



Avocado packaging warehouse in Chincha, Peru: additional reforms—including labor reforms—will be critical in helping Peru increase potential output (photo: MARIANA BAZO/REUTERS/Newscom)

### IMF COUNTRY FOCUS (#)

## Peru's Future Growth Can be Lifted Through Structural Reforms

By Francisco Roch, IMF Western Hemisphere Department

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After sustained improvements in economic and social indicators since the turn of the century, Peru has its eyes set on becoming a high-income nation, but achieving this goal will require additional reforms, the IMF said in its latest assessment of the country.

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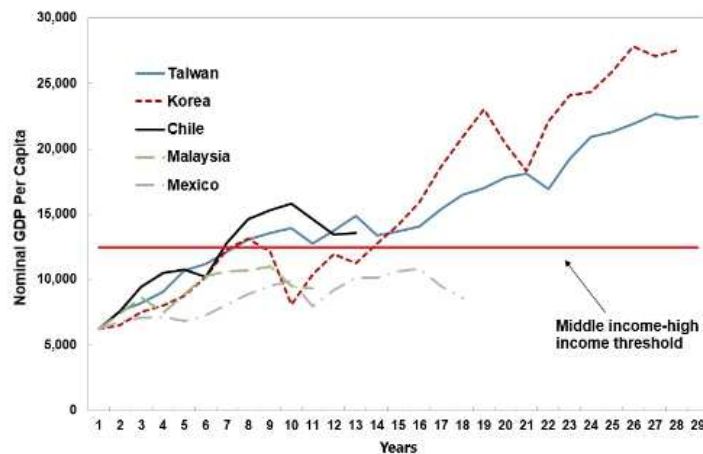
With growth averaging over 5¼ percent since 2000, Peru has significantly reduced unemployment and poverty. Inflation is in the low single digits, the fiscal position has strengthened, and dollarization (borrowing and saving in U.S dollars) has declined markedly. Sound economic policies and structural reforms—in the context of the recently ended commodity boom—have played an essential role in this improvement.

But building on these gains will require additional reforms to help Peru, an emerging middle-income country, reach high-income status. Given the experience of other countries, Peru will need to be careful to avoid being stuck in a “middle income trap.” Even if high-income status is attainable, international experience suggests that it will take time.

## Elusive goal

Since reaching Peru's 2016 level of income, it will still take time for countries to reach high-income status.

(in US dollars)



Source: IMF, *World Economic Outlook*.



### Short-term picture: resilience in the face of major domestic shocks

The current environment is difficult given the Odebrecht corruption scandal and one of the worst episodes of flooding and landslides in over 50 years. On the external side, while commodity prices have recovered somewhat since late 2016, they remain significantly lower than during the commodity boom. There is also uncertainty about the U.S outlook and how much protectionist pressures will rise globally. These developments will hurt growth in 2017—forecast at 2.7 percent—but the economy is expected to bounce back in 2018–19, the report said.

### Boosting potential growth: increasing investment and productivity

#### FAST FACTS

REAL GDP GROWTH (2016): 3.9% PER CAPITA GDP (2016): \$6,199 UNEMPLOYMENT RATE (2016): 6.7% POVERTY RATE (2016): 20.7%

LIFE EXPECTANCY AT BIRTH (2015): 74.6 YEARS ADULT LITERACY RATE (2015): 94%

Potential growth in Peru has been declining since the end of the commodity boom. During 2001–08, before the Great Recession, the country's potential growth averaged 5.7 percent, and it has been on a steady decline ever since. The main factors behind this decrease are low productivity and not enough capital. The IMF estimates potential growth over the medium term at about 3¾ percent.

To enhance potential growth, the government has introduced several structural reforms to tackle the main impediments to higher investment, stronger tax collection, and lower financing costs. These policies include:

- a new institutional framework for public and public-private infrastructure investment to reduce red tape;
- improving the business climate by cutting administrative procedures and promoting the use of digital processes;
- a new tax regime for small and medium enterprises to make the current tax system more progressive, reduce compliance costs, increase the use of electronic payments, and formalize value chains.

Increasing potential growth above 4 percent over the medium term, however, will likely require additional reforms to boost investment and productivity. The IMF recommends that Peru consider measures that help investment grow at a similar pace to during the commodity boom and that increase productivity to around double the rate assumed in the report's baseline scenario.

### Labor market policies

The government is also looking to modernize labor markets that make it easier for employers to hire new workers and hence boost growth. With labor laws that offer generous protection to workers, the result is that about 53 percent of Peru's workforce is outside the formal job market, with no protection, no social security or unemployment contributions and paying no taxes.

A recent opinion survey also pointed to labor market regulations as a key impediment to growth in Peru. For instance, terminating employees for economic reasons is severely limited as it requires authorization from the Ministry of Labor or the courts. And these regulations are linked to informality, although other factors such as education levels, the tax system, access to public services, and enforcement of laws have also played a role.

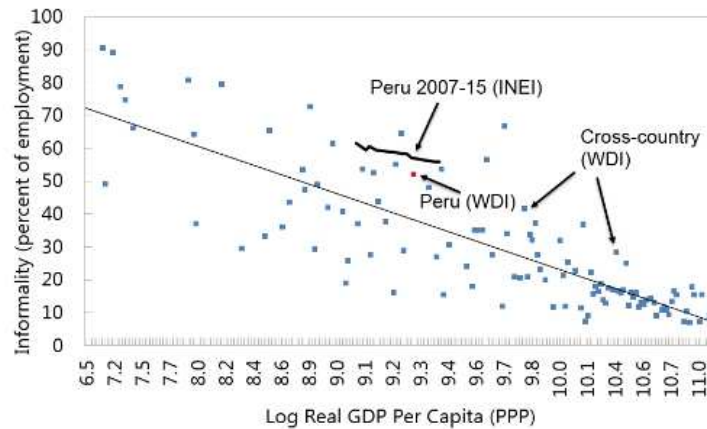
The government, therefore, is rightly focusing on reducing the high levels of informality. It has set up a Social Protection Commission to reform the social security system, with the aim of increasing its coverage while reducing informality.

IMF analysis suggests that the growth gains from labor market reform—such as relaxing policies that push labor costs above productivity growth, or reducing labor taxes and firing costs—can be significant. The Social Protection Commission can therefore make an important contribution to help Peru reach its high-income goal.

## Informal employment

### Peru's informal labor sector is a key impediment to growth.

(informality and GDP per capita, in percent)



Sources: WDI, INEI, and IMF staff estimates.  
Note: Cross-country WDI is for 2012 and reflects the share of self-employment in total employment. INEI data reflects the measure of informality by Peru's statistical agency.



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