

Chapter 2

Social inclusion and sustainable development in Peru

This chapter focuses on three key aspects: health, education and skills, and work. Peru is underperforming relative to its upper-middle income status in these three areas, and they seem to be particularly important for the future well-being of Peruvians and essential for social inclusion. The access to the health system is unequal. Coverage in education has expanded widely, but quality remains poor across all levels and the most socio-economically disadvantaged, especially women and the rural and indigenous population, experience significant inequality. A mismatch between existing skills and the needs of the economy is a key barrier to development. Furthermore, informal employment is still widespread, albeit declining. To overcome the persistent inequalities, Peru needs to create the incentives to formalise the labour market extensively.

Improving the well-being of all is the ultimate development goal for any country, and requires a sustainable and inclusive approach: sustainable in terms of long-term viability and resilience; and inclusive in terms of allowing everyone to participate in the socio-economic progress brought by development.

Peru has made significant progress in social inclusion and sustainable development in recent years. However, large inequalities and high levels of poverty and vulnerability remain, with some structural constraints preventing the country from achieving further progress.

This chapter presents a diagnosis of these key constraints. It first presents an overview of recent trends in poverty and inequality levels, and the extent to which the period of economic expansion has promoted socio-economic inclusion. It then goes on to analyse three dimensions of well-being in which Peru seems to be particularly lagging behind according to the results of the well-being analysis and benchmarking exercise presented in Chapter 1: health, education and skills, and work. These three issues are of great importance as they are both means and ends. Good health has an intrinsic value for quality of life, but it also translates into human capital accumulation. Education and skills not only help individuals to participate in their society, but they also increase labour productivity. Similarly, good jobs and employment opportunities provide a financial livelihood for workers, while enabling them to use their productive capacities. Tackling these three areas will not only improve overall well-being in Peru, but also increase the level of human capital and productivity, hence paving the way for social inclusion and sustainable development.

Social progress is remarkable, but vulnerability and inequality remain

Peru's recent period of economic growth, which began in 2003, has seen an improvement in living standards and the reduction of inequality and poverty levels. From this point of view, its growth can be labelled as “inclusive”, as it “creates opportunity for all segments of the population and distributes the dividends of increased prosperity, both in monetary and non-monetary terms, fairly across society”, as stated in the OECD definition of inclusive growth (OECD, 2015a). However, there are significant nuances to this, as not all groups have benefitted equally, and inequalities and vulnerabilities are still a threat to social inclusion and development in the country.

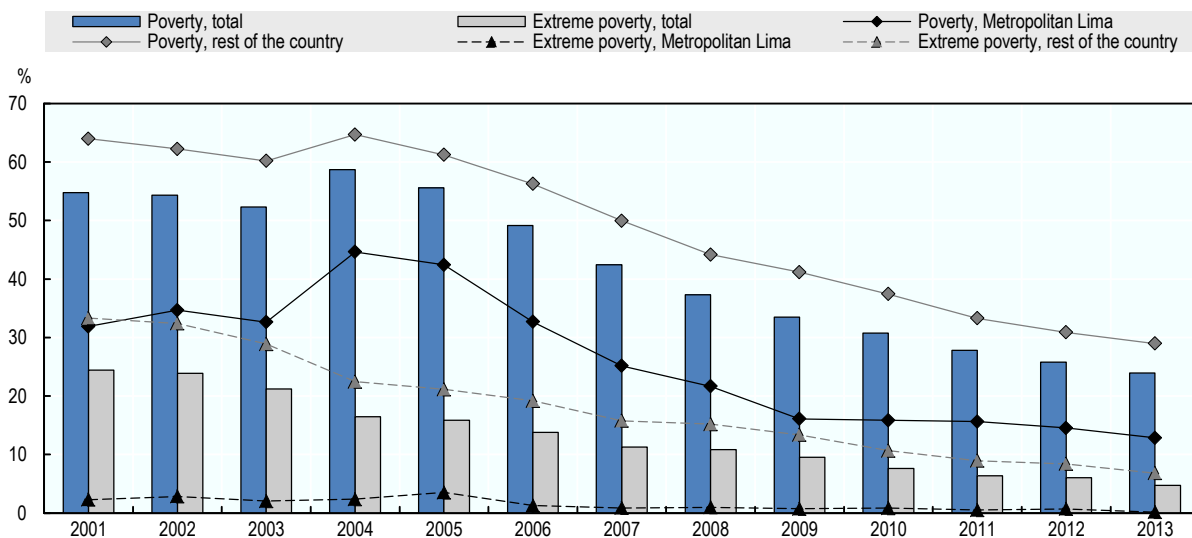
Poverty reduction has been one of the main successes of the recent economic expansion

The past decade of economic expansion has been accompanied by remarkable progress in social inclusion and, in particular, in poverty reduction. The alleviation of poverty has been one of the most outstanding phenomena in the last decade across Latin America and the Caribbean region. Peru has been particularly successful in this respect, with poverty rates falling by half since 2001 to a level of around 24% in 2013, and with extreme poverty rates falling from close to 25% to around 5% in the same period (Figure 2.1). In addition, the poverty gap decreased from 21% in 2003 to 8.6% in 2012 (CEDLAS and World Bank, 2014).¹

Yet despite this progress, poverty rates are high for certain groups and regions and vulnerabilities remain large. A great divergence exists between metropolitan Lima and the rest of the country, in particular in terms of aggregate levels of poverty. In addition, there are areas where the incidence of poverty is particularly high, such as the rural parts


of the Andes, where around 53% of the population was still poor in 2013 (INEI, 2015).² Finally, poverty remains concentrated in population groups which are more difficult to target, such as the elderly, unemployed youth and working-age women, among others. This may complicate further reductions in poverty, as such groups may not benefit so easily from growth, unless specific, targeted policies are put in place (Martinez-Restrepo and Gray-Molina, 2013). Interestingly, while poverty in Latin America has stagnated since 2012, in Peru it has continued to decrease. However, the reasons behind this regional stalemate – the recent downslide in economic performance in the region (ECLAC, 2014) – could also negatively affect the reduction of poverty in Peru in the near future. Despite the sharp reduction in poverty rates, it remains uncertain whether those who escaped poverty are still vulnerable to falling back into it, and whether the conditions still exist for continued poverty reduction. A forthcoming study by the OECD Development Centre will be focused on one of the main vulnerable groups in Peru: youth. This *Youth Well-Being Policy Review* will be conducted in ten developing countries, including Peru, and will include the profiling of vulnerable youth, identifying the determinants of vulnerability and reviewing sectorial policies like health, education and employment.

Figure 2.1. Poverty and extreme poverty in Peru 2001-13



Note: 2013 data are estimates. According to INEI, total poverty includes individuals who belong to a household where either income or consumption per capita is less than the cost of a minimum basket of minimum and essential goods and services; extreme poverty includes those where this is below the value of a minimum basket of food.

Source: INEI (National Institute of Statistics).

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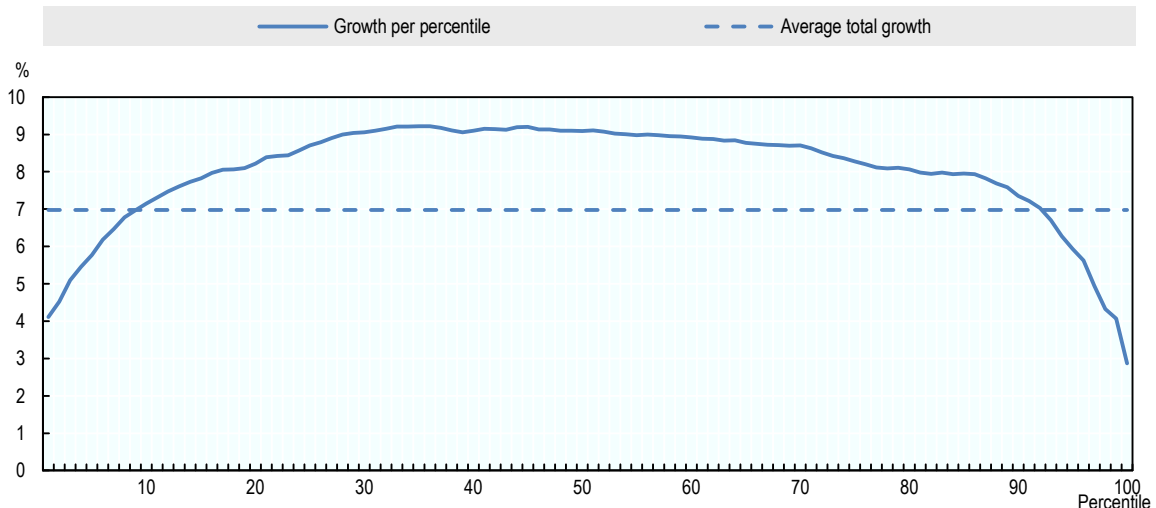
Growth has been relatively more beneficial for the middle class

The evolution of income in this period shows that while economic growth has benefitted all income groups in absolute terms, it has been relatively more important for those in the middle class (Figure 2.2). This feature has been one of the main drivers of the expansion of the middle class in Peru in recent years; many of those who have been lifted out of poverty have now joined this group. This emergence of a middle class is one of the main features of Peru's recent history, and is also a regional phenomenon. Depending on the methodology employed, Peru's middle class increased between 10 percentage points

and 20 percentage points in the past decade (Ferreira et al., 2013; Tornarolli, 2014). It is estimated that 34.3% of the population belongs to the middle class in Peru today. However, the heterogeneity in growth across income groups suggests that the gap between the poorest and the rest of society is widening and that growth has had an unequal impact across income groups.


Figure 2.2. **Incidence of growth in Peru across income percentiles, 2003-12**

Percentage annual growth of gross household income across income percentiles



Note: Data at household level. Gross income refers to labour income, transfers and any other source of income, before taxes.

Source: OECD calculations based on household surveys (ENAHO, INEI).

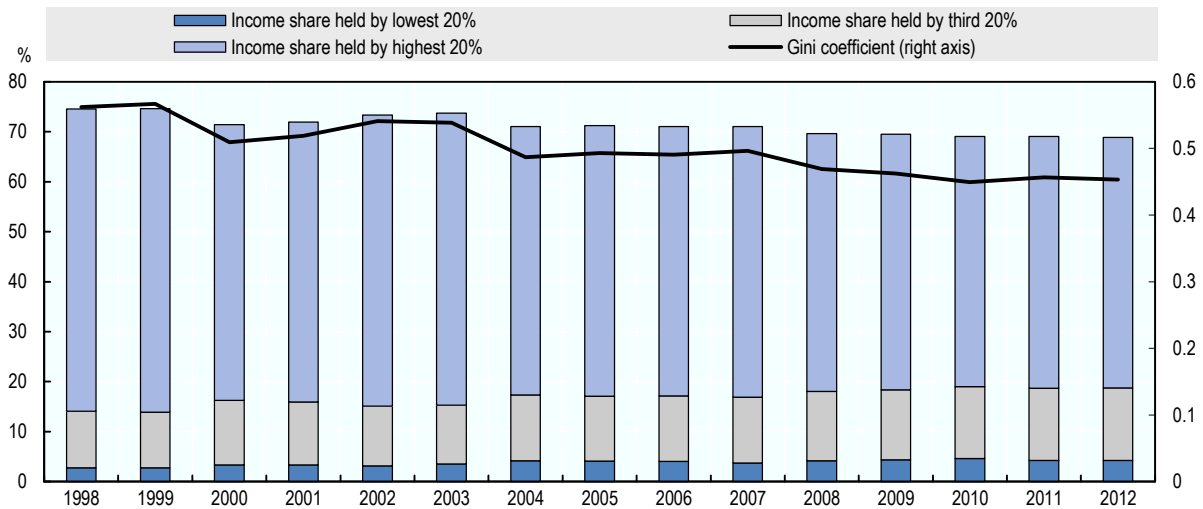
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Inequalities and vulnerabilities remain large


Despite some improvement, income inequality across socio-economic groups remains high in Peru. The Gini index has declined significantly, from 0.56 in 1998 to 0.45 in 2012 (Figure 2.3; CEPALSTAT, 2015). While this is below some other countries in the Latin America and Caribbean region, such as Mexico (0.48), Chile (0.51) and Colombia (0.53), inequality is still very high relative to OECD standards. The concentration of national income across income quintiles shows the persistence of large inequalities in the country (Figure 2.3). In this context, the impact of redistributive mechanisms, such as taxes and social transfers, seems inadequate (Chapter 4).

Overall, while socio-economic conditions have improved, large challenges remain in the pursuit of a sustainable development pattern that promotes inclusion and, ultimately, well-being for all. It is therefore critical to get to grips with some key constraints undermining further social inclusion and sustainable development. The results of the well-being analysis and the benchmarking exercise (Chapter 1) showed that Peru's performance in health, education and skills, and work is lower than one would expect given its income level. We explore these issues in the sections which follow.

Figure 2.3. Gini coefficient (index) and income shares by quintiles (%), 1998-2012



Source: World Bank (2015a), *World Development Indicators* (database), Washington, DC, <http://data.worldbank.org>.

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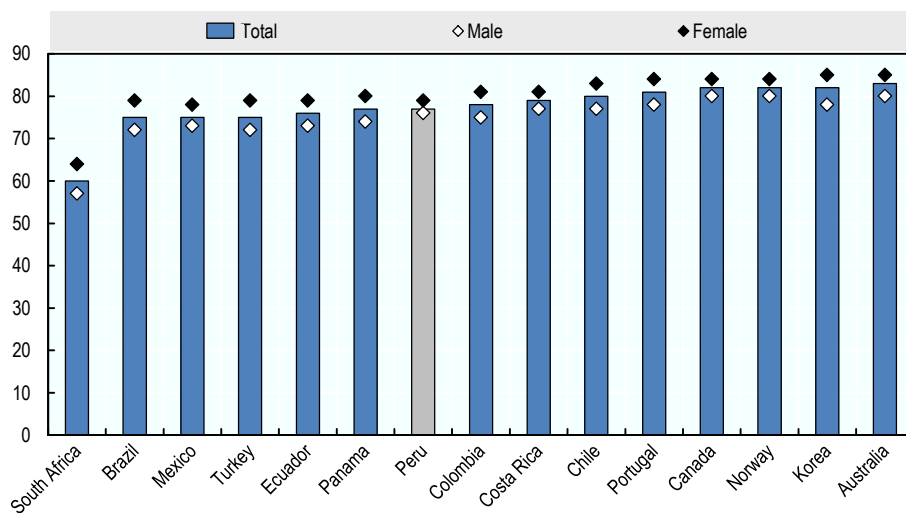
Health is a necessary condition for development

Good health is key to well-being and directly related to quality of life. Disability, illness and disease hinder people's ability to participate fully in social life, the education system and the labour market, reducing their autonomy and control over their lives. Providing good quality and universal health service is a major item on Peru's development agenda. This section examines overall health outcomes in Peruvian society. Major challenges include the high number of years of life lived with disabilities, the relatively high rates of child mortality and large inequalities in access to insurance and good quality healthcare services.

As Chapter 1 shows health in Peru, in terms of life expectancy, appears relatively good, with only minimal gender differences. Average life expectancy at birth is 77 years (76 years for men and 79 years for women), which is relatively normal for countries at this level of economic development (Figure 2.4). Of the group of selected benchmark countries (described in Annex 1.A1 of Chapter 1), Peru's gender gap in life expectancy is the smallest (three years); in some countries – such as South Africa, Korea and Brazil – it is as much as seven years.

Despite the reasonable average life expectancy, most Peruvians do not live long healthy lives and child mortality is relatively high. The “disability adjusted life year” is an indicator of the gap between current health status and the ideal health situation in which the entire population lives to an advanced age, free from disease or disability (WHO, Global Health Estimates). Age standardised years lived with disability in Peru are higher than most of the benchmark countries, with 11.6 years lost every 100 years (Figure 2.5, Panel A). As for child mortality, for every 1 000 live births in Peru, 15 will die before reaching the age of 5. These figures put Peru behind many OECD members, as well as Costa Rica and Brazil (Figure 2.5, Panel B).

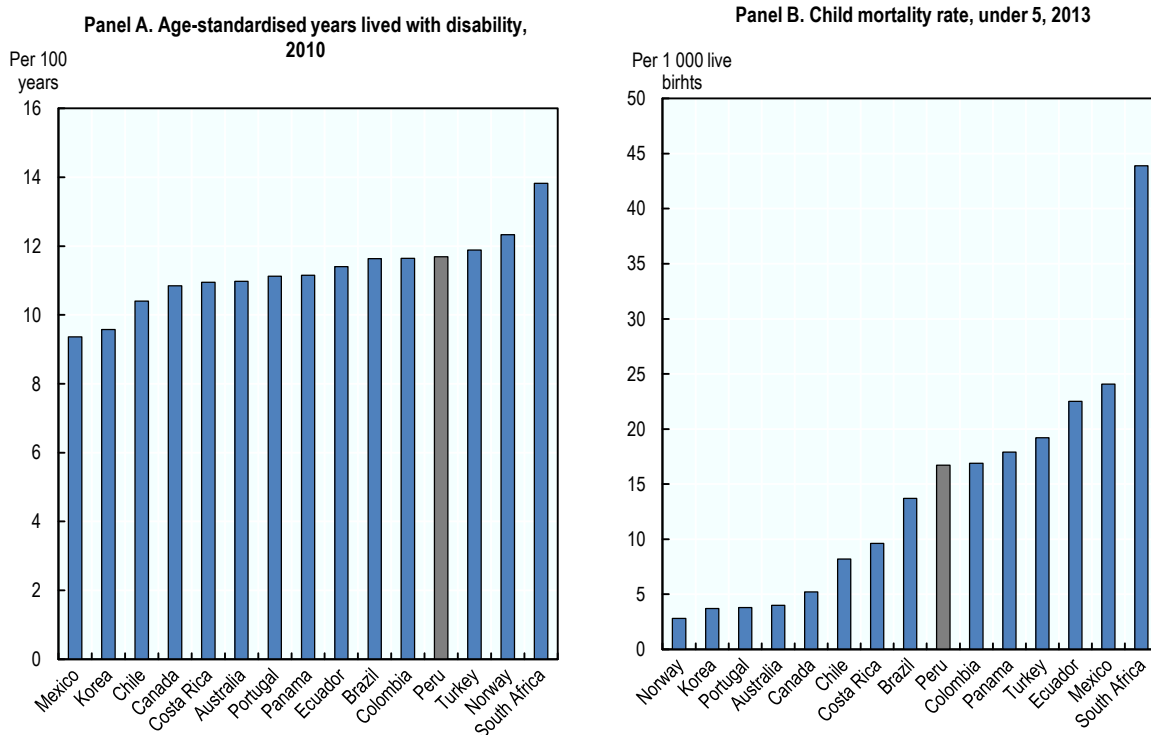
Figure 2.4. Peruvians have relatively good life expectancy at birth, whatever their gender
Years of age, 2013



Source: OECD calculations based on the Global Health Observatory Data Repository of the World Health Organisation, <http://apps.who.int/gho/data/node.main.688>.

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Figure 2.5. Healthy life and child mortality



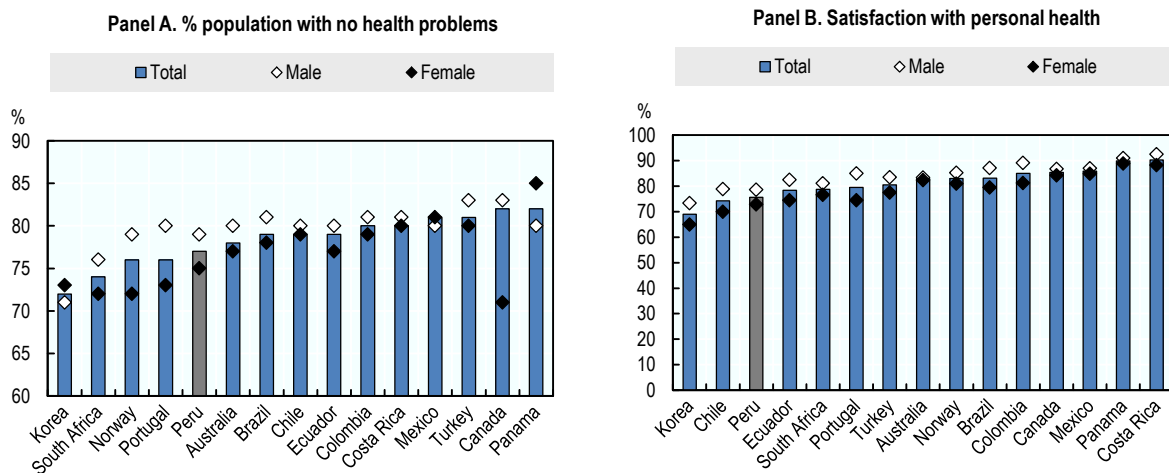
Note: Years lived with disability from Panel A are estimated by weighting the prevalence of different conditions based on severity.

Source: OECD calculations based on Global Burden of Disease Country Profiles of the Institute for Health Metrics and Evaluation for “Years Lived with Disability”, and World Bank (2015a), *World Development Indicators* (database) for “Child Mortality Rate”.

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Peru does not do so well on self-reported health outcomes either. Compared to the other countries in the group, a relatively low proportion of the population (around 77%) report that they do not have any health problems that prevent them from doing things people their age can normally do (Panel A, Figure 2.6). This ranks Peru 5th from the bottom of the 15 benchmark countries. Peru also performs poorly in personal satisfaction with health (Panel B, Figure 2.6), with 75.6% of the population reporting they are satisfied with their personal health, only above Korea and Chile.

Figure 2.6. Self-reported health among benchmark countries, 2014



Note: Data for the “% of the population with no health problems” show the percentage of people responding “no” to the question “Do you have any health problems that prevent you from doing any of the things people your age normally can do?”. Data for “Satisfaction with personal health” show the percentage of people responding “satisfied” to the question “Are you satisfied or dissatisfied with your personal health?”.

