

Peru

Status Index (Democracy: 3.4 / Market economy: 2.7)		6.1	Management Index		5.1
System of government	Presidential Democracy		Population	26.4 mill.	
Voter turnout	81.4 % (Pres. elections)		GDP p. c. (\$, PPP)	4,570	
Women in Parliament	18.3 %		Unemployment rate	8.5 % (2000)	
Population growth^a	2.1 %		HDI	0.752	
Largest ethnic minority	32 %		UN Education Index	0.88	
			Gini Index	44.6	
Data for 2001 – if not indicated otherwise. ^a Annual growth between 1975 and 2001. Source: UN Human Development Report 2003. Gini-Index: IMF (2003): Country Report 03/73.					

1. Introduction

When the authoritarian regime of Alberto Fujimori (1990–2000) abruptly ended, Peru started to change its political system under Valentín Paniagua's interim government. In July 2001, Alejandro Toledo was elected president in a run-off election. Lacking a solid majority in Parliament and faced with high popular expectations, Toledo had to shore up the eroded democratic foundation and deal with an incompletely reformed, unstable economic system.

An assessment of the status of Peru's democratic and market-economy transformation over the past five years (1998–2003) indicates that the political pursuit of a stable democracy has made major advances since 1998. But in large measure these have merely regained the ground lost in the 1980s and 1990s; compared with the start of the 1980s, when democracy was restored, development has stagnated.

The long-term evaluation of economic transformation is more favorable. Peru's economic institutions and performance showed signs of stagnation since the mid-1990s with no signs of improvement in the past five years. Given how much they needed to accomplish, the key decision-makers of the transformation scored only moderate managerial successes; the interim regime earned better marks than Toledo's administration has to date. The current government faces tremendous challenges, especially regarding the rule of law, patterns of political representation, reform of the existing market and competitive structure, and the social sustainability of economic development.

2. History and characteristics of transformation

As in the other transformation countries of Latin America, the political and economic transformation processes in Peru did not unfold concurrently during the last two decades. The political transformation to a third-wave democracy began in Peru in the mid-1970s, when the political and economic failure of the military, leftist reform government (1968–1980) led to its retreat in a negotiated transition. After this rebirth of democracy, Peru experienced a gradual crumbling of the democratic order—a process that culminated in Fujimori’s so-called self-coup (*autogolpe*) of April 1992 and did not end until the authoritarian *fujimorismo* collapsed in autumn 2000.

The delegative style of governing that characterized the Presidents Belaúnde Terry (1980–1985) and Alan García Pérez (1985–1990) finally was unsuitable to the crisis atmosphere prevailing since the early 1980s. Engendered by accelerated socio-structural change, a played-out development model, a debt crisis, hyperinflation and terrorism, these overlapping crises burdened the state’s capacity to act, as well as the country’s structures of political representation. In particular, García Pérez’s erratic policies exacerbated the national and economic crisis and—as illiberal tendencies expanded and the military increasingly flexed its muscles as a veto power—brought the country to the brink of collapse.

Fujimori—a newcomer whose election in 1990 came as a surprise—managed to take the first steps toward easing the economic crisis. But his efforts to combat terrorism fell short; he was unable to forge agreement between Parliament and the *de facto* powers in the military and the intelligence service. The 1992 *autogolpe* turned Peru back toward authoritarianism; the constitution was suspended, Parliament dissolved, the judiciary obstructed. Under international pressure, Fujimori partially restored constitutional processes: A constitutional convention was elected, which until 1995 also functioned as the legislature. In fact, a triumvirate ruled Peru; the president, the chief of the intelligence service and the commander of the armed forces determined the course of Peruvian politics even after the 1995 elections.

The 1993 constitution was tailored to support Fujimori’s claims to power and authority. Together with the political developments of 1994–1995, this produced a concentration of power in the hands of the president, coupled with privileged status for the military, weak representation structures and government domination of the media.

