



## **A Basic Income Policy for Peru: Can it Work?**

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## 1. Introduction

Vulnerability to income insecurity, disease, social and political exclusion, violence and crime is the context in which the majority of the people live in many developing countries. In Peru, for example, eight out of ten individuals are poor in rural areas and four out of ten in urban areas. Among the poor, only half of them have running water in their dwellings (one third in rural areas), less than one quarter has a bathroom (two per cent in rural areas), and 84 per cent of residents in their neighbourhoods are in the informal sector (94 per cent in rural areas) (INEI, 2002, p.44 and p.48). Under these circumstances, a universal basic income grant can be an adequate instrument to smooth consumption and distribute some purchasing power to the poor. The shift in effective demand after paying a basic income may have important multiplier effects on small local markets and on the creation of work opportunities. But even if a basic income can be implemented and funded, it would be only one element in an overall development package including major social policies to address very complex issues that include inequity, the high incidence of poverty and sustained economic growth. Guy Standing (2002, p. 205) spells it clearly out: “A citizenship income must not be understood as a panacea. It is only part of a distributive strategy that would be consistent with globalization and flexible product and labour markets. Without other components, it would be ineffectual. And one should think of moving in the direction of citizenship income security, not imagining that such a scheme could be introduced overnight.”

This paper analyzes some opportunities, challenges and ramifications of introducing a basic income scheme and how this instrument can be made appealing using Peru as a case study. The exercise is motivated by the attractiveness a basic income can have in moving societies toward less exclusion and more human security. There are however big obstacles. Opposition from groups whose income could decrease, creation of an incentive to move to informality, confusion and disagreement on what is the adequate monetary value of the basic income, lack of sustainability of the scheme in the medium/long run are only some of the problems that would have to be resolved. The most

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fundamental restriction in Peru's case is inability to fund a basic income for everybody. But there are steps that can be taken to make the idea of a basic income appealing. If shifts in effective aggregate demand have expansionary effects government revenues can increase and fund small grants. Introducing the notion of a basic income in a gradual manner maybe the most convenient way to assess its impact on equity and growth.

## **2. What is a basic income?**

A basic income is “an income unconditionally paid to all on an individual basis, without means test or work requirement” (Van Parijs, 1992, p.3). Combined with the idea that it will meet “basic needs,” the basic income provides a government funded minimum income guarantee that eliminates poverty. Basic needs vary among individuals, therefore legitimate claims on how a person fulfils them - according to one's conception of the good life and one's idea of occupation - should be considered in practice. Every adult receives a basic income at subsistence level that strengthens terms of negotiation of workers with potential employers and it removes the need for minimum-wage legislation deemed to protect workers. Children would receive a smaller basic income that would be paid to one of their parents. Senior citizens would receive a pension that in essence is the continuation of the basic income policy. These cash transfer payments replace any other welfare transfers (social security, social assistance, social funds or any other transfer program employment or non-employment related) and it is funded with a flat income tax on income accrued to work (a decent occupation in Guy Standing's sense). The idea of basic income is based on the state's responsibility to be the guarantor of last resort in fulfilling every citizen's basic needs. The concept has strong legitimacy because it overcomes the major failure of exclusion and poverty that cannot be corrected by automatic market forces. In this sense, a basic income that sets socially desirable fundamental benchmarks can be conceived as a necessary complement to the market economy.

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For its most part, the debate on the appropriateness of introducing a basic income has been largely confined to fully-fledged market economies and developed countries.<sup>1</sup> Important hiatus are the system of “school grants” that poor families in a number of Brazilian municipalities receive - equivalent to a minimum wage - on the condition that they sent their children to school and attempts to incorporate a universal citizens’ grant in South Africa. While there is consensus on the need to eliminate poverty and reduce inequity, analysts and policymakers differ in their views on the adequacy of a basic income to replace employment related and conditional welfare systems or targeted anti-poverty programs. Differences of opinion range from ethical considerations on how to attain a fair and good society to the more nitty-gritty aspects of a basic income policy implementation (the monetary value of the basic income, its funding, attracting international migration, etc.). In the developing world, the introduction of a basic income faces additional challenges and difficulties to the already multifaceted dilemmas. Here, the structural heterogeneity of economies (duality and informality of labour markets), large incidence of poverty, weakness of institutions, and unstable economic growth as well as the politics of macroeconomic decision making makes, I believe, introduction of a universal scheme harder. One way to go about adoption of a basic income policy is to use a gradual approach that begins with the introduction of programs such as the “school grant” and moves steadily toward a universal basic income scheme. The Brazilian grant is a non-universal and conditional version of the basic income, and rightly so, it may be an appropriate way to introduce the concept and assess the positive impact of the instrument and how it operates to combat poverty, increase human and social capital and contribute to the creation of a more inclusive and democratic society.

