Poverty Profile
Peru
(Executive Summary)

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In 2006, almost half the Peruvian population was under the poverty line. Although we must account for the fact that a series of changes have been introduced in the sampling framework comparing figures over time, the national poverty rate can be seen to have deteriorated in the second half the 1990s and improved after 2001. It is possible to say, however, that the level of improvement after 2001 is not as much as the level of the deterioration before that. In rural areas and the Sierra, poverty rates are higher, access to basic infrastructure, education and primary health care is less than it is in the rest of the country. As for the work of the poor, the proportion of employment in agriculture and the informal sector is higher than the non-poor. It is also necessary to pay attention to the fact that women and the Indigena poor have less access to several public services than the rest of the poor.

When we examine determinants of poverty at household level, education levels of the household head and access to public services are related to poverty. At regional and departmental levels, the key factor of poverty is the industrial structure, with agriculture as the major industry and a large number of informal enterprises. At national level, the main determinants of chronic poverty are informal economic activities originated from the rigid economic and social system in urban areas and low agricultural productivity and limited access to non-agricultural income sources in rural areas. In addition, the main determinant of transient poverty, especially in rural areas, is the impact of natural disasters.

### 1.1. Measuring of Poverty and Inequality

There exist two household surveys to obtain data for poverty and inequality in Peru, the National Household Questionnaire Survey (ENAHO: Encuesta Nacional de Hogares) administered by the National Institute of Statistics and Information (INEI: Instituto Nacional de Estadística e Informática) and the National Survey on Living Standards (ENNIV: Encuesta Nacional sobre Niveles de Vida) administered by the Instituto Cuanto. The ENAHO provides continuous annual data, while the ENNIV provided its last data in 2000. For the sake of the examination of time-series poverty rate trends over the 1997-2004 period, it is appropriate to refer to the data of poverty assessment (“Opportunity for All: Peru Poverty Assessment” of year 2005, hereinafter referred to as “Peru: Poverty Assessment”) in which the World Bank, calculated the ENAHO data with some necessary adjustments. This report, therefore, bases its analysis mainly on the adjusted figures by the World Bank for 1997-2004, while referring to ENAHO data analysis by the INEI for 2004-2006.

#### 1.1.1. Poverty Line

The ENAHO defines the poverty line as “a minimum expenditure deemed necessary for an individual in order to obtain all the goods and services which satisfy his or her basic needs”. The poverty line (total poverty line) is the aggregation of food expenditure (an extreme poverty line that is calculated based on a minimum daily caloric intake) and non-food expenditure. In Peru, respective poverty lines are calculated for urban and rural areas and each region, such as the Costa (Coast), the Sierra (the Andes) and the Selva (Jungle). According to INEI, the national poverty line was calculated as 202.5 nuevos soles in 2004, while the extreme poverty line was calculated as 113.2 nuevos soles (i.e. 56 percent of the poverty line). The proportion of extreme poverty line to poverty line, however, varies across regions from about 44 percent (the Metropolitan Lima) to 63 percent (the Selva). In comparing poverty rates over time, we must account for the fact that the ENAHO has introduced a series of changes in sampling framework since 1997.
1.1.2. Poverty

In 2004, 51.6 percent of the Peruvian population (approximately 27 million) was under the poverty line and 19.2 percent was under the extreme poverty line. While the national poverty rate deteriorated during 1997-2000, it gradually improved after 2001. Extreme poverty particularly declined during 2001-2004. It is, however, possible to consider that the level of decline in poverty rates after 2001 was not far over the level of increase before 2001, while the data for 1997 and 2001 onwards cannot be compared simply due to large difference in sampling method. It can be at least seen that there was no dramatic progress in reducing poverty rates in the last decade.

The poverty rate in rural areas is well over the same in urban areas. According to the INEI estimates, 69.3 percent of the rural population was under poverty lines in 2006, compared with 31.2 percent in urban areas. This means that the estimated number of the rural poor was 6.8 million, while the number of the urban poor was 5.7 million. Poverty rates increased in both urban and rural areas from 1997 to 2000, after which the rural poverty rate, especially the extreme poverty rate, declined from 2001 to 2004. From 2004 to 2006, the urban poverty rate showed a downward trend while the rural poverty rate did not change to any great extent. With respect to the poverty gap, rural areas show a larger poverty gap and a larger squared poverty gap than urban areas. This implies that the poverty situation in rural area is severer than the one in urban areas and that inequality among poor households in rural areas is higher than the ones in urban areas.

At the regional level, the poverty rate is the lowest in Metropolitan Lima (36 percent) and the highest in the Sierra (67.7 percent). In terms of distribution of the poor population, the Sierra has approximately 50 percent of the poor and 70 percent of the extreme poor of the country. At the departmental level, the six departments of Huancavelica, Huanuco, Puno, Apurimac, Ayacucho and Pasco in the Sierra exhibit the highest poverty rates at more than 70 percent. It was estimated in 2006 that Lima, which presents a lower poverty rate, had the largest number of poor (approximately 2.25 million including Callao), followed by Puno (approximately 1.02 million) and Cajamarca (approximately 1 million). On the other hand, Madre de Dios has the smallest number of poor (approximately 20 thousand), followed by Tumbes (approximately 30 thousand) and Mosqueta (approximately 40 thousand). While Huancavelica has the highest poverty rate, it ranks at 14th among all departments in the number of the poor population (approximately 430 thousand) due to the small size of its total population.

