

Trends in informal employment in Peru: 2004 – 2012

Non-agricultural informal employment in Peru declined from 75% in 2004 to 68.6% in 2012. The favourable economic cycle accompanied by job creation contributed to this decline, as did changes in the structure of employment in production areas and institutional factors such as the creation of e-payroll and tax incentives promoting the formalization of enterprises and employment.

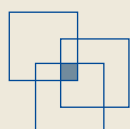


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Foreword

Informal employment is a persistent problem in Latin America and the Caribbean. Following a decade of economic growth and decline in unemployment rates, there are still 130 million workers holding informal jobs, deprived of social protection and labour rights.

This does not mean, however, that there has not been any progress made on the issue of formalization.

Formal employment, wage labour and social protection coverage have increased in Latin America and the Caribbean. Now, it is important to speed up this process to confront the long-time growth and consolidation of informality in the region.

We cannot forget that the reduction of informality is a key component of the efforts to reduce inequality and social exclusion.

The experience of the last few years confirms that economic growth is essential for the generation of more and better jobs, but it is not enough. To reduce informality, it is necessary to implement deliberate and integrated economic, social and labour policies and actions that complement economic growth, in the framework of sustainable development.

In fact, the policies implemented in several countries were key components of the progress achieved on the subject of formalization. This formalization process has not been uniform. In some countries, processes were faster and took a relatively short time. In others, progress has been slower.

In 2013, the ILO Regional Office for Latin America and the Caribbean launched the **Programme for the Promotion of Formalization in Latin America and the Caribbean, FORLAC**. The programme has three components: a) generation and dissemination of knowledge on formalization policies, b) technical assistance to specific countries, and c) capacity-building of workers' and employers' organizations in formalization issues.

The ILO FORLAC Notes presented here are part of the first component. We analyze public policy experiences trying to identify the most remarkable ones according to the academic or political discussion.

Formalization strategies require a favourable economic context, as well as articulated policies that allow us to address a multidimensional and highly heterogeneous phenomenon.

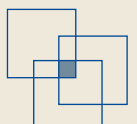
The persistence of high levels of informality is a major challenge requiring the implementation of measures that produce sustainable results.

The ILO expects that the dissemination of these experiences will help promote broader discussion on the strategies that countries may use to facilitate the transition to formality in the region.

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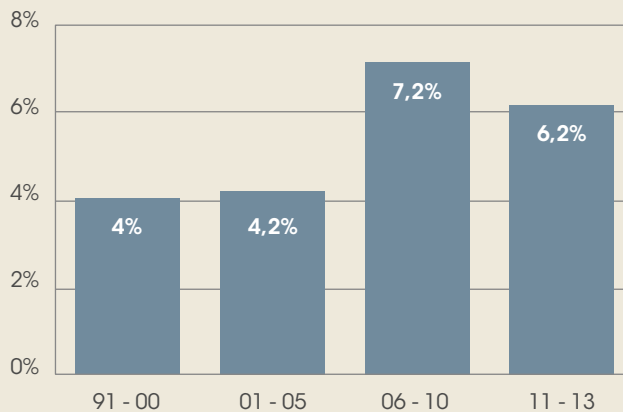
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1. Recent economic and labour market performance in Peru

Over the past decade, the Peruvian economy has experienced rapid growth. In 2001-2012, average growth was 5.8%, with the greatest increase occurring between 2004 and 2008, when it reached a rate of 7.6%. This process enabled the country to weather the 2009 global crisis reasonably well, as well as the subsequent crisis in the euro zone and the recent economic slowdown in the United States and China.

Figure 1. Peru: Economic growth, 1991 - 2013
(% average annual change for each sub-period)



Source: ILO, based on IMF (2013).¹

In a context of increased trade opening, Peru benefited from a favourable economic scenario, which was reflected in a significant improvement in its terms of trade –of 59% between 2000 and 2012– and of increased investment flows. At the same time, monetary and fiscal policies were applied with explicit inflation and fiscal deficit targets.² After the crisis, the economy again grew, although at a slower pace.