Source: Gallup Organisation (2015), *Gallup World Monitor* (database).

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Access to healthcare is increasing, but not yet universal

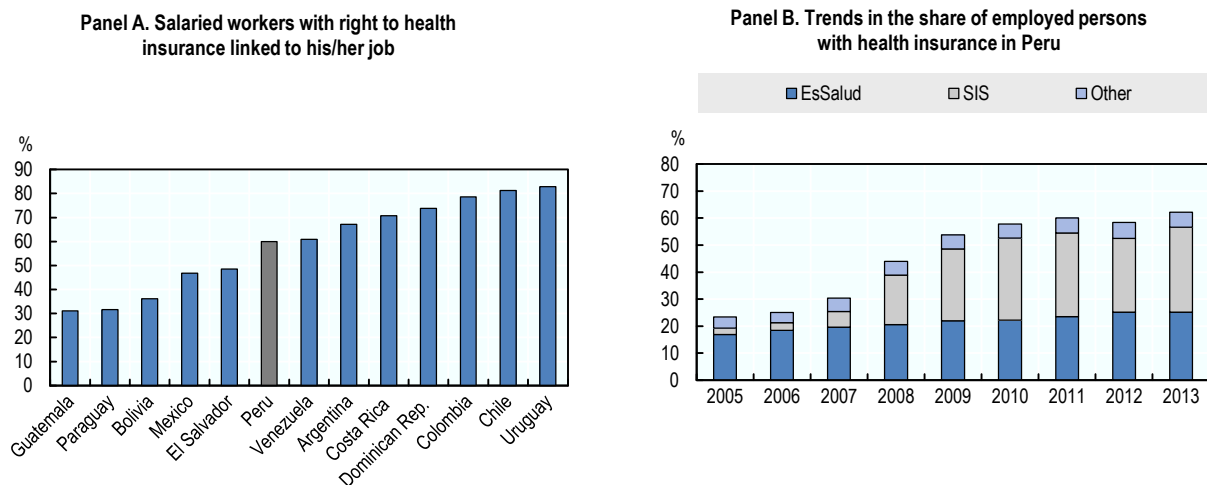
The health system is currently regulated by the General Health Law of 1997, and is divided into a universal public health sector and a private sub-sector. This law turned the state into a “subsidiary” agent rather than a “provider” agent (Mesa-Lago, 2005), allowing the affluent Peruvians to purchase healthcare from the market. The public health insurance system has three components: 1) *Sistema Integral de Salud* (SIS); 2) *Sistema Social de Salud* (EsSalud); and 3) *Sanidades de las Fuerzas Armadas y de la Policía Nacional* for police and army officers.

- The *Sistema Integral de Salud* is a non-contributory system that offers only basic medical care to a wide section of the population. It was created in 2001 by combining the *Seguro Escolar Gratuito* and *Seguro Materno Infantil* and aimed at covering all uninsured populations. In 2005, the coverage of SIS was extended to young adults over 17, and in January 2015 to all age groups. Since the SIS was designed to primarily serve those in poverty and workers in small and medium-sized enterprises (SMEs), it has made a tremendous impact in reducing inequalities in access to health services.

- EsSalud is a contributory health insurance programme and is obligatory for wage earners. Members of co-operatives and independent workers can also choose to join the EsSalud. EsSalud is a more comprehensive system than SIS and provides medical care for illnesses, accidents and maternity and subsidised medicines.
- *Sanidades de las Fuerzas Armadas y de la Policía Nacional* is funded from the Treasury, and like EsSalud, provides a wide range of healthcare services (Lavigne, 2013).


Access to health insurance has increased remarkably, especially thanks to the creation of the SIS, but Peru is still far from achieving universal coverage. The share of insured individuals was 36% in 2005 and increased to 62% in 2012. Among salaried workers, only 23% of employed people had health insurance as recently as 2005 (Figure 2.7). The coverage rate expanded significantly in 2008 and has continued to increase since then. However, as of 2013, 38% of those in employment and 4 out of 10 people overall in Peru still lack health insurance. Not surprisingly, Peru is outperformed by other Latin American and Caribbean countries: for example the coverage rate is around 80% in Colombia, Chile and Uruguay.

Figure 2.7. Access to health insurance in Peru (over time) and selected benchmark countries



Note: Figures for benchmark countries are from the most recent year for which data are available. 2005 data for Paraguay, 2006 data for Venezuela, 2007 data for El Salvador, 2010 data for Mexico and Costa Rica, 2011 data for Guatemala, Bolivia, Peru, Dominican Republic, Colombia, Chile and Uruguay, and 2012 data for Argentina are used.

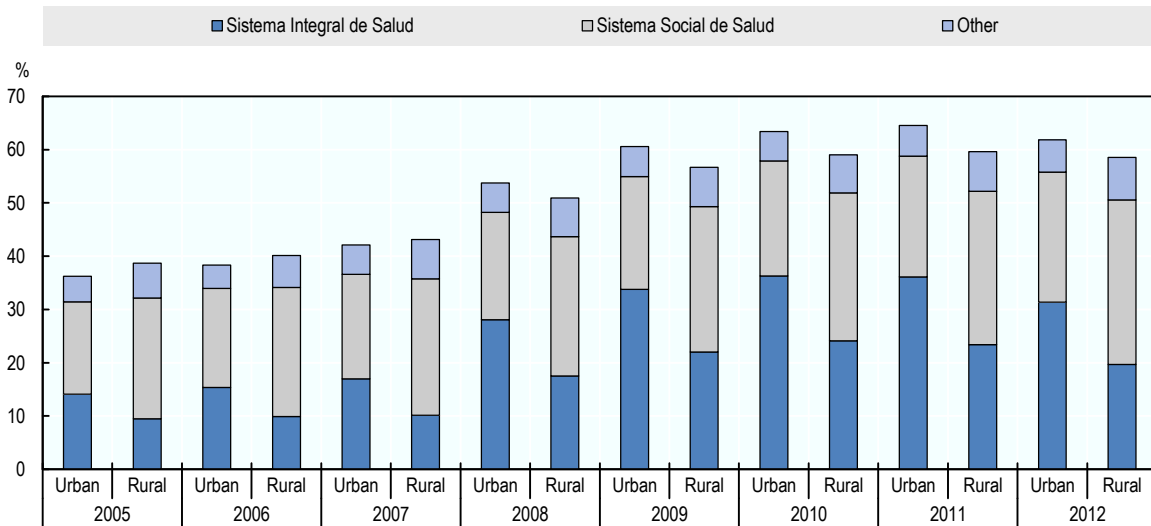
Source: CEDLAS and World Bank (2014), *Socio-Economic Database for Latin America and the Caribbean (SEDLAC)* (database), <http://sedlac.econo.unlp.edu.ar/eng/index.php> and Instituto Nacional de Estadística e Informática (INEI), *Evaluación de los indicadores de empleo e ingresos por departamento* (2013), http://www.inei.gob.pe/media/MenuRecursivo/publicaciones_digitales/Est/Lib1105/.

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While both urban and rural populations now have better health insurance coverage, some discrepancies have emerged between the two. The share of those insured was more or less the same in urban and rural areas between 2005 and 2007. However, since 2008


the urban population is now more likely to have access to health insurance as a result of higher growth in access to the SIS in urban areas (Figure 2.8). The poorest populations do not have access to SIS services because they mainly live in remote locations that lack health services, widening the gap in access to health insurance among income groups.

Figure 2.8. **Evolution of the population affiliated to a health insurance scheme in Peru, 2005-12**
Percentage, by type of insurance and urban/rural population



Note: “Other” category includes Seguro Privado de Salud, Entidad Prestadora de Salud, Seguro de las Fuerzas Armadas/Policiales, Seguro Universitario, and Seguro Escolar Privado.

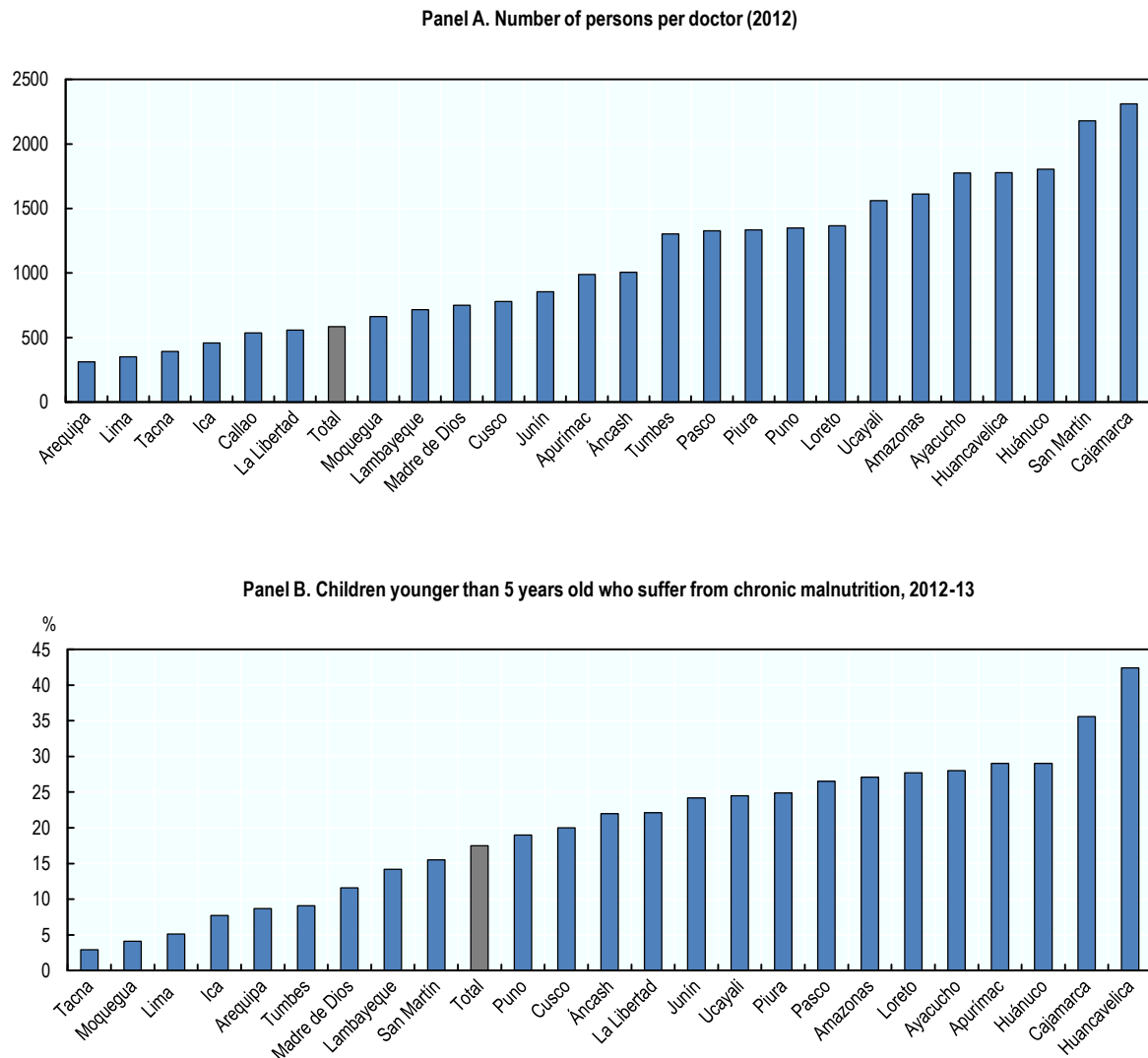
Source: OECD calculations based on figures published by Evolución de los indicadores de empleo e ingresos por departamento, National Households Survey Data (ENAHO, Encuesta Nacional de Hogares) from INEI (National Institute of Statistics).

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Despite a remarkable increase in access to health insurance in both urban and rural areas, geographical inequalities remain with respect to access to health and to health outcomes (Figure 2.9, and also discussed in Chapter 5). For instance, there are far fewer doctors per inhabitant in rural regions compared with urban ones. In Peru, on average one doctor attends to 568 persons, but there is a large variation across geographic regions. There are fewer than 350 inhabitants per doctor in Lima and Arequipa, whereas there are almost 5 times as many in Huancavelica, Huánuco, San Martín and Cajamarca. Because of the variation in health services, middle-class Peruvians typically prefer to pay for private healthcare services.

Moreover, indigenous people, especially women, have difficulties in accessing health centres and, once accessed, often receive discriminatory treatment (Mora-Bernasconi, 2006). The Ministry of Health adopted the *Estrategia Sanitaria Nacional Salud de los Pueblos Indígenas* in 2009 in order to tackle the health inequalities faced by indigenous people, prioritising the Amazonian region. This plan aims to increase public health services for these regions, and to give greater respect to traditional practices and traditional medicine of indigenous people through an intercultural approach.

Figure 2.9. Health indicators across Peru's regions, 2012-13



Sources: Data from Instituto Nacional de Estadística e Informática, Compendio Estadístico Perú (2014). Figures for persons per doctor by regions are based on Ministry of Health (MINSA), and figures on chronic malnutrition among children come from Encuesta Demográfica y Salud Familiar.

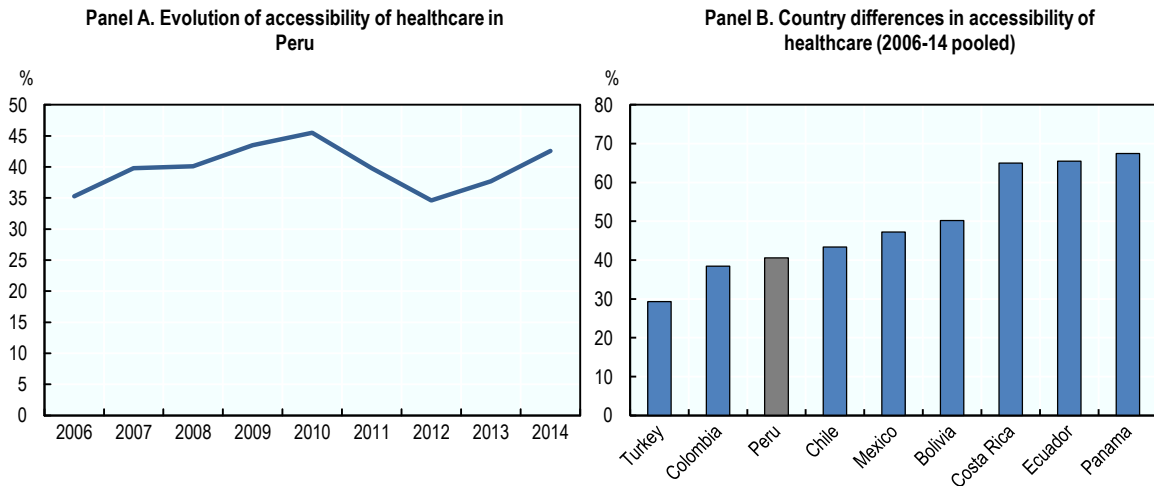
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Satisfaction with healthcare facilities is poor

Many Peruvians are dissatisfied with the level of accessibility and the quality of their healthcare services. The Gallup World Poll asks individuals each year whether they think healthcare services in their country are accessible to anyone who needs them, regardless of their economic situation. The share of Peruvians who believe anyone can access healthcare increased between 2006 and 2010 from 35% to 45%, reflecting the expansion of the SIS (Gallup, 2015). While there was a deterioration in people's perceptions of healthcare accessibility between 2010 and 2012, opinions improved in 2014 (Figure 2.10, Panel A). Despite the overall upward trend, international comparisons show that Peruvians are not as satisfied with their health-care system as other nations. Peru outperforms Turkey and Colombia but has fallen behind Chile, Mexico and Bolivia (where on average 43-50% of the population think healthcare is accessible), and


particularly Costa Rica, Ecuador and Panama (where over 65% of the population are satisfied with the accessibility of healthcare services) (Figure 2.10, Panel B).

Figure 2.10. **Perceptions of the accessibility of healthcare services, 2006-14**



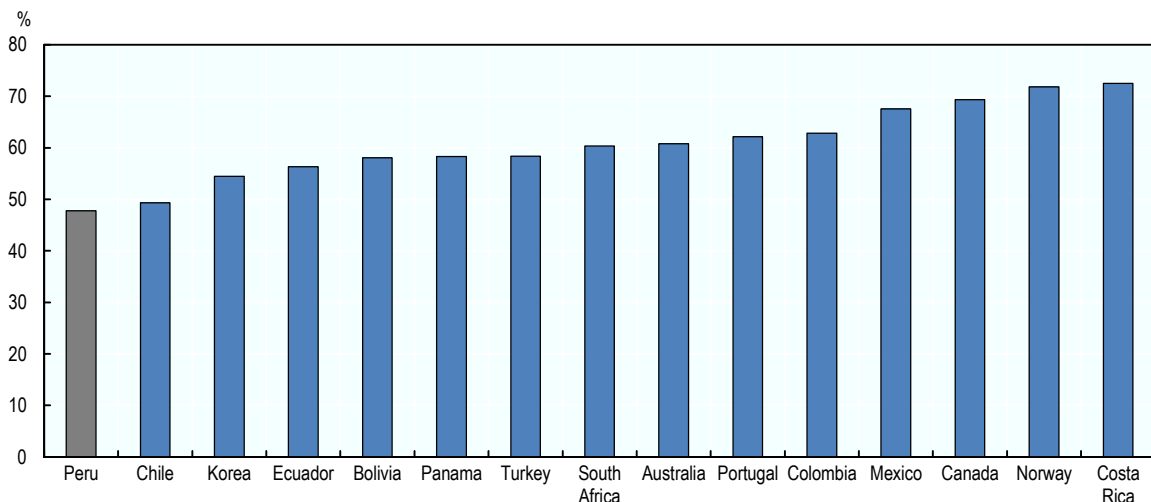
Note: Data for “perceptions of accessibility of healthcare” show the percentage of people responding “yes” to the question “Are healthcare services in this country accessible to any person who needs them, regardless of their economic situation, or not?”.

Source: Gallup Organisation (2015), *Gallup World Monitor* (database).

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Peruvians have very little confidence in their health-care and medical system. Between 2006 and 2010 (the most recent data available), only 48% of Peruvians had confidence in the health system, placing Peru behind all of the benchmark countries (Figure 2.11). For instance, confidence in the health system reached 63% in Colombia, 68% in Mexico and 73% in Costa Rica. Perhaps this is why many middle-income Peruvians prefer to pay for private healthcare.

Figure 2.11. **Confidence in health systems in benchmark countries, 2005-10**



Note: Data for “confidence in health systems” show the percentage of people responding “yes” to the question “Do you have confidence in healthcare or medical systems?”.

Source: Gallup Organisation (2015), *Gallup World Monitor* (database).

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Health is still holding back Peru's economic development

Health and development are closely linked: a healthy population is a key to sustainable development. Good health can be viewed as capital; healthier individuals are capable of investing more in human capital accumulation and so are more productive, thus contributing to sustainable growth. Economic growth in turn can improve health: higher incomes can allow people to spend more on healthier diets, and technological advances help improve medical science.

Despite Peru's remarkable efforts to extend health insurance coverage and adapt it to the specific needs of indigenous people, health remains a challenge. Deficiencies in healthcare services and persistent inequalities in access and quality are preventing all Peruvians from leading healthy lives and realising their productive potential. Since the health system was recently reformed, the main challenge has been the shortage of public funding for the health sector, placing the state in a subsidiary position, rather than as a sole provider. Because the SIS aims to provide a minimum service to a wide share of the population, significant inequalities in healthcare quality have been created between the contributory beneficiaries of EsSalud and Sanidades de las Fuerzas Armadas y de la Policía Nacional and the non-contributory beneficiaries of the SIS. Peru needs to continue increasing health insurance coverage while improving the quality and accessibility of services provided via the SIS.

Effective health expenditure is crucial for ensuring that public resources produce gains in health outcomes. One crucial issue for the effectiveness of health spending is drug procurement. Drugs in Peru currently are free of charge only for specific groups covered by the SIS, while some treatments can be extremely costly, especially in the private sector (Seinfeld and La Serna, 2007; Meza-Cornejo, 2007). Drug procurement and the overall efficiency of the health system will be discussed in detail as part of the OECD's country programme with Peru which will include two thematic reviews. One of these will specifically focus on the Peruvian health system and in particular on the issue of universal health coverage. A second review will assess the current status and availability, as well as the underlying data infrastructure, of Peru's routinely reported health statistics. These reviews will be crucial for assessing the impact of reforms that the Peruvian government will implement in order to improve the quality and accessibility of healthcare services to all citizens.

Education is one of the main pillars of inclusive development

Education stands out as one of the main pillars of sustainable and inclusive development. As such, it is very relevant both for economic growth and for individual well-being. Good education has a positive impact on individual earnings, on the distribution of income, and on economic growth (Hanushek and Woessman, 2007). High quality education has a strong link with higher labour productivity (OECD/CAF/ECLAC, 2014). Peru's low levels of human capital explain a large part of the gap in labour productivity between Peru and the United States (Chapter 3).

