



THOUGHT FOR ACTION POLICY COMMENTARY

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Peru turns 200 on July 21

Can the economic miracle now move into political maturity?

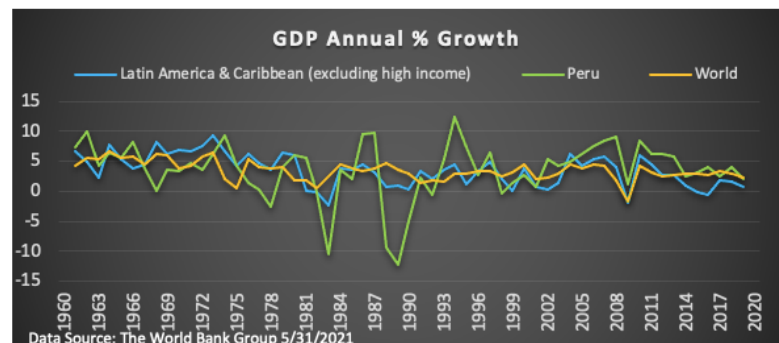
The stakes are high.

Peru ploughed into the new millennium like a powerhouse economy. The Peruvians, it seemed, had achieved mission impossible; evolving their socio-economic level demonstratively while graduating into a middle income country from a defaulted, marginalized state that had sunk slowly but deeply in the misery of poverty and informality since the late 1960s. The country was sinking not only in economic malaise, but in a democratic and political deficit that was becoming all the more obvious, creating deeper inequalities, leading to financial and economic mayhem.

This is what led Peruvians to either seek bare survival, or flight from the country, leading to a massive brain drain for those who could. It was simply unattractive with no opportunity on site, to live with hyperinflation, sovereign default, isolation from world trade, rising poverty and informality. Peru had become dangerous. Insecurity and social unrest grew to be uncontrollable, leading to a rough and bloody internal conflict with the Shining Path (Sendero Luminoso) and Movimiento Revolucionario Tupac Amaru (MRTA) with thousands of murders. Peru was marginalized even further away from the rest of the world - socially, and economically (World Bank 1990).

And yet, Peruvians managed to change. Economic output boosted, enjoying more than two decades of growth -- achievements that have made the country into one of the fastest growing economies in Latin America. The dramatic turnaround has long been noted internationally, applauded because the country succeeded in breaking ranks with its turbulent and troubled past, progressing as if it was on an unstoppable economic growth path.

In July, Peru celebrates its 200 years of existence as a republic independent from the then Spanish Kingdom. Although one would normally expect a year-long string of celebrations, the looming feeling is one of anxiety and concern. The run-off presidential elections set on June 6 pose a challenge. Political outsider, far-left candidate, Pedro Castillo (Peru Libre - PL) will face off against right-wing candidate, Keiko Fujimori (Fuerza Popular - FP).



Figure#1: GDP annual % growth

Both candidates represent the extremes of recent Peruvian politics. The stage is set for political extremism, a major cause of concern as it will add to a highly fragmented Congress where 10 parties are represented. Both candidates are new. Castillo is connected to the statist and socially conservative party Action Popular (AP). Fujimori served the previous Congress and has already run for President in two previous run-offs. She is also the daughter of former President Alberto Fujimori, who was at the helm of Peru's successful reform, winning popularity among the nation's lowest echelons. He remains, however, a controversial figure frowned upon for waging human rights violations.

Castillo is a self-avowed Marxist, advocating an increased role for the State while spending up to 10% of the GDP for health and education, respectively[1]. To finance this, he suggests increasing revenue through heightened taxation. He wants to renegotiate contracts with private firms so as to increase the State's share of profits, threatening to nationalize the private firm if they do not agree to the new terms. Castillo promises to rewrite the Constitution, re-negotiate bilateral trade agreements turning the country more insular. His audience is mainly the poor and disenfranchised. While these groups have decreased by up to 40 percent in the last 20 years, they represent a sizeable chunk of the population, between 18 and 20 percent today. They make up a major pool of voters, linked to the narrative of the country's 500 years of disenfranchised history.

Keiko Fujimori on the other hand pushes for the country to open further and consolidate its world position, as well as deepen reforms. She suggests strengthening relations with the US, finalizing a free-trade agreement (FTA) with India, and ratifying the comprehensive and progressive agreement for the Trans-Pacific Partnership (CPTPP). She strongly addresses entrepreneurs, the private sector, the wider middle class, and the disenfranchised, tapping into her fathers' recognized popularity with the informals and poor.

