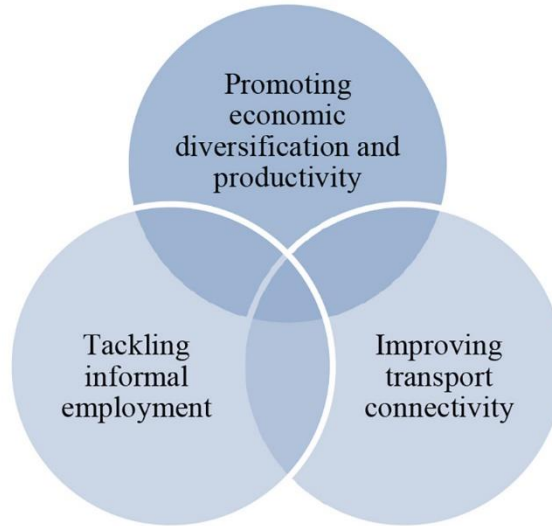


Chapter 2. Plan of action to become a high-income economy with greater well-being for all

Engaging in sound policy reforms to achieve the high-income level with greater well-being for all is the next step in Peru's development path. The country has already achieved substantial socioeconomic gains in the last few decades, including the development of a resilient and attractive economy and a sizable middle-class. Further efforts are needed on three main fronts: economic diversification, connectivity and formalisation of jobs. This chapter sets up the policy action plan in these three priority areas. This is based on the recommendations presented in Volume 2 of the MDCR of Peru, and adds to the results of the workshops held in Lima with various stakeholders in the country, including civil society, private sector, academics and public authorities. It also includes the expected results of such reforms, detailed actions for implementation, and their degree of priority.

Peru aspires to become a high-income economy with greater well-being for all. One of the main barriers to achieving this objective is the persistence of the middle-income trap, which to be overcome requires the implementation of meaningful reforms. While the reform agenda is broad, the MDCR stresses three areas on which the country should focus to promote sustainable and inclusive development, namely: promoting economic diversification and productivity, improving transport connectivity and tackling informal employment (Figure 2.1).

Figure 2.1. Key areas for achieving sustainable and inclusive development

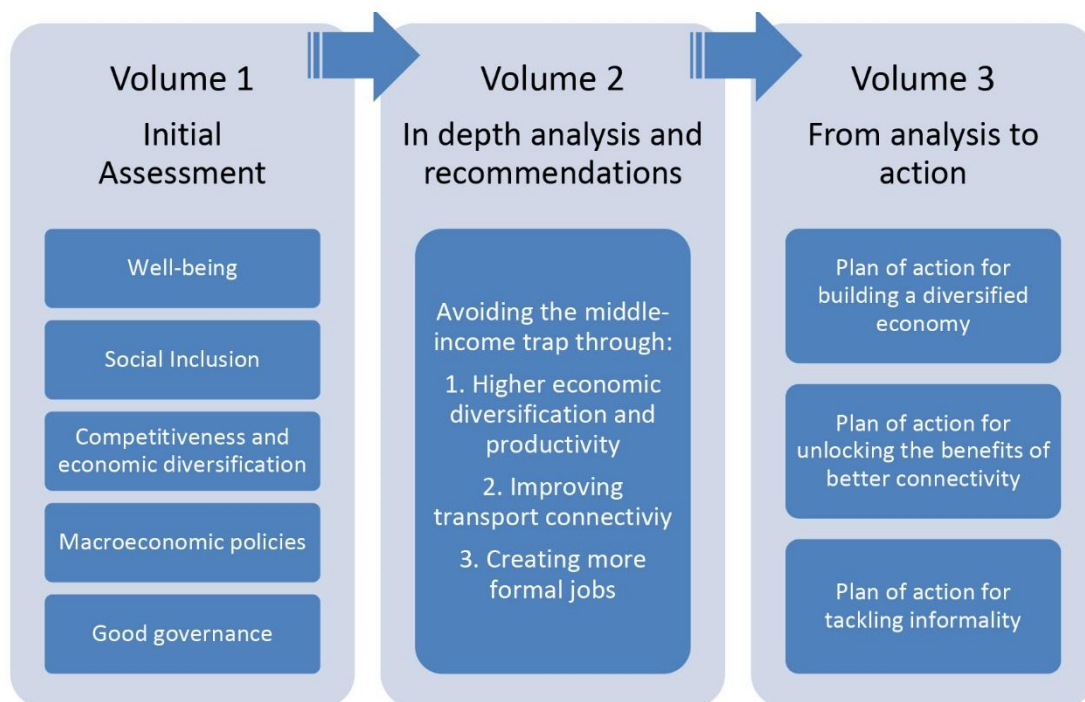


Source: Authors' elaboration based on (OECD, 2015).

Volume 3 of the MDCR of Peru synthesises the analysis of the first two reports and enriches the recommendations put forward for the abovementioned three priority areas. For this, MDCR uses the “government learning” approach, which is a useful technique for discussing public policy findings or recommendations in complex political-economy environments. The purpose of this dialogue is to transfer the knowledge gathered in the reports to local policy-makers as a first step before their implementation (OECD, 2018).

Three workshops were held in Lima between end 2017 and April 2018 to discuss the policy recommendations put forward by the MDCR Peru. Public administration, private sector, civil society, academics, technical and financial partners and other international organisations took an active part in this joint effort. During the workshops, the participants endorsed, rejected or reformulated the policy recommendations proposed by the OECD in Volume 2. Subsequently, a discussion was held on the potential modalities and relevant actors for implementation and their priority level. This exercise proved useful to ensure that the OECD recommendations are relevant to the local context and endorsed by the Peruvian government. Figure 2.2 summarises the process of the Multi-Dimensional Country Review (MDCR) of Peru.

Figure 2.2. The multidimensional review process in Peru



Source: Authors' elaboration.

This chapter summarises the main findings and recommendations for the three priority areas, as presented in Volumes 1 and 2 of the MDCR. It also builds on the results of the workshops. Taken together, these inputs are used to build a plan of action in each one of the three priority areas. These action plans, in turn, will guide policy action in the near future, contributing to Peru's ultimate objective of developing into a high-income economy with greater well-being for all.

Building a diversified economy

Increasing economic diversification in Peru requires ambitious reforms in many different policy areas. Market regulation and openness; development of new competitive industries; innovation strategies; taxation and the use of commodity-based resources; and the enhancement of the strategic institutional framework are some of these key priorities in the coming years. The new growth driver needs to be greater productivity, assisted by a host of structural policy changes to continue or accelerate the pace of convergence.

Peru had a challenging agenda of broad-based policies to boost productivity and competitiveness, implemented during the period 2014-18. The overall objective of the *Agenda de Competitividad* 2014-2018 was to increase competitiveness, and to foster formal employment and the well-being of the population. As of June 2016 (i.e. the latest available report), 38% of this Agenda had been achieved. In particular, scores in the three main areas for improving competitiveness were as follows: 47% for connectivity, 37% for productivity and 29% for the state's efficiency (MEF, 2016). In this sense, challenges remain for improving productivity and diversification, meaning that new actions are required to achieve these objectives.

The Peruvian government recently approved the *Política Nacional de Competitividad y Productividad (PNCP)*, i.e. the National Policy on Competitiveness and Productivity. This policy is the result of a participatory process. Actors from the public sector, private sector, academia, international co-operation and civil society participated in its design, which started in July 2018. It is composed of nine key objectives and 36 policy guidelines that frame the strategy that Peru will follow on competitiveness and productivity until 2030.

Moreover, on 28 July 2019, the government published the *Plan Nacional de Competitividad y Productividad* (National Competitiveness and Productivity Plan), which contains 84 concrete policy measures related to PNCP's Key Objectives, and four time milestones for monitoring and accountability of the Plan. This Plan, as well as the Policy, is the result of intense coordination between stakeholders from the public and private sector, academia and civil society (see Box 2.1).

Box 2.1. The Peruvian Government's Strategy towards Competitiveness and Productivity

In recent years, changes in competitiveness in international markets — due to decreasing technology adoption costs and higher connectivity amid globalisation — have revealed market failures and institutional weaknesses in Peru. These two factors have translated into a reduced factor productivity with a scarce contribution to economic growth, as well as the provision of low quality public services. The country needed to implement policies that aimed at medium- and long-term structural changes to boost the country's competitiveness and productivity. Therefore, on 31 December 2018 the Peruvian government published the *Política Nacional de Competitividad y Productividad (PNCP)* after a process started in July 2018.

The PNCP is a result of the joint work of different actors from the public sector, the private sector, international cooperation, academia and civil society. It was co-ordinated and articulated by the National Council of Competitiveness and Formalization (CNCF). The goal of the PNCP is to provide the necessary conditions for increasing the well-being of all Peruvians. The PNCP is composed of nine key objectives and 36 policy guidelines that will set the path to promote and consolidate medium- and long-term sustainable and inclusive economic growth, resulting in better public services, poverty reduction, and increasing income and welfare of citizens. The key objectives of the PNCP are the following:



Key Objective 1

Quality economic and social infrastructure



Key Objective 2

Strengthen human capital



Key Objective 3

Innovation, adoption and transfer of technological improvements



Key Objective 4

Promote local and external financing mechanisms



Key Objective 5

Create conditions for a dynamic and competitive labour market towards decent employment for all



Key Objective 6

Develop conditions for a productive business environment



Key Objective 7

Facilitate conditions for foreign trade of goods and services



Key Objective 8

Strengthen institutions



Key Objective 9

Promote environmental sustainability in the operation of economic activities

Following the issuance of the PNCP, the government, with the CNCF as its main driver, published the National Competitiveness and Productivity Plan on 28 July 2019. This plan contains 84 specific measures, all of which are related to the 9 key objectives of the PNCP. The design of this plan was also participatory. Public-Private Technical Committees (CTPP) were constituted for each key objective. The purpose of the CTPPs is to formulate and prioritise the interventions of the Plan and to guarantee the representativeness of all relevant actors in the decision-making process. The committees are conducted by different sectors with the participation of other stakeholders from the public sector, the private sector, academia and civil society. The implementation and monitoring of the Plan will continue to be participatory, with a strong coordination component through the CTPPs and with CNCF as its main driver.

