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Swiss Confederation

Federal Department of Economic Affairs,
Education and Research EAER
State Secretariat for Economic Affairs SECO

COUNTRY
STRATEGY

Swiss Economic Cooperation and Development

Peru

2017–2020



Abbreviations

APCI	Peruvian Agency of International Cooperation (<i>Agencia Peruana de Cooperación Internacional</i>)
CAF	Development Bank of Latin America (<i>Banco de Desarrollo de América Latina</i>)
CEPLAN	National Centre for Strategic Planning (<i>Centro Nacional de Planeamiento Estratégico</i>)
CHF	Swiss Franc
CO ₂ eq	CO ₂ equivalent
CPS	Country Partnership Strategy
DDO	Deferred drawdown option
EFTA	European Free Trade Association
EU	European Union
FTA	Free trade agreement
GDP	Gross domestic product
IDB	Inter-American Development Bank
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
LAC	Latin America and Caribbean Region
MMMR	Revised Multiannual Macroeconomic Framework (<i>Marco Macroeconómico Multianual Revisado</i>)
ODA	Official development assistance
OECD	Organisation for Economic Cooperation and Development
O&M	Operation & Maintenance
PEFA	Public Expenditure and Financial Accountability Programme
PESEM	Multiannual Strategic Plan by Sector (<i>Plan Estratégico Sectorial Multianual</i>)
PFM	Public financial management
PLANAA	National Environmental Action Plan (<i>Plan Nacional De Acción Ambiental</i>)
PPK	President Pedro Pablo Kuczynski
PROINVERSIÓN	Peruvian Promotion Agency for Private Investment (<i>Agencia de Promoción de la Inversión Privada</i>)
RG	Regional Government
SDG	Sustainable Development Goals
SECO	State Secretariat for Economic Affairs
SME	Small and medium-sized enterprise
SNIP	National System for Public Investment (<i>Sistema Nacional de Inversión Pública</i>)
TPP	Trans-Pacific Partnership Agreement
UN	United Nations
USD	United States Dollar
WBG	World Bank Group
WEF	World Economic Forum

State Secretariat for Economic Affairs SECO – Economic Cooperation and Development

SECO's Economic Cooperation and Development division is responsible for the planning and implementation of economic cooperation and development activities with middle-income developing countries, with countries of Eastern Europe as well as the new Member States of the European Union. It coordinates Switzerland's relations with the World Bank Group, the regional development banks and the economic organisations of the United Nations. SECO is part of the Federal Department of Economic Affairs, Education and Research (EAER).

Switzerland's international cooperation efforts as defined in the Federal Council's 2017–2020 Message on International Cooperation aim to reduce poverty and global risks, alleviate suffering, and promote peace and respect for human rights. Accordingly, SECO's economic and trade policy measures strive to support sustainable and inclusive growth. The Economic Cooperation and Development division focuses its activities on its specific areas of competence and experience in four target outcomes aligned with the 2030 Agenda for Sustainable Development: 1) effective institutions and services, 2) more and better jobs, 3) enhanced trade and competitiveness and 4) low-emission and climate-resilient economies. Special emphasis is placed on issues related to economic governance and gender.

Editorial

With the present Country Strategy 2017–2020, SECO reiterates its commitment to supporting Peru’s sustainable, regionally balanced growth and convergence toward international standards of good economic governance to create opportunities for all.

Today, poverty remains a crucial issue also for middle-income countries like Peru. While a number of these countries have experienced significant growth in recent years, the gap between rich and poor has widened in many cases. In an increasingly interconnected world, middle-income countries are often particularly vulnerable to global risks, such as climate change, economic and financial crises, or political instability. It is thus more important than ever to ensure that all sections of the population can benefit from sustainable, resilient economic growth. This is where SECO applies its core competencies and comparative advantages in economic cooperation and development.

In line with the UN 2030 Agenda for Sustainable Development and the Federal Council’s 2017–2020 Message on International Cooperation to the Swiss Parliament, SECO aims at fostering sustainable and inclusive growth in its partner countries. Such growth addresses economic as well as social and ecological aspects

and shall not compromise the well-being of future generations. It contributes to reducing poverty and the impacts of global risks. It enables the private sector to create more and better jobs and the state to provide adequate services. Competitive economies and effective institutions are also key to reinforcing the resilience of societies increasingly confronted by different dimensions of fragility.

This Country Strategy defines the following three objectives of the economic and trade policy measures deployed by SECO in Peru. First, SECO supports inclusive economic institutions and policies at national and sub-national levels. Second, SECO’s measures strive towards an internationally competitive and responsible private sector generating more and better jobs. Third, SECO aims at fostering sustainable, climate-resilient urbanisation contributing to green growth.

Building on lessons learnt and the encouraging results achieved in the past cycle 2013–2016, this Country Strategy sets the frame for SECO’s continued activities in Peru for the next four years. Based on the goals and priorities described therein, we firmly believe that we can make a significant contribution to Peru’s further development path.

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State Secretary,
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1
Extractive industries represent an important part of the Peruvian economy.

2
Organic cocoa production is of growing importance for Peru.

3
Decent jobs, which generate high value-added, remain scarce.

4
Over 90% of Peruvian exports benefit from trade agreements.

Country context

Political and institutional

Democratic continuity: Since the year 2000, Peru has entered a sustained period of democratic stability and economic growth. In 2016, for the fourth time in succession, Peruvians chose their president in open, free and universal elections, marking a democratic continuity without precedence. President Pedro Pablo Kuczynski started his five-year term of office on 28 July 2016. The election process has shown the importance of reforming the current electoral system to strengthen the political party environment and ensure the unicameral Congress is more representative of and accountable to its electorate. For the time being, if he is to govern effectively, President Kuczynski will have to forge alliances and build bridges with the party of his final presidential contender Keiko Fujimori, who holds the absolute majority in Congress, but also with the left-wing "Frente Amplio", which was decisive in his victory.

Modernisation of the state: By 2021, when Peru celebrates its "Bicentenario" and aims to become a member of the OECD, President Kuczynski's major goal is to establish a representative, transparent and efficient state administration that creates economic, social and cultural opportunities for all citizens. The two following underlying conditions will be necessary to achieve this ambitious goal.

