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Institute of Social Studies

GRADUATE SCHOOL OF DEVELOPMENT STUDIES

The Political Economy of Growth, Population and Poverty in Peru

Why the structural reforms on privatization and trade liberalization of the 1990s benefited the economic elite and increased poverty

A RESEARCH PAPER PRESENTED BY

Lionel Vigil Angulo

(Peru)

In partial fulfillment of the requirements for obtaining the degree of

MASTERS OF ARTS IN DEVELOPMENT STUDIES
SPECIALIZATION: POPULATION AND DEVELOPMENT

MEMBERS OF THE EXAMINING COMMITTEE

Dr. Eric Ross
Dr. Cristóbal Kay

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This document represents part of the author's study programme while at the Institute of Social Studies; the views stated therein are those of the authors and not necessarily those of the Institute.

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ACRONYMS

AFPs Administradoras de Fondos Privados de Pensiones/Administrators of Private Retirement Funds

APRA Alianza Popular Revolucionaria Americana/ Popular Aliance Revolucionary American

BCRP Banco Central de Reserva del Perú/Peruvian Central Bank of Reserve

COPRI Comisión de Promoción de Inversion Privada/Commission for Promotion of Private Investment

CPT Compañia Peruana de Teléfonos/Peruvian Telephone Company

ECLA/CEPAL Economic Commission for Latin America and the Caribbean/Comisión Económica para America Latina y el Caribe

CELADE Centro Latinoamericano y Caribeño de Demografía/Latin America and the Caribbean Demographic Center

ENAHO Encuesta Nacional de Hogares/National Households Survey

ENTEL Empresa Nacional de Telecomunicaciones/National Telecomunication Enterprise

GDP Gross Domestic Product

ICPD International Conference on Population and Development

IFIs International Finance Institutions

IGV Impuesto General a las Ventas/General Tax to Sales

IMF International Monetary Fund

INEI Instituto Nacional de Estadistica e Informatica/National Institute of Statistics and Informatics

INRENA Instituto Nacional de Recursos Naturales/National Institute of Natural Resources

ISI Import Substitute Industrialization

MEF Ministerio de Economia y Finanzas/Ministry of Economics and Finance

MINSA Ministerio de Salud/Ministry of Health

MRTA Movimiento Revolucionario Turpac Amaru/Tupac Amaru Revolutionary Movement

OECD Organization for Economic Cooperation and Development

RAP Rights Accumulation Programme

SAP Structural Adjustment Programme

SENASA Servicio Nacional de Sanidad y Calidad Agroalimentaria/National Service of Sanitation and food quality

TFR Total Fertility Rate

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The Hague, December 2003.

ABSTRACT

The structural reforms of the 1990s in Peru focused on privatization and trade liberalization, has promoted economic growth by using the old traditional primary-export model but presented by the economic elite as the "modernisation" of Peru's economy. Thus, this model was assumed that would contribute to reduce poverty by creating jobs and prosperity for all Peruvians that unorthodox policies with more state participation in the past were unable to do. However, the structural reforms of the 1990s, increased poverty, inequalities and unemployment because of the economic elite's culture of exclusion and internal colonization against the vast majority of Peru's population that denies them access to good public services in education and health, as well as housing, institutions and natural resources. This rather than being and external factor of the dependency theory, as it has commonly been argued, constitutes an internal factor of internal colonization, which represents a major constraint for Peru's successful transformation into a modern society.

Key words: economic elite, exclusion, internal colonization, poverty, economic growth, structural reforms and population.

THE POLITICAL ECONOMY OF GROWTH, POPULATION AND POVERTY IN PERU

Why the structural reforms on privatization and trade liberalization of the 1990s benefited the economic elite and increased poverty

> *"One of the greatest dramas of a country like Peru is that, the ones who most feel about the tragedy of poverty are those who know less how to solve it, and those who most know about it have no sensitivity for the poor"*
>
> **Hernando de Soto[1].**

INTRODUCTION

The dominant discourse of the advocators of the structural reforms of the1990s in Peru has been that trade liberalization and privatization would bring high economic growth and reduce poverty by a trickle down mechanism in which as the economic elite become well off, the poor will also do so. The former was true; during that decade, GDP grew on average by 6.5 per cent per year between 1993-97, one of the largest in the region and the largest in the last 25 years (Diaz, et al. 2000:5-6). The latter however, did not happen; absolute poverty has reached 54.8 per cent and extreme poverty 24.4 per cent at the end of that decade. These levels are comparable to the ones of the 1960s when the country was in a stage of a traditional agriculture economy.

At the end of the structural reforms of the 1990s Peru had achieved not only one but two of the fundamental conditions for neo-liberal policies to succeed: economic growth and decreasing population growth. Both were assumed to modernise the Peruvian economy and reduce poverty. However, such reforms, instead of diversifying the economy in sectors where Peru has clear comparative advantages, such as agriculture and small manufacturing, they have concentrated on the primary-export model controlled by economic elites.

Thus, economic modernisation has marked the return to the old primary-export model within the neo-liberal reforms of privatization and trade liberalization, which has clearly

benefited the elites from which they have access to Peru's natural resources, markets and institutions and have largely, excluded the majority of Peruvians from productive assets. As a result poverty and inequalities in Peru have increased during that neo-liberal reforms. The aim of this paper is to explain why this has happened. Why despite high economic growth as a result of privatization, trade liberalization and decreasing population growth has poverty increased? To find out the answers we have looked at the political economic of Peru during the structural reforms of the1990s. In other words, we have to study at the economic policies implemented in that period to promote growth, and how such policies have affected the population dynamics and how these two have affected poverty.

This leads to a paradox in which a country rich in natural resources has one of the highest levels of poverty and inequality levels in Latin America as a result of the economic elite's control and overuse of the country's natural resources and of the state. On the other hand, the economic elite has perceived Peru's population growth within the Malthusian pessimistic approach of diminishing returns as a constraint for the country's development. Therefore, the current social structure that sustains inequalities and poverty is justified by elite's economic discourse of insufficient economic growth, high population, natural phenomena and terrorism.

Our hypothesis is that economic growth during the structural reforms of the 1990s depended on a primary-export model, which represents to a great degree an internal factor of internal colonization and socio-economic exclusion rather than an external factor of the centre, and periphery dependency theory as it has been commonly argued. This paper presents data and evidence that explains the increase of poverty in Peru associated with economic policies of privatization and trade liberalization, which have favoured the Peruvian economic elite to benefit from the primary export-model and the state during the structural reforms of the 1990s. It challenges the elite's argument that Peru's high poverty level rather than being lack of redistribution is due to insufficient growth or low average income related to its high population growth (Escobal, 2000:39).

[1] Peruvian Economist, president of the Instituto Libertad y Democracia, in an interview in "Expreso" a Peruvian newspaper 18/06/03.

This paper is organised in the following chapters. Chapter one provides the theoretical framework of the relationships between of economic and population growth. Moreover the theories of internal colonization and exclusion used as tools of analysis to explain our hypothesis. The second chapter refers to Peru's population dynamics, rural-urban population changes influenced by industrialisation and the land and education reforms and how these affected fertility rates and population growth. It also provides a profile of the poor, the definition of poverty and its causes in Peru. The third chapter describes the characteristic of structural reforms of the 1990s, and how the economic elite has benefited from privatization and trade liberalization using the primary-export model, presenting the state as a constraint for the country's development. Chapter four explains why poverty has increased despite economic growth, which lies in the limitations and vulnerability of the primary-export model as an internal factor of social and economic exclusion. Finally, some policies to improve Peru's human and social capital by investing in education, health and housing are proposed, for which tax reform to finance such policies and bring equity and inclusion are crucial.

CHAPTER 1

I. ANALYTICAL FRAMEWORK

1.1. Economic and population growth

The debate about the relationship between economic and population growth is as old as the beginning of modern economics. Two visions, the pessimistic and the optimistic, have clearly influenced theories and policies that claimed to favour economic growth while keeping population at a lower rate, or promote economic growth with high population growth rates. However, this relationship is complex and ambiguous the historical links between economic and population growth and cause are complicated (Thirlwall, 2003:291). The relationship should be looked within a country's political, social, economical and cultural context. There is a danger of drawing wrong conclusions from aggregate data if one does not examine what happens within a country's population dynamics, largely influenced by its culture and determinants of fertility, both related to internal and external socio-economic factors and institutions.

Some scholars have provided enlightenment to this debate; among the most influential is Adam Smith, who had an optimistic view of the relationship between population and economic growth. He based his theory of **increasing returns** as a result of the division of labour or gains from specialisation and the role of the market in generating per capita income growth, which in turn, would lead to rising labour productivity and employment. Therefore, population growth would contribute towards productivity and increase individual's and society's wellbeing. Others, however, presented this relationship as having a gloomy fate. These were the latter classical economists such as Malthus and David Ricardo. They opposed Smith's theory and presented a pessimistic vision of this relationship, referred to as the theory of **diminishing returns** to labour and capital. According to this theory, labour productivity falls to the point where the marginal product of labour equals the level of the subsistence wages (ibid. 127-31). Therefore, following this theory, population growth would decrease productivity, individual's utility and society wellbeing.

Furthermore, Thomas Malthus, at the forefront of the pessimists, defended his theory of the diminishing returns to labour and capital by arguing that the increase of population would affect economic growth since it would depress income per capita through diminishing marginal productivity to greater labour supply. In contrast, low population growth would favour more income distribution per capita. But, economic growth itself would also encourage population growth (Becker et al. 1999:146). However, Malthus' theory as he had predicted did not occur in any society. Not even in the most populated underdeveloped countries where demographers and economists have predicted Malthusian outcomes of population explosion and diminishing returns on labour and capital. Malthus' assumptions might have occurred if societies had been frozen in the Eighteen-Century and high levels of innovation in science and technology never took place.

In Nineteen-Century Western Europe, however, population growth was still high even though some countries increased income per capita through innovations in science and technology and improved human life expectancy. Nevertheless, income per capita grew faster than population. This has been observed in modern urban economies where

specialisation and more investment in human capital have had a positive effect on economic growth, and economies of scale.

David Ricardo, a great Malthus' admirer developed his **labour supply theory**, which states that as population in rural areas grows, more land is needed. Hence, agriculture expansion would have to take place either by expanding land to new areas that he assumed would be infertile and therefore of low productivity, or by intensifying agriculture productivity by intensive cultivation. In both cases, diminishing returns to labour and capital would happen. His theory converged with Malthus' that in the long run, a population increase would have diminishing returns as per capita food and consumption declines vis-à-vis the decline in real wages. However, what Ricardo did not consider was that a third type of agriculture expansion in response to population growth would happen, fallow intensification in agriculture, by using the increasing labour force that leads to different food supply elasticities[2] in response to population growth (Boserup, 1987:11) through agriculture innovations and intensification.

A study in 15 low and middle-income developing countries, including Peru, shows that there is not clear evidence to support neo-liberal position that high rates of population growth have a deleterious impact on economic growth. Conducting a Granger causality test[3], that study argues that population and economic growth has two ways of causality: negative and positive effects on population and economic growth, depending on the characteristics of the country. In the case of Peru, studying a long period of population growth (between 1961-1991), the Granger causality tests results shows that population growth improves economic growth and higher economic growth has not significant effect on population growth (Kapuria-Foreman, 1995:531-7). Peru experienced high economic growth from 1970 to 1980 (see figure 3.1) despite its high population growth rates, and population mobilisation from rural to urban, due to the industrialisation process, mainly

[2]Elasticities show the extent to which one variable respond to another. The price elasticity of demand shows how the quantity demand of a product responds to a change in price.

[3]Clive W. J. Granger, Shared Nobel Prize in Economics 2003 with Robert Engle for their discoveries in the analysis of time series data. Granger who has invented the concept of co-integration, describing a means of analyzing the relationship between variables, which follow trends over time, has developed the Granger Causality Test to estimate, which of several variables led to movements in others.

centralised in the Costa region particularly in Lima. From this study, we can conclude that population growth in Peru did not constitute a diminishing return factor as it has been presented by the economic elite, but a increasing return to improve the social and economic conditions and create economies of scale.

1.2. Internal colonization

One of the explanations of high levels of inequality and poverty in Peru is the concept of internal colonization, which refers to the structure of the social relations based on domination, subordination and exploitation among culturally heterogeneous groups in a society (Kay, 1989:66-71). This explains how the social structure of Peruvian society, in which an economic elite (usually located in Lima), has historically exploited the rest of the population as cheap labor and benefited from Peru's natural resources orientated to export. The Peruvian economy has been designed towards the export of such primary resources, from which the metropolitan elites of the *Costa* region, mainly from the capital, and their foreign counterparts benefit. Internal colonization explains why in the case of Peru, the primary-export model rather than being an external factor of the dependency theory argument, represents an internal factor in which development is perceived by the elite as being exogenous driven. Thus, according to the elite, development should and must come from outside because of their economic, racial and cultural links with outside that make them perceive the foreign culture as superior, whereas the internal culture is seen as inferior. The core represented by the elite creates a social structure in which access to natural resources, credits, and public services are reserved only for themselves, to the detriment of the disadvantage peripheral colonized group (Hechter, 1975:30-8).