The formulation of this Policy (strategic approach) and the Plan (operational approach) presents some improvements with respect to past efforts. It tackles the issue of weak coordination among public institutions and between the public and private sectors. In addition, the formulation strategy contains a territorial approach that recognises the differences in economic potential and needs throughout the territory in favour of competitiveness and productivity. For instance, in February 2019 Peru started a Subnational Doing Business study, which will be carried out for the first time in 12 cities to diagnose the ease of doing business and to promote reforms according to particular local

conditions. The Subnational Doing Business study is being carried out by the World Bank Group in collaboration with the Swiss Cooperation in Peru and the CNCF. The study will be co-ordinated with local authorities and public officials. Finally, an important feature of this strategy design is its nature of State policy; both the PNCP and the Plan have a time horizon of more than ten years, until 2030, moving beyond the current administration and providing room for short-, medium-, and long-term measures on the progress.

Source: MEF.

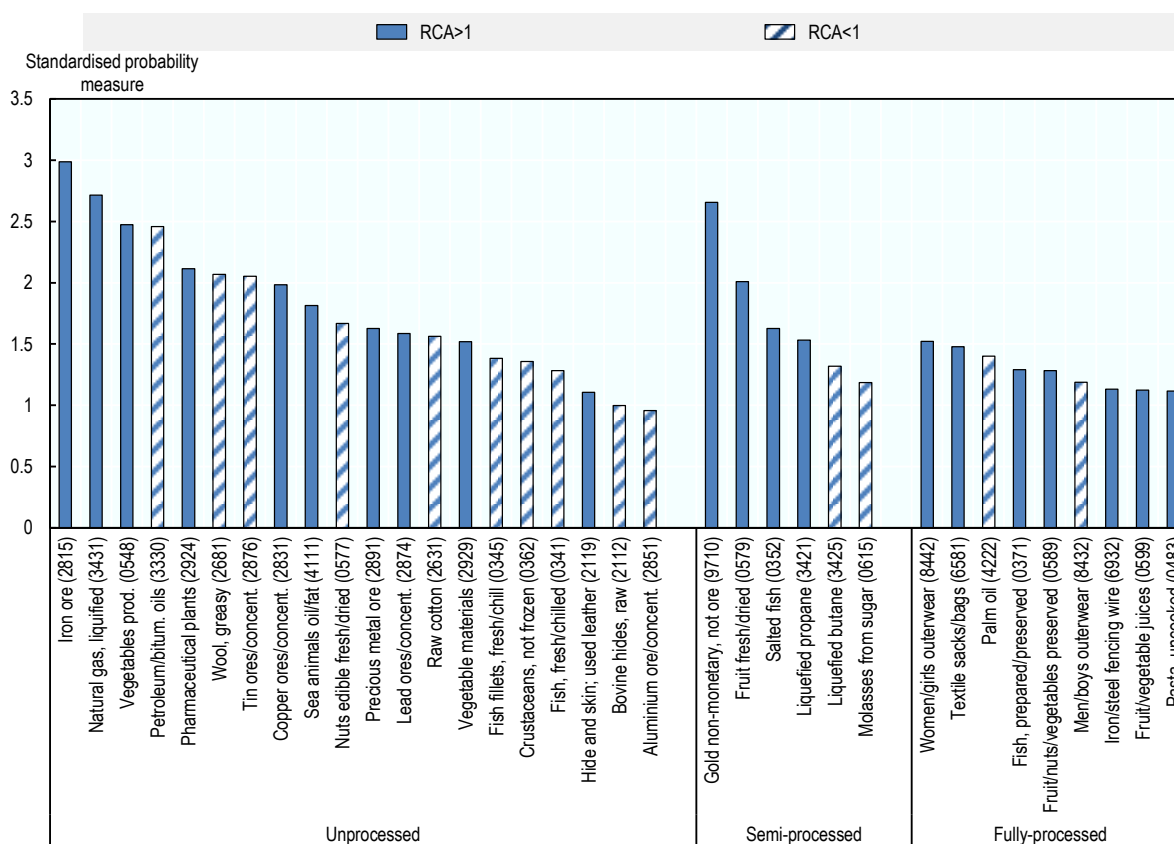
Peru needs to diversify its economy and increase productivity

Pillar 1. Identify new products and sectors

Hard commodities continue to represent a high proportion of the trade and capital accounts in Peru. While commodities only accounted for around 10% of Peru's GDP in 2015, regarding the external sector, mining attracted about one-third of foreign direct investment and represented 61% of Peru's annual exports in 2015. These natural resources comprise several mining components and, to a lesser extent, oil and natural gas. With its abundant and diverse natural resource supply, Peru stands among the top global producers of some of these minerals (OECD, 2015).

Promotion of economic diversification should target industries that could profit from the latent comparative advantages of Peru's economy. Industries that exploit comparative advantages become competitive in domestic and international markets, making them sustainable beyond government support (Lin and Monga, 2010). Comparing Peru's current resources to equivalent international economies is informative in identifying unexploited sectors.

Peru has at its disposal a large set of products with untapped potential with which it could expand the country's economic diversification and boost productivity. Given current global trends and domestic challenges, there are opportunities for new exports that could create formal jobs, boost productivity and produce more processed products. Various semi- and fully-processed products could be exploited by Peru. The analysis of revealed comparative advantages (RCAs) suggests that Peru would benefit from developing a RCA in unprocessed products such as edible nuts, greasy wool or fish fillets (fresh or chilled). Among those fully- or semi-processed products, Peru could profit from the production of wine from fresh grapes, olive oil, palm oil, sugar confectionery, smoked fish, liquefied butane, electronic switch boards or crocheted textile fabrics (Figure 2.3).

Figure 2.3. Top 35 most likely Peruvian exports by level of processing and RCA index, 2014

Note: : RCA (revealed comparative advantage) is an index based on Balassa (1977); values larger than 1 suggest current specialisation in a product by the country. Products are classified according to the SITC rev. 3 at the 4-digit level (in parenthesis in X axis). Density is a measure based on Hausmann and Klinger (2007), which captures a country's propensity to export a product. Y axis = normalised values of the density measure (i.e. average set to 0 and standard deviation equal to 1). The categorisation of products according to manufacturing levels follows Rieländer and Traoré (2016).

Source: OECD calculations based on export data from the World Integrated Trade Solution (WITS)/United Nations (UN) Comtrade (database) (accessed on 1 June 2016).

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Pillar 2. Promote education, innovation, entrepreneurship and regional market integration

Improving skill levels is key to increasing productivity, and can lead to better access to formal jobs and even to their creation. The correlation between the use of skills at the workplace and productivity is very significant (OECD, 2016a). Unfortunately, informality limits the expansion of the pool of skills as, in a context of informality, certain skills tend to deteriorate or remain limited to a low value-added range, and access to training and intermediation services in the informal sector is scarce.

Education and skills are also a driver of innovation and entrepreneurship. Universities have become relevant in supporting start-ups in Peru. The *Emprende Ahora* programme, organised by the Invest Institute in conjunction with the Center for International Private Enterprise and the University of Lima, seeks to promote entrepreneurship among young

people by providing scholarships to outstanding students from regional universities. Recipients benefit from a four-month training programme in business management and mentoring support to develop a business plan. In 2014, the programme attracted 130 applicants from 40 universities in 24 regions (OECD, 2016a).

Supporting entrepreneurship could positively impact the diversification and productivity of the Peruvian economy. For instance, market regulations designed to promote entrepreneurship may result in further formal jobs and consolidate new firms and activities in Peru.

Investment in innovation and research and development (R&D) is key for supporting SMEs and economic diversification. Yet, Peru's level of investment in R&D remains low, which affects innovation outcomes. Peru's business expenditure on research and development (below 0.1% of GDP) remains significantly below the average for OECD member countries (close to 1.6% of GDP) and many other countries in Latin America (0.17% for the Latin American benchmark countries).¹ Peru also remains well below benchmark and OECD member countries in intellectual property imports and exports, figuring into the country's low contribution to global activity in research and development (OECD, 2015).

Pillar 3. Improve the use of commodity-based resources and enhance domestic resource mobilisation

Proper management of the extraction process and the revenues raised from commodities can be a relevant source of funding to invest in productivity-enhancing policies. At the national level, Peru's fiscal rule has a structural fiscal balance (i.e. cyclically-adjusted) as it targets to manage the volatility of commodity-based revenues (OECD, 2015). However, at the sub-national level, the volatility of international commodity prices and the uncertainty of commodity production have affected revenue streams to these authorities. A fiscal rule at this level would avoid pro-cyclicality of sub-national expenditures in boom periods. Linked to this, following the experiences at the national level, sub-national authorities, in co-ordination with the national government, can establish the creation of a stabilisation fund to better manage these resources.

