ILO NOTES

International Labour Organization

FACING THE CRISIS IN EUROPE: REFLECTIONS ON THE CASE OF PERU

I. CRISIS IN EUROPE AND ITS EFFECT ON PERU

The European crisis, and especially the Eurozone crisis, has had an impact on world economic performance, producing a slowdown of overall economic activity that was also reflected in Latin America (see table 1). The case of Peru is special, because Peru is one of the countries where forecasts for 2012 were revised up, both by the International Monetary Fund as well as by ECLAC. Peru is estimated to have ended 2012 with 6% growth, and although revisions are slightly down for 2013, forecasts are between 5.5% and 5.8%.

From this point of view, one could conclude that the Peruvian economy will not be greatly affected by the European crisis. Nevertheless, there are certain elements that do indicate a certain impact. On the one hand, Peruvian exports recorded a 6% setback in 2012 in comparison to 2011, primarily due to the fall in the price of traditional exports, as exported volumes continued to grow. In spite of this, the appreciation of the Peruvian sol in relation to the US dollar has continued its trend, reflecting the impact of US expansive monetary policy. It is worth noting that the Central Bank of Peru actively intervened in the exchange market, aiming to moderate this appreciation and maintain a more stable exchange rate.

TABLE 1: Latin America and Peru: 2012-2013 GDP trends and forecasts
(annual GDP percentage variations)

Institutions	2009	2010	2011	2012	2013
Latin America and the Caribbean[a]	**-1.6**	**6.2**	**4.5**		
- International Monetary Fund (IMF)				3.7a 3.4b, 3.2c	4.1a 3.9c
- Economic Commission for Latin America and the Caribbean (ECLAC)				3.7d2.8e	4.1e
Peru					
- International Monetary Fund (IMF)				5.5a 6.0a	6.0a 5.8c
- Economic Commission for Latin America and the Caribbean (ECLAC)				5.7d 5.9e	5.5e

Source: ECLAC and IMF

a) IMF (2012) *World Economic Outlook: Growth Resuming, Dangers Remain. World Economic and Financial Surveys* (Washington D.C., IMF)
b) IMF (2012) *World Economic Outlook Update* (Washington D.C., IMF)
c) IMF (2012) *Regional Economic Outlook Update* (Washington D.C., IMF) Autumn
d) ECLAC (2012) *Informe macroeconómico de América Latina y el Caribe* (Santiago, ECLAC)
e) ECLAC (2012) *Estudio económico de América Latina y el Caribe. Las políticas ante las adversidades de la economía internacional* (Santiago, ECLAC) October

As to the labour market, after a rise in 2009, the unemployment rate followed a steady downward trend since 2010 and stabilized in 2012 at levels around 7.5%. Informal employment indices in the non-farming sector have fallen from 76.1% in 2005, to 70.3% in 2010 and 68.8% in 2011. Nevertheless, the monthly variation-index for employment, prepared by the Ministry of Labour, shows sluggish employment in the manufacturing sector since early 2012.

II. DIFFERENCES BETWEEN THE CURRENT SITUATION AND 2008 IN PERU

a) The 2008/2009 international crisis

The 2008/2009 international crisis mainly affected Peru through a fall in the price of raw materials as well as through increased capital outflows. Peru's general terms of trade dropped by 14% and 3% in 2008 and 2009, respectively. A fall like in 2008 had not been observed since 1958. In the period January-June 2009, total exports fell by 29.6% as exports of raw materials (ores, fishmeal, and so on) dropped by 31.7%, and non-traditional exports (garments, agri-business, and so on) by 22.9%. The areas of economic activity that suffered the greatest impact were non-primary manufacturing (-10.2% in January-June 2009) and construction (where growth fell from 18.6% in 2008 to 1.9% in 2009). In addition, significant short-term (almost 11% of GDP in the last quarter 2008, and 5% of GDP in the first quarter 2009) and long-term (1.1% of GDP in the last quarter 2008) capital outflows were registered.[1]