The key question at stake right now is whether Peru will maintain its openness and whether institutional reforms will deepen so as to reduce inequality even further and finish up with informality once and for all, shifting the country, this time, from middle to high income.

A glance at Peru's complex history and socioeconomic reality

Established as a country of its own in 1821, Peru is built on all sorts of different formal rules, norms and agreements, also known as institutions.

Institutions have been built along the lines of different behaviours and community interests. Indigenous demands, for example, varied from those of the colonials, and then, from later date immigrants.

Part of what makes the case of Peru so interesting is its rich historical legacy, all depicted in its institutions. The mystical stories of the legendary Incas and Machu Picchu, Tupac Amaru and his battles with the Spaniards, the mysterious Nasca Lines, the beautiful pure gold and silver handmade relics in the churches of Cuzco are all part of Peru's enticing history. Its journey through modern times is painted in the same strong colours of its past, with migrants searching for opportunities in the new world replacing conquistadores and explorers. Peru is a mosaic of cultures, a melting pot of indigenous people, whites, blacks, Europeans, Chinese, Japanese and Africans, whose art and music are renowned and whose sophisticated cuisine is one of the world's greatest.



Figure#2: Peru, a mosaic of cultures

Peru was one of many countries that suffered from informality, sclerotic institutions and the absence of solid, enforceable property rights capable of providing citizens with the ability to trade their own properties in a formal market (Prosperity Unbound, 2007). The informals were an exception: they were unable to properly establish the right to their own existence, let alone their homes.

[1] Public spending on Education was 3.8% in 2019 and on healthcare was 3.3% in 2018

Those who were not able to own and have property were used as property

For decades, or else since its inception, Peru was known as a largely landless society of farmers structured around a handful of wealthy land owners. The rich were few; the poor, legions and the middle class, practically hollow. It was not a divisive culture and behaviour based on colour; rather the old colonial establishment pit against new waves of immigrants and the country's indigenous population. For years, Peruvians of Spanish descent faced off against the indigenous, plus growing numbers of trade-based immigrants that streamed in from countries bursting out of colonial rule [2].

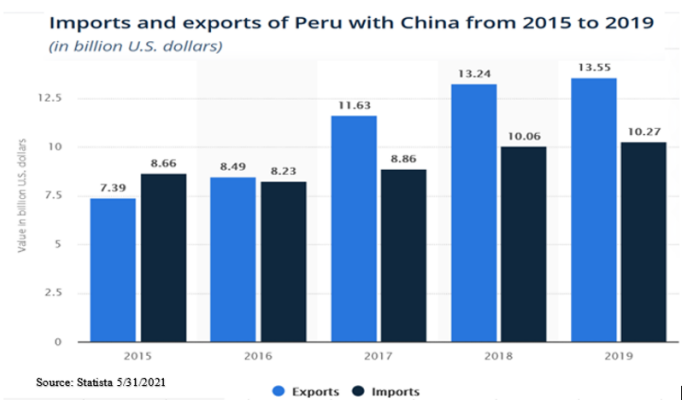
The country was effectively controlled by a clutch of Spanish surnames. It was a very rich country but for the very few. And as a result, discontent led to a massive left- guided dictatorship in 1967, led by General Juan Velasco Alvarado, that forced the sweeping Agrarian Reform - the most emotionally charged and massive land redistribution in all of the continent. But it remained unfinished, leaving more than two-thirds of the population in an even weaker, insecure and economically vulnerable state. Attempts to restart the economy and re-create the Peruvian society after the dictatorship were not successful; rather the opposite, leading to a socioeconomic meltdown.

By the late 1980s, and while the country continued to be extremely rich in natural resources (gold, silver, copper, oil, fisheries among some) Peru defaulted. Its GDP sunk to -13%, political corruption grew rampant, populism soared, yielding to 1000% inflation a month. Poverty levels spiked to nearly 60% of the population living below the poverty line, and informality rates varied from 70% in the urban areas to 90% in the rural areas, thus Peru's middle class was left listless. Measuring formal economic indicators, including unemployment, was impossible.

The suffering spanned over several generations. A crisis ensued. Peru, hit its bottom. It was this nadir that provided the incentive for the country to embark upon unprecedented reforms.

The change

The deep crisis, is pushed Peru to change its economic course (rumbo económico). The country managed in a record time to stabilize its macro fundamentals. It adjusted its currency restructured debt, opened to world trade, and pioneered innovative institutional reforms on registries and property rights -- all with deep and consistent changes that ultimately set the standard for such reforms. Peru managed to even launch trade with China, seeing its volume double in the last decade alone especially in its exporting of one of its important product - pottery.