Need for institutional strengthening: Despite major reforms adopted over the past 15 years to improve governance, studies such as the OECD Multi-dimensional Country Review highlight Peruvians' lack of confidence in their executive, legislative and judicial institutions, which are generally perceived as weak, inefficient and corrupt. Moreover, political parties at national level are fairly volatile, giving rise

to a multitude of political movements at sub-national level often lacking a clear programme and long-term commitment. In this context, some of the most pressing issues included in President Kuczynski's Government Plan are the reform of the judiciary and police system to fight corruption and crime, the above-mentioned electoral reform, as well as improving territorial planning and regulatory policy to address the multitude of social conflicts, most prominently around (legal and illegal) mining activities. Also of increasing concern is the role of drug-trafficking and its impact on the public and private sphere.

Make decentralisation work: Institutional deficiencies are particularly acute at the sub-national level and above all in rural areas, where capacities and state presence in general are more limited, ultimately affecting the availability and quality of public services. Closely related to that, an important pending issue is improving coordination and cooperation between different institutions at the three levels of government – national, regional and municipal. Against this background, President Kuczynski stressed the importance of the decentralisation process to modernise the state and bring it closer to all citizens. Accordingly, the government has pledged to work closely with sub-national authorities to facilitate the coordination of intergovernmental policies and attend to regional requirements more proactively. In this context, the Peruvian Promotion Agency for Private Investment (PROINVERSIÓN), for instance, will be strengthened and its scope expanded so that it can provide decentralised assistance to facilitate private-sector participation in the financing and operation of key public services.

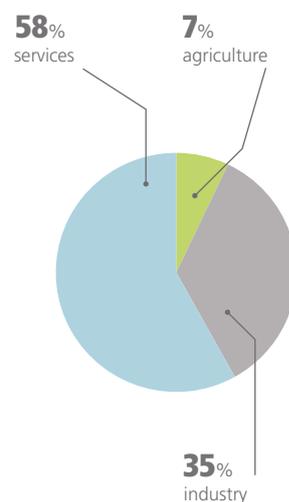
Economic

Slowdown of economic growth: After growing at an average rate of 6.4% during the decade between 2004 and 2013, the Peruvian economy has lost steam in recent years (2014: 2.4%; 2015: 3.3%) and is expected to recover only gradually. Key factors behind the slowdown are a more difficult external environment (e.g. economic deceleration in China; declining prices of major export commodities

such as copper or gold; monetary tapering in the US), as well as a decline in entrepreneurial confidence due to internal dynamics (e.g. social conflicts around mega-mining projects; crime and associated costs), resulting in lower levels of investment. Still, over the coming four years, Peru is expected to continue registering growth rates well above the Latin American average.

Economic sectors in Peru

Primary (agriculture), secondary (industry) and tertiary (services) sector in %.
Source: Central Intelligence Agency, World Factbook (2015)



Strong macroeconomic fundamentals:

At the turn of the millennium, Peru adopted important structural reforms to increase its credibility on both the monetary and fiscal front, such as the fiscal responsibility law of 1999 and the inflation-targeting regime of 2002. These reforms have contributed to reducing public debt levels to below 25%, while foreign exchange reserves grew continuously to almost one-third of GDP or 20 months of imports (2015). A fiscal stabilisation fund supplied by fiscal surpluses has accumulated almost USD 8 billion (4% of GDP) since its creation in 2000. Moreover, Peru introduced a new macro-fiscal framework in 2013, which incorporates medium-term fiscal objectives and thus allows for more counter-cyclical interventions.

Open economy with a wide network of FTAs:

Peru has a broad array of free trade agreements (FTA) covering nearly all major trading partners, including the United States, China, the European Union, EFTA and Mercosur. As a result, nearly 95% of Peruvian exports are covered by preferential trade agreements. The recently signed Transpacific Partnership Agreement (TPP), pending its entry into force, may further deepen the commercial integration with this important group of American and Asian countries. Moreover, Peru is a founding member of the Pacific Alliance¹, which has strengthened Peru's regional integration.

Still a long way to go to OECD accession:

Despite significant progress in economic development over the past 15 years, Peru still faces sizable challenges in its declared objective of becoming an OECD member by 2021, the year Peru celebrates its 200th anniversary of independence. These challenges include:

- **Low productivity and competitiveness:**

The Peruvian economy is still poorly diversified and generally produces goods that are at the bottom of global value chains. Increased international competitiveness in higher value-added products, however, would require a substantial increase in labour productivity. One of the key problems in this regard is the predominance of the informal sector, accounting for 60–70% of the working population. Despite several reform attempts, “red tape” for existing and especially for new businesses as well as rigid labour laws pose the main obstacles to formalisation. Moreover, the combination of a predominantly low-skilled labour force,

scant resources invested in research and development and the subsequent low level of innovation poses a major barrier to increasing productivity and competitiveness.

- **Low base and little redistributive effect of taxes:**

A key challenge for Peru is to convert its tax policy into a more effective tool for economic and social development. The current centralised tax system lacks efficiency and equity. Notwithstanding the significant increase over the past 25 years, Peru's tax revenues, at 18.8% of GDP (2014), are almost 3% lower than the LAC average and far below the OECD average of 34.4%; less than 2% of Peruvian taxes are collected locally. Moreover, the progressivity of the tax system and thus its potential impact on increased equality remains low: whereas in Peru inequalities decline by only 2% after taxes and social transfers, in OECD countries they are reduced by more than 15%.

- **Shallow financial sector:**

Despite the relatively high solvency of the financial system, access to finance remains very low compared to OECD members, but also other Latin American countries such as Chile, Brazil or Colombia. At 18%, average interest rates faced by customers are very high and, depending on the size and location of the company, they can be up to 100% higher. Also, dollarisation within the economy remains high, despite the Central Bank's efforts to encourage banks to provide local-currency-denominated loans.

- **Long path to a sustainable, low-emission economy:**

Peru is one of the few mega-biodiverse countries in the world, but also one of the most affected by climate change. Its economy largely depends on the exploitation and extrac-

GDP growth of Peru

Gross Domestic Product (GDP) per capita based on purchasing power parity (PPP) in current international dollars.

Source: *International Monetary Fund, World Economic Outlook (2016)*



1 Since 2013, Switzerland has an observer status in the Pacific Alliance.

tion of natural resources. 70% of exports stem from non-renewable, extractive industries. Apart from the sensitivity to changes in commodity prices and the resulting impact on revenues, the importance of the extractive sector also presents major sustainability challenges regarding the sectors' potential environmental and social impacts. Critical sustainability issues also exist in the case of other important export sectors (e.g. agro, fishery, wood), such as deforestation, unregulated use of limited water resources, overfishing and illegal logging. Climate change is

estimated to lower GDP by 11.4%–15.4% between 2010 and 2100, with fishing, livestock in the Andes and agriculture likely to be the most affected. In this context, finding ways to decouple economic growth from an increase in greenhouse gas emissions and bringing it more in line with environmental conservation and sound management will be one of the country's key challenges over the coming decades. At the same time, adaptation measures to increase Peru's resilience to the increase in climate change-related natural disasters will be critical.

