Chapter 1.

Contextualising public governance reform in Peru

This chapter provides an overview of Peru’s politico-administrative and socio-economic changes in recent years, as well as an analysis of the political history of Peru with the aim of understanding many of the challenges the country’s political leadership and public sector are facing today in their quest to make national growth more inclusive. This chapter proposes that addressing the challenges outlined and building resilient institutions can ultimately result in more inclusive growth and increased living standards for all Peruvians.
Introduction

An ethnically, culturally and geographically diverse country, the Republic of Peru is the sixth most populous state in Latin America and the seventh largest economy in the region (OECD, 2014). With an average economic growth rate of 5.3% between 2000 and 2014, the country stands out as one of the most rapidly evolving economies in Latin America, driven by significant reform and impressive economic momentum. This momentum, sustained by a combination of prudent macroeconomic policies, the country’s abundant natural resources and thorough structural reforms, has enabled Peru to make impressive socio-economic progress in recent years. These socio-economic advances are all the more outstanding as consecutive military coups, social unrest and recurring economic crises have negatively affected the country’s governance frameworks while eroding trust in public institutions.

An analysis of the political history of Peru can foster a greater understanding of many of the challenges the country’s political leadership and public sector are facing today in their quest to make national growth more inclusive. History can explain such factors as the limited resilience of the public sector, strong centralism that prioritised the coastal areas around Lima, and the weakness of political parties, which continue to influence the country’s governance frameworks and decision-making process.

Since 2001, in a period of relative political and economic stability, millions of Peruvians have overcome poverty to join the ranks of the middle class. Levels of human development and of gross domestic product (GDP) per capita are rising while income inequality is falling. Nevertheless, Peru remains a deeply unequal and divided country caught in a middle-income trap. Regional disparities, gender inequality and, in particular, ethno-cultural inequalities and poverty, geographically concentrated in the country’s Sierra and Selva regions, remain high compared to OECD standards and are putting pressure on the Peruvian state to guarantee equity and make growth more inclusive.

In response to these challenges, the national government is focusing its policy and governance reform efforts on pursuing more inclusive growth outcomes, whether through a greater focus on public administration reform, a decentralisation agenda aimed at giving voice to the country’s rural and remote regions, or counter-cyclical investment strategies to drive job creation and economic diversification nationally and in the regions, recognising that a participatory, transparent, open, and efficient and effective public sector can play an essential role in achieving inclusive growth objectives and narrowing inequality. As observed in OECD countries, government capacity and quality of government have strong effects on well-being, social trust and political legitimacy (OECD, 2015b). But Peru’s public sector faces considerable challenges that impede it from taking its role as promoter of inclusive growth. These challenges include enhancing whole-of-government co-ordination to address multi-dimensional policy challenges, bolstering the evidence base for policy making, enhancing multi-level governance for better service delivery and contributing to interregional equity, increasing citizen participation and making use of the benefits of open government, creating stability and resilience of the public workforce, and making more effective and efficient use of the potential offered by ICTs and digital government.

This OECD Public Governance Review proposes that addressing these challenges and building resilient institutions can ultimately result in more inclusive growth and increased living standards for all Peruvians. This review provides practical advice aimed at
supporting the government’s efforts at tackling the key public governance barriers to inclusive growth.

History’s influence on present-day governance in Peru

Since its independence on 28 July 1821, the Republic of Peru has been marked by considerable instability generated by rapid swings between democracy and dictatorship. The political history of Peru contains a long list of short-term reforms, hobbled by political instability, as reform objectives have historically shifted between cabinet compositions and between presidential terms. This section will focus on reform efforts undertaken by different governments since 1945 to address economic, ethnic and geographic divisions aimed at making the state more effective and efficient.

The post-war period: Growing disparities, in-migration to Lima and heightened conflict

In 1945, José Luis Pablo Bustamante y Rivero, leader of the Frente Democrático Nacional (FDN) that included Apra, the American Popular Revolutionary Alliance, the oldest political party in Peru, was elected president. While initially popular (he notably restored freedom of the press upon entering office, and would eventually chair the International Court of Justice in the late 1960s), increasing political polarisation led to his overthrow in 1948 by a military coup led by General Manuel A. Odria. The following years saw a prolonged period of strong, export-led growth of on average 5% per year (Taft-Morales, 2013). However, it was mainly the coastal areas around Lima that benefited from the country’s economic development. The unequal economic progress reinforced the “dualistic structure of the country” that had existed since colonial times (Taft-Morales, 2013), while also contributing to an increase in the levels of conflict.

In the mountainous Andean regions of the Sierra, living standards and well-being stagnated and in some areas decreased, contributing to increasing migration to the coastal areas (Gonzales de Olarte, 2000). From approximately 0.5 million inhabitants in 1940, Lima’s population rose to 1.6 million in 1961 and to 4.1 million in 1981 (Taft-Morales, 2013). In the capital, thanks to economic progress, a middle class began to emerge. With this middle class appeared new political actors who started challenging the political and military elites (Taft-Morales, 2013).

Levels of conflict rose steadily in the 1950s and 1960s. In the elections of 1962, Haya de la Torre, the founder of Apra, gained most of the votes without obtaining the necessary two-thirds majority to be elected president. As a consequence, the military annulled the election results and launched a coup d’état. The military junta led by General Pérez Godoy held power for a year before calling new elections. The junta undertook attempts at modernising the Peruvian state: it created, for instance, the National Economic and Social Development Planning System and the National Planning Institute (Government of Peru, 2015a).

1963-1980: From civilian rule to a reformist military government

In 1963, Peru returned to civilian rule and Fernando Belaúnde Terry from Acción Popular (AP) was elected president. President Belaúnde’s government initiated a series of reforms to make the Peruvian state more effective and efficient. Efforts focused on strengthening local governments, enhancing the efficiency of state enterprises and improving the functioning of different ministries (Alonso et al., 2007). President Belaúnde
further tried to calm the increasingly violent conflict in the Sierra by means of modest agrarian reforms, infrastructure projects in the high jungle and the construction of a modern road through the Amazon (US Library of Congress, 1993).