Figure#3: Positive trade balance with China.

Still, it has been Peru's pioneering property rights that has made it a global paradigm, becoming an international best practice, winning innovation awards across the board. Such was the impact, in fact, of these reforms, that they gave rise to a new and stable middle class, creating a socio-economic makeup that left little room, if any, for political influence.

At the heart of the post 1990 reforms: land and property ownership rights were secured for Peru's people, along with stability in the banking sector and the country's macroeconomic outlook - all helped drive "informals" into the mainstream, irrespective of their class and origin.

[2] These included for example Japanese, Chinese, Italian.

The drive helped transform the country at a deep institutional level increasingly consolidating the middle class as the number of property owners grew. Slowly but surely Peruvians became armed with the right to create a life of their own, securing their independent rights.

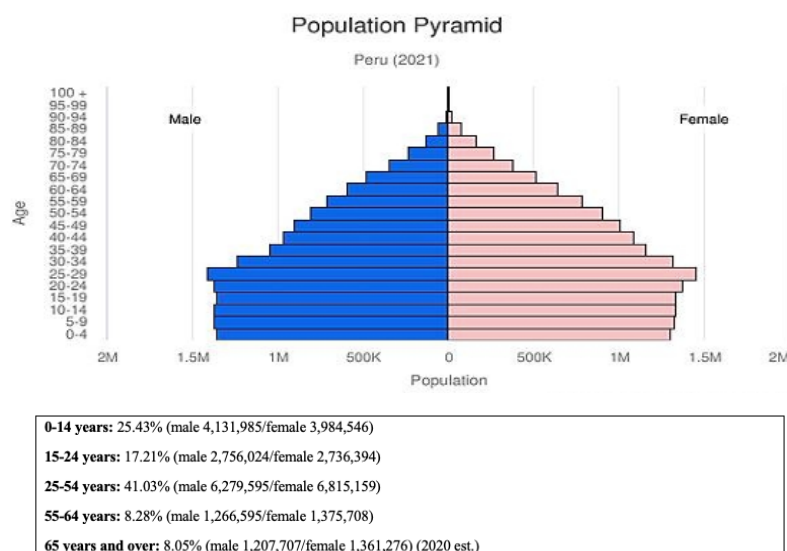
Unlike a string of other countries in Latin America, Peru was impressively affected, little by the 2008 global financial crisis like Chile and Columbia, the country never allowed its fiscal deficits to exceed about 3% of GDP. In fact, during the global financial crisis, Peru eradicated an additional 4 % of the population from poverty. Its resiliency rested on its robust reforms that built sound macro-economic conditions with ample liquidity, strong reserves, prudent diversification, especially when it came to metals and increase in FDI. But even before then, from the start of the century, financial markets lauded the country as one of the best managed economies, not least, as reflected in the decline of the spread of Peruvian sovereign bonds over US Treasuries.

The challenge

Its strong socio-economic growth and maturity has gone unmatched by political reform. Politicians remain guided by greed, populism, and an immature political leadership, enmeshed in vested interests, mainly focused on rent seeking, or else, the source of corruption. Political leaders feel they have the luxury to waste valuable time in striking congressional fights, generating divisions as opposed to catching up with new innovative growth sectors that can promote trust, while helping create much-needed jobs for the country's youth. It seems like Peruvians decided to sit back and relax on the reform front, living on earlier laurels. As a result, poverty and informality have not reduced further. Delinquency, in the meantime, has increased.

What next?

Peruvians have proven themselves already once, and made history, so we want to see the country ploughing through the 21st century with the same energy it burst into it. But there is an important factor to consider: demographics. More than 60 percent of the population is aged under 30, with the median age at 29 [3] providing a sweeping memory gap in the nation's jump to prosperity from the doldrums of poverty. Today, high rates of unemployment, especially after the covid-19 pandemic, have mainly hit the youth. It seems that Peru's political leadership has failed to find new outlets for growth. What is more, if it does not do so fast, its legacy of success will at best stagnate.



Figure#4: Population Distribution

It was only until 2014 that Peru managed to match the riches of its purchasing power of 1963, losing over 60 years in government and political experiments that led to more discontent, more divisiveness, more inequality, more poverty and more informality. This is not a situation anyone wishes to repeat itself. Peru should create new outlets, building on existing energy and growth engines. We have noticed that when it follows correct institutional reforms, it thrives. It needs to further develop these reforms and expand them to create a stronger economic equilibrium, anchoring its future growth with greater security. It needs to build on the gains of its most recent past.