Fujimori began to engineer his reelection in 2000 in spite of its disputed constitutionality—a goal that increasingly shaped the regime’s course. When the Constitutional Tribunal in 1997 declared that the law on the “authentic interpretation” of the constitution (instigated by Fujimori and his followers in

Parliament) was inapplicable, Fujimori gutted the Tribunal, completely suspending the separation of powers.

From then until Fujimori resigned, a second wave of authoritarianism brought subtle infringements of freedom of the press, selective violations of individual civil liberties, and ultimately electoral manipulation, which secured Fujimori another presidency by July 2000. While civic protest against re-election was growing since 1996, the uncovering of Montesinos corruption network in 2000 finally accelerated the erosion of the regime's legitimization and forced Fujimori to flee to Japan. After the collapse of the Fujimori regime in November 2000, the transitional government under Valentín Paniagua and Toledo's election in May 2001, 20 years after the end of military rule, Peru returned to the starting point of its democratic consolidation.

In its market economy transformation, Peru turned away from the outmoded development model of import-substituting industrialization; this model had been typical for Latin America since the 1930s but came late to Peru. Peru's pursuit of this model—with insulation and regulation of the domestic market and expansion of the public sector—began in the early 1960s and was amplified under the military regime. In the second half of the 1970s, when the crisis came, the military regime lost legitimacy, but reforms were not pursued. Even the democratic governments of the 1980s failed to embark upon fundamental reform. Neither the austerity policy of the conservative Belaúnde nor the heterodox economic policy of the leftist/populist García Pérez could curb the deepening economic crisis; instead, they accelerated it to the point of hyperinflation in 1990.

The necessary economic structural reforms were finally tackled in 1990–1991 under Fujimori, at first with support from the opposition in Parliament. Fujimori's ambitious blueprint for reform—an orthodox policy of recessive stabilization combined with aggressive structural reforms—included a package of drastic measures (*fujishock*) that aimed primarily to fight inflation. Among these were revision of collective bargaining agreements, reduction of subsidies, budgetary discipline and a restrictive monetary policy. In 1991, comprehensive structural reforms were added to the program. Most state companies were privatized; the state withdrew from the financial sector; an independent central bank was established; foreign trade was deregulated; the exchange rate was allowed to float; and restrictions on the movement of capital were lifted.

As supplementary measures, the labor market was drastically deregulated and the market for agricultural land liberalized. Fujimori's reforms brought relatively rapid macroeconomic stabilization and, until the Asian and Brazilian crisis of 1998, a very strong economic recovery. However, the reforms stopped short of redressing the decades-old structural imbalances. Of the deficiencies Fujimori left behind, the most serious were (and still are) Peru's unstable, segmentary integration into the global market, its volatile financial sector and above all its

severe societal distortions—the informal sector, poverty, underemployment. In part because of social policy shortcomings, the latter have become even more structurally entrenched.

3. Examination of criteria for democracy and a market economy

3.1 Democracy

When the Fujimori regime collapsed, Peru's political order reverted from one in which democracy was a façade to one in which the minimal rules of political democracy applied. To that extent, the quality of the political order has definitely improved in the last two years. However, transformation shortcomings remain regarding the rule of law. Democratic stability is impaired by a weak party system, a weak civil society and meager social capital, but this impairment at present does not threaten the system.

3.1.1 Political organization

Peru's current political order rests on the 1993 constitution initiated by Fujimori, which, compared with the 1979 constitution, concentrates power in the executive branch. This facilitated Fujimori's authoritarian rule. Although the constitution's legitimacy was seriously flawed from the start, no approach to constitutional reform has yet been found. In dispute are not only the nature of the outcome (a new constitution, reform of the existing constitution or a return to the 1979 constitution) but also the process itself (parliamentary decision, constitutional convention, extent of popular participation).

(1) *Stateness*: Peru has only slight problems related to stateness. The state monopoly on the use of force is in place without major limitations, although remnants of the once virulent guerrilla movements—Túpac Amaru Revolutionary Movement (MRTA) and Shining Path (the latter reputedly tied to the coca economy)—remain. Defining citizenship and who qualifies as a citizen is not a politically relevant issue. Peru's ethnic diversity—particularly in regard to the indigenous population—is minimally politicized. All citizens formally have the same civil rights. Church and state are separated; the political process is secularized. A basically functioning administrative system and public safety and order are assured, with some limitations, throughout the country.

