PERU: STABLE DESPITE EVERYTHING

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ABSTRACT. This research article seeks to answer a crucial question in collective mindset: Why does the Peruvian economy maintain steady growth and not experience a significant downturn despite the ongoing social and political crises the country faces? The reasons outlined in this article are five fundamental pillars of the country's stability: the independence of key institutions, the "dirty float" exchange rate regime, sound fiscal policy frameworks that ensure current accounts, the constant inflow of foreign exchange through the primary-export model, and finally, advances in diversification that reduce

dependence on a single industry. Criticisms, proposals for improvement, and questions that may lead to future research are also addressed in this study.

KEYWORDS: Peru / development / stability / dirty float / central bank independence

PERÚ: ESTABLE A PESAR DE TODO

RESUMEN. El presente artículo de investigación busca responder una pregunta crucial en el pensamiento colectivo, ¿por qué la economía del Perú sigue creciendo y no ha sufrido de una baja significativa a pesar de las constantes crisis sociales y políticas que el país presenta? Las razones que detalla el artículo son cinco pilares fundamentales de la estabilidad del país: independencia de instituciones claves, la estrategia monetaria de la "flotación sucia", sólidos marcos de política fiscal que aseguran las cuentas corrientes, el constante ingreso de divisas por el modelo primario exportador y, finalmente, los avances en materia de diversificación que reduce la dependencia en una sola industria. En esta investigación, también se encuentran críticas, propuestas de mejora y preguntas que pueden conllevar a futuras investigaciones en torno al tema de reflexión.

PALABRAS CLAVE: Perú / desarrollo / estabilidad / flotación sucia / independencia del banco central

1. INTRODUCTION

The Peruvian economy has remained stable despite the political crises the country has experienced in recent years—a paradoxical situation given that public finances might be facing the same problem. However, Peru has demonstrated strong resilience to external shocks and is considered one of the most stable countries in the region.

Several factors explain this economic stability. They include the Banco Central de Reserva del Perú (Central Reserve Bank of Peru, BCRP) independence and effective monetary policy management, as well as an exchange rate regime known as "dirty float," which helps maintain a strong national currency. On the other hand, the fiscal policy established since the 1990s allows for optimal performance of economic cycles. In turn, the export-based economic model links the country's economic dynamics more closely to external rather than internal factors. Finally, productivity diversification supports the country's long-term economic growth. This article will highlight the strengths and weaknesses found in these dimensions.

Velarde and Rodríguez (1992) emphasize the importance of providing greater independence to central banks regarding monetary and exchange rate policy, as this would maintain inflation rates at adequate levels. This situation is closely linked to Peru's contemporary economic history prior to the reforms of the 1990s, characterized by extensive political intervention in monetary matters and the creation of parallel exchange markets. Such conditions arose from high political interference within the monetary authority and the zero confidence of Peruvian citizens in the national currency. However, this began to change with reforms implemented during the 1990s, which granted the BCRP greater independence and reduced the influence of political motivations in monetary policy.

With its newfound independence, the BCRP began implementing technical measures to manage its issuance policy and maintain monetary stability. One of the strategies attributed to the success of the Peruvian model is the dirty float exchange rate regime, under which a central bank tends to buy dollars when the exchange rate falls and sell them when it rises, within a range previously established by an inflation target (Mendoza, 2017).

Regarding fiscal policy, a key factor contributing to the stability of the exchange market is the implementation of fiscal rules aimed at achieving balance in the economic cycle. These rules enable fiscal surpluses during periods of economic expansion and moderate deficits during recessions. The application of these measures has strengthened BCRP's independence and enabled the net public debt to be notably reduced in recent years. This situation, complemented by low inflation rates, corresponds to the concept of great moderation, initially proposed by Stock and Watson (2002) to define the economic cycles with low volatility experienced by certain countries before the 2008 financial crisis. Peru's economy was relatively less affected by this recession due to the boom in raw materials, of which it is the main exporter.

During the past decade, Peru's economy experienced a period of prosperity fueled by a significant surge in international metal prices, which the country heavily exports. This situation triggered a revival of mining projects, benefiting various mining countries as outlined by Connolly and Orsmond (2011). Although growth in this sector has been declining since 2011, the Peruvian economy has remained stable, largely due to the its mining industry, which has emerged as the country's primary economic activity.