1.3. The exclusion factor

The concept of social exclusion refers to the prevention by some groups of the participation of others in important aspects of social life. As opposed to the concept of social integration, exclusion and integration are the two sides of the same coin and both can happen at the same time. A group or its members could be highly integrated internally, but excluded in relation to other groups. These processes happen at all levels of the society. At the micro-level such as the household, at the intermediate-level or national level in a country and at a macro-level such as at the international community level. The

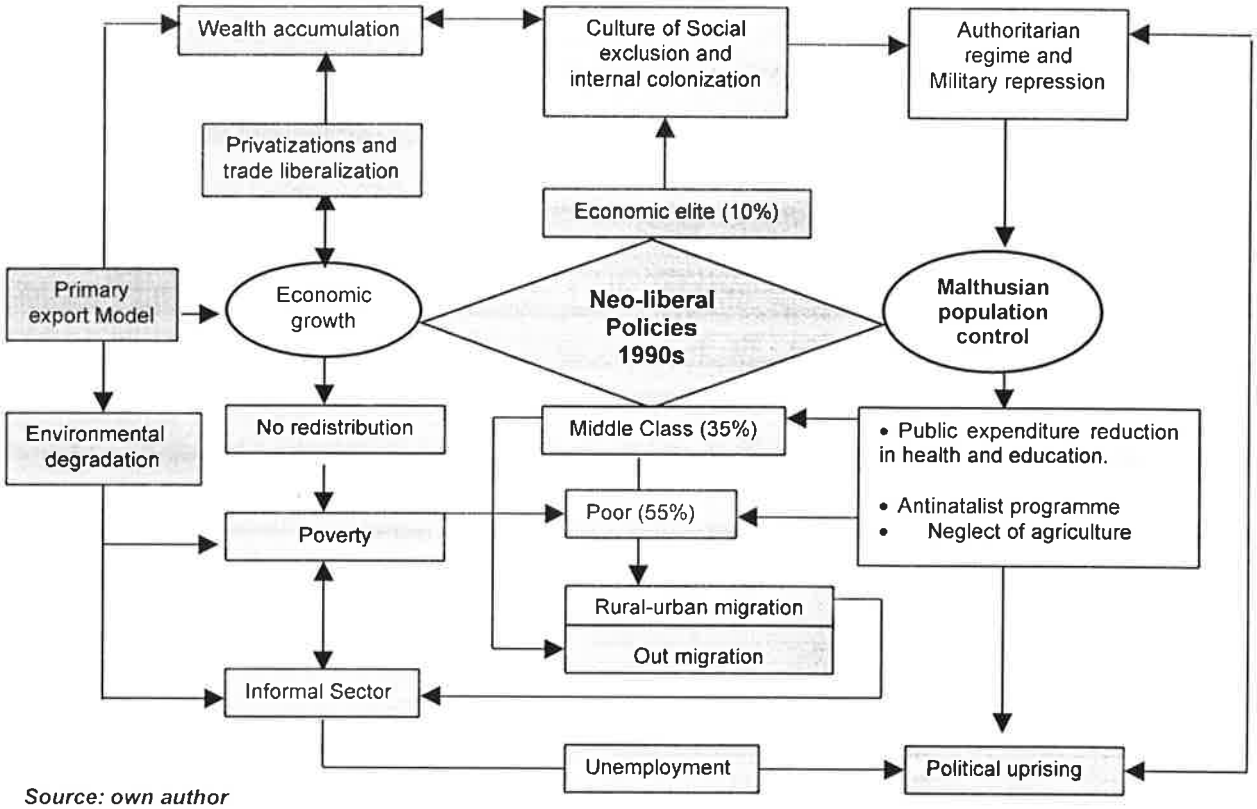
exclusion factor includes three important areas of social life: economics, politics and culture (Figueroa, et al. 1996:11.).

Economic exclusion occurs when individuals or groups are excluded from participating in the market either as consumers or producers. Exclusion of consumers happens because of the low purchasing power that people have as a result of economic policies which prevent them from having access to the basic commodities that the society produces, such as food, clothing and housing, which undoubtedly leads to poverty. The exclusion of producers occurs due to unequal competition. In the case of Peru, the formal sector, with access to credit and protection from the state, prevents other groups such as those in the informal sector –the small entrepreneur and farmers– from having access to the market, therefore they are repressed by law. This in turn, affects these groups' potentiality to create physical capital, economies of scale and market expansion.

Political exclusion occurs when people are prevented from having access to the decision-making, political participation and influence of state policies. Moreover, basic citizens' rights such as, democracy, freedom and equity before the law are not fully recognised. These undermine peoples' participation in the country's affairs and the policies that the state designs (ibid: 16-9). Regarding cultural exclusion, in Peru this happens at two levels. First, when the indigenous people and the poor, mainly the *Quechua*, *Aymara* and Amazonian languages-speakers do not have access to certain basic modes for communication due to the lack of education programmes to prepare them to speak, read and write in their own language. Second, the same groups are discriminated again because of their particular physical and ethnic characteristics that the excluding group considers as inferior or undesirable (ibid: 23-6).

Figure 1, shows the link between the political economy of the 1990s and the theories used in this paper to explain why the policies of privatization and trade liberalization have benefited the economic elite and impoverished the majority of Peruvians.

Figure 1. Peru's Political Economy in the 1990s



Source: own author

CHAPTER 2

II. POPULATION DYNAMICS AND THE LAND REFORM

2.1. Fertility rates and rural-urban population

In the 1940s the industrialisation process started to change Peru's population composition from rural to urban. According to the first reliable census, Peru's total fertility rate (TFR)[4] between 1950-1965 was 6.8 children per woman (see figures 2.1 and 2.2), which characterised a country predominantly rural[5] with an incipient process of urbanisation mainly in the *Costa*[6], with high levels of illiteracy and limited access to information and

[4]Total Fertility Rate (TFR) is the number of children a woman has during her reproductive life span (between 15 and 45 years of age).

[5] Between (1950-1965), 52.6 per cent of Peru's population was rural, according to official censuses figures.
[6]The Costa (Coast) represents 12% of Peru's territory, the Sierra (Highlands) 26%, whereas the Selva (Jungle) represents 62% Peru's territory.

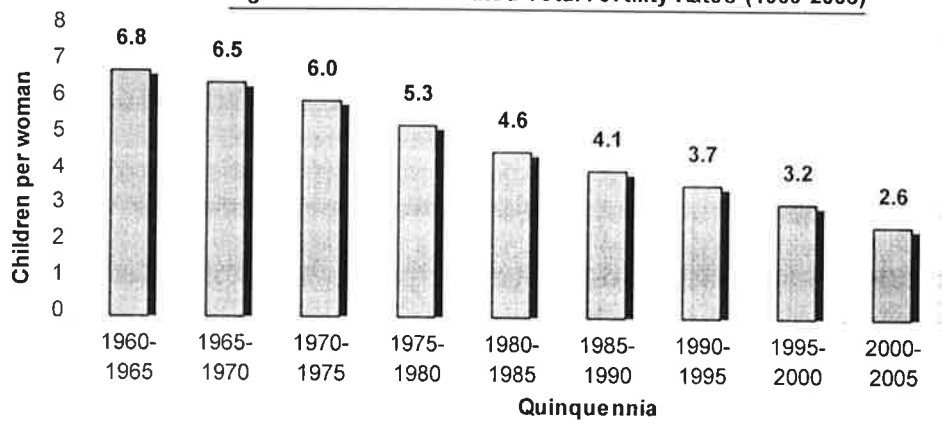
use of contraceptives. Peru's fertility rates and population growth started to drop from the 1960s and dramatically after the land reform in the 1970s.

At the beginning of the 1990s, the average children per woman was 3.7 and currently it is 2.6, (see figure 2.1). Needless to say, the fertility rate varies between rural and urban areas and variation can also be founded within regions. Currently, the bulk of the Peruvian population, 72 per cent, is concentrated in urban areas, of which 29 per cent of the population live in Lima. The remaining 28 per cent corresponds to the rural population.

The decline in fertility cannot only be attributed to the prevalence of contraceptive use[7], but also due to the decrease of illiteracy among women of reproductive age and to the accelerated access to information and communication sources (INEI, 2001:19-20). However, a study found that hardship and economic crisis in the 1980s rather than demographic policies might have been the main factors that have affected fertility rates in the last twenty years. Thus, economic and political crisis rather than modernisation are referred as being the main factors that favoured fertility decline in the urban areas in Peru (Ferrando and Aramburu, 1996:415).

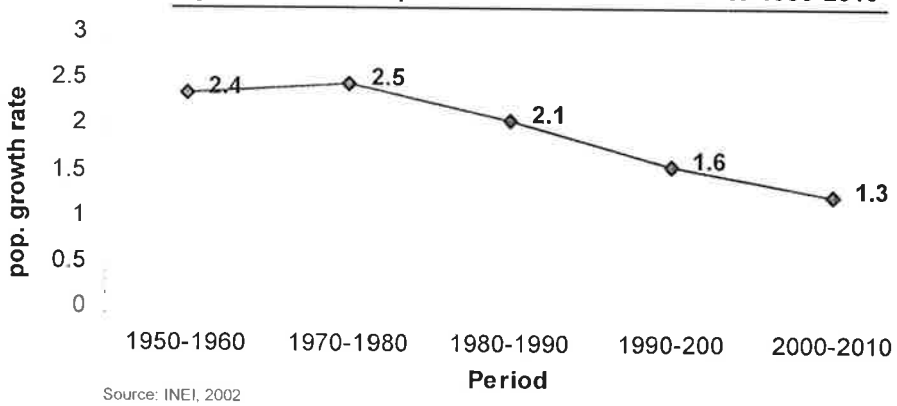
[7] According to Peru's Ministry of Health (MINSA), fifty per cent of couples in Peru now use modern contraceptive methods.

Figure 2.1: Peru Estimated Total Fertility Rates (1960-2005)



Sources: ECLAC/CELADE,1998, INEI, 2001

Figure 2.2 Peru Population Growth Annual Rate 1950-2010



Source: INEI, 2002

2.2. The Land and Education Reforms.

In the 1970s, the land reform was an attempt to create a less unequal Peruvian society by giving land to the peasants highly exploited in the *Latinfundios*[8] mainly situated in the *Costa* region and run by the metropolitan oligarchy. However, the land reform was a top-down policy, in which the participation of the peasants promoted by social activists lacked the real political involvement of the peasants. The state involvement in land management and production in the expropriated *latifundios* revealed the backward situation in which Peruvian peasants remained as a result of years of the economic elite's that excludes the majority of Peruvians from institutions and access to natural resources.

[8] A Latifundio is a large extension of land owned by the Oligarchy State or used for intensive agriculture activities for cash crop production usually for export.

No other reforms have brought down poverty and inequality levels in Peru as the Land and the education reforms did. However these reforms have been highly criticized by the economic elite despite them being the ones who benefited from them. Together with land redistribution and elimination of illiteracy, the land and education reforms were aimed to promote endogenous growth by creating a competitive industrial elite with a high human capital in order to meet the challenges of Peru's integration into the globalized capitalist system. Nevertheless, the reforms have created strong political opposition and passions in the Peruvian elite that has neutralized the reforms during the neo-liberal policies of the 1990s following the recommendations of the Washington Consensus to reduce public investment in public education and health services.

The peasants perceived the land reform as the establishment for the first time of a benevolent state. After years of capitalist exploitation in their place of origin the peasants saw the city as a safe heaven where they would encounter the protection of the state, therefore, they started to migrate from the countryside to the cities. However, when peasants arrived in the cities, they encountered the hostile reception of the elite, which De Soto describes in this way:

> "The hostility was extreme in 1930 when a ban was imposed on the construction of cheap apartments in Lima...[I]n 1940, president Manuel Prado considered a curios proposal for "improving the race" by encouraging the migration of Scandinavians to the country's cities. In 1946 legislature, the senator for Junín, Manuel Faura, presented a bill that would have prohibited people from provinces, particularly from the mountains, from entering Lima. In the next legislature, representative, Salomón Sánches Burga submitted a request, with the House's approval, which would have required people wishing to enter the capital from the provinces to carry an entry passport. All these proposals failed, but they show that, even then, there was a clear desire to deny migrants access to the city". (De Soto, 1989:10).

The elite had assumed that modernisation would go to the countryside and not that the countryside would come to find modernisation in the city.

2.3. Poverty Profile in Peru.

A recent national survey on Peru's poverty carried out by the National Institute of Statistics and Informatics (INEI) reveals that the poverty profile is related to age, gender

access to education, quality of employment, demographic composition, and access to public services and ethnicity see table 2.3a. These characteristics allow us to identify who are the poor and what variables are related to poverty in Peru. However, they do not tell us whether such characteristics are statistically significant or robust, (this is given in table 4.1 in chapter four).

Table 2.3a Poverty Profile in Peru 2001.

Factors	Description
Age	**Households headed by young people have more incidence of poverty.** The head of households in both extreme and not extreme poverty are on average younger than their non-poor counterparts. These results have been observed in 18 out of the 24 departments in Peru. These do not change in the cases of urban and rural areas. Only in the department of Pasco with opposite results are statistically significant. However, in *Loreto* the average age of both poor and non-poor households does not differ.
Gender	**Female-headed households do not present higher risks of poverty, compared with male-headed households**. Although, these results are less significant for total poverty if the population is disclosed in rural-urban. In rural areas the risk of extreme poverty is less for women headed households 90% of confidence.
Education	**Access to education is the most important factor of poverty risk.** A person who has not completed primary education heads eight out of ten extreme poor households. Six out of ten (66.7%) of the poor households have that characteristic.
Employment	**Low quality of employment and not unemployment characterises the poor.** Unlike what happens in developed countries, the fact that the heads of households have an extra activity additionally to their main activity increases the risk of being poor instead of decreasing it. This is due to the low quality of employment that makes people look for other activities as a strategy to get out of poverty. This is a survival strategy instead of an economic promotion. The quality employment is concentrated in the public and private sectors, whereas workers in the informal sector are within the categories of absolute and extreme poor.
Demographic composition	**Poor households have different demographic composition than the non-poor.** Poor households have more family members in both rural and urban areas. The numbers of children aged less than 15 years old are found more in poor households than in non-poor households.
Access to Public Services	**Poor households have less access to public services compared to the rest of the population.** Public services such as water, sanitation, electricity, housing, health and education are substantially less in the poor population in both rural and urban areas compared to the non-poor.
Ethnicity	**Indigenous headed households are the poorest of the poor.** The risk to extreme poverty is higher in indigenous headed households. Seven out of ten persons in the indigenous headed households are poor, whereas at national level one out of two (54.8%). This risk is even higher for extreme poverty. Forty eight per cent of the extreme poor is indigenous; such groups represent 29.7% of the total population.