Social, humanitarian and security

Significant reduction in poverty, but inequality remains: Economic progress over the past 15 years has been accompanied by substantial advances in poverty reduction. Between 2001 and 2013, Peru halved its poverty rate to 24% and reduced extreme poverty from 25% to 5%. Also, according to the Gini Index (0.45 in 2013), income inequality decreased considerably over the same period. This has given rise to a middle class, which today encompasses over a third of the population. Despite this significant progress, inequality in Peru remains high, with a clear urban-rural divide as well as ethnic and gender differences. Despite the increase in the number of people who have escaped poverty, the “vulnerable” group, i.e. people in an unstable situation from which they could easily slip back into poverty, has expanded from 34% to 40% since 2000.

Quality of public services remains deficient: While different infrastructure programmes financed by the central government over the past 15 years have led to considerable improvements in terms of access to safe drinking water and – to a lesser degree – basic sanitation, satisfaction with the quality of services is still relatively low. By the same token, even though access to healthcare and insurance has considerably risen over the last decade, many Peruvians remain dissatisfied with the level of accessibility and the quality of their healthcare services. Similarly, Peru has experienced a large increase in access to education at all levels, but learning outcomes remain poor. At the cur-

rent rhythm of investment, it would take Peru around 20 years to close the public infrastructure gap with the average of OECD countries. However, there are no national or local infrastructure strategies that take account of all sectors of the economy and prioritise between different options.

Public security as the no. 1 concern of Peruvians: According to polls, over 80% of the population feels insecure in Peru's streets. Reports on extortion of small businesses in various districts in Lima and other cities are becoming more frequent, as are stories of criminal activities against citizens. Given the lack of reliable data, however, it is difficult to determine how much the crime rate has actually increased. What is certain, however, is that the sense of security (or rather, the lack thereof) is an important issue for a growing part of the population and could also have a negative impact on private investment.

Frequent social conflicts: Recent years have seen a multitude of social conflicts across the country, often violent and most prominently around mining activities. These are testimony to the state's inability to build confidence among its citizens and to find appropriate means to handle people's claims. Moreover, these conflicts also show that a sizable proportion of the population still feels excluded from the benefits of economic development. Regardless of whether or not such claims are justified, it is clear that these conflicts have a disruptive impact on the investment climate.

GINI-coefficient of Peru

0.45

Degree of income inequality within the population (0 = complete equality; 1 = complete inequality).

Source: World Bank (2013)



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1
The children of Talara benefit from clean water in their primary school.

2
Peru has experienced a notable increase in non-traditional exports, like organic Sacha Inchi.

3
The Peruvian government is committed to promoting the transition to a resource-efficient economy.

Bilateral economic relations

Solid partnership: Peru and Switzerland have strong and long-standing political and economic relations. The institutional basis for bilateral economic relations between the two countries is well established, consisting of an agreement on the promotion and mutual protection of investments (1991), a comprehensive EFTA free trade agreement (2010) as well as a double-taxation treaty (2012). In 2015, Swiss exports to Peru amounted to CHF 151 million and Peruvian exports to Switzerland to CHF 2892 million. Accounting for 7% of overall Peruvian exports, Switzerland remained Peru's third most important export

market in 2015, after China and the US. Almost 97% of these exports are gold, which is shipped to Switzerland for refining purposes. Although the share of agricultural exports in overall exports to Switzerland is low, there is a notable increase in non-traditional exports such as mangoes, asparagus or coffee. Major Swiss export categories to Peru are machinery (38%), precision instruments and watches (24%) and pharmaceutical products (21%). According to the Swiss National Bank, Swiss direct investment in Peru in 2014 amounted to CHF 590 million. Swiss firms provide employment to approximately 6,100 people in Peru.

Development cooperation context

Partner country development strategy

National development framework: After the reestablishment of the democracy, the National Accord was constituted in 2002 as a space for dialogue and consensus-building between the three levels of government, the major political parties as well as social institutions. The National Accord sought to define the course for Peru's sustainable development and assert democratic governance up to Peru's "Bicentenario" in 2021. It outlined 32 state policies based on four strategic pillars: 1. Democracy and rule of law; 2. Equity and social justice; 3. Competitiveness; and 4. Efficient, transparent and decentralised state. Since then, several national strategic plans and agendas for the sustainable development of the country have been articulated, most importantly the "Bicentennial Plan" of 2011, which established six strategic goals and objectives until 2021, such as the one to double the country's per capita income to USD 10,000. Other important plans and documents whose implementation horizon goes beyond the term of a given administration are the Multiannual Macroeconomic Framework, the Competitiveness Agenda 2014–2018 or the National Strategic Export Plan 2025 (2015).

International partnerships: Peru has entered strategic partnerships at the international level to drive essential reforms and improve public policies. The most important one is the collaboration with the OECD, which supports the

country's convergence towards OECD standards in areas including public governance, human capital and productivity. Another key initiative is the Pacific Alliance (2011), a partnership with Chile, Colombia and Mexico to promote growth, development and competitiveness through further economic integration among its members.

President Kuczynski's government plan:

The government plan for 2016–2021 coincides with the strategic pillars and state policies established in the National Accord. It enumerates four major policy objectives to strengthen the Peruvian State and nation: 1. Improve public security; 2. Restore economic dynamism; 3. Fight corruption; 4. Invest in key social sectors, such as education, health or water and sanitation. To stimulate private sector dynamism and encourage a transition towards higher formalisation of the economy, a number of measures are foreseen, such as administrative simplification, a progressive reduction in value-added tax, significant tax incentives for SMEs that decide to formalise as well as for large companies that reinvest their profits, or the reform of the National System for Public Investment (SNIP). These measures should invigorate investment, but at the same time contribute to increasing the tax base and to consolidating the national budget in the medium-term. Complementarily, the plan aims to diversify the Peruvian export basket, mentioning in particular tourism and

agribusiness, which in 2015 generated USD 9 billion annually (compared to USD 2 billion in 2001) and have the potential to further double revenues over the next five to seven years. Other ambitious objectives of PPK's government include guaranteeing universal access to water and sanitation services in urban as well as rural areas, including the modernisation of water administration services; reaching no. 50

in the WEF Global Competitiveness Report; improving financial inclusion and access to finance for small and medium-sized exporters and mining operators; encouraging formal and responsible artisanal and small mining; encouraging renewable energy sources and fostering the transition to a resource-efficient economy based on low fossil-fuel use.

