



Peru's Election: Background on Economic Issues

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Introduction

In Peru's national elections on April 9, Ollanta Humala of the nationalist Union for Peru (UP) party is currently leading in national polls (with 31 percent) against the center-right candidate Lourdes Flores Nano of the National Unity (UN) party (26 percent) and former president Alan Garcia of the American Popular Revolutionary Alliance (APRA) party (23 percent).¹ Regardless of whether Humala wins a majority, or the election goes to a second round in May, the former Army officer's rapid rise in the polls is another example of the political shift toward populist, nationalist, and regionalist politics and economic policy in Latin America.

Humala has expressed these ideas repeatedly in his campaign: "[N]ationalism is the defense of our sovereignty and our resources. It is our answer to the neoliberal economic model that is destroying Peruvian society."² In the last several years, six presidents who ran explicitly against the "neoliberal" economic reforms of the last 25 years have won elections in South America.³ The most likely reason for this continuing political trend is the long-term economic growth failure in Latin America. From 1980-2000, per capita GDP grew by only 9 percent; for 2000-2005, it was 1 percent. By contrast, GDP per person grew by 82 percent in the two decades from 1960-1980.⁴ The last quarter century has seen the worst growth performance for any 25-year period in more than a century in Latin America, and this economic failure has had enormous consequences that will continue to spill over into the political sphere. This issue brief will provide some economic background information on Peru that may be relevant to the current election.

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¹ *El Comercio* and Apoyo, April 2, 2006, (<http://www.elcomercioperu.com.pe/EdicionOnline/Html/2006-04-02/onlPortada0482452.html>).

² "No soy de izquierda ni de derecha," *Página-12*, April 4, 2006, (<http://www.pagina12.com.ar/diario/elmundo/4-65164-2006-04-04.html>).

³ See Weisbrot and Sandoval (2006) "Bolivia's Challenges," p. 5, (http://www.cepr.net/publications/bolivia_challenges_2006_03.pdf).

⁴ From IMF (2005) *World Economic Outlook*, September, and Penn World Tables.

Growth, Employment, and Poverty

Unlike the other six candidates who have run successfully against neoliberalism, Humala is running in an economy that has grown reasonably well under the current president, Alejandro Toledo. Table 1 shows the recent data for growth and other indicators for Peru's economy. Real GDP grew by an average of 5.5 percent annually over the last four years. Per capita GDP, a better measure of economic progress because it factors out population growth, grew by an average of 4.0 percent.⁵ While this is not near the highest ranges of even long-term developing country growth experiences,⁶ it is solid growth, especially by Latin American standards.

Toledo's low approval ratings – currently at 22 percent (they had dipped as low as 8 percent in 2004) – and Humala's rise in the polls have led many observers to conclude that Peru's recent economic growth, while successful, has not “trickled down” enough to the majority of Peruvians. While there is some truth to this idea (see below), the much more important feature of Peru's economic reality is the country's long-term economic failure.

Figure 1 shows real per capita GDP in Peru since 1960. As can be seen from the graph, Peru's GDP per capita peaked in 1981 and is only now just returning to that level. In other words, income per person in Peru – the most basic economic measure of living standards – is currently about the same as it was 25 years ago. This is a remarkable long-term economic failure, and as noted above it follows the economic stagnation of the region, although it is somewhat worse than average.

A long-term growth and development failure of this magnitude produces economic and social problems, including unemployment and poverty, that cannot be resolved with a few years of reasonable economic growth. It is the cumulative results of this long-term economic failure that is most likely driving the electoral shifts of recent years in the region, and therefore Peru's exceptional growth over the last four years is a much lesser influence.

Table 2 shows Peru's poverty rate for the years 2001-2004. As can be seen, measured poverty declined somewhat over this period, from 54.3 to 51.6 percent of the population. It is undoubtedly somewhat lower today due to the strong economic growth since 2004. But this is not a dramatic decline and could go unnoticed by much of the electorate, and it still (as of 2004) leaves a majority of the population living below the official poverty line. In Lima and Callao, where 9 million people (or 32 percent of the population) live, poverty actually increased during this period by nearly 5 percentage points, from 31.8 to 36.6 percent of the population.