Source: (Herrera, 2002:38-59). Elaboration own author.

There are several concepts used to define poverty, however, none of them is sufficient to cover all the complexity of this condition, which relies highly on socio-economic factors that prevail mainly in developing countries. Poverty is a multivariable and multi-cause socioeconomic condition in which a person cannot satisfy her/his minimum basic needs such as food, clothing, shelter, education and recreation to attain a minimum standard of living in order to function with normality in society. This definition implies that a person living in a particular socioeconomic condition has been denied access to basic goods and services as a result of economic, political and cultural factors that would allow s/he to attain a basic state of well being.

The World Bank definition that emphasises the welfare indicator, as the "adjustment per capita consumption" (Glewwe & Van Der Gaag, 1990) is the one used in conventional research on poverty in Peru. The World Bank defines a household as ***poor*** "if per capita consumption is lower than the cost of a minimum basket of goods and services, and ***extremely poor*** if per capita consumption is lower than the cost of a minimum basket of food necessary to maintain adequate caloric intake"(World Bank, 2002:2). The problem with this concept is that it limits poverty to a single variable, economics, and in Peru, research on poverty is highly focused on the economic variable. Thus, it is common to find studies concluding that poverty in this country is highly related to insufficient economic growth rather than to the internal factors of social exclusion, ethnicity and the current social structures that support the culture of internal colonization and discrimination towards a large number of Peruvians.

Other variables such as per capita consumption or household expenditure/consumption, food ratio, calories, medical data and basic needs are being incorporated for better understanding of the causalities of poverty. The Peruvian Ministry of Economy and Finance (MEF) uses the concept of poverty line related to the expenditure in consumption as a measurement of welfare consumption. The MEF defines it as the consumption per capita in the household compared with the prize of a minimal basket –named the ***poverty line***. In which, each minimal basket assures the consumption of 2,318 kilocalories per capita in Peru's three natural regions: the *Costa*, the *Sierra* and the *Selva* (MEF, 2002:11-12). The ***Poverty gap*** is defined as the average difference between the income of the poor

and the value of the poverty line. This gap can be used to refer to both total or ***absolute poverty***, and ***extreme poverty***. Another concept included in the study is ***poverty severity***, which is the indicator of inequality between the poor. It is defined as the average value of the squared differences between the income of the poor and the poverty line (ibid).

Forty years ago poverty in Peru was as high as 64 per cent (see table 2.3b). At that time the country's population was mainly rural and the economy highly depended on extensive agriculture and export of minerals, where the irrigated fertile lands were in the hands of the Peruvian oligarchy, those who Victor Raúl Haya de la Torre[9] called "the cotton and sugar barons". Peru was a country characterised by high levels of inequality and discrimination of a white economic elite against a large number of its population, the indigenous peasants and the *mestizos*. In the early 1970s, poverty showed a decreasing trend until 1985 see table 2.3b, which can be attributable to the land and education reforms promoted by Juan Velasco Alvarado[10] whose regime attempted to construct a less unequal Peruvian society by implementing redistribute policies. Unfortunately, Velasco's policies were neutralised during the implementation of the structural reforms of the 1990s's, characterised by an extreme version of neo-liberalism in which it was assumed that privatization and trade liberalization would bring modernisation, efficiency, low levels of corruption, more competitiveness, jobs, and above all poverty reduction. However, the opposite has happened. The Peruvian private sector is not more competitive in the world economic system than before the structural reforms of 1990s because the enterprises of the Peruvian elite linked to foreign investments have been favoured by special legislation, the decree (DS-120-94-EF). Under which the multinationals and their Peruvian elite partners in the mining and the electricity companies are exonerated from

[9] Victor Raúl Haya de la Torre (1895-1979) Peruvian political leader founder of the APRA Party. Although he never held power and spent much of his political life in exile or in prison, he held great influence on contemporary hemispheric politics. A leading advocate of nationalist revolutions in Latin America, he championed the cause of the indigenous people and fought for radical, although expressly non-communist, social and economic reforms.

[10] Juan Velasco Alvarado (1910-1977) President of Peru (1968-75), born of working class parents he entered the army in 1929 and rose to rank of general. As army commander in chief, he led in 1968 the junta that deposed President Belaunde Terry after his failure to expropriate US owned oil operations. Velasco appointed an all-military cabinet, and immediately seized the disputed oil fields. He restricted the press, launched a sweeping agrarian reform aimed to breaking up the country's large states, and worked toward the nationalization of selected industries.

paying corparate tax and allowed to depreciate their assets twice when they reorganise their companies until the recovering of their full investment. This is a clear tributary shield or corporate tax evasion, which undermines the state's finances and fulfilment of social demands and investment in the public services such as education health, housing, water, sanitation and infrastructure.

Table 2.3b shows how poverty has increased after the implementation of the structural reforms compared to the decrease (despite the economic and political crisis) that happened in the 1980s. It was in the last decade that major poverty alleviation programmes were implemented mainly in the rural areas and in the slums around Lima. In that decade, statistical figures artificially showed poverty reduction levels while Fujimori was campaigning for his re-election. After the collapse of the corrupt and authoritarian regime at the end of 2000, poverty in Peru could be measured in its real magnitude: 54.8 per cent of the population, mainly living in the rural areas of the *Sierra* and *Selva* regions or in the slums around Lima (see Table 2.3b). During the structural reforms of the 1990s, poverty reduction programmes aimed to gain the political support of the poor for the implementation of neo-liberal policies of privatization and trade liberalization, while keeping a corrupt and authoritarian civilian-military elite in power.

Table 2.3b
Poverty Indicators by Region: 1970, 1985, 1991, 1994,1996 and 2001

Region	1971-72	1985	1991	1994	1996	1997	1998	1999	2000	2001
Peru	**64.0**	**43.1**	**59.0**	**53.6**	**50.5**	**42.7**	**42.4**	**47.5**	**48.4**	**54.8**
Urban	39.6	36.0	53.3	46.3	45.5	29.7	29.7	34.7	36.9	35.7
Rural	84.5	55.2	80.7	70.6	68.0	66.3	65.9	71.8	70.0	75.9
Costa	n.a.	n.a.	n.a.	n.a.	n.a.	28.9	28.8	35.2	39.1	34.6
Sierra	n.a.	n.a.	n.a.	n.a.	n.a.	60.4	59.7	64.0	59.0	66.9
Selva	n.a.	n.a.	n.a.	n.a.	n.a.	47.1	48.6	52.2	56.9	62.4

Source: Herrera, (2002), Escobal, (2000).
Elaboration own author

The implementation of poverty alleviation programs consisted mainly in providing food rations to the poor, while asking for political support to the Fujimori regime. In many cases food rations were conditioned to political support. Further, the authoritarian regime seized political control of Peruvian institutions such as the judicial authorities, the congress and the media using bribery and buying off the authorities. In the international arena, the authoritarian regime wanted to show his "success" in the implementation of

neo-liberal policies, which would please the International Finance Institutions (IFIs) and developed countries that had given the authoritarian regime their full political support.

2.4. Inequalities and redistribution

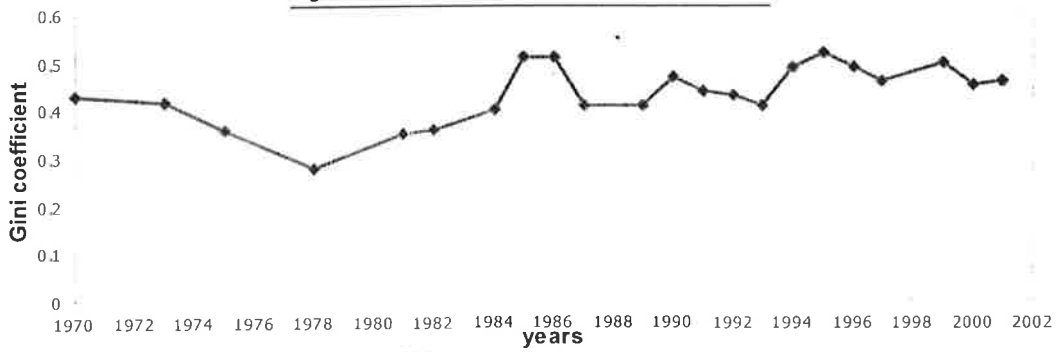
Peru is one of the most unequal countries in Latin America. Its characteristics of being a multiethnic and multilingual nation has been a "theoretical foundation" for the ruling economic elite that Peru's underdevelopment to a great extend lies on the country's indigenous population's lack of understanding of top down economic policies. Hitherto, the economic elite has ruled the country by excluding the majority of Peruvians building a dual society that benefits gives rights to and makes well-off only a few: those who own the means of production usually linked to foreign capital, and institutions that have been ruling the country since its independence from Spanish colonization. A country that the Peruvian historian Jorge Basadre[11] has named the official and the real Peru and Hernando De Soto, the "dualist economy" of the formal and the informal sectors.

In the 1960s, Peru's Gini coefficient[12] was (0.58), and together with Colombia (0.62) these were the two most unequal countries not only in Latin America but also in the world, above Mexico, Brazil and Bolivia, whose Gini at that time were between (0.52 and 0.53). Some economists argue that since the 1970s, there has been a decreasing inequality tendency due to the improvements in the distribution of assets such as land and access to education (Escobal et al, 2000; Saavedra, 1999). However, this decreasing tendency only happened until 1978 (see figure 2.2a) and not during the structural reforms of the 1990s, as Escobal and Saavedra have presented it.

[11] Jorge Basadre Grohmann (1903-1980) notable Peruvian historian who wrote extensible about the history of Peru's Republic.

[12] The Gini coefficient is a summary statistic of the Lorenz curve and a measure of inequality in a population. It ranges from a minimum value of zero, when all individuals are equal, to a theoretical maximum of one in an infinite population in which every individual except one has a size of zero.

Figure 2.2a Peru: Evolution of GINI 1970-2001



Source: Morley, 2001. Saavedra, 1999.
Elaboration own author

Despite the evidence, these authors continue to argue that privatization and trade liberalization during the structural reforms of the 1990s have reduced inequality. They support the argument that poverty and inequalities in Peru are mostly due to low average income and low economic growth rather than to unequal distribution and the population's exclusion of access to resources and assets. At a national level, inequalities during the structural reforms of the 1990s increased (see figure 2.2a and table 2.2). The only significant reduction of inequalities, however, has been in the urban *Costa*, except Lima City where inequalities have increased (see table 2.2.). According to the Gini inequalities at the national level increased with the neo-liberal policies. We can also argue that the neo-liberal policies of the 1990s slowed down the decreasing trend of inequalities that started in the 1970s (see figure 2.2a, table 2.2), mainly due to the return to the primary-export model to promote economic growth, which in turn has increased unemployment.

On the other hand, inequalities in the urban *Costa* have been decreasing due to major social and political changes such as the land and education reforms that happened 30 years ago, which along with more public investment in infrastructure have favored the diversification of the Peruvian economy in that region. These were crucial for intermediate cities' economic growth –such as *Arequipa*[13], *Trujillo* and *Chiclayo*- by creating local industries supported by economic activities from the rural areas and the transfer of technology from cities towards agriculture activities. These have created

[13] Arequipa City (700,000 inhabitants) the second largest city in Peru after Lima, the capital of the region of Arequipa in the southern part of Peru. Its culture and economy have always been recognized to influence and sometimes oppose centralist decisions taken in Lima. It is the birthplace of renown and infamous Peruvian figures among others: Mario Vargas Llosa, Hernando de Soto, Fernando Belaunde Terry (former president), Abimael Guzman (leader of Shining Path) and Vladimiro Montesinos (Fujimori's chief intelligence service).

virtuous circles promoting farming and non-farming activities in these areas, and allowing households to have access to public and private assets, such as physical, financial, human and organizational capital (Escobal, 2001: 497). The handicrafts, tourism, repairing, renting equipment and commerce that Escobal refers as being favored by neo-liberal policies, in fact have occurred only after peasants had full ownership of their lands. Only by living and working there, were farmers able to start non-farming activities and find niches to survive neo-liberal policies of privatization, trade liberalization and import of subsidized food from more protected economies abroad.

A recent analysis of the income redistribution in Peru shows that between 2001-02, the elite 10 per cent of the population received 42.8 per cent of the national income, whereas the 20 per cent of the extreme poor received only 3.3 per cent of the national income. Thus, during that period, the income of the poor has only increased by 9.6 per cent whereas that of the rich has increase by 19.3 per cent (Campodónico, 2003b). We cannot say therefore, that poverty in Peru is mainly due to low average income or insufficient economic growth, as some economists present it, but more to redistribution, which is related to Peru's main social drawback: exclusion and internal colonization, preventing the participation of a large number of Peruvians in the political, social and economic development of their own country.