It is also essential to consider the role of diversification, which enables the expansion of a country and reduces the dependence of a single asset. Foster and Rosenzweig (2004) approach diversification as an effect of a technological change within the rural sector and conclude that growth was driven by areas in which agriculture was underdeveloped but where the manufacturing sector had gained strength. The productivity diversification and the development of a new activity have emerged as the key drivers of economic growth, strengthening the overall economy.

2. BCRP INDEPENDENCE

Maintaining the independence of a central bank and limiting political discretion are crucial factors for effectively controlling inflation and promoting macroeconomic development. Accordingly, several authors (Alesina & Summers, 1993; Blinder, 1999; Cukierman, 2003; Walsh, 2010) argue that central banks should be directed by experts who are not politically elected and who serve long terms, so that they remain independent of political instability.

Under these guidelines, the BCRP was established as an autonomous public institution in 1979, a condition reaffirmed in 1993. Its sole purpose is to maintain monetary stability in Peru, and it has budgetary independence, being financed through its own resources. In addition, the position of chairman of the board of directors is a full-time, exclusive appointment.

The main objective of an autonomous central bank is to effectively control the inflationary process. In this regard, Grilli et al. (1991) and Alesina and Summers (1993) indicated a direct correlation between central bank independence and low inflation rates. During the 1980s, the Peruvian economy experienced high and volatile inflationary cycles that led to hyperinflation by the end of the decade. Castillo et al. (2016) found a direct relationship between inflation volatility and gross domestic product (GDP) volatility in Peru at the end of the 1980s. In this context, Contreras Carranza (2021) highlights that this period was marked by strong state intervention, fiscal dominance, and political interference in the internal management of the BCRP, consequently resulting in high levels of asset dollarization.

Given this, the monetary policy was restructured with the purpose of achieving low inflation levels. This led to the launch of a stabilization plan known as the "Fujishock" in August 1990, which sought to contract demand through a drastic increase in consumer prices. This measure was complemented by a restructuring of the price system and the unification of the different existing exchange rates into a single official exchange rate, along with the replacement of the national currency—from the Inti to the Nuevo Sol.

Armas et al. (2001) evaluated the monetary policies adopted during the 1990s to control inflation, highlighting, among them, the choice of the exchange rate regime and the nominal anchor. These measures contributed to achieve a significant gradual reduction of the inflation rate, allowing real costs to be reduced and enhancing the BCRP's reputation and credibility in its commitment to keep inflation at optimal levels.

Subsequently, in 2002, the BCRP adopted an implicit inflation targeting scheme aimed at modifying policy objectives when projected inflation forecasts change and deviate from their target levels. Castillo et al. (2011) estimated the effects of monetary policy in Peru between 1995 and 2009, finding that, despite the country's partially dollarized economy, these effects were consistent with those expected in non-dollarized economies. The most relevant finding is that, in the face of a contractionary shock, interest rates rise and monetary aggregates contract, allowing the national currency to appreciate, aggregate demand to slow down, and, finally, inflation to fall.

The reduction in inflation and international interest rates that Peru experienced over the past 30 years favored the adoption of a floating exchange rate, which remains in place today. This regime includes occasional interventions by the BCRP to avoid excessive fluctuations that may be inconsistent with the country's economic fundamentals. In this regard, Frieden (2002) states that maintaining an autonomous central bank and adequate inflation control prevent the real exchange rate from being controlled under fixed exchange rate regimes, which, in turn, facilitates compliance with international monetary agreements assumed by the country and supports long-term monetary sustainability.

3. DIRTY FLOAT

Fluctuating terms of trade clearly affect the business cycle, and a floating exchange rate regime enables real exchange rates to adjust in order to reduce fluctuations in economic activity (Armas et al., 2001). Under a dirty float regime, the currency is allowed to fluctuate freely against other currencies in the foreign exchange market. However, central banks may intervene occasionally to influence the exchange rate, aiming to control inflation and make the local market attractive to foreign capital.

The use of a dirty float regime presents both advantages and disadvantages. On the one hand, it allows the exchange rate to respond quickly to changing economic conditions, which can be beneficial in promoting foreign trade and investment. On the other hand, central banks must ensure transparency of the monetary intervention being carried out in the market. A lack of transparency may result in reduced predictability, leading to uncertainty and volatility, which can be detrimental to businesses and consumers.