Donor landscape

Focus: The 2030 Agenda for Sustainable Development with its 17 Sustainable Development Goals (SDGs) will be the overarching framework guiding international cooperation in a comprehensive range of economic, social and environmental issues over the next 15 years. An inter-ministerial commission of the Peruvian government is currently defining the priority areas of the country for the coming years in relation to the SDGs. In addition, Peru's aspiration to become a full OECD member by 2021 also serves as an important reference for defining donor priorities.

Dynamics of bilateral donor scene: Official development assistance (ODA) reached USD 189 million in 2014, of which 86% was provided by bilateral donors and 14% by multilaterals. Private aid reached USD 148 million for the same year. In comparison to 2011, ODA dropped by 30%, (23% in the case of bilateral and 54% the case of multilateral assistance), while private aid declined by only 3%. Due to Peru's middle-income country status, various traditional donors have already withdrawn from the country or are planning to do so, or will significantly reduce their engagement in the coming years. Others plan to focus on regional programmes rather than bilateral assistance. On the other hand, new bilateral donors are emerging and increasing their support. Non-refundable aid from these countries is mainly focused on healthcare and education infrastructure, equipment and IT and is for the most part tied. For SECO as an established development partner, this means that it might make sense to assume a more prominent role to ensure continuity in traditional donor harmonisation mechanisms, where emerging donors are not (yet) present. At the same time, it will be important to eventually bring new donors to the table so as to ensure appropriate coordination.

Multilateral assistance: Although ODA provided by multilateral agencies is relatively limited, the World Bank Group (WBG) as well as the two regional development banks – the Inter-American Development Bank (IDB) and the Development Bank of Latin America (CAF) – still have important financial engagements in the country. The WBG is in the process of revising its Country Partnership Strategy (CPS) for 2017–2021 and will continue its support to reforms deemed important to promote increased access and quality of public services for the poor, supporting growth and productivity, as well as public sector governance. The Inter-American Development Bank (IDB) has a portfolio of USD 2.3 billion covering a wide array of sectors, ranging from rural development and agriculture to urban development, housing and transportation to climate change and disaster risk management, among others. In 2013, CAF approved USD 2.6 billion for operations in Peru, of which 38% accounted for sovereign risk operations. The operations are focusing on strengthening the financial systems and capital markets, promoting social and environmental development and improving the productivity and competitiveness of SMEs.

Coordination mechanisms: The Peruvian Agency for International Cooperation (APCI) maintains the donor forum (Foro de donantes) as a coordination mechanism between the Peruvian government and donor countries. This forum serves as a platform to reconcile international cooperation interventions with national policies and support efforts toward greater effectiveness, efficiency and transparency. In addition, there are specific sectorial coordination mechanisms where government officials, bilateral cooperation agencies and multilateral organisations discuss specific thematic areas, such as public finance management (PFM), decentralisation or environmental issues.

Lessons learnt from 2013–2016

Strong alignment: SECO's programme in Peru is aligned with the country's development challenges and priorities. The programmes and projects supported by SECO contribute to addressing some of the key challenges Peru needs to overcome in order to escape the so-called "middle-income trap" and to converge towards OECD standards: weak institutions, bureaucracy and corruption, high informality, lack of productivity, innovation and thus competitiveness, strong reliance on extractive commodity exports with little value added, rapid and largely uncontrolled growth of urban centres with deficient public services.

Focus on the subnational level: Although Peru's sustained economic growth over the past decade has also led to a sizable reduction in poverty levels and inequality, a large divide still exists between the centre and the regions. On the other hand, regional and municipal governments are responsible for executing a large part of the public budget in areas such as education, health, water and sanitation. Accordingly, the increased focus on strengthening capacities at the subnational level initiated during the period of the previous country strategy is justified and will be maintained. Nonetheless, Peru is a unitary state, and decisions on key policies are taken by the national government in Lima. Hence, a well-balanced mix of interventions at the different levels of government has proven valuable and will thus be pursued.

Need for local presence: Experience has shown that subnational interventions require a high level of local presence of the implementing partner and in some cases also of SECO's local office in Peru. In order not to stretch limited human resources, a focus on certain regions and cities is needed. This will also increase the synergy and complementarity potential between subnational interventions. At the same time, having a solid portfolio in the selected locations contributes to being perceived as a relevant partner by regional and local authorities, which is helpful in policy discussions with counterparts.

SECO as a facilitator of inter-institutional coordination: Thanks to its diverse portfolio of important bilateral, multilateral and multi-bi programmes and projects, SECO has a large network of partners. In this context, SECO is recognised by both the government as well as other development agencies as a trusted partner, striving to facilitate coordination and exchange between different actors, which is particularly important in Peru's weak institutional context. This role also supports SECO's position in different donor coordination mechanisms.

Flexible implementation mechanisms: In a middle-income country like Peru, rather than the lack of financial funds per se, cumbersome administrative procedures hinder access to high-quality expert know-how and constitute the main bottleneck for important investments of the public and the private sectors. The Peruvian government is increasingly aware of this and is striving to simplify administrative processes. In the meantime, the introduction of financing mechanisms that, within a well-defined strategic framework, respond to the specific needs of national counterparts in a flexible and relatively swift way, has proven to be a pragmatic solution, making SECO an important and reliable partner and at the same time strengthening its position in the respective policy dialogues.

"Swissness" and the potential of peer-learning: Swiss expertise in the areas of cooperation is highly appreciated by Peruvian counterparts. As an OECD founding member, Switzerland has solid experience and thus great credibility in different areas that are key for Peru in complying with OECD standards, such as taxes, competitiveness or public service provision. Nonetheless, past experience has shown that, in the case of Swiss implementation consultants, familiarity with the local context and an adequate local presence need to be ensured. And although Swiss know-how can indeed add important value to a project, in some cases, the exchange of experiences with countries with comparable characteristics and which have overcome similar challenges might be more adequate and cost-efficient and should thus be more actively promoted in the future.



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1
The Municipality of Pisac issues licenses to local touristic enterprises – a functioning business environment is key for private sector development.

2
SECO supports effective basic services in urban areas. For instance, solid waste management and infrastructure in Chiclayo are being modernized.

