of applied research and technological innovation projects to public-private partnership projects.

Peru has also increased its capacity to plan and oversee partnerships. It has strengthened the capacity of the public sector to manage them, particularly in the electricity-generation sector, where planning and oversight for private investment have been significantly streamlined (EIU, 2015). In 2014 Peru was ranked third behind Chile and Brazil out of 19 countries in Latin America and the Caribbean in the Infrascopes ranking, which assesses the capacity of countries in Latin America and the Caribbean to carry out sustainable public-private partnerships in infrastructure. This was mainly due to its score on operational maturity from the growing number of recently developed projects (17 since mid-2012). These projects helped build capacity throughout the public sector (EIU, 2015).

In the transport sector, three public institutions primarily determine the institutional design of public-private partnerships. The Ministry of Transport and Communications acts as the public counterpart to the concessionaires. It participates in the prioritisation and design of projects and is in charge of the technical regulation of the transport sector. The national agency responsible for private investment promotion (ProInversión)

promotes projects to national and international investors, and designs, executes and manages their auctioning. Finally, the supervisory institution of investments on public transport infrastructure (*Organismo Supervisor de la Inversión en Infraestructura de Transporte de Uso Público*, OSITRAN) supervises and regulates contracts and adjusts tariffs (Flor and Rojas, 2007).

Poor planning, prioritisation and co-ordination can drive up costs

Although the institutional framework of public-private partnerships is fairly complete, the current distribution of responsibilities between agencies can complicate overall co-ordination. Inefficiencies occur when the agencies responsible for providing a service are not involved in managing the concession through the whole life cycle. Without such a life-cycle approach to contract management, ambiguities can arise over the allocation of responsibility for addressing irregularities. In addition, OSITRAN's oversight role is undermined by its involvement in contract management during construction and operation (Bitran et al., 2013).

Weaknesses in the prioritisation and planning phases can also cause inefficiencies in public-private partnership projects. Ex-ante feasibility studies and value-for-money evaluations could help solve difficulties at these stages. However, the institutional framework supporting value-for-money analysis in Peru remains weak. Delays and inefficiencies in the processes of environmental and land licensing as well as consultation with local actors affect the timing and certainty of concession contracts. Peruvian authorities are already discussing these aspects to improve the regulatory framework of public-private partnership projects.

As with other Latin American countries, Peru has had to renegotiate concessions, which can increase the total cost of public-private partnership projects. The performance of concessions is determined by the contract, and regulatory and institutional design. However, flaws in the design of concession contracts have caused excessive costs in Latin America (OECD/ECLAC, 2012). In the case of Peru, out of a sample of 15 national road concession contracts signed from 1994 to 2010, 11 were renegotiated at least once. These renegotiations led to a total of 53 changes and extra costs of over USD 300 million, and added 9 years to the concessions' terms (Bitran et al., 2013). Nevertheless, compared to other Latin American countries, Peru has experienced only a modest amount of renegotiation, partly due to its well-conceived concession designs.

Poor past performance highlights the need to better account for the risks associated with public-private partnerships in the fiscal framework. While ProInversión's selection process has improved its efficacy in recent years, these partnerships must be included in the reporting of fiscal risks to limit the chances of unexpected costs from renegotiations.

Obras por Impuestos is innovative, but may need greater supervision

In order to increase the efficiency of investments in Peru, the government delegates infrastructure investment to private firms in exchange for tax credits. Despite steady growth and increases in tax revenue received by local governments in mining areas, mining communities still lack basic services (see section below). In 2008, the Peruvian government designed a mechanism called *Obras por Impuestos*, or Works for Taxes, with the objective of accelerating and improving the quality of public investments. This mechanism allows private firms to finance physical infrastructure and maintenance expenditures which are the responsibility of local governments in exchange for future tax credits.

This type of policy secures local government support and aims to increase the efficiency of infrastructure investments. For local governments with limited capacity to carry out capital investment, *Obras por Impuestos* plays a key role in the execution of investment and the delivery of public goods at sub-national level. This mechanism appears to have benefitted regional and local governments by increasing the execution of infrastructure projects, accelerating local infrastructure, using the know-how of private companies to increase the quality of their investments, and enhancing the reputation and image of local governments by helping them to reach their goals and objectives.

However, this policy also means that private sector is taking up the role of the public sector in the execution of public services. A key challenge therefore is to provide the appropriate checks and balances within these projects. The main risk associated with allowing private firms to replace the local and regional authorities in the provision of public infrastructure is how far these investments are aligned with the priorities needed to promote local development.

The regulatory and institutional framework for public procurement has advanced in recent years

The experience of many OECD countries has been that procurement is particularly vulnerable to corruption because of the financial interests at stake and the volume of business opportunities for suppliers. Public procurement in Peru represents close to 50% of total government expenditures, a higher percentage than in other countries in Latin America. For instance, in countries such as Brazil, Chile, Colombia and Mexico, public procurement does not exceed 30% of total expenditure. Furthermore, it has been concentrated in central government operations (OECD/IDB, 2014).

The institutional framework for public procurement has improved considerably over the past seven years. The Law on Public Procurement – *Ley de Contrataciones del Estado (Decreto Legislativo 1017, 2008)* – and subsequent decrees have helped to improve the regulatory framework for public procurement procedures. The executive also enhanced the institutional framework for public procurement by replacing CONSUCODE (*Consejo Superior de Contrataciones y Adquisiciones del Estado*) with the OSCE (*Organismo Supervisor de las Contrataciones del Estado*). Peru's public procurement regulations allow for open and competitive tenders for projects above PEN 11 500 (equivalent to USD 3 500 as of August 2015) with additional requirements depending on project size. One of the main benefits has been improvements in transparency, attributed to greater use of information and technology in the public procurement process. All information regarding individual projects and procurement processes is available on a web portal administered by the OSCE. In that sense, the creation of the platform SEACE (*Sistema Electrónico de Contrataciones del Estado*) may help to increase efficiency and reduce cases of bribery around public procurement.

However, more could still be done to increase the effectiveness of public procurement in Peru. First, the full implementation of a value-for-money approach instead of a unique criteria based on pricing would more appropriately define the assets acquired by the state. Second, increasing the number of private firms participating in public procurement would bolster competition. This could be done by improving procurement procedures, such as the methods of payment.

Given the importance of public procurement in Peru in comparison with other countries in the region, and the need to build the evidence to inform policy making and

improve service delivery, the OECD Country Programme includes an OECD Public Procurement Review.

Policies at sub-national level have not improved equity and productivity across all regions

The decentralisation process needs improvements to boost economic performance in Peru. Co-ordination problems with central government, weak sub-national institutions, political fragility at the regional level and an inefficient allocation of resources have affected the effectiveness of the decentralisation process. Key policies, in areas such as education, infrastructure and innovation have not necessarily been prioritised or properly implemented by sub-national governments. In that context, the institutional framework of public policy implementation has not contributed enough to boost productivity and reduce regional disparities.

Peru is divided into three levels of regional government: departments, provinces and districts, making it the only Latin American economy to have a local government system with two sub-levels: provinces and districts. Peru has 25 departments (including Lima and Callao), 196 provinces and 1 853 municipal districts.

In the past three decades, the regional framework has undergone three transitions between centralised and decentralised governments. The 1979 Constitutional Act moved Peru from military dictatorship to democracy. This act started the decentralisation process by giving Peruvian municipalities resource-management responsibilities. In 1980, the first political cycle of local elections followed. Before the 1980s, 80% of fiscal transfers to sub-national authorities went to Lima and Callao, and the decentralisation process widened transfers to other local authorities. However, the limited capacity of some municipalities, particularly those located in rural areas, has hindered their ability to exploit this new regime and foster local development in Peru (Muñoz, 2010).

During the 1990s, Peru reverted to a centralised government after the regional governments elected in 1989 and 1990 were dissolved (Contreras, 2004). During this period under President Fujimori, Peru started a process that re-centralised the economy. Regionally elected governments were eliminated and central government took on most of the regional leadership by concentrating resources and functions in the Ministry of the Presidency. In 1993 the new constitution eliminated the distinction in competences between the provincial and district authorities. This removed the pre-eminence of the provinces over the district authorities (Muñoz, 2005).