There are several reasons why Peru's dirty float contributes to macroeconomic stability:

i. *Flexible exchange rate*. The dirty float regime allows the exchange rate to adjust to market conditions, enabling the economy respond to external shocks. For example, if there is a sudden increase in demand for Peruvian exports, the exchange rate appreciates, making those exports more expensive and thereby reducing demand. This helps prevent overheating of the economy, which could trigger inflation and other macroeconomic imbalances. Conversely, a fall in prices of foreign goods lowers the real price, worsening the trade balance. The deterioration of the trade balance in the raw materials market causes a drop in demand and consequently in production. To sum up, falling prices of foreign goods slow the economy, increase the exchange rate, and deplete international reserves. As a result, both the central bank exchange rate and the country's international reserves decline (Mendoza, 2019).

ii. *Export competitiveness*. By allowing the currency to depreciate when needed, the dirty float applied in the Andean economy can help make exports more competitive in the global market. This may stimulate the economy and create jobs, leading to a more stable macroeconomic environment. As found by Peña-Vinces and Urbano (2014), the role of the Peruvian government and industry also enables small- and medium-sized multinational companies to specialize in specific activities of industrial value chains, thus improving competitiveness to survive and gaining a foothold in international markets.

iii. *Inflation control*. The Peruvian dirty float helps control inflation by allowing the exchange rate to adjust to changes in supply and demand. If the currency appreciates significantly, it can reduce inflationary pressures by making imports cheaper, thereby contributing to keeping inflation under control. This trend was evident during the period of increased Peruvian exports to China. Thanks to the BCRP's active monetary policy and international inflationary monetary policy, the exchange rate gradually appreciated, contributing to a global decline in inflation (Pastor, 2022).

iv. *Foreign investment*. A stable exchange rate can help attract foreign investment, which contributes to economic growth and stability. By maintaining a relative stable exchange rate, the Peruvian dirty float provides a more predictable environment for investors, encouraging them to invest in the country and thus supporting GDP growth. This was evident in Peru between 1980 and 1990, when the largest percentage change in real GDP (in thousands of millions, constant 2015 prices) was observed, as foreign investment in public enterprises attracted more capital inflows (Bazán Navarro & Álvarez-Quiroz, 2022).

Overall, the Peruvian dirty float is a useful tool for promoting macroeconomic stability, as it allows the exchange rate to adjust to market conditions while providing some degree of intervention to prevent excessive volatility.

4. FISCAL POLICY

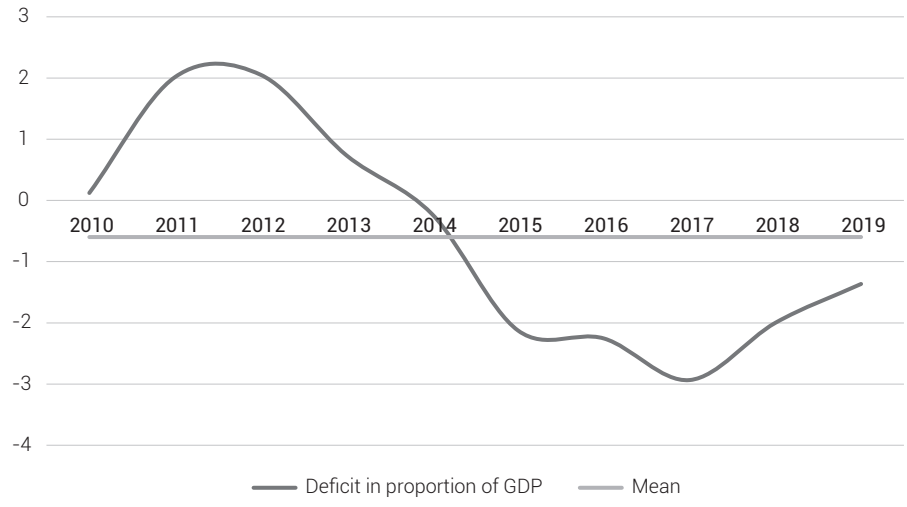
Peru has implemented sound fiscal policies that have contributed to its economic stability. The government has pursued a fiscally disciplined approach, which has helped to keep public debt levels low and maintain a stable macroeconomic environment. This aligns with economic theory; as Mundell (1962) pointed out, fiscal policy is crucial for preserving internal stability.

