

Peruvian economy and its place in the world economics essay



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Nowadays the world lives the era of globalization, characterized by economy and markets expansion, media, and transportation. With it, a new competitive environment arises, requiring countries to open their economies in order to communicate them with these new markets. Peru, a country located in the western coast of South America, is not the exception. Though, it has significant challenges to face in its economic development.[1]

A country sharply divided in three geographic regions: In the North-west coastal areas contain primary oil deposits. Main traditional agricultural products including cotton, fish, and fruits grow along the Pacific coast. And most mineral resources, that involve approximately half of Peru's exports, come from mines in the Andes.[2]

However, despite this bunch of resources, Peruvian economy is essentially heterogeneous, and markets segmentation is extremely high. This can be attributed to major obstacles, differences and barriers in access to these resources companies need to grow their competitiveness.[3]

This paper covers two main sections. The first one discusses the general elements of the Peruvian Economic Structure, and its current economic status compared to the rest of the world, especially with Latin American countries. Bellow in section two, the role of foreign trade and its influence in the Peruvian economy, including the main economic and trade policies implemented are explained. Finally, the impact of the Peruvians economic performance in its development level, poverty and general population welfare is described.

PERUVIAN ECONOMY AND THE WORLD

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This first section describes Peru's economic structure and its performance, in which heterogeneity has been one of its characteristic features of nearly all its markets and productive sectors. (1. 1.).[4]

Moreover, based on some studies the economic status of Peru in the international economic and trade system, and some recommendations about it, are shown (1. 2.).

PRIMARY ECONOMY: A COPPER AND ZINC COUNTRY?

An easier way to classify productive specialization in Peru is by dividing its GDP into four large economic sectors: extractive or primary activities (agriculture, fisheries and mining); basic transformation or infrastructure (construction); intermediate or industrial transformation (manufacturing); and services (home rentals, government, electricity, gas and water, commerce, among others).[5]

However, albeit most of these sectors have evolved, basically influenced by the expansion of government expenditure, and the enforcement of industrial policies in the mid-1970s, leading to a growth in the manufacturing sector[6], throughout its history, Peru's economy has been characterized by high participation of primary activities, being the world's second largest producer of copper and zinc. These primary activities have influenced in the lowering private per capita consumption, salaries and wages.[7]

According to the CIA World Factbook, in general terms Peru's economy performance during the last eight years has presented some ups and downs:

" For the period of 2002-06 Peruvian economy grew by more than 4% per

year. Growth jumped to 9% per year in 2007 and 2008, driven by higher world prices for minerals and metals and the government's aggressive trade liberalization strategies, but then fell to less than 1% in 2009 in the face of the world recession and lower commodity export prices".[8]Moreover, GDP composition by sector in 2009 was distributed 8. 2% in agriculture, 32. 1% in industry, and 59. 7% in services.

As it can be seen, services entail most of the economic activity in Peru. This can be attributed to the openness in the economy Peru experimented in the 90s, which led a reduction of its primary activities; and the privatization of some industries, giving an extensive investment growth, particular in areas such as commerce, transportation, communications and energy.

Furthermore, as services are activities of " higher quality", standards of living and incomes grew as well.[9]

High Industrial sector profit-earnings capacity makes a country more attractive for FDI and international competitiveness. Peru has low profitability in this sector, due to the bank concentration the country presents. This means, that money costs are higher than other parts in the region, increasing the difficulty of getting credit, which in turn reduce companies profitability.[10]

In a general overview, Peru's rapid expansion in the recent years has helped to reduce the national poverty rate by about 15% since 2002, nevertheless unemployment remains high. Inflation has declined in 2009, to below the Central Bank's 1-3% target. Moreover, despite Peru's strong macroeconomic performance, dependence on minerals and metals (which accounts

approximately 60 % of the export earnings) still subjects the economy to fluctuations in world prices, and poor infrastructure impedes the spread of growth to other areas. Therefore, not all Peruvians share its benefits.[11]

A COMPETITIVE COUNTRY TO WORLD?