3
SECO will continue to provide targeted support in different value chains, e.g. in the agro-industry.

4
SECO fosters an efficient public financial management system and fiscal decentralisation.

Overall objective

Sustainable, regionally balanced growth and convergence toward international standards of good economic governance to create opportunities for all

Objective 1

Inclusive economic institutions and policies at national and subnational levels

Objective 2

An internationally competitive and responsible private sector generating more and better jobs

Objective 3

Sustainable, climate-resilient urbanisation contributing to green growth

Development challenges and SECO's response

The overall objective of Switzerland's economic cooperation and development programme in Peru is to support the country's sustainable, regionally balanced growth and convergence toward international standards of good economic governance to create opportunities for all.

This goal is further specified into three objectives that have been defined based on the Swiss Federal Council's 2017–2020 Message on International Cooperation, the Peruvian government's priorities, the country context analysis as described in chapter 1 as well as SECO's track record, experience and lessons learnt from the Peru Country Strategy 2013–2016.

Objective 1:

Inclusive economic institutions and policies at national and subnational levels

Challenges

Despite Peru's sound macroeconomic performance for over a decade, the institutional environment for economic governance still presents significant flaws, which limit the impact of economic growth on people's well-being. As highlighted by the recently published OECD Governance Review, a key impediment to more effective policy-making is the general lack of coordination and collaboration between institutions at all levels of government. Moreover, there is insufficient harmonisation of the various processes along the budget cycle (planning, budgeting, implementation, control and evaluation), ultimately leading to sub-optimal use of public resources. Being directly responsible for a number of key public services, around 40% of public-sector resources is spent at the subnational level. However, absorption capacities of regional and local governments are often not commensurate with their significant fiscal responsibility, undermining the effectiveness and efficiency of investments. As mentioned, another important issue is to increase the tax base and tax collection capacity at the subnational level, which becomes even more important in the context of steadily dwindling government revenues from the extractive sector. In the area of financial markets, continuing the de-dollarisation of the Peruvian economy will be fundamental to minimising the risks of instability. Moreover, it is important to further develop and deepen financial markets, while at the same time strengthening oversight, regulation and enforcement to ensure the stability of the system and prevent money laundering.

Focus

SECO has acquired significant experience in working with the major economic institutions of the central government in the areas of macroeconomic stability, PFM, tax policy and financial market supervision and regulation. SECO will continue to support these institutions through technical assistance and capacity building in designing and adopting important horizontal policy measures. In the

future, a stronger focus will be placed on fostering inter-institutional coordination between all levels of government. Considering the persistent discrepancies in socio-economic development between Lima and other regions, the explicit focus on improving PFM capacities at the subnational level will be maintained, and interaction between SECO interventions at the national and subnational levels strengthened. Given that the ultimate goal of such interventions under objective 1 is to contribute to better public services, there is an immediate synergy and complementarity with measures under objective 3, which directly target public service providers and utilities at the subnational level.

Proposed SECO measures

- Support results-oriented and medium-term budgeting and expenditure at central, regional and municipal level through the provision of technical assistance, capacity building and potentially subnational budget support, thereby strengthening PFM and fiscal decentralisation.
- Targeted assistance to institutions in charge of horizontal planning, asset management, civil service policy and audit functions, influencing effectiveness, efficiency, transparency and accountability of PFM.
- Technical assistance to national and subnational tax authorities, as well as to key institutions of financial and capital market governance.
- Promote inter-institutional coordination through the establishment of technical assistance funds with a governance structure integrating different public entities involved in a given reform plan.

Contribution to Peru's country development objectives

SECO's interventions under this objective will contribute to the Peruvian government's goal of establishing a stable economic and financial environment, fostering growth through private and public investment.

SECO contributions

First priority

- Transparent resource mobilisation and reliable public financial management

Second priority

- Stable and deep financial sector

Objective 2:

An internationally competitive and responsible private sector generating more and better jobs

Challenges

Peru still has many characteristics of a dual economy. Some 60% to 70% of the Peruvian economy is in the informal sector, which is generally characterised by low labour productivity, very limited value addition, deficient labour conditions and a lack of compliance with environmental standards. Even in the formal sector, responsible social and environmental management practices are still an exception rather than the norm. With the notable exception of the formal extractive sector, most competitive industries with export capacity are concentrated in Lima, Callao and a few coastal regions. Productivity is generally compromised by the low quality of the education system and a significant mismatch between existing skills demand and supply. Another important factor holding back the capacity of companies to compete on international markets is the inadequate logistics system (transportation, customs procedures, etc.). In fact, according to a recent World Bank study, logistics costs in agricultural value chains in Peru represent between 20-40% of total product costs. In addition, despite a number of reforms to simplify administrative procedures, institutional deficiencies continue to hamper the investment climate and there is still ample room for reducing bureaucracy and red tape facing existing and especially new businesses. Access to finance remains low, particularly for SMEs outside the city centres, further exacerbating spatial inequalities. The low level of innovation is an additional barrier to increasing productivity, competitiveness and a further diversification of the economy.

Focus

In the area of competitiveness, SECO will continue its two-pronged approach focusing on both national policies as well as concrete assistance to private-sector associations, SMEs and farmers. At the macro level, support will seek to enable the competent authorities to achieve the goals and targets set out in national strategies, such as the Competitiveness Agenda, developed under the auspices of the National Council on Competitiveness and Formalisation, an inter-ministerial body also including repre-

sentatives of subnational governments as well as the private sector. At the meso and micro level, SECO will continue to provide targeted support in different value chains, e.g. agro-industry, small-scale mining, manufacturing or tourism. In strengthening collaboration with representative organisations of the private sector, the idea is to develop public goods that will assist in enhancing international competitiveness as well as the social and environmental sustainability of businesses. Areas of particular interest for SECO include improving the business and investment climate, trade policy and market access, human capital and skills development, entrepreneurship and innovation. Overall, SECO's interventions should allow Peru to integrate into and move up international value chains.

Proposed SECO measures

- Support key initiatives for trade and private sector development, such as reforms aiming at a reduction of administrative red tape or the strengthening of the national quality system.
- Contribute to the integration of Peruvian businesses and producers into sustainable international value chains through the provision of technical assistance, capacity building and targeted skills development.
- Facilitate increased access to finance for entrepreneurs and support financial inclusion of greater parts of the population.
- Sensitise and provide technical assistance to SMEs and producer organisations regarding issues such as corporate governance, labour conditions, sustainability management and reporting.
- Promote inter-institutional coordination by supporting institutions taking a coordination role beyond ministries and government terms.

Contribution to Peru's country development objectives

Measures foreseen under this objective should assist Peru in achieving its goals of increasing formalisation of the economy, improving the investment climate, enhancing productivity and diversifying the Peruvian export basket.