Although the figures for the past ten years are not easily comparable, most departments seem to have made no drastic changes in reducing or increasing the poverty rate. In recent years, the Metropolitan Lima and the Urban Costa showed some improvements in poverty rates, while the poverty rate almost stalled in the Rural Costa, the Sierra and the Selva. During 2001-2004, poverty rates declined in such departments as Ayacucho, Apurimac, Cuzco and Cajamarca, which are among the poorest departments in the country. During 2004-2006, however, poverty rates slightly increased in Apurimac, Ayacucho and Huancavelica.

1.1.3. Inequality

In 2004, the expenditure-based Gini coefficients estimated by the World Bank were 0.43 at the national level, 0.40 in Metropolitan Lima, 0.39 in other urban areas and 0.32 in rural areas. It means that the inequality level is slightly higher in urban areas than in rural areas. (In the Gini coefficients, Peru ranks 100th among 124 countries in the world and fifth among the nine countries in the Latin America.) During 2002-2004, inequality as measured by the Gini coefficients was seemed to be improving at the national level as well as in rural and urban areas. Moreover, the Gini coefficients also decreased during 1997-2006 throughout the country. Particularly in rural areas, it declined from 0.34 to 0.29. It can be that, in the long term, rural inequality among the entire rural population, including the non-poor, has improved.
**1.2. Poverty in Non-economic Dimensions**

INEI uses two alternative measurements besides household income (expenditure) poverty; the Unsatisfied Basic Needs (UBN) index and the caloric deficit. This section examines poverty in non-economic dimensions with the above indicators, as well as other indicators of access to basic infrastructure and social services.

### 1.2.1. Satisfaction of Basic Needs

The UBN index measures the fraction of the population subject to certain deficiencies with five types of household-level situation: (i) characteristics of the dwelling, (ii) overcrowding, (iii) degree of access to basic sanitation services, (iv) the presence of children of schooling age currently not attending school, (v) the household dependency rate. The national UBN index (at least with one unsatisfied indicator) declined from 56.8 percent to 40.3 percent during 1993-2003. These figures that have improved, however, mask a variation of poverty levels and poverty factors across households.

The caloric deficit measures the fraction of the population living in households where per capita caloric intakes are insufficient to satisfy minimum caloric needs. During 2001-2004, the nutritional status of the rural population measured by the caloric deficit improved, while the proportion of the urban population with inadequate caloric intakes increased.

### 1.2.2. Access to Basic Infrastructure

Access to public services, such as water, sanitary services and electricity, in rural areas is lower than in urban areas, and the access is more limited for the poor than for the non-poor. In rural areas, access of individual households to those services is less than 50 percent, even for the non-poor. The rural poor are also less likely to have access to surfaced roads than the rural non-poor. This appears to be a constraint to the mobility of the rural poor. In other words, less connectivity of the rural poor to such places as markets, schools and medical facilities results in less opportunity for business and social services.

### 1.2.3. Employment

More than 50 percent of the poor make a living mainly by the primary sector (agricultural activities), while about 30 percent are engaged in the secondary sector (the service sector). The majority of the rural poor are small-sized farmers or day laborers. Their employment status is usually self-employed or family laborers without a wage. The poor are employed in the informal sector in many cases.

The 25-44 year age group, a generation that is supposed to be primarily engaged in any work, accounts for 37 percent of the working-age poor, followed by the 14-24 year age group that accounts for 32 percent. In Metropolitan Lima, the proportion of women of the working-age poor is 52.6 percent, compared to 47.4 percent of men. The female poor are more inclined to be employed as unskilled service workers than the male poor. For the female poor, non-qualified labor in agriculture, livestock production and fishing account for 40 percent. Since the employment status of the majority of the female poor is self-employed or family laborers without a wage, gender inequality in employment opportunities can be observed.

### 1.2.4. Education

The illiteracy rate of the poor is higher than that of the non-poor. The female poor and the poor in rural areas and the Sierra show higher illiteracy rates than men and the poor in other regions. 60 percent of the female poor, 70 percent of the rural poor and 60 percent of the poor in the Sierra have education at primary level. While primary school gross enrollment rate was
more than 90 percent in 2004, regardless of region and sex, primary school net attendance rate (the share of children of primary school age who actually attend primary school) was 40 to 50 percent for the poor, compared to 50 to 60 percent for the non-poor. In addition, the poor show a higher percentage of repeaters (or any delay in school enrollment, including other causes) and dropouts than the non-poor. The percentage of repeaters in primary school for the rural poor was as high as approximately 40 percent. Average attendance years for girls are less than those for boys. In addition, it is reported that many children who almost complete primary education still do not have enough ability in reading, writing, and so on. It can be concluded, therefore, that Peru needs to improve the quality of education and the education environment for the poor, especially for poor girls. For secondary education, the problem of access should be solved first since secondary school enrollment varies significantly across regions.

