

Peru: A Wasted Opportunity

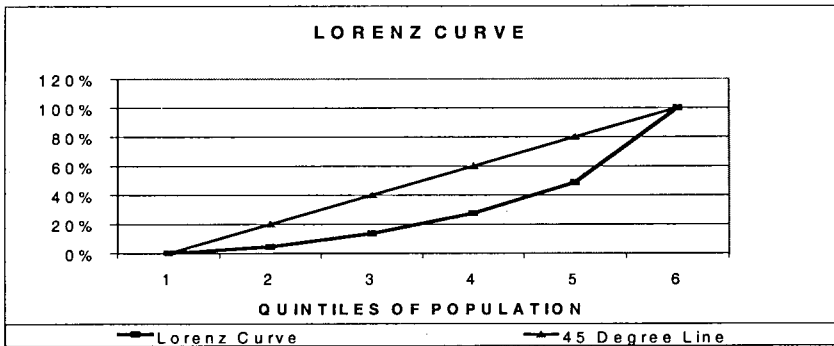
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Peru, a Latin American country looking out on to the Pacific Ocean, has been a classified a less developed country. Michael King takes an in-depth look at poverty in Peru. He introduces the country with a description of its income distribution, before describing the nature of poverty there. He then discusses the causes of that poverty. He brings his discussion to a close with a summary of policy recommendations that would reduce Peruvian poverty.

Introduction: an illustration of the distribution of income in Peru

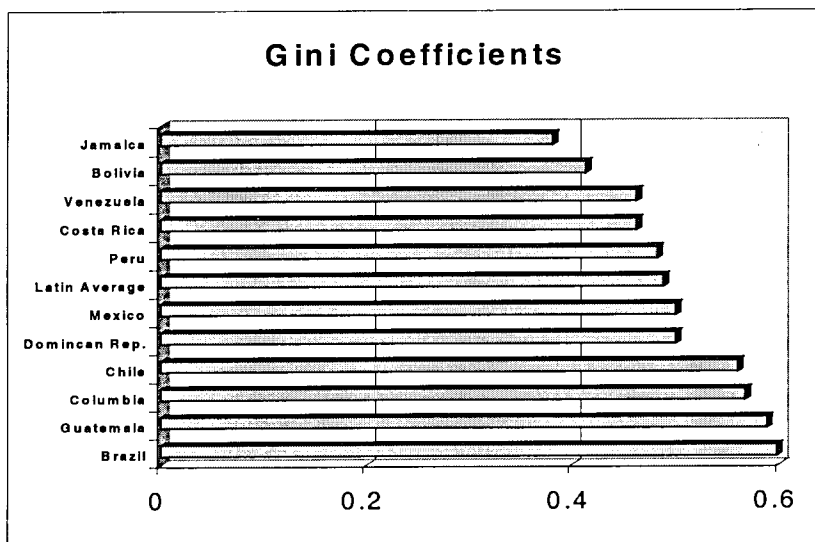
The results of the 1996 Peruvian household survey (World Bank, 1999) illustrate the distribution of income in Peru. It is clear from the following information that the distribution of income is highly skewed in favour of those in the highest quintile. The first table shows the income accruing to each quintile. The Lorenz curve, then, is a graphical illustration of that distribution. It is quite disturbing that over 50% of total income accrues to the top 20% in society.

% Income in each quintile				
1st	2nd	3 rd	4th	5th
1996 4.40%	9.10%	14.10%	21.20%	51.20%