As with previous governments, the involvement of the state in the economy was limited under President Belaúnde (Alonso et al., 2007). From 1964 to 1968, public expenditure remained below 20% of GDP and the share of public enterprises in GDP was approximately 6% (Alonso et al., 2007). In 1968, President Belaúnde’s government was overthrown by a coup caused by the increasing economic difficulties the country was facing and a conflict with an international oil company over claims to Peruvian oil fields.

Consecutive military governments: From nationalisations and land reform programmes to austerity

In the following years, the military government led by General Velasco Alvarado proceeded to undertake a series of important economic reforms consisting mainly in land reform programmes and nationalisations, including in the oil industry (US Library of Congress, 1993). In 1969, a new agrarian reform law was introduced whose purpose was the elimination of large private landholdings and converting them into cooperatives (Immigration and Refugee Board of Canada, 1999). Government spending increased significantly (Alonso et al., 2007) and, as a consequence, the deficit rose from 1% in 1969 to 10% of GDP in 1975 (US Library of Congress, 1993). In addition, General Velasco’s military government significantly reformed the structure of the executive branch, increasing the number of ministries and public agencies, and nationalising private companies.

Velasco’s economic and social reform programmes ran out of steam in the middle of the 1970s and in 1975 he was pushed out of power by General Morales Bermúdez, whose military government focused on the implementation of an economic austerity programme to fight growing inflation (ibid.). But public opinion increasingly despised the military elites, blaming them for Peru’s complicated economic situation, widespread corruption and mismanagement of the government (ibid.). The military junta implemented a new plan to overthrow the sitting military leader and designate a new one based on a new agreement. The new military leadership, more conservative, pursued a less radical reform agenda focused on restoring the Peruvian economy and changing the negative image that the military had in the eyes of citizens. But public pressure through general strikes in 1977 and 1978 continued.

The 1979 Constitution: Universal franchise, decentralisation and safeguards against military coups

In order to prepare for a return to democracy, the military called a Constitutional Assembly to draft a new Constitution. While the resulting 1979 Constitution introduced the universal franchise, by this time, and due to the long military reign, most of the population, especially those without privileged access to power and government services, had already learned not to rely on electoral means for expressing their demands to the government (World Bank, 2001). The Constitution of 1979 established a pluralistic state in the political, economic and social spheres and confirmed the right of the state to intervene in economic activity without undermining free private initiative. For the first time, political parties were recognised and protected at the constitutional level. The Constitution also enshrined respect for human rights in the public and private spheres and established mechanisms for protecting these rights. Several articles refer to the necessity of avoiding military governments and respecting the constitutional presidential periods.
The President of the Republic became the commander in chief of all military forces, thus placing more power in civilian hands as a way to avoid military coups. Finally, by means of a territorial restructuring, the Constitution of 1979 promoted a more decentralised state.

**The 1980s: Back to democracy, economic crises and the rise of the Sendero Luminoso**

Peru returned to democracy in 1980. The winner of the elections, former President Fernando Belaúnde from Acción Popular, built a majority in parliament by forging a coalition with the Partido Popular Cristiano. President Belaúnde inherited a country that was very different from the one he had governed in the 1960s (US Library of Congress, 1993). Due to nationalisations, the old export oligarchy was gone and the amount of foreign investment in the economy had been drastically reduced (ibid.). General Velasco had indebted the country through credits from foreign banks and considerably expanded the size of the state (ibid.). At the same time, the informal sector of small- and medium-sized businesses outside the formal economy had proliferated (ibid.).

Living conditions of poor people in the Sierra deteriorated further and poverty became increasingly spatially concentrated. The 1980s were also characterised by the appearance of the Sendero Luminoso (Shining Path), a radical Maoist terrorist group which launched an armed struggle against the government.

In the 1985 elections, Peru swung to the left with APRA’s Alan García becoming president. President Garcia’s complicated relationship with the international financial community and high levels of spending on social programmes led to hyperinflation and a debt crisis by the end of the 1980s (US Library of Congress, 1993). Inflation had reduced tax revenues and significantly increased the value of the public debt (Alonso et al., 2007). In parallel, real levels of GDP per capita dropped lower than they had been in the 1960s and the reduction in spending on education and health resulted in lower quality public service (ibid.). With the campaign of the Sendero Luminoso intensifying due to the severity of the economic crisis, the country sought help from the International Monetary Fund in 1988 (BBC, 2015).

**The Fujimori years: Centralisation and privatisations to stimulate the private sector**

By the beginning of the 1990s, Peruvians were looking for drastic change. The country found itself in a difficult economic situation characterised by hyperinflation and isolation from international financial markets. Moreover, more than 3,000 political murders had been reported while many more people had “disappeared”. In the 1990 elections, the independent centre-right candidate Alberto Fujimori was elected president. With the election of President Fujimori, an ambitious economic reform programme was initiated and the state started gaining the upper hand on the Sendero. Initially, people seemed pleased with the president’s efforts. Despite not having a majority in Congress or a well-structured party platform, President Fujimori was able to consolidate an important public and international movement, in part due to his significant legitimacy as a man coming from outside the political power structure (Alonso et al., 2007).

Alonso et al. (2007) identify three axes that characterised the Fujimori government in the 1990s:
First, the government – in contrast to the military governments of the late 1960s and 1970s – focused on measures aimed at reducing the role of the state in the economy. This included the withdrawal of the state from the production of goods and services, as well as a cut of non-financial public spending. Juan Carlos Hurtado Miller, Prime Minister at that time, considered that excessive state intervention in economic life stifled and obstructed the private sector (Cortázar Velarde, 2007). The private sector was incentivised by means of privatisation of public enterprises and the promotion of private investment in public service infrastructure (Guerra-García, 1999).

Second, the government conducted a reorganisation of the state, centralising power in a handful of ministries, and concentrating public spending in those ministries (Cortazar Velarde, 2007). President Fujimori considerably restructured public institutions (OECD, 2014) to address what he saw as an oversized government. Bureaucratisation was seen as synonymous with inefficiency, or the intrinsic incompetence of the public administration.

Third, the government created agencies mandated to regulate newly privatised areas (Alonso et al., 2007).