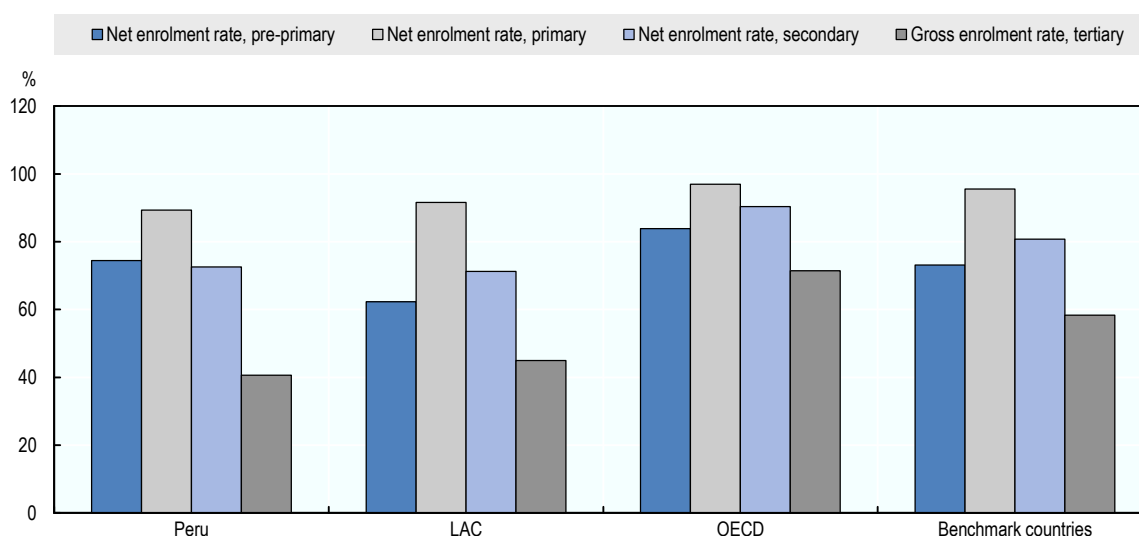
Education also affects social cohesion, and is a key factor in improving citizens' civic engagement, social interactions and democratic participation. Education is therefore an area of public policy where the traditional trade-off between equity and efficiency can be avoided, and is a strategic area for policy action. This section presents the evolution of access to and investment in education in Peru, and focuses on the main education

challenges for the country: quality, which remains low; and the persistence of large inequalities in both access and performance.

Access to education in Peru has expanded significantly

Peru has experienced a large increase in access to education at all levels. A variety of indicators shows that the “quantity” of education held by the population in Peru has increased in recent years. The average number of years of education among 15-year olds reached 10.1 in 2013, up from 9.5 years in 2005 (INEI, 2015). Adult literacy rates (for 15-year olds and over) have also expanded, from 87.6% in 2004 to a projected rate of 94.5% for 2015 (UNESCO/UIS, 2015). But the main improvement has been the number of people participating in education, which has increased substantially at all levels in the last decade. However, gaps between Peru and OECD members still remain, particularly in secondary and tertiary education (Figure 2.12).

Figure 2.12. **Enrolment rates in different levels of education, 2012**



Note: Gross enrolment rates in tertiary education from Peru are from 2010.

Source: UNESCO/UIS (2015), UNESCO Institute for Statistics database, <http://www.uis.unesco.org/Pages/default.aspx>.

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The last decade has seen remarkable progress in access to pre-primary education for children up to five years old. Net enrolment rates for those aged three to five reached around 77% by 2013, up from around 60% in 2005 (INEI, 2015). This is above the average for Latin America and the Caribbean (LAC), which averaged around 62% in 2012, but is still below the OECD average of 84% (Figure 2.12). This expansion has been partly supported by the provision of pre-primary education through formal settings, the *Centros de Educación Inicial* (CEIs), but particularly through non-formal community-based programmes called *Programas No Escolarizados de Educación Inicial* (PRONOEIs). These PRONOEIs have been in place for several decades, mainly serving children from rural and marginal urban areas, and have represented a lower-cost alternative for the government to expand access, given that the community provides most of the infrastructure (Woodhead et al., 2010). Private provision has also progressed in the field of pre-primary education (Woodhead et al., 2010). Overall, social programmes such

as *Juntos* or *Wawa Wasi* have favoured access to early childhood care and education in Peru. More recently, the current administration has made children one of its public policy priorities. It has created the *Cuna Más* programme for the development of children aged three years old and under from poor areas; and *Qali Warma*, a school nutrition programme aimed at children in pre-primary and primary education.

Increased access to pre-primary education is of particular relevance given the importance of early childhood education for better child well-being and learning outcomes. The impact of pre-primary education on performance across the education cycle is highly significant, as shown by the performances of 15-year olds in the Programme for International Student Assessment (PISA). Secondary school children who have attended more than one year of pre-primary education outperform those who had not attended pre-primary education at all by the equivalent of more than one year of secondary schooling on average (OECD, 2013). In Peru, the advantage amounts to 1.3 years of schooling, the second largest difference of all the Latin American countries participating in the test (OECD, 2013). This performance gap persists even when taking into account the socio-economic status of the students, which can account for part of the discrepancy. Early childhood education also has a significant impact on the acquisition of non-cognitive skills (i.e. soft skills, such as motivation and perseverance), which are critical for the development of individuals within a society (OECD/ CAF/ECLAC, 2014).

Access to primary education is high, although it has decreased slightly and students still repeat years and drop out. Net enrolment rates in primary education were around 93% in 2013, similar to the Latin America and Caribbean average (91.5%), and slightly below the rate for OECD members of 97% (UNESCO/UIS, 2015; Figure 2.12). Levels of enrolment do not show significant discrepancies between urban and rural areas, or between girls and boys. The percentage of students that had to repeat a year of primary education decreased from 9.8% in 2002 to 4.8% in 2013 (ESCALE, 2015), leading to a decline in the proportion of over-age students from 18.8% in 2002 to 8.8% in 2013 (Ministerio de Educación, 2015). Dropout rates declined from 2.3% in 2004 to 1.1% in 2013 (ESCALE, 2015), and 80.3% of 12 and 13 year olds now complete their primary education, up from 67.2% in 2002 (UNESCO/UIS, 2015).

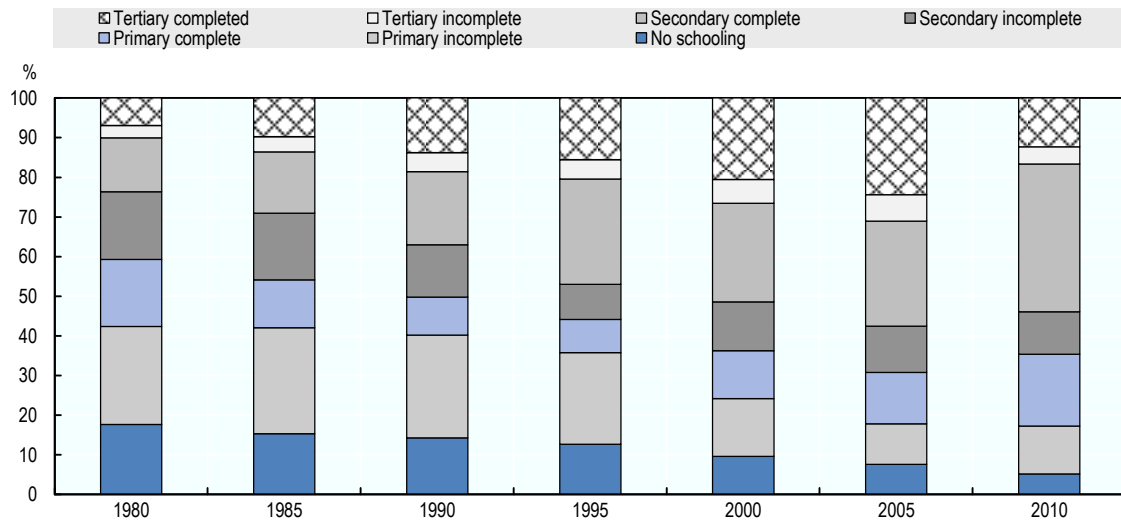
Secondary education is now accessed by almost 8 out of 10 students in Peru, although many leave before completion. Net enrolment rates have increased – from 68.1% in 2004 to around 76.2% in 2013 – slightly above the levels in the LAC region. However, Peru still remains behind the OECD, where access to secondary education reached around 90% in 2012 (UNESCO/UIS, 2015). The percentage of repeaters has decreased, from 5.6% in 2002 to 4.1% in 2013 (UNESCO/UIS, 2015). The percentage of dropouts is higher at secondary than other levels of education, despite a reduction from 11.0% in 2005 to 7.8% in 2013 (ESCALE, 2015). The reasons behind this dropout rate are diverse, and include the opportunity cost of staying in the education system – as opposed to working – and the need to support the income of the household. In fact, 39% of students aged 13 to 19 declared that the reason for dropping out was economic, while 17.4% claimed the reason was problems within the family. Around 10% blamed housework (ESCALE, 2015). The fall in dropout rates meant that 64.8% of those aged 18 and 19 completed their secondary education in 2013, up from 50.4% in 2005 (ESCALE, 2015). Finally, the transition to higher education was 32.9% in 2013, up from 22.9% in 2005 (ESCALE, 2015).

Access to tertiary education has expanded significantly. The expansion began in 1996 with the approval of the *Decreto Legislativo* 882, which liberalised higher education in the country. In 2002, the gross enrolment rate in tertiary education stood at 31.5%, but


reached around 40.6% by 2010. This expansion has to a large extent been fuelled by newly created, or expanding, private higher education institutions. Just 45% of students were enrolled in private universities in 2004, but by 2012 the share had reached 66% (INEI, 2015). Despite this increase in access, only around 20% students aged 22-24 had completed tertiary education in 2013, up from 13.7% in 2005, and around 27% of those aged 25-34 (ESCALE, 2015).

Overall, Peruvian citizens are becoming more educated, with many more people reaching higher levels of education than in the past. In fact, the share of the population aged 15 and over with no schooling fell from 17% in 1980 to about 5% in 2010 (Figure 2.13). The share of the population with incomplete primary and secondary education also fell, showing that many more people now complete their studies. The largest increase was in the share of those who had completed secondary education, which jumped from around 14% of the adult population (aged 15 years and older) in 1980 to more than 37% in 2010. Those who had completed tertiary education also grew, from 7% to 12% between 1980 and 2010.

Figure 2.13. **Educational attainment for total population over 15 years old, 1980-2010**



Source: OECD calculations based on Barro and Lee (2010), dataset.

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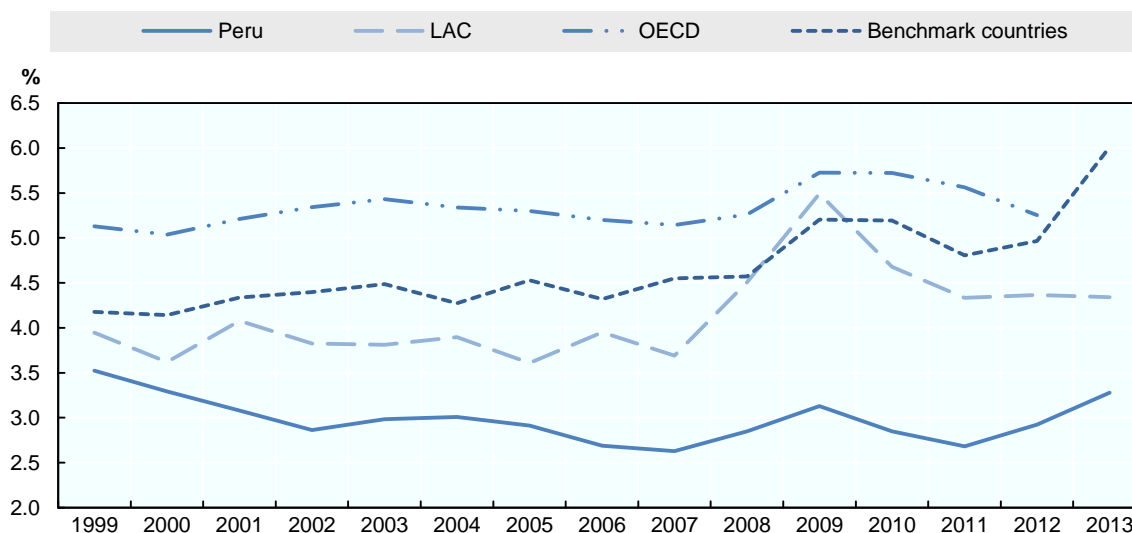
Investment in education still lags behind regional and OECD levels

Investment in education has been persistently low in Peru, well below both OECD levels and those of other Latin American countries of similar levels of development. While the average share of gross domestic product (GDP) spent on education by governments was around 5.3% for the OECD and around 4.1% for LAC over the period 1999-2013, Peru recorded an average of 3% (Figure 2.14). A recent upsurge in spending – from 2.7% of GDP in 2011 to 3.3% in 2013 – indicates the stronger commitment by the current administration to invest in education. However, this indicator of expenditure may be somewhat distorted by the large expansion of Peru’s GDP over the last decade. Other indicators, such as expenditure per student as a percentage of GDP per capita, confirm that Peru is still below the regional and OECD averages (Figure 2.15).


Peru still has much room to improve the education system by investing more financial resources, as well as making better use of resources spent. Peru's level of national income in purchasing power parity (PPP) terms is close to USD 12 000. According to the PISA results, a country's level of economic development is strongly related to its students' performance, but only up to a level of around USD 20 000 per capita GDP, beyond which higher national income no longer predicts educational performance (OECD, 2012a). Students performance is also closely linked to education expenditure, at least up to a level of around USD 8 000 (PPP) per student (Vegas and Coffin, 2015). Peru remains well below that level, with education expenditure at around USD 3 500 per student.

The efficiency of expenditure becomes more relevant after a certain level of expenditure has been reached, as shown by the large disparities in performance among countries with similar levels of educational expenditure (Vegas and Coffin, 2015). The capacity of education systems to absorb additional resources can limit the beneficial impacts of further investment in education.

Figure 2.14. **Expenditure on education as a percentage of GDP, 1999-2013**

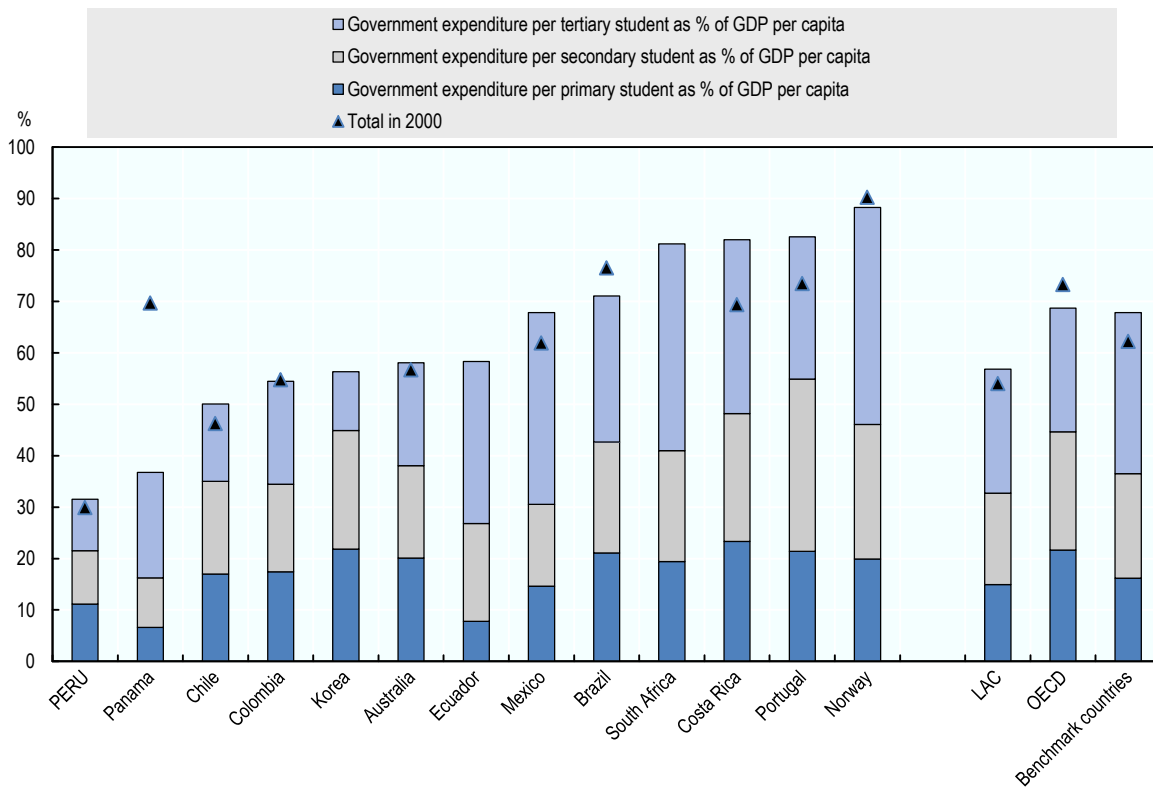


Source: OECD calculations based on UNESCO/UIS (2015), *UNESCO Institute for Statistics database*, <http://www.uis.unesco.org/Pages/default.aspx>.


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A strong political consensus has emerged in recent years in Peru around the relevance of education for inclusive development. One of the commitments expressed in the *Acuerdo Nacional* refers to reaching a level of expenditure on education equivalent to 6% of GDP. Initially this was set as an objective for 2016 and now is referred to as a target for 2021, as stated in the National Education Project for 2021. In addition to this broader national strategy for education in the medium term, the current administration has set a number of priorities for educational policies. One is to close the gap in school infrastructure, which in Peru will cost an estimated 63 billion Peruvian soles (PEN), equivalent to USD 20 billion as of August 2015 (Ministerio de Educación, 2014). Given current spending trends, closing that gap would take almost two decades. To achieve this goal, the government is fostering both public-private partnerships and the programme *Obras por Impuestos*, which reduces tax payments for firms investing in school infrastructure. However, greater accountability in these programmes is needed at sub-national level to quantify the effectiveness of these investments on education outcomes (see Chapter 5).

Figure 2.15. Expenditure on education per student as a percentage of GDP per capita, by level of education (2013 or latest year available)



Source: OECD calculations based on UNESCO/UIS (2015), *UNESCO Institute for Statistics database*, <http://www.uis.unesco.org/Pages/default.aspx>.

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Learning outcomes remain poor

Peru also faces the greater challenge of improving learning outcomes. The quality of Peru's education system remains poor at all levels of education. The increase in access to education has not been accompanied by similar improvements in quality, and in fact has sometimes occurred at the expense of quality. The performance of Peruvian students is generally lower than that of other countries with similar levels of development, and much worse than the OECD average. Low levels of quality translate into low relevance of education, thus discouraging students from pursuing or advancing their education.

Children do not receive a quality education at pre-primary level, which limits the positive impact that pre-primary education can have on the future performance of students. Indeed, at these early stages of education and development, poor education and care can do more harm than good (Schady, 2012). Comparable indicators on the quality of pre-primary education are scarce, but the pupil-to-teacher ratio can be illustrative, given the importance of the care, motivation and pedagogic work given by teachers at this early stage (UNESCO, 2013). In Peru in 2012 there was one teacher for every 18 students at pre-primary level, a similar ratio to the average for Latin America and the Caribbean, but well below the OECD, where there was on average one teacher for every 14 students (UNESCO/UIS, 2015). The quality of teachers is one of the main explanatory variables in the performance of students, and this is particularly true in early childhood education

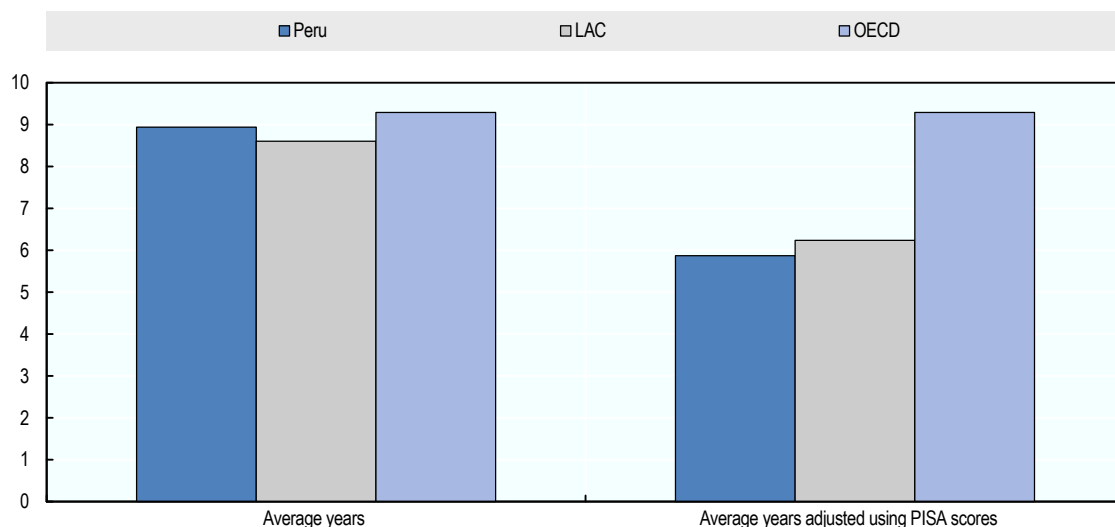
(Verdisco and Ñopo, 2012). In general for Latin America and the Caribbean, however, teachers educating pre-primary children tend to receive less training, earn lower salaries and face more precarious labour conditions than teachers in higher levels of education (Verdisco and Ñopo, 2012). All this is particularly relevant given that interventions at this pre-primary stage are crucial to improving the overall performance of students all along the education cycle.

While the quality of primary education has improved, it still remains far below OECD members. The recent results of the TERCE (*Tercer Estudio Regional Comparativo y Explicativo*) study show that Peru has improved its performance in primary education. This analysis focuses particularly on the 3rd and 6th grade of primary school. It found that in the reading test for the 3rd grade, Peru had greatly improved on the results in the previous study in 2006, and now performs above the regional average for this test. Results in the 6th grade reading test have also improved significantly since 2006, but still remain slightly below the average regional performance (UNESCO, 2014).