As can be seen in Table 2, the last few years of growth have not been enough to lower the unemployment rate, which has increased to 10.5 percent, from 7.8 percent in 2001.⁷ Also, the employment to population ratio in 2004 (at 55.8 percent) was down nearly 4 percentage points from 2000 (59.7 percent) and even more from its peak in 1998. This decline is substantial and indicates that the economy has not been creating nearly enough jobs even to keep pace with the growth in the

⁵ For both of these measures we are comparing the last quarter of 2005 to the last quarter of 2001 (www.bcrp.gob.pe); this is the closest approximation that the data allow for President Toledo's term of office which began in July of 2002, although his actual term of office (July 2002-July 2006) is likely to show somewhat lower growth.

⁶ China has grown by an average of 8.2 percent per capita over the last 25 years; South Korea averaged 6.2 percent per capita from 1960-2005.

⁷ This measures only urban unemployment.

TABLE 1**Peru: Basic Economic Indicators, 2000-2005**

	2000	2001	2002	2003	2004	2005
Real GDP (millions of 1994 Nuevos Soles)	120,882	121,103	127,087	132,119	138,474	147,708
Real GDP (annual % change)	2.94	0.18	4.93	3.98	4.80	6.67
Real GDP per capita (annual % change)	1.28	-1.37	3.36	2.43	3.29	5.14
Consumer prices, end of period (annual % change)	3.74	-0.13	1.52	2.48	2.80	1.50
Public Sector						
	<i>In % of GDP</i>					
General government current revenue	17.8	17.2	17.2	17.6	17.8	18.5
General government noninterest expenditure	18.5	17.8	17.4	17.3	17.0	17.2
Combined public sector overall balance	-3.3	-2.5	-2.3	-1.7	-1.1	-1.4
Debt						
	<i>In % of GDP</i>					
Total Public Debt*	...	41.7	43.4	43.9	40.7	37.3
External	36.5	34.6	36.6	37.4	34.3	29.5
Domestic	...	7.0	6.8	6.5	6.4	7.8
Memorandum Item:						
Nominal GDP (millions of \$)	52,661	54,797	56,573	60,911	71,381	75,473

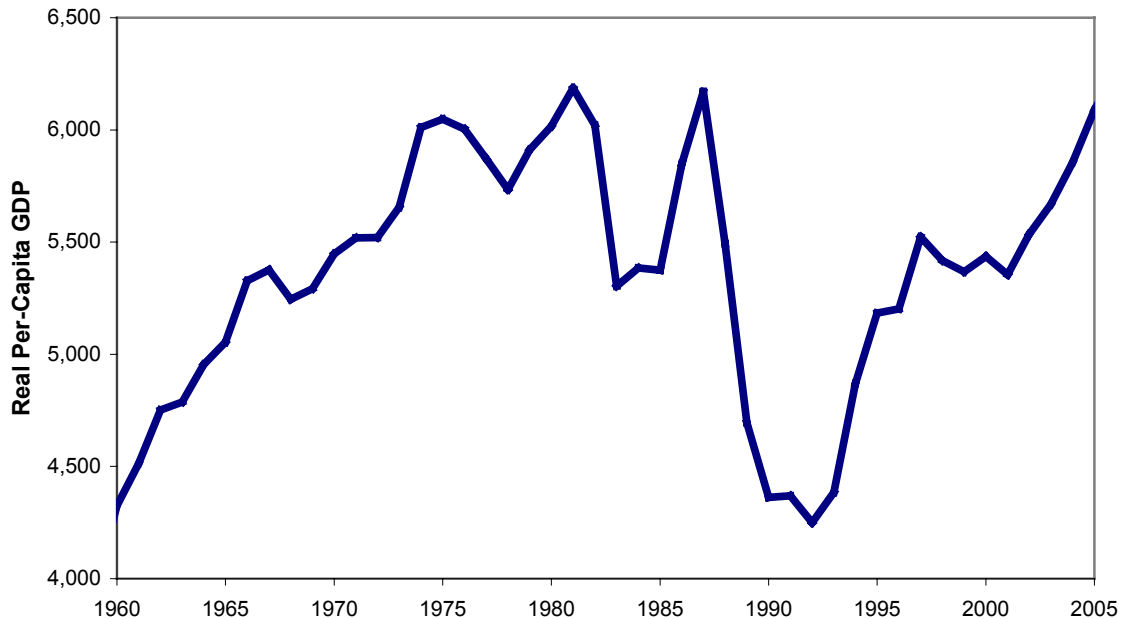
Source: Banco Central de Reserva del Peru, Ministerio de Economia y Finanzas