Improvements in the allocation of commodity-based transfers could increase competitiveness and support formal jobs. The different levels of allocation could be associated to the level of development of Peruvian departments and investment in broad based policies. In Peru, the two main sources of commodity-based revenues for sub-national authorities, i.e. canon and royalties (Korinek, 2015), are distributed exclusively to the regional and local governments where the minerals are extracted. Canon represents half of the corporate tax from mining companies (i.e. the other half is retained by the central government), and revenue from royalties is based on the companies' profits. The fiscal transfers based on commodities per capita received by Cusco and Moquegua alone are greater than those obtained by 15 departments in Peru put together (OECD, 2015). Only five out of the 25 departments received more than half of the total revenues from commodities in 2014 (OECD, 2016b). Therefore, improving the allocation of commodity-based transfers according to the level of development of Peruvian departments is a key challenge for the country. These revenues have not contributed to greater productivity and inclusiveness. The concentration of these revenues in a few departments and the lack of rules regarding their expenditures have negatively affected the efficiency of municipal districts (Muñoz, 2010). Furthermore, these fiscal revenues do not target the poorest regions, exacerbating regional disparities. Using data at the department level, the

correlation between the amount of fiscal transfers per capita and the percentage of the population with at least one unmet basic need is less than -0.3.

Peru has made progress by strengthening the process of decentralisation and sub-national governments. In January 2018, the national government created the Multi-sectorial and Intergovernmental Commission for Strengthening Decentralization (*Comisión Multisectorial e Intergubernamental para el Fortalecimiento de la Descentralización*) with the objective to formulate a proposal of articulated intersectoral and intergovernmental management guidelines. These guidelines aim to promote and strengthen decentralisation and a Plan of action 2018-2021, within the framework of the decentralisation process (El Peruano, 2018).

Pillar 4. Develop an effective strategy to increase productivity and economic diversification

Expanded economic diversification is key for promoting formal job creation, boosting productivity and providing equal opportunities for all Peruvians. Indeed, many national strategic plans have been developed and are being developed, some of which highlight the necessity to reduce informality and create formal jobs. These include the *Plan Estratégico de Desarrollo Nacional Actualizado: Perú hacia el 2021*; the National Plan for Productive Diversification; the National Strategy on Development and Social Inclusion: “*Incluir para Crecer*”, the *Política Nacional de Competitividad y Productividad (PNCP)* and the *Plan Nacional de Competitividad y Productividad*. In particular, a key objective of the Plan Estratégico and of PNCP is to increase economic diversification, boost qualified workers and lower informality.

Strategic development plans, at both the sectoral and territorial level, are based on the objectives of the National Accord and the framework of the *Plan Bicentenario*. These strategic development plans apply horizontally, among different sectoral ministries, and vertically, among different levels of government, following the general principles highlighted in the *Plan Bicentenario*. These plans should also contribute to improving the quality of public investment by enabling stakeholders to prioritise projects that require public investment.

Improving the planning process from the central administration to achieve more effectiveness is at the core of Peru’s challenge. While the plans at the central and sub-national levels aim to tackle the crucial development issues in Peru, a better co-ordination among public institutions is needed to determine policy priorities and a better connection between the budgeting process and these agendas (OECD, 2016c). To achieve it, Peru should strengthen the Centre of Government (CoG) by better integrating and co-ordinating the Presidency of the Council of Ministries (PCM) and the Ministry of Economy and Finance (MEF) in the prioritisation process. In particular, Peru lags behind benchmark countries in this aspect of policy co-ordination. Indeed, despite efforts to increase dialogue among different institutions in recent years, the lack of collaboration and co-ordination among ministries and within the administration remains an obstacle to effective policy making and implementation. On this issue, the recent formulation of the PNCP and its Plan is a positive sign of the government trying to circumvent this issue by providing tools and frameworks for more co-ordination (see Box 2.1).

Overall, for promoting economic diversification, Peru should engage in reforms in at least four different areas of an action plan to increase economic diversification and productivity (Table 2.1): i) identify new products and sectors; ii) promote education, innovation entrepreneurship and regional integration; iii) improve the use of commodity-

based resources and enhancing domestic resource mobilisation; and iv) develop an effective institutional strategy to increase productivity and economic diversification.

Table 2.1. Lines of action for promoting economic diversification and productivity

Promoting economic diversification and productivity	Identify new products and sectors	Determine main pre-conditions for the development of new sectors
	Promote education, innovation, entrepreneurship and regional market integration	Improve the quality of education for all Peruvians
		Increase investment in innovation
		Eliminate existing barriers to entrepreneurship
	Improve the use of commodity-based resources and enhance domestic resource mobilisation	Continue to promote regional integration
		Improve the use of commodity-based resources at the sub-national level
	Develop an effective strategy to increase productivity and economic diversification	Increase fiscal resources to finance broad-based policies
		Design and implement a unique National Strategic Development Plan
	Improve prioritisation and execution of sub-national development plans	

A plan of action to improve economic diversification and productivity in Peru

Pillar 1. Identify new products and sectors to contribute to further economic diversification and productivity

Generic recommendation: Determine the main pre-conditions for the development of new sectors		
Specific recommendation	Stakeholders suggestions for action	Key actors
Improve data to evaluate potential benefits in GVCs	Continue and strengthen technical cooperation to obtain accurate and updated information regarding the insertion of the Peruvian economy in the GVCs	MINCETUR, MEF, CNCF, CEPLAN
Make technical assessments to find new sectors, based on comparative advantage, intl. & domestic demand and spill-overs	Agreement	PRODUCE, MEF, CEPLAN, Ministry of Trade, CNCF
Increase effectiveness in dialogue with academia, sub-national authorities, local communities, intl. actors and private sector in the identification of new sectors	Move forward the <i>Política Nacional de Competitividad y Productividad</i> where public, private, academic and civil society actors are involved	CNCF, PRODUCE, MEF, CEPLAN

Pillar 2. Promote education, innovation, entrepreneurship and regional market integration

Generic recommendation: Improve the quality of education		
Specific recommendation	Stakeholders suggestions for action	Key actors
Improve teachers' performance through better incentive mechanisms	Agreement	MINEDU, MEF, CEPLAN
Implement the Ley Universitaria and objectives for SUNEDU	Agreement	MINEDU MEF, CEPLAN
Increase investment in school infrastructure, in particular in remote areas	Agreement	MINEDU, MEF, CEPLAN

Generic recommendation: Eliminate existing barriers to entrepreneurship		
Specific recommendation	Stakeholders suggestions for action	Key actors
Reduce complexity of regulatory procedures	Continue working with multilateral institutions in that domain	MEF, CNCF
Eliminate administrative burdens on start-ups	Continue working with multilateral institutions in that domain	MEF, CNCF

Generic recommendation: Continue to promote regional integration		
Specific recommendation	Stakeholders suggestions for action	Key actors
Take advantage of and better communicate progress of the Pacific Alliance, in issues like tariffs and cumulative rules of origin	Agreement	MINCETUR
Continue efforts towards greater financial market integration (e.g. MILA)	Agreement	Stock Exchange of Lima, Central Bank of Peru, Financial Superintendencies, MEF

Pillar 3. Improve the use of commodity-based resources and enhancing domestic resource mobilisation

Generic recommendation: Improve the use of commodity-based resources at the sub-national level		
Specific recommendation	Stakeholders suggestions for action	Key actors
Consider a fiscal rule for sub-national commodity-based transfers to avoid pro-cyclicality of expenditures; consider a stabilisation fund to manage revenues	Agreement. Consider creating an institution at national level focused on the dialogue and promoting capacity building with sub-national authorities.	Relevant sub-national authority, MEF, CNCF
Strengthen equalisation mechanisms to reduce inequalities between sub-national governments	Agreement. Consider creating an institution at national level focused on the dialogue and promoting capacity building with sub-national authorities	Relevant sub-national authority, MEF, CNCF
Improve the allocation system of these resources to invest in areas contributing to inclusive development	There is a need to improve the monitoring beyond the SIAF. Greater visibility of such investments is fundamental.	Relevant sub-national authority, MEF, National Controller
Support sub-national authorities with further technical capacity	Agreement. Consider creating an institution at national level focused on the dialogue and promoting capacity building with sub-national authorities.	Relevant sub-national authority, MEF, CNCF

Generic recommendation: Increase fiscal resources to finance broad-based policies		
Specific recommendation	Stakeholders suggestions for action	Key actors
Promote higher dependence on direct taxation (personal income)	Agreement. But need to show the benefits of such policies and to better communicate the linkages with expenditures to build confidence in institutions.	SUNAT, MEF
Gradually increase the tax base, the progressivity of personal income tax revenues, and reduce elusion and evasion	Agreement. Property taxes should be increased where more involvement from SUNAT and MEF is needed.	SUNAT, MEF

Pillar 4. Develop an effective strategy to increase productivity and economic diversification

Generic recommendation: Develop and implement a unique National Strategic Development Plan		
Specific recommendation	Stakeholders suggestions for action	Key actors
Strengthen the role of the Centre of Government (CoG)	Agreement.	MEF, CEPLAN
Strengthen CoG's effectiveness by better integrating and co-ordinating the PCM and MEF	The recent formulation of the PNCP (<i>Política Nacional de Competitividad y Productividad</i>) and its Plan should contribute in that direction.	MEF, CEPLAN, CNCF
Making binding strategic plan policies, both in budgeting (including SNIP) and adherence to the regulatory framework	Agreement	MEF
Monitor the outcomes and objectives of the plan periodically	Agreement	CNCF, MEF, CEPLAN, multilateral organisations

Generic recommendation: Improve prioritisation and execution of sub-national development plans		
Specific recommendation	Stakeholders suggestions for action	Key actors
Ensure the objectives and guidelines in the plan are reflected in planning at the sub-national level	Consider creating an institution at national level exclusively focused on the dialogue and promoting capacity building with sub-national authorities	New institution, sub-national authorities, CNCF, MEF, PCM
Support capacity to sub-national authorities	Support to public servants, capacity building, technological transfers	New institution, sub-national authorities, CNCF, MEF, PCM
Facilitate a partnership-based approach to regional development and consider creating a deconcentrated agency of the PCM and MEF or regional development agencies	Consider creating an institution at national level exclusively focused on the dialogue and promoting capacity building with sub-national authorities	New institution, sub-national authorities, CNCF, MEF, PCM
Develop medium-term capital investment programmes that deliver on strategic priorities identified in regional development plans	Agreement	New institution, sub-national authorities, CNCF, MEF, PCM
Monitor the implementation of Concerted Regional Development Plans	Agreement	New institution, sub-national authorities, CNCF, MEF, PCM

Note: Based on the workshop “Hacia una mayor productividad y diversificación económica en el Perú”, held in Lima on 6 December 2017.