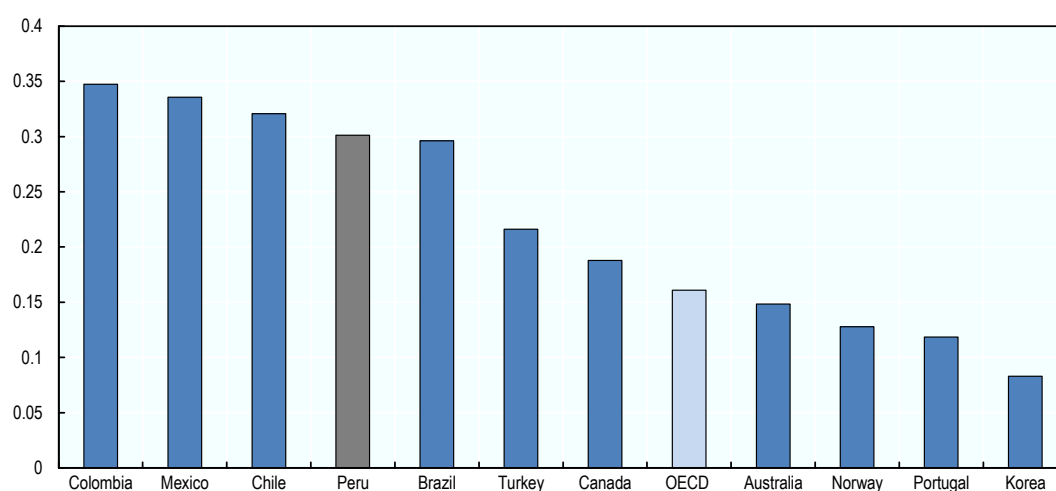
The current sub-national framework was initiated in 2002 in a new process of decentralisation, with constitutional reforms aimed at increasing the fiscal resources and political power of sub-national governments. The main focus of the decentralisation process was to increase fiscal transfers through two key components: the Municipal Compensation Fund (*Fondo de Compensación Municipal*, FONCOMUN) and commodities revenues. FONCOMUN transfers resources based on compensatory mechanisms defined by socio-economic and demographic criteria. The main revenues of sub-national governments obtained from commodity exploitation are *canon* and royalties.⁵ In line with some OECD economies, royalties are based on companies' profits, while *canon* represents 50% of the corporate tax from mining companies (the other half is retained by the central government). These revenues should be spent on capital investment.⁶

Addressing regional inequalities for sustainable inclusive growth

Regional disparities in Peru remain high in comparison with OECD economies, as we have seen in Chapter 2. As with other Latin American economies, there are large differences in per capita income levels between departments. These are greater than the average regional differences within OECD economies – regional inequality in Peru is 18 percentage points higher than the OECD average, using the Gini coefficient of GDP per capita to measure disparities (Figure 5.3). Lack of data on GDP per capita at the provincial and district levels makes it difficult to compare inequality at these levels with OECD economies.


Figure 5.3. **Regional income disparities in Peru**

Gini index of inequality of GDP per capita (2012 or latest available data)



Note: The figure refers to each country's main political divisions (TL2 regions). For instance, states in the United States and departments in Peru. 2013 data for Peru; 2012 data for Australia, Canada, Chile, Colombia, Korea and Mexico; 2011 data for Brazil, Norway, Portugal and Turkey.

Source: OECD calculations based on data provided by INEI (National Institute of Statistics) and *OECD Regional Database*, www.oecd.org/gov/regional-policy/regionalstatisticsandindicators.htm (accessed on 19 March 2015).

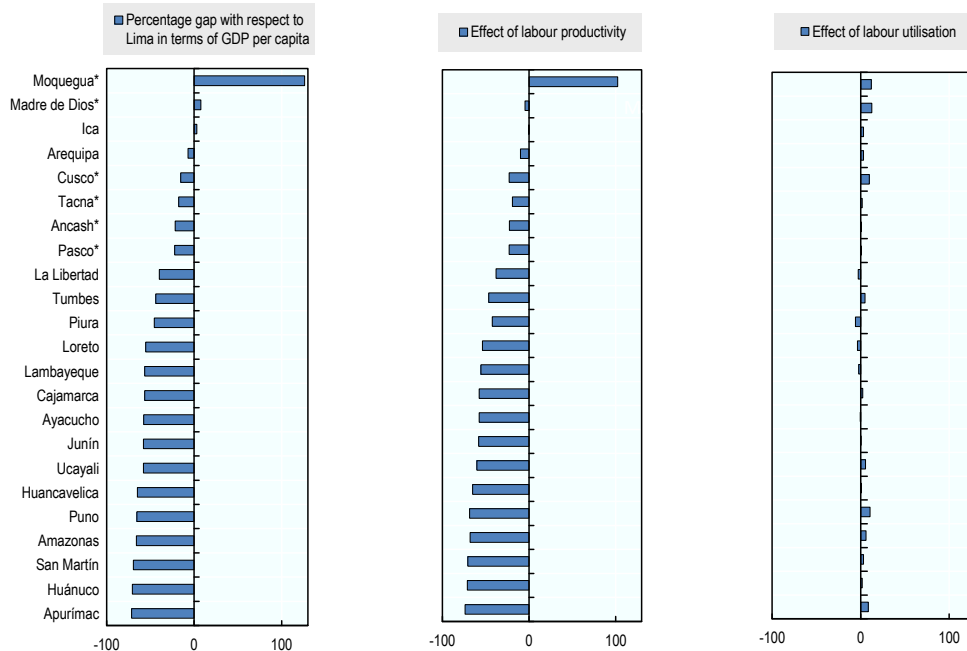
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Regional differences in poverty have also increased in Peru and have become a spatial challenge. While poverty reduction in Peru has been impressive overall (Chapter 2), disparities between rural and urban areas have increased. Monetary poverty fell by more than 70% between 2004 and 2013 in Lima, while in traditionally poor rural areas, such as Sierra and Selva, poverty rates fell by less than 40% and 50% respectively. While the poor represented close to 13% of Lima's population in 2013, the proportion was close to 53% in Sierra and 43% in Selva.⁷

Most of the discrepancies in regional GDP between Lima and the rest of Peru are due to low labour productivity (Figure 5.4). Differences in labour productivity between departments have remained almost constant over the past decade, with the main exception being commodity-producing regions, where highly productive commodity sectors have emerged which created little employment (Chapter 3). This is the situation in Moquegua, a department in which mining is important thanks to its copper resources (a key actor in this department is the firm Southern Copper Corporation) and to a lesser extent gold and


silver. Analysis of total factor productivity corroborates the differences in labour productivity across regions (Céspedes et al., 2014).

Figure 5.4. The sources of real income disparities across regions, 2013



Note: * denotes departments in which the mining sector represents more than 30% of total 2013 GDP (Ancash, Cusco, Madre de Dios, Moquegua, Pasco and Tacna).

Source: OECD calculations based on data provided by INEI (National Institute of Statistics).

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Furthermore, regions with low levels of productivity suffer from a variety of deficiencies. Informality remains high in these less-developed regions with low labour productivity (Chapter 2). Performance in education and health, two sectors which are the responsibility of the sub-national authorities, is also very poor in some municipalities. Access to, and quality of, education differ considerably across departments and between rural and urban areas. While close to 36% of the students in primary schools in urban areas have the capacity to read and interpret a text, this share is less than 7% in rural areas. In urban areas this proportion has increased by more than 15 percentage points in the last five years, but it has not increased at all in rural areas.⁸ There are similarly disappointing differences in health care services and health outcomes (Chapter 2).