The poor learning outcomes of students at age 15 reveal that the quality of the education they receive is limited and insufficient. The results from the PISA 2012 mathematics test placed Peru at the bottom among the 65 participating countries globally (OECD, 2013). An average 15-year-old student in Peru is behind the average Latin American student by the equivalent of 8 months of secondary schooling, and around 3 years behind the average OECD student (OECD/CAF/ECLAC, 2014). Given these PISA scores, it could be argued that the years of schooling of Peruvian students aged 15-19 are thus not equivalent to years of schooling in the OECD, as the knowledge transmitted in one year in Latin America is less than in one year in the OECD. In this sense, a clearer picture of the gap between Peru, the LAC region and the OECD can be seen if average years of schooling are adjusted by quality based on PISA 2012 scores (Figure 2.16). This shows that although Peruvian students aged 15-19 on average have more years of schooling than their peers in Latin American countries participating in PISA 2012, they are below the LAC average, and significantly below the OECD average, when adjusting for PISA scores.

The quality of higher education is far below international standards and highly fragmented. Many higher education institutions (HEIs) have emerged in the last 15 years, but this expansion has been accompanied by deterioration in quality (Castro and Yamada, 2013). This deterioration has been mainly driven by the influx of students from less educated backgrounds; the shift to a model in which teaching is the predominant focus – to the detriment of research and the creation of knowledge; the emergence of HEIs in weak regulatory environments; and a certain commercialisation of higher education in a context of a proliferation of private institutions, with less demanding student selection mechanisms. These are also the main drivers of the deterioration of quality of higher education across the LAC region (OECD, 2015b; Yamada et al., 2013). Both LAC universities and Peruvian ones perform poorly in international rankings. Only 12 LAC universities are included in the top 400 universities in the world, while Peru has no universities among the top 400 (QS University Rankings, 2015). Another sign of decline in the quality of higher education is the increase in underemployment – understood as those who are overeducated for their job position, who work for a non-professional job, or who earn less than a certain threshold- in Peru, which rose from 29% to 35% between 2004 and 2010, showing that labour markets perceive that the quality and relevance of the skills and competencies acquired in higher education fall short of their needs (Lavado et al., 2014).

Figure 2.16. Average years of schooling (ages 15-19), unadjusted and adjusted for academic achievement using PISA scores



Note: LAC comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and Uruguay, which are the countries in the region that participated in the PISA test in 2012.

Source: OECD calculations based on OECD/PISA 2012 database, and UNESCO/UIS (2015), *UNESCO Institute for Statistics database*, www.uis.unesco.org/Pages/default.aspx.

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A University Law was passed in 2014 to strengthen the quality and relevance of Peru's higher education system. The law focuses on the quality of higher education, now managed by the Ministry of Education. This is especially relevant given that recent efforts to assure quality have not been particularly successful (Cuenca, 2015). One of the milestones of this law is the creation of the SUNEDU (*Superintendencia Nacional de Educación Superior Universitaria*). The main objectives of this body are to oversee and control the quality of universities, to grant permission to provide the service of university education, and to control and regulate the public funds given to universities to guarantee that they have been targeted toward improving quality.

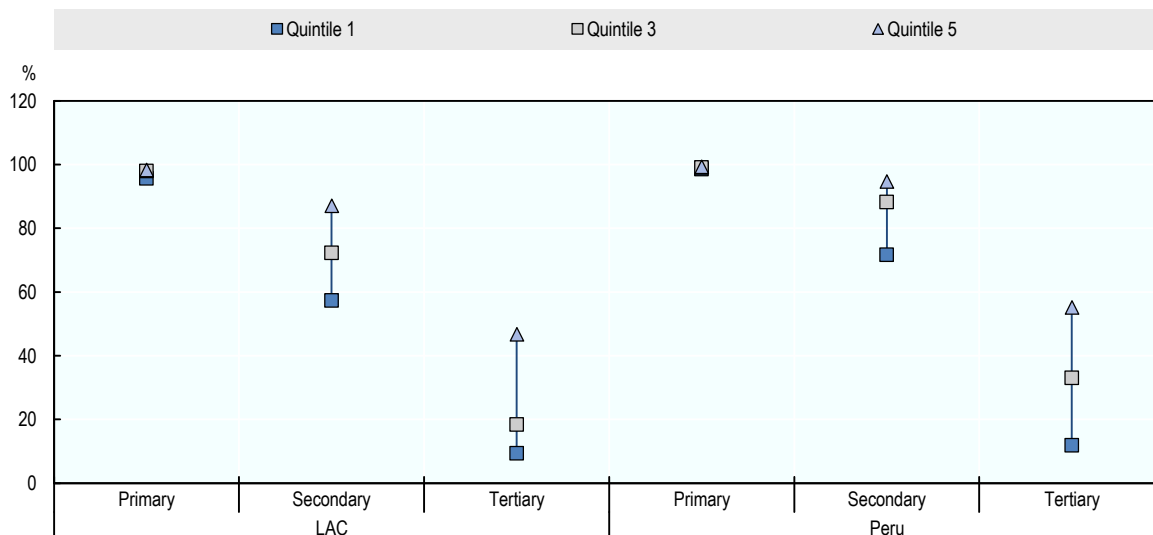
The teaching profession in Peru at all levels of education faces many challenges that affect education quality. The problems suffered by the teaching profession have been one of the main factors behind the poor quality of education in Peru. These include inadequate teacher training, insufficient remuneration, and a regulatory framework that does not create incentives for professionalism (Rivero, 2010). In 2012, a law (*Ley de Reforma Magisterial*) was passed to reform the teaching profession and improve the quality of teachers. This reform aims to introduce more meritocratic criteria in teaching career development, better labour conditions, salaries linked to performance, and incentive schemes to promote continuous professional development. This is one of the main strategic areas of action for the current administration in the field of education.

Large inequalities remain in educational performance and access

Socio-economic factors remain strong determinants of an individual's access to education in Peru. Although access to primary education is broad and the differences are not significant at this level, the higher the level of education the wider the gap becomes.


The rates of access of different income quintiles show large disparities for secondary and tertiary education, a feature also seen across the LAC region (Figure 2.17).

Figure 2.17. Rates of enrolment in different levels of education, by income quintiles, 2011 or latest year available



Note: LAC comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Honduras, Mexico, Panama, Paraguay, Peru and Uruguay.

Source: OECD calculations based on CEDLAS and World Bank (2014).

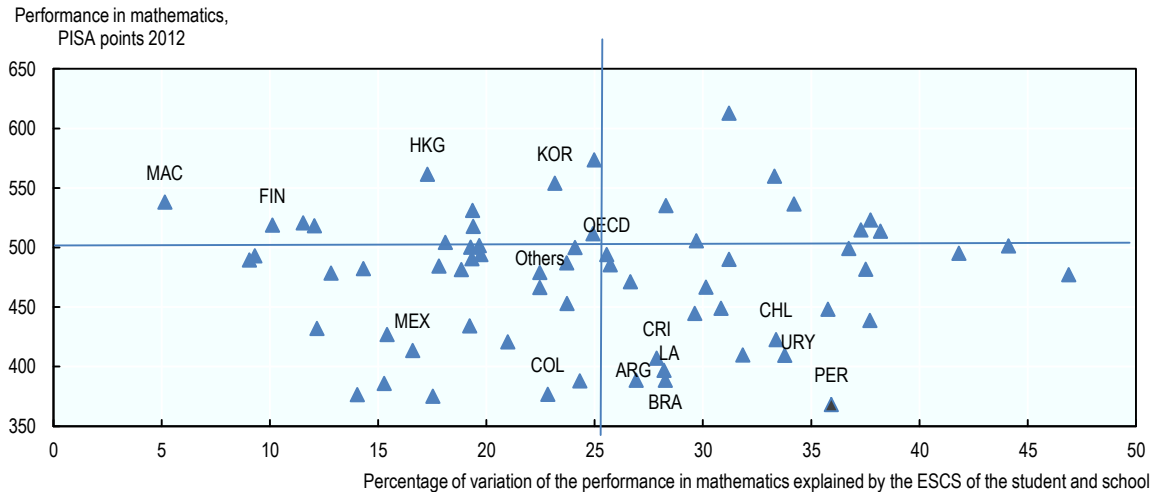
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Educational access and attainment are also determined by the student's ethnic origin, gender and rural/urban location. Although the impact of these factors has generally declined, ethnic origin remains a key factor in inequality. Both enrolment and completion rates at all levels of education are higher among white people than among Amazonians, the Quechua and Aymara population, and the Afro-descendent people, in that order (Castro and Yamada, 2011). The rates of enrolment in secondary education (among those aged 12 to 16) differ significantly between the urban population (89.1%) and the rural population (72.9%), although this is an improvement on 2005 when the respective rates were 81.8% and 57.3% (INEI, 2015). The urban population aged 25-34 had on average 12 years of education in 2013, significantly above the 7.9 year average for the rural population (ESCALE, 2015). The gender gap in urban areas has now closed, but for the rural population there is still a large difference in educational attainment between girls and boys. In 2013 women aged 25-34 in rural areas had completed on average 6.9 years of education compared with 8.7 years for men, while in urban areas the figures were 11.8 and 12.1 respectively (ESCALE, 2015).

The current administration has put measures in place to support access to higher education for the more socio-economically disadvantaged, and these will be key to the continued reduction of educational inequalities in the country. PRONABEC (*Programa Nacional de Becas y Crédito Educativo*) is the national organisation in charge of granting scholarships and educational loans to talented people without resources, in order to promote the formation of human capital and foster social inclusion. PRONABEC has recently put in place an important programme called Beca 18, a scholarship programme to support students coming from poor and extremely poor socio-economic backgrounds,


who have excelled in secondary education. The programme supports their access to higher education and guarantees resources for successful completion and subsequent job preparation.

Figure 2.18. Secondary-school performance and equity in education (PISA 2012)



Note: Latin America (“LA” in the figure) comprises Argentina, Brazil, Chile, Colombia, Costa Rica, Mexico, Peru and Uruguay. “Others” comprise non-OECD and non-Latin American economies. The percentage change in mathematics performance explained by the economic, social and cultural status of students and schools is obtained from a student-level regression where the explanatory variables are the economic, social and cultural status of the student and that of the school.

Source: OECD/CAF/ECLAC (2014).

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Peru also has large differences in educational performance, closely linked to different socioeconomic factors. According to the 2012 PISA results, students from the richest 25% households outperform those in the poorest 25% by the equivalent of around 2.5 years of secondary schooling. While the richest 25% show similar performance to an equivalent student in LAC, the poorest 25% perform well below an equivalent student in LAC (OECD/CAF/ECLAC, 2014). Around 36% of Peru’s variation in performance between students is explained by the economic, social and cultural status (ESCS) of the students and the school, this being the highest percentage among Latin American countries participating in PISA (Figure 2.18). The ESCS largely explains the performance gaps between public and private schools. When the ESCS of students and schools is taken into account, students from private schools in Peru barely outperform those from public schools (OECD/CAF/ECLAC, 2014). School resources are another source of inequality. The correlation between a student’s socio-economic status and the educational resources of his or her school is much stronger in Latin America than in the OECD, and this is particularly true for Peru, where the correlation (0.36) is the highest among the Latin American countries participating in PISA. In terms of gender, boys outperform girls by the equivalent of five and a half months of schooling (OECD/CAF/ECLAC, 2014). Cultural and linguistic diversity also has an impact. According to PISA 2012 scores, Peru has a mathematics performance gap equivalent to more than two years of schooling, between students who report speaking Spanish at home and students who report speaking Quechua (OECD/CAF/ECLAC, 2014).

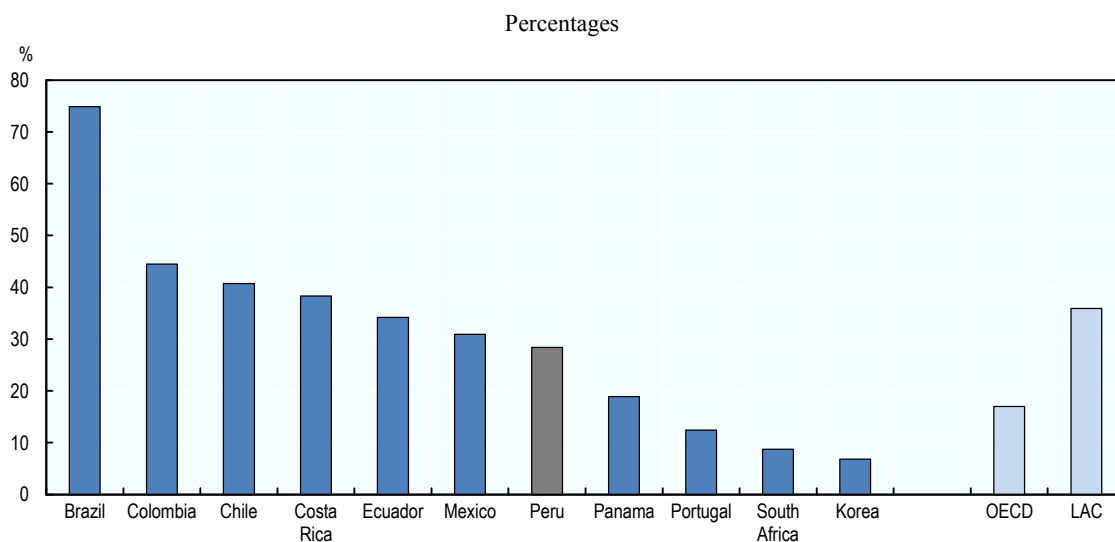
Skills are another challenge to inclusive growth in Peru

Skills are a key dimension for promoting long-term inclusive growth. Skills are defined by the OECD as “the bundle of knowledge, attributes and capacities that can be learned and that enable individuals to successfully and consistently perform an activity or task and can be built upon and extended through learning” (OECD, 2012b). That is why skills matter, as they are directly related to productivity and to the capacity of a country to compete in a knowledge-based economy. Skills also drive economic dynamism; they increase the ability to innovate and to reap the benefits of technological progress, favouring participation in higher segments of the value chain. Finally, skills are also crucial from the perspective of socio-economic inclusion, as more and better skills favour the employability of individuals, while increasing their own job satisfaction.


Skills shortages can be a barrier to growth

In Peru, businesses are experiencing difficulties in finding the skills they need. About 28% of firms report they cannot find workers with the right skills. While this value is lower than the LAC region average (36%), it is well above the OECD average (17%) (World Bank, 2015b; Figure 2.19). Firms in the textile sector face greatest difficulties (one in three firms have trouble finding the skills they need), followed by the food sector (one in four) and the chemical sector (one in five) (World Bank, 2015b). Other surveys paint a more dismal picture; according to a 2014 Manpower survey, for example, approximately two out of three firms (67%) reported they could not find the skills they needed, making Peru a worse performer than Brazil and Argentina (63%), Panama (58%), Colombia (57%) and Mexico (44%) (Manpower, 2014). Around half of large firms reported difficulties hiring skilled workers, according to a sample of large firms whose revenues represented around 30% of Peru’s GDP (Apoyo Consultoria, 2013).

Figure 2.19. Firms identifying an inadequately educated workforce as a major constraint to their growth, 2010 or latest year available



Source: World Bank (2015b), *Enterprise Surveys*, World Bank Group, www.enterprisesurveys.org/data, accessed on May 2015.

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Skills mismatches are larger in middle-income economies like Peru than in low-income and OECD economies, suggesting that skills-related challenges are an important dimension of the middle-income trap (see Chapter 1). This phenomenon possibly stems from the transition in the production system of these countries towards sectors and tasks that demand more and better skills, while low quality education and training systems are holding back supply (OECD/ CAF/ECLAC, 2014).

These skill gaps represent a barrier to growth and labour participation and can lead to a situation in which jobs and economic activity become concentrated in low-skilled sectors. If firms cannot find the workforce they need, and fail to train their staff, they may either continue to operate at sub-optimal levels of productivity, or they may gradually adapt their investment decisions to the existing supply of skills, discarding investment initiatives that would require more complex, higher-level skills. In either case, the impact of an inadequate pool of skills on economic growth and productivity can be large. From a supply side perspective, if skills are not valued by employers then workers' incentives to invest in them declines. The effect on economic dynamism and the employability of the population can be pervasive. All in all, these dynamics can lead to a “low-skills trap”, in which low skills deter economic activity while the scarcity of good jobs acts as a disincentive to skills formation.

In Peru, employment is concentrated in low and medium-skilled sectors, with only 18.6% of jobs requiring high skills and around 15% of the employed equipped with these (OECD/CAF/ECLAC, 2014). Although there are significant gaps between the demand and supply of skills in Peru, they have both been growing. Analysing the evolution of the demand and supply for skills in Peru is critical to better understanding their characteristics and the underlying forces behind the skills gaps.

The economy increasingly demands a broader set of skills

Demand in Peru is concentrated on generic skills, both cognitive skills and “soft”, or socio-emotional skills – such as responsibility at work, the ability to work in teams under pressure and in a changing environment, and the ability to react to and solve problems (World Bank, 2011). Employers perceive these generic skills, which provide the basis for workers to learn more specific, work-related skills, to be particularly scarce in the country (World Bank, 2011). The lack of technical skills, experience and soft skills mean that employers find it hard to fill available positions (Manpower, 2013). These skills are relevant in some of the professions more demanded in Peru, such as security staff, sales technical agents and telephonists (MTPE, 2015).

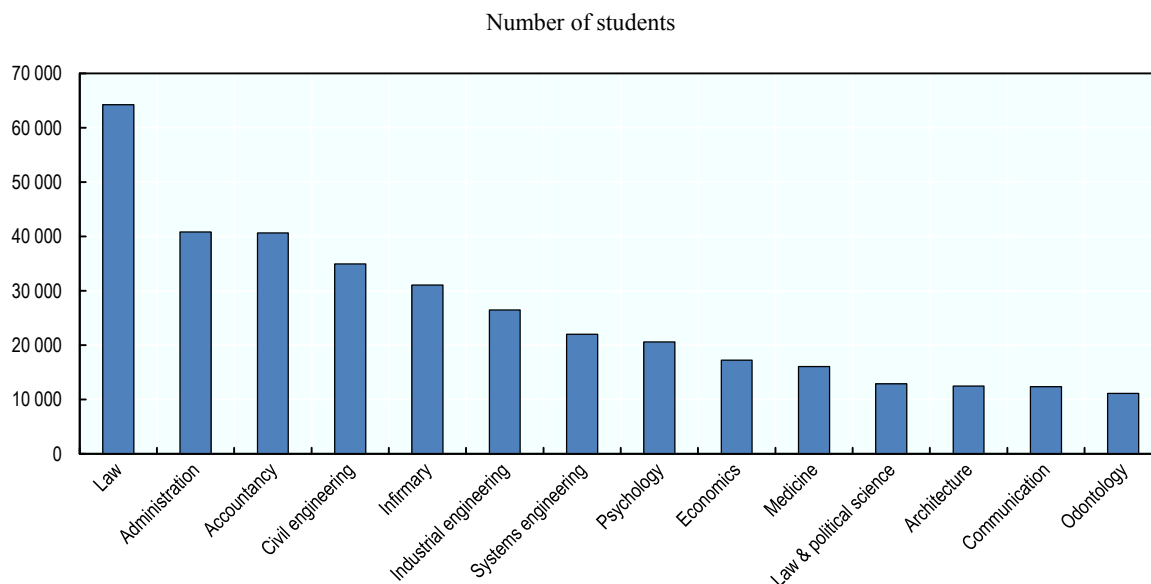
The demand for skills in Peru has been increasing, with more highly skilled jobs now being created, assuming that the evolution of employment by level of education is an indicator of the demand for skills. The demand for highly-skilled workers, i.e. those who have completed higher education (both university and non-university) increased by 52% between 2004 and 2013. Demand for workers with low and medium skills, i.e. primary and secondary education, only increased by around 6%.³

The education and training system is not providing the right skills


Peru's system for building skills is of low quality and poorly matched to the demands of the labour markets. Skills are built through a variety of channels, one of the most important being the education system. In general, the evidence coming from studies like PISA is that Latin American students' skills are poor; this is confirmed by the scarcity of skills that firms report. But the challenge goes beyond that: not only is the overall quality

of education poor, students do not focus on the subjects which employers demand. Fields like law, administration and accounting receive a large share of students (Figure 2.20), whereas labour markets in general demand more technical skills.

Figure 2.20. **Main university subjects studied in Peru, 2010**



Source: ANR (2012), Asamblea Nacional de Rectores, Datos Estadísticos Universitario, Dirección de Estadística.

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Technical and vocational education and training (TVET) is also not well regarded by society and has quality issues. TVET represents a powerful tool to train students in the type of skills that are directly applicable to jobs. A strong and dynamic TVET system is critical to improving the connection between the supply and demand of skills, and to support employability and productivity gains. Most of the TVET in Peru is offered by SENATI, a private institution created by industry to train workers in the skills it needs. However, the TVET system in Peru is of poor quality and is in many cases considered as inferior relative to university studies. Around 70% of students who finish secondary education and want to continue into higher education prefer to do so at university rather than within the TVET system. They consider university to be more complete and to offer a better quality education that is better connected to labour market demands (Alfageme and Guabloche, 2014; CAF, 2014). It is interesting to contrast this with the situation in emerging Asian economies. Here the opposite applies: TVET is much more valued by society and a much larger proportion of students follow that path, fuelling certain particularly dynamic sectors of the economy (Alfageme and Guabloche, 2014). One key recent effort to improve TVET in Peru is the PROJOVEN programme, which aims to provide professional training to young people aged 16-24. The importance of these issues is reflected in the OECD's Country Programme for Peru, which includes various reports on these themes: first, a vocational education and training review, focusing on the functioning of the VET system and on ways to improve it. Secondly, an "Investing in Youth" review, which will deal with issues related to the school-to-work transitions of youth and provide policy options to improve this. Finally, the Country Programme also includes an OECD Skills Strategy for Peru, which will provide a comprehensive assessment of the main skills challenges and needs in the country (Box 2.1).