While these measures led to some “islands of efficiency” (Guerra-García, 1999) that survive to this day, reform efforts did not strengthen public administration as such. Not only did the reforms involve a reduction in the size of government, but they caused a reduction in institutional capacity, thus resulting in weakened regulatory capability over the economy (Alza Barco, 2012).

The 1993 Constitution: Re-election of the president, a reduction in levels of government and a unicameral Congress

President Fujimori’s mistrust of political parties and Congress and his conviction that the executive branch and elements of direct democracy needed to be strengthened, eventually led to a new constitutional framework. President Fujimori dissolved Congress and called for a constituent assembly (the so-called “Democratic Constituent Congress”). In 1993, the Peruvian people approved a new Constitution that reduced the Congress to one chamber and allowed for the re-election of the president (Alonso et al., 2007). The Constitution further reduced the role of the state in the economy and promoted the equality between national and foreign private investment.

Re-election in 1995, then the collapse of the Fujimori government in 2000

Nevertheless, positive macroeconomic results resulted in strong popular support for the president (ibid.). GDP grew by 4.8% in 1993 and 12.5% in 1994 while inflation declined from 15% in 1994 to 10% in 1995 (ibid.). President Fujimori was re-elected in 1995, allowing him to continue his reform programme (ibid.). He pursued actions and measures aimed at addressing the “organisational chaos” of public administration (Alza Barco, 2012) and reform efforts focused on eliminating parallel structures within ministries, overlapping functions among different institutions and inflexibility of public sector labour schemes (Alza Barco, 2012).

The 1990s were also characterised by a slowdown in the economy and by rallies against the government’s control of the media and the restriction of civic rights (Alza Barco, 2012). Moreover, the violent and strong-handed military tactics to wipe out the Sendero Luminoso resulted in serious human rights violations (Taft-Morales, 2013).
In the highly contested presidential election of 2000, Alberto Fujimori ran against Alejandro Toledo. President Fujimori was re-elected, but his government collapsed over a large-scale corruption scandal.

The 2000s: Social transformation and the rebuilding of the Peruvian state

Alberto Fujimori’s retreat marked the end of an historic period in Peru; it opened a window of opportunity to tackle key political, policy and social issues. Reform efforts began to focus on rebuilding the Peruvian state and on redesigning, strengthening and consolidating public institutions as a means to regain public trust (OECD, 2014). The relative political and economic stability that has characterised the county since the early 2000s has allowed for continuously high levels of economic growth and important socio-economic advances.

The establishment of the National Agreement and the Truth and Reconciliation Commission

The short transitional government of Valentín Paniagua shepherded the country back to democracy. In only eight months in office, Paniagua left a legacy of having led a broad-based government that took big strides toward rebuilding Peru’s democracy, including overseeing clean elections (Associated Press, 2006).

In the 2001 presidential elections, Alejandro Toledo and the party Possible Peru he founded in 1994 defeated former president Alan García. Toledo narrowly won in the run-off. The 2001 elections demonstrated the relative weakness of political party structures in Peru. As in the past, parties and electoral alliances had not been created on the basis of philosophical like-mindedness or a shared vision for the country on which to campaign and drive national strategy implementation once elected. Rather, they had been organised around specific personalities.

A great number of incremental reforms took place between 2001 and 2004 (Government of Peru, 2015a), contributing to economic growth and poverty reduction:

- President Toledo’s government increased tax collection, reduced expenditures and the budget deficit, and negotiated a free-trade agreement with the United States (Taft-Morales, 2013).

- In 2002, co-ordination between key public authorities, political leaders and civil society resulted in the establishment of the National Agreement (Acuerdo Nacional) (OECD, 2014, and Chapter 2), a forum for national dialogue on broadening and deepening democracy assembling leaders from all of society’s key public and private stakeholder groups. The establishment of the National Agreement was an important step in generating national debate on a medium- to long-term vision for the county’s development. The National Agreement further highlighted the need for the government to pursue effective national strategic planning. The fifth “state policy” (Política de Estado) prompted the creation of a national system of sector-based, institutional strategic planning, with a clear setting of general and specific objectives, establishing short-, medium- and long-term goals and outcomes, coupled with quantifiable performance measurement indicators.

- The transitional government headed by Valentín Paniagua created a Truth Commission on 4 June 2001 (by Supreme Decree No. 065-2001-PCM), which was ratified and complemented by Alejandro Toledo on 4 September 2001, finally being called Commission of Truth and Reconciliation (Supreme Decree No. 101-2001-PCM). The
commission was created as the body responsible for clarifying the process, facts and responsibilities of terrorist violence and violation of human rights from May 1980 to November 2000, attributable both to terrorist organisations and state agents, and proposed initiatives to affirm peace and harmony among Peruvians. One of its essential purposes is to lay the foundation for a profound national reconciliation process, from clarifying the facts and the restoration of justice (Supreme Decree No. 101-2001-PCM).

A focus on political and administrative decentralisation

In 2002, a constitutional reform on political and administrative decentralisation was adopted (see Chapter 4). The Decentralisation Basic Law, the Territorial Demarcation Law and the Organic Law of the Regions led to the establishment of regional governments. The National Decentralisation Council was created to manage and co-ordinate the decentralisation process (Government of Peru, 2015a). Implementation issues initially created a situation in which the reform did not achieve the results it had been designed to achieve: the reform’s roll-out had not been co-ordinated between the executive branch and the legislative branch (Government of Peru, 2015a). This resulted in a lack of clarity in the allocation of powers between regional and local governments, which received new competencies but did not have sufficient capacity to implement their new functions (Government of Peru, 2015a; see Chapter 4).

In 2004, the Framework Law on Public Employment was approved in a first attempt to create a comprehensive civil service reform. With its Framework Law for the Management of Government Modernisation, the government aimed to improve the efficiency of the state apparatus (Government of Peru, 2015a).

The return of Alan García: Economic growth and progressive governance reform efforts

Apra’s Alan García launched a political comeback and won the presidential race in 2006 (Taft-Morales, 2013). Economic growth continued under President García. He instructed his Minister of Transport and Communications, Veronica Zavala, to lead the state reform process (Government of Peru, 2015). In 2007, the government began with the progressive implementation of performance budgeting through budgetary programmes, follow-up actions based on performance indicators, evaluations and management incentives (see Chapters 2 and 3). Furthermore, by means of a Supreme Decree (No. 027-2007-PCM) 12 “national policies” that are binding on the institutions of the national government were established, including a strong focus on administrative simplification (Government of Peru, 2015a).