<sup>1</sup> See, for example, Atkinson (1995), Fitzpatrick (1999), Standing (2002), and Van Parijs (1992, 1995, and 2001).

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### 3. Why is it justified?

It would be unreasonable to pretend that a few paragraphs can summarize a debate that is extremely rich and sophisticated in content. But a brief review of some important arguments for and against a basic income will help present my views on how the scheme can work in Peru.

#### 3.1 In favour

A basic income improves redistribution of income through income security for all. This in itself is a major step toward greater equality. Market economies generally produce income (consumption) distributions that are very unequal among segments of the population (quartiles, deciles or percentiles) unless pro-equality (solidarity) policies are followed. According to the World Development Report (2002, pp. 234-235), the Slovak Republic with a Gini index of 19.5 in 1992 (it may have deteriorated since) had the less unequal income (consumption) distribution. Scandinavian countries follow in the lead precisely due to their commitment to equity. In contrast, Latin American countries have historically been extremely unequal and poverty levels are very high. A basic income can help even out the difference between rich and poor and increase social cohesion. Equal opportunities for people would provide an incentive to improve one's assets and skills and go out searching for productive and rewarding work that would improve both individual satisfaction of perceived needs and expectations, and society as a whole.

A basic income can provide help to low-paid workers particularly in the informal sector, who do not derive as much benefit as the better off from benefits such as tax allowances and social security. It has been estimated that approximately one half of the population in Latin America lacks social security coverage and they are not likely to be covered because they work informally (informal workers, "independent" workers, the "underemployed") (Cruz-Saco, 2002). There are many people who are not employed such as mothers, old people who never contributed to social security programs, the disabled, students, adults who are capable and willing to work but do not find a job (the unemployed) and



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other groups that are not eligible for social security benefits because they technically are/were not employed and do/did not contribute. As active participants in society, on the various activities they display, they deserve to receive benefits.

The basic income is much easier to administer than most instruments of a modern social security system. Since it is independent on employment status it would do away with the need for tests of availability for work, voluntary employment, any other form of needs assessment, and the overall administration and payment of benefits according to diverse programs and entitlement conditions. The reduction in administrative costs for the government and taxpayers can be reallocated to payment of cash transfers. In developed countries, rational welfare recipients supposedly do not work because their earnings would not be significantly more than what they earn on welfare due to taxes, transportation and day care costs, new clothes, etc. This behaviour - moral hazard - has created welfare dependency and a sticky vicious circle. But a basic income provides an incentive for “old” welfare recipients to enter the labour market because all new earnings are added to their basic income - which is non-taxable - rather than exchanged for the welfare transfer. In the developing world, a basic income that is easy to pay and administer will cost less time and money than any other anti-poverty program that is typically excessively staffed and regulated. In these countries, governments could reallocate unilateral transfers from foreign donors and other multilateral organizations to infrastructure development and other projects that support and complement a basic income policy.

Market deepening through liberalization policies and deregulation has impoverished workers in countries in which the loss of jobs in “old” activities - agriculture, mining, fisheries, manufacturing, services and so on - was not compensated by the creation of “new” ones in companies that were privatized and activities that were export oriented. There is evidence of an increased income gap between workers in high-productivity (often formal) *vis-à-vis* low-productivity (often informal) activities that has led to the establishment of a two-tier labour market (segmented or dual). A basic income would secure income among all workers and help current informal workers strengthen their assets and skills - in

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the same way “old” welfare recipients are incorporated - and allow them to move from low-productivity to high-productivity jobs. As more workers are absorbed by the high-productivity sector, segmentation of the market fades away. A minimum wage legislation to protect workers is certainly unnecessary with a basic income since workers’ individual needs are already guaranteed. When the poverty trap is abolished, the possibilities of low-income families to improve their situation by their own efforts are significantly enhanced. The increased productive employment, higher real wages, and profits would increase national production and the prospects for sustainable development.

A basic income can be a tool for promoting gender-neutral social citizenship rights. Women whose housework remains unregistered and unremunerated will receive a basic income that would at the same time empower them to make their own financial decisions. One can make the argument that a basic income redistributes money within the household from the head of the family - usually a male - who has a paid job to the remaining family members who are engaged in unpaid work. More often than not, these members include women and children who are dependent on the male family head and thus receive whatever amount of money, fair or unfair, at the discretion of the earning member. But the basic income will reach the poorest individuals within the poorest households and therefore, empower both women and children indirectly. With a basic income policy there would be less dependence on partners or families for support. Furthermore, it provides material resources that people need to pursue their aims. A shift from full-time work to part time would take place, that will free up jobs to the unemployed who would have greater incentives to accept these jobs. At the same time, basic income security would lessen the tendency to ignore social costs or environmental considerations in the pursuit of employment. There would be less resistance to closure of obsolescent, polluting factories and machinery, often kept going solely to protect costly jobs.