Box 2.1. **Better skills for better economic and social outcomes: Towards a skills strategy for Peru**

Skills transform lives and drive economies. Effective skill development, activation and use are central to future economic and social development.

Peru's education system performs poorly, as illustrated by the PISA results, among other things. While this is just one of the explanatory factors of skills levels in a country, evidence from the demand side confirms that the skills developed are not relevant and do not match the demands of the production sector.

Investing in skills is one of the main policy strategies for pursuing development and economic growth. In a globalised and increasingly knowledge-based economy, the capacity of countries to compete is becoming more dependent on their ability to innovate and reap the benefits of technological progress, to add value to their goods and services, or to integrate their productive sector into higher segments of global value chains, among others.

In this context, the OECD is working with different countries to develop and implement skills strategies, which aim to provide countries with a strategic approach for building, maintaining and using their human capital to boost employment and economic growth, and promote social inclusion and participation.

The OECD works collaboratively with countries to develop a strategic assessment tailored to each country's specific skills challenges and needs. In particular, the Country Programme for Peru includes a skills strategy. The OECD Skills Strategy provides an overall framework for this work, focusing on: 1) developing relevant skills; 2) activating skills supply; 3) using skills effectively; and 4) strengthening the skills system.

Given the horizontal nature of skills challenges, a national skills strategy project needs to be designed together with all relevant government authorities and stakeholders. This means taking a whole-of-government approach, with dialogue and collaboration across ministerial portfolios, and engaging stakeholders to build a national consensus and commitment to action.

Source: OECD (2012b), *Better Skills, Better Jobs, Better Lives: A Strategic Approach to Skills Policies*, OECD Publishing, Paris, <http://dx.doi.org/10.1787/9789264177338-en>.

Inequalities persist in the labour market

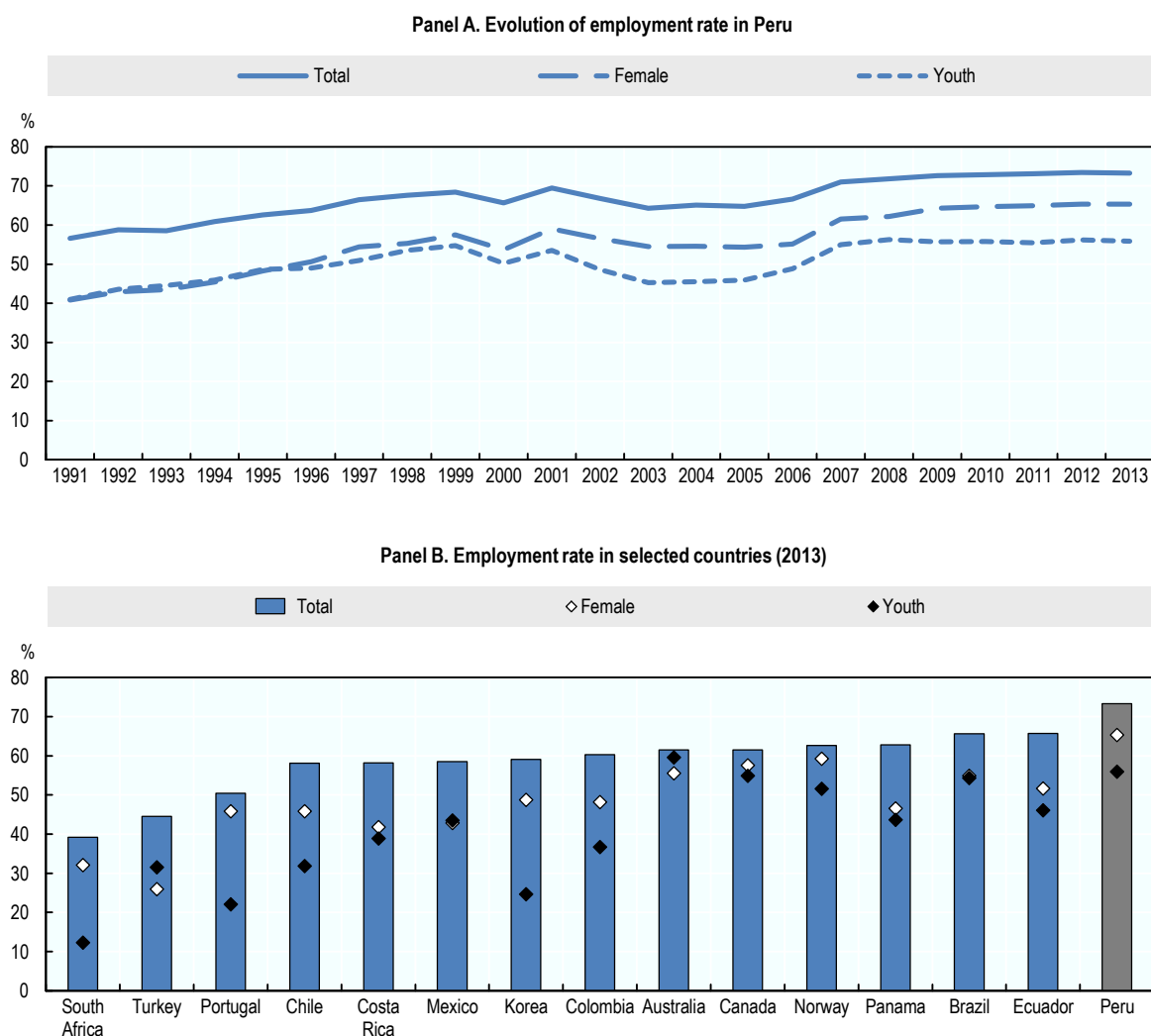
Challenges remain also in the labour market. Many in the workforce still have low wages and rates of informal employment remain among the highest in the region. Inequalities persist between those with high and low levels of education as well as among geographical regions.

A well-functioning labour market is characterised by its ability to allocate jobs to those in search of work that match their skills. It pays workers a decent wage that is appropriate for their skills, protects them from social risks and ensures they can be re-employed without wage loss after spells of inactivity. Peru faces several challenges in improving the functioning of its labour market: a high share of informal work, poor job quality, lack of a comprehensive labour policy and weak law enforcement, and inefficient policies to reduce labour costs and provide both firms and workers with incentives to enter the formal sector. This section describes Peru's recent progress, and then reviews and evaluates these remaining challenges.


Recent progress in increasing labour-force participation has been remarkable

Labour-force participation has grown remarkably in Peru, with 12 million additional individuals joining the labour force between 1991 and 2013. The employment rate as a share of the population has increased from 56.6% to 73.3% (Figure 2.21). This increase was mainly driven by the rise in female labour-force participation and, to some extent, by the increase in youth employment. In 2013, Peru had the highest employment-to-population rate and the highest female employment rate among the benchmark countries.

Figure 2.21. **Employment trends in Peru and in comparison to benchmark countries**
(employment-to-population ratio)

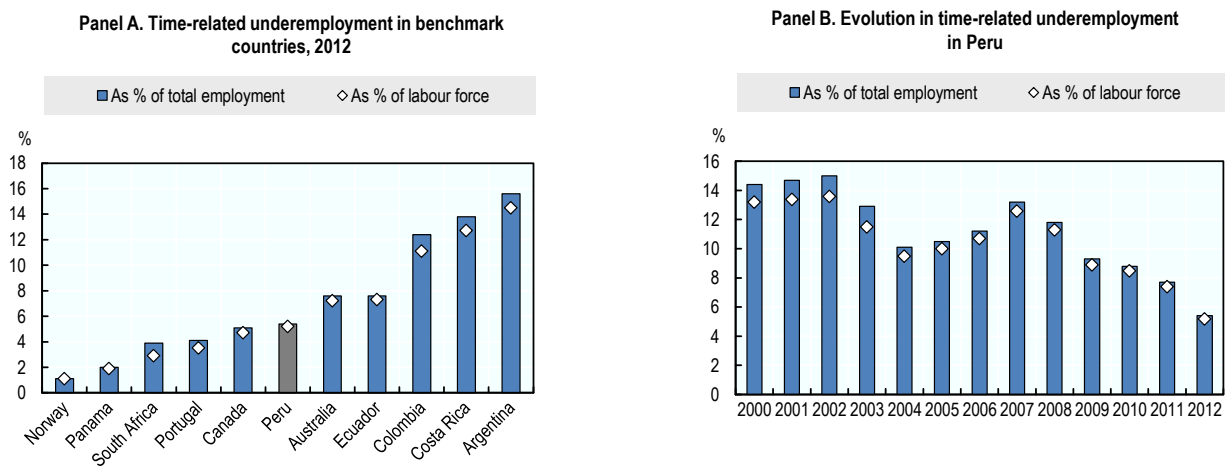


Source: ILO (2014), Key Indicators of the Labour Market, 8th Edition, International Labour Office, Geneva.


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There has also been an improvement in time-related underemployment, which refers to the share of employed people who would like to work additional hours, and reflects the underutilisation of productive labour. Time-related underemployment declined in Peru from the early 2000s to 2012, with a short-lived increase in 2007. Despite this progress, in 2012 around 6% of working Peruvians were underemployed, which was higher than in other Latin American countries including Ecuador, Colombia, Costa Rica and Argentina (Figure 2.22).

Figure 2.22. Time-related underemployment in Peru and in comparison to benchmark countries



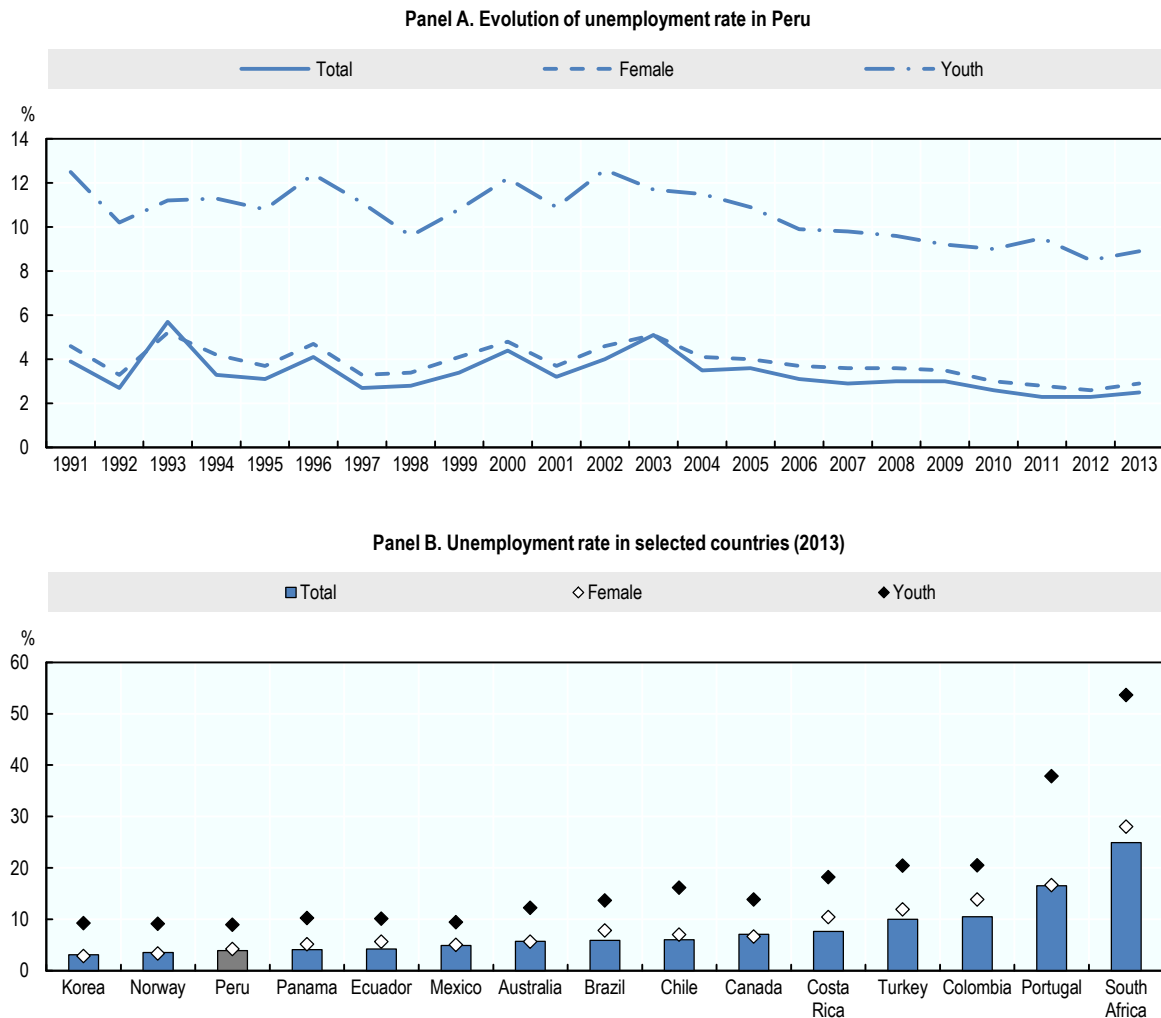
Source: ILO (2014), *Key Indicators of the Labour Market*, 8th Edition, International Labour Office, Geneva.

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Peru's high employment rates are accompanied by low unemployment rates. At 3.9% they are among the lowest in the region as well as among the benchmark countries. After a period of fluctuation in the 1990s, the unemployment rate steadily declined between 2004 and 2013. Male and female unemployment trends have been similar, with slightly more women than men unemployed. At around 10%, youth unemployment has been approximately three times the total unemployment rate since 1990s (Figure 2.23) but is well below levels observed in most benchmark countries.

Peru's low unemployment rate reflects the fact that many individuals cannot afford to be jobless, rather than the efficiency of the labour market in allocating individuals to jobs. Because of the lack of a universal unemployment insurance system, many Peruvians are forced to accept the first job they are offered, which often prevents them from searching for a job in which they would be more productive and could earn higher wages. This is reflected by a very low incidence of long-term unemployment. The 2012 data show that, on average, an individual was unemployed for just 0.77 months in Peru, remarkably low compared with, for example, Brazil's average of 11.5 months or Australia's 9.3 months (Figure 2.24). Time spent unemployed varies with age, education and urbanisation. Prime-age workers (those aged 25 to 54 years old), older workers, those with high education and urban workers take longer to find a job when unemployed, but even for these groups' average unemployment duration is remarkably short compared to other countries. Many of the younger or lower-educated workers in Peru, and those in rural areas who do not have access to social security systems to support them during their job search, are more likely to take the first job available to them.

Figure 2.23. Unemployment trends in Peru and in comparison to benchmark countries



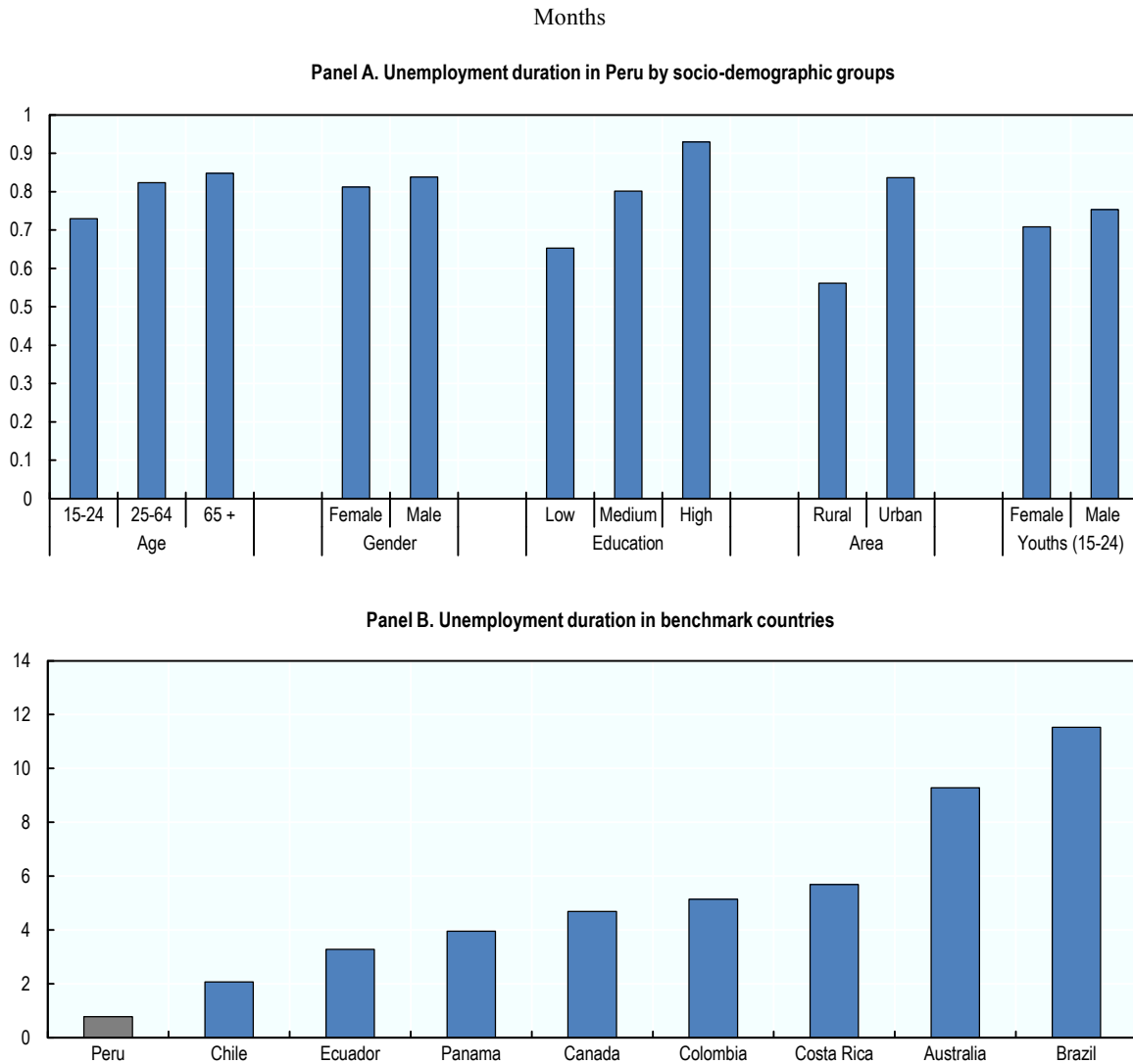
Source: ILO (2014), *Key Indicators of the Labour Market*, 8th Edition, International Labour Office, Geneva.

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Peru's job loss rate is also generally low, although it is high for those in the informal employment. The overall size of the labour market and aggregate employment status are determined by the flows of workers moving from one status to another. Therefore it is crucial to analyse the labour market from a dynamic perspective. The degree of mobility between employment and joblessness effectively translates into income risk and entitlement to social assistance programmes. Figure 2.25 shows the probability of job losses among formal and informal workers from one year to another, calculated from 2009 and 2010 figures. It defines five states individuals can move into or out of: formal

work, informal work, self-employment, unemployment and being out of the labour force. It shows that the probability of moving from formal employment to unemployment or out of the labour force is low in Peru. Only 3% of formal workers become unemployed and another 3% move out of the labour force each year. These figures are in direct contrast to countries like Turkey and South Africa, where job loss rates among formal workers are much higher. Informal workers overall are more likely to become jobless than formal workers. Yet Peru still has the lowest rate of transition from informal work to joblessness among the seven countries for which data are available.

Figure 2.24. Unemployment duration among socio-demographic groups and among benchmark countries, 2012



Sources: CEDLAS and World Bank (2014), *Socio-Economic Database for Latin America and the Caribbean (SEDLAC)* (database) for Latin American countries, <http://sedlac.econo.unlp.edu.ar/eng/index.php> and OECD unemployment statistics for Australia and Canada, http://stats.oecd.org/Index.aspx?DataSetCode=AVD_DUR.