As a result, real GDP declined in the second and third quarters of 2009 by 1.2% and 0.6%, respectively, in comparison to the same quarters in 2008. This negative impact made the annual GDP growth rate drop from 9.8% in 2008 to 0.9% in 2009. Likewise, non-primary GDP (mainly urban, which concentrates 80% of GDP and almost all waged employment) fell -5.8% in the last quarter 2008, -5.7% and -2.1% in the first and second quarters 2009, respectively. This caused urban employment in formal private enterprises, of 10 workers or more, to contract during the first quarter 2009. Nevertheless, global labour market variables –such as unemployment, employment adequacy, real wages, and working hours– did not change significantly.[2]

To face the crisis, the Peruvian government took several monetary, fiscal, and labour market steps. In terms of monetary policy, the Central Reserve Bank applied a series of measures to prevent credit supply chocks and avoid an exchange crisis. Initially –between September and December 2008– liquidity equivalent to 9.3% of GDP was injected, and bank reserve requirements were reduced. The government also intervened to avoid a rise in the exchange rate. Later-on, after a period of major international turbulence, the benchmark interest rate was reduced from 6.5% in February 2009 to 1.25% in August 2009, its historical low.

In the field of fiscal policy, a bi-annual economic stimulus plan *(PEEB – Plan de Estímulo Económico Bianual)* was implemented for the 2009-2010 period, at a cost equivalent to 3.5% of GDP. The aim of the PEEB was to stimulate the economy in the short-term and at the same time close the infrastructure gap and stimulate long-term growth. Almost 50% of PEEB resources were assigned to the first component, through measures to directly boost economic activities[3] and support vulnerable groups.[4] Just over 50% was assigned to public investment in infrastructure.[5] Measures implemented did not only imply increased spending (budget allocations), but also other non-budgetary measures, such as reducing the tax burden and simplifying procedures to spur public and private investment.

One lesson learned in 2009 relates to the fact that implementing fiscal policy takes time. For example, in 2010, once the crisis was over, execution of certain PEEB 2009 funded projects was just starting. It should be pointed out that during 2009 and 2010 the resources deposited in the Fiscal Stabilization Fund (FEF – *Fondo de Estabilización Fiscal*)[6] were not used, according to the report on cumulate FEF savings at 31 December 2011, prepared by the Ministry of Economy and Finance.

In the area of policies directly linked to the labour market, several measures were adopted to improve workers' disposable income. In April 2009 Congress passed a law giving private sector workers access to 100% of funds deposited as compensation for years of service (*CTS - Compensación por Tiempo de Servicios),* with funds becoming available in the months of May and November 2009. According to estimates by the Superintendency of Banks, Insurance, and Pension Fund Administrators, workers withdrew approximately 1.21 billion soles from their CTS funds, out of a potential 2.832 billion soles. Free availability of these CTS funds was progressively restricted after 2010.

End-of-year and national-day bonuses were exempted from charges and social security payments. Thus, the 9% payroll contributions made by employers for Health Insurance were paid directly to workers, which represented approximately 520 million soles.[7] The same was done with pension fund contributions (between 11% and 13% of the payroll) which, according to the Ministry of Labour and Employment Creation, represented approximately 900 million soles.

For public sector workers, in July 2009 the July and December 2009 bonuses for armed forces, national police and pensioners were increased, which represented a liquidity injection of approximately 493 million soles.

For more vulnerable workers at risk of losing their job, a work retraining programme called REVALORA was created in March 2009, with the aim to bolster their employability and

1 Dancourt and Mendoza (2009) "Perú 2008-2009: Del auge a la recesión. Choque externo y respuestas de política macroeconómica", in *Crisis internacional, impactos y respuestas de política económica en el Perú* (Lima, Dancourt and Jiménez, publishers)

2 Yamada and Castro (2010) ***Análisis con base en la información proveniente de la Encuesta Permanente de Empleo (EPE) de Lima Metropolitana*** (Lima)

3 Measures focused on combating the negative effects of the crisis on more sensitive groups, such as exporters and micro and small enterprises. For example, drawbacks were temporarily increased for non-traditional exports from 5% to 8%, government acquisitions from SME's were boosted, and a fund was created as a back-up instrument for up to 50% of the credits awarded by financial system institutions to medium-size enterprises working in production, services, and trade.

