

Pathways to Prosperity: Key Reforms for a Thriving Peru

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Peru has made significant strides over the past two decades in reducing poverty and improving living standards, outperforming many Latin American peer countries as highlighted in the 2023 Economic Survey of Peru[GPE1] . The basis for this progress was the country's robust macroeconomic framework and ambitious structural reforms implemented in 1990s. These reforms have catalysed macroeconomic stability, high economic growth, low inflation and low public debt.

The COVID-19 pandemic, however, exposed remaining challenges. Peru experienced one of the most severe economic contractions and excess mortality rates of any country. The economy bounced back in 2021, thanks to its fiscal buffers. The recovery was short-lived and a series of shocks, including Russia's war of aggression in Ukraine, social unrest and extreme weather events led to inflationary pressures and economic slowdown. The economy is projected to gradually recover with inflation returning to the target range by early 2024. However, Peru faces long-standing structural issues like a large informal sector, infrastructure gaps, and a weak rule of law. These not only magnify the impact of adverse shocks and socio-economic inequalities but also hold up Peru on its path towards better standards of living.

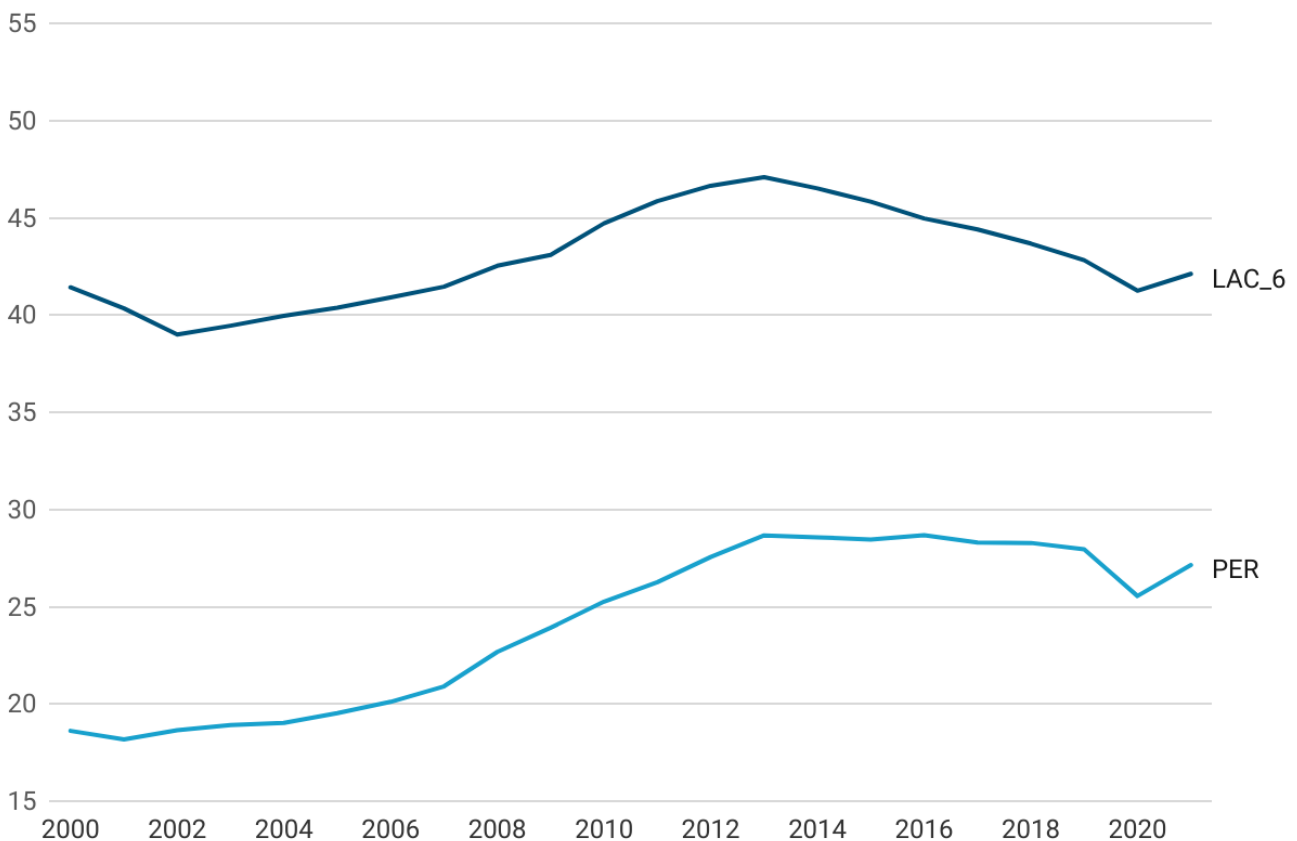
As Peru embarks on its journey towards OECD accession, the process represents a transformative opportunity for the country to design and implement a comprehensive reform agenda to foster convergence to higher living standards for all Peruvians. The 2023 Peru Economic Survey highlights four key priority areas of reforms:

Fostering Long-Term Growth

Income convergence to more advanced countries stalled in 2014 with the end of the commodity price boom, making it of utmost importance to boost productivity and investment. While commodities, particularly minerals, have fuelled past growth, there is a need to expand the economy's productive base. High concentration of market power in a few major business groups reduces market dynamism. This calls for strengthening competition enforcement and simplifying regulations to boost productivity. Additionally, better public spending efficiency would help close infrastructure gaps and deliver essential services while boosting potential growth. This entails enhancing local government capabilities, improving infrastructure planning, and modernising the civil service to enhance overall state capacity. Strengthening the rule of law by fighting corruption and improving judicial independence and efficiency is equally important, as it not only encourages investment but also restores trust in institutions.