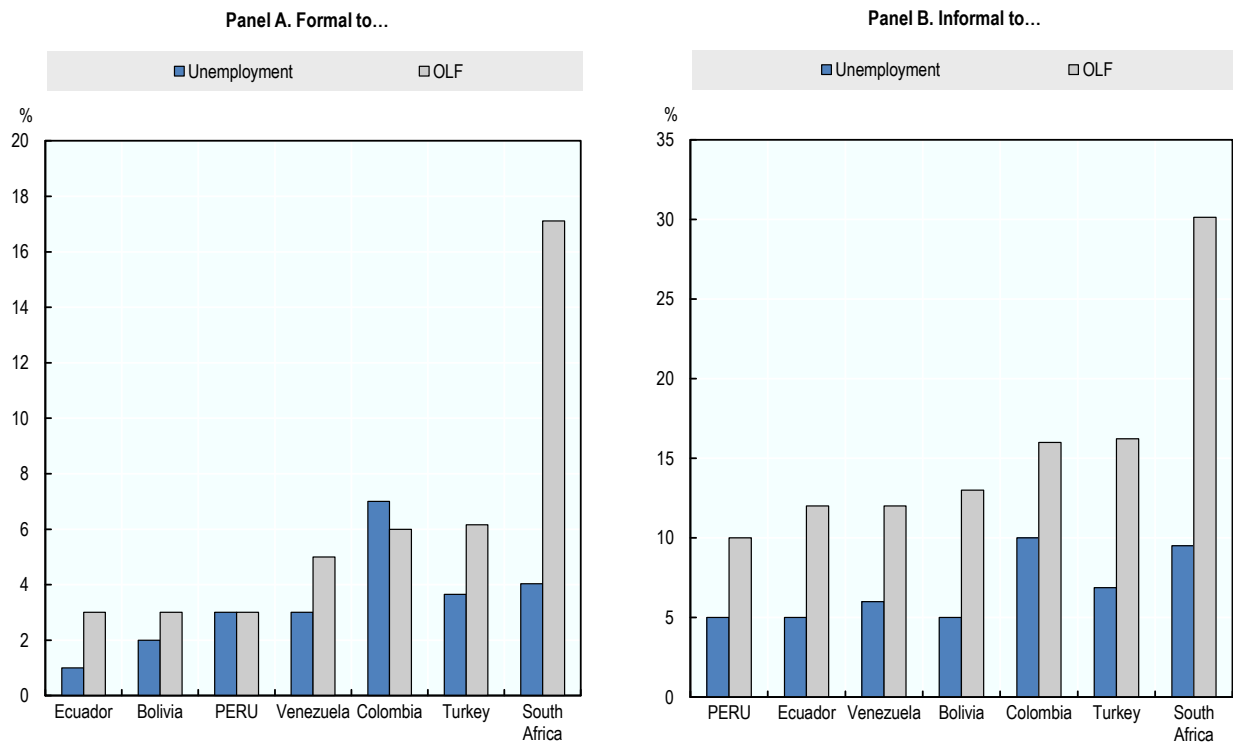

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Figure 2.25. Job mobility trends in Peru and benchmark countries, 2009-10

 $(t-1$ and $t)$ 

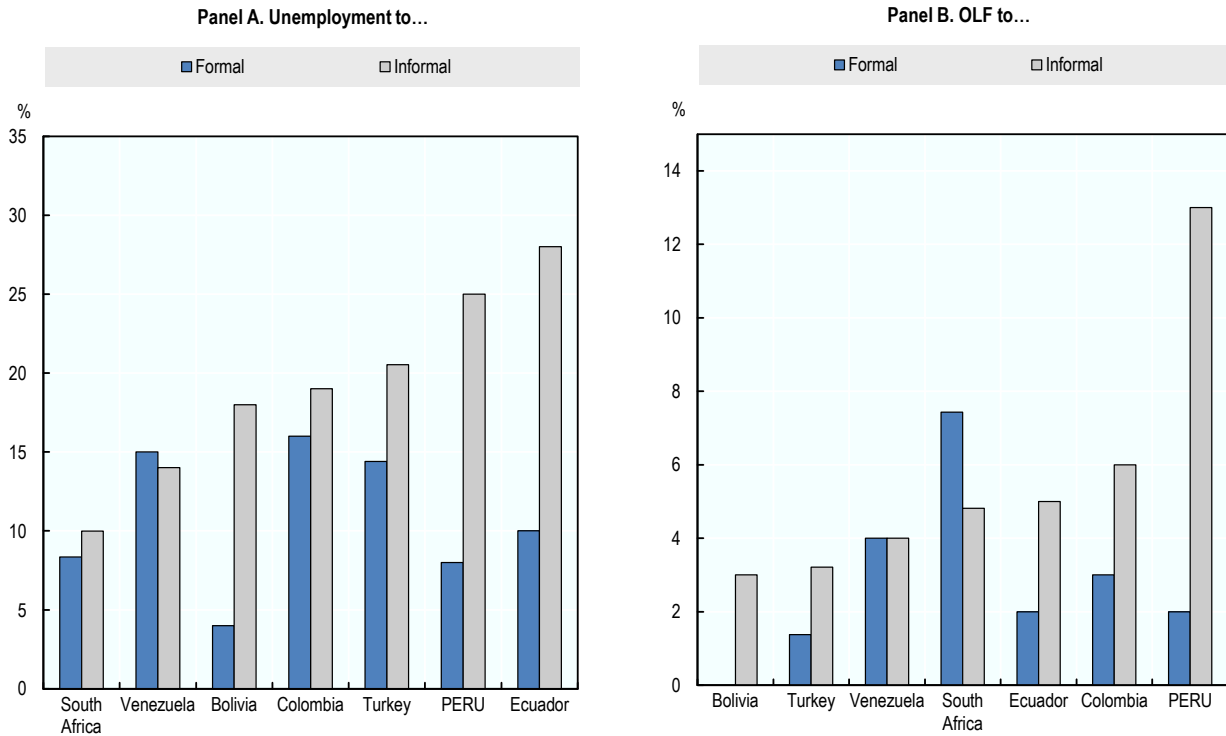
Note: For South Africa transition rates are between t and $t-2$. OLF (out of labour force) refers to working age population who are neither employed nor unemployed.

Source: OECD calculations based on Goñi Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, D.C and OECD (2015c), “Enhancing job quality in emerging economies”, in *OECD Employment Outlook 2015*, OECD Publishing, Paris.

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Job-finding rates are high in Peru although individuals are more likely to enter the labour market through informal jobs than formal ones. For those outside the labour force it is not easy to get straight into the formal sector and many individuals find it easier to get an informal job first. As in many developing countries, social assistance to jobless individuals is limited so most people accept the first job offer, even if it is of poorer quality and in the informal sector. Figure 2.26 shows job-finding rates over two consecutive years for the unemployed and for those who are out of the labour market. In general, it is more common for the unemployed to find a job in the informal sector in all countries except for Venezuela. Ecuador, followed by Peru, has the highest rates of transition from unemployment to informal jobs, whereas Bolivia, followed by Peru, has the lowest transition rate from unemployment to formal jobs. Among individuals who are out of the labour force, Peru has by far the highest transition rates to the informal employment. The probability of entering into formal jobs is lower than the probability of entering informal jobs in all countries except South Africa and Venezuela.

Figure 2.26. Job-finding rates in benchmark countries, 2009-10
($t-1$ and t)



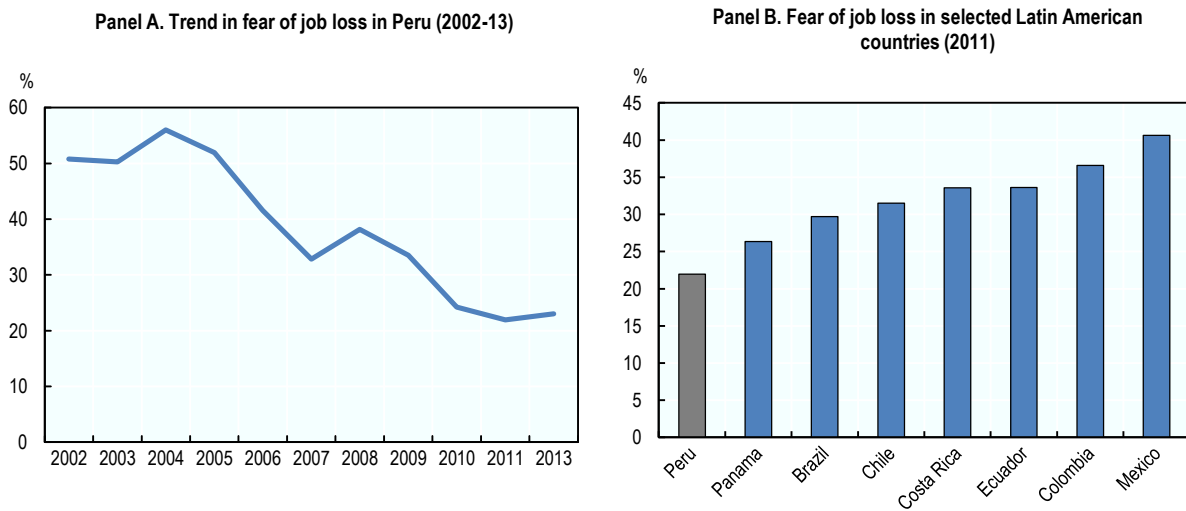
Note: For South Africa transition rates are between t and $t-2$. OLF (out of labour force) refers to working age population who are neither employed nor unemployed.

Source: OECD calculations based on Goñi Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, D.C and OECD (2015c), “Enhancing job quality in emerging economies”, in *OECD Employment Outlook 2015*, OECD Publishing, Paris.

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Subjective job insecurity is also low in Peru. Figure 2.27 presents the percentage of workers who report being very concerned that they will be left without work in the next 12 months. Panel A shows that fear of job loss in Peru fell remarkably between 2004 – when it reached to the highest point in the last 10 years – and 2013. Only 23% of Peruvian workers in 2013 feared they could be left without work. This reflects the country’s relatively low job-loss rate and high job-finding rates. In other Latin American countries the share of workers reporting subjective job insecurity in 2011 was 40% in Mexico, 37% in Colombia and 34% in Ecuador and Costa Rica – all levels much higher than Peru.⁴

Figure 2.27. Subjective job insecurity in Peru and in the region



Note: Data for “fear of job loss” show the percentage of people responding “very concerned” to the question “How concerned would you say you are that you will be left without work within the next 12 months? Very concerned, concerned, a little concerned or not at all concerned?”

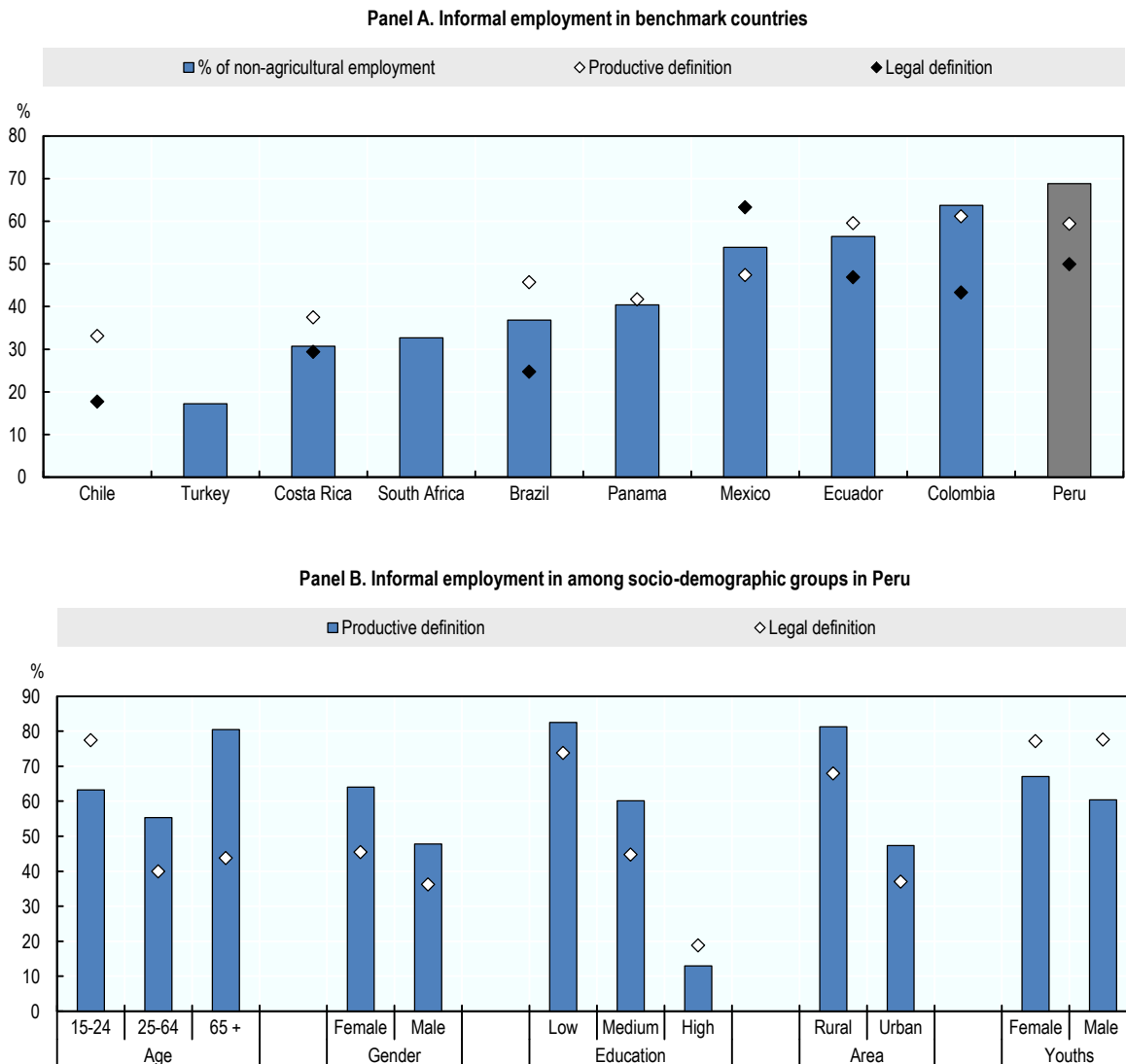
Source: Latinobarometro (2013), “Datos 2013”, Banco de Datos (dataset), www.latinobarometro.org.

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Informal employment in Peru remains high


The high employment rate outlined above is largely explained by the high proportion of people in informal work (Figure 2.28, Panel A). There is a large informal labour market in Peru, and access to formal employment is unequal. There are a number of international definitions for informality, and depending on the definition, between half and two-thirds of individuals are employed informally. According to the legal definition of CEDLAS and World Bank (i.e. informal worker is one who does not have the right to a pension when retired) 49.9% of workers in Peru were in informal work in 2011, the latest year for which we have comparable data for our benchmark countries. When using the “productive” definition (i.e. an employee in a firm with five or fewer employees, a non-professional self-employed, or a zero-income worker) 59.4% of workers fell into the informal category in 2012. International Labour Organization’s (ILO) non-agricultural informal employment rate for Peru, 68.8% in 2012, was the highest share in all the benchmark countries. Using the legal definition, only Mexico has a greater share of informal employment, while Colombia has slightly higher informality rates according to the productive definition.

Figure 2.28. Informal employment in benchmark countries and among socio-demographic groups in Peru



Note: Non-agricultural employment rate are based on 2013 data for Brazil, Colombia, Costa Rica, Mexico, Panama, Peru and Turkey; 2010 data for South Africa and Ecuador. No data available for Chile in that indicator. Productive and legal definitions are based on 2011-2012 data.

Source: CEDLAS and World Bank (2014), *Socio-Economic Database for Latin America and the Caribbean (SEDLAC)* (database) for legal and productive definitions, <http://sedlac.econo.unlp.edu.ar/eng/index.php> and ILO (2014), *Key Indicators of the Labour Market*, 8th Edition, International Labour Office, Geneva for non-agricultural definition.

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There are also remarkable differences across socio-demographic groups with respect to access to formal employment. Taking the productive definition first, informality is higher among young and older workers, women, the less educated and those working in rural areas. Informality reaches 80% among workers over 65 years, the less educated and rural workers, whereas it is only 13% among highly educated workers. These inequalities also hold when using the legal definition of informality. The only difference in the pattern relates to the older workers. The shares of prime-age and older workers who do not have

right to a pension when retired are similar, at 40% and 43.8% respectively. By this measure, 77% of Peru's young people are in informal work (Figure 2.28, Panel B).

There are also significant regional discrepancies in access to formal jobs. The sharpest contrast is between Metropolitan Lima and the rest of the country: 53.7% of employment was informal in Metropolitan Lima in 2013, compared with 84.1% for the rest of Peru (INEI, 2014a; Table 2.1).⁵ A similar contrast persists between urban and rural employment, where informal jobs represent 66.5% and 95.4% of the total respectively. Similarly, the Costa regions have the lowest incidence of informal employment: 65.1% compared with 83.4% in the Sierra regions and 84.6% in the *Selva* regions. Similar regional disparities can be observed in levels of labour productivity (Chapter 5).

While there has been a remarkable reduction in informal employment in the Lima Metropolitan region, other urban areas and in the Costa regions, the decline in informality in the more disadvantaged, areas has been modest, increasing further the gap across regions. For example between 2008 and 2013 informality decreased by 7.8% in urban areas (from 72.1% to 66.5%), whereas in rural areas there was only a 1.2% decline (from 96.5% to 95.4%, Table 2.1).

Table 2.1. **Informal employment trends in Peru's regions, 2008-13**

	Percentages						
	2008	2009	2010	2011	2012	2013	% change
National	79.1	77.2	77.1	75.0	74.3	73.7	-6.84
Lima Metropolitan	60.4	56.8	58.0	54.3	54.6	53.7	-11.04
Rest of the country	88.6	87.4	86.8	85.7	84.6	84.1	-5.07
Urban	72.1	69.6	69.9	67.4	66.8	66.5	-7.82
Rural	96.5	96.3	96.1	96.1	95.9	95.4	-1.17
Costa	71.8	69.1	69.5	66.4	65.8	65.1	-9.31
Sierra	87.2	86.1	85.6	84.5	84.2	83.4	-4.33
Selva	87.6	87.2	86.6	86.2	84.7	84.6	-3.39

Source: INEI (2014a), *Producción y Empleo Informal en el Perú: Cuenta Satélite de la Economía Informal 2007 – 2012*, INEI, Lima, Peru.

To sum up, there are significant discrepancies in access to formal employment in Peru, especially for younger workers, women, those with low education and workers from rural areas. The next section discusses the structural barriers to formal employment and whether these discrepancies are permanent, analysing transitions between the formal and the informal employment.

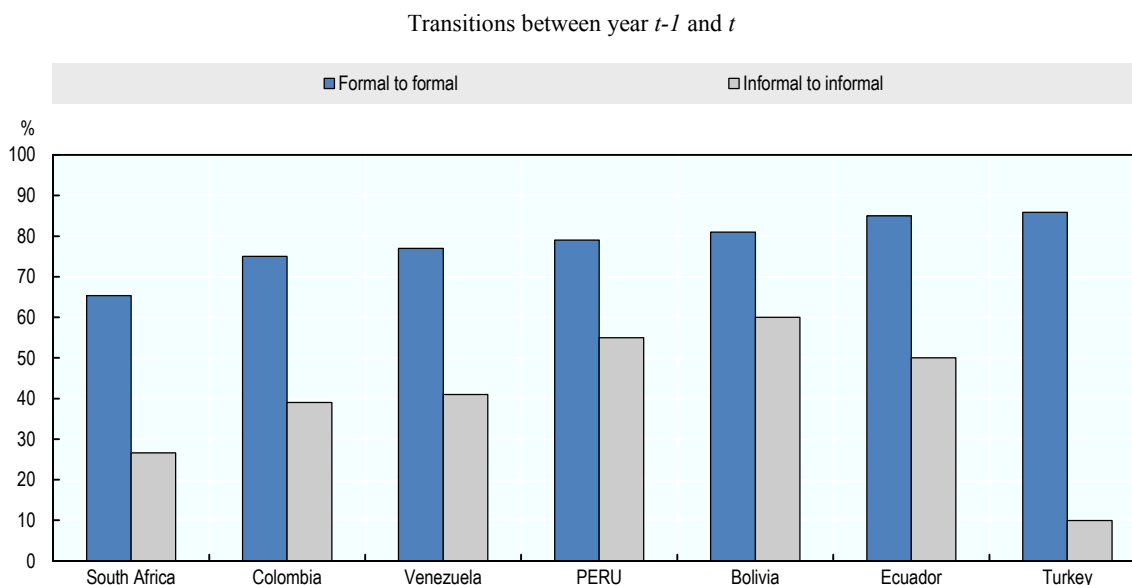
Moving into formal employment is not easy for all groups

Looking at rates of informal employment is useful to assess differences in levels of formality and informality across countries and across socio-demographic groups. However, it is also important to consider the persistence of employment in the two types of employment as well as transitions between them in order to examine the inequalities in the labour market. High persistence in formal and informal employment signals a high degree of segmentation in the labour market. While those with formal jobs benefit from better pay and social protection, those in informal employment remain on the periphery with poorer quality jobs. On the other hand, frequent transitions between formal and

informal jobs hamper skills development and the accumulation of rights and benefits, such as severance pay and retirement benefits. This section looks at year-to-year transition rates between the two forms of employment.


There is a relatively large degree of segmentation in the Peruvian labour market, with limited mobility between formal and informal employment. Looking at the employment status of individuals over two consecutive years, we see that a large degree of persistence in formal employment characterises all the selected benchmark countries (Figure 2.29). In all countries shown in Figure 2.29, between 65% and 86% of workers were in formal employment for both 2009 and 2010, with Peru placed in the middle at 79%. Persistence in informal employment, however, is less widespread, with more cross-country variation. In Turkey, only 10% of workers were informally employed two years in a row, while in Bolivia and Peru more than half of those with informal jobs were still in informal employment a year later. This comparison supports the view that the degree of segmentation in the Peruvian labour market is relatively large.

Figure 2.29. Persistence in formal and informal employment in benchmark countries, 2009-10



Note: For South Africa transition rates are between t and $t-2$. OLF (out of labour force) refers to working age population who are neither employed nor unemployed.

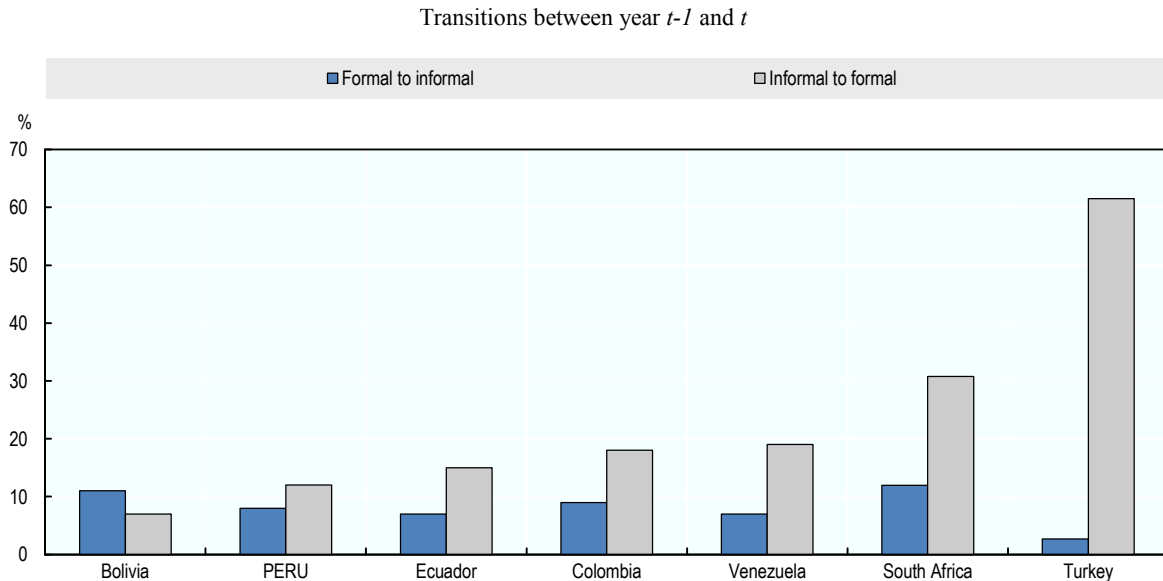
Source: OECD calculations based on Goni Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, D.C and OECD (2015c), “Enhancing job quality in emerging economies”, in *OECD Employment Outlook 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2015-en.