4 By giving priority to projects in basic infrastructure, irrigation infrastructure maintenance, school and health buildings maintenance, social investment, and social programmes

5 The intention was to ensure public investment in infrastructure should increase from 4.3% of GDP in 2008 to 6% of GDP by 2010

6 In Peru there is a Fiscal Stabilization Fund ***(FEF – Fondo de Estabilización Fiscal)*** created in 1999 by Law No. 27245, a fiscal prudence and transparency law that aimed to shield the economy against a possible national emergency (natural disasters) or national/international crisis. At 31 December 2011, according to the report on cumulate savings in the FEF prepared by the MEF, the FEF totalled US$ 5.626 billion, equivalent to 3.2% of GDP. The same report shows that in 2008 the FEF totalled US$ 1.806 billion, equivalent to 1.4% of GDP.

7 These measures were also decreed for 2010 end-of-year and similar bonuses. Special bonus amounts received by workers totalled 611 million soles.

entrepreneurial skills. The programme provides skills training in the form of short technical courses offered at various public and private institutions, certifies or accredits the experience of workers who already master a certain skill or profession, and provides technical assistance to entrepreneurs through training and mentoring of a business plan.

This programme was operational from April 2009 until August 2011, when it trained 53,061 individuals, certified 1,011 workers, provided support to 1,362 entrepreneurs and implemented 195 business plans. Of the workers trained, 34% found a formal job. The total budget for the programme was 62.4 million soles, with an average investment of 1,176 soles per beneficiary (Tostes Vieira, 2011). In September 2011 the Revalora programme was converted into the National Programme for the Promotion of Labour Opportunities "Vamos Peru", which is still operational today.

b) The 2012 international crisis

As already mentioned, until 2012, labour indicators showed limited impact of the international crisis.[8] Nevertheless, national discussions already envisage certain risks associated to:

- International uncertainty on account of the European crisis, the political processes aiming to resolve banking, financial, and fiscal problems in the Eurozone and the USA and above all the slowdown of growth in China, which is Peru's main trading partner and also has significant influence on the price of raw materials exported by the country.
- Greater capital inflows, which lead to concerns on the impact of currency appreciation on the export sector, speculative capital inflows and a credit boom possibly leading to a real estate bubble.
- Domestic supply shocks (possibility of an *El Niño* phenomenon) and especially external shocks (collapse of terms of trade due to lower prices of raw materials on account of lower world aggregate demand and rising prices of food and fuel, due to, for example, drought in the USA and tensions in the Middle East).[9]
- In view of this situation, the government adopted certain preventive measures. A first set of measures was taken between September and October 2011, aiming to mitigate the deteriorating international setting through D.U.N° 054-2011 (1.535 billion soles) and 058-2011 (1.573 billion soles). The majority of these measures consist of investment projects to be implemented by Regional and Local governments, such as infrastructure and equipment maintenance, and acquisitions from SMEs, among others. According to the 2013-2015 Multiannual Macroeconomic Framework, only 34% of the total budget assigned to these measures for the 2011-2012 period had been executed by late 2011.

In June 2012, in the face of international uncertainty and signs of a slowdown in world growth, additional measures were adopted to maintain and promote the dynamism of the national economy and attend the needs of vulnerable sectors through D.U.N° 016-2012 (2.072 billion soles), as part of an economic stimulus plan *(PEE – Plan de Estímulo Económico).* In addition, this same month, the Peruvian government announced 12 measures to supplement the PEE, facilitating export sector credit and competitiveness.

More recently, in November 2012, the government of Peru announced it was supporting the execution of 10 billion dollars private megaprojects in infrastructure before late 2013, fast-tracking bureaucratic procedures and preparing or expropriating land for these projects, as a way to sustain the country's growth. In addition to this, discussions in Congress are on-going on a bill that would authorize the payment of taxes in foreign currency, in order to offset the impact of national currency appreciation.

The final version of the 2013 Budget Law for the public sector was passed in November 2012, which considers a Contingency Reserve equal to 5.273 billion soles destined to finance types of expenditures, which due to their nature and the economic situation, are not included in sectoral budgets. According to the Central Bank, in late October 2012 Peru had US$ 61.902 billion in Net International Reserves, which represents more than a third of its GDP and helps shield the Peruvian economy against potential exchange crises and other effects of the international crisis.

III. POSSIBLE AREAS FOR INTERVENTION RELATED TO EMPLOYMENT

In an atmosphere of uncertainty as indicated, it is useful to review available labour market policy instruments in the country and assess their ability to respond in a timely manner in case of a worsening economic situation. As shown during the 2008 financial crisis, most instruments are not for automatic implementation but, on the contrary, require relatively long implementation times.