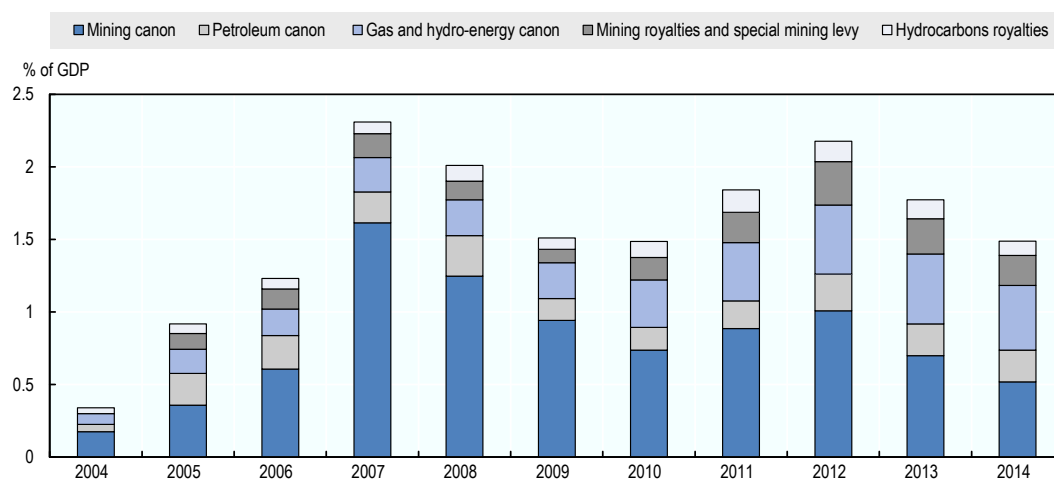
In some departments in Peru, basic needs are still going unmet and people lack access to some services. Departments such as Amazonas, Huancavelica, Loreto, Pasco, San Martin and Ucayali show high levels of unmet basic needs.⁹ Despite some improvements in the last five years, these departments are not meeting at least one of the five basic needs for more than 30% of their inhabitants. In contrast, the figures for Arequipa, Ica, Lima, Moquegua, and Tacna are less than 15% of inhabitants. Other indicators, such as access to finance and other business services, exacerbate the differences in GDP per capita. For instance, while Lima contributes around 50% of Peru's GDP, it receives more than 70% of loans whereas Huánuco received only 0.1% of the loans despite contributing more than 1.1% of GDP.¹⁰

Sub-national governments face crucial challenges in Peru

Commodity-based transfers exacerbate inequality


Commodity-based transfers have been volatile in recent years, requiring counter-cyclical resource management. The volatility of international prices for commodities and the uncertainty of commodity production in Peru have affected revenue streams to sub-national authorities. From the early 2000s, commodity-based regional transfers to sub-national authorities increased considerably. In particular, from 2001 to 2005, funds from *canon* increased by more than 150%. After 2005 these fiscal transfers amounted to more than 1.0% of GDP, and represented close to 1.45% of GDP on average in the period 2010-2014. Between 2012 and 2014, these transfers, as a percentage of GDP, fell by nearly 0.5 percentage points (Figure 5.5). A key challenge therefore is to adopt fiscal rules and a stabilisation fund to better manage these resources and to even out revenue streams to sub-national authorities.

Figure 5.5. Contribution of commodities sectors to regional transfers, 2004-14 (% of GDP)



Note: The *canon* and royalties are transfers of natural resources. *Canon* is distributed exclusively to the sub-national governments where the minerals are extracted. Royalties are based on companies' profits and *canon* represents 50% of the corporate tax from mining companies.

Source: SUNAT – Superintendencia Nacional de Aduanas y de Administración Tributaria (<http://www.sunat.gob.pe/>) for mining royalties; PERUPETRO (<http://www.perupetro.com.pe/>) for hydrocarbon royalties (accessed 15 June 2015); and Ministry of Economy and Finance (2015), “Consulta de Transferencias a los Gobiernos Nacional, Regional, Local y EPS”, Transparencia Económica website, http://apps5.mineco.gob.pe/transferencias/cuadros/Hoja1_1.aspx for *canon* data.

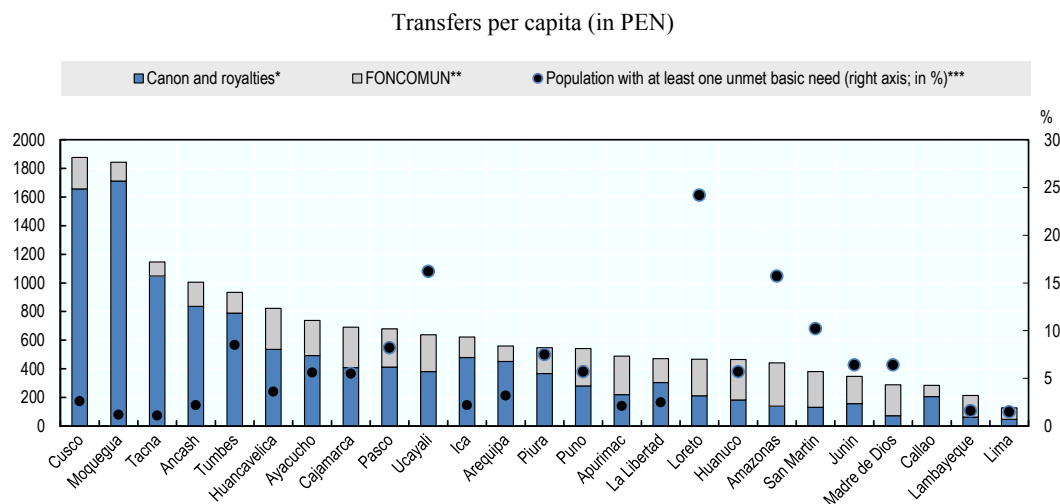
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Commodity-based transfers have been largely allocated to the regions producing raw materials, exacerbating regional disparities. The *canon* and royalties are mainly distributed to the sub-national governments where the raw materials are extracted. The fiscal transfers based on commodities per capita received by Cusco and Moquegua alone are greater than those obtained by 15 departments in Peru put together. Just 5 out of the 25 departments receive more than half of the total resources (Figure 5.6). Nor do these fiscal resources target the poorest regions. Indeed, they are negatively correlated with the level of unmet basic needs the departments have.¹¹ For instance, commodity-based transfers to Moquegua are 8 times higher than those to Loreto and 12 times higher than

those to Amazonas. However, while only 1.2% of the population in Moquegua has at least one unmet basic need, while the figure is 24% in Loreto and 15% in Amazonas.


Therefore, a key challenge is to improve the allocation of commodity-based transfers according to the level of development of Peruvian departments. Similar to the case of Colombia before the 2011 Royalties Reform, there is a need to increase the diversification of these resources across the regions (OECD, 2013). Resources should to be efficiently allocated by accounting for specific department needs according to their socio-economic challenges, and by supporting governance capacity at the sub-national level (see below).

Figure 5.6. **The mismatch between regional commodity transfers (2014 data) and basic needs (2013 data)**



Notes: * See Figure 5.5 for the definition of *canon* and royalties. Customs are also included. ** FONCOMUN is the Municipal Compensation fund. This fund seeks to promote investment at the municipal level with a redistributive objective. It prioritises the poorest municipalities, particularly in rural areas and marginal urban areas. *** The components of Unmet Basic Needs are: quality of the house, non-overcrowding of the house, access to sanitary services, school attendance, and economic dependency. No data for Callao.

Source: OECD calculations based on National Households Survey Data (ENAH0 – Encuesta Nacional de Hogares) from INEI (National Institute of Statistics) for unmet basic needs (<http://www.inei.gob.pe/estadisticas/indice-tematico/sociales/>). SUNAT – Superintendencia Nacional de Aduanas y de Administración Tributaria (<http://www.sunat.gob.pe/>) for mining royalties; PERUPETRO (<http://www.perupetro.com.pe/>) for hydrocarbon royalties; and Ministry of Economy and Finance (2015), “Consulta de Transferencias a los Gobiernos Nacional, Regional, Local y EPS”, Transparencia Económica website, http://apps5.mineco.gob.pe/transferencias/cuadros/Hoja1_1.aspx for FONCOMUN and *canon* data (accessed on 15 June 2015).