1.2.5. Health

The pregnant poor are less likely to give birth attended by skilled personnel, and infant and under-5 mortality rates for the poor are higher than for the non-poor. In the health sector, significant inequality among different income classes is recognized. Only 28.1 percent of the pregnant extreme poor give birth attended by skilled personnel, compared with almost 100 percent for the pregnant wealthy. This means that the poor face a high risk of death during childbirth. The infant mortality rate for the extreme poor is as high as 46 per 1,000, compared with 6 per 1,000 for the wealthy. There has been no significant progress in reducing malnutrition of children since 1997. The poor also have higher mortality rates of prenatal diseases and infectious diseases than the non-poor.

This serious health situation of the poor can be attributed to less access to medical facilities. Accessibility to health services for the poor includes physical problems of distance and transportation to medical facilities and economic problems of cost for the receiving of proper treatment. In order to improve health indicators of the poor, multi-sectoral measures are required with consideration of improvement of the residential environment, particularly access to safe water, as well as the dissemination of education for health and disease prevention.

1.2.6. Financial Service

The majority of the poor are employed in small, informal businesses. According to the “Peru Poverty Assessment” by the World Bank, in urban areas, access to, and the cost of, credit are more commonly identified as main constraints to business expansion in small-sized firms (with 10 or fewer employees) than in medium and large-sized firms. Access to credit by rural firms is likely to be further limited. Only five percent of rural firms declared that they had access to credit in the last 12 months. According to the Ministry of Labor and Promotion of Employment, the financial institutions, from which micro and small firms take loans, are limited to three, including the Peru Credit Bank (Banco de Crédito del Perú). Access to credit by micro and small enterprises with hardly any formal assets is restricted by difficulties in guarantee requirements.

1.3. Determinants of Poverty in Peru

1.3.1. Key Factors of Poverty at Household Level

Out of the total expenditures of poor households, the proportion of non-monetary expenditure is higher than monetary expenditure. This pattern is more distinct in the rural poor. The proportion of non-monetary expenditure of rural poor households, at 50 percent, is significantly high, compared to 34.2 percent which is the national average. Per capita income per month for the rural poor is less than half that for the non-poor. While the majority of the rural poor are
day laborers or self-employed farmers with small quantities of land, non-waged agricultural monthly income per capita generated in such non-salaried agricultural activities is only 109.7 soles for the extreme poor and 199.1 soles even for the poor (excluding the extreme poor), which is significantly low compared to other income sources. Although non-agricultural salaried income is higher than other income sources, the rural poor have less opportunity to obtain this due to such factors as limited access to towns.

According to the “Peru Poverty Assessment” by the World Bank, households with the following four characteristics are more likely to be poor; (i) larger households, (ii) a larger number of dependants per income earner, (iii) lower levels of education of the household head, (iv) limited access of the household to public services. With regard to employment, unemployment of the household head or informal employment correlates with poverty in urban areas, while in rural areas, employment in agriculture of the household head correlates with poverty. It can also be seen that the lower the income quintiles that the poor belong to, the higher the informal rate of the poor becomes. For instance, the informal rate of the extreme poor amounts to 90 percent. Although the World Bank “Peru Poverty Assessment” does not refer to a correlation between the female household head and poverty, women receiving a lower level of education and employed in agriculture are likely to obtain no monetary reward.

1.3.2. Key Factors of Poverty at Regional and Departmental Levels

The UNDP’s Human Development Index (HDI) for Peru was 0.598 in 2005. (In 2004, Peru was positioned 82nd among 177 countries in the HDI). When we calculate the HDI for each department and divide the country into three groups (i.e. the highest 8 departments, the medium 9 departments, and the lowest 8 departments), no significant change in ranks is found during 2001-2005, particularly for the highest and the lowest groups, although there are some small exchanges.

Analysis of the correlation between industrial structure and poverty at departmental level shows that departments wherein agriculture is the major industry tend to show comparatively higher poverty rates. Analysis also shows that departments with a higher informal rate of employment and a larger number of micro and small businesses tend to show higher poverty rates.

Departments with higher poverty rates also tend to have a lower index of social development and less access to infrastructure. Furthermore, such departments as Huancavelica, Cajamarca and Amazonas with the presence of a larger rural and “Indigena” (Indigenous) population have rather higher poverty rates. These correlations, however, may hide inequality, geographical diversity and variety of social conditions within a department.

1.3.3. Key Factors of Poverty at National Level

It is important to analyze poverty dynamics over time when examining poverty and considering policy interventions required at the national level. An analysis of dynamics includes discernment of whether the movements are permanent or temporary and whether the resultant poverty is chronic or transient. According to a study based on the time-series panel data of the ENAHO, the proportion of the poor for whom the duration of spells of poverty is more than one year was estimated at 67 percent during 1998-2001 and 68 percent during 2001-2004. If we define the chronically poor as those for whom the duration of spells of poverty is more than four years, the proportion was estimated at 25 percent during 1998-2001 and 28 percent during 2001-2004. If we define the transient poor as those for whom the duration of spells of poverty is less than four years, the proportion was estimated at 43 percent during 1998-2001 and 39 percent during 2001-2004.
(1) **Determinants of Chronic Poverty**

As we have discussed above, informal employment is one of the key factors of poverty at household level throughout the country. In Peru, approximately 53 percent of the working population (12 million) was employed in micro enterprises having 2 to 9 employees in 2002, out of which 92 percent was estimated to participate in informal activities. The average income per month obtained from informal micro enterprises is one fourth of that obtained from formal enterprises and less than half the national minimum wage.