SECO contributions

First priority

- Dynamic entrepreneurship, strengthened skills and flexible labour market
- An efficient business environment
- Greater international competitiveness of SMEs and facilitated market access

Second priority

- Access to long-term capital
- Favourable framework conditions for sustainable trade

Objective 3:

Sustainable, climate-resilient urbanisation contributing to green growth

Challenges

Latin America is the most urbanised continent in the world and Peru is no exception. Due to large-scale migration from the Andean highland, nearly 80% of Peru's population now lives in urban centres, particularly the capital Lima, with a further increasing tendency. Coupled with a growing and more demanding middle class, this rapid urbanisation (+8% over the past 20 years), which often takes place outside formal planning processes, places further strain on already deficient public-service infrastructure. Peruvian cities are also prone to be affected heavily by climate change, e.g. due to increasing water scarcity. Contributing to a very large proportion of greenhouse gas emissions and environmental degradation (transport, manufacturing, housing, waste), cities are both the source of as well as a potential solution to the problem, provided that public policies encourage resource efficiency measures. Decentralisation has granted local governments significant competencies in urban development, but capacities and financial resources are limited. In this respect, a more "territorial approach" to planning as well as a strengthening of urban-rural linkages in development policies is needed.

Focus

SECO will maintain its focus on intermediate cities, which have substantial potential to become engines of sustainable and inclusive economic growth. Thanks to higher population densities, per capita costs of providing public services are much lower than in rural areas. Interventions are focused on the strengthening of municipalities and public utilities providing basic public services, such as water supply and sanitation, solid waste management or energy, through technical assistance and investments in strategic (climate-) resilient infrastructure. Interventions will encompass strategic support to promote integrated urban planning and the environmentally sustainable investments, namely by strengthening partner cities' capacities to coordinate across sector boundaries and to take evidence-based decisions, taking into account the views of multiple stakeholders. Future interventions will also consider direct collaboration with the private sector, which, thanks to its management and tech-

nical expertise as well as its financial capacity, is well-positioned to contribute to inclusive access to efficient and reliable basic infrastructure services. Close collaboration with both the private and public sectors will also guide interventions in promoting resource efficiency in the production and construction industries, as well as sector-wide climate mitigation measures. Through a targeted exchange with national authorities, experiences generated at the local level should feed back into national policies to achieve scalable impact.

Proposed SECO measures

- Improve the quality, efficiency and access to basic public infrastructure services, such as water supply and sanitation or solid waste management, by strengthening the capacities of municipalities and public utilities, supporting the development of infrastructure and improving the policy and regulatory framework.
- Provide technical assistance to facilitate integrated, well-informed urban planning and management as well as the development of strategic and sustainable infrastructure solutions.
- Technical assistance, capacity building and financial support to promote resource-efficient industrial production processes, environmentally sustainable investments as well as sectoral climate change adaptation and mitigation measures.
- Promote inter-institutional coordination through the establishment of technical assistance funds with a governance structure integrating different public entities involved in a given reform plan.

Contribution to Peru's country development objectives

The proposed measures should support the Peruvian government in its efforts to improve the quality and sustainability of services in areas such as water and sanitation and solid waste management and enhance urban development and general land-use planning. At the same time, interventions should contribute to national goals regarding environmentally friendly and resource-efficient production processes and international commitments on emissions reduction.

SECO contributions

First priority

- Reliable basic public services
- Integrated urban development

Second priority

- Sustainable energy supply
- Resource-efficient private sector

Programme implementation and management

Implementation modalities

SECO's international cooperation seeks to deliver inclusive sustainable growth. To reach this objective, the 2030 Agenda for Sustainable Development and the Addis Ababa Financing for Development Action Plan provide a common language and direction, whereas international aid and development effectiveness principles² provide the common ground on which SECO and its international partners cooperate.

SECO uses an appropriate mix of modalities for its development cooperation, consisting of financial aid, technical assistance and capacity building at the individual, organisational and institutional level.

Partnership and dialogue are necessary to promote reforms as well as to develop and implement policies. This dialogue involves players on several levels that can contribute to coherent and synergistic solutions to development challenges: governments, private and civil society players as well as other donors and multilateral institutions. SECO balances bilateral and multi-bi cooperation and has established guidance to help implement the principle of alignment, harmonisation, and accountability and, when appropriate, the use of national systems.

Partner strategies: SECO's operational activities to deliver inclusive sustainable growth in partner countries are aligned with national development strategies, thereby applying the principles of national ownership and partner

focus. The activities are harmonised with those of other donors and rely on the principle of mutual accountability. SECO's local experts are systematically involved.

Cooperation relations: SECO's cooperation activities are part of the broader set of activities and bilateral cooperation relations between the governments of Peru and Switzerland, including bilateral policy dialogue, cooperation in the area of human security, and the activities of the global programmes of the Swiss Agency for Development and Cooperation in the area of water and climate. The different activities are closely aligned, complementary and can build upon mutual synergies and the long-standing bilateral relations of cooperation between Peru and Switzerland.

SECO increasingly provides targeted impulses to mobilise resources. A relatively modest, yet very specific, Swiss contribution can go a long way. For instance, to leverage the impact of Swiss ODA, SECO supports partner countries in developing framework conditions that foster domestic resource mobilisation and private enterprise. Similarly, innovative programme and project approaches as well as innovative financing mechanisms are very effective instruments to stimulate new forms of collaboration and increase effectiveness.

SECO's activities include sharing of Swiss knowledge and facilitation of technologies. Specificity, high quality and effectiveness are the hallmarks of SECO's international cooperation.

Cross-cutting issues

To meet its objectives, SECO focuses on two transversal topics: gender equality and economic governance. Making a highly relevant contribution to inclusive sustainable growth, gender equality and economic governance are systematically integrated into all SECO activities.

Gender equality: SECO considers gender equality an important element of poverty reduction, social inclusion and economic develop-

ment. Therefore, it is essential to systematically address the gender dimension (social norms, legal provisions and gender-specific risks) in its economically oriented projects. No projects should place either women or men at a disadvantage.

Economic governance: Strengthening economic governance is another essential component of SECO's commitment to promoting

2 These development effectiveness principles are rooted in, for instance, the 2005 Paris Declaration, the 2008 Accra Action Programme and the 2011 Busan Partnership for Effective Development Cooperation, which links all players in the development cooperation space.

inclusive sustainable growth. It is a subset of good governance and refers to the entire set of economic rules and frameworks accounting for a transparent and accountable public and private sector. It is a prerequisite for a stable economy and success in the fight against corruption, which undermines inclusive economic development.