StatLink  <http://dx.doi.org/10.1787/888933265947>

Sub-national governments lack the capacity to govern effectively

Given the limited institutional capacity of the sub-national authorities, better co-ordination with central government is needed to improve the effectiveness of regional public expenditures. The fiscal transfer system lacks the appropriate co-ordination between different levels of government needed for efficient resource allocation. In practice, a discretionary framework at the vertical level defines the allocation of resources.¹² This is highly relevant given that some of Peru’s districts are small (nearly

60% of districts have less than 5 000 citizens), and do not necessarily have the management capacity to spend fiscal resources appropriately.

The poorest municipalities have limited capacity, preventing them from establishing an effective development agenda. Local governments lack the human resources and experience to fulfil their roles, resulting in poor management of municipal public services. In addition, red tape and procedural complexities affect the efficiency of decision-making processes. Some authorities do not follow regulatory frameworks because they lack knowledge of the complete legal process required to adopt and implement policies (Muñoz, 2005). Sub-national authorities require effective support from the central government to improve the efficiency of expenditures from regional transfers. For instance, when public-private partnerships are envisaged at sub-national level, support from OSITRAN would be useful to avoid inefficiencies in the involvement of the private sector.

Furthermore, fiscal transfers are not accompanied by a clear definition of the responsibilities of different levels of government. First, the institutional framework lacks internal controls and checks and balances on decisions taken by mayors.¹³ Second, the hierarchical framework between provinces and district authorities is unclear. This dual system at the municipal level, unique to Latin America, creates conflicts over responsibilities and sources of revenue (Muñoz, 2005).

Peru needs to improve its co-ordination between the allocation of commodity-based fiscal transfers and other sources of revenue. *Canon* and royalties are spent solely on capital investment at the regional level. This rigidity creates a misallocation of resources (Del Valle, 2013). This is particularly evident in the weak co-ordination between capital investment and current expenditure at the regional level. If investments are to function well, capital expenditures have to be planned over a multi-annual framework that includes maintenance and current expenditures.

Transfers to local authorities do not necessarily ensure efficiency gains for local institutions. Efficiency can be measured by the inputs that could be saved while still obtaining the same output or services (e.g. in the areas of education, health, and transport). *Canon* and FONCOMUN transfers have a negative impact on the efficiency of municipal districts (Muñoz, 2010). Further mining transfers have only positive short-term effects, such as an increase in temporary public employment, which are explained in part by the strategic behaviour of local politicians (Maldonado, 2015). Indeed, an increase in transfers helps to boost public expenditure at sub-national level but does not help to improve the quality of this expenditure. Sub-national authorities with higher *canon* revenues did not improve their performance for some social indicators, suggesting inefficiencies in spending (Sanguinetti, 2010; Arreaza and Reuter, 2012). Furthermore, in 2014 most of the departments involved in misappropriation of public funds have received sizeable transfers from *canon* and royalties (Korinek, 2015). In contrast, policy dialogue with local actors through the Local Co-ordination Council (a proxy for civil participation in local government decisions) improves the efficiency of local institutions (Herrera and Francke, 2007).

The fragility of political parties affects the effectiveness of public policies. Peru has a large number of political parties at the local level. For instance, in the 2010 sub-national elections, more than 180 political organisations were registered in the departmental elections, 250 in the provincial elections and 550 in the district elections. Most of these political organisations are local parties; national political parties only made up around 10% of the total political organisations at sub-national level. Furthermore, the small

regional political organisations succeeded in taking power in more than 50% of the departmental and local (i.e. provincial and district) governments.¹⁴ This political fragmentation affects co-ordination both horizontally across local governments and vertically, between levels of government. Decentralisation in a context of weak national political parties and unstable regional political organisations has thus worsened the effectiveness of public policies at the regional level. For instance, political fragmentation and weak political parties, combined with the fact that there is no second round for municipal elections, mean mayors often do not have the political support to legitimise their decisions (Muñoz, 2005). This limits their overall effectiveness and the ability to implement their policies.

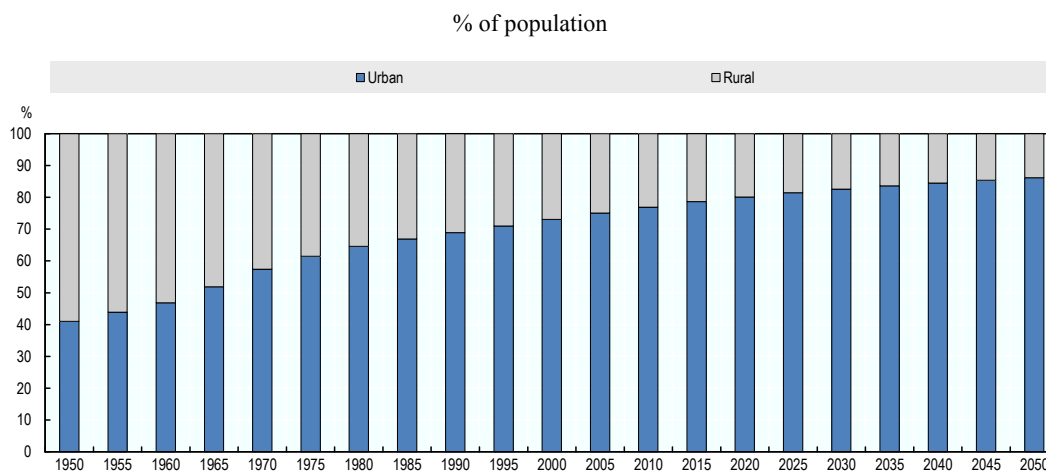
Weakness in the planning of public policies of political parties limits the efficiency of sub-national expenditures, particularly those at the provincial level. Traditional national political parties have not succeeded in improving local efficiency; on average, their efficiency of public expenditures is lower than mayors elected by local parties. This is evident after controlling for other factors such as those concerning fiscal, demographic and socio-economic conditions (Muñoz, 2010). These national parties are least efficient and effective in the poorest rural areas, where strong and transparent candidates are most needed. Furthermore, fragile local alliances sometimes disappear just after an electoral period (Zavaleta, 2014). This affects the planning and prioritisation of policies at sub-national level.

Urban planning is a key priority for developing sustainable cities in Peru


Urban planning and organisation are pressing challenges in Peru. In recent decades, Peru has faced large rural migration outflows, mainly towards urban centres in coastal regions, primarily Lima. This was coupled with a process of demographic transition. While in 1972 the urban population was approximately 8 million, in 2007 that population has grown to nearly 21 million, according to the last census by the National Institute of Statistics (INEI). Lima's growth has been even more striking. Its population now exceeds 9 million, close to 30% of the total population and 43% of the urban population in Peru. Its population has grown by more than 130% over the past 50 years, while the country as a whole has grown by less than 100% in the same period. Similar to other countries in Latin America, Peru's urban population, at nearly 80%, is a larger share of the total population than the average for Africa (47%), Europe (73%) or the world (54%).¹⁵ Furthermore, a significant increase in urbanisation is predicted for Peru over the next 35 years, presenting challenges in urban planning (Figure 5.7). Further growth of the cities will require innovative policies to ensure equal quality of public services to all citizens. In that context, a better linkage between urban and rural development policies is needed to avoid pressures on cities, and improve well-being in Peru.

The process of decentralisation granted local governments important competences in terms of urban planning. Local governments manage urban planning, they form plans for local development in co-ordination with the local community and they approve mechanisms for community participation and auditing of municipal action. The regulations also emphasised the engagement of civil society in decision-making processes. The central government drafts the national and sectoral plans, by taking into account regional and local plans. Cities are also in charge of the management of certain public services such as public transport and traffic, housing and urban renovation, social programmes, and waste management.

Figure 5.7. Urban population in Peru, 1950-2050



Source: United Nations (2015), *World Urbanization Prospects: 2014 Revision, Population Division*, Department of Economic and Social Affairs, United Nations, New York, <http://esa.un.org/unpd/wup/>.