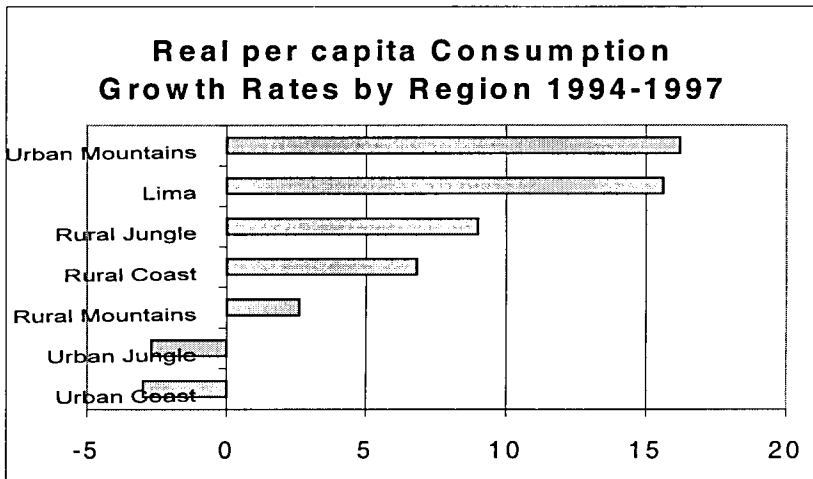
In order to compare income distributions across nations, we can use a simple mathematical construct called the Gini coefficient. The distribution of income in Peru must be considered within the context of countries with similar

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resources, history and political culture. Thus it is best to compare it with other countries in Latin America to evaluate whether its distribution is a problem. The above graph (World Bank, 1998) seems to tell us that Peru's inequality is not as bad as some other Latin American countries'. Peru has a Gini coefficient less than the Latin American average, indicating than income distribution is not as heavily skewed toward the rich.

However, these are aggregate figures and give no indication of the distribution of income within Peru, a country with one of the most diverse terrains and climates on earth. Unfortunately, there are no figures available for the distribution of income for the seven areas within Peru. However, using consumption as a proxy for income, we can see how income has changed in each area in the period of national growth between 1994 and 1997. There is a significant difference between the change in consumption in Lima or mountainous towns and other towns on the desert coast and river towns in the jungle. The final table gives us an indication of the difference in income inequality between urban and rural areas. Inequality is more pronounced in rural areas than in towns and cities.



Source: Staff estimates based on ENNIV (1994-1997)

	1994	1997
National	0.469	0.484
Urban	0.437	0.441
Rural	0.494	0.5

Source: World Bank Report on Peru 1999

The nature and extent of poverty in Peru.

In order to gain an appreciation of the extent of poverty in Peru, we must establish a definition of poverty. A simple but all encompassing definition of poverty is "pronounced deprivation in standard of living." This deprivation can manifest itself in four main ways. There is firstly material poverty, the inability to consume the bare necessities. Secondly, there is access poverty, the inability to avail of state social and non-social infrastructure, health, education, transportation and telecommunications. Access to these has significant effects on a household's standard of living and its potential to escape from poverty. Thirdly, there is political poverty, an aspect of poverty only recently recognized by the World Bank (World

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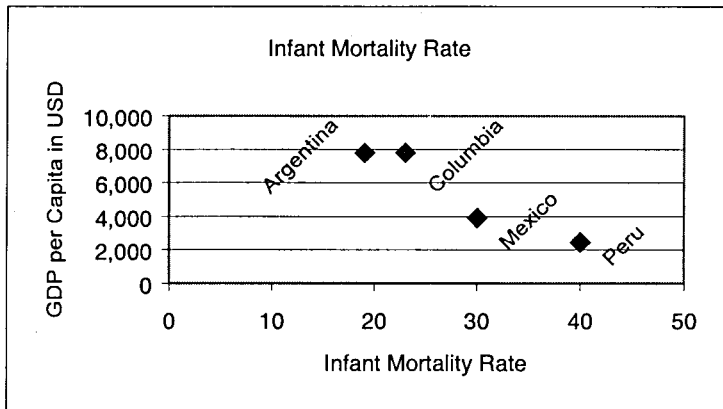
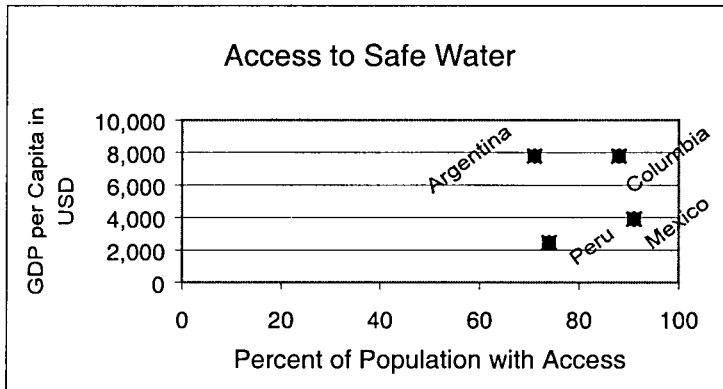
Development Report, 2000). A Latvian woman captures this aspect of poverty. "Poverty is the humiliation of being forced to accept rudeness, insults and indifference when we seek help" (*ibid.*). Political poverty encompasses non-representative government, partial judiciary and an unresponsive civil service. The fourth element of poverty is vulnerability. Vulnerability to external and largely uncontrollable events reinforces poor people's sense of ill being, and exacerbates their material poverty. These four facets of poverty frequently reinforce each other and exacerbate the deprivation in which poor people live.