Table 2.2. Peru. Evolution of Inequalities 1997-2001(Gini-Coefficient)

	1977	1988	1999	2000	2001
National	**0,44**	**0,45**	**0,45**	**0,40**	**0,45**
Urban	0.40	0.41	0.41	0.36	0.40
Rural	0.36	0.35	0.34	0.31	0.34
Urban Costa	**0,35**	**0,33**	**0,33**	**0,34**	**0,32**
Rural Costa	0.30	0.30	0.30	0.28	0.29
Urban Sierra	0.40	0.39	0.4	0.35	0.37
Rural Sierra	0.37	0.37	0.35	0.32	0.34
Urban Selva	0.36	0.39	0.36	0.35	0.36
Rural Selva	0.33	0.30	0.31	0.3	0.32
Lima	0.39	0.14	0.43	0.37	0.40

Source:ENAHO, Herrera:2002:85.
Elaboration own author

The theory of internal colonization explains why despite having many similarities in terms of natural resources Peru, Colombia and Brazil, with different population composition and ethnicity, also have different levels of inequality. A recent World Bank report indicates that Peru's indigenous population represents 47 per cent, whereas of Colombia 1.8 per cent and Brazil 0.4 per cent but Brazil 44.7 per cent of its population are afro-descendents (Perry G.E et al, 2003:83). Let's see the similarities between Peru and Colombia. Both have plenty of endowments in terms of natural resources and have similar problems such as guerrillas and cocaine production. However, Colombia has been more successful in reducing inequalities and absolute poverty than Peru and Brazil. Despite the fact that in Colombia the guerilla movements prevail whereas in Peru they have been controlled by military repression and violation of human rights which has been presented by the Fujimori regime as "successful" and recognized by developed countries. The answer lies in the theory of internal colonization that the economic elite in Peru exercises on its indigenous population. The same is true for Brazil against the Afro-descendents.

Regarding agriculture, if we take for instance coffee as one of the main Colombian exports, small-farm entrepreneurs using labor-intensive methods have successfully performed this economic activity. In Colombia small farmers have struggled against the large growers' opposition against small farmers participation in the cultivation of coffee. Capitalist farmers would push to employ landless peasants as *colonos* in order to clear frontier land to plant coffee (Ross, 1998:181). Nevertheless, small farmers were able to organize a coffee production network and not leave it only to the large growers. The Colombian coffee farming, resembles what is also done in Costa Rica, both countries are successful in the export of this product which is not only in the hands of the multinationals but in is also dome by small farmers (Lal & Myint, 1996:164-168).

Although the Colombian case cannot be seen as a successful story because of deeper social and political problems, it illustrates how internal colonization constitutes a real constraint for Peru's human and economic development and even for neo-liberal policies to succeed. The same is true if we compare Brazil and Peru; agricultural oligarchs using large-scale farming do the productive chain of coffee. In both countries, social exclusion

and internal colonization can be regarded as the cause for high levels of inequality. In Peru this mainly affects the indigenous population and in Brazil the Afro descendant landless peasants, for who trade liberalization, free markets and globalisation have meant poverty, unemployment and exclusion from basic services.

During and after the structural reforms of the 1990s, the economy of Peru has not been diversified; on the contrary it replicates the old traditional colonial model, which has nothing to do with a modern economy. Moreover, corruption has escalated to unprecedented levels in Peruvian history. From the 10 billion dollars from privatization of the main state owned companies, only five hundred thousands were left, 9.5 billion was spend on buying obsolete military equipment and commissions in which officials from the Fujimori regime have been involved.

The economic elite has used the heterogeneity of the Peruvian society as an excuse to justify social exclusion and the internal colonization suffered a large number of the Peruvian population. These are observed in the economic activities such as small entrepreneurs and the agriculture sectors. Despite being the two sectors in which Peru clearly shows comparative advantages, the state does not have a strategic national plan to help small entrepreneurs or small- agriculture to have access to market information, credit or insurance, as the formal sector and large agribusiness firms have. On the contrary, small entrepreneurs are marginalized and pushed towards informality. The formal economic elite influences the state to repress the informal sector perceived as a threat for economic stability.

Despite the exclusion factor, small entrepreneurs have managed to survive the asymmetric integration into the privatization and trade liberalization policies. They largely contribute to the livelihoods of millions of Peruvians, for whom economic crisis is perceived as a "normal" part of their lives. Hernando De Soto has found that, despite neo-liberalism and a state policy of social exclusion, in the last 40 years the poor were able to create assets of about US$90 thousand million. From which, 75 thousand million correspond to housing and 15 thousand million to motor vehicles, machines and equipment in the informal sector. This represents 45 times

the investment in Camisea[14], Peru's most important natural gas project in this century (De Soto, 2003). The informal sector constitutes a large proportion of the Peruvian economy, which has been able to create assets, despite external and internal economic and political crisis and exclusion from credit and protection from the state. This group emerged as a response to Peru's endemic political and economic crisis, in which the majority of Peruvians were left to their own devices and years of economic elite policies focused on the primary-export model and oriented to privilege the elite's wealth accumulation, generating poverty and inequality.

Small farming and non-farming activities in the rural areas have been deliberately neglected on the assumption that the *minifundio* is inefficient and incapable of creating economies of scale. There has been an absolute underestimation of the real potentiality of the agro-ecological diversity of the Peruvian territory in which the diverse bio-climates and biomes can favour the production and agro-industrialization of multiple crops. Instead, neo-liberal policies have offered credit only to the agribusiness elites who are linked to the export of asparagus and edible oil such as the *Alicorp* group[15].

Small-farming agriculture has been considered unproductive and creating low returns. This is mainly because traditionally the Peruvian agriculture sector has been dominated by the agricultural oligarchy located in the *Costa* region represented by local economic elites linked to foreign investors. This sector has advocated for large-scale and capital-intensive plantation products aimed to the external market in which the peasants from the *Sierra* and *Selva* do not benefit from the gains of export and trade (Lal & Myint, 1996:165). However, some economists present the exclusion of these groups as a technical problem of economic growth as Hamann argues:

[14]Camisea regarded as Peru's major investment in fossil fuel resources of the century. A 2 billion investment project to extract natural gas from Peru's tropical rainforest in the Machiguenga Reserve, is expected to boost Peru's GDP by 0.8 per cent per year during its 40-years operative period.

[15] Alicorp group is Peru's leading Food Company and the market leader in edible oils, wheat flour, pastas, laundry soaps, package rice, cookies and crackers. The Romero group, Peru's largest private sector group, controls Alicorp with additional important interest in the Peruvian banking sector. Additionally, shareholders include the Nicolini group and the JP Morgan.

> "Peru is economically as well as culturally heterogeneous. Some economic activities, particularly agriculture and informal business, are not a part of the mainstream economy, often because they have been excluded from the benefits of growth, social services, and, in particular, access to information and training that would improve living conditions and production"(Hamann et al, 1991:167).

And not also as a cultural problem in which the informal sector has been considered inefficient, and have low quality. Both assumptions have more ethnical and racial connotations rather than economic foundations. In general, farmers are highly innovative and keen to introduce alternative and new technologies to solve problems and in Peru they have not been the exception. Agriculture in Peru is as old as its civilisation. Five thousands years ago the Incas, ancestors of the Peruvian farmers, were able to domesticate several crops that nowadays constitute the staple food that the world consumes. Using traditional knowledge of genetics, they have provided a great variety of potatoes, grains and cereals. The ancestors of the Peruvian farmers were also successful in water management and irrigation systems, applying traditional technology and hydrology principles that scientists would discover centuries latter. The Incas were experts in building irrigation canals and preventing soil erosion by building *andenes* or terracing, contour ploughing and rotation crops. Moreover, the Incas were able to create a social and political organisation sustained on principles of equity, justice and protection of nature, that neo-liberalism, presented by the economic elites as modern and advanced to traditional Peruvian culture, has been unable to create.

CHAPTER 3

III. CHARACTERISTICS OF THE STRUCTURAL REFORMS OF THE 1990s

The structural reforms of the1990s consisted in the implementation of a series of economic policies orientated to the stabilisation of the Peruvian economy. The IMF promoted the stabilisation policies and the World Bank implemented the Structure Adjustment Program (SAP). But the distorted vision of the Peruvian economic elite generated an extreme and crude version of neo-liberal fundamentalism and market dogmatism. Even IMF officials commented that the SAP in 1990s was done at an excessive pace. Such reforms consisted of a series of state policies, emphasising more

market participation in the economy by reducing the role of the state in the provisioning of goods and services, known as the Washington Consensus. These reforms emphasised more economic than social or institutional reforms in a broader sense. The elite's assumption was that, "economic reforms were more important and the driving force for the social reforms". And the achievement of the latter would come as a result of the former. Such reforms, although presented, as they would benefit all, in fact had first and foremost benefited Peru's economic elite through foreign investments. The restructuring of the private sector as the neo-liberal advocators called it –meant the saving of the elite's banks and enterprises by using public funds and Peruvian foreign debt. They eliminated state monopolies in trade of fuels and some food products, and the few remaining state enterprises and assets that the state created during the implementation of the import substitute industrialization (ISI). Those neo-liberal policies have benefited the *Romero* and *Nicolini* groups, which now have, access to cheaper products on the world market (Oxfam, 2002:140-1). Agribusiness elites linked to the traditional Peruvian agriculture oligarchy and the financial institutions –the *Alicorp* and *Nicolini* groups– lobbied for neo-liberal policies. The *Alicorp* group, linked to the Romero family, owners of the *Banco de Credito del Peru* and the *Nicolini* group, is the major pasta and livestock producer in the country, both of them were the main financiers of Fujimori's re-election campaigns.

The Minister of Economy and Finance of the Fujimori regime, Carlos Boloña prepared and implemented the neo-liberalism package in Peru. He presented himself as a successful economist and businessman. According to his program, the structural reforms were sustained in four pillars: "(i) economic stabilisation, (ii) modernisation of the economy, (iii) reinsertion into the international economic and financial arenas and (iv) the restoration of law and order" (Boloña, 1996:184-8). These policies were targeted to affect both the macro and the micro economic variables of the Peruvian economy in order to attain economic growth, using the export-led model, within the neo-liberal paradigm presented as modern and innovative.

During the 1990s, the dominant discourse to explain economic stagnation, poverty and political violence in Peru was to blame the Velasco reforms and the failure of "heterodox" policies of the so-called lost decade. The neo-liberal paradigm of the 1990s was presented

as new, innovative, accurate and more measurable, in which theories were replaced by mathematical equations. This appealed to the new generation's pragmatism of the death of theories or anti theories (Ugarteche, 1998:79). In this period most of the Peruvian economic and political elites swapped their discourses of law and order, for pragmatism, operationalised by rentism and corruption. Externally, the country's destiny was handed-over to the IFIs' macroeconomic figures, while internally the elite deposited the money from privatization in their private accounts in Swiss banks. Table 3.0, summarises the main characteristics of anti-small agriculture policies implemented during the structural reforms of the 1990s.

Table 3.0. Main Policies implemented during the SAP

Type of policy	Macroeconomic instruments	Policies for agricultural sectors
1. Price	• Price deregulation in goods and factor markets	• Withdrawal of price controls for foodstuffs and agricultural inputs
2. Fiscal	• Reform of tax system • Fall in government deficit	• Staff reduction in Ministry of Agriculture
3. Monetary and Financial	• Floating exchange rates; elimination of the MUC • Interest rates market determined • Restrictive monetary policy	• Agricultural Bank closed • Interest rates market determined
4. Trade	• Withdrawal of quantitative restrictions on trade • Reduction in dispersion of tariff rates from average of 56% to only two rates (15% and 25%	• Additional protection rates for agricultural goods, through system of surcharges • Elimination of quantitative restrictions on trade.
5.Institutional reform	• Deregulation of goods and factor markets. • Creation of institution to supervise intellectual property and fair competition.	• Elimination of public monopolies in foodstuffs and agricultural inputs. • Creation of institutions in charge of research in natural resources and sanitary control (*Inrena*, *Senasa*).
6.Investment and Property rights		• Investment Promotion Law, promoting private investment and the development of the land market.

Source: Hopkins, (1998:90)

(i). Economic stabilisation.

The aim of this policy was to stop hyperinflation and reach equilibrium on the balance of payments. Inflation was created by the artificial supply of money from the state related to the country's real economic growth and productivity. The elite's argument was that the state spent more than it could collect in trying to meet the social demand without taking into account how such demands could be financed. Therefore, the need to create equilibrium on the balance of payments was a must in order to achieve economic stabilisation and curve hyperinflation where prices reflect the market's laws.

Economic stabilisation was achieved by applying several economic measures: first, the control of inflation, considered by as the "worst of all evils" that had to be stopped was targeted at international rates of less than 10 per cent per year or 1 per cent per month. Second, economic growth–GDP of 4 per cent per year in the short run and 7 per cent in the long run in order to achieve steady growth–and employment growth to less than 3 per cent of the labour force. Third adequate level of net international reserves, which were greater than US$ 3 billion in 1993, and US$ 8.6 billion in 2000, which served as a guarantee for foreign credits. And forth, a fiscal and monetary discipline, the former financed by external rather than internal credit that had not to exceed 2.5 per cent of GDP and the goal was to achieve fiscal equilibrium in the long run (Boloña, 1996: 188-91). The latter referred to the role of the Peruvian Central Bank of Reserve (BCRP), not to allow credit to private and public enterprises, and that monetary emission should be concordant with the increases in the GDP below the level of inflation.