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At the national level, the central government prepared a National Plan for Urban Development for 2006-2015 (Ministry of Housing, Construction and Sanitation, 2006). These plans traditionally cover long periods (the previous covered the period 1974-1990) in order to identify medium and long-term objectives. The latest plan responds to the need for both better-structured cities with their nearest urban areas, and more strategic city planning. To respond to the process of urbanisation, the plan covers four principles: 1) governance and governability; 2) connectivity and communications; 3) specialisation, productive articulation and innovation; and 4) sustainability and competitiveness.

The plan's development is intertwined with the establishment of other national reforms such as the housing plan and the municipal and regional urban development plans. Some of the most significant objectives include increasing the institutionalisation and human capital of local and regional governments, boosting connectivity within and between cities, promoting cities' economic development by exploiting competitive advantages and fostering private sector investment, targeting land regularisation, constructing and improving pre-existing housing, and expanding access to water and sewage.

Lima has its own urban development plan which recognises future challenges from increasing urbanisation, but there are barriers to its implementation. PLAM 2035 (*Plan Metropolitano de Desarrollo Urbano Lima y Callao 2035*) is a renewal of the city's 1993-2010 plan, and comprises an extensive framework for future development (Municipality of Lima, 2014). It outlines strategies to address concerns including the distribution of urbanisation zones and public transport reform and backs plans to increase the city's urban density through more than 200 specific infrastructure projects. Some of these projects have already been presented to the *Sistema Nacional de Inversión Pública* (SNIP). The plan also considers unifying the transport authority for Lima and Callao into a single authority. The biggest challenge of the plan is to gather sufficient political support to carry out its long-term policies. Since the plan was developed and approved by a former local government, and aims to adopt long-term perspective, a key challenge is to

enhance and maintain dialogue between different political parties to implement these policies and develop more effective urban planning methodology.

Transport policies remain a key component of the urbanisation process in Peru. The number of vehicles in Lima alone has increased substantially, from 776 000 in 2000 to approximately 1.4 million in 2012. Peru has followed a similar pattern to other Latin American countries, with significant expansion of the car fleet among people with relatively low incomes, and slow development of the motorcycle fleet. This pattern poses challenges regarding the development of public transportation in order to avoid rapid increases in private motorisation and pollution in Peruvian cities (Box 5.1).

The socio-economic challenges Peru faces at sub-national level require more effective public policies. To tackle these challenges and improve decision making, Peru needs to improve its territorial statistics and the management of public finances at the sub-national level. This will be crucial to boosting rural development through the management of natural resources, and to fostering urban development and competitiveness. Underlying these challenges is the need for better co-ordination between central and sub-national authorities. As these areas represent a binding constraint for inclusive development in Peru, the OECD Territorial Review will be a key review in the context of the OECD Country Programme.

Box 5.1. Public transport, private car ownership and potential pathways of CO₂ emissions in Peruvian cities

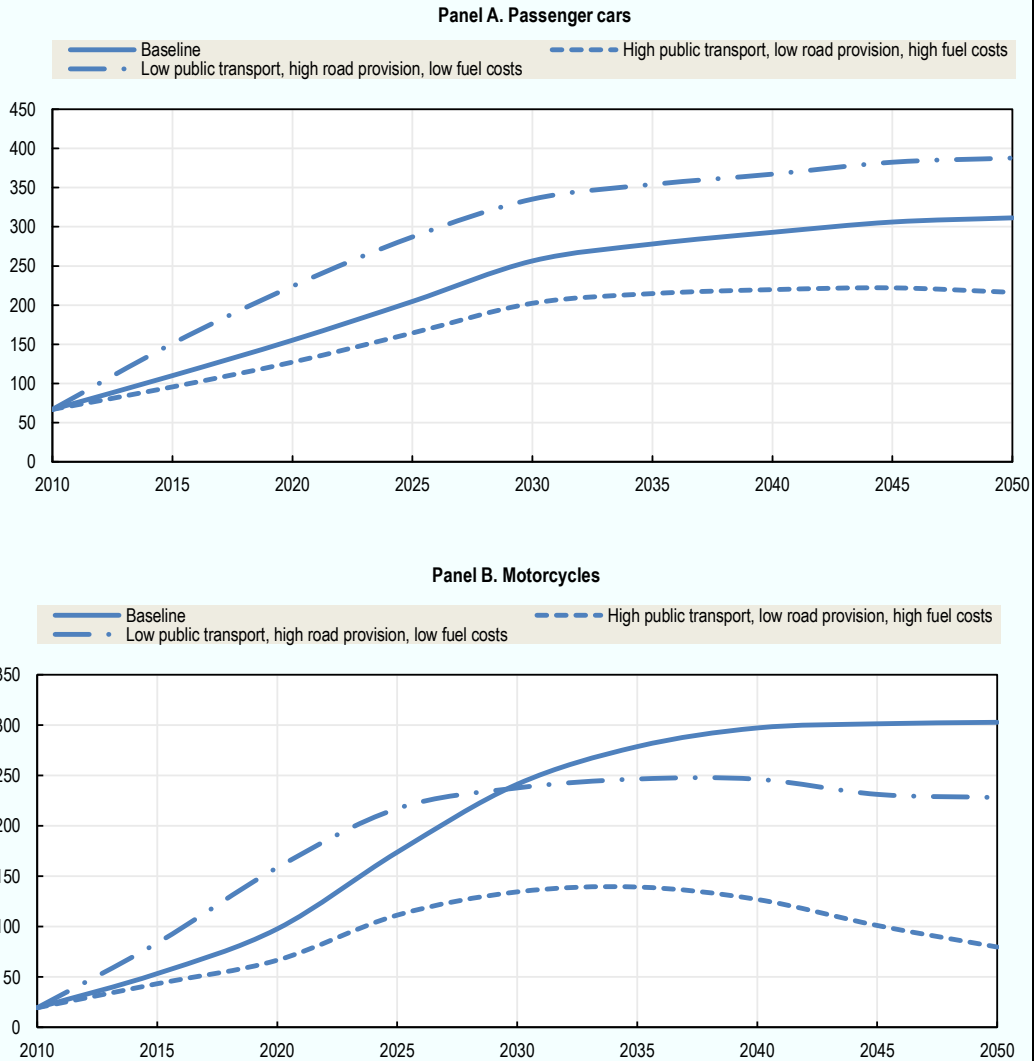
Peruvian policies towards urban transport infrastructure and services have recently aligned with other countries in the region. Large Peruvian cities began developing their systems later than other metropolitan areas of Latin America. Recent investments in bus rapid transit, subway and suburban rail aim to meet increasing travel demand while keeping the mode shares of public transport high. The Ministry of Transport and Communications recently published a comprehensive investment plan up to 2025 for large urban areas in Peru. The main focus of the plan is to promote greater mobility while improving territorial access.

Projections for car and motorcycle ownership in Lima suggests that levels will rise from 2030 onwards if the expected increase in economic growth is not accompanied by greater investment in public transport infrastructure. A recent study of Latin American cities explored various potential pathways for the development of mobility as a function of the implementation of the transport investment and land use policies adopted (OECD/ITF, 2015). The study focuses on cities with populations of over 500 000. Peruvian cities show moderate levels of urban sprawl (with the highest sprawl observed in Argentine cities and the lowest in Colombian ones). Rapid motorisation is expected as households with increasing disposable income prioritise car and, more recently, motorcycle ownership. More intensive investment in roads will only increase growth of car ownership in the longer term, by relieving the current constraints on car use caused by congestion. Accelerated investment in public transport will be the only approach to significantly alter the trend towards private motor transport (Figure 5.8). The study found that poor public transport provision is the strongest incentive for car and motorcycle use. It also stresses the importance of transport policies on vehicle ownership rates.


Box 5.1. Public transport, private car ownership and potential pathways of CO₂ emissions in Peruvian cities (cont.)