In illustrating the extent of poverty in Peru, I will first discuss the indicators of material poverty, before progressing to asset poverty, showing both internal distributions and international comparisons, before discussing the political deficit in Peru. The basic poverty rate has declined by several percentage points between 1994 and 1997 to 49% from 55.5%, i.e. roughly 12 million Peruvians (World Bank, 1999). Severe consumption poverty, an extremely austere measure, has declined to 15% from 19%. This leaves 3.6m Peruvians in immediate danger of severe malnutrition and starvation. This compares poorly with neighbours Chile, with a basic rate of 20.5% (1997), Ecuador, 35% (1994) and Columbia, 16.9% (1991). The household survey of 1994 tabulates four different poverty rates, the national rate 49%, the Lima rate 37.6%, other urban areas 44.5% and rural Peru 68.5%. These results show that poverty is more prevalent in rural areas than in Lima but with 8 million people in Lima, 37.6% is a massive 3 million people.

The quality of life indicators are reflections on both material poverty and access poverty to health care. Malnutrition rates in Peru fell from 30% to 24% between 1994 and 1997, which is significant progress. Malnutrition rates of under-5s stood at 52 per 1000 (1997), higher than Mexico (38), Columbia (30), Chile (13) and Ecuador (39). Life expectancy is 2 years below Columbia and 6 years behind the geographically similar Chile. This evidence from the World Development Report 2000 shows that not only is Peru considerably disadvantaged on a world stage, it is disadvantaged relative to its neighbours.

Peru has always prided itself for the excellent education system it provides. School enrolment topped 5m in 1997, representing over 20% of the population. However, this has not filtered through into a more literate population. 11% of people over 15 are illiterate, compared with 9% in Columbia and Ecuador and 5% in Chile. There is also a marked difference between males and females, unlike these other countries: 6% males and 16% of females are illiterate. Enrolment (91% in primary,

53% in secondary) compares poorly with Ecuador (97% and 84%) where standards are similar.



The assets, to which people have direct access, have a potent effect on their prospect of escaping poverty. From the two graphs, one can see how the relative deprivation of Peruvians compares with their neighbours. In terms of infrastructure, only 10% of roads are paved, as opposed to 17% in Ecuador. In terms of electricity, the consumption per capita is one third of Chile's and almost half that of Colombia. Telephone lines are also considerably less than in Chile, Colombia & Brazil. Sanitation connection is at 84.3% in urban areas and 11.6% in rural areas. Homes

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with mud floors have increased from 41% to 43% (World Bank, 1999a).