(ii). Modernisation of the economy

This consisted of a series of macroeconomic changes, such as market liberalization and institutional reforms. The economic elite considered the state as "interventionist, monopolist and bad entrepreneur". An institution that the economic elite would prefer to reduce to a minimum size and let the invisible hand of the "free market" take control of the supply-demand, the relative prices of commodities and the end run of the individuals' life and the society. In order to achieve that, 745 law decrees were issued and aimed to reduce in the elite's eyes the size and the role of the "plethoric Peruvian State". The liberalization of the money market was part of these reforms by creating a flexible,

profitable and competitive liquid capital market that responds to market demand interest rates, which would eliminate exchange controls and financial monopolies.

As part of the microeconomic reforms, the reduction of tariff to levels of 15 to 25 per cent was implemented–although a flat surcharge to imports of 15 per cent was also installed– and the elimination of restrictions to foreign trade and tariff-like barriers were eliminated. In terms of domestic taxes, the General Sales Tax (IGV), which charges 18 per cent on the consumption of all goods and services, was implemented, as well as, the Income Tax and the luxury consumption tax (ibid: 214-5).

These reforms could not have been completed without the liberalization of the labour market, in which several law decrees were released in order to make the labour force cheaper and more attractive to foreign investors. That included the elimination of job security, which undermines workers rights and benefits by marginalizing trade unions and workers associations. Moreover, the privatization of the retirement system allowed *Administracion de Fondos Privados de Pensiones* (pension-administrative agencies) known as (AFPs) to manage workers pensions and retirements accounts. The AFPs were copied from the Chilean experience, which Peruvian neo-liberal economists and politicians presented as a successful case. This system is now been questioned in Chile because of its inefficiency due to its high commission rates, which give high profits to the agencies to the detriment of the workers' pension. However in Peru, the AFPs are operating in the name of the "free market", which means freedom to charge high commissions as a result of their oligopolistic control of the market, that a minimalist Peruvian state has not powers to control.

The privatization of state enterprises has been the main target of the modernisation model. State enterprises were sold to private companies both local and foreign. This was done by organising a privatization committee in charge of the privatization process know as *Comisión de Promoción de Inversion Privada* (COPRI). In 1991 originally the plan was to privatise 23 state companies, but by February 1997, 100 public enterprises had been privatized. Two Telecommunications state-owned companies: *Compañia Peruana de Telefonos* CPT and *Empresa Nacional de Telecomunicaciones* ENTEL were sold off to

the Spanish firm *Telefonica* (Kisic, 1998:49). The expansion of the privatization plan happened because the economic elite perceived that there was no public reaction towards such policies. They argue that all public enterprises in Peru are inefficient and exist solely for political reasons. For the former Peruvian Ministry of Finance, the intervention of the state in the market creates distortions and privileges, which prevents the free market economy from thriving (Boloña, 1996:203). Therefore, the structural reforms in the 1990s were conceived according to the elite's ideology supported by IFIs in which education, health, housing and social welfare in Peru should be mainly provided by the private sector.

The elite using its power from the state did the structural reforms of the 1990s, with such powers the Peruvian economic elite reaffirmed its economic and political position as a dominant class maintaining the current social structure that resembles the one of a colony in which the majority of Peruvians were excluded from basic public services, rights, employment and the use of natural resources. The economic elite has assumed that privatization and trade liberalization would solve Peru's historical handicaps: high levels of poverty and inequality.

(iii). Insertion in the International Financial Community.

Peru became economically isolated from the international financial community after President Alan Garcia decided due to fiscal problems not to pay Peru's foreign debt. At first, president Garcia proposed to pay only with 10 per cent of Peru's export revenues because the government could only afford to pay the interest, then Garcia decided not to pay the debt at all, arguing: "the internal debt is first than the external one". For such audacity, the international financial institutions presented Peru as economically "ineligible". The Fujimori programme reinitiated arrears payments, which soon brought Peru back to the membership in the international financial community and began again to receive credit from the international support group: the Rights Accumulation Programme (RAP), the IMF, the World Bank, the Paris Club and the Inter-American Development Bank (ibid: 252-3).

(iv). Reestablishment of law and order.

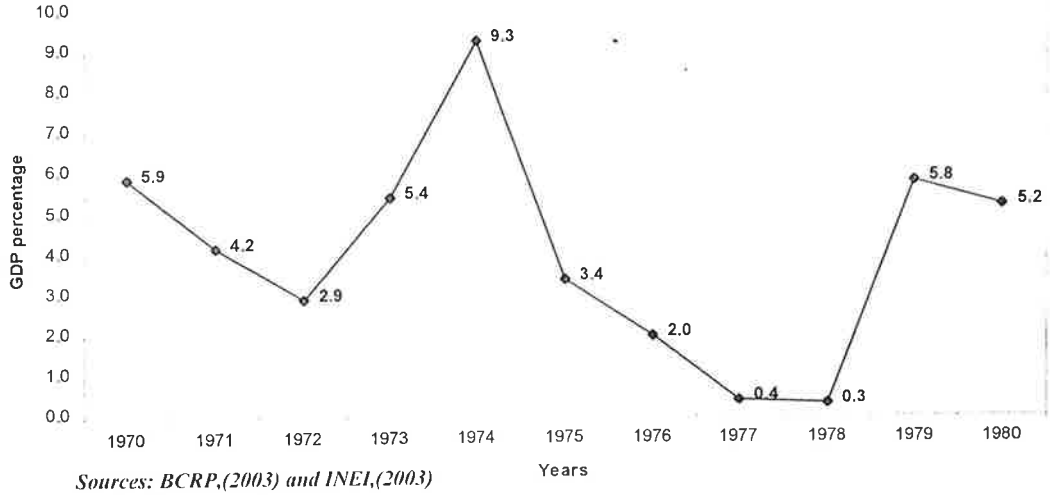
The implementation of the SAP could not succeed unless the state was able to control the two guerrilla groups, *Sendero Luminoso* (shining path) and *Movimiento Revolucionario Tupac Amaru* (MRTA). These groups were financed and armed by cocaine producers in the Upper *Huallaga* in the regions of *San Martin* and *Huánuco* and in the *Ene* River Valley in *Apurímac*. These groups had been successful in undermining the state's role to exercise its legitimacy and implement law and order in the country, causing disastrous damage to the Peruvian economy. Therefore, political violence had to be stopped and social peace established. This was a clear target for the government. Thus, the state had to design an effective strategy to dismantle the two guerrilla groups. The Peruvian police designed an effective strategy that led to the capture of *Sendero Luminoso*'s main leader Abimael Guzman in September 1992. This in turn influenced the capture of other guerrilla leaders, which helped to create at least one important factor for social change, political tranquillity, –although not social peace– and prompted the rebuilding of the country's infrastructure and economy.

3.1. Prioritisation of the primary-export model

The primary-export model has been the main contributor to Peru's economic growth. In the 1970s, the country experienced a change from this model through the implementation of Import Substitution Industrialisation (ISI). Figure 3.1 shows that between 1973-74 Peru's economy experienced high growth, mainly in the manufacturing sector (24 and 26 per cent) and in agriculture (15 and 13 per cent) between 1970-75 (see table 3.1).

Commerce during that period contributed more to the GDP compared with the negative figures shown during the structural reforms of the 1990s (see tables 3.1 and 3.2), which indicates the high dynamism and more diversification that the Peruvian economy had before the structural reforms of the 1990s. The economy of the 1970s favoured the creation of employment and secured the livelihood of Peruvians more than the economy of the 1990s.

Figure 3.1 Peru's Economic Growth between 1970-1980



Sources: BCRP,(2003) and INEI,(2003)
Elaboration own author

Table 3.1. Peru: Composition and growth of GDP 1950-75

Sectoral Composition	1950	1955	1960	1965	1970	1975
Agriculture	**20,4**	**19,3**	**18,5**	**15,3**	**15,1**	**12,7**
Fishing	0,4	0,6	1,4	2,1	2,7	0,7
Mining	6,8	7,5	10,4	8,5	8,2	6,0
Manufacturing	**16,7**	**18,0**	**20,0**	**22,2**	**23,8**	**26,2**
Construction	6,3	7,5	5,0	5,2	4,2	6,1
Utilities	0,6	0,6	0,8	1,0	1,1	1,1
Government	9,1	8,2	8,0	8,3	8,0	7,7
Finance	2,3	2,6	2,8	3,0	3,2	5,5
Transport	3,9	4,6	4,3	4,5	6,0	3,5
Commerce	**11,4**	**11,1**	**12,1**	**15,1**	**13,2**	**15,0**
Services	22,1	20,0	16,7	14,8	14,5	15,5
Total	100,0	100,0	100,0	100,0	100,0	100,0

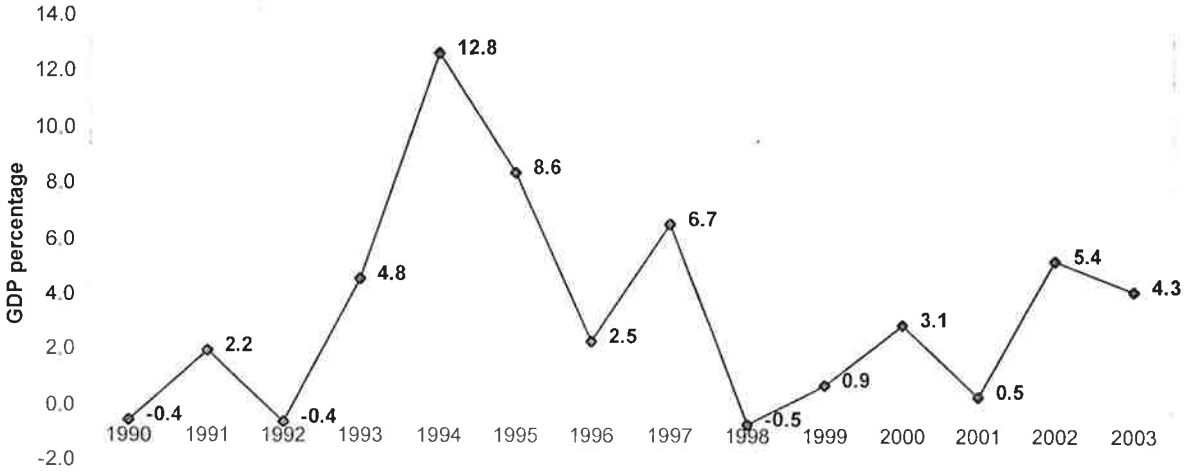
Sectoral growth Rates	1955-60	1960-65	1965-70	1970-75	1975-78
Agriculture	3,6	2,7	4,0	1,8	1,2
Fishing	25,5	15,9	10,4	-18,8	5,7
Mining	11,4	2,4	3,8	-1,1	17,8
Primary	**6,6**	**3,4**	**4,5**	**-0,6**	**6,9**
Manufacturing	6,7	8,9	5,9	7,1	-2,3
Construction	-3,7	7,7	-0,3	13,7	-5,5
Utilities	13,8	9,7	6,7	6,6	3,5
Secondary	**4,3**	**8,7**	**4,8**	**8,4**	**-2,6**
Tertiary	**3,3**	**7,6**	**4,0**	**6,3**	**2,4**
Total	4,5	6,7	4,4	5,5	-0,1

Source: (FitztGerald, 1979)

During the structural reforms of the 1990s the Peruvian economy grew on average 6.5 per cent per year between 1993-1997(see figure 3.2.), due to the privatization and trade liberalization processes that emphasised the primary-export model. Metallic mining

constituted Peru's main export (13 per cent) in the year 2001, whereas agriculture and manufacturing showed negative figures (see table 3.2.). Growth in that period was based on the old traditional model of primary-export resources, but was presented by the economic elites as Peru's modernisation and engagement in the world market economy.

Figure. 3.2. Peru's Economic Growth between 1990-2003



Sources: BCRP, (2003) and INEI,(2003)
Elaboration own author

Table 3.2.
PERU GROSS DOMESTIC PRODUCT BY INDUSTRY
(Percentage change at constant prices)

	1992	1993	1994	1995	1996	1997	1998	1999 1/	2000 1/	2001 1/
Agriculture and livestock 2/	-9.1	9.0	13.2	9.5	5.2	5.4	1.5	11.7	6.2	-0.6
- Agriculture	**-17.1**	**17.1**	**17.7**	**9.9**	**8.0**	**3.7**	**-1.1**	**13.9**	**6.7**	**-2.4**
- Livestock	4.5	-1.8	6.1	9.1	0.9	9.0	6.3	9.2	6.0	1.7
Fishing	27.2	3.9	21.1	-13.9	-4.8	-1.8	-13.4	29.2	9.1	-13.3
Mining and fuel 3/	0.9	10.2	12.0	4.2	5.1	9.0	3.8	12.9	2.4	11.2
- Metallic mining	**0.8**	**10.9**	**15.2**	**6.5**	**7.3**	**10.7**	**3.9**	**17.0**	**3.4**	**12.8**
- Natural gas and oil	1.3	7.4	-0.6	-9.5	-4.0	-2.0	-0.2	-6.9	-6.5	-2.0
Manufacturing	**-3.3**	**3.4**	**16.6**	**5.5**	**1.5**	**5.3**	**-3.2**	**-0.5**	**6.7**	**-1.1**
- Based on raw materials	-1.6	7.8	15.4	-3.2	3.6	1.8	-8.7	20.6	8.5	-2.9
- Non-primary industries	-3.8	2.1	17.0	8.1	0.9	6.3	-1.8	-5.6	6.1	-0.6
Construction	2.3	17.9	36.1	17.4	-2.3	14.9	0.6	-10.5	-4.3	-6.0
Commerce	**-0.9**	**3.0**	**15.9**	**11.1**	**0.9**	**7.8**	**-3.2**	**-1.9**	**5.1**	**0.0**
Other services 4/	1.3	3.6	8.8	8.5	3.3	6.0	0.3	0.5	1.8	0.4
GROSS DOMESTIC PRODUCT	**-0.4**	**4.8**	**12.8**	**8.6**	**2.5**	**6.7**	**-0.5**	**0.9**	**3.1**	**0.2**
GDP primary	**-3.6**	**8.9**	**13.7**	**4.2**	**4.5**	**5.5**	**-0.3**	**14.1**	**5.6**	**1.9**
GDP non-primary	**0.2**	**4.0**	**12.7**	**9.5**	**2.1**	**7.0**	**-0.6**	**-1.6**	**2.6**	**-0.2**

1/ Preliminary.
2/ Includes silviculture.
3/ Includes non-metallic mining.
4/ Includes indirect taxes and import rights.
Source: INEI, (2003) and BCRP, (2003).