Figure 5.8. The influence of public transport policies on car and motorcycle ownership in Peruvian cities

Car and motorcycle ownership per 1 000 inhabitants in cities over 500 000 inhabitants (2010-50)



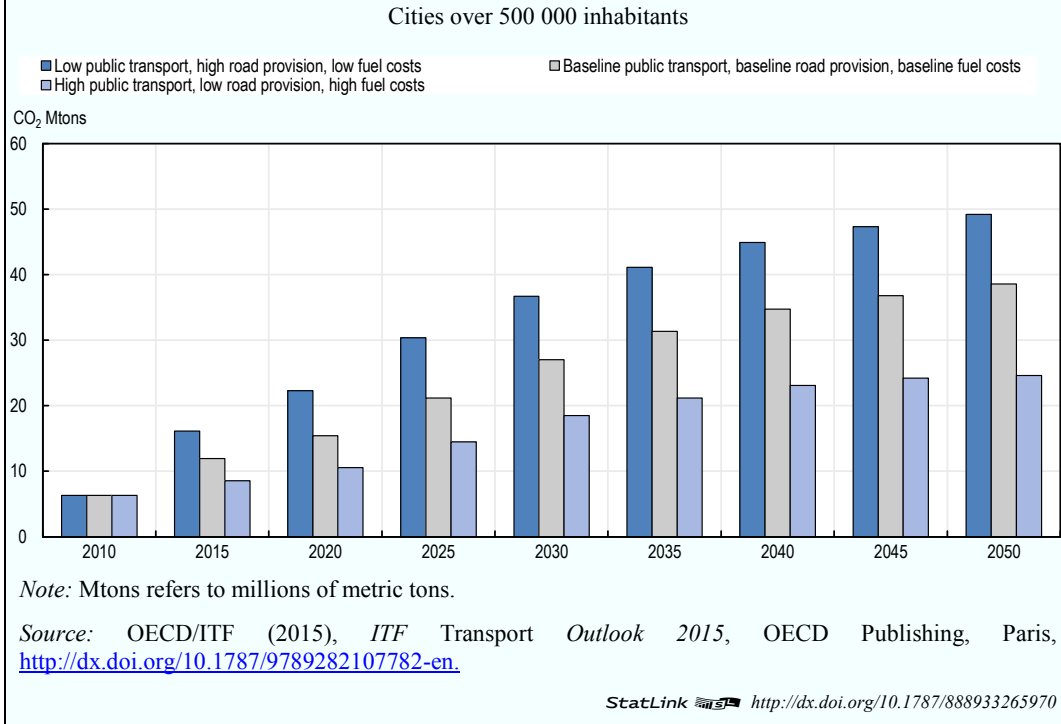
Source: OECD calculations based on OECD/ITF (2015), *ITF Transport Outlook 2015*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789282107782-en>.

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Trends in car and motorcycle use largely determine the transport-related emission levels of local air pollutants and CO₂. The report explored outcomes from three CO₂ emission scenarios: 1) low investment in public transport, high road provision and low fuel costs; 2) high investment in public transport, low road provision and high fuel costs; and 3) baseline levels of public transport investment, road provision and fuel costs. It showed the significant effect of private mobility on overall CO₂ emissions in large Peruvian cities (Figure 5.9). This highlights the importance of aligning policies to reduce CO₂ emissions and local pollutants with transport policies at the city level. The development of well-designed public transport would reduce environmental damage in Peruvian cities.

Box 5.1. Public transport, private car ownership and potential pathways of CO₂ emissions in Peruvian cities (cont.)

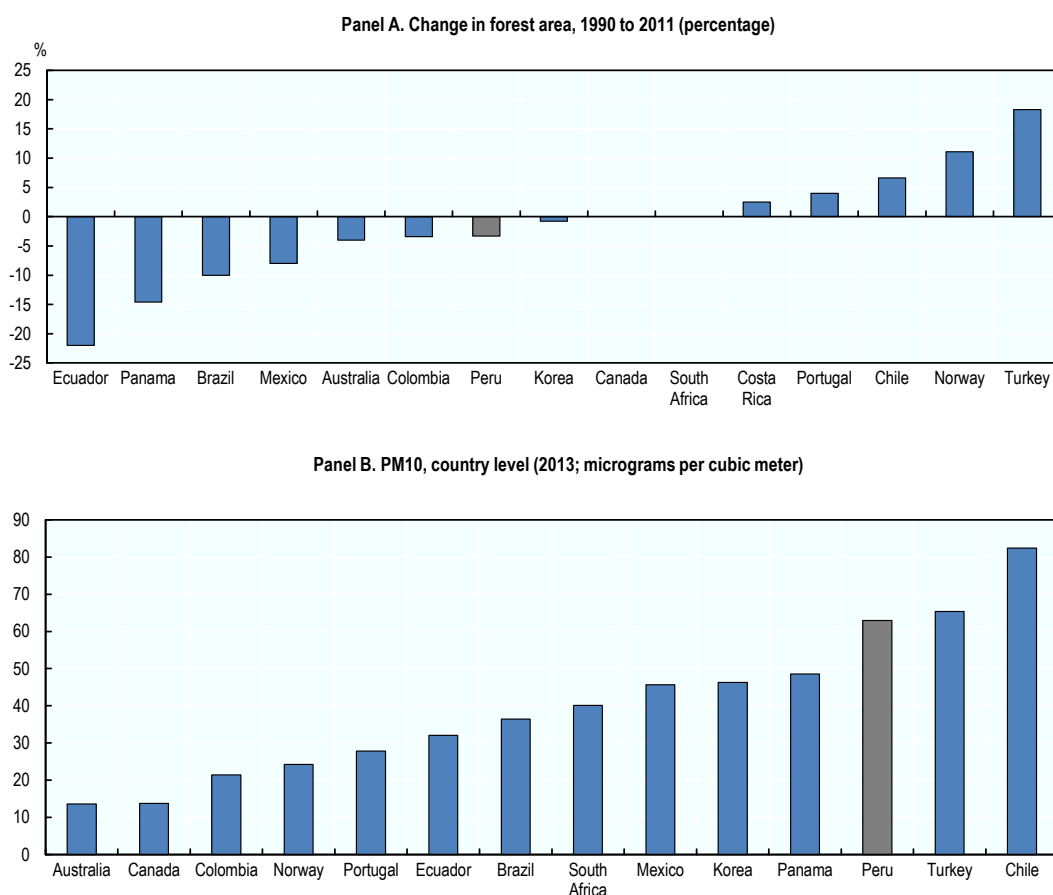
Figure 5.9. The influence of car-oriented vs public transport-oriented policies on CO₂ emissions in Peruvian cities, 2010-50



Environmental risks should drive improvements in Peru's environmental policy


Peru faces a range of environmental risks, including climate change. Environment is a key pillar for the well-being of all (Chapter 1). The effects of climate change are estimated to lower potential GDP by 4.3 percentage points (CAN, 2008) by 2025, and could further generate a loss of 6 percentage points of potential GDP by 2050 (Vargas, 2009). GDP losses at between 11.4% and 15.4% over the period 2010-2100 (IDB/UNECLAC, 2014) are forecasted according to a recent estimate released in December 2014 at the 20th Conference of the Parties to the United Nations Framework Convention on Climate Change (UNFCCC-COP 20) in Lima. Fishing, livestock in the high Andes and agriculture would be most affected by climate change in Peru.¹⁶ In terms of land use, Peru has lost close to 3.0% of its forest area in the last two decades, which contrasts with the slight increase of forest cover in the OECD area, but it is lower than the deforestation rate in other Latin American economies (Figure 5.10, Panel A). Another environmental indicator is the level of air pollution by particulate matter, the air pollutant that most commonly affects people's health. Concentrations of particulate matter less than 10 micrometres in size (PM₁₀) have been measured at 63 micrograms per cubic metre (µg/m³) in Peruvian cities, which is high by OECD standards and exceeds Peru's own ambitious target and World Health Organization (WHO) air quality guideline of 20 µg/m³ (Figure 5.10, Panel B).

Figure 5.10. Environmental risks in Peru and benchmark countries



Note: HDRO calculations based on data on forest and total land area from Food and Agriculture Organisation (FAO) (<http://faostat.fao.org/site/377/default.aspx#ancor>).