Finally, in a populist regime like Fujimori and Garcia before him, political power is extremely centralised. It excludes representative institutions from the decision-making (Crabtree, 1998). Corruption and harassment have been features of Fujimori's regime in the 1990's and his policies are not accountable to the people. The legal system is weak, inaccessible to the poor and frequently influenced by the military and government. The lack of a party political system impoverishes the Peruvian people and the citizens have no faith in the judiciary. Political poverty in Peru is structural and severely impinges on the standard of living of the people.

The main causes of poverty in Peru

Causes of poverty are many and varied. They encompass almost all of the economic, political and social make-up of a country. Peru is not the classic underdeveloped economy and my argument is that mismanagement is the key cause. I identify the macroeconomic disaster of the 1980's and the inability to control the narcotics trade, the inability to provide adequate services to the poor, the representative deficit in politics, the corrupted and weak judiciary, and the non-preparation for crises, as chief among these causes.

Mismanagement

When Alan Garcia, the youthful leader, took office in 1985, GDP was 6% lower than in 1981 and real wages 40% lower. His economic "Plan de Emergencia", which restructured fiscal and monetary policy, was slow to show results and financial discipline was relaxed. Monetary controls were ignored and policies coercing business to buy bonds were introduced, with a devastatingly negative response. Inflation soared; strikes and civil unrest ensued. The annual inflation rate to March 1989 was 3414%, with devastating effects for real wages and in particular the poor. The Garcia administration single-handedly depreciated the earnings of the poor and eliminated their savings, with GDP per capita down to levels not seen since the 1960s. Accumulated inflation between July 1985 and July 1990 was 2.2m per cent. To Fujimori's credit, and why many supported him till the bitter end, he managed to stabilise the economy. Inflation was reduced and he redefined the role of the state. No longer was the state the principal actor in the economy. Instead, it was to take up its proper responsibilities of ensuring health, education, security and adequate supervision (Goodhart, 1994). He achieved moderate growth rates, but well below the country's potential in my opinion. The poverty caused by fiscal

mismanagement in the 1980s will plague Peru well into the 21st Century.

Political poverty

Populism is a style of government characterised by an appeal from strong charismatic leaders to the people, over the heads of existing parties and politicians and unrestricted by institutions (Crabtree, 1998). In Fujimori's case, he has concentrated power on himself and his elite, bringing to nil public accountability and input. Despite bringing economic stability, he has failed to ensure this will continue in his absence, by not reforming the political structure to ensure ultimate power doesn't reside with one individual. This renders uncertain Peru's economic future. His failure to widen political power has led to the political deprivation of the people, and restricted investor confidence in the sustainability of economic stability. While Fujimori's and Garcia's economic policies had startlingly different results, both were leaders of an authoritarian inclination, disposed towards abruptly changing the existing rules of the game when it suited them. Both shunned sharing power with others, preferring to bypass institutions and legitimise themselves through direct appeal to the people (Crabtree, 1998).

This propensity towards populism is closely related to the absence of a functioning and embedded system of representative government. The people feel they have no political input and when they do, in the presidential election every five years, their say is influenced by military involvement, harassment and media bias. The most recent example of this was Fujimori re-election to a third term in office in June 2000, before which he changed the constitution, which previously had a maximum of two terms. Peruvian politics in the 1990s has seen the collapse of political parties as mediators between state and society. This has marginalized the public further from decision-making. The Peruvians are voiceless and powerless. This subjects them to rudeness, humiliation, shame, inhumane treatment and exploitation at the hands of the state and the military.

In an ideal political environment, the legal system should guard against abuse of power by the state or other agents and is independent of executive and legislative branches. However, the judiciary in Peru has never enjoyed political autonomy. The system is slow and unreliable and the low salaries encourage corruption. According to Javier de Belande (1995), the man in the street sees the law as something arcane, remote and divorced from his everyday interests; he seeks to avoid the system, preferring to resolve his problems in informal ways. Corruption is widespread among the governing elite and takes its toll on economic performance.

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The burden of petty corruption falls disproportionately on poor people. It increases taxation on the poor in Peru and biases government away from socially valuable goods. It diverts public resources from infrastructure investment for the poor to defence contracts.