Social indicators also showed positive trends. The GDP per capita grew 57% in real terms, and the poverty rate fell sharply, from 58.7% in 2004 to 25.8% in 2012, as a result of economic growth and social policies associated with increased fiscal solvency.³ Moreover, inequality in personal income declined,⁴ although the participation of remunerations in GDP remains one of the lowest in the region.

For its part, the labour market recorded a growth in employment of approximately 2.5 million workers between 2004 and 2012. Output per worker rose approximately 44% in real terms and the rate of open unemployment was 3.7% at the national level and 5% in Metropolitan Lima in 2012, the lowest levels recorded since comparable national statistics became available.

¹ IMF (2013). World Economic Outlook Database. October 2013.

² Infante, Chacaltana and Higa (2014). "Perú. Aspectos estructurales del desempeño macroeconómico. Situación actual, perspectivas y políticas." In: Infante and Chacaltana (Eds.) *Hacia un desarrollo inclusivo. El caso de Perú*. Santiago, Chile: Economic Commission for Latin America and the Caribbean (ECLAC) and the International Labour Organization. In printing.

³ Infante and Chacaltana (2014). "Introducción." In: Infante and Chacaltana (Eds.).

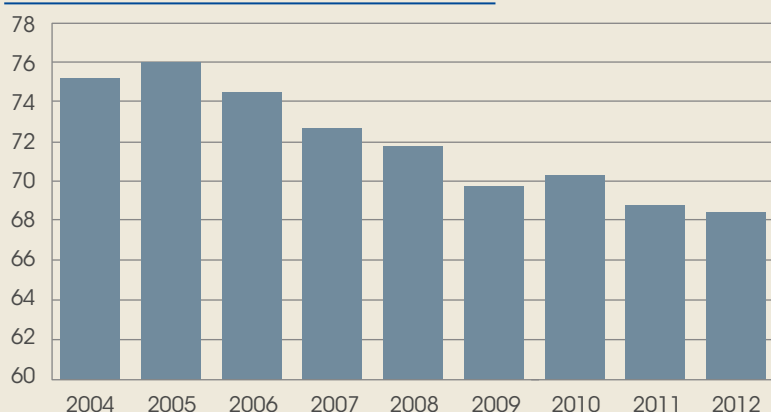
⁴ There is some debate on this issue, especially if the calculations on personal income inequality are made on the basis of the adjustment of national accounts. See Mendoza (2011). "El "milagro peruano" y la desigualdad." *Actualidad Económica del Perú*. 9 May 2011.

The expansion of employment was concentrated in urban zones and wage employment increased from 38% in 2004 to 46% in 2012.

2. Trends in informal employment, 2004-2012⁵

In 2004, nearly 75.2% of the non-agricultural labour force had informal employment, a percentage that fell to 68.6% in 2012.⁶

Figure 2. Peru: Informal employment, 2004 - 2012
(% of total non-agricultural employment)



Source: SIALC ILO, based on the National Household Survey.

Non-agricultural informal employment – which totalled 68.6% in 2012– is made up of 18.3% in the formal sector; 47.2% in the informal sector; and 3.1% in domestic service. Informal employment fell in all of these components, particularly in domestic service.⁷

Table 1. Peru: Components of non-agricultural informal employment 2009-2012
(% of total non-agricultural employment)

	2009	2010	2011	2012
Non-agricultural informal employment	69,9	70,3	68,8	68,6
In the informal sector	48,2	49,2	48,8	47,2
In the formal sector	17,8	17,6	17,0	18,3
Domestic service	3,9	3,6	3,0	3,1

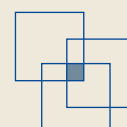
Source: SIALC ILO, based on the National Household Survey.

Informality is more frequent among own-account workers, domestic workers and contributing family workers, a group which concentrates 57% of all non-agricultural informal employment.

⁵ For a more detailed discussion on the definition of informal employment, see ILO (2012). *Measuring Informality: A Statistical Manual on the Informal Sector and Informal Employment*. Geneva: ILO.

⁶ This information is consistent with estimates of the National Statistics Institute (INEI).

⁷ Informal employment declined at a higher rate in urban areas, as compared with rural areas, where there is a higher incidence of informal employment. Díaz (2014). "Formalización empresarial y laboral." In: Infante and Chacaltana (Eds.).