(2) *Political participation*: After the manipulation of the Fujimori decade, Peru has restored universal suffrage and the right to campaign for office, and elections are again conducted properly. The government of Alejandro Toledo, elected in 2001, and other power groups observe the principles of open and competitive elections. This was demonstrated in the regional elections, conducted for the first

time in 2002, in which the opposition scored clear successes. Now that the military, the intelligence service and the judiciary—once riddled with corrupt henchmen of Fujimori and his national security chief, Vladimiro Montesinos—have been cleansed of this political mafia, the government has the effective power to govern. It seeks to strengthen this through further reforms to consolidate civilian supremacy over the military.

There are no longer veto powers or other political powers in the hands of the military, although vestiges linger and rumblings are occasionally heard in response to drastic personnel and financing cutbacks.

The rights of political organization and communication are also respected. The state-run and private media are free of government influence. Political and civic organizations can form freely, but union activity is still subject to certain regulations (resulting from the neo-liberal reforms) that violate international conventions on labor rights. Despite Peru's ethnic diversity, ethnic cleavages as such do not represent a fundamental obstacle to the dynamics of association in civil society. However, the combination of geographic and social marginalization encounters barriers for parts of the indigenous population, as well as in exercising their right to vote.

A decentralization process initiated in 2002 established elected governments in Peru's 25 regions, allowing greater participation than that afforded by the central government in Lima. However, the competences—and the financing—of the regional governments are still largely undefined.

(3) *Rule of law*: The rule of law in Peru was in even more lamentable condition after the Fujimori regime than when it began. Since then, both the functioning of checks and balances and respect for civil liberties have improved noticeably, although they do not meet the standards of a constitutional democracy under the rule of law. While Paniagua's transitional government de facto had its origin in Parliament and few conflicts arose between the two, President Toledo does not have an absolute majority in Parliament. So far, Toledo has relied on coalitions and consensus to secure his ability to govern; despite this divided government, there has been no attempt to suspend the division of powers. The feared political stalemates have been rare; as a result, parliament has gained a greater voice in political decisions.

The government also respects the constitutional authority of the judiciary, which the Paniagua administration started to rid of links to Montesinos's mafia-like network. The role of the highest courts has developed positively; in particular, the Constitutional Tribunal, inoperative since 1997, has been completely reinstated and has asserted its newfound independence in several decisions. Nevertheless, it will be years before the essential institutions and persons of Peru's judicial system can operate on a solid footing.

After the era of Fujimori and Montesinos, the political realm, civic actors and the public are highly sensitized to political corruption. The public views fighting corruption as the most urgent problem of good governance; it also ranks high on the political agenda as shown by the establishment of parliamentary investigation committees and the National Commission to Fight Corruption. Hundreds of people are being prosecuted for corruption, including many former government officials, businessmen, mass media owners and high rank officers. This does not only bring about a change in Peruvian political and judicial culture, which might support democratic consolidation; but also signifies the prosecution of political crimes of the immediate past – in opposite to most other countries in Latin America.

Civil liberties are respected in principle and should be further consolidated as the judiciary grows stronger. Civil rights are sometimes compromised by the discrepancy between government behavior and legal norms, as well as by the authorities' selective application of established law. In Peru's ethnically diverse and pervasively discriminatory society, this means 'low intensity citizenship' for some segments of the population such as indigenous peoples and Afro-Peruvians. There are instances of torture and abuse at the hands of the state security forces.

Strengthening the judiciary as a bulwark of civil liberties will take years, but the blueprint has been drawn up. Procedures have been initiated to address the human rights violations of 1980–2000 (25,000 dead, about 6,000 disappeared), many of which have not been clarified. These include reviewing the 1996 law that granted amnesty for transgressions by the military after 1980, investigating the legality of the frequent proceedings by military tribunals, and investigating cases of innocent people who were unjustly convicted of terrorism (about 200 pardons, and about 1,600 applications that are unresolved).