[3] https://www.indexmundi.com/peru/demographics_profile.html

Today's rather dysfunctional party politics and fragmented Congress heighten concerns of a relapse to its dark ages. People are growing wary of political dillydallying. A spirit of political unity for a common goal of social homogeneity is lacking. Rather than working together to build on Peru's success story, political opponents are stuck crossing swords in proffering different views, propelling, therefore, a political, social and economic stalemate. What is more, Peru's population distribution works in favour of such a stalemate because it naturally erases the memory of the country's recent past and devastating problems, allowing for a possible repeat of its traumatic past.

What's next

Peruvians have a responsibility to both themselves and their country, not to neglect their turbulent past and the success of their achievements.

They need to:

- Retain the openness of their economy
- Build on the property rights registry reforms to widen the transformation of the informals and adjust new, appropriate innovation on technology.
- Create and build technology and innovation ecosystems through investments and incubator outlets. This will attract specialized FDI, capital inflow, specialised knowledge for the creation of new types of sectors.
- Simplify its public sector service process delivery focusing on reforming the Judiciary. (Peru's political leadership must be daring in undertaking bottom-up reforms.)
- Introduce innovative digital technology and methods only after successfully reforming and simplifying bureaucracy involved at each service provision.

Whoever is elected should lead a vision of turning the country into Latin America's innovation incubator. This will keep Peru on the edge of novelty, inspiring its population and most importantly its youth.

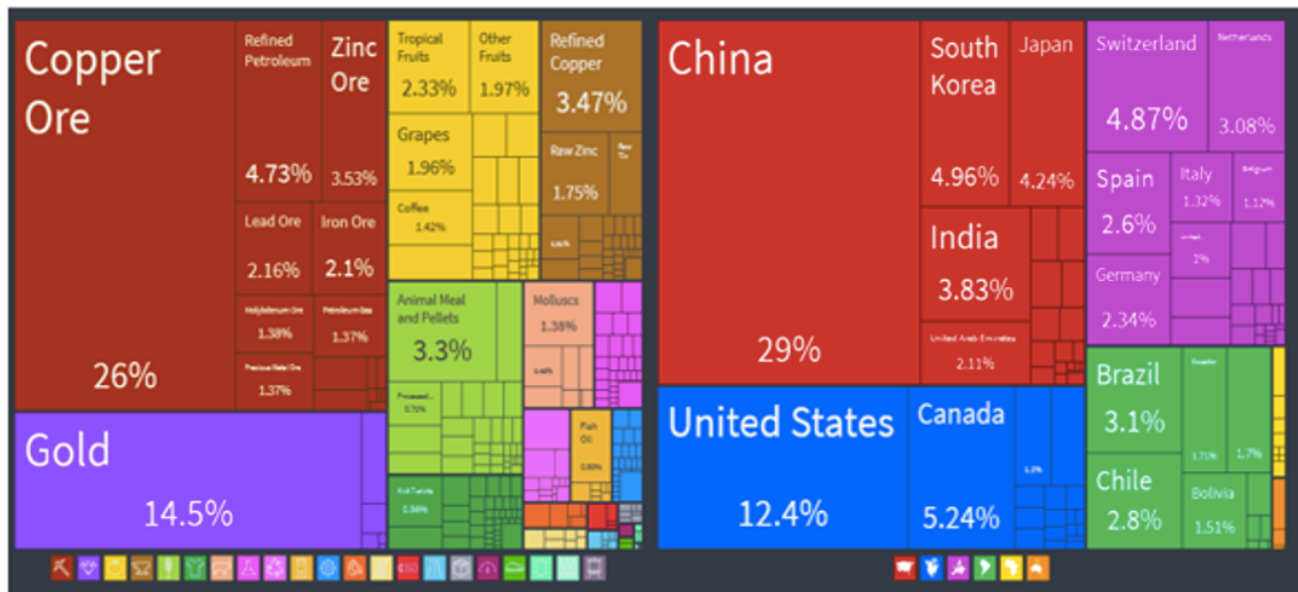
Thought For Action, advises of the need for a significant push on all types of innovation allowing for greater changes in new sectors, giving outlets to greater employment. Peru's political leadership must be daring in undertaking bottom-up reforms, starting from the public sector and the judiciary. Most importantly, though, it should be looking at creating a new vision people want to be part of: innovation in government and public sector involving technology.

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Additional information on Peru trade

Peru Exports \$46.8 Billion (2019)

Destinations \$46.8 Billion (2019)



Source: OEC 5/31/2021