One of the determinants of chronic poverty for the urban poor is participation in informal activities. Relying on informal sector economic activities can create a higher poverty risk, through lower income, unstable status, and lower access to social protection. The main determinants of participation in informal activities are as follows: limited formal economic opportunities, low educational level, and demographic characteristics (i.e. female household heads are more likely to be engaged in informal sector economic activities). The World Bank “Peru Poverty Assessment” indicated that recent economic growth in Peru has not translated into better employment and has not increased formal employment creation for the poor due to labor legislation offering high level of protection to workers. It can be said that such excessive rigidity of economic and social structures is one of the key factors of poverty.

The rural poor derive most of their income from agricultural activities. Determinants of poverty for the rural poor are dependence upon a single source of income and low agricultural productivity. The majority of the poor in the Sierra rely upon small plots of un-irrigated farms with low productivity. According to the “Peru Poverty Assessment” by the World Bank, the education level of the household head and access to basic services such as electricity are positively correlated to access to non-agricultural income sources and productivity of agriculture. Other determinants of agricultural productivity are possession of the land title and access to services such as technical assistance and credit. In rural areas, it can be inferred that the lack of all these factors constrains the improvement of agricultural productivity, which in turn results in the situation of the chronically poor. In addition, poverty reduction strategies in rural areas require a consideration for the Indigena, since the rural poor involve a large Indigena population. The Indigena poor have less access to education, health care and basic infrastructure than the non-Indigena poor.

(2) **Determinants of Transient Poverty: Risks and Vulnerability**

According to the “Peru Poverty Assessment” by the World Bank, poor households in Lima and other urban areas are more vulnerable to economic shocks (such as the loss of employment of the household head) than the rural poor. Poor households have fewer ways of overcoming the impact of shocks, because they have less existing savings and assets than the non-poor. In rural areas, on the other hand, the impact of natural disasters is related to transient poverty. The rural poor are very vulnerable to the influence of natural disasters since they are mainly employed in agriculture. Reduction in agricultural income through the loss of crops and damage to houses, health influenced by abnormal weather, flooding and earthquakes, brings about transient poverty.
Chapter 2  Poverty Reduction Efforts and Performance of the Government of Peru

2.1. Policy Framework for Poverty Reduction

2.1.1. General Conditions

Alejandro Toledo was sworn in as Peru’s president in 2001 succeeding Alberto Fujimori who was elected to the presidency in 1990 and who had served three terms in office over a period of a decade. Toledo’s Government, pledging “poverty alleviation”, “employment creation” and “anticorruption”, basically adhered to the policies of his predecessor and succeeded in macro-economic stabilization. The government, however, failed to deliver real results in expanding employment opportunities and alleviating poverty, and in 2006, Alan Garcia was elected to the new presidency. From the Garcia period on, Peru’s GDP growth rate has reached its strongest in the past at 8 percent. Stability of other macro-economic indices has been also delivered.

Analysis of Peru’s economic structure shows that the service sector is the largest sector, contributing 38-39 percent of the GDP. Combined with the commercial sector, the proportion amounts to more than 50 percent. This means that the tertiary industries account for the largest proportion in Peru. This is followed by the manufacturing sector, accounting to approximately 20 percent, and the agriculture, livestock and forestry sectors accounting to 8-9 percent, which is below 10 percent even in combination with the fishery sector. No significant change has been observed in this proportion in the last decade. Analysis of real GDP growth rate by sector indicates that, despite the negative or decelerated growth of the country as a whole during 1998-2001, the manufacturing and services sectors held the decline to a minimum and quickly recovered. The real GDP growth rate of the primary sector (agriculture, livestock, forestry and fishery), on the other hand, is highly volatile and fluctuates every year. The construction sector has also been experiencing a severe recession due to curtailed public expenditure.

2.1.2. Development Plans and Poverty Reduction Strategies

Putting poverty reduction at the top of the agenda, the Toledo Government developed a “National Strategic Plan” (2001-2006), focusing on “employment creation”, “fight against poverty”, “decentralization” and “modernization of the state”. The “National Plan for Poverty Elimination” (2004-2006) was also further elaborated by the “Inter-sectoral Commission for Social Affairs (CIAS)”, consisting of three pillars and 13 strategic policies: (i) the development of human capabilities and respect of fundamental rights (primary health, food security and nourishment, basic education, basic sanitation, basic justice and security of the civil society), (ii) the promotion of economic opportunities and capabilities (technical capacity, rural development, income improvement, basic housing, electrification, rural roads, telecommunications), and (iii) the establishment of a social safety network (social funds and protection for vulnerable groups). In addition, a common statement called the “National Agreement (Acuerdo Nacional)”, signed by the Government and civil society after democratic dialogue, also included guidelines for poverty reduction. In spite of the development of the several definite plans towards poverty reduction as mentioned above however, the Government could not manage the planning and implementation of definite policies at ministerial level.