The gender and economic governance dimensions are taken into account regarding the project design, implementation, risk assessment and monitoring in order to contribute to the greater effectiveness and sustainability of SECO's projects.

Accountability and monitoring

The country strategy will be monitored annually for the following purposes (cf. also chapter on Results monitoring):

- **Steering:** Data and information for evidence-based decision-making
- **Risk mitigation:** Identification of relevant risks and mitigation measures
- **Learning:** Identification of factors for success and failure, challenges, gaps and good practice
- **Accountability:** Data and information for accountability towards SECO headquarters, the Swiss government, the Swiss public, and the partner country

The country strategy is aligned with the partner country's development goals and strategies as well as with the SDGs. Therefore, the annual monitoring ensures that SECO's portfolio does indeed contribute to the achievement of the partner country's goals.

In the case of major changes in the country context or development goals, the results framework for the country strategy will be adapted.

Financial resources

SECO's activities under this strategy will be financed through the Swiss framework credit 2017–2020 for economic and trade policy measures within development cooperation. The final allocation of funds to individual countries, programmes and projects will depend on the identification of suitable interventions, the absorption capacity as well as the efficiency and effectiveness of the cooperation with the relevant partners in each priority country.

claimed as such by the partner country. This information serves merely as a basis for the forward spending plans that are reviewed each year by the Swiss Parliament. Actual disbursements will depend on various factors, such as the changes in the project portfolio and the framework conditions of the partner country as well as available disbursement credits authorized by the Swiss Parliament. Portfolio and planned disbursements are regularly discussed with the partner authorities.

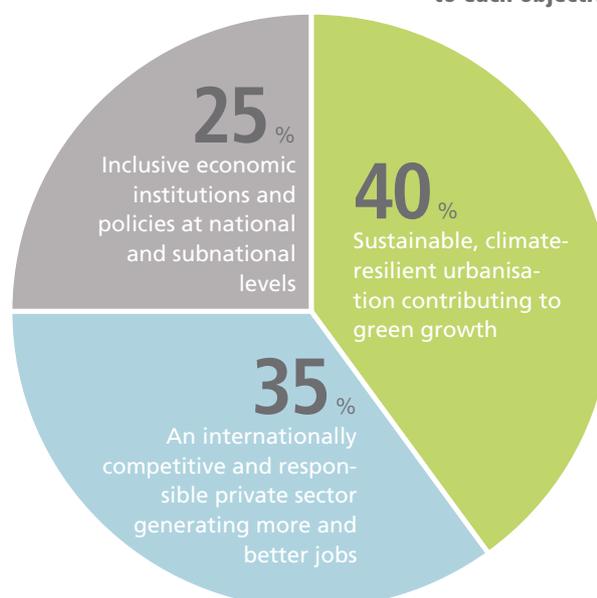
Accordingly, the following information on planned commitments for the four-year period of this strategy is indicative. It cannot be considered a firm commitment or

Planned commitments for Peru 2017–2020:

70 CHF million*

*Peru also benefits from regional and global initiatives financed by SECO. When these measures cannot be earmarked to a specific country, they are not accounted for in the financial projections mentioned above.

Projected funds allocated to each objective



Results monitoring

The following table contains the results framework for Switzerland's economic cooperation and development programme with Peru. It will be monitored under the SECO quality management system, which is based on international standards (results-based management). These are aligned with the country development objectives as well as with the SDGs and will be monitored at outcome level.

The results framework covers the overall economic cooperation and development portfolio. However, the proposed indicators will be measured only in relevant projects and will provide a selection of key data for steering and accountability.³

The results framework allows for focused monitoring, reporting and evaluation of key issues identified by and agreed between SECO and the partner country counterpart. Both are committed to results orientation and the highest possible effectiveness of economic cooperation. Both want to learn about factors for success and failure as well as about risk management and mitigation in order to continuously improve results. Even though the results framework should contribute to efforts to capture and assess SECO's contribution to achieving the partner country's development objectives, it is not meant for measuring the partner country's achievements as a whole.

³ For the systematisation of results measurement and the collection of aggregated data, SECO has formulated so-called Standard Indicators which are part of Country Results Frameworks and most project logframes. The Standard Indicators also allow for the collection of results information on cross-cutting issues (see also Chapter 4.2.). With regard to economic governance, many Standard Indicators require the collection of relevant data. Regarding gender, the Guidelines on Results Reporting with SECO Standard Indicators explain in detail which kind of relevant information (e.g. gender disaggregated data) should be collected per Indicator.

Overview

SECO overall objective in Peru:

Sustainable, regionally balanced growth and convergence toward international standards of good economic governance to create opportunities for all

SECO objectives	SECO contributions			
<p>Objective 1</p> <p>Inclusive economic institutions and policies at national and subnational levels</p>	<p>First priority</p> <p>Transparent resource mobilisation and reliable public financial management</p> <p>Second priority</p> <p>Stable and deep financial sector</p>			
<p>Objective 2</p> <p>An internationally competitive and responsible private sector generating more and better jobs</p>		<p>First priority</p> <p>Dynamic entrepreneurship, strengthened skills and flexible labour market</p> <p>Second priority</p> <p>Access to long-term capital</p>	<p>First priority</p> <p>An efficient business environment</p> <p>Greater international competitiveness of SMEs and facilitated market access</p> <p>Second priority</p> <p>Favourable framework conditions for sustainable trade</p>	
<p>Objective 3</p> <p>Sustainable, climate-resilient urbanisation contributing to green growth</p>	<p>First priority</p> <p>Reliable basic public services</p>			<p>First priority</p> <p>Integrated urban development</p> <p>Second priority</p> <p>Sustainable energy supply</p> <p>Resource-efficient private sector</p>
	<p>Effective institutions and services</p>	<p>More and better jobs</p>	<p>Enhanced trade and competitiveness</p>	<p>Low-emission and climate-resilient economies</p>

SECO's target outcomes

Economic and trade policy measures deployed by SECO in its development cooperation efforts with its partner countries are targeted towards achieving the above-mentioned four outcomes.

Objective 1: Inclusive economic institutions and policies at national and subnational levels

Partner objectives

First priority

Transparent resource mobilisation and reliable public financial management

Economic policy reforms and an improved financial policy lead to more transparent and efficient resource mobilisation and more reliable public financial management.

Selected indicators:

- Measures for improving public financial management
- Key PFM indicators as per the PEFA framework
- Measures for improving capacity development
- Resources mobilised

Second priority

Stable and deep financial sector

Better regulation and supervision of the financial sector contribute to a stable, diversified and competitive financial market and strengthen the international financial system.