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Table 2. Peru: Non-agricultural informal employment by status in employment 2012
(% of total non-agricultural employment and % in each category)

	% of informal employment	Informality rate
Status in employment	100%	68,6%
Wage workers	43,1%	49,7%
Enterprises with 1 to 10 workers	27,2%	80,7%
Enterprises with more than 10 workers	15,9%	30,0%
Own-account workers	44,8%	95,4%
Domestic workers	4,5%	90,4%
Contributing family workers	7,6%	100,0%

Source: SIALC ILO, based on the National Household Survey.

Notably, the number of registered workers (on the payroll) also increased significantly during this period). Between 2004 and 2012, this number tripled, as discussed later in this paper.

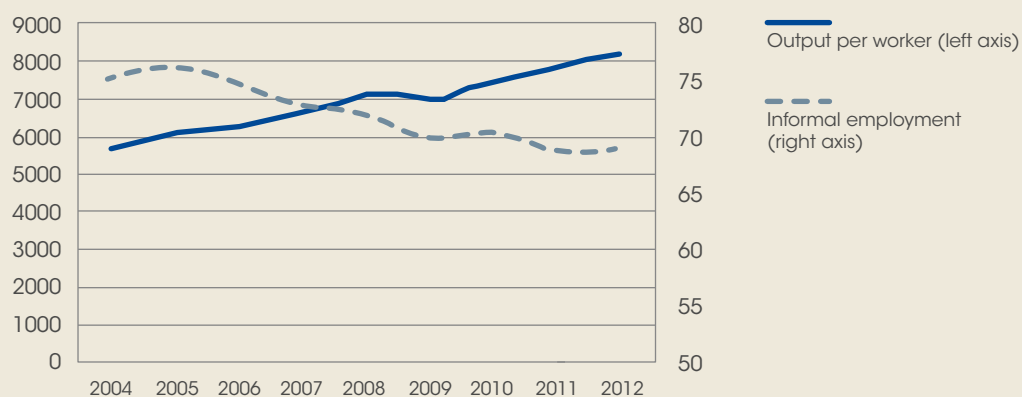
3. Factors contributing to the reduction in informal employment⁸

The reduction in informal employment observed in recent years in Peru resulted from a combination of economic growth and institutional reforms.

3.1 Economic growth

The strong economic growth mentioned contributed to reducing informal employment. Between 2004 and 2012, output per worker increased by 44%, in other words, an average of 4.5% per year. At the same time, informal employment indicators experienced a downward trend.

Figure 3. Peru: Non-agricultural informal employment and output per worker, 2004 – 2012 (% of total employment, US\$ of 2005)



Source: Cepalstat and SIALC ILO, based on the National Household Survey.

⁸ Díaz (2014) contains a detailed discussion of the policies implemented.

Clearly, the decline in informality observed was not comparable to the decrease in poverty, which fell by half, according to the INEI. This is because economic growth is a necessary but insufficient condition for the formalization of employment.

A key characteristic of the Peruvian economy is that growth tends to be concentrated in sectors with high productivity but a low percentage of job creation and with limited sector linkages.⁹ This is also observed when analyzing the productive structure by enterprise strata, given that output is concentrated in large enterprises with high productivity; whereas in own-account employment, microenterprises and small enterprises with very low productivity levels, there is little production, even though these categories employ the bulk of the country's labour force.¹⁰

For this reason, it is also important to analyze informality trends by the productive structure and structure of employment.¹¹ To this end, Díaz (2014) carried out a breakdown by enterprise stratum –modern, intermediate, traditional–, of the changes in informality during the period 2002-2011. He estimated that the participation in employment in intermediate and modern strata in total employment has increased, whereas that of the traditional stratum has declined.

Díaz concluded that over half of this reduction can be associated with changes in the informality rate in each production stratum considered, whereas the other half is most likely associated with changes in the structure of employment among productive strata.¹²

3.2 Institutional factors

One major institutional change was the implementation of the e-payroll in August 2007. This is an electronic procedure through which employers with three or more workers must send monthly reports to the National Tax Authority (SUNAT) regarding their workers, pensioners, service providers, personnel in training, outsourced workers and claimants. Previously, this report was sent directly to the Ministry of Labour.