Narcotics

The Haullaga valley is the most important coca-growing zone in the world. According to US officials, 200,000 acres of coca were under cultivation in Haullaga in 1990, almost 40% of the world's coca crop. Most of Haullaga's coca farmers are poor migrants from the Andean highlands, who own small plots of a few acres or less. They sell their coca harvests to wholesale buyers who process the leaves into cocaine. Many of the manufacturers in the Haullaga were Colombian representatives of the big name traffickers like the Escobars and Ochoas. In my research, I have uncovered a few ways in which the production and trade of coca impacts negatively on Peruvian poverty.

First, it increases poverty by shifting resources away from food production, pushing up domestic food prices to the detriment of those lacking assets to purchase basic bundle of goods. Secondly, many harmful chemicals dumped into rivers kill wildlife and are detrimental to the health of the working population. This serious degradation of the environment hinders production of all products, reduces tourism, kills wildlife and farm animals and has a serious impact of the economy, outside of ascetic consequences. The illegal nature of the industry and the figures involved significantly reduce governmental tax intake, hindering redistribution. Furthermore, its illegal nature coupled with free foreign exchange market contributes additionally to the money laundering of narcotics. The latter becomes the *de facto* regular of the foreign exchange market, with the undermining of Lima's monetary and exchange rate policy (Crabtree, 1998). In addition to this, the necessary accompaniment of guerrilla groups discourages investment in the region. If the threat of violence were not around every tree, primary, secondary and tourist investment would embrace the region to a greater extent. Unfortunately for Peru, the supernormal profits of cocaine cultivating and manufacturing do not, in the main, accrue to its residents.

Sub-optimal exploitation of resources

Growth potential in the Peruvian economy is enormous. The 2.4% growth

rates of the Fujimori regime have been well applauded and appreciated by much of the population. The system's inherent instability and absence of progress towards representative government would have hindered significantly the extent of foreign direct investment's embracing of Peru in my opinion. A civil society that has the potential to revolt at any time in no way aids the security of assets.

Although agriculture has fallen as a percentage of GDP, it does provide a living for large sections of Peruvian society. The destruction of the estates and the expropriation of land scared investors away from the sector. Peru has the great asset of being one of the most botanically and zoologically diverse countries in the world. Within its borders, it can count 84 of the 103 different climates classified by the World Bank and its three distinct zones, Costa, Stena and Seba, each favouring different products (Goodhart, 1994). The coast has large areas of land that can still be brought into cultivation through new irrigation systems. It is also estimated that the jungle has two million hectares of jungle suitable for intensive cultivation (Goodhart, 1994). Not only are Peruvian yields far below international standards, they are also way below what used to be achieved in Peru itself. Peru has a great chance of becoming a major force in agriculture if they encouraged farmers to turn their attention towards foreign currency earning export goods like asparagus and investment.

Peru's massive coastline is one of the country's greatest assets. There is high diversity in the fish stocks, which has yet to be developed properly. One of its problems is that it concentrates to too great a degree on low margin catches such as anchovy and sardine (Goodhart, 1994). It also suffers from underdevelopment; the Peruvian fleet lacks refrigeration facilities and has a much shorter range. Another example of this is that although Peru is the number one fishmeal exporter, it is not the world's most efficient producer. Further investment in new technology for the countries processing plants is necessary.

Peru is well endowed with mineral wealth; after all it was this wealth that attracted the Conquistadors. The oil giant, Shell, discovered the Cami sea gas field just north of Cuzco in the mid 1980s. It is estimated to hold 10.8 trillion cubic feet of gas and a little under 1 billion barrels of oil (Sachs, 1991). This resource, if administered properly, would provide massive benefit to the Peruvian economy. An example of this is the possible wiping out of the current Peruvian power shortage and crises which result when lack of rainfall reduce capacity from hydroelectric stations. There is a similar story with Peruvian manufacturing, where investment and energy shortages from droughts have led to industrial stagnation.