* Does not include regional governments

TABLE 2**Peru: Selected Social Indicators, 2000-2004**

	2000	2001	2002	2003	2004
Poverty					
Total	...	54.3	53.8	52.2	51.6
Lima and Callao Province	...	31.8	34.2	33.7	36.6
Rest of population	...	63.3	61.8	59.6	57.7
Urban	...	50	46.4	44.1	43.3
Rural	...	77.1	77.7	75.7	72.5
Employment (Lima Only)					
Unemployment rate	7.8	8.8	9.7	10.3	10.5
Employment-to-population ratio	58.4	59.7	56.8	56.7	55.8

Source: Instituto Nacional de Estadística e Informática, Ministerio de Trabajo y Promoción del Empleo

FIGURE 1. Peru: Real Per-Capita GDP, 1960-2005

Source: Maddison (2005) and author's calculations

labor force. Although there are problems with all of these official data in terms of how well they measure the employment situation of the whole labor force, they indicate that the economic growth of the last four years has not brought noticeable improvements in living standards to a large part of Peru's labor force.

Economic Indicators and Issues

Whoever wins the election will inherit an economy that is sound on a number of macroeconomic indicators in addition to growth, and does not appear to suffer from any dangerous macroeconomic imbalances. Inflation is well under control with consumer prices rising only 1.5 percent in 2005. The public sector deficit was 0.7 percent of GDP in 2002, and is projected at 1.0 percent of GDP for 2006. The public sector debt is projected at 37.1 percent of GDP for 2006, down from 47.1 percent of GDP for 2002.

The government is currently running a trade surplus of \$5.2 billion or 6.8 percent of GDP; its current account surplus is much lower, at \$1.03 billion or 1.4 percent of GDP, primarily due to debt service (see Table 3). But it is still significantly improved from a \$1.06 billion (1.9 percent of GDP) current account deficit in 2002. Foreign exchange reserves have grown substantially from \$9.7 billion to \$13.1 billion, or 17.4 percent of GDP, for 2005.

These measures of economic stability will certainly make it easier for Peru's new government to pursue any economic program that it chooses.

TABLE 3
Peru: External Sector, 2000-2005

	Current account balance	Merchandise trade	Exports	Imports
Total, In Millions of current US dollars				
2000	-1,526	-410	6,955	7,366
2001	-1,144	-195	7,026	7,221
2002	-1,063	292	7,714	7,422
2003	-934	836	9,091	8,255
2004	-10	2,793	12,616	9,824
2005	1,030	5,163	17,247	12,084
Annual % change				
2000	--	--	14.3	9.2
2001	--	--	1.0	-2.0
2002	--	--	9.8	2.8
2003	--	--	17.9	11.2
2004	--	--	38.8	19.0
2005	--	--	36.7	23.0
In % of GDP				
2000	-2.9	-0.8	13.2	14.0
2001	-2.1	-0.4	12.8	13.2
2002	-1.9	0.5	13.6	13.1
2003	-1.5	1.4	14.9	13.6
2004	0.0	3.9	17.7	13.8
2005	1.4	6.8	22.9	16.0

Source: Banco Central de Reserva del Peru

The current government is operating under a 26-month Stand-By Arrangement with the International Monetary Fund (IMF) that expires in August. Humala's campaign has announced that it would not seek a new agreement with the IMF, saying that "the economic indicators for the future don't point to the need for a new agreement."⁸ The data would seem to support this statement, and Peru would be following a regional and worldwide trend of countries choosing not to borrow from the IMF.⁹ This does not appear to be a major campaign issue, although it could be seen as part of the Humala campaign's overall rejection of the "neoliberal" reforms of the last 25 years, since the IMF is widely seen as having promoted these reforms.