One key feature of Peru's fiscal policy is the *Ley de Prudencia y Transparencia Fiscal* [Law of Fiscal Prudence and Transparency] (Ley 28278, December 23, 1999), which has been amended several times. The law aims to ensure fiscal discipline and transparency by establishing rules for government budgeting, debt management, and financial reporting. For example, it sets limits on the fiscal deficit and public debt levels and requires the government to publish regular reports on its fiscal performance.

In recent years, Peru's level of indebtedness has remained mostly stable and low compared to other countries in the region. To support this statement, data from the International Monetary Fund (IMF) over the 10 years preceding the global health crisis indicate that Peru's average debt has been -0,5984 %. This figure stands out as one of the lowest in comparison to its Latin American peers.

Figure 1

Borrowing/Lending as a Percentage of GDP in Peru, 2010-2019



Note. Adapted from *Report for selected countries and subjects: October 2021*, by International Monetary Fund, 2021 (https://www.imf.org/en/Publications/WEO/weo-database/2021/October/weo-report?c=293%2C).

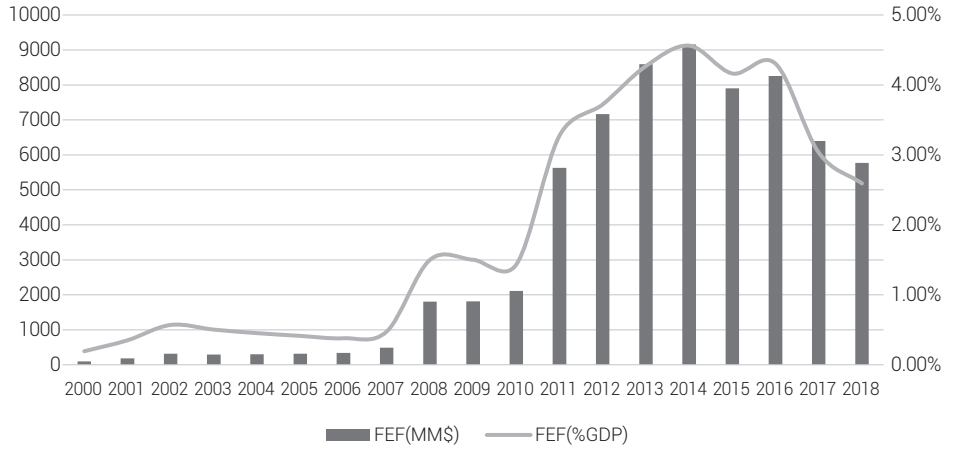
It is worth noting that the analysis covers a 10-year period, since annual variations are highly probable and can be caused by multiple factors, including economic conditions, government policies, and unexpected events—such as the aforementioned pandemic or the war in eastern Europe. Therefore, it is important to examine the trend over time rather than focus on a single year. In this regard, Peru's consistent fiscal discipline and its ability to maintain a relatively low fiscal deficit during the 2010–2019 period serve as positive indicators of the country's economic stability and improved long-term growth prospects, which encourages foreign capital investment.

In 1999, as part of Peru's first macro-fiscal framework set forth by the Law of Fiscal Prudence and Transparency, a tool called the "fiscal stabilization fund" was established. This tool was designed to stabilize the economy during recessions or unforeseen contingencies—such as the health crisis occurred during 2020 and 2021—by using surpluses accumulated during times of economic boom.

This tool is particularly useful for primary-exporting countries. Sugawara (2014) found that primary-exporting countries like Peru reduce volatility by 13 % when they have this type of funds in place. Additionally, Balding (2012) points out that these funds help smooth fluctuations in public spending during crises without affecting the country's public finances by resorting to debt.

Figure 2

Balance of the Fiscal Stabilization Fund of Peru, 2000-2018



Note. Adapted from Banco Central de Reserva del Perú (2021); *GDP (current US$). Peru*, by World Bank, n.d. (https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&locations=PE&start=2001).