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Peruvian tourism is another striking example of a missed opportunity. The natural beauty of Peru has long been an attraction for foreign visitors, from the mountain top ruins of Machu Picchu, to the deep jungle, from the sea wildlife of the Parachus to Lake Titicaca. Peru's diversity of terrain, plant life and wildlife is second to none. Tourist numbers visiting peaked at 370,000 per annum by 1980 (Goodhart, 1994). Since then, the gradual collapse of Peru's image overseas, resulting from terrorism, hyperinflation, extreme poverty and the cholera epidemic, has led to a sharp drop in numbers visiting the country. The late 1990's, with a stable civil society, saw a temporary resurgence of tourist numbers. However, 2000 was a disastrous year with political instability deterring a significant number of travellers. The potential benefits from a developed, properly managed tourist industry in Peru, is exponential. The presence of political stability could mean that the industry could treble in 10 years with benefits for those in poverty. A quick glance at the numbers of visitors registered by other South American countries confirms this, 6.5 million in Mexico and 1.3 million in Chile.

Social Services

Access poverty refers to non-ownership household wealth which greatly contributes to the well being of the household. An overriding problem is the lack of scope for extra spending on services and infrastructure, within given fiscal limits. Secondly, within the given fiscal limits, resources are not allocated appropriately. In aggregate terms according to the World Bank (1999) Peru continues to allocate fewer resources to health than most of its neighbours. Thirdly, inequality is illustrated by the fact that while the rich spend more on private health care, the ministry of health does not redress this imbalance by directing almost equal amounts to the poor and non poor instead of serving the poor (*ibid*). The World Bank Peruvian Health Report describes it as fragmented and lacking competition and refers to the non-separation of financing and provision. There is a similar story in education.

Infrastructure

In terms of infrastructure, power shortages were one of the principal reasons for a drop in industrial output in 1992. An improvement in the country's power generating and distribution capacity is vital if growth is to be improved. This is also a source of poverty to those in both urban and rural areas, as they are not connected. Peru's road network is in a parlous state, its rail system inadequate. If

fiscally viable it is important as far as industrial growth is concerned to expand both these networks. On average there are only 2.4 power lines per inhabitant, and only 1.4 lines per rural inhabitant, which is less than Peru's neighbours (Goodhart, 1994).

Natural Disasters

If one considers that 3.6m Peruvians face imminent starvation and 11m are in poverty, natural disasters have devastatingly pronounced effects. El Niño, and Peru's history of earthquakes, volcanic activity and avalanches are a constant threat to Peru's poor. Each disaster as they occur will force thousands into poverty.

Conclusion: a summary of how such poverty might be reduced.

Approaches to reducing poverty have evolved over the past 50 years in response to a deepening understanding of the complexity of development. The importance of access to education and health was highlighted in the 1970s. The 1990 World Development report broadened this, emphasising asset building, the microeconomic environment and low cost labour. However the 1990s and the mixed experience of developing countries, had led the World Bank to broaden their thinking to include vulnerability and exposure to risk, and voicelessness and powerlessness. The 2000 World Bank report on poverty aggregates policies aimed at reducing poverty into three areas.

Firstly there is promoting opportunity, i.e. poor people's ability to access material goods such as jobs, credit, roads, electricity, and markets for their produce through market liberalisation, schools, water, sanitation and health care. Overall economic growth is crucial for generating opportunity, but so too is redistributing policies that are biased towards the poor in education and health care. The second aggregated policy aim is facilitating empowerment for citizens. Diffusing political power to the people, creating representative institutions and mechanisms that are responsive and adaptable to the will of the people. An unbiased and efficient legal system is also required. It also involves the encouragement of participation of minority ethnic groups and poor people. Finally, enhancing security, reducing vulnerability to economic shocks, natural disasters and ill health, is central to enhancing well-being and in turn reinforces opportunity, as it encourages investment and higher risk return activities.