According to Jackson (1999, p.640) income maintenance schemes whether cash-based (the unconditional basic income or conditional unemployment

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benefits) or work based (both guaranteed and basic work) can sustain the level of output and reduce inequality.<sup>2</sup> Often, it is believed that these programs create excessive fiscal stress and cannot be funded out of tax revenues unless the tax rate is substantially increased. This is precisely why neoclassical analysts object to the use of active social policies. However, Jackson postulates that the combination of work-based measures that raise output and employment and unconditional measures that encourage a more even income distribution can increase the macroeconomic efficiency, redistribute employment and prevent extreme income disparities. On a similar line of reasoning, Groot and Peeters (1997, p.593) have argued that a moderate basic income scheme is compatible with lower unemployment, higher output, higher real incomes for workers, lower income inequality between workers, but a lower real income for the voluntary unemployed. They have indicated that it is expected that the larger winners from a transition from conditional to unconditional social security are workers in activities where the wage-productivity relationship is weak. These are still theoretical considerations that would need to be implemented to test their validity. Income maintenance schemes in Latin America are for the most part inexistent. Occasionally, some governments created some type of work-based schemes often following populist goals. In the absence of social assistance measures, the informal sector offers people the possibility of making an income through their unregulated and unregistered work. Therefore, an interesting issue to be analyzed is how a basic income would affect the extent of informality in the region.

### **3.2 Against**

Higher tax rates and increased labour costs - wages will go up after implementation of the basic income - can slow down the rate of economic growth and eventually, tax revenues. Reduced savings due to higher taxes will have a detrimental impact on the use of technology and innovation rates thus negatively affecting economic growth. With rising production costs, prices will go up and the

<sup>2</sup> Cash-based schemes replace income lost due to unemployment and work-based schemes aim to keep people in work with jobs for those who want them.

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real value of the basic income will decrease. Unable to index the basic income due to financial constraints (inability to keep on raising taxes when output is slowing down) government will not be capable of securing satisfaction of basic needs any longer. People at the poverty level will fall below it and the original goal will be self-defeating. A plan that weakens low-paid workers and people at the poverty level only worsens the situation and causes less rather than more liberty. In the developing world there are additional complications. Countries that do not have stable forms of government (institutions in general) tend to have excessive volatility in their government revenues and in tax collection. Under these circumstances, there are substantial risks to the stability of cash income security. Inability to pay can create unavoidable social turmoil when citizens claim fulfilment of their rights.

The broader tax base that is needed to fund the basic income may induce government to expand the revenue collected beyond the socially desirable level. The argument has been made that there is a sharp trade-off between the level of a basic income payment and the flat income tax rate required to finance it. A significant study for Ireland found that:

“If the income guarantee is to be close to that provided by the current system, and is to grow in line with other incomes, then tax rates of the order of 60 per cent or more would be required to finance a basic income. Tax rates of this magnitude would be likely to frustrate the hoped-for dynamic effects on work incentives and employment” (Callan, O’Donoghue, and O’Neill, 1994, p.xv).

Another study for Canada estimated that the necessary flat tax rate for a basic income system that granted transfers to children and adults would be no more than 41.4 per cent (Lerner, Clark, and Needham, 1999, p.46.). In a developing country with very small availability of funds to support the basic income, heavy taxing to fund it would be necessary and the required tax would be at least as high as in the Irish case. These estimations do not incorporate the effect the basic income policy can have on output (national income) that can be positive - if it is assumed that

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reactivation occurs - or negative - if savings decrease and economic (political) instability results.

There would be strong disagreements with regard to the flat income tax and marginal income tax that can lead to political instability (along with economic instability). People will vote for larger redistribution since the majority with below average incomes can force those above the mean to pay under democratic rule. But the elites will oppose redistributive measures and class conflict over how the pie is distributed will arise with disturbing effects on the economy.

Higher marginal income taxes on top of an already high flat income tax can dissuade workers in high productivity/high income jobs to shift to middle paying jobs. Money collected from income taxes would not amount to as much, meaning less revenue to fund the basic income scheme. In a developed country where much of the income comes from those high paying jobs, it would be harmful for the integrity of the scheme for workers to switch to middle income jobs. Similarly, a developing country cannot afford to lose its workers in high productivity/high paying jobs to middle paying jobs because there is already a lack of highly skilled/paid workers whose contribution in the economy is vital. These workers will lose out and oppose a basic income scheme.

If the scheme does not seem to generate enough support from the top, it does also not help the very needy either. It has been argued that a basic income causes single persons, lone parents, disabled and extremely vulnerable or sick persons to lose out because the scheme is not targeted at groups in most need of assistance. In developed countries, very needy individuals are often assisted by many plans that overlap and support them in many ways. These programs would be cut off and extremely vulnerable persons could find themselves worse off than without the scheme. It has been claimed that the basic income scheme has a large deadweight loss because the bulk of the money is paid out to people who do not need it. In developed countries the majority do not need another source of income. Thus, it seems a shame that a large bulk of the money that could have gone to those who really need it would go to those who do not. In the developing world, the nature of the deadweight is different. The need is so immensurable and the

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resources so little, that the better-off will be over-taxed to the point that their savings that are needed to expand economic opportunities will be completely wasted in lifting the poor a little bit above their current poverty levels.