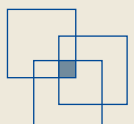
This administrative change increased the Ministry of Labour's capacity to supervise and monitor compliance with labour obligations since it takes advantage of the SUNAT's installed and detection capacity. In real terms, payroll reporting has increased significantly, especially in enterprises that already reported to the SUNAT but not to the Ministry of Labour.

⁹ See Távora, Gonzales and del Pozo (2014). "Heterogeneidad estructural y empresas de menor tamaño." In: Infante and Chacaltana (Eds.).

¹⁰ See Villarán (2007). "Políticas e instituciones de apoyo a los Mype en el Perú." Manuscript. Lima: SASE; Chacaltana and Yamada (2009). "Calidad del empleo y productividad laboral en el Perú." Inter-American Development Bank. Working Paper No. 691.

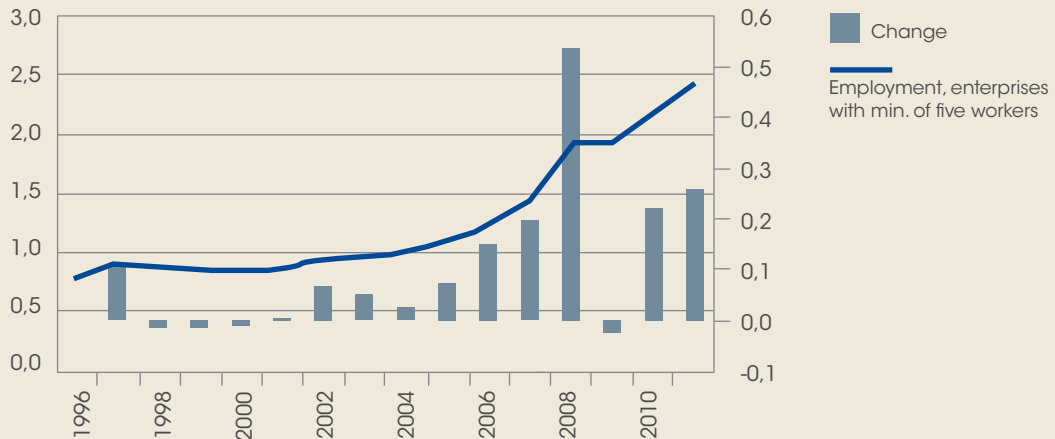
¹¹ Díaz (2014) uses the number of workers to classify production strata into traditional, intermediate (101 to 200 workers) and modern (more than 200 workers and the public sector).

¹² Using the method known as *shift share*.



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Figure 4. Peru: Registered employment, 1996 - 2011
(% of annual change and millions of registrations)



Source: Díaz (2014).

In 2008, the first year that e-payroll information was available, 1.96 million jobs were registered in private-sector enterprises with five or more workers, which signified 535,000 new formal jobs in these enterprises. Figure 5 shows that this increase positively compares with that of previous years.

It is estimated that the introduction of the e-payroll has contributed to the registration of 340,000 jobs as the upper range. If the effect of increased economic growth is subtracted, this contribution was of 276,000 new formal jobs. Added to this are the nearly 208,000 new jobs registered in private-sector enterprises with fewer than five workers. This group of enterprises was not required to register employment prior to the introduction of the e-payroll. At any rate, coverage of micro and small enterprises (MSEs) is low in the e-payroll since the 219,000 enterprises with fewer than 99 workers registered in 2011 represent just 7% of the total of MSEs existing in Peru that year.

This demonstrates that efforts to improve the capacity for supervision and monitoring of compliance with legislation are clearly positive and that the implementation of the e-payroll has significantly contributed to this end.¹³ Nevertheless, tax and labour supervision of smaller enterprises is a pending government task.

Important advances were also made in increasing coverage of the different types of health insurance in Peru. In 2011, 64.5% of the population was covered by some type of health insurance. An upward trend has been observed in this area for the past 10 years, in particular due to the recent expansion of the Integral Health Insurance Scheme (SIS), which has a subsidized component and a semi-contributory one. In the specific case of contributory insurance (EsSalud), the number of affiliates registered has also been on the rise since the 1980s. The number of insured (affiliates and beneficiaries) rose from 5.9 million in mid-2006 to 9.2 million in early 2012. This is largely due to the growth in formal wage employment.¹⁴

Another area of interest is the support to MSEs. For example, there are simplified tax mechanisms, such as the Single Simplified Regime (RUS) and the Special Income Tax Regime (RER) that seek

¹³ Another initiative of the Ministry of Labour as the implementation of *Plan Reto* (Mandatory Registration of Payroll Workers) between December 2008 and May 2011. This plan consisted of labour inspections to incorporate unregistered workers on enterprise payrolls. Although the plan has been completed, inspections of private enterprises continue.