While the Garcia government has not continued this kind of development plan and poverty reduction strategy up to August 2007, statements have been made by the President pledging development of “social programme reform”, “declines in poverty rates” and “nourishment of
children” in his public speeches. The Joint Committee for Fighting against Poverty (CCLCP), consisting of representatives from concerned organizations, was established in November 2006, aiming at reducing extreme poverty and improving chronic infant malnutrition. Furthermore, the “Multiannual Macro-economic Framework (MMM)”, published by the Ministry of Economy and Finance at the end of May 2007, indicated a scenario for poverty reduction. The social programme reform is aimed at a substantial cutback of the existing 82 programmes and harmonization among the programmes. The “household targeting system (SISFOH)”, introduced by the Toledo Government, still continues. In order to achieve the MDG goals and poverty reduction targets stated in the “National Agreement”, the aim of the social programmes was set out in the MMM as improving the main social indicators especially focusing on rural areas. The MMM has also set national targets to be achieved by 2011 to decrease poverty rates to 40 percent, reduce the chronic infant malnutrition rate by 5 points, and reduce the infant mortality rate from 24 to 20 per 1,000.

2.1.3. Major Programme for Poverty Reduction

The Garcia Government continued poverty reduction programmes from the Fujimori and the Toledo administrations, while implementing a mechanism for the programmes which has been changed following the trend of decentralization.

Multi-sector Programmes

One of the multi-sector programmes is the “JUNTOS Programme”, under the Ministry of the Presidency, for health, nutrition, and education. The “Social Development Cooperation Fund (FONCODES)” is another multi-sector programme that provides supports for the development of small-scale social and economic infrastructure and productive activities for obtaining sustainable income. Currently, the implementation, operation and maintenance works of FONCODES are under decentralization to local governments.

Sector-wise Programmes

Social Services

The Toledo Government aimed at providing quality education services based on the decentralized management model for primary and secondary education, and built on the “National Plan for Education for All (Plan Nacional de Educacion para Todos) 2005-2015” as a long-term policy. In order to increase the literacy rates of Peru, the Ministry of Education has implemented the “National Programme of Literacy (PNA)” since 1990s. Currently, the “National Programme of Mobilization for Literacy (PRONAMA)” for the period of 2006-2011 is under implementation, addressing the needs of 2 million of the illiterate Peruvian population, enabling them to become literate and to learn the fundamentals of arithmetic. Education programmes with a special focus on rural areas and bilingual education programmes for indigenous people also exist. For quality improvement of teachers, nationwide evaluations of teachers in public schools and of national teachers training programmes (2007-2011) are undertaken.

In the sectors of nutrition and health, the Garcia Government continued the “National Programme of Alimentary Assistance (PRONAA)” following the previous government and is further promoting the transfer of the authority for implementation functions to local governments. A new programme named the “Growth Programme (CRECER)” which focuses on children under 5 was also initiated in June 2007. In addition, the Government is expanding the targeted groups of the “National Medical Integral Insurance (SIS)”, originally intended to deliver services to the poor and the extreme poor, to women working in communal kitchens (Comedores Populares) and informal laborers.
**Production activities and the Economic Infrastructure**

Although the Toledo and Garcia Governments have continued assistance for economic activities and infrastructure development for the poor, their sector priorities and focus in connection with poverty reduction are yet to be distinctly announced. This contrasts with the education, nutrition and health sectors to which relatively more attention is paid by the government as priorities. The existing support for economic activities such as agricultural activities and economic infrastructure development for the poor include the following programmes under charge of the Ministry of Agriculture: (i) the improvement of agricultural productivity for mountainous regions with a large number of poor, (ii) sustainable management of natural resources through the “Management of Natural Resources in the Southern Highlands Programme (MARENASS)” and the “National Programme for the Management of Watershed Basins and Soil Conservation (PRONAMACHCS)”, and (iii) the provision of land title. The programmes for the urban poor are as follows: (i) support for micro and small-scale enterprises, (ii) vocational training programmes for women and young people, and (iii) the “Urban Employment Programme (A Trabajar Urbano)” generating temporary employment opportunities for the urban poor. For economic infrastructure, the Garcia Government regards the national programme for water supply as of importance. In September 2006, the President announced the diffusion plan for piped water named “Water for All” aiming at increasing by 2.5 millions the users of piped water by 2011. For rural roads and rural electrification, the long-term plans have been further developed.

