

ISSUE BRIEF

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Peru: President Humala Should Push for More Economic Freedom

James M. Roberts and Edwar Enrique Escalante

When Peruvian president Ollanta Humala took office three years ago, some feared the worst. After all, during his first presidential run in 2006, Humala (a former Peruvian army officer) had donned the fire-breathing mantle of the populist, “Bolivarian” left that was personified by Venezuela’s then-president (and also ex-army officer) Hugo Chávez.

So although Humala lost the 2006 election and then moved to the center and won as a more moderate-sounding candidate when he ran again in 2011, no one knew for sure how he would govern. Would he remain a centrist (à la Lula in Brazil) or veer hard left? Now the world knows the answer.

Humala Has Stayed the Course for Economic Freedom. When Humala took office in 2011, the country was ranked 41st out of 178 countries worldwide in The Heritage Foundation/*Wall Street Journal* 2011 *Index of Economic Freedom*¹ and had made steady progress, up from 45th place in 2010.² Humala’s predecessor, Alan Garcia (also a reconstructed leftist), had improved Peru’s investment climate. Peru became more business-friendly as Garcia relaxed (somewhat) a rigid labor code and forged free trade agreements (e.g., the 2009 U.S.–Peru FTA). As

a result, average annual economic growth was about 7 percent during Garcia’s five-year term.

Although Peru’s economic freedom score has declined slightly, Humala has largely kept those policies in place. In fact, Peruvians have even realized some significant gains in trade freedom: In 2014, Peru’s score reached 87 points, a 20-year high.

Peru’s more open trade regime is illustrated by the growth of imports and exports.

Much More Work to Do. Nevertheless, Peru’s political and economic institutions remain chronically underdeveloped—although, as the 2013 “Freedom in the World” study demonstrates, they have rebounded from all-time lows reached during the Fujimori government in the 1990s.³ The legacy of that notorious era—systematic and widespread corruption—continues to infect the judiciary, legislature, and law enforcement agencies. As Transparency International notes, these are the weakest institutions in the country.⁴

In fact, Peruvians themselves consider corruption the country’s most serious problem. More than three-quarters see common crime as an urgent problem; 80 percent are afraid to complain about official corruption lest authorities retaliate against them.⁵ Peruvian courts are massively inefficient, with long delays that disincentivize the seeking of justice. Political pressures on judges and extensive corruption in the judiciary resulted in Peru’s ranking just 83rd out of 177 countries in the *2013 Corruption Perceptions Index*.⁶

Other areas for improvement cited in the 2014 *Index of Economic Freedom* include business freedom, which the Humala government has done little to improve. Licensing requirements for construc-

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The Heritage Foundation
214 Massachusetts Avenue, NE
Washington, DC 20002
(202) 546-4400 | heritage.org

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tion have become more costly and time consuming.⁷ In neighboring Colombia, it takes only 54 days to obtain a construction license; in Peru, it takes 173 days. These delays led to a decline in 2013 housing sales (down nearly 25 percent in Lima alone). Bankruptcy regulations also impose long and expensive legal processes that overwhelm the resources of insolvent firms.⁸ As a result, the bankruptcy recovery rate is low (28 percent), and it takes an average of 3.1 years to collect.

Labor freedom has also declined under Humala. In July 2013, his government announced reforms in the Peruvian labor code through a new law intended to create incentives for public workers to improve the efficiency of the bureaucracy, but it has yet to be implemented.

Humala's failure to modernize Peru's onerous labor regulations for private employers is an even more pressing concern. Currently, they must pay two annual bonuses and a month of vacation regardless of longevity. Altogether, state mandates add 60 percent to the annual cost of each worker. No wonder Peru continues to struggle to reduce its very large and economically harmful informal sector—to the ongoing disadvantage of Peruvian workers.

Even in the trade area, many challenges remain in the area of sanitary and phytosanitary requirements to increase trade in agricultural products.