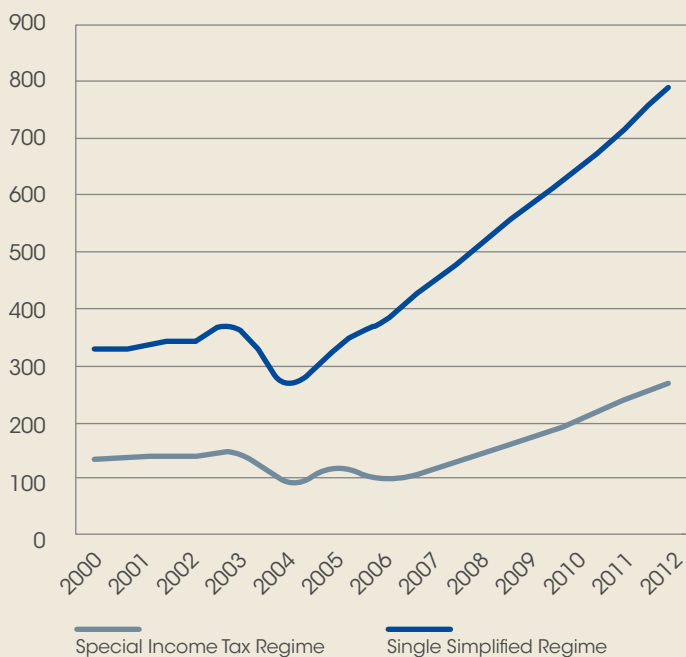
¹⁴ Cetrángolo, O.; Casalí, P.; Bertranou, F.; Casanova, L. (2013), "El Sistema de Salud en el Perú: situación actual y estrategias para orientar la extensión de la cobertura contributiva." ILO, Lima.

to increase tax revenue. Both regimes apply exclusively to microenterprises and individuals with business activities. The RUS is for individuals and permits the payment of a fixed sum to avoid filing a tax return and paying income, sales and municipal taxes. In addition, it exempts microenterprises from having to keep all accounting records. Payment of taxes is not the only obstacle to formalization; the complexity involved in filing a tax return and keeping accounting records is also a disincentive.

In the case of the RUS, only sales receipts can be issued, which limits the regime's benefits to individuals since enterprises must support all expenses and/or spending with an invoice. As with all special regimes, the RUS implies a real risk since larger enterprises take advantage of this regime through sub-divisions or the underreporting of sales volumes. However, not being able to issue invoices is a constraint since formal enterprises require these for reimbursement of sales taxes on their purchases.

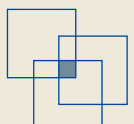
The RER does allow issuance of invoices and also seeks to simplify tax payments through a monthly fixed payment on monthly net income, which is considerably below the 30% third-category enterprises must pay on revenues. This regime does not exclude sales tax payments and enterprises must also keep accounting records. The goal of reducing income tax payments is to promote formalization and expand the tax base, since MSEs comprise a significant share of GDP.

Figure 5. Peru: Number of active contributors to RER and RUS, 2000-2011 (in thousands of persons)



Source: Díaz (2014).

To December 2011, the SUNAT had more than 700,000 taxpayers registered under the RUS, whereas it had just over 236,000 microenterprises under the RER. These regimes focus on aspects of compliance with tax obligations. Enterprises of this type often comply more with tax law than with labour law.