In 2009, the National Administrative Simplification Policy was approved to complement the Supreme Decree and introduce methodologies, tools and information systems to monitor progress in the implementation of the reform. The policy would later be absorbed by the National Modernisation Policy of 2013. During the second García administration, GDP grew by 7.5% in 2006, 8.5% in 2007 and 9.1% in 2008 (World Bank, 2015c).

The 2011 elections: A renewed focus on the modernisation of the state

In the 2011 elections, Ollanta Humala supported by the electoral alliance Gana Perú narrowly defeated the Fuerza Peru candidate Keiko Fujimori, the daughter of former President Alberto Fujimori. In his presidential campaign, candidate Humala promised to make considerable efforts to reform the state and to create a stronger link between economic growth and social inclusion. To this end, after President Humala was elected,
the Public Management Secretariat (Secretaría de Gestión Pública), a unit in the Presidency of the Council of Ministers (see Chapter 2), developed the National Policy on Modernisation of Public Management. The Implementation Plan of the National Policy on Public Management Modernisation for 2013-16 was adopted in May 2013 (Ministerial Resolution No. 125-2013-PCM; see Chapter 2).

The National Policy sets the vision, principles and guidelines for consistent and effective public sector performance by a state that is to be at the service of citizens and the country’s development. The current public sector modernisation agenda aims to guide, co-ordinate and promote the process of modernising public management towards results that have a positive impact on the welfare of citizens and the development of the country (Government of Peru, 2015a). The vision of the policy can be summarised as follows: “A modern state is one that is oriented to the citizen; it is efficient, unitary, decentralized, inclusive and open (transparent and accountable)” (Government of Peru, 2015b).

The National Policy has five pillars:
1. public policies, strategic plans and operating plans
2. performance budgeting
3. process management, administrative and institutional organisation
4. meritocratic civil service
5. information, follow up, evaluation and knowledge management system.

It further has three transversal axes:
1. open government
2. electronic government
3. inter-institutional co-ordination.

**Today: Impressive progress, but important disparities persist**

The comparatively stable democratic political environment and favourable macroeconomic conditions since the beginning of the 2000s, including high international commodity prices and relatively easy access to international finance, have allowed Peru to make impressive socio-economic progress (OECD, 2015a).

Nevertheless, Peru is still a deeply divided country with structural deficiencies that cut and block opportunities for large sections of the population. Important economic, gender-related, ethno-cultural, social and political disparities remain. At the aggregated level, well-being and human development have improved and poverty has been reduced, but inequality between different groups of the population and between different regions remains high and has actually increased in recent years. The next section discusses the socio-economic progress made in recent years while highlighting the necessity to tackle persisting inequalities, which explains the nature and scope of the governance reform agenda currently being pursued by the national government.

**Strong macroeconomic performance**

Peru’s macroeconomic performance has been extraordinary (OECD, 2015a). The country has one of the most rapidly evolving Latin American economies. Between 2000
and 2014, economic growth averaged at 5.3% per year and was second only to Panama in Latin American and Caribbean countries and well above the regional average of 3.1% (ibid.). Even during the worst moments of the global economic crisis, Peru was one of the few Latin American countries that still registered positive growth (1.1%). From 2010 to 2013, while the global economy grew very slowly, Peru had an average growth rate of 6.7% (OECD, 2014).

This stable economic growth has contributed to an expansion of GDP per capita (current USD) from USD 1 180 in 1990 to USD 1 960 in 2000 and USD 6 594 in 2014 (World Bank, 2015b).

![Figure 1.1. Growth of GDP per capita between 1960 and 2014](http://data.worldbank.org/indicator/NY.GDP.PCAP.CD)

The World Bank Doing Business Index ranks economies on their ease of doing business. Peru was in 45th position in 2015, up from 56th in 2010 (World Bank, 2015c). This score is comparatively high among transition countries (OECD, 2015a).

Economic growth has been accompanied by a similar growth in government revenues. Since 1990, tax revenues increased from 12.1% (OECD average: 32.2%) to 18.3% in 2013 (OECD average: 34.1%) (OECD, 2015e).

**Falling levels of poverty**

Relatively high levels of economic growth and a growing emphasis on social policies and redistributive programmes have helped reduce poverty rates and inequality, and to increase the overall well-being of Peruvians (OECD, 2015a).

Poverty levels have fallen drastically in the past decade. While 56% of the population was still considered poor in 2005, this number had fallen to 22.7% in 2014 (World Bank, 2015a). This impressive development has resulted in 7 million Peruvians that are no longer considered poor (World Bank, 2015a). It is estimated that in 2014 alone, almost 300 000 Peruvians managed to escape poverty (World Bank, 2015a).
Table 1.1. Poverty headcount ratio at national poverty lines in Peru, 2005-13

<table>
<thead>
<tr>
<th>Year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
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<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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</thead>
<tbody>
<tr>
<td>Percentage of population</td>
<td>55.6</td>
<td>49.2</td>
<td>42.4</td>
<td>37.3</td>
<td>33.5</td>
<td>30.8</td>
<td>27.8</td>
<td>25.8</td>
<td>23.9</td>
<td>22.7</td>
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The proportion of the population living below USD 1.25 per day decreased from 15.8% in 1999 to 7.8% in 2005, and to 3.0% in 2012 (United Nations, n.d.). According to the World Bank (2015a), extreme poverty is highly rural and is concentrated in the regions of Cajamarca, Piura, La Libertad and Apurímac (see below).

An emerging middle class and increasing levels of human development

According to data from the United Nations Development Programme (UNDP, 2014a), between 2000 and 2012, the share of the middle class rose from 12.28% to 34.3% of the population. In parallel, life expectancy at birth rose from 60.1 years in 1980 to 74.6 years in 2014. These trends are reflected in Peru’s Human Development Index value which improved from 0.577 to 0.734 over the same period (Table 1.2). This value is similar to the Human Development Index of Brazil (0.755) and Mexico (0.756), but remains far below the OECD average (0.887).