Source: Authors' elaboration.

Unlocking the benefits of better connectivity

Greater connectivity is fundamental to reduce transport costs and boosting productivity and competitiveness in Peru. Good transport connectivity can make Peru more efficient and facilitate reaching sustainable and inclusive development goals. Improving connectivity requires going beyond transport infrastructure provision, recognising the need for policies and strategies that focus on increasing efficiency and reducing the costs of transport, including time, financial costs and negative environmental and social impacts.

Improving transport connectivity to support productivity and competitiveness

Pillar 1. Develop a national strategy to reduce transport costs, improve connectivity and promote multi-modality

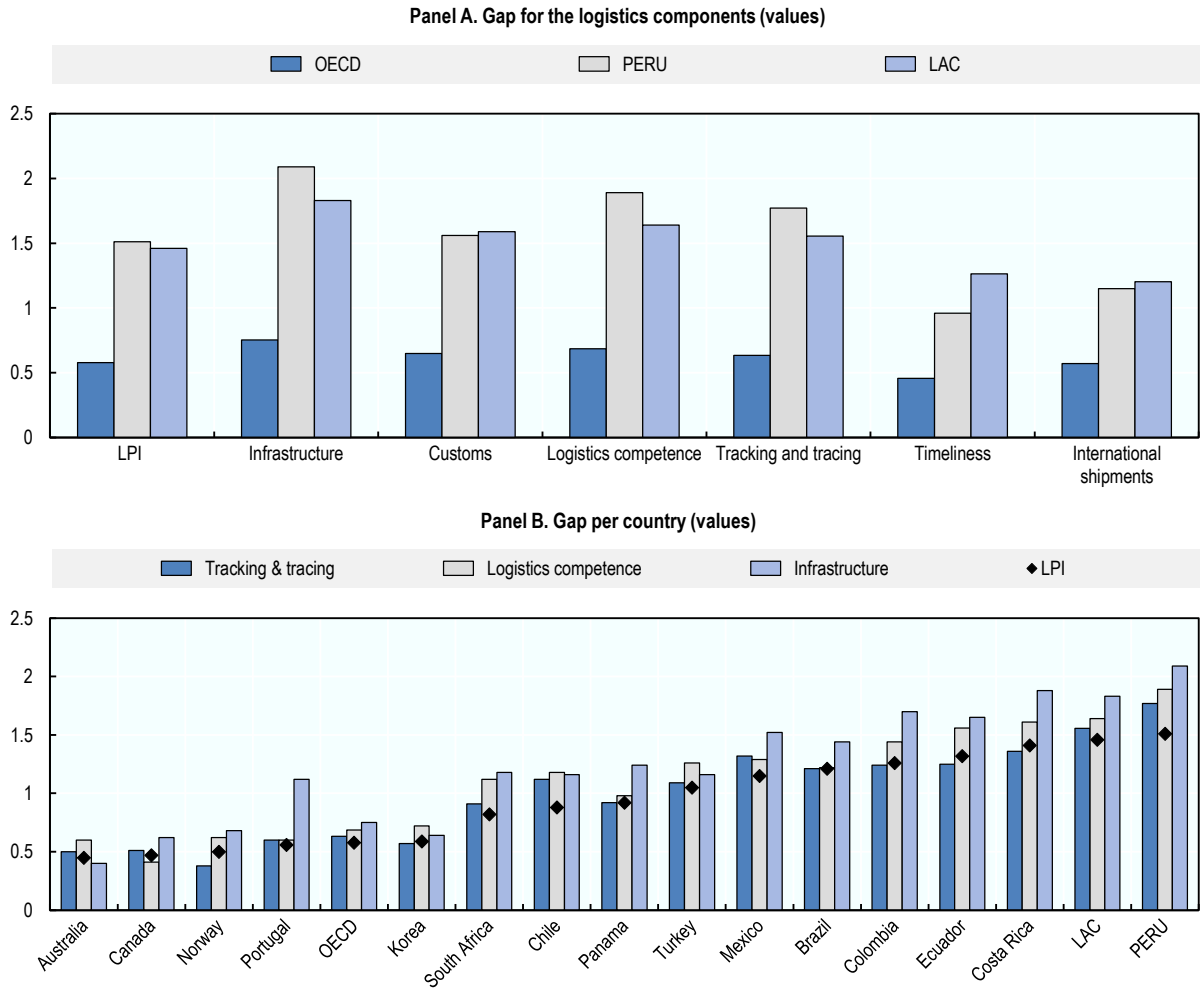
Better connectivity can make the Peruvian economy more efficient and promote productivity and competitiveness. The development of a strategy for improving connectivity is particularly relevant for Peru, where transport costs are high compared to OECD member countries and transport is considered one of the main bottlenecks to development. Better logistics in transport as well as adopting a multi-modal approach that shifts focus from roads (e.g. developing railways, ports and waterways) are central to this strategy. Another key area are improvements in the institutional framework related to the design and implementation of transport policies at national and sub-national levels.

Peru should set a transport plan according to the guidelines and objectives of the National Strategic Development Plan. Transport plans in Peru assess indispensable logistics corridors based on interactions with local communities and technical evaluation, yet several bottlenecks affect the design and implementation of these plans. The logistics corridors and transport infrastructure projects lack adequate links to a national strategic agenda. Prioritisation and planning defined in a development agenda should be the basis for a transport strategy in Peru. Indeed, the *Programa de Inversiones 2011-2016 Gestión Estratégica – Corredores Logísticos* only refers to the *Plan Bicentenario 2021* domestic trade analysis (and not to policies to boost exports) and does not contain specific criteria to match development objectives with the transport framework. In addition, investments needed for the implementation of these plans are not binding and not necessarily included in the budget for results (*presupuesto por resultados*) or in the national framework for public investment – *Sistema Nacional de Inversión Pública* (SNIP).

Consequently, defining transport strategies to realise outcomes for the economy and the population, rather than for infrastructure development exclusively, is key. With this framework of reference, increasing connectivity in Peru means developing a national strategy focused on reducing time and financial transport costs, as well as negative environmental and social externalities, and promoting multi-modality.

Additionally, improving logistics could boost Peru's productivity. Despite some recent improvements, logistics and transport infrastructure continues to underperform versus benchmark and OECD economies. There are important differences for the six Logistics Performance Index (LPI) categories between the best-performing OECD country and Peru, Latin America, and the OECD average (Figure 2.4, Panel A). The largest gaps occur in infrastructure (the quality of trade and transport infrastructure), logistics competence (competence and quality of logistics services, e.g. transport operators, customs brokers), and tracking and tracing (ability to track and trace consignments). Peru performs below the OECD average and the Latin American average for these three indicators. Furthermore, Peru's overall logistics performance is below most of the benchmark countries and OECD economies (Figure 2.4, Panel B). The Peruvian gap is equivalent to 2.6 times the gap for OECD countries.

Figure 2.4. Logistics performance gap versus the best-performing OECD country, 2018



Note: Scale of 1 to 5, where 5 = the best logistics performance. The gap refers to the difference for each logistics component from the best-performing OECD country, these being Germany for the overall LPI, infrastructure, logistics services and customs; Finland for tracking and tracing; and Belgium for international shipments and timeliness.

Source: Based on World Bank 2018 data (LPI), <http://lpi.worldbank.org/>.

StatLink  <http://dx.doi.org/10.1787/888933996030>

Transport policies should be integrated into wider strategies. Indeed, transport and connectivity directly affect other policy areas such as environment, economic diversification and competitiveness, labour market, and education and skills. In addition, careful study of the factors influencing trip lengths and modal choice has stressed the importance of integrating spatial and transport development in regional and urban environments.

To achieve it, Peru should develop a transport plan according to the guidelines and objectives of the National Strategic Development Plan. In Peru, the transport strategy is articulated through different transport plans. In 2014, the Ministry of Transport and Communications (MTC) created the Development Plan of Logistic Services on Transport

(*Plan de Desarrollo de los Servicios Logísticos de Transporte*) in order to improve connectivity. The plan proposes medium- to long-term measures for strengthening domestic logistics and building on existing opportunities in international markets. Twenty logistics corridors were prioritised based on the main productive activities that require logistics transportation services. In addition, the MTC set out key plans to increase multimodality in Peru: *Plan Nacional de Desarrollo Portuario* for the development of ports and *Plan Nacional de Desarrollo Ferroviario* for the development of railways.

