

PERU

UNITARY COUNTRY

BASIC SOCIO-ECONOMIC INDICATORS

INCOME GROUP: UPPER MIDDLE INCOME

LOCAL CURRENCY: PERUVIAN NUEVO SOL (PEN)

POPULATION AND GEOGRAPHY

Area: 1 285 220 km²
Population: 32.165 million inhabitants (2017), an increase of 1.3 % per year (2010-2015)
Density: 25 inhabitants / km²
Urban population: 77.7 % of national population
Urban population growth: 1.5% (2017 vs 2016)
Capital city: Lima (32.3 % of national population)

ECONOMIC DATA

GDP: 432 118.5 billion (current PPP international dollars), i.e. 13 434 dollars per inhabitant (2017)
Real GDP growth: 2.5% (2017 vs. 2016)
Unemployment rate: 6.7% (2017)
Foreign direct investment, net inflows (FDI): 6 769.5 (BoP, current USD millions, 2017)
Gross Fixed Capital Formation (GFCF): 20.6% of GDP (2017)
HDI: 0.750 (high) rank 89 (2017)

MAIN FEATURES OF THE MULTI-LEVEL GOVERNANCE FRAMEWORK

The Republic of Peru is a unitary, semi-presidential representative democratic republic. Legislative power is vested in the Congress (*Congreso*) of the Republic of Peru, the unicameral house. The 130 members of the house are elected directly by the population for a five-year term by proportional representation. The Head of State is the President, elected through direct vote for a five-year term.

After the country's transition from military dictatorship to democracy with the 1979 Constitutional Act, and the promulgation of the 1993 Constitution, a decentralisation process was launched in 2002, which is still on-going. The 2002 constitutional reform established four levels of government in Peru: central, regional, provincial and district.

The country has two tiers of subnational government, with regions (*departamentos*) and provincial and district municipalities (*municipalidades*). Both regional and local governments enjoy political and administrative autonomy over matters within their jurisdiction. Both have representatives (regional councils headed by presidents, and local councils headed by mayors) elected for four years according to an electoral system that mechanically hands a governing majority at the local level to the political party owning a majority in the subnational assembly. In regard to regions, if no candidate has obtained 30% of the votes cast, a run-off election between the two main candidates is held within 30 days of election day. Regional coordination councils (*Consejos de Coordinación Regional*) are consultative entities composed of elected officials (60% of the council) and civil society members (40%), with a mission to coordinate and advise the regional president on a broad range of issues, including the budget

To improve co-ordination between levels of government, an institutional framework for inter-governmental commissions was put in place as of 2007. However, its implementation remains poor and limited. In fact, as of the end of 2015, there were just three commissions considered active by the Decentralisation Bureau: health, labour and education. The lack of implementation is partly due to disagreement about how representatives of local governments should be elected. To overcome this gap, Decentralised Cabinet meetings have been used in recent years for vertical and horizontal co-ordination between levels of government. In March 2017, the Government created a new structure under the Prime Minister's Cabinet to manage dialogue and coordination with subnational governments.

TERRITORIAL ORGANISATION

2017	MUNICIPAL LEVEL	INTERMEDIATE LEVEL	REGIONAL OR STATE LEVEL	TOTAL NUMBER OF SNGS
	1 671 district municipalities (<i>municipalidades distritales</i>) and 195 provincial municipalities* (<i>autonomías indígenas originarias campesinas</i>)		24 regions (<i>departamentos</i>) and the Constitutional Province of Callao	
	Average municipal size: 17 238 inhabitants			
	1 866		25	1 891

* Excluding the province of Callao

OVERALL DESCRIPTION. Peru has a two-tier subnational system of SNG, composed of departments (regional level) and provincial and district municipalities (local level).

REGIONAL LEVEL The regional level includes 24 *departamentos* set as regional governments, as well as the Constitutional Province of Callao, surrounding the capital city of Lima, which has the status of a *departemento*. The country's main development challenges stem from acute regional disparities and difficulties in the mountainous zones, and the over-concentration of economic activity in specific territories, especially Lima. Despite the framework established by the National Strategic Development Plan for national policy priorities, and Concerted Regional Development Plans providing a complementary framework for priority setting at a regional level, national policies and priorities are not necessarily reflected or considered in sub-national planning.