Suppose that in fact individuals' needs are revealed, satisfied across the board through a basic income policy and that the latter is completely funded out of tax revenues. But aren't individuals responsible for satisfying their needs themselves? Or is the government the appropriate agent to seek for their provision? Under the basic income approach responsibility falls on the latter, which often leads to paternalism and agency problems. Defining a basic income scheme depends on the cohesiveness of society and its ability to achieve at least some consensus on claims of need and compensation. Has society achieved the required level of integration that a basic income policy requires? If so, why are inequity and poverty still such major problems? Is the basic income financed by a clearly egalitarian redistribution? Admittedly, not every way of paying for basic income (for example, by reducing some existing welfare payments for the very needy) can promote equality of outcome. After all, societies have to realize what their ultimate goals are. If these goals are elimination of poverty, addressing the inequalities between men and women, enhancing income security through decent and productive work for low-paid workers, reducing the size and restructuring the scope of public administration or reforming welfare systems maybe there are other policies that are less intricate than a basic income scheme (see John Baker, 1992, pp.123-125).

### **3.3 Is it justified?**

Based on social justice grounds a basic income is fully justified. It combats social exclusion and promotes social integration. The closest models to basic income schemes are benefits such as universal minimum pensions in non-contributory welfare systems, education grants for currently enrolled students, or living wages rather than minimum wages to sustain a minimum level of décor.

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The efficiency argument that effective demand helps boost economic growth has been widely used even under conservative regimes. The argument says that increased spending reactivates economies hit by recessions. Other studies have shown that more equity enhances economic growth or put differently, lack of equity hinders growth prospects. Countries (for example Botswana, Costa Rica, Korea, Malaysia, Mauritius, Sri Lanka and Zimbabwe) that regarded economic growth and equity as mutually supplementing processes became high-achievers in terms of attaining both economic progress and better living standards for their people. Irrespective of their size, ethnicity, socio-economic system, and pace of economic growth with social achievement, governments were committed to ensure that the vast majority of the people have access to social services and more equity (see Mehrotra, 2000). Certainly in a developing country the argument that regional development can be stimulated through a basic income policy is essential.

De Soto (1987, 2001) has eloquently stated that the removal of “bad laws” and granting property rights to the people are necessary conditions to spur economic activity. He has recommended that poor people be granted right to the land they use for agriculture or where they have built their dwellings. They can use the land as collateral for loans and have the adequate incentive structure to operate in the market economy in a productive and efficient manner. These rights can be conceived as models of a basic income.

The idea that citizens or residents have also the right to benefit from the use of natural resources that are exploited for a profit by corporations is very persuasive. Why should everybody not share the fruits from these revenues through a well-designed redistribution mechanism? Why should said benefits only accrue to businesses and governments?

An adequate assessment of a basic income policy on economic growth requires dynamic modelling of how the economy adjusts to effective demand shifts. The additional government revenues motivated by higher growth rates can fund an important portion of the scheme in the long run. It is also crucial that policymakers and stakeholders agree on a basic income development strategy and

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synchronize action and reaction in what should be a genuine participatory process. Without this crucial political support and commitment, a basic income strategy can face structural barriers.

#### **4. Is a basic income viable in Peru?**

Peru is a middle-income country with a total population of 26 million and a per capita income of \$2,100. Life expectancy is 69 years, the demographic growth rate is 1.7 per cent (INEI, 2000a) and the illiteracy rate is 10 per cent. It adopted structural economic and institutional reforms in the early nineties that opened up the economy to foreign investment (privatization) and increased trade. Economic growth was 4 per cent per year in the nineties; it peaked in 1994 (12.8 per cent) and 1995 (8.6 per cent) and dropped substantially by the end of the decade. In recent years, economic growth has been slow due to a combination of factors including the reduction in foreign investment after the completion of major privatization projects, the loss of competitiveness of domestically produced tradables, specialization in exports of primary commodities with relatively small value added, limited internal multiplier effect, high cost of credit and smallness of the internal market due to low domestic aggregate demand and adverse international prices. The level of per capita income currently has reached the 1970 level. The only spectacular accomplishment in the nineties was the drop in inflation from 7,500 per cent in 1990 to less than 3 per cent in 2001. But gains in productive employment have been small while informal activities are blossoming.