2.1.4. **Fiscal Framework and Public Expenditure for Poverty Reduction**

The budget formulation process of the central government starts by conveying an initial ceiling amount from the Ministry of Economy and Finance to each ministry. Each ministry prepares a draft budget of current and capital expenditures, referring to the ceiling. The Congress finally approves the “Budget Act” after reviewing the draft budget. With the current Peruvian decentralization attempt initiated in 2002, the spending responsibilities are shared among levels of government. Expenditures on management of local public services, the development of public infrastructure, the promotion of agriculture and so on are under the exclusive responsibility of the regional (departmental) or municipal governments. Expenditures on education and public health are under the shared responsibility of the departmental and municipal governments. Based on the legal system developed by the Toledo administration, the Garcia administration is promoting the National Public Investment System (SNIP) under decentralization, with participatory budget formulation involving citizens, and a trial introduction of results-based budgeting.

The Peru government has achieved a good fiscal standing and, since 2003, has experienced a budget surplus which is increasing every year. While the overall balance had been in deficit until 2005, efforts to eliminate deficits through higher taxes have materialized in 2006, at once resulting in a surplus equivalent to approximately 4.4 billion soles. The proportion of tax revenue in the total fiscal revenue amounts to 82-88 percent, which has remained almost constant from the 1990s. Of the total fiscal expenditure, on the other hand, the proportion of current expenditure has gradually increased from 79 percent in 1997 to 85-87 percent from 2000 onwards. The proportion of capital expenditure has gradually declined since 2000 and amounts to approximately 14 percent in 2006, compared to 28 percent in 1999. The stagnation of capital expenditure from 2000 implies that the government could not cope with strong demand for infrastructure investment.

The share of social expenditure including that which is pro-poor has been approximately 50 percent of the total fiscal expenditure since 2003 and is inclined to slightly increase. The proportion of social expenditure to GDP is 8-9 percent, which has been constant compared to the scale of the economy. Of total social expenditure, the proportion of expenditure on the education and health sectors, at above 40 percent, is the largest. During 2003-2007, the annual
budget for social expenditure increased by 43 percent at nominal value (above 30 percent at real value in consideration of 8 percent inflation). The share of poverty reduction programmes for the extreme poor within social expenditure increased from 12.5 percent in 2003 to 14 percent in 2007. Out of the total social expenditure for the extreme poor, expenditure on the FONCODES is the largest, as of 2006, followed by the “Glass of Milk (Vaso de Leche)”, the “National Programme of Alimentary Assistance (PRONAA)”, the programme for drinking water and sanitation in the care of the Ministry of House, Construction and Sanitation, and the programmes in the care of the Ministry of Health. For the programme for drinking water and sanitation and the JUNTOS Programme of the Council Presidency of Ministries, an increase in expenditure is expected in 2007.

As we have discussed above, pro-poor expenditure is prioritized by the government. The problem is that Peru could and should achieve a better outcome with the amount expended. For example, educational shortcomings such as the poor ability to read and understand and poor arithmetic ability are relevant in terms of the poor quality of education services, and these need to be improved. It is also necessary to clarify the effectiveness of rising current expenditure in social expenditure, and to solve the problem of capacity limitations in executing spending for the programmes in accordance with the original plans. In addition, on average, it is estimated that 30% of social programme beneficiaries are non-poor and more than 70 % of the poor are non-beneficiaries. This implies there are some problems in the selection method of beneficiaries.

2.2. Capacity for Poverty Reduction

Currently social programme reform by the central government, including improvement of programme management, is under way. It has been recommended that a restructure of 86 ongoing programmes into 26 takes place, in accordance with the priorities and strategic goals of the PNSP. It is estimated that social programme reform will contribute to automatic fiscal savings of 350 million nuevos soles. Reform also means the introduction of results-based budget management and participatory planning and monitoring system by citizens to the resource allocation process. These efforts indicate that the Government is trying to create full transparency and efficiency in their execution of programmes. Social programme reform should be accompanied not only by a reduction of the number of programmes through merging and closing, but also by an improvement of programme contents, resource allocation and expenditure that could enhance poverty reduction outcomes and narrow the regional gap.

The Garcia Government implemented a “decentralization shock” policy for the immediate transfer of authorities to departmental and municipal governments and an “investment shock” policy for the rapid increase in public investment. At the same time, the SNIP reform is under way although its tangible outcomes are yet to be recognized. In order to promote public investment, the Government allocated a supplementary budget equivalent to about 1.9 billion nuevo soles to nearly 800 social investment projects. The average budget enforcement rate was 43 percent of the total amount as of March 2007, half a year after allocation. The health sector, however, exhibited only 17.3 percent and the education sector as low a figure as 19.4 percent of the planned amount. Measures to promote budget enforcement must therefore be considered. The SNIP reform also faces the problem of the low quality of responsible civil servants who are inexperienced in project management. This means that further efforts are required to strengthen the administrative capacity of local governments. Furthermore, it is important that the recommendations of the Joint Committee for Fighting against Poverty (CCLCP) and the outcomes of the household targeting system (SISFOH) are continuously reflected into effective planning and implementation of poverty reduction programmes.

While departmental and municipal governments can collect their own taxes, most of their
revenue accrues from central government transfers which amounted to 64 percent in 2005. Forty-one percent of the central government transfers is to fund municipal compensation (FONCOMUN) and for social programmes such as the “Glass of Milk”, while 23 percent is from shared-tax revenue for natural resources (such as mines, petroleum, water power and gas) known as the Canon.