Pillar 2. Develop a national urban transport plan

Improving urban mobility is one of the priorities for the Peruvian population. In fact, citizens listed public transport as the second greatest problem limiting quality of life in Lima (after insecurity). As many as 30.3% of surveyed citizens claim that they spend between 0.75 and 1.5 hours commuting between their homes and workplaces each day. In addition, 73.5% consider tackling vehicle emissions a priority to address pollution in the city, which is seen as the third greatest problem hampering quality of life (Lima Cómo Vamos, 2016).

A national urban transport plan is needed to support efficient, integrated and sustainable transport systems across the country. Sustainable urban transport policies are a common objective for the country that should be supported at the national level. Transport policies impact the vehicle fleet in the country, CO₂ emissions and overall environmental effects linked to transport. Having a solid strategy provides certainty on the links between the city's objectives and investment decisions. In this effect, the Ministry of Housing, Construction and Sanitation (MVCS) recently started to support cities by financing urban mobility studies as part of the City Programme (*Programa Nuestras Ciudades*). Studies have been developed for Huaral, Tacna, Conglomerado Cañete and Huancayo.

Defining a single national institution for leading the national urban mobility plan should be a priority. In Peru, the MVCS, in close co-ordination with the MTC, would be an adequate institution for developing the national urban mobility policy. Third-country experiences show that national urban mobility policies have been developed with diverse administrative structures. In Brazil and Mexico, new ministries have been created to lead urban policy at the national level. Other countries have assigned responsibility for developing national mobility policies to existing ministries, such as Colombia, France or India. The MVCS could build on the current programme, which comprise urban mobility studies, to create a national framework for urban mobility master plans. The process of developing mobility master plans can significantly strengthen the planning capacity of urban authorities. A mobility master plan identifies the challenges faced by an urban area and sets out a roadmap to guide the city on a sustainable course regarding its land use and transport system (GIZ, 2013).

Pillar 3. Improve policies implemented at the local level

Establishing a unique metropolitan mobility authority is necessary for the Lima-Callao metropolitan area. As Peru's capital city and main port, and its economic and cultural hub, the metropolitan area of Lima-Callao and its performance is essential to the country's development. Lima itself concentrates 50% of GDP. The metropolitan region includes two regional jurisdictions: Lima (43 districts) and Callao (7 districts). Lima-Callao reached 9.3 million inhabitants in 2018 (INEI, 2018), representing 32% of Peru's total population and over 40% of Peru's total urban population (INEI, n.d.). Its location has strategic

advantages as both a gateway for Latin American trade and a competitive alternative to the Panama Canal ports for trans-shipment, especially on the Asia-Latin America route.

The many success stories that have implemented such a policy show the potential benefits it can bring. Internationally, mechanisms for the co-ordination of metropolitan mobility planning and policy come in many forms. For example, Indonesia employs informal metropolitan-wide co-ordination forums; and Mexico employs more formal metropolitan commissions, but without a legally binding obligation to co-operate. Although simple to implement, these mechanisms have often proved limited by the need for consensus in order to pursue their programme of work, with, consequently, long delays. They also tend to be particularly sensitive to changes in administration. By contrast, formal metropolitan-wide authorities with transferred responsibilities, capacities and funds generally deliver more solid and long-term improvements (Aguilar and Glocker, 2015).

In some cases, metropolitan mobility bodies are implemented as part of a wider metropolitan governance structure. Transport for London (TfL), for example, was created through the Greater London Authority (GLA) Act with the purpose of facilitating GLA's transport responsibilities. In other cases, although without a wider metropolitan governance structure, metropolitan scale transport planning and regulation is nonetheless recognised and dedicated authorities have been created for this purpose (e.g. Syndicat des transports d'Île-de-France [STIF]).

In the case of Lima-Callao metropolitan area, co-operation from municipalities remains a key barrier to be addressed by the strategic mobility authority. The lack of metropolitan strategy has limited initiatives to reform the bus system, or implement the *Metropolitano* and the *corredor azul*, for instance. Re-grouping small and semi-formal bus providers into more professional enterprises subject to higher quality standards and providing services through high-capacity, cleaner buses was central to Lima's ability to implement the *Metropolitano* and other new bus corridors. Callao, however, has been slow in preventing semi-formal services — concessioned by this government — from competing with the *Metropolitano* and the new corridors.

This policy recommendation was taken into account by national authorities after the publication of the second volume of the *Multi-dimensional Review of Peru, In-depth Analysis and Recommendations* (OECD, 2016b). Law no. 30900 of 26 December 2018 created the Urban Transport Authority (*Autoridad de Transporte Urbano - ATU*) for Lima and Callao. The ATU is a specialised technical body attached to the Ministry of Transportation and Communications (MTC), with legal status under internal public law; it has administrative, functional, economic and financial autonomy (see the entire law here: <https://busquedas.elperuano.pe/download/url/ley-que-crea-la-autoridad-de-transporte-urbano-para-lima-y-c-ley-n-30900-1727064-7>).

Box 2.2. The challenges of improving transport at the local level: The case of Lima-Callao metropolitan area

As Peru's capital city and main port, and its economic and cultural hub, the metropolitan area of Lima-Callao and its performance is essential to the country's development.

Port traffic in Callao has been growing rapidly. Container throughput between 1995 and 2014 grew by 650%, making it the sixth largest port in Latin America in Twenty-Foot Equivalent Units (TEUs). More than 60% of Peru's foreign trade goes through Callao (Mesquita Moreira, 2013). In 2013, containers handled at the port represented close to 85% of all container traffic in Peru (author's calculations based on World Bank, 2014).

Deficient transport services and restricted connectivity hinder Lima-Callao's potential for economic development and improvement of citizen well-being. The number of motorised trips in the metropolitan area increased by 10 million between 1989 and 2012, corresponding to an increase from an average of 1.1 daily motorised trips per inhabitant to almost 2 trips per capita. Including walking, in 2012, the metropolitan area reached 22.3 million yearly trips (2.4 per person daily). While total trips increased by 4.2% yearly between 2004 and 2012, the population increased by 2.1% yearly during the same period (Municipalidad Metropolitana de Lima, 2014).

The urban mobility system of Lima-Callao is struggling to meet mobility demand and ensure reliable, safe, clean and accessible transport services. Increasing congestion is perceived as an important problem by the population. Average travel time for the average trip in the metropolitan area increased almost 20% between 2004 and 2012, from 31 to 37 minutes. Working trips have higher than average travel times and have increased from 40 minutes on average in 2004 to 45 minutes on average in 2012 (Municipalidad Metropolitana de Lima, 2014). Lima-Callao also has high levels of pollution, which jeopardises the health of the population (Transitemos, 2015). Between 70% and 80% of the pollution in Lima is estimated to be caused by vehicles (Barbero, 2006). Another major concern is the high and increasing number of deaths due to transport accidents. Lima concentrates about 62% of the national accidents and reports an average of 590 deaths, 180 injuries and 30 permanently disabled yearly as a consequence of transport accidents (Transitemos, 2015).

Source: (OECD, 2016b), *Multi-dimensional Review of Peru: Volume 2. In-depth Analysis and Recommendations*.

Overall, unlocking the benefits of better transport connectivity requires Peru to engage in policy actions in at least three different pillars (Table 2.2).

Table 2.2. Lines of action for reaching better transport connectivity

Improving transport connectivity	Develop a national strategy to reduce transport costs, improve connectivity and promote multi-modality	Design and implement a national transport plan under the auspices of the MTC and other sectors and stakeholders involved
		Develop a logistics observatory to improve assessment of logistics policies
		Continue to improve the criteria determining the modality of investment

Develop a national urban transport plan	<p>Appoint the Ministry of Housing, Construction and Sanitation as a lead agency, in close collaboration with the Ministry of Transport and Communications</p> <p>Focus on developing elements identified as effective policy by international experience</p> <p>Adjust the institutional framework to facilitate metropolitan governance of urban transport</p>
Improve policies implemented at the local level	<p>Move forward in establishing a unique mobility authority for Lima Callao, while ensuring essential conditions for its success</p> <p>Once established, the mobility authority must address priority areas to deliver public value</p> <p>Develop a strategy to generate port city benefits</p>

A plan of action for improving transport connectivity to support productivity and competitiveness

Pillar 1. Develop a national strategy to reduce transport costs, improve connectivity and promote multi-modality

Generic recommendation: Design and implement a national transport plan under the auspices of the Ministry of Transport (MTC) and other sectors and stakeholders involved		
Specific recommendation	Stakeholders suggestions for action	Key actors
Link transport policies to national objectives on environmental, social and economic aspects	Stakeholders agreed and identified as a key priority. There should be a Transport Policy and a Law of Mobility where MTC takes the lead but where other actors are involved through an intersectoral commission, including among others the Ministry of Housing, the Ministry of Economy and Finance, and local authorities. A specific timeline must be set up for the implementation of this policy	MTC, strengthen the PPPs Unit and improve the institutional framework of INVIAS
Define transport policy priorities in the transport plan and establish a budget for new public works and maintenance	Stakeholders agreed and identified as a priority. It is key to establish priorities and link them to budget lines and objectives, and determine the criteria for the transfer of resources and responsibilities to local and regional authorities	MTC and PPP Unit
Establish cost-benefit analysis (CBA), along with other assessments, to define priorities, and link with the SNIP (National System for National Investment)	Stakeholders agreed, but the CBA must include the environmental, social and urban dimensions. Other methodologies could also be considered, such as the WebTag (UK)	MTC
Monitor the outcomes and objectives of the plan periodically	Stakeholders declared that it will be critical to establish a hierarchy of planning documents. The role of the General Comptroller must be enhanced in this process to secure appropriate use of public resources	MTC