The incidence of poverty without public transfers is 55.4 per cent and with public transfers is 54.8 (figures are for 2001) per cent which shows the little impact public transfers have on the alleviation of poverty (INEI, 2002, p. 31). Extreme poverty is 24.4 per cent. As expected, the probability of falling into the poverty trap increases with the youth of parents, greater number of children, fewer years of schooling, Indian or non-white ethnic background and lack of access to health care (INEI 2002, 2000b). It is of concern that structural reforms and adoption of liberal policies has neither reduced inequities nor poverty since the



early nineties. In fact, the incidence of poverty increased by approximately 16 per cent in 1997-2001 (INEI, 2002, p. 82).

With a Gini index slightly less than 50, Peru's income (consumption) inequality is among the highest in the region:

Table 1. US\$ Average expenditure per capita/month by deciles, 2001<sup>1</sup>

Deciles	Total	Urban	Rural
First (poorest)	15.8	29.7	11.6
Second	26.3	45.1	16.9
Third	35.7	55.4	21.2
Fourth	45.4	65.9	25.4
Fifth	55.4	76.9	29.8
Sixth	67.5	88.9	34.8
Seventh	82.0	104.7	40.4
Eighth	101.9	127.9	48.3
Ninth	137.4	169.6	59.8
Tenth (richest)	295.8	354.7	103.3

<sup>1</sup>Calculated using Metropolitan Lima prices.

Source: INEI 2002, p.87, using an exchange rate of 3.5 soles per 1 US\$

The National Institute of Statistics (INEI 2002) has estimated poverty lines by regions as shown in table 2:

Table 2. Poverty lines in dollars (per capita/month), 2001

Regions	Total	Extreme
Urban Coast	57.3	29.9
Rural Coast	46.6	27.6
Urban Sierra	59.7	32.6
Rural Sierra	46.1	30.0
Urban Amazon	62.7	39.5
Rural Amazon	42.1	27.1
Metropolitan Lima	74.3	34.8

Source: INEI 2002, p. 124, using an exchange rate of 3.5 soles per 1 US\$

Differences among regions are explained by the composition of baskets and price differentials. While the consumption basket includes items representing clothing, food, furniture, health, recreation, rent, transportation, and other, most of

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the emphasis is given to “food.” Specific quantities or types of goods included in “food” vary from region to region due to sharp differences in the environment, climate, diet, and market characteristics. In some cases prices for the same good can vary quite ostensibly. For example, the price of meat, meat sub-products, dairy products, coffee and tea can be almost three times higher in Metropolitan Lima than in all rural or Sierra regions (INEI, 2000c, p.71). It can be observed that estimates of the extreme poverty line are for their most part consistent with the World Bank’s proposition that people living under \$1 a day are (extremely) poor (World Bank 2001b).

One of the technical difficulties in defining a national basic income for Peru is the enormous difference that exists between urban and rural areas, among geographical regions and between formal and informal production processes and input requirements. Peoples’ demand composition and market prices differ due to structural heterogeneity or dualism (modern/traditional, formal/informal, etc.). Productivities and prices vary markedly by locality, by income group, by type of business, and so on. Is it possible to set one national basic income or would the basic income be defined by locality/region? Complexities of this sort illustrate that the Peruvian society is progressing toward full marketization but has not achieved homogeneous market development yet. For example, there are many productive activities and services that are paid in kind or non-remunerated at all. An across-the-board basic income, assuming that these differences can be dealt with effectively, could contribute to accelerate economic development as effective demand operates through the conventional Keynesian multiplier effect. Deeper monetization of the economy will also impact price setting including wages and depending upon consumption patterns it can make a substantial impact on trade and the exchange rate.

Schuldt (1997) has advanced the idea that “regional money” - that could be distributed as a basic income (although he did not consider this possibility in his writings) - can reactivate a local or regional economy that is largely stagnant due to some sort of external or nation-wide shock or structural isolation (non-marketization). Examples of shocks are wars, hyperinflationary processes, and economic crises. A basic (regional) income could have important cultural,

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political, psychological and social consequences. For example, reactivation of the economy at the local level can protect communities from the ups and downs of the national or international economy and set them on a more independent path of development. Protection from external shocks and incentives to raise production and consumption locally can have a powerful development impact, raise the self-esteem of the people, and lead to more participatory processes and increased social cohesion. A new ethics will emerge, one that is not based on the individual and profit-seeking behaviour but on the common good and the interests of the entire community. The generation of productive and decent work for the people would reinforce their commitment and conviction in this development paradigm.

There are however major previous conditions and parallel policies that would need to be implemented for this reactivation mechanism to work. A crucial necessary condition is of course that it can be funded. Also, those social actors have agreed on a development package that is long run and require participation. Other social policies that would be needed include initiatives in education and health to protect and enhance human capital; supporting policies to help producers expand output and satisfy the new aggregate demand; support for the creation of a social protection system that covers social risks in an efficient manner; adequate management of international reserves and balancing international trade to secure exchange rate stability; and most of all, balancing public finances given needs and constraints. Finally, there is fear that a basic income scheme in one single country can pool international migrants who want to receive the benefit. If this were the case, the issue of migrant workers would have to be addressed when implementing the scheme.