Table 1.2. Peru’s Human Development Index trends (selected data)

<table>
<thead>
<tr>
<th>Life expectancy at birth (years)</th>
<th>Mean years of schooling</th>
<th>Human Development Index value</th>
</tr>
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<tbody>
<tr>
<td>1980</td>
<td>60.1</td>
<td>5.5</td>
</tr>
<tr>
<td>1985</td>
<td>63.0</td>
<td>5.9</td>
</tr>
<tr>
<td>1990</td>
<td>66.5</td>
<td>6.6</td>
</tr>
<tr>
<td>1995</td>
<td>68.0</td>
<td>7.3</td>
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<tr>
<td>2000</td>
<td>70.5</td>
<td>8.0</td>
</tr>
<tr>
<td>2005</td>
<td>72.4</td>
<td>8.4</td>
</tr>
<tr>
<td>2010</td>
<td>73.9</td>
<td>8.8</td>
</tr>
<tr>
<td>2011</td>
<td>74.2</td>
<td>8.9</td>
</tr>
<tr>
<td>2012</td>
<td>74.5</td>
<td>9.0</td>
</tr>
<tr>
<td>2013</td>
<td>74.8</td>
<td>9.0</td>
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Lowering income inequality

While less spectacular than the fall in poverty, there has also been a decline of inequality, which is consistent with the overall Latin American trend of lowering inequality (Prado, 2013). The Gini coefficient, the global measure for income inequality, dropped from 0.52 in 2003 to 0.44 in 2014. While this drop is important, the level of inequality has historically been high. Income inequality remains significantly above the OECD average (0.32 in 2012), and close to or above the level in high inequality OECD countries (OECD, 2015c).
The middle-income trap and vulnerabilities of certain groups

Its strong economic performance elevated Peru to the group of “upper middle-income” countries in 2008 (OECD, 2015a). However, as in many other countries at similar stages of development, the period of productivity growth was followed by a slowdown of the economy, which the economic development literature has termed “middle income-trap” (OECD, CAF and ECLAC, 2014), a situation where productivity growth stagnates after countries have reached middle-income status (OECD, 2015a). The country’s drivers of growth, which are strongly reliant on labour, capital accumulation and the commodity exporting sector, seem insufficient to sustain further socio-economic progress (ibid.).

In the short and medium term, the effects of the “middle-income trap” could mean a deterioration of the economic situation of the newly expanded middle class in Peru. Still vulnerable parts of this class may fall back into poverty if the economy faces turbulence or a slowdown. Many Peruvians are officially classified as “not poor”, but still lack access to basic services and social protection and are therefore particularly vulnerable to economic shocks. The size of those belonging to this group increased from 33.8% in 2000 to 40% in 2012 (UNDP, 2014b).

In order to tackle these challenges, the government has to combat high and widespread informality in the labour market and decrease the prevailing inequality among its regions (OECD, 2015a). Simultaneously, newly evolving demands for public services, most notably education, health and transportation, need to be addressed in order for Peru’s growth to be sustainable and inclusive (ibid.).

Regional disparities and the urban-rural divide

The decrease in overall income inequality reflected in the country’s Gini Index hides significant geographical differences. As seen above, Peru’s development has historically focused on Lima and large coastal cities. The improvement of the socio-economic situation of rural Peruvians has been much slower than that of urban Peruvians (World Bank, 2015a; OXFAM, 2014).

In 2004, a resident of a rural area of Peru was approximately twice as likely to be poor as a resident of an urban area. By 2013 this likelihood had tripled (OXFAM, 2014). Moreover, while also declining, the Gini coefficient for rural areas has decreased

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**Note:** World Bank and IndexMundi estimate.

significantly less than urban inequality (World Bank, 2015a). The poverty gap between the country’s rural and urban areas remains wide (World Bank, 2013).

**Spatially concentrated ethno-cultural poverty**

Regional disparities coexist with and are reinforced by the persistence of inequalities among Peruvians of different ethnic backgrounds. Peru is characterised by great levels of ethnic and cultural diversity (Government of Peru, 2015a). It is estimated that the country has more than 50 different groups of indigenous or native peoples and 20 further ethnic groups that arrived after Spanish colonisation (ibid.). According to the Peruvian Ministry of Education (2013), 47 different languages are spoken in Peru, Quechua being the most prevalent. Overall, among the population that speaks indigenous languages, 80.9% live in rural areas (ibid.). At 45.7%, the Quechua-speaking population is the indigenous group with the highest percentage of urban population (Government of Peru, 2015a).

Although poverty decreased for both indigenous and non-indigenous populations between 2004 and 2013, the reduction was significantly lower for indigenous Peruvians (Government of Peru, 2015a). According to the National Household Survey (2013), the percentage of poor people in the Amazon indigenous population was still 60.5%, compared to 34.8% in the Quechua population, 48.4% in the Spanish-speaking rural population and 15.6% in the Spanish-speaking urban population.

The gap is even wider when one looks at extreme poverty: the percentage of people living in extreme poverty among the Amazon indigenous population is 27.6%, while it lies at only 1.1% for the urban population who speak Spanish and at 8.3% for the population of Quechua or Aymara origin (Government of Peru, 2015a). Similarly, the Human Development Index is lower in the districts with the largest indigenous populations, particularly in rural areas (Government of Peru, 2015a).

The results of National Household Survey (2013) also highlight the gaps in access to services between different indigenous groups. For example, only 3.1% of the Amazon indigenous population has access to potable water, sewerage and electricity utilities, while overall 76.8% of non-urban indigenous people have access to these utilities (Government of Peru, 2015a). A study based on the National Household Survey conducted by Yamada and Montero (2011) finds that households with indigenous characteristics not only reach lower levels of access to public services, but also lower rates of successful completion of formalities.

**Gender inequality**

With a value of 0.387 in the 2013 Gender Inequality Index, Peru ranked 77th out of 149 countries (UNDP, 2014a). Only 21.5% of parliamentarians were women. While 66.1% of adult men reached at least a secondary level of education, significantly less women (56.3%) had reached this level. Female participation in the labour market was 68.0% compared to 84.4% for men (ibid.).