In the first place, the employment variable should be included in the assessment of public works. One economic sector quickly affected by a significant slowdown of economic growth is the construction sector. As shown, Peru preventively increased its expenditure in public investment with a clearly countercyclical intention. In this framework it would be appropriate to systematically include an assessment of the impact on employment of the portfolio of projects in execution and planning in order to be able to prioritize projects in the case of a crisis. Likewise, and considering the importance of acting in a timely manner, the necessary mechanisms should be established to minimize administrative times required for the start-up of new projects.

There are programmes of a countercyclical nature in the labour market, such as the *Trabaja Peru* programme, which executes labour-intensive public works; and *Vamos Peru*, aiming to retrain workers displaced from sectors affected by the crisis to other sectors with a growth potential. In both cases, it is important to introduce mechanisms that, in the wake of a possible crisis, allow the extension of these programmes to enhance their countercyclical effects.

There is no unemployment insurance system in Peru. Various options have been discussed in the past, with great interest among social partners, but there have been differences in

8 An incipient change in migration has been observed. From January 2011 to January 2012 the population of Spanish residents in Peru increased by 15% (from 13,180 to 15,214 Spanish nationals) according to the National Statistics Institute of Spain. Likewise, according to the Ministry of Labour of Peru, the number of returned migrants who accessed training programmes increased significantly

9 Inflation report, September 2012, Central Reserve Bank of Peru and 2011-2013 Multiannual Macroeconomic Framework (Lima, Ministry of Economy and Finance of Peru)

relation to the desired funding mechanism. Perhaps now is an appropriate time to resume these discussions. In relation to this point, it would be important to assess to what extent the use of deposits for years of service as a countercyclical mechanism during the previous crisis altered, or not, this important fund for workers in times of unemployment.

Along the same line, young people as a whole deserve priority attention, since past crises have disproportionally affected this segment of the labour market (the youth unemployment rate is four times the rate for adults). Added to this, according to the INEI, in 20018 8.5% of unemployed youth had prior working experience, and only 11.5% had never worked before. In 2011, the percentages were 79.5% and 20.5% respectively.

Another pending task –although more structural in nature– is to strengthen connections between skills training and private sector demands. Available data suggests skills training in Peru faces obstacles in terms of funding, relevance, and quality. Three possible ways to progress in these aspects are:

Between 2010 and July 2012 there was a mechanism to fund training by enterprises called the Human Capital Law *(Ley de Capital Humano)*, which allowed deducting training expenditure by enterprises from income tax. In 2011 this mechanism mobilized resources equivalent to more than 50 million dollars, and permitted more than 100 thousand workers to be trained at about two thousand enterprises. The system is still operational for the 2012 fiscal year, but has by now been repealed, and therefore will not be implemented in 2013. According to some stakeholders, the system restricted the ability of enterprises to deduct training expenditure (without the law it was possible to deduct everything, whereas the law set a ceiling), and hence without the law there would be more training at enterprises. Nevertheless, the law for the first time introduced a mechanism to monitor these deductions, which has been important, and the continued ability by the State to monitor these deductions should be assessed.

- Matching the needs of the private sector. For this purpose, with assistance by the ILO, the government began using a model to estimate employment trends by area of activity and occupation, which allows a more effective scheduling of skills training. Supplementary mechanisms involve social partners participation in sectoral councils. Their functions include supporting strategic productive sectors through effective human resource training and development, which usually include training for innovation and sectoral growth, as well as the provision of specific competencies required by each sector.
- Improving the quality of training providers. In this respect, the role played by the National System for Accreditation of Education Quality *(SINEACE - Sistema Nacional de Acreditación de la Calidad de la Educación)* is very important. This institution should be strengthened in its execution capacity and accountability, above all in terms of reform of the tertiary non-university training sector.

Finally, and in attention to a more structural objective, coordination with employment services should be strengthened, as has been done in the case of the one-stop job promotion offices known as *Ventanillas Únicas de Promoción del Empleo (VUPE*). VUPEs are in the process of reaching national coverage, in agreement with regional governments, but it is important to consider a next stage with greater territorial coverage in agreement with local governments to ensure these services reach more remote areas and more vulnerable potential beneficiaries.