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## 5. Basic income estimates

For simplicity, I will assume that price differentials and the demand composition among regions are negligible. The estimations below serve the purpose of illustrating the magnitude of the cash benefit.<sup>3</sup>

### 5.1 Scenario 1: Poverty line

To obtain a national poverty line that can be used as a proxy for the basic income, the vector of poverty lines by regions is multiplied times the vector of regional population over the total population. The resulting estimate is a population weighted national poverty line, US\$ 58.3.<sup>4</sup> Now, suppose that the basic income is rounded up at US\$60/month for citizens 15 years and older and US\$ 42/month for children under 15 (who get by assumption 70 per cent of the adult cash transfer). Incidentally, this poverty line is about \$2 per person/day. Consider that the population 0-14 years is 34.4 per cent of the total population (INEI, 2000d, p. 24), thus 8.9 million:

Table 3. Scenario 1. Basic income estimates

Age groups	Population	Annual per capita basic income	Total per capita basic income	Per cent of national income
Less than 15	8.9 million	\$504	\$4 485.6 millions	8.3
15 and more	17.1 million	\$720	\$12 312.0 millions	22.8
Total	26 million		\$16 797.6 millions	31.1

Source: Author's estimates based on INEI's data. The national income use in these calculations is \$53,900 (World Bank, 2002, p.233)

<sup>3</sup> Estimation of a basic income would require a thorough and comprehensive study including analysis of legitimate and perceived needs, valuation of needs, an analysis of demand composition by various categories, and so on. Once a basic income is defined (using simplifying assumptions) one would have to assess the impact on growth created by aggregate demand shifts. This analysis needs to be dynamic to estimate the net impact of the scheme on public finances and economic growth.

<sup>4</sup> Share of the regional population over the total is 17.5 per cent for the Urban Coast, 5.2 per cent for the Rural Coast, 12.7 per cent for the Urban Sierra and 22.7 per cent for the Rural Sierra; 6 per cent for the Urban Amazon and 7.2 per cent for the Rural Amazon. The share of the population in Metropolitan Lima is 28.3 per cent (see INEI, 2000c, p.85).

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As can be clearly seen, the basic income policy would cost US\$16.8 billion that represents 31 per cent of total national income.

## 5.2 Scenario 2: A minimum consumption level

In the next scenario I expand the notion of the basic income (poverty line). Three categories are included: “food consumption,” per capita “investment in human capital” mainly education and health (public and private) and “recreation time” that is available to engage in activities that enhance the well being of the people. Information was obtained from the latest available input-output tables, 1994 (INEI 2000e). “Food consumption” is calculated as the total consumption of food (domestic and imported) divided by the total population and converted to dollars. Similarly, investment in education and health (private and public) is calculated from total expenditures in these categories divided by the total population and converted to dollars. Finally, to proxy “recreation time” I have calculated the cost of one hour of Peruvian labour (total annual wage payments divided by total employees and then obtain the hourly ratio) that comes up to \$1.72. Arbitrarily, I assume that every person is entitled to five hours of “recreation time” a week. These assumptions lead to the following calculations:

Table 4. Expanded basic income in dollars, 1994

Categories	Per capita
Food consumption	40.0
Investment in human capital	20.5
Recreation	34.4
Total basic income	94.9

Source: Author's estimates based on the input-output tables (INEI 2000e), converted to dollars using the exchange rate of 2.2 soles to US\$1.

Rounding up the basic income to \$95, assuming that in dollar value it has remained constant in the last eight years, and again, using 70 per cent of it as the cash transfer paid to children under 15 gives the following results:

Table 5. Scenario 2. Basic income estimates

Age groups	Population	Annual per capita basic income	Total per capita basic income	Per cent of national income
Less than 15	8.9 million	\$798	\$7 102.2 millions	13.2
15 and more	17.1 million	\$1 140	\$19 494 millions	36.2
Total	26 million		\$26 596.2 millions	49.4

Source: Author's estimates based on table 4.

In this scenario, the total per capita basic income would cost \$26.6 billions that amounts to 49.4 per cent of national income.

## 6. Can it work?

The majority of Peruvians that live with very little (under, at, or slightly above the poverty line), who are underpaid, unprotected, often hopeless and disenchanted would favour a basic income policy regardless of the activity they perform, their age, their gender, or their location of residence. Middle-income groups, clearly non-poor for Peruvian standards but with very low incomes for international standards, would also encourage the policy. This is quite obvious. Theoretically speaking, a basic income for everybody will give everybody a necessary lift at all dimensions financially, socially, politically, psychologically. It would raise prices and wages, spending and the reactivation of the economy. The Keynesian multiplier should work almost interruptedly given the fact that only 20 per cent of the population is adequately employed.