Gender-related gaps in income also persist. Even though the revenues of both men and women have increased over the last decade, the gender gap has not narrowed. Nowadays, working women in urban areas earn on average 70% less than men (PEN 1 118 a month for a woman to PEN 1 747 in the case of a man) – the same difference as ten years ago (OXFAM, 2014). Furthermore, only 5% of mayors were female and the percentage of female ministers was 18% in 2009 (Inter-American Development Bank, 2010).
In sum: A need for better governance

The socio-economic challenges identified in this section have important implications for public governance. In order to address them, the state needs to be reformed. Priorities that will be discussed in the following sections include:

- the requirement for better co-ordination efforts led by the centre of government to articulate integrated multi-dimensional policy responses due to the increasing levels of complexity of the challenges the country and its people are facing
- the greater need for a more robust evidence base to improve policy design and long-term planning
- the need for a greater focus on regional development and better multi-level governance to ensure that policies are tailored to the circumstances and conditions in different places
- the need for a better connection between the budgeting process and the different policy agendas to adopt and implement reforms for inclusive growth that can be fully funded
- the requirement for a different and more advanced skillset in the state labour force due to the specificities of these challenges
- the need for better and greater citizen participation to ensure that policies adequately reflect the population’s needs
- the need for better use of available data and information and communication to maximise access to, reach and quality of public services.

The government is aware of these challenges. In recent years, Peru has proposed a large number of policies to tackle the barriers to inclusive growth. Several ministries and public sector entities have presented valuable analysis on the current socio-economic challenges and set out objectives for the medium term (OECD, 2015a). These include:

- the Agenda de Competitividad 2014-2018
- the National Plan for Productive Diversification
- the National Strategic Export Plan
- the National Strategy on Development and Social Inclusion: “Incluir para Crecer”
- the “Plan bicentenario: El Perú hacia el 2021” (ibid.).

In particular, the “Bicentenary Plan: Peru to 2021” established concrete socio-economic development goals such as increasing per capita income between USD 8 000 and USD 10 000, doubling GDP between 2010 and 2021, multiplying the volume of exports by four in the period 2010-21, having an average annual growth rate close to 6% and an average annual investment rate of approximately 25%, maintaining an average annual taxation 5 points higher than GDP, and reducing poverty to less than 10% of the total population. The public administration will play a key role in achieving these ambitious targets.
Public governance for inclusive growth in Peru

To sustain past achievements and address the challenges outlined in the previous section relating to growing inequality and remaining high levels of spatially and ethno-culturally concentrated poverty, Peru needs to continue reforming its public sector to achieve more inclusive growth and strengthen the linkages between growth and equity. OECD research (2015b) shows that public governance plays an essential role in achieving sustainable economic growth and narrowing inequality in all its dimensions. Government capacity and quality of government have strong effects on almost all standard measures of well-being, and on social trust and political legitimacy. Governance failures lead to increasing inequalities (OECD, 2015b) while good governance can contribute to a more equal society.

The next section introduces the OECD approach to inclusive growth. It then discusses the main challenges faced by Peru’s public sector in key areas of public governance and explains how public governance reform can help Peru address the challenges associated with the middle-income trap, fight inequality, and improve living conditions and well-being for all Peruvians.

Good governance matters for inclusive growth

Governance matters for achieving sustainable, inclusive economic growth. There is a broad evidence-based consensus that good governance is key for a number of important policy outcomes at the national and subnational levels, including but not limited to social cohesion, public expenditure efficiency or control of corruption.

Coase (1960) argues that good institutions, such as strong property rights, reduce transaction costs and consequently support economic development. Similarly, North (1991) contends that institutions that strengthen contract enforcement are necessary to economic development. More recently, Rodrik, Subramanian and Trebbi (2004) empirically found that the quality of institutions is more important for growth than geography or trade. Other scholars (e.g. Acemoglu and Robinson, 2012) argue that institutions, including an efficient public sector and absence of corruption, are the fundamental drivers of economic growth (OECD, 2015b).

Inclusive institutions ensure that markets are functional and open to competition, and allow for broad citizen participation, pluralism, and an effective system of checks and balances, leading to better access to services and opportunity. Cross-country evidence shows that inclusive governance can improve development outcomes, such as better literacy and health, or lower infant mortality (e.g. Halperin, Siegle and Weinstein, 2010; Evans and Ferguson, 2013). Rajkumar and Swaroop (2002) also find that, for example, corruption disproportionately denies the poor access to education and health services.

Public governance is an essential lever for high-impact public spending, which in turn enhances the potential of economic policies aimed at inclusive growth. For example, stakeholder engagement and consultation can help identify needs and preferences, better targeting government programmes and increasing efficiency. Public governance also affects the quality and efficiency of public investment. In this respect, strengthening inclusive institutions has great potential to enhance citizen participation, provide better public services, reduce transaction costs, and – ultimately – reduce inequalities while promoting economic growth.
Box 1.1. The OECD’s growing attention to inclusiveness and the cost of inequalities

Growing attention to inclusive growth is motivated to a large extent by rising inequalities across OECD countries and an increase – or remaining high levels – of poverty in many parts of the world, including in Peru (OECD, 2015b). Conventionally, an emphasis on “average economic growth” (such as GDP per capita) as a measure of performance relies on the assumption that the benefits of growth will necessarily trickle down to all social groups and deliver higher welfare to people. Recent OECD research has challenged this assumption, calling for a shift from the traditional binary approach of either growth or redistribution, to win-win policies where growth and equity go hand in hand (OECD, 2015e). This shift is not only conceptual, but also has practical implications for every aspect of public policy and is in line with the United Nations Sustainable Development Goals (SDGs) among which are to “promote sustained, inclusive and sustainable economic growth (…)” (SDG 8), “reduce inequality within and among countries” (SDG 10) and “promote peaceful and inclusive societies for sustainable development” (SDG 16).

OECD research shows that income and spatial inequalities, informality and low productivity are strongly affecting the prospect of inclusive growth in any country (OECD, 2015a). As outlined in the OECD publication In It Together: Why Less Inequality Benefits All (OECD, 2015d), high levels of income inequality not only raise social and political concerns, but also economic ones. Growth in material living standards affects income inequality, but the reverse is also true, so that the distribution of the benefits of growth matters for future prosperity (ibid.). Hence, inequalities tend to drag down GDP growth. In addition, high levels of inequality can entail large social costs, including those due to reduced social cohesion, eroded confidence in public institutions, and decreasing attachment to democratic processes and values.