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The other side of the coin is the flow of workers between the two types of employment: these also point to segmentation in the Peruvian labour market. Figure 2.30 shows that it is quite unlikely for people with formal jobs to move back to informal ones. With 8% of formal workers shifting to informal employment, Peru is placed right in the middle of the range among benchmark countries. The share of informal workers moving to formal jobs in one year is larger than the share of those moving from formal to informal employment in all countries except for Bolivia. The formalisation rate is particularly high in Turkey, with 62% of informal workers finding a formal job the


following year. Conversely, the formalisation rate in Peru is 12%, the second lowest after Bolivia. This signals a duality in the Peruvian labour market. Low transition rates from formal to informal employment suggest that only a small proportion of workers are at risk of interrupting their skill development and accumulation of right to benefits when they have a formal job. However, high persistence in both formal and informal employment, low rates of transition from informal to formal employment, and high informality in absolute terms indicates a substantial level of segmentation in the labour market in Peru.

Figure 2.30. Transition rates between formal and informal employment in benchmark countries, 2009-10



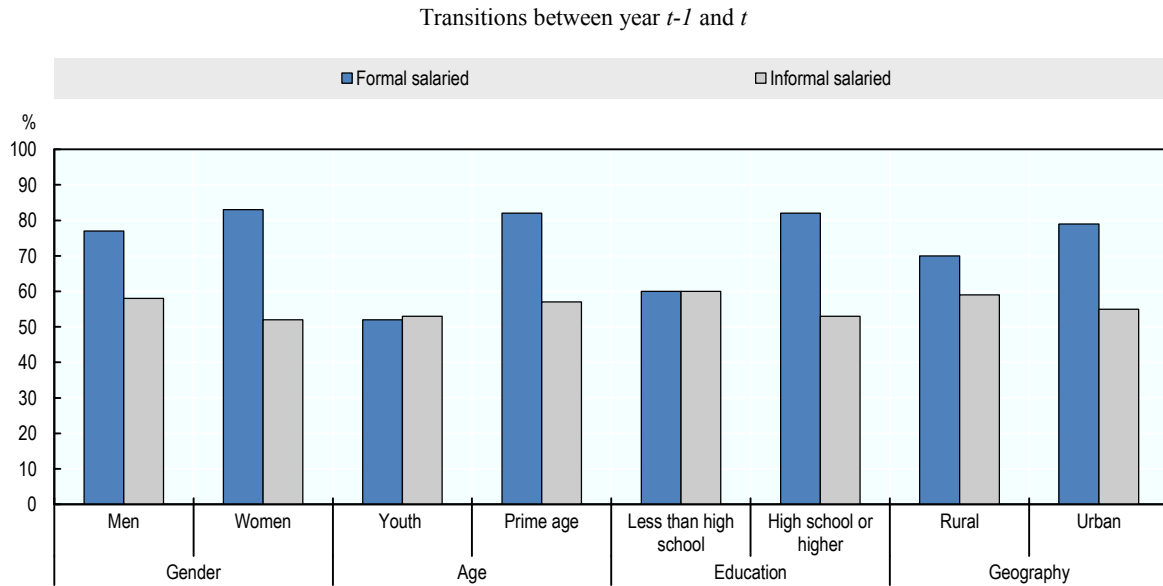
Note: For South Africa transition rates are between t and $t-2$. OLF (out of labour force) refers to working age population who are neither employed nor unemployed.

Source: OECD calculations based on Goñi Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, D.C and OECD (2015c), “Enhancing job quality in emerging economies”, in *OECD Employment Outlook 2015*, OECD Publishing, Paris, http://dx.doi.org/10.1787/empl_outlook-2015-en.

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Labour flow analysis by socio-demographic groups reveals notable differences in labour market mobility in Peru. Figure 2.31 shows very small difference across socio-demographic groups in persistence in informal work over two consecutive years. However, there are remarkable differences across groups in terms of persistence in formal employment. Women, prime-age workers, high-school graduates, and workers in firms with ten or more employees are more likely to stay in formal employment than other groups.

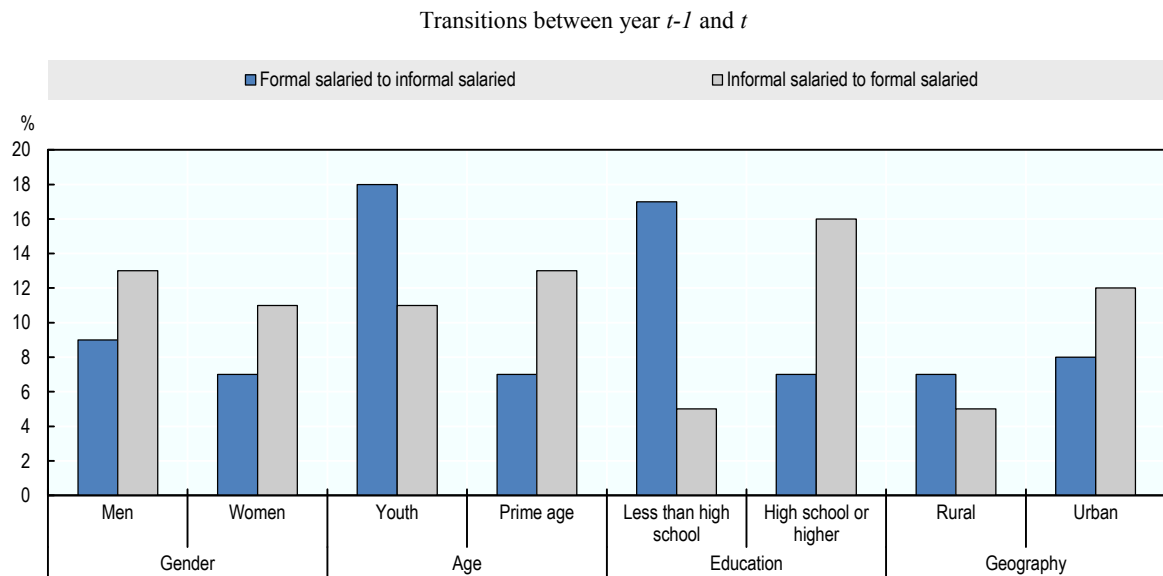
Figure 2.31. Persistence in formal and informal employment by socio-demographic group, 2009-10



Source: OECD calculations based on Goñi Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, D.C.

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Figure 2.32. Transition between formal and informal employment by socio-demographic group, 2009-10



Source: OECD calculations based on Goñi Pacchioni, A. (2013), *Andemic Informality: Assessing Labor Informality, Employment and Income Risk in the Andes*, Inter-American Development Bank, IDB, Washington, DC.

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The socio-demographic differences in transitions between formal and informal work are more concerning (Figure 2.32). Both men and women are more likely to move from informal to formal employment than from formal to informal employment, with little

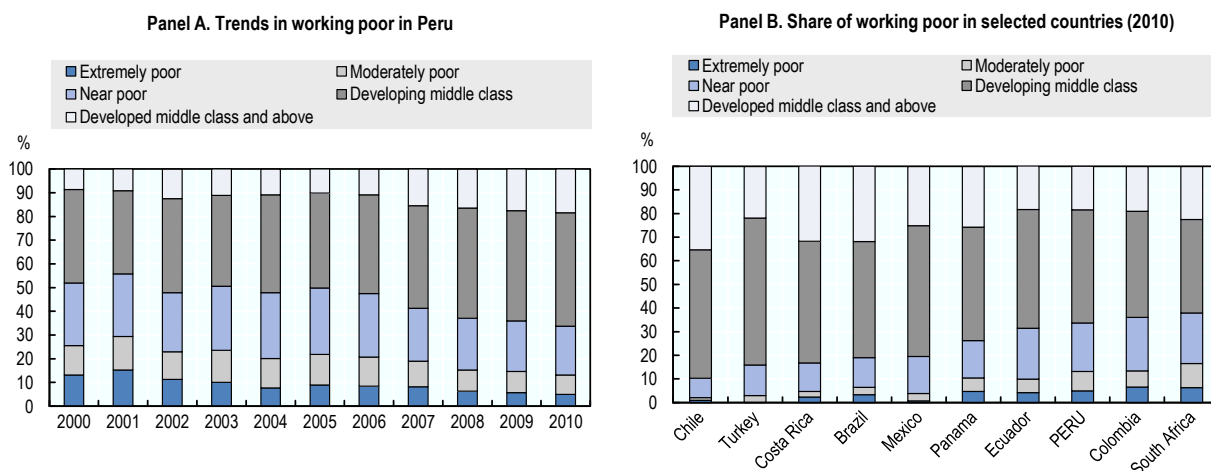
difference between their transition rates. However, for young workers between 16 and 25, for the low skilled and for rural workers, the probability of moving from formal to the informal jobs is greater than the probability of moving from informal to formal jobs. In contrast, prime-age workers, high-school graduates and urban workers are more likely to move into the formal sector than out of it. These figures reinforce the picture of higher incidence of informality among the same socio-demographic groups: young, low-skilled and urban workers face barriers to both accessing and remaining in formal employment.

Pay and work hours have improved in recent years

The material conditions of households in Peru depend heavily on workers' wages. The economic conditions of working individuals have improved substantially in the last ten years, with the share of workers who are extremely poor (i.e. those who live in households with less than USD 1.25 per day, PPP) falling from 13.1% to 5% between 2000 and 2010 (Figure 2.33). The share of workers in the middle class also grew over the same period. Nonetheless, one-third of employed individuals were still considered "poor" in 2010, with a daily income below USD 4 (PPP). This places Peru behind other Latin American countries such as Chile, Costa Rica, Brazil, Mexico, Panama, Ecuador and Turkey in terms of the share of workers who are 'poor' and only outperforming Colombia and South Africa.


Figure 2.33. **Employment and economic class**

Shares, in total employment



Note: Extremely poor: <USD 1.25, PPP; moderately poor: ≥USD 1.25 & <USD 2, PPP; near poor: ≥USD 2 and <USD 4, PPP; developing middle class: ≥USD 4 and <USD 13, PPP; developed middle class: ≥USD 13, PPP.

Source: ILO (2014), *Key Indicators of the Labour Market*, 8th Edition, International Labour Office, Geneva.

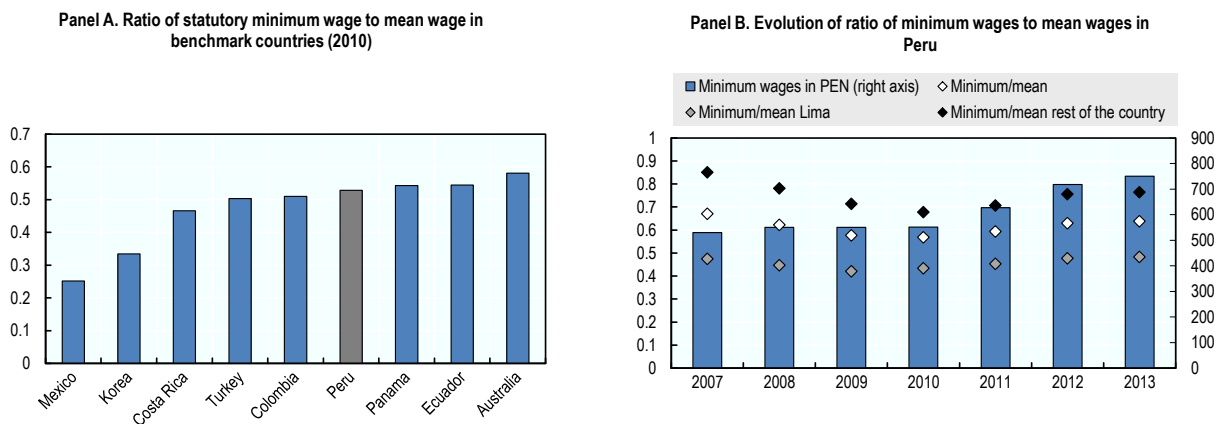
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The minimum wage in Peru has risen in the last five years, placing Peru among those countries with a relatively high minimum-to-mean wage ratio. In absolute terms, the minimum wage increased from PEN 500 (Peruvian soles, equivalent to USD 153) to PEN 750 (USD 269) between 2007 and 2013. Panel B of Figure 2.34 shows the ratio of the minimum wage to mean wage in Peru, in the Lima Metropolitan area, and in the rest of the country. Two periods can be distinguished. Minimum wage relative to mean wage


shrank steadily between 2007 and 2010, falling from 0.67 in 2007 to 0.57 in 2010. Following the recent rises in the minimum wage, this ratio increased to 0.63 by 2013. Similarly, the minimum wage was 41% of the mean wage in the Lima Metropolitan area in 2009 (the lowest level observed since 2007) but recovered to 48% in 2013. In 2007 the minimum wage was 85% of the mean wage in the regions outside the Lima area. This ratio steadily decreased until 2010 to a level of 68% and recovered partly in 2013 to 76%.

Empirical evidence suggests that when the minimum wage exceeds remuneration based on productivity levels, job creation in the formal sector can be hampered (Jaramillo, 2012; Céspedes, 2006). In order to ensure that minimum wage does not increase informality, further increases in minimum wage should be linked to improvements in labour productivity.

Figure 2.34. Minimum wages and the ratio of minimum wages to mean wages



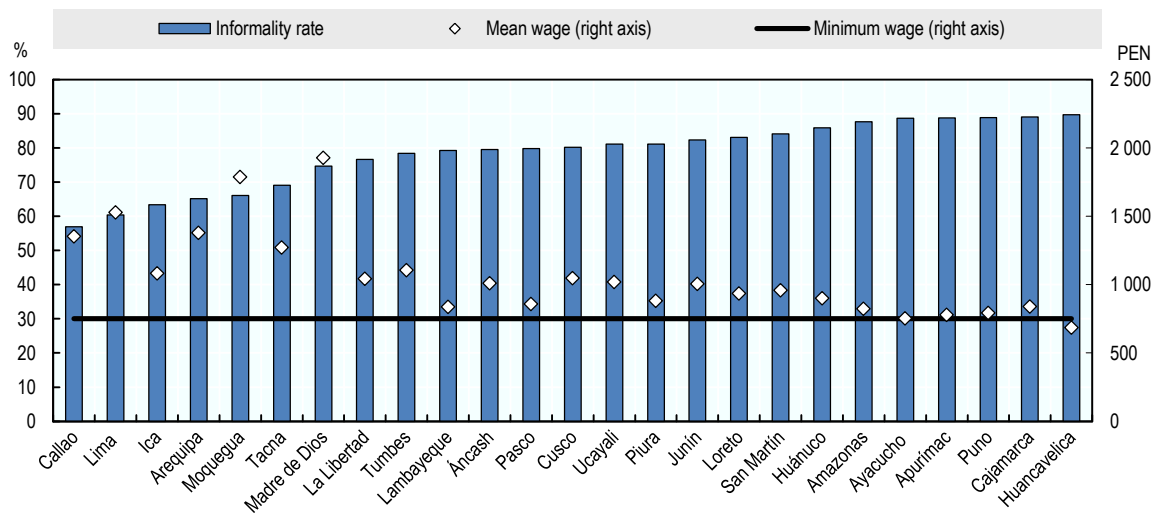
Source: ILO (2015), “Global Wage Report, Earnings and Employment Related Income” (database), International Labour Organisation, Geneva for benchmark countries, http://www.ilo.org/ilostat/GWR?_afLoop=1879138947117377&_adf.ctrl-state=vonxe8gvc_4 and “Evolución de los Indicadores de Empleo e Ingresos por Departamento”, 2004-2013, Instituto Nacional de Estadística e Información (INEI) for trends in Peru.

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Peru exhibits large and persistent territorial inequalities in wage levels. Data from the INEI show that average wages were the lowest in Huancavelica, Ayacucho, Apurímac and Puno, and the highest in Tacna, Callao, Arequipa, Lima provincial, Moquegua and Madre de Dios in 2013 (Figure 2.35). Wages in the highest region, Madre de Dios, are 2.8 times higher than Huancavelica and 1.6 times higher than the mean wage in the country. These ratios were 2.9 and 1.4 in 2007. Even though minimum wages (and their ratio to mean wage) improved between 2010 and 2013, regional differences in mean wages seem to be persistent. Again, the main determinants of these disparities are differences in labour productivity across geographical regions (Chapter 5).

Informal employment is strongly associated with lower wages; thus regions with high rates of informality are likely to experience lower average wages. This is borne out for Peru’s 25 administrative regions. The correlation between the share of informal employment and mean wages across regions is -0.75 (Figure 2.35). High informality depresses mean wages and thus decreases the mean-to-minimum-wage ratio.

Figure 2.35. Regional variations in informal work and wages, 2013



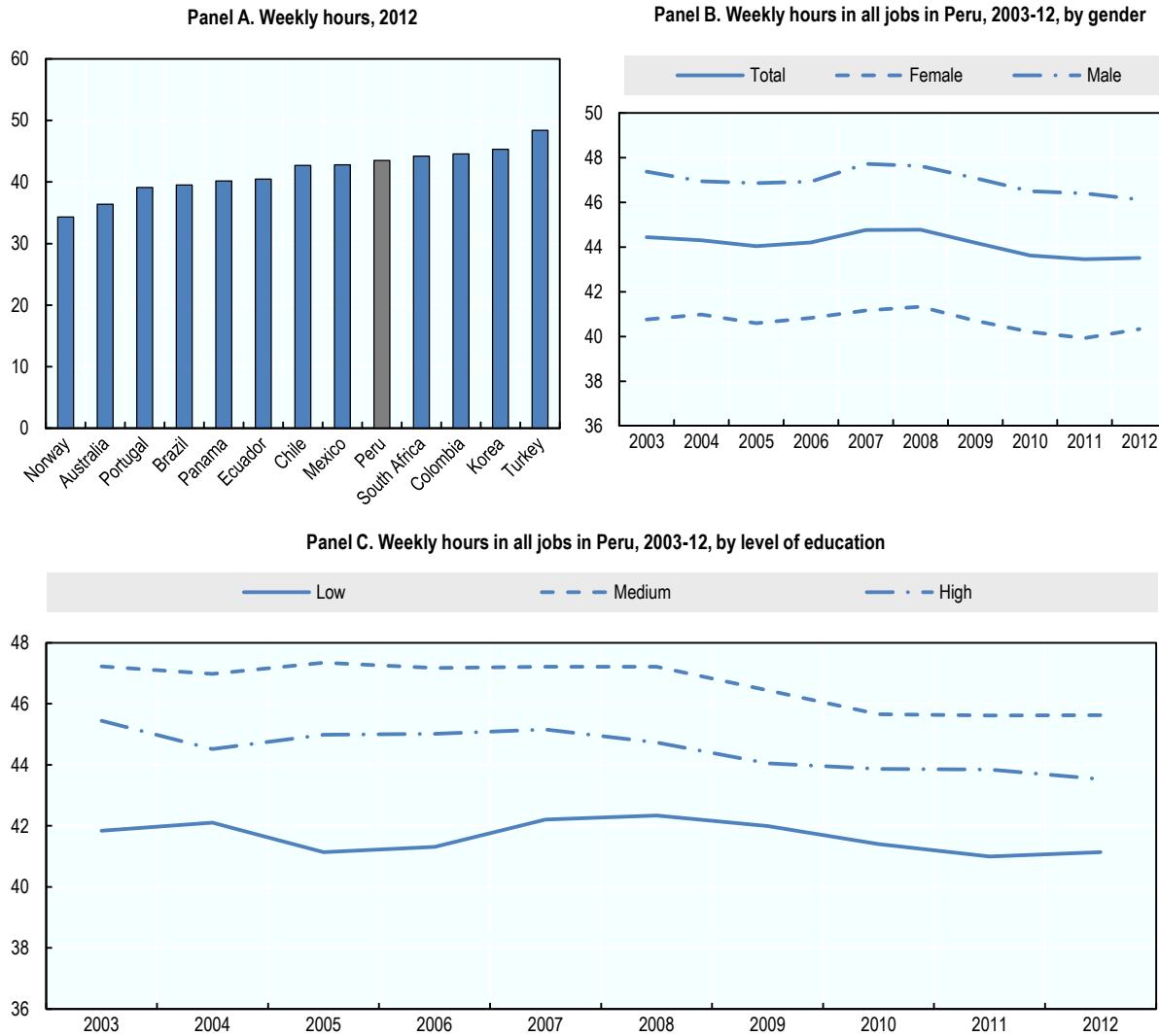
Source: INEI (2014b), *Perú: Evolución de los Indicadores de Empleo e Ingresos por Departamento, 2004-2013*, INEI (Instituto Nacional de Estadística e Informática), Lima, Peru.

