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**Statement by Mr. Mozhin and Mr. Palei on Peru
(Preliminary)
Executive Board Meeting
March 19, 2021**

1. We thank staff for the insightful report on Peru supported with several Annexes and Mr. Chodos and Mr. Hendrick for the additional details in their BUFF statement. We note the similarities in views expressed by staff and the authorities, notwithstanding the uncertain situation in the economy and rather unusual nature of the shocks.
2. We regret that the human cost of the COVID-19 crisis has been so high in Peru, despite the authorities' quick response with a strict lockdown, and the very large anti-crisis package of fiscal and monetary measures. According to staff, the total size of the announced package is almost 27 percent of GDP, and even with the difficulties in implementation, the assistance of 19 percent of GDP is huge by the emerging market standards. The fact that even this timely and substantial assistance was associated with large human costs and one of the deepest economic contractions in the world, about 11 percent, raises many questions.
3. According to staff, among the factors diminishing the effectiveness of mitigation measures is the underdeveloped healthcare system that was unable to respond to the overwhelming increase in demand. Also, a large share of the informal sector in the economy, close to 72 percent of total employment before the crisis, played the role. The social protection system was tailored to the traditional users, and it took time for the authorities to refocus it on a much broader group of population in need of assistance. Finally, access to internet in Peru is lagging behind its peers, and the opportunities for tele-working are limited. *We would invite staff to elaborate on the key contributing factors and on the issues with timing of the measures and their implementation.*

4. We also noted the use by staff of the *Global Health Security Index* as one of the key sources of evidence of the poor state of the healthcare system in Peru in Annex II (paragraph 4, page 40). It is well known, however, that this particular “third party indicator” failed spectacularly as a predictive tool of the costs of the pandemic¹. Moreover, the level of income was also a poor predictor of the relative success of the authorities in various countries in arresting the COVID-19 fallout. Perhaps, at some point staff could consider these issues in one of the SDNs or another publication.

5. “The Great Divergence” is one of the key scenarios the Fund is trying to convey to the world now. From this perspective, we note that staff referred in the report and in the press release to high economic growth rates averaging 5.2 percent in Peru over the past 15 years. At the same time, we were somewhat surprised that the “historic scenario” in the DSA was based on the growth rates of only 2.5 percent. *Could staff elaborate on these differences? When we discuss long-term trends, it would also be informative to refer to per capita GDP growth, so that demographic trends are taken into account. What was the corresponding average number for Peru over the past 15 years? In addition, we recall that there was a substantial slowdown in growth rates starting in 2014, when the commodity prices collapsed. Could staff compare the average per capita GDP growth rates in Peru in 2004-2013 and in 2014-2019, before the COVID-19 crisis? Going forward, what would be the per capita GDP growth rate corresponding to estimated potential growth of 3¼ percent annually? Finally, do staff have any comments on the messages from the table offered by Mr. Chodos and Mr. Hendrick in their BUFF? How should we compare growth rebounds and growth prospects and what are the appropriate yardsticks? For example, wouldn't it be less speculative to compare the timing of reaching the precrisis peak rather than the forecasted growth path?*

6. In the monetary policy area, we note that staff considered the authorities' multi-instrument framework with active foreign exchange interventions to be very strong. Indeed, the framework delivered on the key goal of maintaining low and stable inflation and anchored the inflation expectations well. One could argue that close attention to excessive exchange rate fluctuations was one of the driving forces in this outcome. *Are there any time-bound plans in Peru to gradually phase out reliance on foreign exchange interventions?*

7. We welcome the authorities' decision to extend the “*Reactiva Peru*” program, as it was useful in limiting the costs of contraction and may well contribute to a more vigorous rebound expected by the Peruvian authorities. At the same time, we note that a delicate balance will be required in deciding when to phase out such an

¹ See Branco Milanovic. *Beware of Mashup Indexes: How Epidemic Predictors Got it All Wrong*, at <https://www.globalpolicyjournal.com/blog/28/01/2021/beware-mashup-indexes-how-epidemic-predictors-got-it-all-wrong>

assistance. The risk of multiplying “zombie” companies potentially harming medium- and long-term growth prospects should be monitored closely. Excessive extension of assistance may also lead to growing contingent liabilities and, eventually, outright fiscal costs. Overall, however, we are pleased that, according to the authorities and staff, the financial sector remains resilient.

8. In the fiscal area, during the crisis, the authorities demonstrated initiative and ability to adjust their programs to evolving circumstances and emerging evidence. We are particularly impressed by the authorities’ careful consideration of alternative solutions and their effectiveness. One example is presented in Annex IV with the description of the World Bank staff four scenarios of poverty mitigation. Another headline example of the authorities’ approach was an estimate that “*Reactiva Peru*” saved about 2.8 million jobs. *Could staff elaborate on how widespread was evaluation of the effectiveness of various measures? What are the institutional features of such analyses? Does the Peruvian legislation guide the authorities’ approach, or they just follow the best practices? What is the role of the Fiscal Council in this work?*

9. We agree with staff that the authorities need to initiate a tax reform going well beyond the improvements in administration. In the medium term the Peruvian authorities face serious fiscal challenges, as we have suggested on many previous occasions. Of course, it is commendable that the gross public debt in Peru is low, and even after the anti-crisis package is expected to stay below 40 percent of GDP. Fiscal health, however, may also mean that the government underdelivers in many areas. Relatively low fiscal revenues-to-GDP ratio does not allow the authorities to address many bottlenecks, as it was also highlighted by the COVID-19 crisis. The authorities need to upgrade the healthcare system, improve access to education, broaden coverage of the social safety net, develop infrastructure, including in the area of digitalization. In the past we have also argued that, as a commodity exporter, Peru needs to aim at a fiscal balance commensurate to intergenerational objectives. Hopefully, staff and the authorities will address these issues when they revisit the redesign of fiscal rules.

10. At the time of the FCL approval for Peru, the Board discussed persistent tensions between the executive branch and Parliament. The more recent political turmoil once again highlighted related risks and also raised questions about the state of governance in the country. If we understand it correctly, the President was impeached on the basis of corruption allegations. *Could staff provide more details? What are the risks of the recent political developments to the quality of anti-crisis policies and broader reforms in the country? How did the departure of the President affect the perceptions of corruption and some of the indicators occasionally used by staff? How would the measures the authorities are putting in place affect governance? What else can be*

done, say, in the area of fiscal transparency or streamlining the rules and procedures to further improve governance?

With these remarks, we wish the Peruvian authorities success in facing challenges ahead.