Highly paid workers and firms that operate in the formal sector would strongly oppose to the scheme if the expected net impact were negative (lower after tax income). It seems that those who can avoid paying higher wages and higher taxes would want to join the informal sector and slip out of the registered stream of income that is taxable. Can the basic income create a win-win situation for these two interest groups? If the economy can adjust to excess demand by increasing production thereby avoiding inflationary pressures (or hyperinflationary pressures if governments experience recurrent deficits and are highly indebted). If the economy can grow at a high rate and tax revenues increase

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due to greater output. If businesses support the strategy of equity and economic growth. In sum, if the political conditions are such that a basic income is perceived as an appropriate development instrument.

Basic income falls under the category of demand management policy making often associated to populism. When President Alan García in the mid-eighties implemented a heterodox (populist) demand-based reactivation (with strong effective demand shifts), the economy grew for two consecutive years at 6 to 8 per cent to then fall into absolute economic disgrace and hyperinflation eighteen months later. If a basic income idea would to be given serious thought, García's populism would have to be carefully analyzed to avoid repeating the same mistakes. Actually, the strong legacy of failed populism in Latin America could be a thorny impediment for analysts and policymakers in considering this scheme.

But the most serious impediment to the basic income scheme is raising tax revenues in a very short period of time. However, the estimates presented above do not consider the economic growth that can be derived from effective demand shifts - which requires further research. A tax reform implemented in the early nineties raised revenues to 14 per cent of GDP over the course of the decade. However, tax revenues over GDP in Peru are below the average for developing countries and for Latin America and the Caribbean respectively (see table 6).

In the period 1998-2000, tax revenues as a proportion of GDP fell from 13.8, to 12.5 and further down to 12.1 per cent. In 2000, income taxes represented 2.7 per cent (personal income taxes, 1.1 per cent; profit taxes, 1.6 per cent); import taxes, 1.6 per cent; sales taxes, 6.4 per cent; oil and petroleum taxes, 1.8 per cent; and net tax credits, 0.4 percent (BCRP, 2002, p. 79). It means that four fifths are consumption taxes and one-fifth, income taxes. This tax composition can become an issue to be addressed in the model of a basic income with a flat income tax.

In 2000, government revenues, tax revenues plus non-tax revenues (2.6 per cent of GDP), were allocated in the following way: wages, 4.4 per cent; goods and services, 3.8 per cent; total transfers (pensions and local governments) 4.6 per cent; investment 2.8 percent; interest payments mostly on the external debt 2.2 per cent (BCRP, 2002, p.238). The resulting fiscal deficit was 3.1 per cent of GDP.

Table 6. Total Tax Revenue over GDP (in per cent)<sup>1</sup>

Regions <sup>2</sup>	1980-1984	N	1985-1989	N	1990-1994	N	1995-1999	N
East Asia and Pacific	17.3	13	17.1	13	17.0	13	16.9	13
Europe and Central Asia	28.9	21	30.6	22	30.7	22	31.1	23
Latin America and Caribbean	15.3	15	14.8	16	15.6	16	16.6	13
Middle East and North Africa	19.1	10	15.5	12	15.4	13	16.1	13
North America	17.2	2	17.5	2	18	2	18.9	2
South Asia	9.7	7	11.2	7	12.3	6	12.4	6
Sub-Saharan Africa	15.7	12	16.9	11	16.7	12	18.2	7
Total N <sup>3</sup>		80		83		84		76
Peru	12.8	1	10.8	1	13.4	1	14.9	1

<sup>1</sup>Tax revenue comprises compulsory, unrequited, non-repayable receipt collected by central governments for public purposes. It includes interest collected on taxed arrears and penalties collected on non-payment or late payment of taxes and are shown net of refunds and other corrective transactions. Values are simple averages for countries in each category.

<sup>2</sup>Classification according to World Bank, *World Development Indicators 2001a*, CD-ROM. Includes countries with most available data.

<sup>3</sup> Number of countries included.

Source: World Bank, *World Development Indicators 2001*, Table 5.5, pp.286-288; World Bank, *World Development Indicators 2001*, CD-ROM.

With the introduction of a basic income, there would be some reallocation of funds from wages, goods and services, and transfers toward payment of the basic income. The crucial problem is how can tax revenues increase from the 12-14 per cent range to the levels needed to pay a basic income according to the first and second scenario (tables 3 and 5)? A doubling of current taxes (income and sales) would probably not be enough. The current sales tax is 18 per cent, the tax on oil and petroleum is more than 40 per cent, and the highest income tax is 35 per cent. It is materially impossible to raise tax revenues in the proportions needed by the basic income scheme as illustrated above in a short period of time.

But, what can be done instead? What is feasible in the more immediate future that can set up people's minds on equity as one fundamental objective?