In light of this, the OECD looks at development from a multi-dimensional perspective considering growth in GDP as only one element of a country’s overall development: economic growth is only a means to an end: the sustainable and equitable improvement of people’s lives (OECD, 2015a). Public governance plays a key role in this approach.

Last but not least, governance matters for well-being (OECD, 2015b). People are more satisfied with their lives in countries that have better governance. Actual changes in governance quality (understood as the way in which policies are designed and delivered) lead to large changes in the quality of life. Changes in average life evaluations in 157 countries over the period 2005-12 can be explained just as much by changes in governance quality as by changes in GDP, even though some of the well-being benefits of better governance are delivered through increases in economic efficiency and hence GDP per capita. The well-being payoff of improved governance in that period can be compared to a 40% increase in per capita incomes (OECD, 2015b).

Building resilient public institutions to pursue inclusive growth

This review identifies an overarching need to bolster the resiliency of public sector institutions in order for Peru’s public sector and its public policies to become the drivers for inclusive growth. Public governance reform can help Peru address challenges such as the disparities between the coast and the Sierra/Selva, poverty of certain indigenous groups, and inequality faced by women and ethno-cultural minorities. While Peru has already started adopting important reforms to improve its public governance and proposed a large number of policies to tackle the public governance barriers to inclusive growth, further efforts – in particular with regard to their implementation – are needed to make reform happen.
Improving whole-of-government co-ordination lead from the centre of government (Chapter 2)

Pursuing inclusive growth calls for a whole-of-government approach that leverages informed decision making and aligns vision, incentives and delivery mechanisms across the policy-making cycle (OECD, 2015b). The centre of government (CoG) has to take a strong leadership and co-ordination role. This includes, for instance, the promotion of performance and accountability mechanisms that focus on outcomes and cut across administrative silos (OECD, 2015b). Translating multi-dimensional objectives like the fight against inequalities into concrete deliverables requires joined-up efforts that cut across policy areas and the ability to deal with complexity and to co-ordinate actions across administrative boundaries and levels of administration (OECD, 2015a).

In Peru, intergovernmental and inter-sectorial co-ordination within the government remains scarce, difficult, expensive and ineffective (Government of Peru, 2015a). This has implications for the government’s efforts to tackle multi-dimensional challenges such as the ethno-cultural poverty in the Sierra and the Selva of the country which require a whole-of-government approach and better co-ordination among public institutions to determine priorities, and a better connection between the budgeting process and these agendas to adopt and implement reforms. But co-ordination mechanisms show limitations in their legal design and have no consensus for their implementation or, in practice, have been ineffective to achieve effective interagency and intergovernmental co-ordination which is essential to address the important socio-economic challenges the country is facing. The lack of clear articulation between national, sectorial, regional and local policies constitutes a further stumbling block to effective poverty alleviation and reduction of inequalities.

Chapter 2 of this review advises Peru on ways to enhance whole-of-government co-ordination led from the CoG to achieve improved service delivery and ultimately the country’s inclusive growth objectives.

Enhancing performance management and strategic planning (Chapter 3)

The evidence base for policy making plays an important role in the achievement of inclusive growth objectives. Information gaps need to be filled, including on the distributional impacts of policies on social groups, so that a broader set of indicators can be identified to inform policy making and reinforce government implementation capacity (OECD, 2015b). The use of policy instruments for aligning inclusive growth objectives with resource allocation mechanisms over different time horizons can allow for the identification of trade-offs and complementarities among multi-dimensional objectives and evaluations of policy impacts on a wide variety of social groups (OECD, 2015b). Furthermore, strengthening available evaluation techniques and extending them into broader reaches of public policy can be essential to assess and communicate progress in delivering inclusive growth outcomes (OECD, 2015b).

In public institutions in Peru, planning as a tool to achieve medium- and long-term policy objectives such as the reduction of poverty, as outlined in the juntos programme, is yet to be established (Government of Peru, 2015a). In day-to-day governance, plans are considered a formality rather than a governance and management tool that allows facing the complex socio-economic challenges Peru is facing. Limitations in the capabilities of officials at different levels of government to develop a proper planning process impede the identification and prioritisation of key policies that could have an impact on the
quality of life of citizens, particularly of the most disadvantaged citizens, and foster inclusiveness (Government of Peru, 2015a).

Chapter 3 advises Peru on ways to confront these challenges and enhance performance management and strategic planning to achieve its inclusive growth objectives.

**Strengthening multi-level governance to address multi-dimensional policy challenges (Chapter 4)**

Multi-level governance is particularly important for policy coherence in the design and delivery of inclusive growth policies (OECD, 2015b). Across the OECD, many policies that have a significant impact on inclusive growth are managed at least in part by subnational governments. The almost 134 000 subnational governments in OECD countries are responsible for around 63% of public procurement, 59% of public investment and 40% of total government expenditure. A whole-of-government approach at the central government level (Chapter 2) will have a greater potential impact on inclusion if all levels of government are on board. Such a whole-of-government approach at national level towards a common goal requires adaptation of some actions tailored to circumstances in different places. The design and implementation of policies for inclusive growth therefore need to take into account the wide regional variations in conditions across the country.

As seen above, the Peruvian government has historically shown a relatively weak presence in rural areas, which is where most of the indigenous population is concentrated and where poverty, notably absolute poverty, is most pronounced. The decentralisation strategy – a laudable initiative started in 2002 – has not yet achieved its regional growth objectives and its ambitious aim to reduce regional disparities. In order to improve the living conditions of people living in the Amazon lowlands and parts of the Sierra, for instance, and provide equal access to public service to all Peruvians, a greater focus on regional development is needed. This includes stronger and better mechanisms for multi-level governance.

Chapter 4 of this review proposes actionable recommendations on how to foster multi-level governance in the context of Peru’s decentralisation process in order to reduce poverty gaps and inequalities.