3.1.2 Political patterns of behavior and attitudes

(1) *Institutional stability*: After the collapse of the 1980s and their dismantling in the 1990s, the institutions of the democratic state have not regained a solid footing. In addition to the question of a new constitution, this applies especially to the rule of law—where the necessary reforms, now in their infancy, will take several more years to mature—as well as to the incipient process of decentralization. The prospects for relatively swift institutional consolidation are still good, because all influential political actors accept the democratic institutions and regard them as legitimate.

Furthermore, with the National Agreement on Governance (*Acuerdo Nacional*)—a carefully prepared master plan, supported by all important political and social forces, to shape the longer-term course of politics in Peru—President Toledo has also buttressed the foundation of institutional stabilization. On the other hand,

Toledo's strategy of consensus and concerted action may not hold up; in this case the competing political majorities in Parliament and the government may lapse into institutional inefficiency and even political stalemates.

(2) *Political and social integration:* The problems with institutional stability and efficiency also involve the unstable structures of political representation, which cannot adequately mediate between the state and a highly heterogeneous and segmented society. The established party system broke down in 1990–92; since then, it has been unable to regain organizational stability or anchor itself in society. It is plagued by severe fragmentation, little ability to formulate programmatic objectives, strong tendencies to focus on personalities and patronage, and a high level of voter volatility. The party system remains one of the greatest obstacles to the consolidation of democracy. Granted, the regional elections instituted as part of the decentralization effort promise to bring the parties closer to society, but the strong showing of regional groupings bodes further changes to the party system.

Peru's civil society is relatively well differentiated but highly fragmented. On occasion, interest groups can make their voices heard. The employers' associations still wield great influence, while the unions—in the wake of neo-liberal reform and massive impoverishment since the end of the 1970s—have lost almost all their political punch. Civic organizations have little willingness to work cooperatively and strategically because higher-level organizations lack adequate capacity, which results in fragmentation. Time and again—for example, when plans to privatize certain public utilities were launched in 2002—this led to explosive political protests followed by government crises.

Partly despite and partly because of the long-lasting spiral of impoverishment and the growth of the informal sector, the ability of Peruvian society to organize itself is relatively high. According to surveys, the level of interpersonal trust is below the low Latin American average. On the other hand, the broad-based campaign to deal with human rights violations, bringing the victims into the process, has helped to consolidate social consensus in Peru.

While the dynamics of civic organizations are fairly positive, in recent years a drop in satisfaction with democracy and citizens' trust in the institutional underpinnings of democracy has been observed. Despite experiences under the Fujimori regime, approval of democracy has declined since then. Half of the population is at least ambivalent about democracy as a form of government; less than one fifth is satisfied with the performance of democracy.

3.2 Market economy

After the drastic neo-liberal reforms in the first half of the 1990s, Peru has made little progress in transforming its economic order. Major transformation shortcomings remain in regard to organizing competition, restoring the health of the banking and capital markets, combating market concentration and the formation of oligopolies, and especially promoting sufficient inclusion of additional population strata in formal economic life. A great part of these Peruvians connect the neo-liberal reforms of the 90ies with the corrupt regime of Fujimori, a circumstance that complicates further economic reforms.

3.2.1 Level of socioeconomic development

The key indicators show a medium level of development for Peru. Measured in terms of the HDI, where a severely segmented society is a factor, the country's level of development does not permit adequate freedom of choice for a large segment of its citizens. Social exclusion and marginalization on the basis of poverty, education and gender discrimination are evident, especially in the highlands and the Amazon basin, where most of the indigenous population lives.

Throughout the past years, Peru failed to reduce its social disparities, high poverty rate and income disparity. Furthermore, from 1997 until mid-2002, economic development still flagged. Existing development imbalances among the various regions, especially between the coast and the highlands, were not reduced.