MUNICIPAL LEVEL. The municipal level comprises two sub-levels: 195 provincial municipalities at the upper level and 1 671 districts municipalities at the lower level. These two municipal levels are independent (*Ley Orgánica de Municipalidades*); however, provincial municipalities have a co-ordination role across district municipalities within the province. The Metropolitan Municipality of Lima, with the status of provincial municipality, has been transferred additional powers and functions close to those of regional governments since 2011 under a special regime. The central government passed a law on Municipal Amalgamation in 2007 encouraging the consolidation of districts through fiscal incentives but districts did not make use of it. Regarding departments, a referendum on mergers took place in 2005, which led to the rejection of the proposal (the programmed 2009 and 2013 referenda were postponed indefinitely).

SUBNATIONAL GOVERNMENT RESPONSIBILITIES

SNG competences are determined by the 2002 Basic Law of Decentralisation (Ley de Bases de la Descentralización) which established a distinction between exclusive, shared and delegated competences. Organic laws for each level of government provide more details. Yet this process was not effectively implemented before 2007, when the Decentralisation Secretariat was created within the Presidency of the Council of Ministers (PCM), which replaced the former National Council for Decentralisation. This has caused overlaps across all levels of government. As of today, the central government is still refining the delimitation of competencies between the different levels of administration. Regional competences include education, public health, environmental protection, support for economic growth, land-use planning, as well as culture and citizen participation (shared or delegated). Provinces and districts are responsible for promoting local economic development, and providing public services. They share some basic competences and in addition, provincial municipalities have extended responsibilities regarding local development and spatial planning within the province, as well promoting, supporting and executing investment and public service projects.

MAIN RESPONSIBILITY SECTORS AND SUB-SECTORS

	REGIONAL LEVEL	MUNICIPAL LEVEL
1. General public services	Internal administration; Enhance citizen participation	Internal administration (organisation and budget); Supervision of local public works
2. Public order and safety		Public safety
3. Economic affairs /transports	Regional development planning; Road infrastructure, energy, communications; Promotion of employment; Tourism; Support to economic and productive activities and SMEs	Local development and spatial planning (provincial municipalities); Urban and rural development; Public transport and traffic and urban transit management; Tourism
4. Environmental protection	Promote sustainable use of forestry resources and biodiversity; Preservation and management of natural reserves and protected natural areas	Defence and protection of the environment; Waste management
5. Housing and community amenities	Land-use planning	Land zoning plans (provincial municipalities); Housing and urban renovation
6. Health	Participation in the management of public health	Participation in the management of public health
7. Recreation, culture & religion	Access to culture; Strengthening of regional artistic and cultural institutions	Culture; Sport and recreation; Conservation of archeologic and historic buildings
8. Education	Management of preschool, primary, secondary, and higher non-university education	Participation in the management of education
9. Social protection		Management of social programs

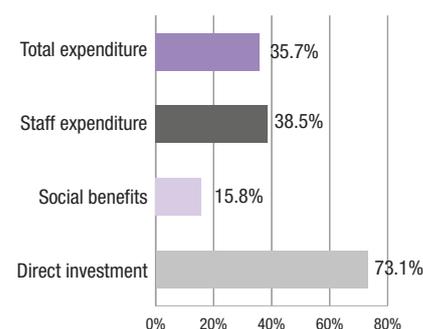
SUBNATIONAL GOVERNMENT FINANCE

Scope of fiscal data: regions, provincial councils, district councils and decentralised agencies.	SNA 2008	Availability of fiscal data: Medium	Quality/reliability of fiscal data : Medium
--	----------	---	---

GENERAL INTRODUCTION. Peru is, with Colombia, one of the most decentralised unitary countries of Latin America. SNGs have a key role in the economic and social development of the country, assuming important responsibilities, especially in public investments and in the delivery of such essential public services as health and education. According to the Law on Fiscal Decentralisation, the transfer of resources to regional governments is to be implemented gradually, in two stages: first, through the transfer of resources from the national level, and then through the allocation of a certain percentage of national taxes and resources to subnational governments. All regional and local governments approve their own budgets. Yet the way resources are assigned to local governments in Peru leads to resource imbalances between provinces, and fiscal decentralisation is currently mostly limited to municipalities, and to spending through intergovernmental funding transfers.