5. AN EXPORT-BASED ECONOMY

An export-based economy is a defining characteristic that influences Peru's economic stability. This occurs because prices are influenced by external factors determined by international markets. For example, in terms of growth dynamics, fluctuations in copper prices will follow their own course regardless of whether the president completes the term or is impeached. As long as the "rules of the game" are generally maintained and the state institutions and political functions uphold the necessary clauses to encourage private investment, the economic activity will continue to take place despite eventual episodes of political instability.

Since the 1990s, with the adoption of the social market economy model—which limited state intervention in the productive and commercial sectors—the necessary conditions were established for private investment to become the main driver of the economy and to foster trade liberalization. One of the most relevant aspects of this transition, as highlighted by Contreras Carranza (2011), was the liberalization of the exchange rate. This reform allowed exporters to no longer be forced to sell their dollars at a fixed exchange rate, thereby encouraging foreign capital inflow.

These new conditions were slightly disrupted by the political instability followed by the fall of the Fujimori regime in the early 2000s. However, subsequent governments

maintained the core principles of the economic policy established in the 1990s, which allowed Peru's position in international markets to remain stable. One factor that contributed to Peru's consolidation in these markets was the so-called "commodity boom," which brought a notable increase in the prices of the main metals produced by the country (copper, lead, zinc, gold, silver, among others). This led to accelerated economic growth, with an average GDP growth rate of 6,12 % between 2002 and 2012. This period was marked by low international interest rates, which encouraged foreign capital inflows into the Peruvian economy and increased private investment, as detailed by Ascarza Mendoza (2017).

Similarly, mining activity in Peru has been accompanied by the emergence of different social conflicts related to its operations. In this regard, De Echave et al. (2009) explain that in recent years, an expansionary trend in the mining sector has consolidated a primary-export economic model, giving rise to conflicts over the exploitation of mineral resources. On several occasions, social protests have caused the prolonged suspension of important mining projects, such as the Las Bambas project in the Apurímac region, the Conga project in the Cajamarca region, and the Tía María project in the Arequipa region, as documented by the Observatory of Mining Conflicts in Latin America (Observatorio de Conflictos Mineros de América Latina, 2023). Despite this, mining activities have continued to expand constantly and remain the country's main source of foreign currency and tax revenue, as detailed below in Table 1. This evidences Peru's clear dependence on this type of productive activities and the difficulty other sectors have faced in keeping pace with the mining industry.

Table 1

Average Percentage Distribution of Peruvian Exports by Product Type, 1990-2022

Decade	Agriculture	Mining	Oil and Gas	Fishery	Non-Traditional	Others	Total
1990-1999	5,10	45,90	5,10	13,40	29,20	1,30	100,00
2000-2009	2,50	54,80	6,90	8,60	26,20	1,00	100,00
2010-2018	2,30	57,70	9,00	4,30	26,20	0,50	100,00
2010-2019	1,60	59,10	6,20	4,00	26,47	0,47	100,00
2020-2022	1,73	60,33	6,20	3,63	27,80	0,33	100,00

Although the data indicates that the volume of goods with export potential continues to grow, it presents an opportunity for the Peruvian government to invest in infrastructure and expand various industries. This would help reduce the country's dependence on mining revenues and prevent the risk of developing a potential case of "Dutch disease."