Generic recommendation: Develop a logistics observatory to improve assessment of logistics policies needed		
Specific recommendation	Stakeholders suggestions for action	Key actors
Develop data and indicators measuring components and costs of logistics at the national and sub-national level	Stakeholders identified it as a key priority in order to have policies adopted and implemented under an evidence-based framework. They also declared that urban mobility should be included	MTC
Improve co-ordination between different agencies involved in logistics policies to simplify and harmonise customs procedures, and better use ICTs with the existing infrastructure	Stakeholders declared that it will be critical to designate someone in the MTC for the co-ordination with the multi-sectoral commission. The Plan should set policy objectives and lead actors for each of these targets	MTC and other relevant actors

Generic recommendation: Continue to improve the criteria determining the modality of investment (Public-Private partnerships, public works, "obras por impuestos")		
Specific recommendation	Stakeholders suggestions for action	Key actors
Improve the institutional framework to carry out ex ante feasibility studies and value-for-money analyses, and other assessments	Stakeholders agreed and stressed the need to strengthen the APP Unit and the planning capacity at the MTC. There must be a technical scheme to support cities in assessing financial issues	MTC
Improve the implementation of the environmental and land licensing permits; make more effective and efficiently the consultation with local communities	Stakeholders agreed and stressed the need to involve efficiently the private sector in such processes	MTC
Support sub-national authorities by providing technical capacity and pursuing more accurate value-for-money analyses and assessment of public-private partnerships	Stakeholders agreed. They insisted that national transport modes should not be delegated to sub-national authorities	MTC

Pillar 2. Develop a national urban transport policy

Generic recommendation: Appoint the Ministry of Housing, Construction and Sanitation as lead agency, in close collaboration with the Ministry of Transport and Communications		
Specific recommendation	Stakeholders suggestions for action	Key actors
Assign a legal mandate for national urban transport policy	The policy should be on urban mobility, not only on transport. The current configuration could be reconsidered, in order to bring the MTC and MVCS together, or to create a Ministry of Cities. Other stakeholders insisted that MTC should take the lead in such policies, since MVCS does not have the necessary empowerment with sub-national authorities (e.g. very few municipalities have a national cadastral system)	MTC in close co-ordination with the MVCS
Strengthen technical capacity and human resources	Stakeholders agreed. This should be accompanied by more resources for urban planning, and incentives for local governments to implement the plans.	MEF
Establish a co-ordination mechanism with the MEF, the Ministry of Transport and Communications and the Ministry of Environment	Stakeholders agreed.	MVCS, MEF, MTC, MINAM

Generic recommendation: Focus on developing elements identified as effective policy pillars by international experience		
Specific recommendation	Stakeholders suggestions for action	Key actors
Develop specific objectives, targets and guidelines for urban transport that translate the general principle of sustainable and inclusive mobility into operational goals	Stakeholders agreed.	MTC, MVCS, MEF
Create a national framework for the development of urban mobility master plans	Agreement. These should be in line with the urban development plans.	MTC, MVCS, MEF, MINAM
Develop national programmes for enlarging the capacity of urban authorities to fund mobility projects	Stakeholders agreed.	MEF, MTC, MVCS, MINAM

Pillar 3. Improve policies implemented at the local level (focus: Lima Callao)

Generic recommendation: Move forward in establishing just one mobility authority for Lima Callao, while ensuring essential conditions for its success		
This policy recommendation was taken into account by national authorities. Law no. 30900 of 26 December 2018 created the Urban Transport Authority (Autoridad de Transporte Urbano - ATU) for Lima and Callao. The ATU is a specialised technical body attached to the Ministry of Transportation and Communications (MTC), with legal status of internal public law and administrative, functional, economic and financial autonomy (see the entire law here: https://busquedas.elperuano.pe/download/url/ley-que-crea-la-autoridad-de-transporte-urbano-para-lima-y-c-ley-n-30900-1727064-7).		

Specific recommendation	Stakeholders suggestions for action	Key actors
Responsibility over a range of transport policies rather than over public transport only, so it can develop comprehensive strategies	Stakeholders agreed that this recommendation is a key priority. Agreement, including infrastructure policies. It should deal with planning and urban transport, freight transport, and binding agreement	MTC and local authorities
Develop an institutional arrangement that guarantees co-ordination of transport, land use and housing planning and policy	Stakeholders insisted on the need to enforce current policies regarding land use	MTC, MVCS and local authorities
Provide the new authority with dedicated legislation that clarifies its responsibilities, capacity and jurisdiction	Stakeholders agreed	MTC and local authorities
Benefit from leadership of key political actors and foster support from other authorities	Stakeholders agreed and insisted to include efficiently and effectively the private sector	MTC, local authorities, private sector
Support the new authority with technical capacity, human resources and secured funding	Stakeholders agreed	MTC and local authorities

Generic recommendation: Once established, the mobility authority must address priority areas to deliver public value		
Specific recommendation	Stakeholders suggestions for action	Key actors
Prioritise investment and road space for walking, cycling and public transport	Stakeholders agreed that such measures should be accompanied by efficient transport mode solutions for long distances	MTC and local authorities
Resume efforts to improve planning and data collection	Stakeholders agreed and insisted on the role of e-government policies	MTC and local authorities
Move forward with bus reform and development of a well-integrated transport network	Stakeholders agreed	MTC
Implement transport demand management policies and effective vehicle regulation		
Adopt a safe-system approach for improving road safety		

Generic recommendation: Develop a strategy to realise port city benefits		
Specific recommendation	Stakeholders suggestions for action	Key actors
Implement port gate solutions to reduce congestion around the port.	Stakeholders agreed. The former project on a truck holding area could be revived.	MTC
Take advantage of rail infrastructure to relieve port gate congestion	Stakeholders agreed, but there is an issue with expropriations that needs to be solved. Additional rail lines to logistical zones (e.g. Lurin or Carretera Central) could be considered.	MTC
Prioritise congestion alleviation with better traffic management tools	Agreement. A possibility would be a centre to manage traffic in the logistic corridors.	MTC
Develop frameworks for multi-stakeholder planning and decision making	Stakeholders agreed	MTC
Assess infrastructure development projects according to long-term social, economic and environmental objectives	Stakeholders declared that this should be reformulated to “Improve and deepen the analysis of social, economic and environmental objectives in the design of infrastructure development projects”. Some stakeholders insisted on the need to improve the methodology to assess projects included in the public investment system	MEF and MTC

Note: Based on the workshop “*Hacia una mayor conectividad en el Perú*”, held in Lima on 16 April 2018.
Source: Authors’ elaboration.

Improving working conditions through formal and better quality jobs

Informality in Peru is high and persistent, with a pervasive impact on economic activity and on jobs. More than two-thirds of workers and almost 90% of firms are informal. Although informality has decreased, it remained high throughout the most recent period of economic expansion and progress and continues to stand among the highest in Latin America and the Caribbean.

The negative impact informality has on jobs, firms and the overall economy makes it one of the main barriers to inclusive development in Peru. Informality is a complex, multi-dimensional phenomenon, both cause and consequence of the low levels of development in the country. The broad concept refers to all economic activity that happens outside of government regulations, whether by evasion or by being beyond the scope of regulation. Weak institutional frameworks, the costs associated with formalisation, the large size of low-productivity sectors and certain cultural and socioeconomic conducts common among economic agents are some of the most relevant drivers of informality. In turn, informality has a pervasive impact on economic efficiency and productivity, tax collection, firm development and job conditions, among other consequences. In order to promote more formal jobs and economic activity in Peru, it is crucial to better understand the complexity of this phenomenon in the country – its main causes and consequences.

Because informality in Peru is caused by diverse and structural factors, the response must be multi-dimensional. Informal employment and economic activity in Peru are very heterogeneous and manifest themselves in different ways, requiring different policy approaches, including actions to address specific barriers to formalisation in the short term, as well as longer-term strategies to create opportunities for more formal jobs and economic activities.

Informality is widespread in Peru and requires policies that both address its causes and alleviate its pervasive impact

Pillar 1. Mitigate the pervasive impact of informality on jobs and labour conditions

Informality has several adverse consequences on social protection and labour conditions for informal workers and the population. As informal workers are excluded from national labour laws and social security regulations, they are less likely to have access to pensions and health insurance systems. They also face more difficult working conditions, in particular lower wages and greater difficulty in finding sufficient work.

On the one hand, informality and the prevalence of self-employment are the main causes of relatively low health insurance coverage. Of the 9.7 million Peruvians estimated to lack health insurance in 2014, only 2.6% were living in households with no active workers. Even among the poor (e.g. in the first income quintile), only 9% of citizens without health insurance are in households with no workers, a percentage that is lower the higher the income level. On the other hand, 6.3 million were living in households with no formal workers.

On the other hand, affiliation to the pension system is as well a challenge. Peru has one of the lowest rates of affiliation to the pension systems in Latin America. Only 40.5% of employed urban workers were affiliated to a pension system in 2013 (ILO, 2014). Additionally, the low coverage of the pension system is largely driven by informality. Formal workers are much more likely to have access to pensions than informal workers. While only 16% of informal workers are affiliated to a pension system, 83% of formal workers are affiliated. Contributions are, in fact, compulsory for dependent formal workers. Since younger workers are more likely to be informal, coverage is lower for those aged 15 to 29, with 81% not covered. Coverage improves for those 30 and over, although 64% lack affiliation.