Source: HDRO (2014), *Human Development Statistical Tables, Human Development Report Office* (database), New York, <http://hdr.undp.org/en/data> (Panel A), and World Bank (2015), *World Development Indicators* (database), Washington, DC, <http://data.worldbank.org> (Panel B).

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By international comparison, Peru appears to be ahead in regulating air pollution by sulphur dioxide (SO₂), another key pollutant affecting human health. This results from a stepped approach in 2014 to align the air quality standard (24-hour mean) for sulphur dioxide to the WHO guideline of 20 µg/m³ (WHO, 2006).¹⁷ However, the private sector argued that environmental quality standards had been set too high for Peru's level of development (Zubieta, 2014). Indeed, the new standard is proving difficult for some sectors (e.g. metal processors) to achieve in the short-term. In that context, three cities have been given more time to comply.¹⁸ This is consistent with WHO recommendations to move gradually towards full compliance.

The institutional framework for environmental protection has been strengthened

The Peruvian government created the Ministry of Environment (MoE) in 2008 out of the National Council for Environment to tackle environmental challenges and increase

environmental legitimacy. By raising the council to ministerial status, the government gave environmental policy more political leverage. The ministry's overarching mission is to promote environmental conservation to ensure a sustainable, responsible, rational and ethical use of natural resources, and the environment that sustains them. It also contributes to social, economic and cultural development in harmony with the environment.¹⁹

A key mandate of the MoE is to enhance coherence between environmental policies and other sectoral policies. A multi-sectoral commission was created in 2012 to develop regulations and policy proposals aimed at improving environmental and social conditions under which economic activities take place, especially from extractive industries.²⁰ Proposals are discussed in a multi-sectoral commission composed of the ministries of Agriculture, Culture, Economy and Finance, Energy and Mining, Environment (which serves as the secretariat of the commission), Health, Production, Development and Social Inclusion, and chaired by the Presidency of the Council of Ministers. Several tasks have been allocated to the MoE. Its lead roles include: formulate, supervise and evaluate national environment policy; ensure compliance with environmental standards; coordinate implementation of national environmental policy with sectors, regional governments and local governments; and, provide technical support to regional and local governments (Comisión Multisectorial, 2012).

Six bodies assist the MoE in accomplishing its mission (Ministry of Environment, 2015a). Three of them focus on providing information in the areas of meteorology and hydrology, geophysics, and biodiversity in the Peruvian Amazon. The other three are more oriented towards management and policy execution and include the Environmental Evaluation and Inspection Agency (OEFA), the National Service of Protected Natural Areas (SERNANP), and the National Service of Environmental Certification for Sustainable Investments (SENACE).²¹

SENACE was created in 2012, and reviews and approves detailed and semi-detailed environmental impact assessments (EIA, *Estudios de Impacto Ambiental*) for high-impact and medium-impact public, private or mixed capital investment projects.²² Different ministries have been in the process of transferring their competences on their respective subject to this new institution. As this process has not finished yet, SENACE is not fully operating today. EIAs are carried out during project planning. SENACE approval of EIA reports is required to obtain operating permits. The projects subject to EIA are mainly in the fields of agriculture, energy, mining, construction and certain types of industrial production. EIAs estimate the environmental impacts of such activities and propose actions for the project holder to mitigate them. Smaller projects simply require a declaration of environmental impact (DIA, *Declaración de Impacto Ambiental*). In that case, the parties involved are either the ministries in charge of the relevant sector or regional and local governments.²³

Yet, the implementation and legitimacy of environmental policies are challenging

In recent years, measures to promote investments have focused on reducing environmental regulatory burdens. Prior to 2013, amendments to an EIA were not regulated and followed an ad-hoc process. Since 2013, the procedure to amend EIAs and to operate on public land has been expedited.²⁴ In particular, the government has given investors the possibility of amending EIAs by presenting technical reports. As a result, investors do not have to initiate a new administrative proceeding to amend an EIA, which

could take up to a year. Prior to 2013, obtaining investment permits over public land was difficult, onerous and time-consuming. Today, investors can request easements from the Superintendence of National Properties (SBN), which is a much more expeditious approach to obtain required rights over vacant public land. Moreover, Law N°30230, enacted in July 2014 to promote and revitalise investments in Peru, lowers by half the maximum fines for the three-year period 2014-16, but excludes the most serious of environmental violations.²⁵ Furthermore, this law strips the government of its ability to quickly create reserve zones, hindering the expansion of protected natural areas.²⁶ The law also reduces to 45 days the time allotted to governmental entities for reviewing EIAs, and civil servants are subject to sanctions for failing to meet the deadline.²⁷

Other measures have been approved to reduce red tape and the multiplicity of government bodies required to approve investment projects. Fast track processes for EIAs and environmental permits have been approved through Law N°30327 (enacted in May 2015).²⁸ Also, investment projects can now obtain “global environmental certification” (GEC), which combines EIA and environmental permitting (Box 5.2). In addition, procedures, responsibilities and deadlines for granting easements in vacant public land have been clarified in Law N°30327. The law also shortens the process of land expropriation for major infrastructure projects (e.g. highways, electricity transmission lines).²⁹ These recent measures to promote investment require effective and adequate implementation to guarantee the legitimacy of environmental policy in Peru.

Box 5.2. Greening investments through the global environmental certification (GEC)

The GEC’s first step is to approve the EIA terms of reference and the EIA baseline (i.e. the part of the EIA that describes the state of the environment in the project area). The baseline must be approved simultaneously by the National Forestry and Wildlife Service (SERFOR) for impacts on forest areas, the Ministry of Production (PRODUCE) when it regards fishing and SERNANP in relation to protected areas. To speed up the EIA process, projects located in the same geographical area can share the same baseline. The Ministry of Environment estimated that publicly sharing baseline studies could cut the time needed to draw up EIAs by almost a year.

Acting as a single window, SENACE then integrates the EIA approval with the granting of up to 14 environmental permits by the Ministry of Agriculture and Irrigation (National Water Authority (ANA) and SERFOR); the Presidency of the Council of Ministers (Supervisory Agency for Investment in Energy and Mining or OSINERGMIN); the Health Ministry (General Directorate of Environmental Health or DIGESA); and the Peruvian Coastguards (DICAPI). SENACE facilitates simultaneous (rather than sequential) issuance of environmental permits in a range of activities, such as for water abstraction, building water supply infrastructure, wastewater discharge, and deforestation (for purposes other than timber harvest). The GEC approval procedure must be completed within 150 days from the submission of the draft EIA.

Law N°30327 considerably strengthens SENACE powers in managing EIAs by supervising the nomination of experts in charge of reviewing EIAs and by coordinating formally dispersed environmental permitting. The law’s effectiveness will largely depend on providing SENACE with the necessary means to perform these additional functions.

Mining brings conflicts as well as rewards

Mining activities play a major role in the Peruvian economy and are also the largest contributor to socio-environmental conflicts in Peru, accounting for close to 70% of the

total (Defensoría del Pueblo, 2015). Many of these conflicts are fuelled by actual or perceived risks of environmental degradation, as well as distributive issues between the mining company and local communities (Dargent and Muñoz, 2012). For instance, the Camisea project to exploit reserves of natural gas in the Peruvian Amazon was delayed 20 years after environmental and social concerns escalated. The project is located near the Urubamba River, home to several indigenous communities and one of the world's most biodiverse regions. Also, the Conga mining project in Cajamarca was suspended in 2011 after violent community protests about risks to water resources.

Environmental problems associated with mining include air emissions of sulphur dioxide, particulate matter and heavy metals and spillage of toxic chemicals used to extract minerals. Encroachment of protected areas is also a concern: fifteen protected areas are threatened by illegal mining (Ministry of Environment, 2015c). In Madre de Dios (Peruvian Amazon), 20 000 hectares of forest have been destroyed between 1999 and 2012, and the area affected by informal alluvial gold mining has increased by 400%. Alluvial gold mining has also produced mercury contamination. In Puerto Maldonado, Madre de Dios' main city, 60% of the fish consumed exceed levels of mercury deemed acceptable by WHO, and 78% of adults have hair mercury levels three times higher than the maximum allowable limits (Ministry of Environment, 2015b).