Convergence has slowed down

GDP per capita % average OECD



USD, 2017 PPPs. LAC_6 is the simple average of Argentina, Brazil, Chile, Colombia, Costa Rica and Mexico.

Chart: OECD • Source: WDI, World Bank • Created with Datawrapper

Tackling Informality

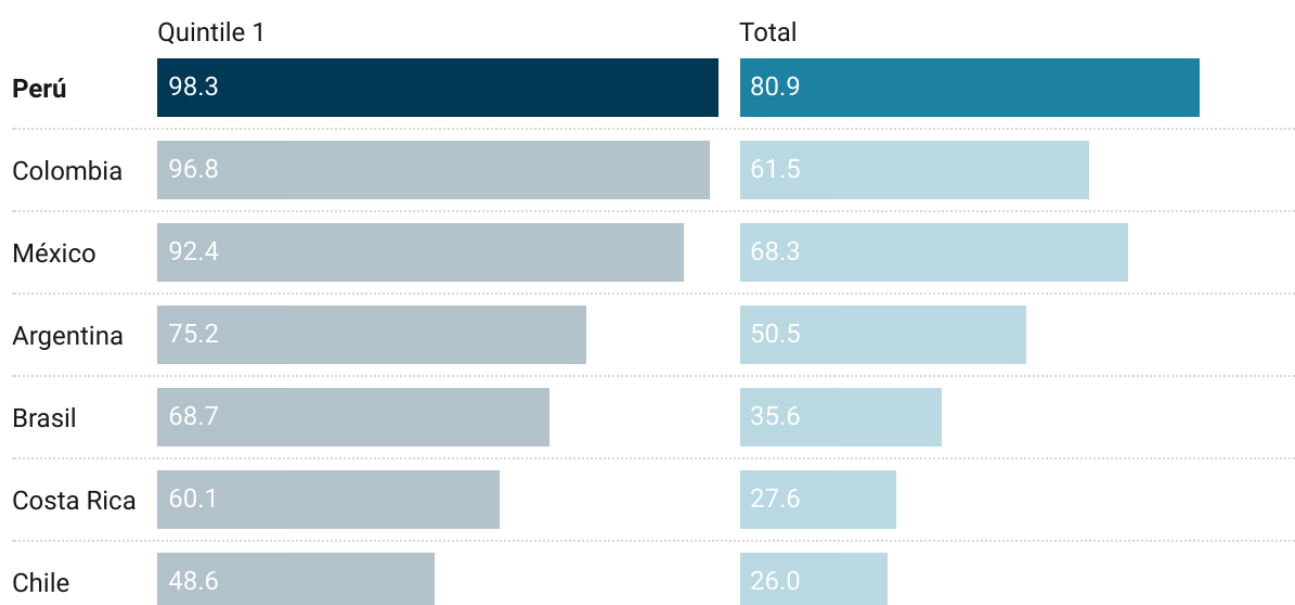
The challenge of informality looms large in Peru, with around 80% of workers in informal jobs, without social and labour protection, and on the margin of the formal tax and benefit system. Though there is no silver bullet solution as the roots of informality are multi-dimensional, fostering formality through a comprehensive reform package is essential for reducing poverty and inequality, boosting productivity, and improving tax collection. Ensuring universal access to basic social benefits – health, pensions, and social assistance – for both formal and informal sector workers alike, could remove some distortions that incentivise informality. This requires increased social spending funded by general taxation instead of by social contributions that make formal job

creation expensive incentivising informal job creation. Providing universal access to pensions and health services financed by general taxation offers the possibility of reducing social contributions for low-income workers, promoting formal employment, and boosting productivity. Improving access to high-quality education tackles another root cause of informality, low labour productivity. Closing the gap in learning outcomes, especially among disadvantaged students, requires improving teachers' training and addressing school infrastructure gaps.

Informality is widespread

% employment

■ Quintile 1 ■ Total



Informal workers are those not contributing to the pension system.

Chart: OECD • Source: SIMS database, IADB • Created with Datawrapper

Strengthening Public Finances

Peru's current tax revenues, at 17% of GDP, lag both OECD and regional peers. A key challenge for Peru is sustaining fiscal responsibility while addressing social and infrastructure needs. Addressing this gap requires a multifaceted approach: improving spending efficiency while strengthening tax administration, reducing tax expenditures, modernizing

property registries, and streamlining corporate tax schemes.

Confronting Climate Change

Climate change poses another significant challenge for Peru. The country is highly vulnerable to extreme weather events and is committed to achieving carbon neutrality by 2050. To achieve this goal, the country must combat deforestation—a major contributor to greenhouse gas emissions—and accelerate the use of renewable energy sources implementing stricter regulations and consistent price signals to reduce reliance on fossil fuels, tapping the enormous potential that the country has in this area.

As Peru navigates these multifaceted challenges, its process of accession to the OECD can offer a framework for long-term reforms that address existing vulnerabilities and allow the convergence to higher living standards. This roadmap, grounded in evidence and best practices, should build on the successes of the past, such as the robust macroeconomic setup that fuelled Peru's economic growth. Realising this transformation demands political consensus, evidence-backed policies, and collaborative efforts.

References



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OECD (2023), *OECD Economic Surveys: Peru 2023*, OECD Publishing, Paris, <https://doi.org/10.1787/081e0906-en>