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From a labour perspective, one area of discussion is the special regime for small enterprises (Law 28015 of 2003 and Legislative Decree 1086 of 2008),¹⁵ which provides tax incentives and reduces labour obligations. This regime, created in 2003, was initially designed for enterprises with a maximum of 10 workers. In 2008, the definition of small enterprise was expanded to include all enterprises with a maximum of 100 workers. At the same time, the annual sales maximum was increased from 850 Tax Units to 1,700.¹⁶

With respect to tax incentives, facilities for microenterprises were incorporated, such as the reduction of the net sales tax, from 2.5% to 1.5%. Small enterprises were excluded from this regime but were allowed to apply accelerated depreciation for calculating the income tax in the modified law of 2008.

In terms of labour, the minimum wage was maintained, although several employment benefits were significantly reduced, such as payment for unjustified dismissal, compensation for time of service (CTS) and bonuses. In addition, the obligation to contribute to Essalud for microenterprise workers was eliminated, and government-worker co-financing was established for affiliating workers to the SIS. In the 2003 Law, no contribution to any social protection system was established for microenterprises, but in the 2008 modified law, the Social Pension System was created, which microenterprise workers can voluntarily access and which includes government co-payments (50%).

Available evidence suggests that the application of these modifications has not had a significant effect on formalization. Rather, it has generated a heated debate with regard to the deterioration of the resulting working conditions, as well as their pertinence and effectiveness. Díaz (2014) found that, according to recent information from the Registry of Micro and Small Enterprises, only 5% of the total estimated MSEs in Peru (2011 ENAHO survey) are registered. Other studies had similar results.¹⁷

There are other measures to promote MSEs that could help to increase productivity, such as the promotion of access of MSEs to government procurement (the existing target is that at least 40% of public procurement should come from MSEs); programmes for opening, consolidation and diversification in international markets; policies to promote technological innovation through the 2006 Innovation, Science and Technology Fund (FINCYT); and the creation, in 2000, of the Network of Technological Innovation Centres (Cite), both public and private. There is also an e-government project which seeks to simplify administrative procedures through electronic access and the promotion of government transparency. These initiatives include the online establishment of enterprises. Currently, the programme is in a preliminary stage, for which reason the service is only available to individuals with national identity documents. With the implementation of this service, the number of days needed to create an enterprise decreased from 10 to three. In the area of finance, the law enables the Financial Development Corporation (Cofide) to finance the discount on microenterprise sales invoices. Also noteworthy are activities to promote association of the 2010 National Competitiveness Plan and the 2006 Law of Real Estate Guarantees, which is designed to facilitate access of MSEs to financial services.

¹⁵ Law N° 28015 of 3 July 2003 "Law for the promotion and formalization of micro and small enterprises" and Legislative Decree N° 1086 of 28 June 2008, which adopts the law of promotion of competitiveness, formalization and development of micro and small enterprises and access to decent work.

¹⁶ In 2013, the law was again modified (Law N° 30056 of 2 July 2013) although it still is not in effect given that it lacks regulations.

¹⁷ See, for example: Garavito (2005). "Impactos económicos de la extensión de la Ley Mype al resto de unidades económicas." Lima: Ministry of Labour; Chacaltana (2008). "Una evaluación de la ley Mype en Perú al cuarto año de vigencia"; Jaramillo and Díaz (2010). "Evaluación de los Programas de Apoyo a los Pyme en Perú." In: Acevedo and Tan (Eds). Impact Evaluation of SME Programs in Latin America and the Caribbean. Mexico City: World Bank.

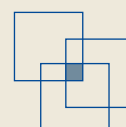
Because these initiatives have not been implemented in a coordinated manner, they require strengthening given the importance of MSEs for job creation in the country.

4. Conclusions

Both economic growth and institutional factors have contributed to the increase in formalization in Peru during the period 2004-2012, although economic conditions had more impact. Among institutional factors, the expansion of the capacity of the labour authority through the e-payroll played a central role in promoting formalization.

Nevertheless, it is clear that both economic growth and institutional strengthening have limited effectiveness in achieving formalization given the diversity of the productive and labour market structures in the Peruvian economy.

Even with relatively strong economic growth, such as that recorded in the years studied, results in terms of creation of formal jobs would be limited by the aforementioned characteristic of the Peruvian economy, which tends to concentrate the most positive production performance in sectors that create few jobs. Consequently, it is crucial to address this characteristic if the goal is to achieve more and better results in reducing informal employment in the future.

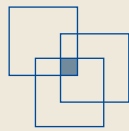




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