A small economy, such as Peruvian, is immersed in the global arena of emergent economies. As it was mentioned before economic primarization has been the way by which the country has participated in the world economy.[12] However, it is imperative to analyse Peru's situation from both, a home based point of view, on the one hand, and globally, on the other.

In a comparative analysis of competitiveness on the Peruvian economy done by Jesús C. Peña-Vinces, in which he compared Peru with other Latin American countries such as Chile, he found that Peruvian economy is more prepare to compete locally, and less attractive to FDI than Chile. This can be attributed to the low macroeconomic stability that the country shows (67 position compared to the world). The study also determined that Peru presents an excessive administrative bureaucracy, and for that reason Peruvian industry has fewer opportunities to offer its products in the foreign markets.[13]

It is then suggested that the government of Peru might to invest in a higher level of computerization, which will let to achieve not only an improvement in education (allowing citizens access to knowledge developed), but also allowing companies, especially small ones, make known their products in global markets.[14]

Moreover, due to the existing high volatility in exchange and interest rates in developing countries, another pattern that allows Peru's international comparison, is analysing the use of derivatives as an instrument of hedging. In a survey designed by Wharton School of Business (University of Pennsylvania) to study and measure the activity of financial derivatives, 1000 largest Peruvian private companies were analysed by their gross revenues. The survey found that most of those firms do not practice a generalized use of derivatives, and moreover, there is a lack of legal and tax regulation framework. In this sense, there are a low percentage of firms and a small traded volume. Therefore, in order to get market development and competitiveness it is necessary to prioritize on the stimulation and enhancement of regulation on financial derivatives use.[15]

However, not all are bad issues. Despite the situations showed above, in 2006 a rapid expansion in the external demand for minerals and other extractive product took place. By lowering tariff barriers and stimulating diversification of non-traditional products, Peruvian exports grew, to the U. S mainly.[16]

INTERNATIONAL TRADE PARTICIPATION AND POPULATION WELFARE

This section, following the structure and performance of Peruvian economy illustrated in section 1, shows the relevance of the foreign trade in the country, highlighting the importance of its relation with China; and the recent implemented economic policies, which has fostered certain key sectors of the economy (2. 1.).

Then, it is important to understand how trade in specific products has impacted either positive or negative the economic growth and standards of living in Peru (2. 2).

2. 1 FOREIGN TRADE AND GOVERNMENT INTERVENTION

Peru's foreign trade has been dominated by an asymmetric relation. On one hand, an increasing demand for sophisticated imported products, technology, and goods with high value component. On the other hand, Peru's conventional exports are based on the use of natural resources, which account almost 80% of total exports, including agricultural, mining and fisheries industries. Thus, Peru pays more for imported goods than what it receives for exports.[17]

Among these factors, Peru's market segmentation is another relevant characteristic of its economy. Meaning that a given policy measure to improve foreign trade has different effects in each segment, therefore the process of adjustment and speed, differ from one to another. Moreover, in order to increase development, economic policies are generally targeted on a country's modern and structured segments. However, in Peru this is not enough. The existence of numerous micro-enterprises, with rudimentary technology, weak management capacity, and unskilled workers, makes economic improvement harder.[18]

Consequently, policies to raise productivity and competitiveness should include potentially competitive micro-enterprises and promote greater access to the resources they need. Thus, it is essential to establish, among other policies, reforms in labour standards and minimum wage, taxation

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regime; and promote policies to improve micro-enterprise access to credit, markets, management training, and innovation.[19]

Another crucial issue is to promote initiatives among Peruvian micro-entrepreneurs to form clusters based on the needs and common goals of their firms. In that way economic development would be easier.[20]

But, is there anything advantageous for Peru? Well, throughout years, China nowadays the second largest economy in the world has had big influence in Peru. A process that started 160 years ago, had led a wide cultural and racial mixture between Peruvians and Chinese, and millions of Peruvian are interested in make business with Chinese entrepreneurs.[21]In fact in 2009 exports estimation to China accounted for 15. 96%, representing the second Peruvian trade partner after the U. S. (17. 86%).[22]Consequently, China represents a big opportunity to Peru to increase its participation in the international trade system, and ensuring somehow its economic stability.