The coverage of non-contributory pensions could be extended. The Pension 65 social pension aims to cover the extreme poor over 65. Since the end of 2015, Pension 65 reached 500 000 beneficiaries, which is the limit set by the credits allocated. Given the coverage gap among older adults, the progressive universalisation of the social pension should be considered – that is, extending the programme to all adults above retirement age, beginning with those subsisting under the poverty line. Realising this in a financially sustainable manner would require taxing pension income and possibly progressively reducing the amount of the social pension for those receiving contributory pensions.

Additionally, working conditions are weaker in the informal sector. Informal workers earn significantly less than formal workers in terms of wages, job stability and contracts. Among employed persons with a contract working more than 30 hours per week, formal workers earn hourly wages 24.3% higher than informal workers and monthly wages 22.3% higher (Jaramillo, 2013). This disparity is amplified by the fact that, of the workers considered, formal workers work fewer hours – about one day less per month (Jaramillo, 2013). The pattern of working hours differs across the income distribution and between formal and informal workers. Informal workers are more likely to work short hours, but among those at higher income levels, fewer work short hours and more work long hours (over 48 hours per week). By comparison, formal workers in higher income quintiles are more likely to work full time (30 to 48 hours), and a significant proportion works over 48 hours in a normal week. These patterns suggest that the earning potential of informal workers heavily influences the quality of their jobs.

Pillar 2. Promote the formalisation of jobs

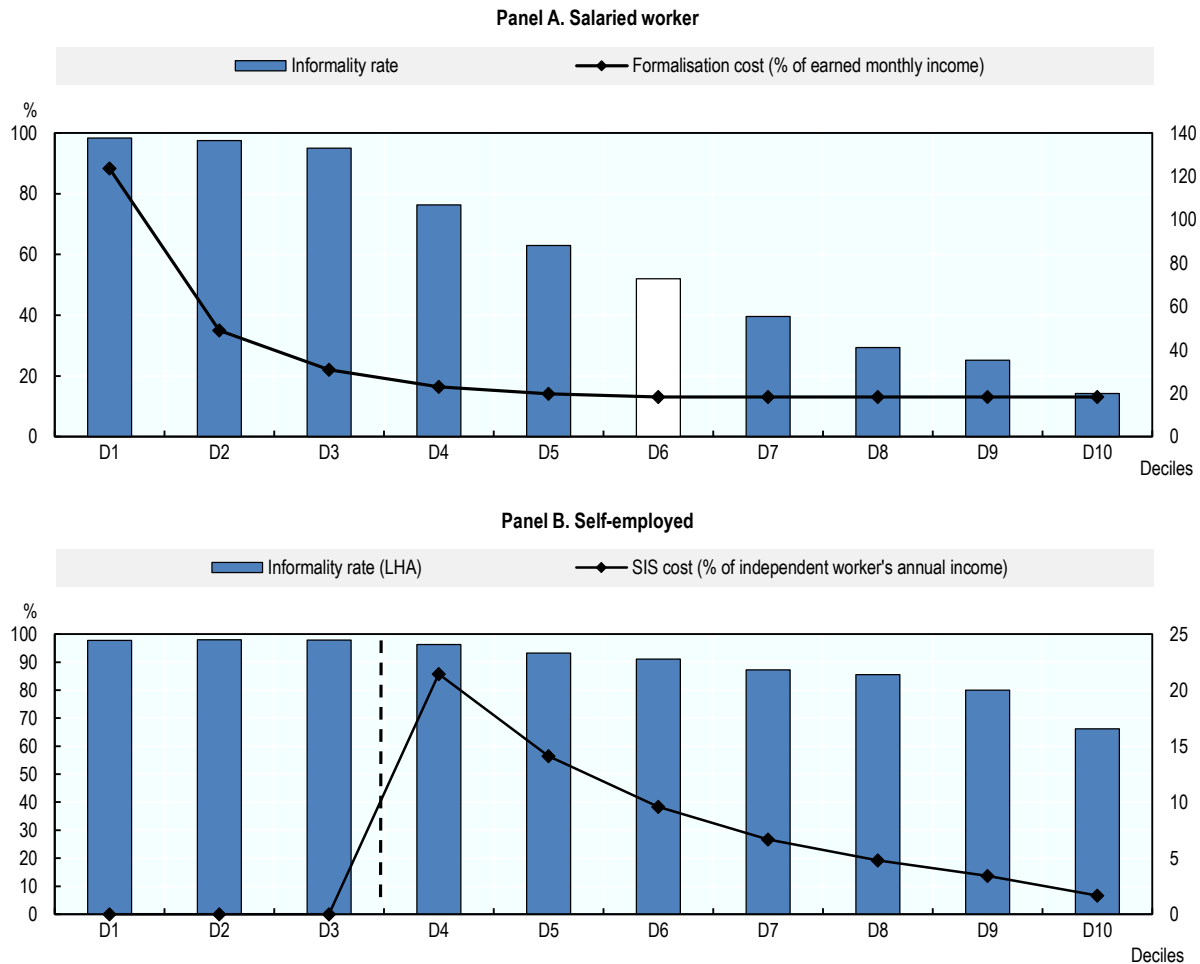
Peru has adopted a number of programmes to reduce informality and improve job quality, yet, informality remains high. To promote the formalisation of jobs, a combination of policies should be adopted. For instance, programmes facilitating workers' registration in the formal sector, reductions in non-wage labour costs, and improving labour productivity through training programmes.

Relative to other countries in the region, the share of the social security burden to both employee and employer appears as low. The costs of pension and healthcare programmes represent 17.5% of total labour costs for salaried workers, 10.1% of which is paid by the employee, and 7.4% by the employer. However, collusion between the employer and employee might arise to lessen the tax burden on both (i.e. they both agree not to contribute to pension and healthcare such that the employer reduces the total labour cost, while the employee increases the net payment in the short-run), thereby encouraging informality.

Labour costs of formalisation represent a barrier to formality for low-income groups. For informal salaried workers who earn an average labour income of the first decile (the lowest in the income distribution), the cost of contributing to social security programmes would be 124% of his/her labour income, rendering it unaffordable (Figure 2.5, Panel A). The cost of becoming formal diminishes as incomes rise, evidencing the positive association between higher social security contributions as a share of income and higher levels of informality within the Peruvian economy. The price of social security contributions stabilises at the level of the minimum wage (sixth decile); however, overall levels of informality remain high even after costs for social security schemes become constant.

Most informal workers are not beneficiaries of the general regime, given that a large share of them are self-employed. At the fourth decile, self-employed workers have to contribute almost 90% of their income to social security programmes. This percentage declines for workers with higher income, but is still relatively high and represents a particularly large barrier to participation in social security for those in the third, fourth and fifth decile (Figure 2.5, Panel B). This creates a large gap and may create incentives to remain self-employed and not declare a share of income in order to remain with free access to SIS, which diminishes the benefit of being formal.

Figure 2.5. Informality and formalisation costs in Peru, 2014-16



Note: The white bar in Panel A represents workers earning minimum wage (PEN 750, although it rose to PEN 850 in May 2016). In Panel B, the poverty threshold to be eligible for the free SIS for 2014 – illustrated by the vertical dotted line – was established at PEN 161 per month for every member of a household.

Source: OECD calculations based on IDB (2015), *Base de datos Sociómetro-BID: Sistema de Indicadores Sociales de América Latina y el Caribe* and OECD/IDB/CIAT (2016), *Taxing Wages in Latin America and the Caribbean* for Panel A; OECD based on ENAHO (INEI, 2014), *Encuesta Nacional de Hogares (ENAHO)* (National Household Survey) (database) for Panel B.

StatLink  <http://dx.doi.org/10.1787/888933996068>

Low labour productivity is one of the main barriers to formality. A large share of informal workers have an output per worker that does not cover minimum regulatory costs of formal hiring (i.e. the minimum wage). If labour income is used as a proxy for labour productivity, then the productivity of a significant share of workers in Peru is below the minimum wage they would need to be paid if they were hired formally. Low productivity, then, is a functional barrier to formality for this share of workers, as employers will not readily bear the costs of the formalisation of workers who do not produce enough to cover them. In fact, labour income of more than half – around 52% – of informal wage earners (dependent workers) remains below the PEN 750 threshold (which was the official minimum wage until May 2016).

Pillar 3. Promote the formalisation of firms

The informal sector is large in Peru and remains concentrated in micro and small productive units and in the agricultural, commerce and transport sectors. As much as 87% of all productive units were informal in 2012. Of these informal firms, almost all have fewer than 5 workers (98.4%), suggesting a strong association between informality and firm size. Only 1.2% of firms have between 6 and 10 workers, and 0.3% of all firms have more than 11 workers (INEI, 2014). In addition, approximately one in three informal firms (33.8%) in the agricultural and fisheries sector are informal, while in the non-agricultural sector, most informal firms belong to the commerce sector (23.9% of total informal firms) and transport (12.2%) (INEI, 2014).