Illegal mining has been identified as a major health and environmental concern. Illegal mining is present in virtually all regions of the country, closely related to changes in international gold prices. It is estimated on average to account for more than 20% of gold exports, generate some USD 1 billion annual profits and evade taxes by USD 300 million (Ministry of Environment, 2015c). Several attempts have been made to simplify the complicated and lengthy formalisation process. Campaigns to promote formalisation have been combined with direct regulatory measures to address illegal mining. According to the MoE, nearly all of the estimated 70 000 informal miners came forward to declare their intent to achieve full formalisation.

Lack of effective socio-environmental management in the mining industry hinders Peru's sustainable development objectives. It has had significant negative impacts in terms of social unrest as well as political and financial instability. Investors have faced uncertainty over continued access to mineral resources.

Good environmental policies require the effective involvement of public and private actors in both planning and implementation. Furthermore, Peruvian authorities should ensure that environmental regulations should be both powerful and efficiently administered at the same time. A forthcoming UNECLAC/OECD Environmental Performance Review, as part of the OECD Country Programme, will provide more in-depth analysis of Peru's environmental policies, including measures to promote green growth.

Conclusions

Good governance and effective state capacities are two key pillars for development in Peru. They are fundamental to increasing the effectiveness of public policies in areas such as education and skills, environment, infrastructure, and innovation. Promoting inclusive and sustainable development in Peru will require closing gaps in terms of both the quality and quantity of expenditure in these areas. A long-term strategic framework that allows for a more effective role of the centre of government, and better co-ordination among different levels of government (i.e. between different ministries and agencies of the

central government, and with sub-national authorities) are essential for achieving medium and long-term development objectives in Peru.

Inefficiencies hinder the governance of public policies in Peru, and not just in the executive branch. First, Peru needs to increase the efficiency and transparency of the judicial sector. Second, the legislative branch lacks the capacity to administer checks and balances on the executive and is thus perceived as a source of ineffective policies in Peru.

Significant efforts have been deployed to better leverage the private sector for expenditure and investment, but greater transparency and accountability are required to avoid inefficiencies and unexpected fiscal costs. Although the regulatory and institutional frameworks for public-private partnerships have continuously improved, adjustments are still needed in areas such as environmental permits and land acquisitions to avoid delays and renegotiation of contracts. In addition, the *Obras por Impuestos* programme should be accompanied by a fully-realised set of checks and balances within the sub-national and central governments. Finally, tracking spending and implementing value-for-money analysis in the first stages of the procurement process would improve public procurement.

Several means should be considered to tackle regional disparities and enhance socio-economic development at the sub-national level. First, the allocation of commodity-based fiscal transfers at sub-national level needs to be improved. Second, sub-national governments will need to strengthen their capacity to spend resources more strategically, according to local socio-economic needs. In that context, the central government will need to support and co-ordinate better with sub-national authorities in order to avoid persistent public expenditure inefficiencies in Peru.

Finally, environmental regulations can be both powerful and efficiently administered at the same time. Although the regulatory and institutional frameworks for environmental policy have improved in recent years, Peru continues to experience difficulties in implementing policies to foster sustainable growth and preserve the environment. More can be done. It is necessary to strengthen environmental risk management, including stakeholder co-ordination, in setting environmental objectives and assessing the instruments to achieve them more cost effectively. This would also facilitate conflict resolution in the mining sector.

Notes

1. Furthermore, while more than 41% of the households trusted in the police in 2002, this had fallen by more than 20 percentage points in 2013 (INEI, 2014).
2. The most recent case happened in May 2015 where the Attorney General was dismissed by Congress for misconduct such as covering up for a corrupt ex-governor of a mining province.
3. Based on Proética (2013).

4. See <http://www.oecd.org/gov/cog.htm> for further OECD analysis of the role of Centre of Government.
5. In contrast, the special mining levy (*gravamen especial a la minería*) is a fiscal revenue of the central government. This *gravamen* is a voluntary and temporary surcharge that mining companies pay by virtue of agreements they have made with the government. It is only applicable to firms with valid stability contracts signed before 2011 and those that agreed to the application of this levy with the Peruvian government (Korinek, 2015).
6. See SUNAT – *Superintendencia Nacional de Aduanas y de Administración Tributaria* – website (<http://www.sunat.gob.pe/>) for more details on how royalties are calculated.
7. Data based on the National Households Survey Data (ENAHO, *Encuesta Nacional de Hogares*) from INEI (<http://www.inei.gob.pe/estadisticas/indice-tematico/sociales/>), accessed on 15 July 2015.
8. Based on information from the Ministry of Education (Resultados de la Evaluación Censal de Estudiantes, 2007-2011).
9. The concept of unmet basic needs in Peru is defined by INEI and comprises: quality housing, non-overcrowding of housing, access to sanitary services, school attendance and lack of economic dependency.
10. Based on information from the *Superintendencia de Banca, Seguros y AFP*.
11. Using data at the department level, the correlation between the amount of fiscal transfers per capita and the percentage of the population with at least one unmet basic need is -0.32.
12. See Muñoz (2008) for concrete examples on the lack of clarity in the tasks among different levels of government and political fragmentation in the Puno department.
13. In particular, mayors have discretionary power in the municipal councils, affecting the existence of internal control at the municipal level.
14. More precisely, these regional political parties governed during the period 2010-14 in 14 regional governments, 112 provincial regions, and 845 districts (see *Jurado Nacional de Elecciones* website <http://portal.jne.gob.pe/default.aspx>).
15. Data based on United Nations (2015).
16. See <http://www.cepal.org/en/pressreleases/climate-change-peru-seen-affecting-fishing-high-andes-livestock-and-agricultural>.
17. The standards in Peru were 365 $\mu\text{g}/\text{m}^3$ in 2001 and 80 $\mu\text{g}/\text{m}^3$ in 2009 (Supreme Decrees 003 -2008 –MINAM and 074-2001-PCM).
18. These places are the coastal city of Ilo, the highland town of La Oroya, and Arequipa, Peru's second-largest city.
19. Legislative Decree N° 1013 of 14 May 2008 which approves the establishment, organisation and functions of the Ministry of Environment.
20. Supreme Resolution N° 189-2012-PCM.
21. More precisely, the OEFA is in charge of the evaluation, supervision, inspection and sanctioning on environmental matters.
22. Law N° 29968 on the creation of SENACE, available at: http://www.peru.gob.pe/docs/PLANES/14284/PLAN_14284_2014_Norma_creacion_SENACE.pdf

23. See Law N° 27446, Supreme Decree 002-2009-MINAM on environmental impact assessment (EIA), available at: <http://www.minam.gob.pe/wp-content/uploads/2013/10/Ley-y-reglamento-del-SEIA1.pdf>, and <http://www.minam.gob.pe/seia/entidades-que-participan-en-la-certificacion-ambiental/> regarding the institutions participating in EIAs.
24. Supreme Decrees 054-2013-PCM and 060-2013-PCM.
25. Law N° 30230 establishes tax measures, simplifies procedures and permits for the promotion and revitalisation of investments in the country, available at: <http://www.minem.gob.pe/minem/archivos/file/Mineria/LEGISLACION/2014/JULIO/LEY30230.pdf>
26. As is the case for establishment of a protected natural area, reserve zones creation must now be approved by Supreme decree (issued by the executive/signed by the President) and not any longer by ministerial resolution (issued by the Minister of agriculture).
27. This contravenes the 50-day deadline prescribed by the National Environmental Impact Assessment Law (N° 27446) for detailed EIAs.
28. Law N° 30327 to promote investment for economic growth and sustainable development.
29. However, provisions on easement and expropriation do not apply to lands and territories of indigenous.

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From:
Multi-dimensional Review of Peru
Volume 1. Initial Assessment

Access the complete publication at:
<https://doi.org/10.1787/9789264243279-en>

Please cite this chapter as:

OECD (2015), “Good Governance and effective state capacities in Peru”, in *Multi-dimensional Review of Peru: Volume 1. Initial Assessment*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/9789264243279-10-en>

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