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These three policy aims are deeply complementary. For example promoting opportunity through asset and market access increases the independence of the poor, strengthening their bargaining position relative to state and society. It also enhances security, since an adequate stock of assets is a buffer against adverse shocks. Similarly, strengthening democratic institutions and empowering the disadvantaged, for example, by eliminating legal discrimination will in turn expand their economic opportunities (World Bank, 2000). An effective poverty reducing strategy in Peru will require action on all three fronts by all actors in society and will have to reflect and suit the country's social, and economic characteristics. With these three policy aims in mind, I shall discuss eight areas, upon which I believe an effective poverty reduction should be based.

Long-term political stability, based upon the principle of representation, would infinitely enhance citizen empowerment in Peru, while contributing to both opportunity promotion and security enhancement. Peru's populist tradition must be overcome by a broad and embracing regime with check and balances, which restricts the power of any one individual or institution. The World Bank believes that the state will deliver more effectively to the poor if public administration implements policies effectively and if it is accountable and responsive to users, through decentralization. To breach this deficit Peru must establish representative institutions that reach the people. Decentralisation will also enhance security as crises responsive mechanisms are maximised.

Enhancing the quality of the Peruvian civil service is also vital, by eliminating nepotism and cronyism, through merit based recruitment, as if promotion is unrelated to performance, staff have much less incentive to perform. Secondly, if elected representatives are overseeing their work and a free media is observing their decisions, efficiency is helped and corruption reduced.

It is clear that any defeat or substantial success against terrorism and the narcotics trade will greatly improve the circumstances of the Peruvian people. How this is done or if it is possible is an entirely different issue. In terms of terrorism, very harsh action is needed and it is important that the next government maintains suppression of the Shining Path. With regard to the drug trade, although this will antagonize the US, it would be worthwhile to partially legalise coca production and cocaine manufacturing, thus allowing possible taxation to accrue to the government rather than, certain generals in the army. And reduce violence in the Haullaga valley breeding confidence to investors, both in agriculture and tourism.

Although the policy of promoting an unskilled, low cost workforce to the international business community had been qualified since it's pure advocacy in 1990, this is something from which Peru and Lima in particular could benefit. Empirical evidence, from Ireland in particular, has shown that labour export orientated growth, which is low skilled, can in time lead to a second generation of a more skilled labour force. This can contribute more to a value adding manufacturing base. Diversification into manufacturing goods, aimed at the US market, should be allied with greater diversification in agriculture. Any argument contrary to the benefits against agriculture production exporting does not mitigate against agriculture promotion but encourages cross-sectional diversification.

Another way in which poverty will be reduced is through the development of credit markets. Households can benefit from credit, savings and insurance services. They help to smooth consumption in the fall of sharp fluctuation in agricultural prices and yields, economic shocks and natural disasters, while on the other hand encouraging investment. Peru's government sponsored credit system aimed at meeting this need of the people, however proved not to be financially viable and the program collapsed under its high losses (WDR, 2000). According to this report, practices identified in the Bank Rakyat Indonesia should form the basis of credit programs in Peru. These include interest rates that fully cover cost, availability of well rewarded saving schemes, performance based compensation for staff, intensive staff training and low cost distribution networks.

Market encouragement policies have to be allied with redistribution policies in health and education to maximise the correlation between economic growth and poverty reduction. The equitable division of funding in this area has to be redressed. The education system should design programmes to meet the needs of the people. In rural Peru, academic courses should be augmented to include courses such as entrepreneurship, civics, agriculturally productive practices, asset and family management and practical skills. Such courses would prove advantageous to the children in question. I also believe an increased emphasis on English would be very advantageous, as it will complement the proposed tourism and multi-national manufacturing development. Allied to these changes, I would propose equal treatment and the encouragement of women in education. It has been shown that better-educated women are more able to communicate with their spouse about family size, use contraception more effectively and have higher aspirations for their children (World Bank, 2000).

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