The prevalence of informality among SMEs can be associated to the particular barriers they face to becoming formal. Costs of formalisation, like those linked to taxes and the associated book-keeping and filing procedures, can be particularly hard to overcome for SMEs, given their limited size, capacity and revenues. In an effort to bridge the barriers faced by SMEs, governments have adopted special simplified tax regimes with narrower tax bases tailored, in theory, to encourage formalisation through cost reduction and ease of compliance. Tax compliance costs average PEN 915.80 (Peruvian soles) for a business to adhere to special taxation regimes, which is a significant reduction relative to PEN 7 489.00 for firms to adhere to the general tax regime (SUNAT, 2015). These measures address the cost of tax compliance and, to some extent, special regimes have lowered efficiency hurdles for firms, but they generally do not enhance labour inspection capacities or address other regulatory hurdles.

Tax regimes for SMEs can be improved to provide incentives to become formal and grow. Peru has made efforts to strengthen and simplify the procedures needed for formalisation. There is a general regime and two simplified special tax regimes for SMEs (RUS and RER). However, tax regimes show various overlaps that can generate perverse incentives. For example, RER users can use invoices to deduct intermediate inputs and to recover VAT, while RUS users cannot. This turns the VAT into a de facto cost, hurting efficiency for firms under this scheme. Moreover, given the duplication and the tax benefits of these schemes, firms (single proprietor or larger) might opt for horizontal disaggregation (i.e. some firms split into two or more parts when they reach the maximum size to continue in the most advantageous tax regime), creating tax dwarfism (Inter-American Development Bank [IDB], 2013). Another driver of persistent informality across SMEs is that some elements of the SME legislation (mainly the Law on SMEs approved in 2007) have not been implemented, such as the social protection regime for workers of SMEs. In addition, some of the advantages (such as the general health insurance provided through the SIS) were already accessible without having to bear the costs of formalisation.

Pillar 4. Create the conditions for formal job creation and formal job opportunities

A more diversified economy would support formal job creation. An economic structure concentrated in primary and/or low-productivity sectors that employ large shares of the population in low-quality informal jobs impedes the expansion of formal employment (La Porta and Shleifer, 2014). This is the economic structure seen in Peru, coinciding with a dualist view of informality, which suggests the informal and formal sectors are largely separated, with a large informal sector consisting of many uneducated entrepreneurs running small, unproductive firms that add little value to productivity and a smaller formal sector of educated entrepreneurs who run bigger, more productive firms.

Improving vocational education and training and skills could bring higher opportunities to access formal jobs. Upgrading skills and improving their link with the productive system can raise labour productivity levels. Together with recognition of skills acquired in informal employment, it could also favour access to formal jobs. Improving overall skills levels is critical. A curricula generally more focused on developing STEM, technical and soft skills, and a stronger connection between the education system and skills demands in the economy, are critical to raising skills levels and productivity in Peru (OECD, 2016a). Recognition and certification of skills acquired in the informal sector can be another critical area for policy action, while moving towards a national qualifications framework could be a relevant policy goal in the medium term.

Overall, improving working conditions through formal and better quality jobs requires Peru to engage in policy actions in at least in four different pillars (Table 2.3):

Table 2.3. Lines of action for tackling informal employment

Tackling informal employment	Mitigate the pervasive impact of informality on jobs and labour conditions	Move towards universal basic health coverage
		Extend pension coverage
		Improve working conditions
	Promote the formalisation of jobs	Strengthen systems of inspection and supervision
		Increase the incentives of being formal by reducing the costs of formal hiring, increasing the benefits of being formal, and making it easier, particularly for groups where these are clearly bidding
		Improve communication and financial knowledge, highlighting the benefits associated to formal employment
	Promote the formalisation of firms	Reduce incentives not to formalise
		Reduce the costs and increase the incentives of formalisation
	Create conditions for formal job creation and formal job opportunities	Create the conditions for formal job creation and formal job opportunities
		Improve labour market institutions to improve matching in labour markets and increase the dynamism of the Peruvian labour market
Link efforts to create formal jobs with broader productivity diversification strategies and skills strategies		

Pillar 1. Mitigate the pervasive impact of informality on jobs and labour conditions

Generic recommendation: Move towards universal health coverage		
Specific recommendation	Stakeholders suggestions for action	Key actors
Implement a universal basic health package	Agreement, though the word "quality" should be included. The possibility of eliminating compulsory contributions was discussed	MINSA, Congress
Alternatively, move towards a unique health regime, gradually unifying SIS and EsSalud	Stakeholders agreed	MINSA, Congress
Rationalise existing coverage plans to ensure a complete set of articulated plans	**	MINSA, Congress

Generic recommendation: Extend pension coverage		
Specific recommendation	Stakeholders suggestions for action	Key actors
Extend the coverage of non-contributory pensions (Pension 65) and move towards universal coverage by first expanding Pension 65	Agreement	MINDES

Generic recommendation: Improve working conditions		
Specific recommendation	Stakeholders suggestions for action	Key actors
Increase the capacity of the labour inspectorate (inspection, information and facilitation)	Agreement, but the mechanisms should have two stages: first, alerting, and second sanctioning.	MTPE, SUNAFIL
Provide for financial education and foster the creation of savings and insurance instruments for vulnerable groups	Agreement, but SMEs should be included among these "vulnerable groups"	

Pillar 2. Promote the formalisation of jobs

Generic recommendation: Strengthen systems of inspection and supervision		
Specific recommendation	Stakeholders suggestions for action	Key actors
Increase efforts to supervise informal workers in the formal sector as a potential "low-hanging fruit"	Agreement. It will be important to support protocols for exchange of information across institutions.	SUNAFIL, MEF

Generic recommendation: Increase incentives of being formal by reducing costs of formal hiring, increasing benefits of being formal, and making it easier, particularly for groups where these barriers are clearly binding		
Specific recommendation	Stakeholders suggestions for action	Key actors
Establish a clearly defined mechanism to determine minimum wages in order to reduce discretion and link its future evolution to productivity and prices	Agreement	MTPE
Explore having a different evolution of minimum wages across regions	Agreement, though some caution among participants about the feasibility of its implementation	MTPE
Subsidise social contributions of low-and low-middle income workers	Agreement, but fiscal cost can be large	MTPE
Match contributions, combined with immediate benefits (e.g. insurance)	Agreement, but fiscal cost can be large	MTPE
Provide alternatives to incorporate independent workers in the system: 1) more info and possibilities for gradual incorporation; 2) allowance for specific contribution patterns	Partial disagreement: a broad-based reform of the pensions system should be proposed.	MTPE, ONP

Generic recommendation: Improve communication and financial knowledge, highlighting the benefits associated to formal employment		
Specific recommendation	Stakeholders suggestions for action	Key actors
Associate inspection and supervision with information and counselling	Agreement	MTPE, SUNAFIL
Communicate the benefits of formality and the risks of informality	Agreement	MTPE, SUNAFIL

Pillar 3. Promote the formalisation of firms by providing incentives for and reducing the costs of formalisation

Generic recommendation: Reduce incentives not to formalise (and to remain small, which encourages firm informality)		
Specific recommendation	Stakeholders suggestions for action	Key actors
Simplify and reduce SME regimes	Agreement, with some participants suggesting that RUS should be eliminated.	PRODUCE, SUNAT, MEF
Reduce the gaps in employment protection	Agreement	MTPE, MEF
Extend the use of invoicing, including special regimes and excluded sectors	Agreement	

Generic recommendation: Reduce the costs and increase the incentives of formalisation		
Specific recommendation	Stakeholders suggestions for action	Key actors
Reduce red tape and administrative/recurrent costs of formality	Agreement	PRODUCE, Min of Justice, MEF
Facilitate transition to formality by reducing/eliminating costs associated with the recognition of past benefits of formalised workers	Agreement	MTPE and MEF

Pillar 4. Create the conditions for formal job creation and formal job opportunities

Generic recommendation: Improve labour productivity through more and better skills		
Specific recommendation	Stakeholders suggestions for action	Key actors
Finalise the application of <i>Ley de Institutos de Educación Superior</i>	Agreement. Digital skills must be strengthened.	MINEDU
Recognise skills acquired in the informal sector and move towards a National Qualifications Framework (NQF)	Agreement. The relevance of strengthening the credibility of the certification authority was highlighted. Also, a gradual approach should be taken, given the large implications and costs of a NQF	MTPE

Generic recommendation: Improve labour market institutions to improve matching in labour markets		
Specific recommendation	Stakeholders suggestions for action	Key actors
Strengthen training programmes for youth to avoid massive entry into informality	Agreement, though the scale must be larger. Entrepreneurship should also be part of these programmes.	MINEDU, MTPE, SENATI
Favour information mechanisms such as <i>Ponte en Carrera</i>	Agreement, but diffusion must be better	MTPE

Generic recommendation: Link efforts to create formal jobs with broader productivity diversification strategies and skills strategies		
Specific recommendation	Stakeholders suggestions for action	Key actors
Co-ordinate formalisation efforts with productive diversification strategies	Agreement	Min. of Education, Min. of Labour, PRODUCE, Private sector
Include formalisation as part of national development strategies	Agreement	MEF, CEPLAN, National Council For Competitiveness

Note: Base on the workshop “Hacia más empleos formales y una economía formal en el Perú”, held in Lima on 17 April 2018.

Source: Authors’ elaboration.

Notes

¹ Benchmark countries correspond to the selected countries for the Multi-dimensional Country Review Volumes 1 and 2: 8 OECD member countries (Australia, Canada, Chile, Korea, Mexico, Norway, Portugal, and Turkey), 5 Latin American countries (Brazil, Colombia, Costa Rica, Ecuador and Panama) and South Africa.

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