Selected indicators:

- Measures for financial market regulation and supervision

Stable economic policies that foster economic growth through private and public investment.

- By 2018, tax income reaches 15% of GDP (MMMR 2016–2018, p.52)
- By 2021, gross fixed investment reaches 24% of GDP (Plan Bicentenario 2021, p.173)
- By 2018, public debt reaches 25% of GDP (MMMR 2016–2018, p.57)

Strengthening management capacities of civil servants.

- By 2017, 800 professional managerial positions covered by professional public managers (Directivos Públicos) in RGs (Public Expenditure and Fiscal Risk Management Development Policy Financing DDO 2016, p.6)

Transparent and efficient financial markets with solid institutions that facilitate financing and investment.

- By 2021, the level of financial intermediation – national currency reaches 20% of GDP (Plan Bicentenario 2021, p.178)
- By 2021, 30% of the economically active population is in public/private pension fund system (Estrategia Nacional de Inclusión Financiera, p.68)

Objective 2: An internationally competitive and responsible private sector generating more and better jobs

Partner objectives

First priority

Dynamic entrepreneurship, strengthened skills and flexible labour market

The promotion of entrepreneurship and skills together with improved framework conditions for the labour market and the social partnership help to create new jobs and retain existing (better) jobs.

Selected indicators:

- Number of jobs created and retained
- Number of persons undergoing training or continuing education (entrepreneurs, producers, staff)
- Measures for improving working conditions

An efficient business environment

Improving the business environment through less bureaucracy and more effective regulation promotes the growth and competitiveness of businesses.

Selected indicators:

- Direct compliance cost savings (mio. USD)
- Investments generated (mio. USD)

Greater international competitiveness of SMEs and facilitated market access

More efficient work processes by producers and SMEs improve their productivity and promote international competitiveness. Sustainable standards facilitate access for partner countries' goods and services to the Swiss and EU markets.

Selected indicators:

- Increase in trade volumes (as a % and in USD million) of sustainably certified commodities (soya, coffee, cocoa, cotton, timber, palm oil, tea, BioTrade products) from developing countries
- Number of jobs created and retained
- Increase in export volumes (as a % and in USD million) of sustainable goods and services (textiles, furniture, tourism, etc.) from developing countries
- Productivity increase in export value chains
- Percentage of producers with better living conditions

Second priority

Access to long-term capital

Easier access of companies to long-term investment capital through innovative and more efficient financial instruments as well as public-private partnerships creates new jobs.

Selected indicators:

- Number of companies with access to capital
- Capital mobilised (loans, participation, etc.) in USD
- Number of jobs created and retained
- Measures for improving working conditions

Favourable framework conditions for sustainable trade

A better understanding of the framework conditions for international trade facilitates access for partner countries' products to the global market.

Selected indicators:

- Improved rules and regulations and enhanced competitiveness for facilitating market access

Strengthening of the ecosystem of innovative entrepreneurs with high growth potential.

- By 2018, at least 20% of 500 high-impact innovative enterprises that received public support (since 2014) are on the market (Goal no. 12 of Competitiveness Agenda)

Increase labour productivity by promoting capacity building requested by the labour market

- By 2018, reduce the percentage of companies with difficulties filling job vacancies from 28% to 20% (Goal no. 38 of Competitiveness Agenda)

Trade facilitation and efficiency of international supply chain

- By 2018, decrease in logistics costs of product value from 32% to 23% (General goal of Competitiveness Agenda)

Improving access to credit.

- By 2021, the First Venture Capital Fund of Peru for financing entrepreneurs will be operating (Presentation of the Prime Minister at Peruvian Congress)

Improved business climate.

- By 2018, simplify 100% of prioritised procedures related to private investment (Goal no. 50 of Competitiveness Agenda).

Continued and sustained growth of non-traditional export sector.

- By 2018, 70% increase in the value of goods exported by SMEs (in relation to 2013) (Goal no. 21 of Competitiveness Agenda).
- By 2021, exports are doubled in comparison to 2015 (Presentation of the Prime Minister at Peruvian Congress).

Objective 3: Sustainable, climate-resilient urbanisation contributing to green growth

Partner objectives

First priority

Reliable basic public services

Through technical and financial support, public utilities are better placed to offer a reliable and affordable public service.

Selected indicators:

- Number of persons with access to better (basic) services
- Proportion of O&M costs recovered through charges
- Measures for improving capacity development
- Leverage effect of SECO's financing in USD

Integrated urban development

Improved planning criteria and selective measures promote sustainable urban development in partner countries.

Selected indicators:

- Number of inhabitants benefiting from sustainable urban development projects
- Number of cities with urban development measures (including for improving governance) in the sectors of public transport, energy efficiency and natural disaster risk management
- Greenhouse gas emissions saved or avoided in t CO₂eq

Second priority

Sustainable energy supply

By including sustainable and climate-compatible aspects, SECO contributes to improving the energy policy as well as reforms and investment measures and to increasing energy efficiency and supply (e.g. by promoting renewable energy).

Selected indicators:

- Kilowatt hours saved through energy-efficiency measures and kilowatt hours additionally produced from renewable energy
- Greenhouse gas emissions saved or avoided in t CO₂eq

Resource-efficient private sector

Promotion of a resource-efficient private sector.

Selected indicators:

- Number of jobs created and retained
- Greenhouse gas emissions saved or avoided in t CO₂eq
- Kilowatt hours saved through energy-efficiency measures and kilowatt hours additionally produced from renewable energy
- Increased resource efficiency
- Green investments additionally triggered in USD and financing instruments supported

Increase access to sustainable and quality water and sanitation services throughout urban areas

- By 2021, provide 96.50% of the population with water service and 91.30% of the population with sanitation (PESEM 2016–2021, p.29)

Increase the volume of the safe disposal of municipal solid waste

- By 2021, 100% of solid wastes will be managed, recycled and disposed of safely (PLANAA 2011–2021)

Increase the safe disposal and reuse of electronic waste

- By 2021, 100% of this waste will be treated (PLANAA 2011–2021)

Increase the contribution of renewable energy in the national energy matrix

- By 2021, contribute 56% of renewable energy (Plan Bicentenario CEPLAN al 2021)

Improve the environmental management of small-scale and artisanal mining operations

- By 2021, 100% of these mines will implement and use environmental management instruments (PLANAA 2011–2021)

National contribution for emissions reduction in compliance with international commitments

- By 2030, 30% reduction of greenhouse gas emissions (INDC)

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