Since the implementation of the structural reforms of the 1990s control over the primary-export model was given entirely to the private sector on the assumption that it is more efficient and competitive than the public sector. An analysis of this old economic model but presented as new by the elite is referred by Portocarrero as follows:

> "The Fujimori regime represented a return to the primary export model and to Peru's traditional comparative advantages, abandoning the model of import substitution industrialisation (ISI). However, unlike other times of the Peruvian history, this time there was not the exogenous impulse of a particular single raw material. Another important difference was the significant role of foreign investment attracted by privatization, in particular in the telecommunication sector. The winners were the external investors, to which the end of the Garcia moratoria was "celestial music", the financial sector favoured by high interest rates and the traditional exporters, specially mining that was the only sector with a preferential treatment that could resist the low exchange rate. The losers were the industrialist oriented the to internal market, the worker of the formal sector that saw the diminishing of his power of negotiation of his real salary, the worker of the public sector and part of the middle class. The alliance in power was composed by the international financial institutions, foreign capitals, the financial sector, the traditional exporters, particularly the mining interests, the military forces and a network of political operators" (Portocarrero, 2002).

Now, Peru's traditional export products count for 70 per cent of total exports from which minerals correspond to 45 per cent, fishery to 14 per cent and agriculture to only 5 per cent. On the other hand, the non-traditional export products represented by 30 per cent of total export products correspond to textiles, agriculture and livestock (see table 3.2).

With the privatization of major strategic state enterprises, private companies mainly multinationals have become the only sector to extract and export Peru's natural resources. This is done under favourable profit conditions that would not be allowed in any country that defends its sovereignty and the livelihoods of its people. This sovereignty is represented by the state's authority to exercise its power, which would allow it to create fairness between profit making (that any enterprise is entitled to) and the revenues that the state collects from the extraction of its resources, and the establishment of law and order within a country's territory in which such enterprises operate. This is a fundamental principle to guarantee that private self-interest does not affect people's common property

and resources. In the case of Peru, special legislation under the Fujimori's regime was given to the multinationals. They invested in the mining sector –metal and petroleum– which allowed them, take draconian profits with negative impacts imposed on the environment, since economic elites perceived environmental legislation as a constraint for foreign investment in Peru.

Examples of such policies can be observed in the cases of *Yanacocha*[16] in *Cajamarca*, the largest and most profitable gold mining company in Latin America, owned by the American company *Newmont*, the Peruvian company *Buenaventura* and the International Financial Corporation (part of the World Bank). On 2 June 2000, a lorry transporting mercury from Lima to *Cajamarca*, dropped 180 grams of that liquid heavy metal on the road, affecting the *Choropampa* community. The company has presented it as an accident passing the responsibility on the individuals from the community, linking this mercury poisoning to their ignorance of the hazardous effect of mercury. The company has not assumed its responsibility on this matter and has refused to compensate the affected community.

Another case is the oil consortia in charge of extracting the natural gas from Camisea[7]. The consortia *Pluspetrol* and *Hunt Oil* in charge of the extraction and distribution of the natural gas have built their extracting and fractionating plants without meeting international environmental standards. This would create negative impacts on the biodiversity of the Nahua-Kugapakori Reserve in the Lower *Urubamba* affecting the uncontacted indigenous communities that live in the pristine tropical rain forest. Moreover, the company's fractionating plant that is being built in the *Paracas* Reserve in *Pisco* has a high probability and risk of affecting the marine ecosystem in the Reserve due to Peru's high prevalence of earthquakes due to the presence of the Nazca tectonic plate. The government and the consortia present this as a problem of environmentalist lobbies that are opposed to Peru's economic growth and development. Despite the well-founded evidences on the negative environmental impacts that the *Camisea* project would create,

[16] Yanacocha is the most profitable gold mine in South America and second biggest gold mine in the world (the biggest is in Tanzania). Owned by the American Newmont Mining Corporation (51.35%), the Peruvian company Buenaventura (43.65% and the International Finance Corporation (5%).

the IFIs have financed it. *Camisea* has not been conceived to use natural resources exploitation revenues to invest in Peru's human development, but firstly and foremost to supply the energy demand of the USA most powerful economic state, California where 50 per cent of the production will be exported.

3.2. The antinatalist population programme.

The question of why the Peruvian elite has perceived population in Peru as a problem during the structural reforms of the 1990s can be answered by looking at Enke's work[17], on which neo-liberal family planning control policy relies. Enke and collaborators have found that investing in birth control is a hundred times more cost-effective in raising the rate of growth of per capita income rather than investment in alternative programmes for population growth reduction (Thirwall, 2003: 308-10). It has been assumed that a reduction in population growth in Peru would lead to increase in income per capita. The economic elite has supported this neo-liberal cost effective analysis by going even further; financing a sterilisation programme mainly targeted to the poor in rural areas.

The Peruvian elite has assumed that the poor are too many due to their high fertility and not because of the internal colonization and inequalities that prevail in the country, in which the extraction of Peru's natural resources to supply the world market economy benefits the elite that uses the state in its own benefit. This antinatalist policy, targeted towards the most vulnerable groups in the Peruvian society, is a clear signal of ethnical bias that the economic elite has towards Peru's indigenous groups and the poor. Neo-liberal policies were behind the political momentum for the implementation of such policies.

During the structural reforms, a major programme of population control targeting, mainly of the rural poor, was implemented. The Ministry of Health focused on demographic targets, such as the family planning programme, designed and financed by international agencies that advocated for the retrenchment and privatization of Peru's health services. Peru's health indicators lag behind the average in Latin American, for example chronic malnutrition in children less than 5 represents 25 per cent in Peru, whereas it is12 per cent

[17] Stephen Enke, an American economist that has written extensively in the 1960s about population explosion in India.

in the region. Infant mortality is 33 per 1,000 live births in Peru, whereas 30 in the region. Under 5 years old mortality reaches 48 per 1,000 live births in Peru, whereas it is 38 in Latin America (World Bank, 2002:4).

Demographic targeted programmes received more funding than health services such as reproductive health, maternal care, nutrition, TBC prevention, malaria, AIDS, and infant infectious diseases. The argument in designing Peru's health services policies has been that the poor's fast population growth, consumes the limited resources that the state can allocate according to its production size. Therefore, investments in health as well as in education have been perceived as a waste of limited resources consumed by the growing population of poor. Thus, privatization has been presented as the solution for better resource allocation in health and education. However, such policies have been proved to be even more detrimental to the well being of Peru's largest population, the poor.

A report from *ReproSalud*, a project that advocates reproductive and health rights in Peru, says that during the 1990s, the Peruvian government had adopted and implemented population policies focused on achieving demographic objectives. These were clearly targeted to the poor in rural areas, by increasing the use of modern contraceptives, but above all, prioritizing sterilization which was launched on a nation-wide scale, claiming to be the highest women's unmet demand in the country (Coe, 2001:6). Sterilization programs were implemented without more investment in equipment, clinics or medical training, leading to high incidence of infections and maternal deaths (ibid). Sterilization services in many cases were performed using coercion or without the consent of the patient. It represented a clear Human Rights violation implemented by the state, which targeted the most excluded group, the rural indigenous poor, contradicting the mandate of the International Conference on Population and Development (ICPD), Cairo 1994 of which Peru is a signatory country.

In 1998, The Miami Herald reported that from the 248,358 sterilization performed between 1995-1998, 92 per cent corresponded to female sterilization and 8 per cent to male, and despite government claimed to the contrary not all had been done voluntarily. There were specific cases in which some sterilization procedures were performed by

coercion, offering free food to poor women if they accepted to be sterilized. On several occasions, sterilizations were performed while women visited clinics asking for common ailment treatments. The report also presented identified cases of women being abducted in public places and taken to the clinics to be sterilized. Several women died as a result of sterilization complications due to the lack of sanitary conditions in which those sterilizations were performed (Johnson, 1998).

Surprisingly, such complications were blamed on women not taking proper care after the operation or not listening to doctors' advice. When such complications arose, patients were asked to pay the full cost of their treatment. All of those cases involved the activities of health personnel working under the quota system (ibid.). The media presented these cases both in Peru and abroad, shocking the public and Human Rights Organizations. That forced the USA government, being the largest single donor to the health sector in Peru–US$21 million in 1998 –to ask the Peruvian authorities to explain such allegations. An independent enquiry has reported more than 100,000 force sterilization cases. The government's answer was that the media had exaggerated these numbers, and although cases of force sterilization were found after the investigation, they were isolated cases and not the intention of the program. Despite the evidence, no concrete results or responsibility has so far been taken in response to the investigation.

CHAPTER 4

IV. EXPLAINING THE INCREASE OF POVERTY

The economic elite has presented Peru's abundant natural resources as the panacea for the country's structural problems of underdevelopment. Traditionally, the elites have implemented economic policies that would use the comparative advantage in natural resources for world trade through the export-led economic growth model. However, this model has benefited only a few, creating an unequal society that excludes from the economy a large number of its population either as producers or as consumers, reinforcing the vicious circle of poverty and inequality.

Poverty in Peru has multiple factors, but broadly they can be classified into two interrelated groups: internal and external. The explanation of the increase of poverty can be found in both. The internal factors are related to the microeconomic and social policies that the elites have implemented. Peru is a country that excludes, socially, economically, politically and culturally a vast majority of its population. For instance, good quality education and health services are not reserved for the poor but for those who can afford to pay for these services. Access to credit, housing and sanitation are not available for the poor but only for wealthy individuals and businesses linked to the capital monopoly of banks. A large number of Peruvians living in the slums around Lima do not have water, sanitation and electricity services because of the zero economic value that the Peruvian social structure has given to them. Peru's economic and political elites have abdicated their principles on ruling the country to create a prosperous society for those in the corrupt and rent seeking economic elite's.

The external factors are related to the macroeconomic policies of primary-export led model to achieve economic growth, used as the main argument by economic and political elites to explain Peru's underdevelopment. A model regarded as been solely influenced by consumption in the north over which Peruvian elites would have no influence, and highly vulnerable to external shocks such as the declining of mineral prices. The Peruvian elites and their partners in the north have favourable economic and legislative conditions provided by the state to extract Peru's natural resources. The state was presented as a constraint for social and economic development by the economic elites during the structural reforms of the 1990s to benefit a few to the detriment of the vast number of Peruvians. During these reforms, the elite greatly benefited from privatization and trade liberalization, whereas the poor have been presented as the ones who milk the state's scarce resources, destroy the environment, reproduce too fast and create little or negative returns for the economy.

4.1. Empirical data on poverty in Peru

Table 4.1 shows a nation-wide household survey in which the characteristics of poverty were identified and tested using multivariable regressions. The statistical significance,

robustness and relationships of the data presented in table 4.1 have 82 per cent of confidence (Herrera, 2002:63-4).

Table 4.1. Robustness of the empirical data on poverty in Peru

Factors	Explanation
Gender	Female-headed households have more probability of being poor than those of men. At national level, belonging to a female-headed household increases the probability of being poor by 28.6%. In rural areas, this probability reaches to 40%, in particularly in the Sierra compared to the Costa region where this risk is absent. On the other hand, the rural coast and Lima constitute significant risk factors, but not statistically robust.
Ethnicity	The fact of speaking a native language as a mother tongue (Quechua, Aymara or any Amazonian languages) increases by 26% the probability of being poor. Surprisingly the risk of being poor due to the ethnic factor is more important in the rural areas (39.2%) than in the urban areas (11.4%) and positive only in the Sierra.
Demographic Composition	Exists a strong correlation between the size of the household, its demographic composition and the risk of poverty. Each member added to the household increases the probability of being poor, 35% in the rural *Selva* and 64% in the urban Sierra. At a national level this rate is 50%. A greater proportion of members younger than 16, or over 60, increase the poverty risk by a factor of 7 and 1.5.
Age	The empirical data for age are not robust in this study, contrarily with the poverty profile; poverty risk does not decrease when the age of the household increases. This was only confirmed in urban households and in the Sierra as a whole. If the household is 10 years older, the relative probability (odds ratio) of being poor decreases by 7% in the urban area and in the Sierra.
Income	As the proportion of household members receiving income increases, the risk of poverty decreases significantly. This impact is stronger in Lima Capital and weak in the urban Sierra, in the latter there are more members of the households involved in the domestic unpaid work, due to paid economy is small in relation with the labour supply.
Social Capital	Participating in local association and networking, reduces by 18% the risk of being poor in Peru. These results are only robust in the rural areas of the *Sierra* and *Selva*. In the Sierra 60% of individuals are members of community association, such as *Rondas Campesinas* and water irrigation members.
Education	When the education level of the household members does not surpass primary education, the probability of being poor would be of 54.6%. Secondary education reduces the poverty rate by 10% but for the ethnic groups only by 6%. Crossing the bridge from secondary education to higher education strongly reduces poverty by 14%. The variable *years of education*, reduces the probability of being poor by 5% each year. Five years of education reduces the risk of poverty by 23%, ten years by 40% and 15 years reduces it by 54%.
Household durables	The risk of poverty reduces when the households have durables accumulated over the years that can use when harsh times arise. Each added durable that households have reduces the probability of poverty by 40 %.
Place of residence	The fact of living in a place where the informal sector constitutes the bulk of the economy increases the risk of poverty compared with living in a place where the informal sector has lower presence. In Peru, living in a neighbourhood where low human capital increases the risk of being poor.