A somewhat bigger issue is the proposed Free Trade Agreement with the United States, for which Peru finished negotiations in December, but has not yet ratified. Humala has pledged to renegotiate

⁸ "Peru's Humala Wouldn't Renew IMF Loan Agreement," Bloomberg, March 31, 2006 (http://www.bloomberg.com/apps/news?pid=10000086&sid=a5hEmw8Ecr.4&refer=latin_america)

⁹ See Weisbrot and Sandoval (2006) "Bolivia's Challenges," pp. 10-11, (http://www.cepr.net/publications/bolivia_challenges_2006_03.pdf)

the agreement.¹⁰ This is also part of a growing trend in the region – e.g. the proposed Free Trade Area of the Americas, which was launched nearly 12 years ago, now appears nearly dead. Countries have become increasingly wary of commercial agreements that threaten to harm their agricultural or in some cases key industrial sectors, and impose new protections for intellectual property – beyond those agreed to in the World Trade Organization – that would raise the price of medicines.

In the past, more countries were willing to take these risks and even make economic sacrifices in return for access to a rapidly growing U.S. market for their exports. However, the United States is now running a trade deficit of 7 percent of GDP, which most economists view as unsustainable.¹¹ Even under generous assumptions about how much foreign debt the U.S. can sustain, an adjustment is inevitable over the next decade. The dollar will have to fall in order for the U.S. trade deficit to adjust, not to balanced trade but to a deficit that can be sustained without an explosive foreign debt trajectory. This means that the U.S. import market, instead of growing as it did in the past, can actually be expected to shrink over the next decade.¹² The implication is that countries hoping to increase their access to the U.S. market for their exports will find that they can only do so by displacing countries that are already there, such as Mexico or China. This economic reality provides considerable grounds for caution for any country considering making economic sacrifices in order to gain access to the U.S. market. At the same time, the Chinese import market is projected to grow by about \$1 trillion euros over the next decade, making the U.S. market – whatever its size and shrinkage – increasingly less important for countries like Peru.

Table 4 shows Peru's exports, with some sorting by category, since 2000. As can be seen from the table, total exports soared from \$7.03 billion to \$17.25 billion from 2001 to 2005. This is an enormous 145 percent increase in export revenue in just 4 years.¹³ While the increased export production did account for about a third of the real GDP growth in the last four years,¹⁴ the impact of this export revenue on economic and social development – exports are currently about 23 percent of GDP – could conceivably have been bigger. Real per capita social spending by the government, for example, increased by about 2.5 percent annually from 2001 to 2005; but most of this was in the election year 2002, with the last three years seeing increases of less than 1.3 percent annually.¹⁵

The idea that the country's poor majority may not have benefited sufficiently from the country's natural resources – especially during a boom in exports of these products – is another election issue, as it was in Bolivia and Venezuela. This is the situation that candidate Humala has pledged to rectify. From Table 4, it can be seen that the mining sector accounted for the largest part of the increased export revenue since 2001 – about \$6.5 billion of the \$10.2 billion increase. Copper (\$2.7 billion increase) and gold (\$2 billion increase) were the leading minerals, with oil and oil derivatives also rising by \$1.1 billion. Most of the increased revenue in these sectors was due to increased world market prices, and only secondarily to increased production.

¹⁰ See “Peru nationalist targets global mining groups,” by Hal Weitzman, *The Financial Times*, March 30, 2006.

¹¹ See e.g. Cline (2005), *The United States as a Debtor Nation: Risks and Policy Reform*. Institute for International Economics, Washington, DC.

¹² This is measured in non-dollar currencies. See Baker and Weisbrot (2004) “Fool's Gold: Projections of the U.S. Import Market,” (http://www.cepr.net/publications/trade_2004_01_08.htm)

¹³ These are current dollars, but U.S. CPI inflation was only 8.5 percent for this four-year period.