6. PRODUCTIVITY DIVERSIFICATION

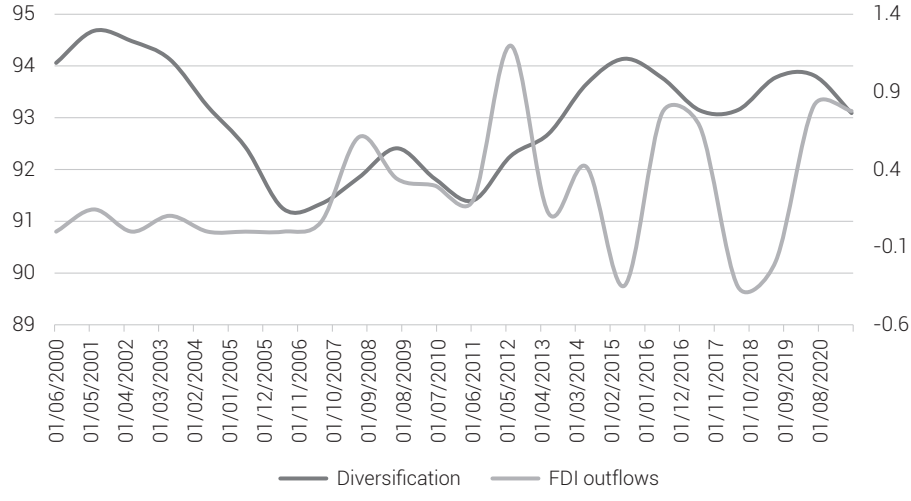
Exports are known to play a favorable role in a country's production and, therefore, in its economic growth. In recent years, a debate has emerged regarding the significant effect of diversification on growth, especially in developing economies. Ben Hammouda et al. (2010), using data from 1981 to 2000 for 35 African countries, examined the relationship between growth, productivity, and diversification. Their findings indicate that diversification has a significant effect on productivity factors, which will lead to economic growth. The study also highlights that countries with production focused on a single sector exhibit positive but low growth compared to those with more diversified economies.

The qualitative study by Fu et al. (2021) adopts a slanted focus on the business domain, treating diversification as an effect of foreign direct investment (FDI) by multinational companies. The paper reviews more than 100 research articles, categorizing them according to their perspective on FDI. Some of these studies suggest that the presence of foreign investors has a positively effect on export knowledge (Anwar & Nguyen, 2014) and export competitiveness (Anwar & Nguyen, 2011; Fu et al., 2021; Melitz, 2003). However, FDI can also negatively impact diversification, since multinationals tend to concentrate on the sectors in which each country specializes, exploiting them and investing only in those areas (Mijiyawa, 2016). The authors conclude that, although FDI contributes to development, growth, and innovation, it tends to concentrate in sectors aligned with the interests of investing companies, so diversification often does not benefit. In addition, the presence of FDI depends on the characteristics of the country receiving funds and its compatibility with multinationals in terms of objectives, policies, processes, among other factors.

The following discussion will focus on the topics previously addressed regarding the Peruvian case, based on macroeconomic data such as indexes or measures and their interrelationships.

Figure 3

Peru: Productivity Diversification Index vs. Foreign Direct Investment Outflows, 2000-2020



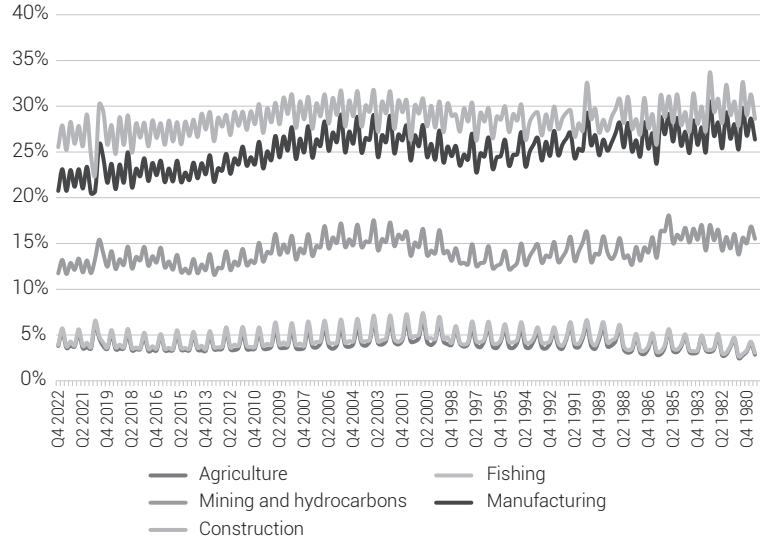
Note. Adapted from "Global economic diversification index: Peru", by Mohammed Bin Rashid School of Government, n.d. (https://economicdiversification.com/?country_gedi=peru); *GDP (current US$). Peru*, by World Bank, n.d. (https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2018&locations=PE&start=2001).

Figure 3 shows Peru's productivity diversification index and the FDI outflows. From 2012 onwards—after the 2008 financial crisis had subsided—a clear direct relationship can be seen between both series. In addition, since that year, foreign capital outflows became more abrupt, together with the steady increase in diversification. This trend reinforces the conclusions drawn by Mijiyawa (2016) and Fu et al. (2021). In years preceding this period, both indicators increased in 2008. This may be due to the fact that, despite Peru was experiencing one of its highest growth rates, investors distrusted the market and preferred liquidity in the face of the ongoing American financial crisis.