It seems to me that one major goal is to raise tax revenues progressively. The immediate objective should be to attain the regional average of approximately 17-18 per cent. In a country that faces such important market failures, government needs resources to support the infrastructure development and the social



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investment that is required and that will eventually reduce the number and the size of these market failures. Raising tax revenues is almost synonymous with raising the tax base. To this effect, it is crucial that informal activities are incorporated into the registered stream. A key consideration in estimating tax revenues is incorporating the expansionary impact of effective demand shifts on output. Thus, the reactivation boost can bring about increases in tax revenues that otherwise could be difficult to expect.

A second major goal is to introduce small “versions” of the basic income idea. For example, a universal minimum pension or student grants. Senior citizens in the developing world are among the poorest of the poor and it would be perfectly justified to address their needs. Suppose a universal minimum pension of let say one thousand dollars a year is created that everybody age 65 and above gets (including those who receive benefits from contributory schemes). The total cost would be the following:

26 million people multiply times 4.6<sup>5</sup> per cent equals 1.2 million beneficiaries.  
Now, multiply the 1.2 million beneficiaries times one thousand dollars per year.  
The total cost of the benefit is 1.2 billion dollars or 2.2 per cent of GDP.

Or the example of student grants. Suppose that an incentive is created for the age bracket 15 to 24. Young people can receive one thousand dollars a year if they are enrolled and attending school (to complete their high-schools diplomas, acquire a technical skill, enrolled in a higher education program, etc.). The total cost of this benefit would be the following:

26 million people multiply times 20.6<sup>6</sup> per cent times one quarter<sup>7</sup> equals 1.3 million beneficiaries.  
Now, multiply the 1.3 million beneficiaries times one thousand dollars per year.  
The total cost of the benefit is 1.3 billion dollars or 2.4 per cent of GDP.

<sup>5</sup> 4.6 per cent of the total population is above 65 years.

<sup>6</sup> 20.6 per cent of the total population is 15 to 24 years.

<sup>7</sup> Assuming that one quarter of the people ages 15 to 24 become beneficiaries.

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If tax revenues can go up by four percent with additional economic growth, incorporating informals into the tax base and improved tax collection practices, then, either one of these two small “versions” of the basic income could be introduced.

The third and final goal is to build consensus on a plan of action that can lead to a more socially just and equitable society. All intervening stakeholders should participate in a process of consultation and policy making. Civil society, businesses and governments should establish trustworthy relationships and be committed to a development strategy that is largely of the “within” type. The politics behind a development path that is alternative to other ways of thinking about development is highly complex. However, it is worth giving it a try.

## **7. Conclusions**

The basic income idea is certainly a proposal to rethink development altogether. Liberalization policies implemented in the last two decades have failed to provide work and income stability for the majority of people in the developing world. Time has come to explore other routes toward progress and security. The basic income idea is a good starter because it is an attractive model of equity and growth.

The debate on the basic income has pulled analysts apart. One of the difficulties is that proponents of the idea suggest that its introduction can be more or less immediate. Claus Offe (2001, p.114) reminds us that it is wiser to take a step-by-step approach:

“I suggest that efforts to implement a UBI [universal basic income] should be governed by principles of gradualism and reversibility. The idea is to provide a context in which people can change their preferences through learning, as in the saying that the appetite comes with the eating (rather than with coercive feeding). Instead of thinking about the UBI in terms of “before” and “after,” we need to conceptualize and promote it in the dynamic terms of less and more.”

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In Peru's case, introduction of small grants can be an effective way to introduce the concept, following the Brazilian "school grant" example. It can be used among other things to assess the impact a basic income can have on well-being, funding and taxes, ability of the supply side to respond and accommodate to demand shifts, effect on prices and wages, impact on perceptions and social cohesion, etc. It will contribute to put people on the right mode of thinking and to collect evidence on the experience. In preparation for a basic income scheme, governments should strengthen their capacity to collect taxes and should implement policies to promote and encourage domestic production at competitive levels. Investment in education and in health should have top priority to enhance the assets and skills of the people. Social protection programs that help the people cover exposure to social risk should also be introduced. The communication infrastructure of the country should be strengthened and developed to facilitate and reduce the cost of communication, information and transportation. What is more important, different social groups at different regions, ages, gender, activities, sectors, etc. need to come to terms with a development package that can create opportunities for all.

Further research needs to be done to assess costs and benefits associated with this instrument. The point of departure is modelling economic growth in an adequate manner. Then, under different assumptions of a basic income and relevant macroeconomic aggregates, one can estimate the net effect of aggregate demand shifts on output, employment and public finances. The social policies that should accompany a basic income strategy should also be thoroughly investigated. The analysis should not be centred on economic variables only. As this paper shows, a basic income policy can have a constructive impact on nationhood and social cohesion.



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