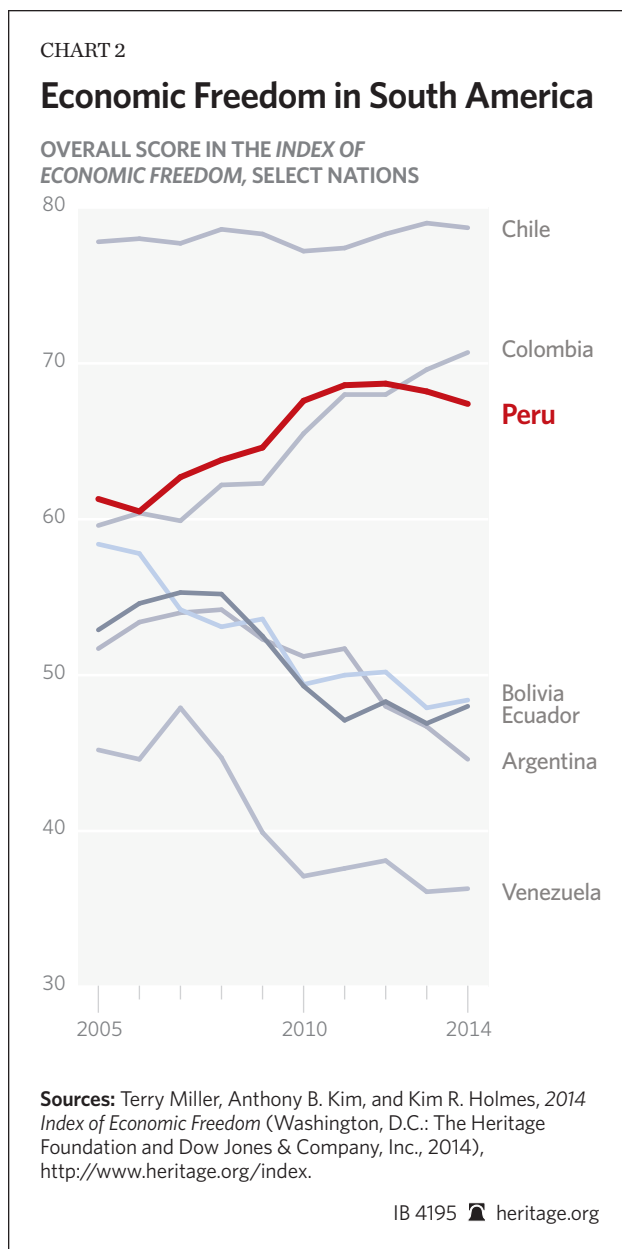
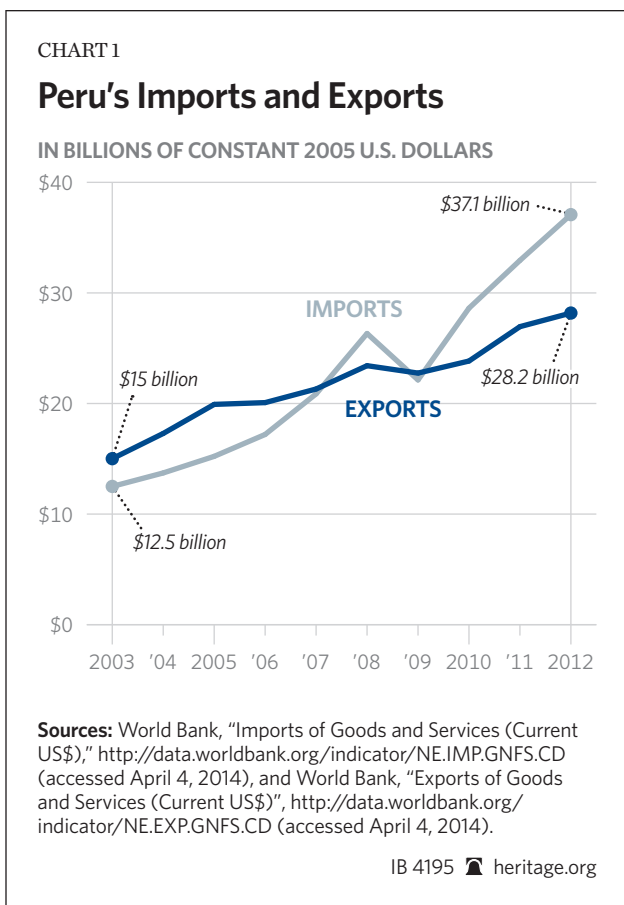
Alliance of the Pacific: Good for Peru. The Humala government made an excellent policy decision to become one of the founding members of the Pacific Alliance (which includes Chile, Colombia, Mexico, and soon Costa Rica and Panama), a regional political and economic bloc that began in 2011 with the goal of synchronizing and deepening intra-