Regarding diversification, it is important to consider the limited development of key economic activities in certain areas. In Peru, there may be significant differences between sectors such as manufacturing and mining, compared to construction, fishing, and agriculture. Furthermore, the country shows a tendency toward economic centralization, and these latter sectors are mostly limited by cyclical production stages. As shown in Figure 4, the Peruvian economy is not undergoing a process of diversification. Instead, the relative proportions of the three largest and three smallest contributing sectors to Peru's GDP have remained relatively stable over time. A closer examination reveals a slight decline in the manufacturing sector and a modest increase in agriculture, while the other sectors shown in the graph have maintained a consistent proportion of total production.

Figure 4

Proportion of Economic Activities in Peru's GDP (%)



Note. Adapted from "Cuentas nacionales", by Instituto Nacional de Estadística e Informática, n.d. (https://m.inei.gob.pe/estadisticas/indice-tematico/national-accounts/).

Although Peru has not experienced a drastic increase in diversification levels, it has managed to maintain or slightly increase the participation of the others sectors despite the significant growth in mining and hydrocarbons exploitation. This presents an opportunity for future development of secondary goods industries or final goods, provided that the conditions are favorable.

7. CONCLUSIONS

In summary, Peru's economic solidity and stability can be explained by five key factors, despite the ongoing social and political crises the country is facing. First, the BCRP independence, which ensures that national monetary policy remains free from political interference. Second, the dirty float regime, which allows inflation to be controlled and the exchange rate to remain stable, even in times of political turbulence. Third, solid fiscal discipline which enables the anticipation of economic decline, safeguarding national accounts and maintaining stable public spending without excess. Fourth, an export-based economy, which allows a constant flow of foreign currency and limits the dependence of national product prices on domestic market. Finally, the country's progress in productivity diversification, which advances in line with the buoyant mining and hydrocarbons industries, avoiding complete dependence on these sectors.

However, there are several areas that require improvement. For example, although the BCRP is an autonomous institution, free from political influence, the legislative and executive branches have the power to appoint a large part of its board of directors. On the other hand, there is limited compliance with environmental regulations regarding mineral deposits, as well as the minimal audit conducted by the relevant bodies on this topic. Furthermore, progress in terms of diversification remains insufficient since mining and hydrocarbons revenues play a key role in tax collection, leaving the country vulnerable to fluctuations in the international market.

Beyond the aforementioned criticisms, there are also proposals to improve these outstanding areas. To increase the BCRP independence, it is proposed to reduce the number of board members appointed by state authorities. Regarding fiscal discipline, one possible improvement would be the implementation of regulations on regional government budgets, aimed at readjusting them given their limited utilization. This approach is constantly supported by the office of the comptroller general, which is responsible for auditing government expenditures and preventing misuse of public funds. Additionally, the implementation of digital processes is proposed to reduce state spending on payroll and increase bureaucratic efficiency. In terms of revenue collection, the responsible agencies should focus on improving collection mechanisms rather than increasing taxes on current taxpayers. To foster diversification of the Peruvian economy, it is proposed that the state adopt a mixed investment model in high-tech companies and/or offer them tax exemptions.

Finally, this research raises the following questions for future studies: Could Peru be experiencing a form of Dutch disease? To what extent has mining improved the income of the Peruvians? How sustainable is the current economic model? How much longer can this model of mineral exports be sustained?

Author Contribution

Patricio Fabian Cortez Frisancho: conceptualization, validation, formal analysis, investigation, writing (original draft), writing (review & editing), visualization, supervision, project administration.

Carlos Leonardo Burga Sempertegui: conceptualization, validation, formal analysis, investigation, writing (original draft), writing (review & editing), visualization, supervision, project administration.

Níkolas Sebastián Díaz Zegarra: conceptualization, formal analysis, investigation, data curation, writing (original draft), visualization.

Gonzalo David Guerrero Teixeira: conceptualization, investigation, writing (original draft).

Grace Botzwana Palomino Fernandez: investigation, data curation, visualization.

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