Source: Herrera, 2002:63-8. Elaboration own author

According to table 4.1 poor people in Peru have the following characteristics: young, usually a female head of a household. Illiterate or with low education level, living in a

rural area, or in a slum around Lima, unemployed or underemployed, belonging to an ethnic group either from the *Sierra* or the *Selva*, whose first language is not Spanish but Quechua, Aymara or any Amazonian language. This picture represents a long historical social exclusion of a group that Peruvian society has placed at the bottom of the social structure, for whom policies to improve their livelihoods have not been designed. The poorest of the poor live in places where the state has never been present, except when the military arrive accusing the peasants of been supporters of terrorist groups. Among this excluded population belong the 69, 280 victims that were killed during the political violence between1980-1994. Two decades later, however, nothing has changed in the areas where *Sendero Luminoso* and the MRTA were active (Caretas No. 1788). Poverty and social exclusion there remain high.

At a national level, the fact of belonging to a female-headed household increases by 28.6 per cent the probability of being poor. This is even greater in rural areas; in particular in the *Sierra* where this probability reaches 40 per cent, compared with those of male-headed households with the same characteristics elsewhere. However, according to the same study this does not constitute a risk factor in the urban *Costa* outside Lima but it does in the rural *Costa* and in Lima itself, although it is not statistically significant (Herrera, 2002:64). The gender relationships in the *Sierra* could be an explanation for this. Women in rural areas, particularly in the *Sierra* and *Selva* are socially excluded because they carry the stigma of being abandoned. The patriarchal society punishes it as a sign of inferiority and where no social welfare is available to protect abandoned women whose vulnerability is high. As a result, these groups do not have access to land or social networks. Land is very important in rural areas for food security and to generate income and social networks that can guarantee more protection from the society during difficult times. Female-headed households who have not access to these assets in rural areas in Peru are poorer compared to male-headed households.

4.2. Economic exclusion and the primary-export model

Peru's economic elite's power and dominance has relied on the control and use of natural resources using the primary-export export model of the Ricardian theory of comparative advantages for economic growth. The export of primary resources benefited the ones who

were directly involved in the traditional export activities such as mining and cash crop agriculture exports, responding to the demands of industrialised countries. During the 1990s structural reforms there was no alternative to the primary export model and nothing new in terms of economic growth was presented. The country started its "economic modernisation" by using the old model of the Nineteen-Century. Multinational corporations in the mining sector, mainly in gold mining, once again started exploiting Peru's natural resources. Between 1990-2002, the gold mining sector increased by 147 times and currently provides US$ 3 billion export revenues per year (Caretas, No. 1786). This was achieved through capital intensive and technology investments and the *laissez-faire* policies implemented during the Fujimori regime, in which the companies benefited from tailored-made legislation, notably the decree (DS-120-94-EF), which gives mining companies advantageous tax preferences. Such preferences include: fixed tax payments, independently of their production, double depreciation of their assets and the option to merge, split or create new companies all clearly in the spirit of tax evasion. All of these were presented in the name of the "free market economy" and the prevention of the state participation in the market. Moreover the primary-resource export-led model has increased the vulnerability of the Peruvian economy to external shocks because the demands for primary resources are directly affected by factors such as price fluctuations in the world market, If demand of the Peruvian commodities in the external market falls, so does the price of the Peruvian exports.

Because the mining sector is a capital-intensive activity in Peru, it demands little highly skilled labour and does not create enough jobs, especially for the local population where the gold mines are located. Therefore, only a few people in local communities experience the gains of trade. The export-led model has created an even smaller wealthy economic elite group that is unable to see the necessity for the country's economic diversification. This creates discontent and protest among the population, which does not see the benefits of "modern" economic policies, despite the efforts of the mining functionaries who try to convince the local population of the "advantages" of their activities for the community. Such advantages are presented in terms of building towns' main square, gardens, schools, infrastructures and health centres, but they say nothing about community participation, employment, improvement health, education or clean environment from those extractive

activities. Moreover, the directors and top functionaries of the mining companies present themselves as victims of an environmentalist conspiracy, and the population's lack of understanding of the importance of mining in Peru's development.

Foreign investment in Peru not only took control of the market but also of the laws in which the market operates. The neo-liberal policies in the Peruvian case were never about the engagement of the Peruvian economy to a world free market but more about the "freedom" to benefit the voracity and corruption of local and foreign elites using the Peruvian State. This group that has always controlled the state and benefited from it, but now has become smaller and richer, and sees redistribution as a leftist conspiracy of hoping to the "return of the old model of an inefficient state".

The economic policies of the 1990s, instead of diversifying the Peruvian economy, have favoured the creation of monopolies and oligopolies in which, consumers have neither voices nor choices. A case in point is *Telefónica del Peru,* in which the prices for telecommunication services are not decided by the market, but by the legislation that the Fujimori regime gave to the Spanish multinational which had the monopoly to provide telecommunications services for 10 years, after which new providers would be allowed to enter in the market. So far this has not happened, *Telefónica* is the only company that provides fixed line telephone services in Peru. The free-market economy is free only for the multinationals in which consumers have not alternatives but to accept the power of their monopoly. In such conditions the market is "free" for those who have and exercise power over the state, preventing it from playing its fundamental role of protecting the rights of all its members: citizens, institutions and firms.

4.3. The increase of unemployment

The most important condition for a country to reduce its poverty lies in the fact that its citizens can have accesses to jobs and earn their incomes. This is done either by being employed or self-employed. Employment in the public sector in Peru dropped from 60.7 per cent in 1981 to 46.0 per cent in 1995. In contrast, the informal sector increased from 32.8 per cent in 1981 to 49.3 per cent in 1995 (Thomas, 1998:156). The Washington Consensus recommendation to reduce the size of the state has contributed to these trends.

During the 1986-1992 period employment only grew by 1.3 per cent per year i.e. at a lower rate than the labour force that grew by 2.7 per cent per year (Díaz, 2000:20-5).

The increase of unemployment was a result of neglecting the two most dynamic economic activities: manufacture and agriculture. Before the structural reforms of the 1990s, manufacture employed 22 per cent of the labour force. After the reforms, it only accounted 16 per cent. Commerce, mainly due to the informal sector increased from 30 per cent during 1986-89 to 36 percent in 1997(see table 4.3). In the same years, public administration was reduced to 34 per cent (ibid.). The trade liberalization proposed by the Washington Consensus and the IFIs, produced the collapse of the incipient Peruvian manufacture industry. Peruvian industrialists could not compete either on prices or quality with the imported products coming from countries with highly protected economies such as the USA, China and East Asia. The gains of trade, as presented by the advocators of the "free market", do not function in countries such as Peru in which inequality and social exclusion from economic production activities affects a large number of the population.

Agriculture was another activity that was neglected under the assumption that it yields low productivity (it employed only 1.2 per cent of the labour force in 1997), see table 4.3. However, the defenders of such policies were surprised by what they called the East Asian countries "miracle" of high economic growth. The dominant discourse during the implementation of the 1990s reforms in Peru was to emulate the economic growth of the East Asian countries. Peruvian neo-liberal advocators admired the industrialised export-led model that those countries achieved as a result of trade liberalization, and cheap labour policies. However, they failed to mention that such prosperity has been the result of applying the principles of endogenous growth, in which investments in human capital bring about high economic returns. In those East Asian countries, agriculture has never been neglected, at least not in those where land was available. The successful case is Taiwan in which the state plays promoter and regulatory roles (Mellor, 1995:21).

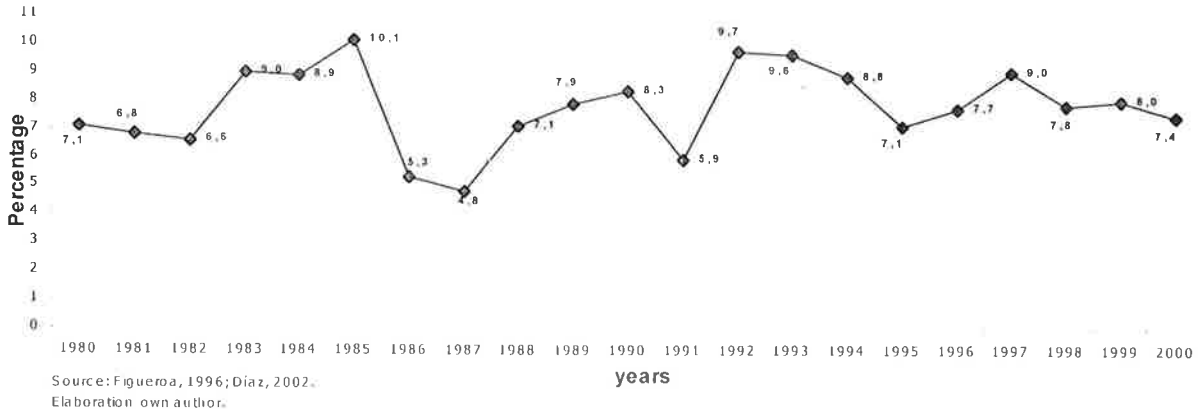
Table 4.3.
Peru, distribution of employment (1986-1997)

	1986-89	1992	1997
Total	100	100	100
Agriculture, hunting and fishing	1,1	0,8	1,2
Mining	0,7	0,3	0,2
Manufacture	21,7	17,2	16,1
Sub-total	23,5	18,4	17,5
Electricity, gas, water	0,5	0,5	0,3
Construction, catering	5,4	5,7	6,3
Commerce, wholesale & retail	29,9	33,7	35,8
Transport and communications	6,6	6,9	9,0
Sub-total	42,3	46,8	51,3
Finance and business services	5	6,1	9,2
Personal services	23,2	23,9	18,3
Public administration	6,1	4,8	3,6
Sub-total	34,3	34,8	31,2

Source: Díaz, (2000)

Urban unemployment in Lima was lower during the "unorthodox" reforms of the García period, compared to the neo-liberal reforms of the 1990s; during which unemployment did not drop to lower levels than those of the García period (See figure 4.3). The jobless economic growth produced by the 1990s reforms represents the inappropriateness of the Peruvian economic model. The primary-export model was unable to promote local jobs to overcome the increasing supply of labour force.

Figure 4.3. Unemployment in Lima (1980-2000)



Source: Figueroa, 1996; Díaz, 2002.
Elaboration own author.

4.4. The elite's culture of social exclusion

The causes of Peru's poverty do not lie entirely in the macroeconomic policies and the production factors of the economic models implemented and commonly presented as an external factor of the dependency theory, rather this is more an internal centre-periphery factor of socio-economic exclusion and internal colonization factors. In Peru, the culture of social exclusion and discrimination has been institutionalised to such an extent that Peruvian society perceives it as "normal". It is hard to believe that nowadays Peruvian discriminate against each other as a way of affirming their claimed social status. This culture of discrimination uses the language of economics, to justify the unacceptable levels of inequality and social exclusion in the Peruvian society. Some economists commonly argue that because the market discriminates, among producers, consumers, commodities, prices and individuals make informed free choices, discrimination is therefore a "normal" phenomenon. They avoid mentioning that such discrimination in the market could only be regarded as normal if all individuals have been given the same opportunities. This is certainly not the case in Peru, where the state as an institution does not give rights and protection to all its citizens on an equal basis. In many geographical areas of the country the state has never been present, but only when the economic elite decides that military repression is required. For the poor, who cannot afford to pay the costs of having good education, health services or housing, those services are simply not available or if they are, they usually are of bad quality. This is how the market excludes the poor in Peru, from fundamental, basic services and rights. These services in OECD countries and in some developing countries have been provided since long time ago and require the implementation of state policies on equity and rights. Table 4.4, shows how social exclusion operates in the Peruvian society. The most excluded groups have the following characteristics: indigenous people speaking native languages but not Spanish, women, children or young, illiterate, living in shanty towns around Lima or in rural communities.

Table 4.4. Peru, diagram of exclusion

Vectors of exclusion	Agents of exclusion	Intermediate	Excluded
Language	Spanish	Bilinguals	Natives with mono-language
Ethnic origin	White and/or mestizo	Cholos	Indigenous peasants
Residence	Urban	Intermediate cities and town	Peasant communities
Gender	Men	Markets/households	Women
Age	Adults	Young people	Children and the elderly
Religion	Catholic elites	Protestant minorities, Catholics poor.	Native religions
Education	Formal	Semi illiterate	Illiterate
Organizations	Individualization of the urban culture	Voluntary associations	Peasant communities

Source: taken and adapted from (Ugarteche, 1998:162).