SUBNATIONAL GOVERNMENT EXPENDITURE BY ECONOMIC CLASSIFICATION

2016	DOLLARS PPP / INH.	% GDP	% SNG EXPENDITURE	% GENERAL GOVERNMENT EXPENDITURE (SAME EXPENDITURE CATEGORY)
Total expenditure	987	7.6%	100%	
Incl. current expenditure	632	4.8%	64.0%	
Staff expenditure	320	2.5%	32.4%	
Intermediate consumption	254	2.0%	25.8%	
Social expenditure	40	0.3%	4.0%	
Subsidies and current transfers	18	0.1%	1.8%	
Financial charges	1	0.0%	0.1%	
Others	0	0.0%	0.0%	
Incl. capital expenditure	355	2.7%	36.0%	
Capital transfers	4	0.0%	0.4%	
Direct investment (or GFCF)	351	2.7%	35.6%	



PERU

UNITARY COUNTRY

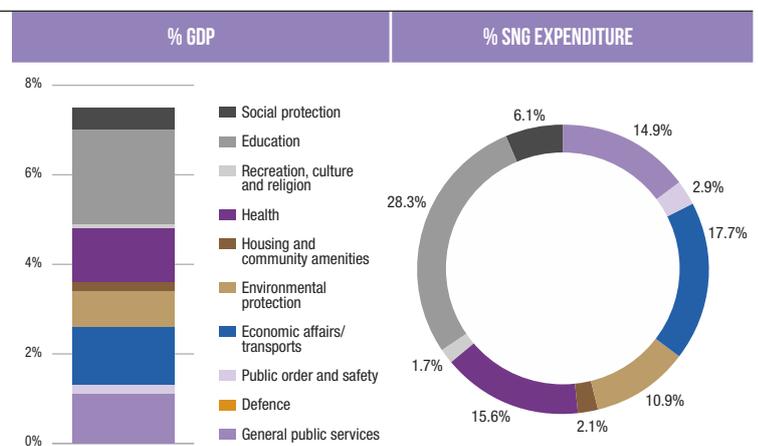
EXPENDITURE. In line with the decentralisation process, but also thanks to the increase in revenues resulting from the boom in commodities revenues (*canon* funds), SNG expenditure rose from 33% in 2004 to over 40% in 2013, before decreasing slightly to 35.7% in 2016, more in line with fluctuations in commodity prices than with the granting of new powers. 38.5% of public staff expenditure are made at the SNG level, as SNGs are responsible for the payment of wages and pensions in the sectors of education and health, on behalf of the central governments. Regions represented 53% of SNG expenditure in 2016 and municipalities 47%, indicating a reverse from past figures.

DIRECT INVESTMENT. One distinguishing feature in Peru is the high share of public investment made at the subnational level (73.1% of total public investment in 2016), above the OECD average (56.9%). In 2016, direct investment represented 36% of SNG spending (vs 10.7% in the OECD on average in 2016) and 2.7% of GDP vs 1.7% in the OECD in 2016).

This level is maintained partly due to transfer mechanisms (*canon* and earmarked transfers), whose funds must be dedicated entirely to public investment. The main categories of SNG investment are transportation, sanitation, and education, as well as health for regional governments. The Department for the Promotion of Private Investment (*Gerencia de Promocion de la Inversion Privada*) is responsible for promoting private investment and strategic alliances with the national, regional and local governments, private investment and civil society. A Metropolitan Fund for Investment was also created in the metropolitan municipality of Lima to provide resources for financing the Programme for Investment and Urban Works and supervise compliance with contracts involving local private investment.

SUBNATIONAL GOVERNMENT EXPENDITURE BY FUNCTIONAL CLASSIFICATION – COFOG

The vast majority of responsibilities regarding SNG expenditure are shared with the national government. SNGs have little spending discretion in several areas. Education as well as economic affairs/transport, are the two primary expenses, representing almost 45% of SNG expenditure. In both sectors, local and regional government spending have low efficiency due to the lack of comprehensive master plans and investment strategies and the need to build capacity. Regions have undertaken major spending on infrastructure in the past years, yet maintenance costs are weighing on regional budgets in the absence of medium-term investment strategies. In addition, local councils in charge of some school infrastructure spending lack operating and planning capacity. As such, there are major differences in educational infrastructures across regions. Other significant items, after “general services expenditure”, are health (regional responsibility) and environmental protection (municipal responsibility).



