

COMPETITIVENESS: A NEW STRATEGY FOR PERU

Professor Michael E. Porter
Harvard Business School

Peru's improvement in economic performance has been unmistakable, and encouraging. Through implementing sound macroeconomic policies, the country has made great strides over the last decade in overcoming its long history of economic instability. This allowed Peru to weather the current global crisis, and make its economy one of the most resilient in the western hemisphere over the last several years.

It would be easy to declare Peru an economic success, but claiming victory is perhaps the greatest risk facing the country and its leaders. Sustaining recent growth rates is by no means assured, or even likely. While the commodity boom has driven short-term growth, prosperity per citizen remains low, high unemployment persists despite rapid growth, and nearly 60% of the rural population lives below the poverty line.

The recovery of commodity prices from their collapse in 2008 is welcome, but the real work in creating a bright future for Peru has just begun. Peru must substantially improve its competitiveness or the economy will not sustain growth, create jobs, or improve the standard of living for citizens. Continued reliance on commodities as the economic driver is a dead end. Instead, Peru must adopt a comprehensive economic and social strategy to transform the economy, building on the country's unique advantages.

Peru's Economic Progress

No country's economy can advance without macroeconomic stability, which creates the conditions for investment by both domestic businesses and foreign investors. Peru has made good progress in macroeconomic management, including a strong commitment to reducing public debt, balancing the budget, and creating a stabilization fund. Peru has also led the region in opening the economy to foreign trade and investment and protecting investors. According to the World Bank, Peru is the first among Latin American countries in foreign investor protection, producing a major increase in capital flowing into the economy--over \$6 billion in 2009 alone.

Peru's macroeconomic stability remains overly dependent on commodities, with as much as one third of tax revenues coming from commodity-related sources.

Peru has also made important progress in some areas of the business environment, notably, the soundness of banks and financial markets, protecting civil rights, free enterprise, and private property. The country has made some infrastructure improvements, including the inter-oceanic highway to increase the volume of trade between Peru, western Brazil, and northern Bolivia. An emerging middle class is increasingly aware of the quality of products and demands high standards in terms of services.

Deeper Challenges

Despite this progress, Peru remains highly uncompetitive in numerous areas, which will severely limit further economic growth and especially improvements in the standard of living.

Peruvian companies face extremely high costs of doing business, ranging from an inefficient tax system, to difficulty enforcing contracts, to challenges in employing workers. Peru's tax burden and labor regulations, for example, are among the most cumbersome in the world: ranked 135th and 158th, respectively according to the World Bank's Doing Business measures.

Despite some progress, Peruvian businesses are hamstrung by low quality physical infrastructure (air, ground and sea) as well as an inadequate supply of electricity and water. The Peruvian government needs to invest a higher share of its GDP in public infrastructure, while encouraging greater participation in infrastructure by the private sector. Peru suffers from low quality public services and lack of independence in government.

Peru's education system is broken. Without an effective education and workforce training system, Peruvians will never be able to support higher wages. Addressing the lack of education, health and nutrition in poor regions is especially urgent in order to reduce disparities in human development and create equitable economic opportunities across socioeconomic groups. In addition to weaknesses in human capital, there is insufficient investment in science and technology.

Corruption continues to be a major drawback for businesses. Tackling Peru's pervasive corruption at every level of government is essential to business growth outside of mining, efficient investment of the nation's capital, and effective government. Equally important is the strong protection of property rights (both physical and intellectual), which is essential in order to encourage investment and innovation. Peru's political stability is challenged by organized crime in the form of drug trafficking, the re-emergence of domestic terrorism, and the prevalence of common crime.

Cluster development initiatives need to play a central role in Peru's economic policy, to trigger badly needed new business development. Instead of picking winners, business and government must collaborate to help all of Peru's existing and emerging industries to grow through streamlining regulations, improving skills, and fostering internationalization.

Each region of Peru needs a clear strategy in order to build its own unique economy based on local strengths. Decentralization and greater local accountability is the right way to address the social and economic inequality between highland and coastal regions. Improving physical linkages within the country by improving logistical infrastructure between Peruvian regions, and raising the capacity of local governments to plan, design and implement development policies, are essential steps in this process.

Peru needs to foster closer relations with its neighbors to coordinate economic development policies across borders. In a region consumed by ideological debates about the benefits of international integration, Peru is positioned to become the springboard for South American firms seeking access to U.S. and Asian markets. Peru should continue its trade liberalization agenda, but understand that FTAs alone do not make the country competitive. FTAs create opportunities for productive firms to access markets and for foreign companies to invest in the country, but only if Peru offers a competitive business environment.

Creating a National Economic Strategy

Creating and implementing a national economic strategy must become Peru's highest national priority in this time of economic transition. The nation cannot solve all its competitiveness

challenges at once, but should create a prioritized strategic agenda for the next decade which is understood by all parts of society and against which progress can be measured.

A Peruvian economic strategy should build on the country's unique strengths, while addressing the constraints holding back Peru's productivity. The nation should not imitate the policies of other countries, but create its own path forward.

Peru is a country with great potential, but a new relationship between the public and private sectors will be needed to fulfill this promise. The government's job is to create a business environment in which the private sector can compete and thrive. The business community, for its part, must assume a far greater role in driving and supporting competitiveness improvement, as should labor unions and universities.

Upgrading Peru's competitiveness is the only way to create a brighter future for all Peruvians. With stability, momentum, and growing self-confidence, the time for Peru to tackle competitiveness is now.