Finally, Peru is in a better position than many of its regional neighbors to face the impact of the global economic crisis, the fiscal discipline displayed by current President García has created substantial room for an aggressive response to it. In December 2008, the government launched a stimulus plan of \$13 billion, to be spent on infrastructure projects, social programs, and poverty mitigation.[23]Furthermore, Garcia's trade and macroeconomic policies are committed to Peru's free-trade path. Since 2006, Peru has signed trade agreements with the United States, Canada, Singapore, and China, concluded negotiations with the European Union, and begun trade talks with Korea, Japan, and others. The US-Peru Trade Promotion Agreement (PTPA)

entered into force 1 February 2009, opening the way to greater trade and investment between the two economies.[24]

2. 2. ECONOMIC IMPLICATIONS ON POPULATION WELFARE

Nowadays, companies are the engine that drives economy of a country, because when they are competitive, also generates better paying jobs, improving country's economy, and increasing people welfare.[25]

A simple way to classify levels of income and standards of living is through economic indicators such as per capita product and consumption, wages, and salaries. Knowing that, in the long-term opening will allow countries to acquire the necessary external competitiveness, promote economic growth and enhance standards of living.[26]

Moreover economic growth and standards of living depend also on the type of activities performed by nations, and on the use and abundance of capital, labour, natural resources and technology as well. Due to the deep-rooted productive heterogeneity of Peru's economy (highly segmented labour market), rapid growth and modernization of certain segments of the economy did not spread as quickly towards other segments, meaning that welfare is not perceives as such by a large proportion of the population.[27]

For instance, in 2006 Peru had a primary goods exports expansion. This led to a rapid growth of economy. However its contribution to total employment growth, and to welfare, was relatively small. This can be attributed also, to the fact that most employment in the country is in very low-productivity jobs,

which didn't see a significant improvement in incomes during the exports boom period.[28]

A second feature that affects negatively the Peruvian economy is the dichotomy in the urban and rural sector. In 2004, the last accounted for 34.5% of the country's total employment, and wage-earnings were just 20.7% of total employment, compared to 50% in urban areas. The next chart shows the problem of low productivity in the rural sector.[29]

The chart indicates that most of economically active persons in the rural region earn less than half of what is needed to buy the basic consumption basket, compared to the coast and Lima (Metropolitan capital).

Thus, it is possible to see that world current economic situation is characterized by markets globalization, technology, and knowledge management, giving emergence to a new competitive environment. Thus, countries have had to open their economies looking for cooperation and deeper interrelation between companies and the market. In Peru case, it must enter in the new global and trade era ensuring the production of those goods and services that will generate faster growth.[30]

As it has been mentioned during this paper, Peru's economic characteristic features includes primarization of economic activities (exporter of raw materials and natural resources), importance of micro-enterprises for employment in the country, few and weak public and private policies, which have been intimately linked to declining standards of living. Therefore, in order to create dynamic competitive advantages in the production of high quality goods, and to improve Peru's standards of living, it is necessary to <https://assignbuster.com/peruvian-economy-and-its-place-in-the-world-economics-essay/>

combine strategic policies and market orientation that will speed up the increase in micro-enterprise productivity and their competitiveness.[31]

Despite the mining exports expansion in 2006, it is also unlikely that this boom, last for many years, because this sector is highly sensitive to developments on external markets. Therefore it is urgent to implement some public policies in favour of other sectors and micro-enterprises.[32] However, according to the IMF, high commodity prices and continued vitality in Asia are expected to sustain exports, representing a good opportunity as was mentioned before to Peru if it can take advantage of its historic relation with China.[33]

Moreover, regardless of the growth in 2006, low productivity of micro-enterprises does not allow them to spend on labour and management training in the same way as larger firms. Among these factors, there were others that explain this mismatch. First, highly unequal access to opportunities; lag with which economic growth affects employment and incomes; and finally the concentration of exports in a relatively small number of firms.[34]

Finally, this paper showed that it is necessary to promote industrialization policies to achieve the long-term economic stability, and to reduce economic primarization index; improving also the standards of living in Peru.