SUBNATIONAL GOVERNMENT REVENUE BY CATEGORY

2016	DOLLARS PPP / INH.	% GDP	% GENERAL GOVERNMENT REVENUE (SAME REVENUE CATEGORY)	% SNG REVENUE
Total revenue	1 023	7.9%	40.7%	
Tax revenue	57	0.4%	3.1%	5.6%
Grants and subsidies	966	7.4%		94.4%
Tariffs and fees	0	0.0%		0.0%
Property income	0	0.0%		0.0%
Other revenues	0	0.0%		0.0%

GENERAL DESCRIPTION. Peru has a lower degree of decentralisation for revenue than for expenditure. Despite a sharp increase in the budget of local governments since 2002, SNGs depend heavily on central government transfers, while the share of tax revenue in their total revenue is very limited (5.6% versus 44.6% on average in OECD countries). However, SNGs benefit from an important source of revenue, namely the exploitation of natural resources (royalties redistributed through *canon* funds).

TAX REVENUE. Currently, responsibilities transferred to subnational governments are mostly financed by national government transfers. Regions have no assigned taxes, in contrast with provincial and district municipalities. Besides, the latter cannot set tax bases or rates, which are set by the Central Government through the Municipal Taxation Act. The most important municipal tax is the property tax (*predial*) which is assigned to districts. It is based on property value in urban and rural areas, including land and buildings. Districts and provincial municipalities are also assigned a tax on property transactions (*Impuesto de Alcabala*). Property taxes represented 57.1% of SNG tax revenues in 2016 and 3.2% of total SNG revenue (accounting for 0.3% of GDP, compared to 1.1% of GDP on average in the OECD in 2016). The real estate transfer tax accounted for 29.4% of SNG tax revenue and the municipal tax on services for 8.1%. Provincial municipalities also benefit from the vehicle tax and gambling and lottery taxes. Overall subnational tax revenue in Peru in 2016 were well below the OECD average regarding the share of GDP (0.4% versus 7%), public tax revenue (3.1% versus 31.9%) and SNG revenue (5.6% versus 44.6%)

GRANTS AND SUBSIDIES. There are seven types of intergovernmental transfers in Peru, which constitute the main source of funding for SNGs. The primary transfers are the FONCOMUN for the municipalities (*Fondo de Compensación Municipal*, formula-based on demographic, geographic, socio-economic and fiscal criteria), and the FONCOR for regions (*Fondo de Compensación Regional*, also formula-based). They are complemented by discretionary ordinary transfers, for both regions and municipalities, which are mostly earmarked to cover the payment of wages and pensions in the sectors of education and health.

In addition, SNG also receive, in some cases, commodity-based revenues, canon and royalties, which are distributed exclusively to the regional and local governments where the minerals are extracted. Canon represents half of the corporate tax from mining companies (i.e. the other half is retained by the central government), and revenue from royalties is based on the companies' profits. They are earmarked to finance capital investment. Departments are almost fully financed through ordinary transfers from the central government- Canons and royalties account for 10% of their revenues, whereas they represent a larger share of municipal resources (37%) The second biggest source comes from the FONCOMUN. The importance of canon in the subnational financing system explains the importance of capital transfers in total transfers (28.1% in 2016) as well as the high level of SNG investment. Yet this system generates high disparities across SNGs (only five out of the 25 departments receive more than half of the total revenues from commodities). Since 2012, *canon* transfers have been decreasing, and compensated by an increase in other transfers earmarked for investment, which had a constraining impact on SNG autonomy for undertaking investment.

OTHER REVENUES. Revenues from user charges and fees, including street cleaning, road tolls, park maintenance, public safety services, administrative fees, etc. are typically larger than tax revenues. This category also includes revenues from property (sales, rents and dividends) and fines and penalties.