For some Peruvian technocrats and defenders of diminishing returns theories of the economy, GDP growth is presented as the most important indicator for economic success. They present the poor as being irrational in their demands. Commonly they argue that the illiteracy and low education levels of the poor make them incapable of seeing and perceiving the benefits of privatization and the free market economy. The truth is that illiteracy and the low education of the poor did not happen by chance. Neither was it the choice of the poor to live in such conditions, but rather the effect of polices that creates social exclusion, designed by the Peruvian elite.

The primary export model and the selling off of state enterprises to foreign direct investments have concentrated more wealth in the hands of only a few. The structural reforms of the 1990s meant to minimise public expenditure in health, nutrition, education, housing, water and sanitation, increased unemployment, the informal sector and deeply stagnation of small agriculture activities in favour of monopolistic agribusiness for which import of subsidised food was a profitable activity. They changed the country's consumption of staple food such as potatoes and corn flour for processed imported foodstuffs such as pastas and white bread.

CHAPTER 5

5. HUMAN DEVELOPMENT POLICIES

5.1. Human development and the role of the state

Peru needs an economy that benefits and gives equal opportunities and conditions to its entire people and not only to the economic elite. In order to ensure that such conditions happen, the state has to play its full role, not a minimal role as neo-liberalism's defenders have proposed. The state should provide public goods, emphasising the areas badly damaged by neo-liberal policies, such as education, health and employment. Development (economic, social and sustainable) can only be achieved if the state invests in human capital as well as in physical capital. In the last ten years Peru's human capital has been badly affected by neo-liberal policies. Now the World Bank, promoter of neo-liberal policies, admits that development should include an effective role of the state, together with the private sector and the civil society as states in its 1997 report:

> "It is increasingly recognized that an effective state–not a minimal one–is central to economic and social development, but more as partner and facilitator than as director. States should work to complement markets, not replace them. A rich body of evidence shown\s the importance of good economic policies (including the promotion of macroeconomic stability), well-developed human capital, and openness to the world economy for broad-based, sustainable growth and reduction of poverty...[T]he historical record suggests the importance of building on the relative strengths of the market, the state, and civil society to improve the state's effectiveness."(World Development Report, 1997:18).

In order to create policies that can lead the Peruvian society towards a stage of human development, the culture of social discrimination ought to be eliminated. This could be done only if the economic elite is willing to create a less unequal society.

Economic growth is required to create development; however, high economic growth is not a condition *sine qua non* to create development, as this did not happen in Peru. Countries like Barbados, Costa Rica, Sri Lanka, Zimbabwe, Mexico and Kerala, (province of India), some more than others, show cases of how social development can be achieved with medium or even low economic growth if effective policies of distribution

and investments in health, education and nutrition are implemented (Taylor et al. 1997:445-7).

GDP microeconomic figures alone cannot be the indicators for economic development since economic growth as in the case of Peru, does not mean that everybody benefited from it. In Peru, economic growth from privatization and trade liberalization has greatly benefited the rich and almost nothing the poor. Those who have been globalized are the economic elite, due to their full control of the country's natural resources and the state, whereas the poor have not access to basic public services. Unlike few countries in Latin America, economic growth in most countries in the region, and particularly in Peru benefits the top percentile of the population. The economic elite presents the macroeconomic figures as if they benefit to all. Their argument is that if they become richer, their wealth would spill over to the poor. They also argue that the poor are irrational in their demands and do not understand that privatization and trade liberalization would make them better off.

Despite the high costs that the poor have to assume for getting access to credit and the state institutions, they have been able to create their assets outside the formal system. A system in which laws and rights are tailored made to benefit only a few. The question is why if the poor have assets they remain poor? The answer lies in the internal factors of social exclusion and internal colonization in which historically the poor were placed. A country in which the economic elite has been unable to see it as a nation of many realities and ethnic groups, therefore as having a great potential to generate its own development. In which the institutions, particularly the most important of all in a society, the state should no be used to benefit only the economic elites that advocates for a minimum sate for the poor but for all its members, citizens, institutions and firms.

5.2. Policies on effective redistribution

Economic growth with effective redistribution should be the foundation of an effective policy focused on human development. Not a trickle down, as has been proposed during the neo-liberal reforms. In Peru, the rich got richer while the poor had to struggle more to get a tiny piece of the cake. The elite claims that the Peruvian cake is not big enough. The

unfair sharing of the cake is the result of the structural reforms implemented in a country with high levels of inequalities and social exclusion inherited from its colonial past. Peru cannot fully engage into the gobalized world unless its main problem of inequalities and social exclusion is solved. Globalisation itself would no bring down the levels of inequality and exclusion as presented by the neo-liberal advocators. The decreasing trends of inequality that have started in the 1970s have been slowed down during the 1990s, whereas poverty has increased (Saavedra and Díaz, 1999:31-2). With such social structure, neo-liberal policies constitute a double burden for Peruvians since they have to struggle two folds, against the internal colonization of exclusion and against the incapability of neo-liberal policies to create wealth, redistribution and access to basic commodities and services to the majority of Peruvians.

Empirical data shows that not a single growth factor is more important that others to reduce poverty. For instance, income-poverty reduction, social development and economic growth, that create synergies and virtuous circles between policies and outcomes within the social sectors, are needed (Taylor et al.1997: 450-51). Another study on poverty reduction in developing countries in the 1990s concludes: "to reduce poverty, growth is not enough, nor is redistribution enough. What is required is a growth policy that incorporates equity as a forethought, rather than an afterthought, by shifting the ideological debate so that the costs and limits of growth are viewed as sceptically as the costs and limits of redistribution". (Dagdeviren et al. 2002:405-6).

The policies required are those that would reduce the inequality gap between the rich and the poor. This gap is a constraint for Peru's development. The state should start such policies by calling for a broad coalition for poverty reduction. This ought to address the question of the opportunity cost of reducing poverty by increasing the growth rate and implementing redistribution. This is determined by the specifics of the programme to achieve redistribution, the size of the redistribution, and the administrative capacity of the public sector. Data from Latin America shows that equal distribution growth would be a more efficient way to reduce poverty, because it has a lower opportunity cost (3 per cent of GDP), one per cent of equal distribution growth would distribute 0.5 per cent of the national income (ibid. 399). In the case of Peru another study found that, it can be

demonstrated that 24.3 per cent transfer of the income of the richest 1 per cent of the population would be needed to close the income gap o the whole national population living in extreme poverty (Shack, 1999:89).

5.3. Tax reform

Peru requires tax reform in which those who earn more pay more, particularly the private companies that extract Peru's natural resources, mining, oil and fishing industries. This would bring more equity and redistribution, allowing the state to finance its investment in human and social capital by targeting three crucial sectors: health education and housing. Furthermore, these sectors, which constitute mainly labour intensive activities, would contribute to job creation that the current economic model lacks of and to build a strong middle class; an important factor for the spinning up of Peru's economy.

Peru has one of the lowest tax revenues in the region (12.3 per cent of its GDP), compared with the average 18 per cent in Latin America. The tax system in Peru is regressive; i.e. it is easily influenced by political factors, which does not necessarily reflects what happens in the economy. Influential private companies can easily get away paying fewer taxes by using the special legislation that the Fujimori regime has granted to them. For example the corparate tax for private companies has decreased from 2.66 per cent of the GDP in 1997 to 1.87 per cent in 2000. This drop in 0.8 per cent of the GDP represents US$438 millions that the state failed to receive in 2000 as it did in 1997. However, the same did not happen with the income taxes for individual earnings (Campodonico, 2003a).

(i). Education

The education system in Peru excludes from receiving good quality and relevant education services to a large number of Peruvians. Investment in education for the excluded groups should be a state priority to tackle exclusion and poverty. The state should retake its role of ensuring good quality education for all its citizens in order to bring about equity. Good quality education for the population in public schools should be the state's main target and not only the number of enrolments of each year. Data has

probed that investing in education is investing in human and social capital, which in turn brings high returns that, constitutes the bases for endogenous growth.

According to a study, if the probability of being poor in a particular region in Peru is the same for any educational level of the head of the household, certainly we can conclude that the education system, particularly public education, is not relevant to the demands of the productive sector (Shack, 1999:32). This study indicates how the Peruvian education system has been badly damaged in the last twenty years and during the structural reforms of the 1990s, in which privatization was perceived as the solution for the education crisis. This has reinforced and increased inequalities and poverty in Peru. Public education for the poor is usually of bad quality; the economic elite presented the rates of enrolments during the structural reforms in the 1990s to the World Bank as a successful education policy. In fact those who could afford to pay for their education were able to receive good basic and tertiary education services. The quality of the education system has left the majority of the Peruvians out of the labour market.

The education policy in Peru during the structural reforms of the 1990s, contradicted to what has been found world-wide, in which good basic education, which includes primary and secondary education, should be a priority public service. That educating females bring more returns than educating males, the academic secondary curriculum is better than the technical/vocational one, and that the returns to education follows the same rules as the investment in conventional capital (Psacharopoulos, 1994:1335). Improving education also includes investing in school infrastructure, curriculum content, and teaching training. Increasing teacher's salaries would promote teaching quality since it will increase teachers' motivation and bring the most qualified people into the teaching profession.

Education should be linked to other sectors such as health, agriculture, manufacture, nutrition and other productive-related factors. Curriculum content ought to include developing students' skills in topics related to their daily lives and interests. Learning processes should take into account students' involvement in solving surrounding

community problems as health and economic activities, ranging from agriculture and local knowledge to innovative technologies.

(ii). Health

Primary health services, targeting preventive health care, can be successfully achieved by giving local communities autonomy in administrating health centers. Health provision services accessible to all the population should be a state priority. Addressing the issue of equity by improving Peru's human and social capital. Health provisions should cover a wide range of education, prevention, counselling, diagnostics and treatment services. Emphasising maternal and childcare. Reducing maternal and child morbidity and mortality should be the main indicators of the efficiency of the Peruvian health service. Partnership between the state and the private sectors might also be required in order to promote research and innovations to guarantee good quality health services. Further, a new ethics in the health system is needed. Health professionals' training requires more emphasis on improving services provision. This urges for co-ordination and substantial changes in medical schools curriculum and university faculties. Policies should emphasise, health workers' wages and working hours by increasing salaries and the number of health workers in health centres and hospitals.

(iii). Housing

Nowadays, 26`749 thousand inhabitants in Peru live in 6 million houses, which reveals the housing demand that Peruvians have since few own most of these houses. 58 per cent of the housing demands are in the provinces. Represented by 14.14 per cent of the medium sectors called sector (C); 26.1 per cent of the medium lower sector or sector (D); and 41.83 per cent of the low sector known as sector (E), [*Ministerio de Vivienda*, 2003]. Housing creates positive impacts on security and well being for individuals and families. It represents an important asset that reduces the risk of poverty, facilitates access to credits from formal finance institutions and it is the first stage towards formalisation.

In the year 2002, the state has started housing programmes –*Mi vivienda and Techo Propio*– are the two most important state programmes, which allow the population to have access to housing in which the private sector (construction and finance) working in

partnership with the state, play an important social role. In which, the former receives an economic injection, creating employment whereas the latter fulfils its social role of ensuring its citizens to have access to housing. However, further improvements in the access requirements are needed. For the bulk of the population requiring housing, the requirements are difficult to fulfil since it follows the traditional financial institution's schemes. Therefore, flexibility and new instruments for credit evaluation from alternative finance institutions are needed; otherwise a large proportion of the population of the lower income might not be able to have access to housing.

CHAPTER 6

VI. CONCLUDING REMARKS

Poverty in Peru rather than to the country's external factor of an uneven integration into the world-market economy is the result of the internal factor of socio-economic exclusion and internal colonization, that historically a large number Peruvians have been subdued. That has created an asymmetrical integration of Peru's population to economic activities designed by economic and political elites, which therefore constitutes the cause of the uneven globalization. Since the economic elite has institutionalised in the Peruvian society the "culture" of exclusion against a vast majority of its population, the poor and ethnical groups, these exclusions inherited from Peru's colonial past, represents the main constraint for the country's attempt to successfully engage in the modern world.

During the structural reforms of the 1990s, Peru's human and social capital has been badly damaged. The privatization of public services and the reduction of the state investment, basically in education and health services have been the key factors for the deterioration of Peruvians' living conditions. Moreover, the focus on the primary-export model implemented in that decade has left the agriculture and manufacturing sectors out of state economic policies, leaving many Peruvians unemployed. The primary-export model has benefited more to the top percentile of the population whereas the rest has to wait for the spill over to benefit from economic growth because of Peru's unresolved structural constraint of social exclusion and internal colonization. In the last decade,

Peru's economic elite has regarded the state as inefficient and interfering with Peru's modernization. Thus, they have advocated for the reduction or for a minimal state; whereas, they have used the state to benefit from privatization, trade liberalization and globalisation by controlling Peru's natural resources.

After the implementation of the structural reforms in the 1990s, poverty in Peru has increased because such reforms did not tackle the exclusion and redistribution problem that the country faces. Any attempt to modernise the Peruvian economy would be diluted unless the political and economic elites do not perceived the county's ethnical and culture diversity and not only the natural resources as Peru's main endowment. Economic growth is an important factor for Peru's development; however, it does not automatically lead to poverty reduction by a trickle dawn mechanism as Dollars and Kraay (2001: 2:8) have defended would happen to the poor in developing countries. Finally, unless policies on redistribution are implemented where all actors of the society can converge to eliminate poverty and inequalities, economic growth without targeting the causes of poverty and exclusion will not benefit all Peruvians but only to the economic elite as happened during the structural reforms of the 1990s.

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