**Reinforcing human resources management across the public administration to achieve inclusive growth objectives (Chapter 5)**

Civil service management practices that ensure merit, professionalism, stability and continuity in staffing provide the foundations for an efficient and effective public sector that can promote strong, sustainable and inclusive growth. The multi-dimensional nature of inclusive growth outcomes calls for reinforcing the capacities of public servants to contribute to a whole-of-government view of interlinked and complex policy challenges (OECD, 2015b). Public performance is dependent on the quality, capability and motivation of public servants, which is particularly challenging in the context of inclusive growth. As responsibilities for inclusive growth outcomes lie across ministerial lines, the challenge becomes one of not only aligning senior civil servants’ performance goals with ministerial expectations, but also incentivising co-operation and co-ordination across institutional silos. In parallel with aligning performance assessment frameworks to reflect the demands of increasingly horizontal work and encourage engagement, it is necessary to reconsider the capacities and skills needed to design, implement and assess inclusive growth policies (OECD, 2015b).
Peru faces significant challenges when it comes to the stability and resilience of its public workforce. The churn in key institutions is unusually high by international standards. This adversely affects the relationship between citizens and state institutions and contributes to the lack of institutional memory, which in turn hinders the implementation of whole-of-government long-term strategies to address key socio-economic challenges like the fight against poverty and the reduction of inequalities. The fact that civil servants respond to different labour schemes and comply with different rules, despite performing functions or exercising similar charges (Government of Peru, 2015a), further creates serious distortions in the payments and the applicable rights and duties, affecting the work environment, and hinders a whole-of-civil service approach to complex multi-dimensional challenges such as the “middle-income trap”. The establishment of a stable and professional civil service will ensure that Peruvians are treated fairly and in an equitable manner across the country, regardless of regional, ethnic or political affiliation.

Chapter 5 of this review offers advice to the government on the implementation of the comprehensive whole-of-government civil service reform (SERVIR) that is being designed and implemented for HRM to become a strategic enabler of good governance.

Promoting the use of information and communication technologies and knowledge management systems and methods (Chapter 6)

Digital governance can play an important role in the attainment of inclusive growth objectives. Information and communication technologies (ICTs) offer opportunities for maximising the access, reach and quality of public services while empowering beneficiaries and communities (OECD, 2015b). For instance, the open government data (OGD) movement has increased the availability of a broad range of data that public organisations produce and collect while performing their tasks. Overall, the new digital environment offers opportunities for more collaborative and participatory relationships that allow relevant stakeholders to actively shape political priorities, collaborate in the design of public services, and participate in their delivery to provide more coherent and integrated solutions to complex challenges.

The main focus areas for e-government in Peru are related to improved management, inclusion and integrity within public agencies as well as bringing information and services closer to citizens. However, the Peruvian public sector modernisation strategies are not embracing a strategic view of digital government as instrumental to more open, innovative and participatory public sectors, despite the key role ICTs could play in providing access to public services and – given Peru’s complex geography – in ensuring that all parts of the population can have a say in the policy cycle.

Chapter 6 of this review provides recommendations for the government to shift from e-government to digital government to create public value throughout the whole public sector ecosystem.

Harnessing open government to achieve inclusive growth objectives (Chapter 7)

Inclusive, open and transparent institutions are essential for shaping policies to deliver inclusive growth outcomes. Openness, accountability and citizen participation in decision making ensure that the needs, preferences and concerns of stakeholders, including underserved populations, are reflected in policy making (OECD, 2015b). An inclusive public sector can better represent and address the needs of society, while offering greater opportunity and capitalising diversity to boost public sector engagement and innovation (ibid.). OECD countries are increasingly mainstreaming stakeholder
consultation and engagement at different stages of the policy-making cycle, recognising that open government initiatives can lead to more effective policies, better targeted services and stronger accountability.

In Peru, efforts to foster open government and formalise transparency, while being high on the political agenda, have not yet been fully translated into effective policy and practice despite the important role they could play in addressing the country’s socio-economic challenges. For instance, citizen participation has the potential to provide tangible improvements to people’s lives but is still not used widely enough. Effective and efficient engagement mechanisms could become a key tool to ensure that all parts of the population, no matter where they live in the country, are involved in the policy cycle and receive the public services they need.

Chapter 7 of this review frames the relevance of open government initiatives within the broader framework of the ongoing public sector reform efforts Peru is undertaking, with specific reference to the challenges the government is facing in finalising its second Open Government Partnership Action Plan, and the role played by stakeholder engagement initiatives at the central and local levels and their role to guarantee better accountability and improve policy results.

**Conclusion: Better governance and more resilient institutions for inclusive growth in Peru**

The government of Peru is aware of the enormous socio-economic challenges it is facing if it is to succeed in moving the country and its society closer to the world’s most advanced economies. Other countries that have been successful in meeting complex multi-dimensional policy challenges reform efforts have focused on maximising the public sector’s resiliency for addressing these challenges effectively. Good public governance plays a key role in achieving better policy outcomes for citizens, in particular for the most vulnerable and poorest among them.

Declining levels of productivity growth associated with the middle-income trap, spatially concentrated ethno-cultural poverty (according to INEI [2013], 36% of the Amazon’s indigenous population is still considered poor), and lower levels of education and insertion into the labour market of women, require establishing a stronger link between economic growth and equity and enhancing government capacity and quality of government. This involves building a more strategic Peruvian state that ensures long-term strategy-setting and implementation capacity in a dynamic and consistently changing policy environment.

A state’s strategic agility emphasises leadership and stewardship from the centre, integrity and transparency, the importance of networks and institutions (both inside and outside government), the need to draw inspiration from subnational initiatives and citizens, and crucially, the importance of effective implementation and performance monitoring of national strategy. This review assesses key governance areas as a means to offer advice on ways to enhance the government of Peru’s strategic agility and responsiveness in meeting complex multi-dimensional policy challenges effectively.

In offering this advice, this review identifies international good practice that can help shape and define specific reforms for enhancing state capacity to design and deliver policy and services to citizens and business in all regions of the country in a way that addresses socio-economic development needs and achieves measurable results for people in every region of Peru. The review will provide concrete and actionable support to build resilient institutions, both nationally and locally, for the Peruvian state to become the driver of the country’s efforts to make growth more inclusive.
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