■ SUBNATIONAL GOVERNMENT FISCAL RULES AND DEBT

2016	DOLLARS PPP/INH.	% GDP	% GENERAL GOVERNMENT DEBT	% SNG DEBT
Total outstanding debt	446	3.4%	14.4%	100%
Financial debt*				

* Currency and deposits, loans and bonds

FISCAL RULES. Fiscal discipline is a key component of the Peruvian decentralisation process. The revised Fiscal Responsibility and Transparency Law (Law 30099), enacted in 2013, reformed the previous Fiscal Responsibility and Transparency Law 27245 and the associated Decree no. 955, which were particularly complex (seven fiscal rules). Indeed, most SNGs did not comply with them. The 2013 Fiscal Responsibility and Transparency Law streamlined the framework into two rules, and aligned them with the national macro-fiscal framework. The first rule limits the annual growth in total non-financial public expenditure to the average of revenue growth of the last four years in order to smooth the volatility of SNGs' revenue. The second rule restrains the overall fiscal framework by capping the overall stock of debt that a given SNG can take to less than their own revenue (measured as an average over the last four years). The debt stock now includes "other accounts payable. Law 30099 also empowers the executive to regulate the full management and reporting framework associated with these two rules.

In 2015, a Supreme Decree 287-2015-EF established an independent Fiscal Council to provide technical, independent and non-binding opinions on the fulfillment of fiscal rules by the national government but also by subnational governments. In 2017, a new Legislative decree D.I. No. 1275 was enacted that set a new Framework for Subnational Fiscal Responsibility and Transparency (*Marco de la Responsabilidad y Transparencia Fiscal Subnacional – MRTF-SN*). The MRTF-SN introduced a budget balance rule for SNG current accounts, with the aim to limit SNG current expenditure and to provide incentives to increase SNG own revenue. The MRTF-SN establishes a gradual scale of sanctions for non-compliance with fiscal rules or failing to submit financial information as required by the MEF, easier to be implemented than in the framework of the previous law.

DEBT. SNGs can only borrow under the state guarantee and only for capital investment projects ("golden rule"), and they are required to submit multi-year reports on fiscal management. The MRTF-SN, which replaced the 2013 Fiscal Responsibility Law, established a set of measures associated with the debt restructuring of regional and local governments. It established that SNG debt balance must not exceed the average current income of the last 4 years, nor the limits for the issuance of Regional and Local Public Investment Certificates (CIPRL) established by law. Currently, SNG debt levels amount to approximately 3.4% of GDP.

In 2016, regions accounted for 55% of total SNG debt while the other 45% was held by municipalities. The financial debt is essentially composed of loans, as bond issuing is forbidden for most SNGs. Other accounts payable represented a large part of the total outstanding debt. Subnational debt is concentrated in a few regions and cities, in particular Lima, which is the only SNG with access to financial and foreign markets.



World Observatory on Subnational Government Finance and Investment

Lead responsible: OECD
Last update: 02/ 2019

www.sng-wofi.org

Socio-economic indicators: World Bank // UNDP // UN DESA // ILO // Instituto Nacional de Estadística e Informática, Directorio Nacional de Municipalidades Provinciales, Distritales y Centros Poblados

Fiscal data: Central Bank of Peru (2017) Public Finances report // Ministerio de Economía y Finanzas databases // Ministerio de Economía y Finanzas (2016), Reporte Fiscal sobre el saldo de deuda de los gobiernos regionales y gobiernos locales // OECD Revenue Statistics // OECD (2018) Subnational Government in OECD countries: key data (brochure and database), IMF-GFS.

Other sources of information: World Bank (2017) Peru, Public expenditure review // OECD (2016) Territorial Review of Peru // OECD (2016) Multi-dimensional Review of Peru: Volume 2. In-depth Analysis and Recommendations // // Ministerio de Economía y Finanzas (2016), Informe Anual Actualizado de Cumplimiento de Reglas Fiscales de los Gobiernos Regionales y Locales // Neyra Araoz G. (2013), The effects of decentralisation of natural resource revenues on local service provision in Peru // Neyra Araoz G. (2013), Fiscal Decentralization in Peru: Achievements // Martínez-Vázquez J. (2013) Fiscal Decentralization in Peru: A Perspective on Recent Developments and Future Challenges.