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However, the wage gap between formal and informal jobs has narrowed in Peru. Between 2003 and 2012 the pay ratio of informal to formal workers moved in different directions among different Latin American countries. In Peru formal workers earned 2.4 times more than informal workers in 2003, but the ratio decreased to 1.9 by 2012. This was one of the strongest declines, together with Panama, recorded in Latin America. In the case of Peru, the relative convergence in pay was mainly driven by an increase in the hourly pay for informal workers rather than by declines in the wages of formal workers.⁶

Working hours not only determine total earnings but also have important implications for worker well-being. While time-related underemployment is undesirable as it lowers productivity, working very long hours is typically associated with poor health. Long working hours generally reflect the degree of (or lack of) enforcement of regulations concerning working conditions. Actual weekly work hours in Peru are relatively high, especially compared to OECD countries (Chapter 3). Working hours are also significantly longer than in some Latin American countries such as Brazil, Panama and Ecuador. However, Peru has experienced a decline in weekly hours since 2008 for both men and women and for workers with different levels of education (Figure 2.36).

Figure 2.36. Weekly working hours in benchmark countries and Peru



Source: OECD calculations based on CEDLAS and World Bank (2014), *Socio-Economic Database for Latin America and the Caribbean (SEDLAC)* (database) for Colombia, Ecuador, Panama and Peru, <http://sedlac.econo.unlp.edu.ar/eng/index.php> and OECD Labour Force Statistics (database), http://stats.oecd.org/Index.aspx?DataSetCode=AVE_HRS for Australia, Brazil, Chile, Korea, Mexico, Portugal and Turkey.

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Labour regulation remains complex and its enforcement poor

Peru is one of the countries in the world with the lowest level of compliance with labour regulations but it remains one of the most regulated labour markets even after a series of deregulatory reforms. Peru went through two rounds of “flexibilisation”, one in 1991/2 and the other in 1995/6, replacing its once highly regulated labour system. These reforms had, however, negative implications for working conditions and hiring procedures, as well as employment termination procedures. The rapid deregulation of the labour market shifted the balance heavily in favour of employers by eliminating many of the institutions responsible for granting collective bargaining power to workers (Chacaltana, 2003). This has had a negative impact on job quality for workers in small and medium-size enterprises. Furthermore, the 2008 Legislative Decree 1086

substantially weakened the terms and conditions of work in the majority of workplaces, lowering the amount of paid leave and wages for all workers in workplaces of 100 or fewer workers. Poor enforcement mechanisms by the Ministry of Labour and the Promotion of Employment, and little oversight by local authorities on SME's intensified the deterioration of worker rights and benefits.

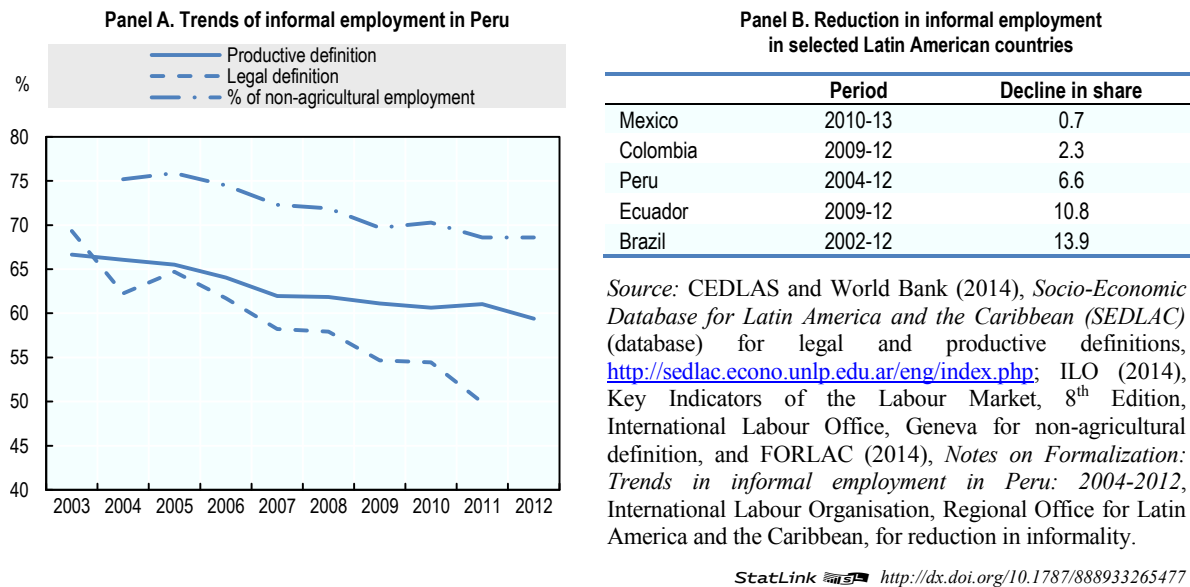
Peru has an elaborate but fragmented labour legislation. All labour contracts, in principle, are open ended. With either a verbal or written contract, a job is assumed to be of indefinite duration until there is mutual agreement on its termination. After a probationary period, employees are protected against arbitrary dismissal. However, Peruvian law specifies a number of conditions that permit employees to be contracted on a fixed-term or part-time basis, either directly by employers or through temporary work agencies. Regulations for fixed-term contracts distinguish between nine forms falling into three main groups: contracts with a temporary nature (beginning new activity, market needs and corporate restructuring), contracts with an accidental nature (occasional, replacement and emergency) and contracts for a specific work or service (for certain work or specific services, intermittent services and seasonal activities). In addition, a special labour regime regulates working conditions of employees in SME's. On the whole, there are nearly 40 different labour regulations applying to different types of work in Peru (India stands out as another country where employment is regulated by 45 distinct legislations). This fragmentation contributes to Peru's low compliance with labour regulations.

Efforts to reduce informality have yet to have much impact

Peru has made efforts to reduce informality, but there is ample room for improvement. Over the last few decades, the Peruvian state has implemented various programmes to create jobs, provide vocational training and encourage formalisation. These include *Construyendo Peru*, *ProEmpleo*, *Programa de Capacitación Laboral Juvenil* (PROJOVEN) and Red de Centros de Intermediación Laboral Pro-empleo (RedCIL ProEmpleo) for the creation of jobs, as well as *Mi empresa*, aimed at promoting new ventures, competitiveness and the formalisation and development of micro and small enterprises. However, most of these programmes have not had a major impact on workers' conditions and access to social benefits, or on formal employment. Only PROJOVEN made substantive improvements in training provision and in the conditions of young people in Peru (Toyama et al., 2009).

The extent of recent formalisation in Peru was dependent on two factors: the supervision and oversight capacity of the Labour Inspectorate, and the actions of the courts and labour chambers in resolving disputes. Thanks to the favourable economic climate, Peru achieved significant reductions in informality between 2004 and 2012 through initiatives undertaken by the Ministry of Labour (Figure 2.37). Before the implementation of the e-payroll in August 2007, employers with three or more workers had to send a report to the Ministry of Labour regarding their workers, previous workers receiving old-age benefits from the firm, service providers, personnel in training courses, and outsourced workers. With the new electronic system, firms now send these reports directly to the National Tax Authority. This reform has increased the capacity of the Ministry of Labour to monitor compliance with labour obligations (FORLAC, 2014). Another initiative, *Plan Reto* (Mandatory Registration of Payroll Workers) was introduced between December 2008 and May 2011 to allow labour inspections of unregistered workers on enterprise payrolls. The plan is now complete but inspections of private enterprises continue. However, the judicial system is ineffective as it is overburdened and it cannot fully contribute to formalisation through resolving disputes, although the judiciary adopted some changes to reduce its workload.

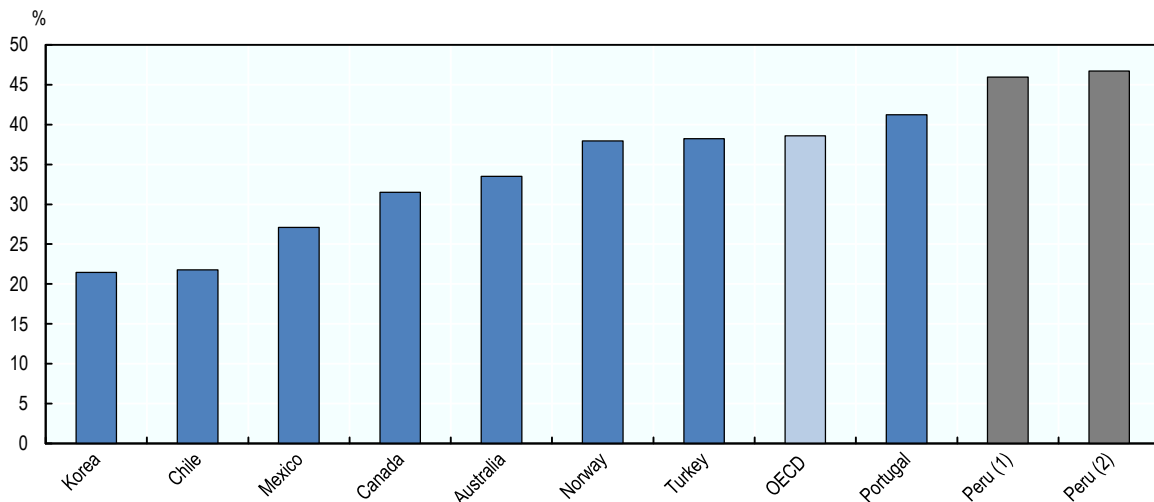
Figure 2.37. Formalisation outcomes in Latin America



Another recent initiative was the *Ley de Régimen Laboral Juvenil* (known as “Ley Pulpín”) aimed at promoting youth access to labour markets and social protection. The law was passed in the congress in December 2014 and advocated as a key policy to solve the problem of high informality and low productivity among young people. The new law was controversial because it gave tax benefits to employers reducing their labour costs while cutting benefits (wages, holidays and severance payments) to young people. The law was scrapped in early 2015 by the congress as a result of strong opposition, particularly from the youth.


Incentives to formalise jobs have focused mainly on cost reduction, rather than creating market-based incentives for enterprises opting for formality. Non-wage labour costs are high in Peru. Despite deregulation of the labour market, the wedge created by compulsory payment increased drastically during the 1990s (Chong et al., 2007). In 2008, contributions and taxes, vacations, dismissal pay and other benefits were estimated to represent 59% of the total remuneration in Peru (Pagés, 2010). This value was the highest among Latin American and Caribbean countries for which comparable data were available, and well above levels observed in Jamaica (10.4%), Venezuela (22.9%), Chile (31.7%), Costa Rica (33%) and Mexico (36.4%). More recent data comparing Peru and Colombia with OECD countries show that the wedge created by compulsory payments in Peru was among the highest, at 46.7% of total labour cost (Figure 2.38). High non-wage labour costs provide incentive to firms to remain informal. However, labour reforms targeting cost cutting only at SMEs by reducing employee benefits will not have enough impact, let alone improve working conditions. The government should rather adopt active policies focusing on market incentives, for example by providing special treatment for investment in training programmes or frameworks for improving productivity and competitiveness.

Figure 2.38. Average compulsory payment wedge as a percentage of augmented total labour costs in selected OECD benchmark countries and Peru



Note: 2014 data. (1) Basic. (2) Manufacturing workers with SENATI.

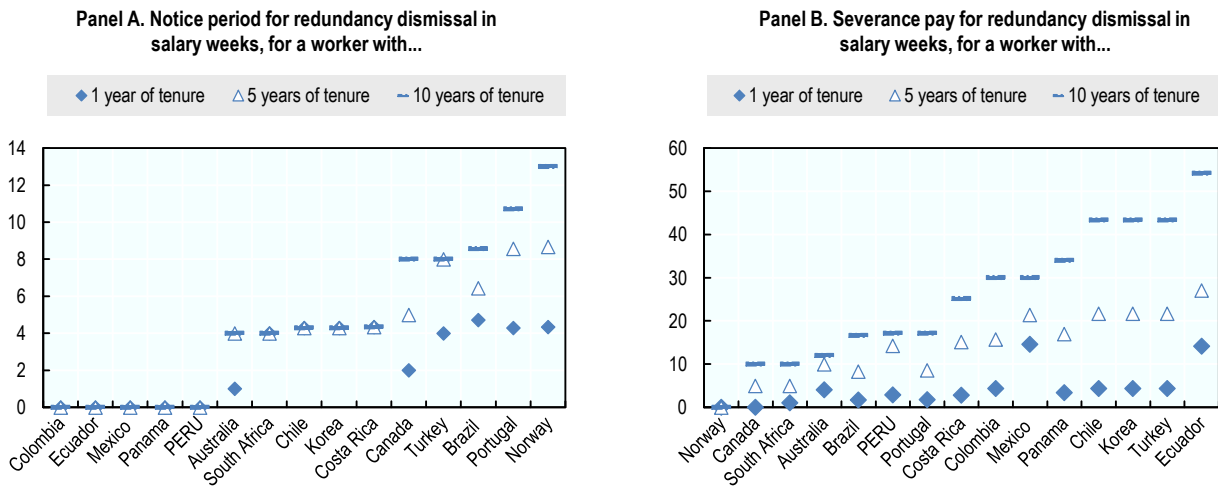
Source: OECD (2015d), *OECD Tax Database*, <http://www.oecd.org/tax/tax-policy/tax-database.htm> for OECD countries, and online tax calculator http://www.empleo.com.pe/empresas/calculadora/calculadora_empresasPe.aspx for Peru.

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Reforms to labour regulations have also reduced enterprises' firing costs but other obstacles remain, limiting firms' capacity to formalise their jobs. Individual dismissals are not allowed unless there is a legal basis or misconduct on the part of the worker; otherwise workers have a right to severance pay consisting of 1.5 times their monthly salary for each year of service up to a maximum of 12 monthly salaries in the case of an indefinite-term relationship. Neither the notice period for redundancy nor severance pay are very high in Peru (Figure 2.39). Furthermore, the firing cost (measured in weeks of wages) was reduced to 17 weeks in 2010 (from 52 weeks in 2005, Figure 2.40). However, regulations regarding dismissals in the case of bankruptcy or financial difficulty prevent firms from dismissing workers individually, unless they dismiss ten or more workers at the same time. Allowing enterprises to process individual lay-offs for economic reasons could lower overall firing costs, hence encouraging firms to hire more workers on a formal basis (Toyama et al., 2009).

Informality and low labour productivity are closely related. The improvements in the Peruvian economy have not so far translated into an adequate increase in labour productivity (Chapter 3). The drastic decline and slow recovery in labour productivity are caused by the economic instabilities experienced in the 1980s and 1990s and the change in the demographic structure of the country, as the young and unskilled population became more important (Chacaltana and Yamada, 2009). Declining productivity in the 1990s together with a remarkable increase in the non-wage labour cost, both to employers and to employees, lowered firms' incentives to formalise, and many small firms opted for operating informally (Chong et al., 2007). Workers in the lowest quintile of the earnings distribution had to opt for current compensation over future compensation by voluntarily taking informal jobs where they do not contribute for benefits (Yamada, 1996; Saavedra and Chong, 1999).

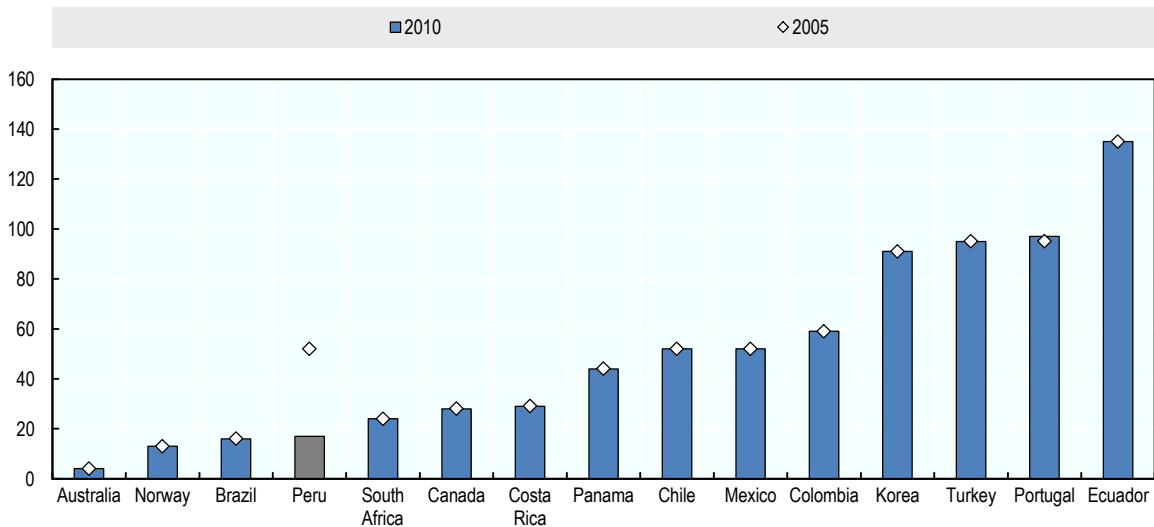
Figure 2.39. Dismissal and severance pay regulations in benchmark countries



Source: World Bank (2015c) Doing Business, Labour Market Regulations (database), <http://www.doingbusiness.org/data/exploretopics/labor-market-regulation>.

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Figure 2.40. Firing cost measured in weeks of wages in benchmark countries, 2005 and 2010



Note: Firing cost is the cost of advance notice requirements, severance payments and penalties due when terminating a redundant worker, expressed in weekly wages. One month is recorded as 4 and 1/3 weeks. Data are listed for 2010 are for June 2011.

Source: World Bank (2012), *The Little Data Book on Private Sector Development 2012*, World Development Indicators, World Bank, Washington, DC.

StatLink <http://dx.doi.org/10.1787/888933265497>

The productivity differences between the formal and the informal jobs are mainly due to high non-wage labour costs and skill differences between workers in formal and informal employment. Recent efforts to reduce the non-wage labour cost should be maintained, combined with a comprehensive skill strategy to increase the human capital

of the Peruvian labour force. The PROJOVEN programme, mentioned above, offered training to disadvantaged youth and resulted in improvements in individuals' productivity and lower informality among the target population (Chong et al., 2007). There are also significant differences in productivity levels between different sectors of the Peruvian economy; this requires orienting the economy towards the more productive sectors but also developing sector-specific policies to promote productivity (Chacaltana and Yamada, 2009).

Conclusions

Peru has made great social and economic strides in recent years. Poverty levels have fallen, the size of the middle class has increased, and inequalities have been reduced. However, the gaps between different socio-economic groups are still very large, and many people are at risk of falling back into poverty. In this context, the three areas of health, education and skills, and work are key to inclusive and sustainable development and ultimately improving the well-being of all. There have been advances in all three areas within the last decade, in part due to the favourable economic climate and to policy reforms adopted by the administration. However, the analysis presented in this chapter reveals the existing challenges in these dimensions that are still holding the country back on its sustainable and inclusive development path.

Although life expectancy at birth, a general indicator of overall health, is close to the one expected for a country at Peru's level of economic development, many people live with disability and child mortality rates are high. The share of Peruvians who report health problems is higher than in most comparator countries, and the proportion of those who are satisfied with their personal health is also lower. Peru has made remarkable advances in terms of health insurance provision over the last seven years, particularly due to *Sistema Integral de Salud* (SIS), a non-contributory insurance scheme covering the most disadvantaged segments of the population. However, major inequalities remain in the quality and extent of the healthcare services between those who are covered by SIS and those covered by *EsSalud* and the army and police insurance scheme. This is reflected in lower levels of satisfaction, access to and confidence in the healthcare system. Despite increasing coverage, the quality of health system falls short of acceptable levels especially in remote areas. Training health professionals and increasing the capacity of human resources in the health sector will be critical for Peru to overcome the inequalities in healthcare and improve overall quality.

In terms of education, considerable expansion of access has been achieved in recent years, although gaps still remain when compared to OECD standards. The poor quality and relevance of education are still challenges, as are the low levels of financial resources devoted to it. Public investment in education in Peru is well below the OECD average, and there is room for more investment. Improving the quality of teaching and learning, as well as reducing overall inequalities should be the priority. School-specific policies such as extra classes taken by students, feedback from the school principals to teachers, and weekly classroom time can help improve students' performance (Avendano et al., 2015).

The education system is also not well-gearred to the needs of the labour market, and there is a mismatch between the available pool of skills and what the economy demands. The role of vocational education and training, as well as a stronger emphasis on the skills most needed by the business sector (i.e. technical and soft skills) remain crucial to foster a better matching between the demand and supply of skills, as well as to favour employability and social inclusion. Effective mechanisms for skills matching between

demand and supply are needed, such as providing information on career paths through qualification frameworks and setting up mechanisms to anticipate future demands, even at the sectorial level. Life-long learning is also key, including mechanisms to provide training at the workplace to update and renew workers' skills.

Peru stands out as a society with a remarkably high employment rate. However, informal work accounts for a large share of employment, the labour market is highly segmented, working conditions are poor and there are large inequalities in the workforce. High informality and poor working conditions are perpetuated by the high costs of formalising, strict regulation of the labour market, weak labour inspections and the lack of an overarching labour law which is obstructing the enforcement of labour laws. In recent years Peru adopted a number of programmes to reduce informality and improve job quality. Nonetheless, informality remains high, even compared to other Latin American economies. More needs to be done to increase formalisation and improve the working conditions for all segments of the population. To reduce informality, a combination of policies should be adopted, such as programmes facilitating companies' and workers' registration in the formal sector, reductions in non-wage labour costs, and improving labour productivity through training programmes.

Notes

1. The poverty gap is a measure of the “intensity of poverty”. It measures how far the poor are from the poverty line. It is calculated as a proportion of the poverty line, and thus expressed as a percentage, so that the larger the percentage, the larger the distance.
2. According to INEI, total poverty includes individuals who belong to a household where either income or consumption per capita is less than the cost of a minimum basket and essential goods and services; extreme poverty includes those where either income or consumption per capita is below the value of a minimum basket of food.
3. Based on data provided by INEI.
4. The latest year with comparable data.
5. Note that there is a small discrepancy between the numbers from CEDLAS and World Bank, and those from INEI due to different definitions of informality. INEI defines informal employment as the set of jobs that do not have the benefits mandated by law.
6. Based on CEDLAS and World Bank (2014) data.

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