MAP 1



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1. Terry Miller and Kim R. Holmes, *2011 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2011), pp. 331-332.
2. Terry Miller and Kim R. Holmes, *2010 Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2010), pp. 341-342.
3. Freedom House, "Freedom in the World 2013," <http://www.freedomhouse.org/report/freedom-world/2013/peru#.UyzdJPI5PW8> (accessed March 25, 2014).
4. Transparency International, "Corruption by Country/Peru," http://www.transparency.org/country#PER_PublicOpinion (accessed March 25, 2014).
5. *Diario La República*, "Delincuencia y Corrupción son los Principales Problemas del País," October 27, 2013, <http://www.larepublica.pe/27-10-2013/delincuencia-y-corrupcion-son-los-principales-problemas-del-pais> (accessed March 25, 2014).
6. Transparency International, "Corruption Measurement Tools," <http://www.transparency.org/country#PER> (accessed March 25, 2014).
7. World Bank, "Ease of Doing Business in Peru: Dealing with Construction Permits," <http://www.doingbusiness.org/data/exploreeconomies/peru#dealing-with-construction-permits> (accessed March 25, 2014).
8. World Bank, "Ease of Doing Business in Peru: Resolving Insolvency," <http://www.doingbusiness.org/data/exploreeconomies/peru#resolving-insolvency> (accessed March 25, 2014).



regional trade and enhancing trade and investment with the bloc's dynamic partners in East Asia.

In 2013, Peru agreed with other members to zero-out all tariffs and excise taxes on 92 percent of products and services traded within the alliance.⁹ As a group, the countries of the Pacific Alliance already constitute the eighth-largest economy in the world.¹⁰ By deepening the trade and investment ties between them and integrating their economic institutions (e.g., customs), the Pacific Alliance countries can empower significant drivers of additional economic growth.

What Washington Should Do. Congress and the Obama Administration should:

- Ensure that U.S. assistance programs—mandated by the U.S.–Peru FTA—focus on improving

the rule of law. Less than a third of the roughly \$78 million annual budget for U.S. foreign aid—mostly through the State Department's Bureau of International Narcotics and Law Enforcement Affairs (INL)¹¹—directly targets improvements in Peru's judicial systems.

9. Sara Schaefer Muñoz, "Latin Countries Forge Trade Accord with Eyes on Asia," *The Wall Street Journal*, February 10, 2014, <http://online.wsj.com/news/articles/SB10001424052702304104504579375334031270344> (accessed March 25, 2014).

10. Mary Anastasia O'Grady, "The Next Big Free-Trade Breakthrough," *The Wall Street Journal*, July 14, 2013, <http://online.wsj.com/news/articles/SB10001424127887324399404578588121962343016> (accessed March 25, 2014).

11. U.S. Department of State, *Congressional Budget Justification Volume 2: Foreign Operations, 2014*, April 2013, p. 157, <http://www.state.gov/documents/organization/208290.pdf> (accessed April 4, 2014).

- Increase State/INL funding for rule-of-law projects.
- Decrease the U.S. Agency for International Development (USAID) budget for Peru and force USAID to reprioritize its limited funds, eliminate ineffective projects, and introduce new ones that emphasize improvements in Peru's judicial system.

An Important Partner and Friend. Peru has been an important partner and friend of the United States, and under President Humala, that strong and positive relationship has grown. Humala's concern for poverty alleviation is well known, but as the *Index of Economic Freedom* demonstrates, the best way to help the poorest in Peru is to expand economic freedom. That cannot be done without strong institutions to protect property rights and enforce contracts.¹²

—*James M. Roberts is Research Fellow for Economic Freedom and Growth in the Center for International Trade and Economics (CITE) at The Heritage Foundation, and Edwar Enrique Escalante is executive director of the ANDES LIBRES think tank in Cuzco, Peru. CITE interns Tori Whiting and Mo Fan made valuable contributions to this report.*

12. Transparency International, "Corruption by Country/Peru," <http://www.transparency.org/country#PER> (accessed March 25, 2014).