¹⁴ IMF (2006), “Peru: Third Review Under the Stand-By Arrangement,” IMF Country Report No. 06/47, Washington, DC, p. 5.

¹⁵ *Ibid*, p. 34.

TABLE 4**Peru: Value of Exports, 2000-2005***In millions of current US dollars*

	2000	2001	2002	2003	2004	2005
Total Exports	6,955	7,026	7,714	9,091	12,617	17,247
Traditional Exports	4,805	4,730	5,369	6,356	9,028	12,840
Agriculture and Fisheries	1,204	1,134	1,109	1,046	1,429	1,634
Mining	3,220	3,205	3,809	4,690	6,953	9,724
Copper	933	986	1,187	1,260	2,446	3,360
Gold	1,145	1,166	1,501	2,102	2,383	3,140
Zinc	496	419	429	529	577	805
Others	647	634	692	799	1,547	2,419
Oil and Oil Products	381	391	451	621	646	1,482
Nontraditional Exports	2,044	2,183	2,256	2,620	3,476	4,271
Agriculture and Fisheries	571	634	714	828	1,076	1,332
Textiles	701	664	677	823	1,092	1,274
Chemicals	212	247	256	316	415	538
Metal Products and Jewelry	265	243	222	262	392	493
Others	295	396	388	391	501	635

Source: Banco Central de Reserva del Peru

According to Peru's Ministry of the Economy and Finance, Yanacocha, a company owned by the U.S. - based Newmont Corporation, exported \$1.5 billion in gold last year¹⁶ and did not pay royalties, although it paid other taxes. There are a number of mining companies that have "tax stability" contracts and don't have to pay royalties, which are otherwise set at 3 percent. According to the mining and energy companies' trade association, mining companies paid about \$874 million in taxes last year.¹⁷ As has been the case elsewhere in the region, it does look like there is room for the government to capture more of the revenue from natural resource-based exports.

Conclusion

The Peruvian election is following some trends that are common to the region, which have their basis in important regional economic factors. The most important of these is the long-term growth failure over the last 25 years, which many have blamed on the economic reforms that have been implemented over this period. As a result, candidates who campaign against "neoliberalism" will probably find this to their advantage for some time to come, as different actors, including political

¹⁶ Estadísticas de Comercio Exterior, Superintendencia Nacional de Administración Tributaria, <http://www.sunat.gob.pe/gestionTransparente/notatributaria/index.html>

¹⁷ According to the Sociedad Nacional de Minería, Petróleo y Energía, the government collected 3 billion Nuevos Soles (\$874 million) in tax revenue from the mining sector, of which 50% (\$437 million) is distributed to local governments as part of a law called Canon Minero (Mining Canon or Tax). For more information: <http://www.snmpe.org.pe/pdfs/Canon%20En%20Cifras/Canon%20Minero.pdf>.

parties, governments, and civil society look for alternatives that will reverse this long-term economic failure. Peru is exceptional in that its economic growth under Toledo was reasonably good, but four years of such growth is not enough to restore public confidence in the neoliberal program offered by more traditional candidates such as Flores Nano. This is especially true in Peru's case since the economic growth of the last four years does not seem to have had much positive impact on employment and only a limited impact on poverty.

Nationalistic campaigns that advocate capturing more of the rents from oil and mineral extraction, as is the case with Humala, also have an economic basis as a result of the increase in world prices for these commodities, as well as the successes so far in Venezuela and Bolivia. New norms and expectations are being established as contracts with foreign corporations are being re-negotiated in the energy industry, and as demands for more national control over these sectors increase. Argentina's rapid economic growth of the last three years (averaging 9 percent annually), while implementing unorthodox economic strategies and refusing a number of IMF recommendations, has also increased the appeal of alternative policies and made them seem more feasible. So, too, has the rapid decline in the influence of the International Monetary Fund in recent years, which is related to the Argentine experience. Finally, the increasing reluctance of governments to enter into commercial agreements with the United States in which they put various sectors of their economies at risk and incur certain costs, in return for increased access to the U.S. market, also has an economic basis – since that market can now be expected to shrink over the coming decade.

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