An analysis of the fiscal stance of local governments during 2000-2006 shows that local current revenues grew from 3,600 million nuevo soles (1.9 percent of GDP) in 2000 to 7,800 million soles (2.6 percent of GDP) in 2006. Despite the fact that the primary balance as well as the overall balance fluctuates across fiscal years, there has not been a deficit as a whole except for 2001. Approximately 30 percent of local governments, however, fail to achieve the minimum level of fiscal indicators established by the Law of Fiscal Responsibility and Transparency. This implies that fiscal management ability varies across local governments.

While the tax revenue known as the Canon has increased in recent years, the poor departments do not necessarily benefit from the tax revenue increase since it more is transferred to departments with a larger amount of natural resources. On the other hand, the average of per capita local fiscal expenditure (year 2007 budget) of the rich departments (Lima, Callao, Tacna, Arequipa, Moquegua and Ica) with a low index of human deprivation is almost twice of that of the poor departments (Huancavelica, Huanuco, Cajamarca, Apurimac and Ayacucho) with a high index. Although the fiscal transfer system from the central government to local governments gives certain consideration to poor departments, further optimization is required for intergovernmental fiscal transfer.

Under decentralization, on the other hand, the transfer of authority to local governments is progressing with social programmes such as the FONCODES and the PRONAA. Considering the fact that the progress of the FONCODES varies across regions and that each community used to have an autonomous body for implementation of the FONCODES, it is necessary to verify the present state of implementation, operation and maintenance by the local governments which are now responsible for them.

### 2.3. Progress of Poverty Reduction

#### 2.3.1. Achievement of MDGs

The Millennium Development Goals (MDGs), a set of eight goals for the eradication of poverty and hunger, education, health care, gender, environment and global partnership in terms of poverty and hunger, are to be accomplished by 2015. We examined “The MDGs Country Table” of the World Bank and the “MDGs: Progress Report” (2004) of the United Nations, and assessed the progress Peru has made towards achieving the set of eight goals and the likelihood of target attainments.

**Goal 1**
For “the alleviation of extreme poverty and hunger”, poverty rates have declined since 2000. At the rate of progress during 1990-2005, however, Peru has difficulty to achieve the target of reducing poverty rates to 27.3 percent and extreme poverty rates to 11.5 percent by 2015. The “proportion of children under age five who are underweight” has improved from 10.7 percent in 1990 to 7.1 percent in 2001. Peru is on track to achieve its target to reduce the proportion to 5.4 percent by 2015 assuming the current political support for improvement is continued.

**Goals 2-6**
Regarding the indices of education, health and gender, many of these are seen to be improving. There is, however, a difference in data for health related indices between international agencies and the Peruvian institutions. It is thus necessary to clarify factual information.
For “net enrollment ratio in primary education” (Goal 2), Peru progressing. As of 2005, the “literacy rate of 15-24 year-olds” was 97 percent, the “proportion of students who reach 5th grade” was 90 percent, the “primary education completion rate” was 100 percent, and the “net enrollment ratio for basic education” was 97 percent. It can be seen that, for access to primary education, Peru shows a high level of achievement towards its goal of 100 percent in 2015.

For indicators of educational opportunities, out of four targets for “gender equality” (Goal 3), Peru has either already met or is on track to achieve its targets. For gender equality in employment and politics, Peru has not indicated a particular numerical target. Peru is, however, considered to be lagging behind in these issues, compared to those of gender equality in education.

Health indicators (Goal 4-6) are follows. Since 1990, the “under-five mortality rate” and the “infant mortality rate” have significantly improved. In addition, target figures for “births attended by skilled health staff” and the “incidence of tuberculosis” are increasing, although Peru has made almost no progress in “measles immunization” and “tuberculosis cases detected under DOTS” in recent years.

Goal 7-8
Access to water, sanitation, communication infrastructure such as telephone and internet connections is improving. “Per capita aid” has tended to decrease, while “debt service to exports” is increasing due to the increase in external borrowing since 2000. The unemployment rate of young people was as high as more than 20 percent in 2005, and, thus, requires public intervention.

2.3.2. Economic Growth and Poverty
According to the “Peru Poverty Assessment” by the World Bank, the relationship between growth and poverty is relatively weak in Peru, although economic growth in Peru from 2001 has translated into a decline in poverty rates. The assessment report concludes that one of the factors in the weak relationship is as follows: since economic growth was biased towards the mining sector with a high capital intensity and therefore has been slow to translate into higher employment, it could have only a limited impact on the poor.

According to the results of a simulation exercise in the assessment report, the translation of economic growth into poverty reduction requires: (i) 5 percent economic growth to be maintained, (ii) the penetration of growth effect into rural areas, (iii) growth in the commerce and agricultural sectors, and (iv) the redistribution of income by means of changes in taxation rates in combination with economic growth. Results from a simulation analysis by the Ministry of Economy and Finance shows that an annual economic growth rate of 7 percent is required for the achievement of the MDGs.

2.3.3. Infrastructure Development and Poverty
An examination of the impact of public investments on basic infrastructure and social services on household income shows that public intervention provides a certain increase in the household income of the poor, although they tend to benefit the non-poor more than the poor. While the impact on income of increased access to public phones, primary and secondary schools and sewerage is particularly greater for the non-poor, no significant difference is recognized between the poor and the non-poor with respect to the impact of increased access to main roads.

2.3.4. Past Results of the Government and Future Policy Implications
To cope with criticism that the achievement levels in poverty reduction and that decreases in the numbers of underweight children are inadequate, the Garcia Government decided to decrease
poverty rates to 40 percent by 2011 and to reduce the proportion of underweight children by 5 points. It is necessary for the Government to make further efforts in achieving these targets.

The following are suggestions to the Government for attaining to the targets: (i) the establishment of a proper targeting system for the poor, (ii) the execution of basic system reform for the major sectors (especially the education sector), (iii) efficient implementation of restructured social programmes, (iv) the formulation and implementation of the national plans under political leadership. All of these should be undertaken with harmonization between programmes to enhance the synergistic effect.
Chapter 3 Partnership for Poverty Reduction

3.1. International Donors

The disbursements of net official development assistance (ODA) received by Peru fluctuate between 390 million dollars and a little less than 500 million dollars during 1997, in which major multilateral donors such as the IMF and the World Bank resumed their loans to Peru, up to 2005. Net ODA disbursements in 2005 were approximately 400 million dollars. The proportion of the net ODA disbursements to GNI, which is 0.5 percent at the average level of Lower Middle Income Countries, has tended to decrease in recent years due to the favorable performance of the economy. Analysis of the distribution of ODA received shows that grant assistance accounts for a great majority of the total amount of ODA compared to loans. This also indicates that bilateral ODA received from DAC countries account for about 78 percent of the net ODA disbursements. The United States, Japan, Spain, EC and Germany are the major high-ranking donors.

The net ODA disbursements received from Japan reached their peak of 190 million dollars in 2000, at the time of the Fujimori administration. The amount was, however, limited to 43 million dollars in 2005, and no new yen loan project commitments were made until 2006. The United States has been the largest donor for Peru since 2001. Spain is also one of the main donors of ODA, with its emphasis placed on private investments. Many donors, like Sweden, the United States, Spain, Belgium, France and Japan, focus their assistance on social infrastructure. Japanese aid is characterized by its focus on economic infrastructure together with social infrastructure.

A comprehensive framework of donor coordination with a high level of participation has not existed, mainly due to the low degree of dependence of Peru on ODA assistance. The Peruvian International Cooperation Agency (APCI), established in 2002, aims to shoulder the responsibility for donor coordination and harmonization. Donor coordination is, however, not yet actively promoted for enhancing the aid effectiveness in poverty reduction. For the sake of necessity, donor coordination in certain sectors has continued, such as in the water sector.

3.2. Civil Society and NGOs

In Peru, civil organizations including Non-Government Organizations (NGOs) and Community-based Organizations (CBOs) have played an important role in poverty reduction, complementing the government or even acting on behalf of the government. While NGOs have been commonly registered as legal entities (Registro Público), there has been no obligation to register NGOs for international cooperation. APCI, since its establishment, began to verify all grant assistances including NGO activities, and consequently identified that many projects are delivered by NGOs, and has recognized the necessity to monitor those operations. The so-called “NGO Bill” was correspondingly approved in Congress in December 2006. The law made it obligatory for all NGOs with funds from the Government or foreign donors to register with the APCI.

CBOs, without a formal definition, are referred to in law as non-profit, independently and privately managed organizations, formed by low-income individuals “to fight their food problems in order to achieve comprehensive human development”. The following are examples of CBOs in Peru; the Communal Kitchen (Comedores Populares) organizations, the Mothers’ Club (Club de Madres) organizations and the Glass of Milk (Vaso de Leche) committees.

Among several domestic NGOs with a nation-wide network, the “Coordination Roundtables for
Fighting Poverty (MCLCP: Mesa de Concertación para la Lucha Contra la Pobreza)” are the ones that extensively institutionalizes citizen participation in poverty-related programmes. The MCLCP, established in 2001 with the approval of the Supreme Decree, devote themselves to equality, including women’s empowerment, citizen participation, transparency and integrity. Having a formed nation-wide organization, the MCLCP earnestly participate in the process of developing social policies and implementation plans for social programmes by the Government and making recommendations that are actually adopted in Government policies.

### 3.3. Private Sector

The privatization of state enterprises and private sector participation in public services has been promoted since 1990, pursuing improvement in the efficiency, revenue collection, and quality of services. There are, however, few cases where design that is pro-poor, such as the introduction of pro-poor tariff systems, is applied.

The Rural Electrification Law, passed in 2006, allowed rural electrification projects to spend one percent of the project cost for education and capacity development of those electricity consumers in rural areas involved in programs for the development of the productive use of electricity. To date, there is no project in which increase in income has been attained through such kinds of programs, although the promotion of the development of private economic activities related to agriculture or other areas is expected. This is then expected lead to increases in income generation opportunities for the rural poor.

Private companies such as mining companies have made social investments in a part of affected or in surrounding communities, including the poor, as one of their CSR (Corporate Social Responsibility) initiatives.