3.2.2 Market structures and competition

The foundations of a competitive market economy are by and large assured. The dense regulation of the economy was greatly pruned back after 1990. Price controls, subsidies and restrictions on foreign investment were lifted. However, about half of Peru's economic activity takes place in the informal sector. Anticartel legislation has existed since 1991, but it relates almost exclusively to anticompetitive behavior such as price fixing or market sharing. The laws are applied only sporadically, bureaucratic corruption still takes its toll, and the desired market dynamics definitely have priority. Controls on mergers exist only in the electricity sector.

Foreign trade has been extensively deregulated, and there is no fundamental state intervention in free trade. This particularly applies to the treatment of foreign investments and stockholding. The banking and financial sector underwent both internal and external deregulation in the 1990s and now rests on a more solid foundation. Further measures to strengthen bank supervision are being implemented according to IMF recommendations, but they are not up to the

highest international standards. The high dollarization of the banking and financial sector presents an unresolved question.

3.2.3 Stability of currency and prices

The Toledo government is continuing its predecessor's consistent policy on inflation and currency. The rate of inflation, which returned to single digits in 1997, has been kept low. The central bank has been independent since the mid-1990s. But the heavy dollar dependency of the banking and financial sector and the resulting dependence of private debt on the exchange rate are problematic.

According to some estimates, 50 % to 60 % of loans in foreign currency are exposed to exchange-rate risk. Neither the previous administration nor the current one has tackled this problem. So far, negative consequences have not appeared, in part because the exchange rate has remained relatively stable in recent years. After the boom of the 1990s, the government's fiscal and debt policies have been less stability-oriented. The Toledo government managed to keep the budget deficit stable (at about 2.5 % of GDP), but the political situation may challenge this budgetary discipline (possible costs of decentralization, further drop in revenues because of failed tax reform).

The administration stabilized the foreign debt, which had risen continuously since 1992, but the total national debt hovers at a high level. Foreign currency reserves have stabilized at a favorable level and can cushion some of the risks noted here.

3.2.4 Private property

In general, property rights and property acquisition are adequately defined with regard to the acquisition, use, benefits and sale of property; they have their barriers in the liberal basic rights. Exceptions occur in some areas inhabited by the indigenous population, where land titles are not defined, not clearly defined, or defined in a way that is incompatible with indigenous values. Time and again, this creates conflict between the population and petroleum companies. Also, property rights are not always adequately protected in practice, because the judicial and administrative systems are still flawed.

The legal framework for a functional private sector exists in Peru. Private enterprises form the backbone of the national economy, but a few state companies remain. The privatization of state companies continues at a slower pace under the Toledo administration. The privatization of two electricity companies in southern Peru was suspended in the wake of protests, some of them violent. There is also resistance in Parliament to further privatization, but so far this has not altered the program's course.

3.2.5 Welfare regime

Peru's hybrid welfare regime is limited to certain sectors and reaches only part of the population. Even before the deep crisis of the 1980s, the social insurance system—which the constitution had prescribed since 1933—offered scant coverage and excluded the rural population. Since then, lack of funds and the expansion of informal employment have further eroded its effectiveness.

The insurance system, which covers about 30 % of the population, provides payments in case of illness, pregnancy, disability, old age and death. Since 1992, the pension scheme has included private plans (following the Chilean model), but it falls far short of the intended complete conversion. As the social situation deteriorated, state social programs became more important; under Fujimori, they were increasingly linked with patronage practices. About half the population lives in poverty; in rural areas, the rate is uniformly above 60 %. The disparity of income distribution in Peru is severe, although more moderate than in Brazil or Chile.

The Toledo administration has introduced a new social welfare program that is supposed to create more than 400,000 jobs, but to date it has fallen far short of expectations. Equal opportunity and equal access to public services do not exist. There are hardly any mechanisms to promote the advancement of women, persons with disabilities or the socially disadvantaged. Discrimination against women consists in their limited access to post-secondary education, income and public office.

3.2.6 Strength of the economy

After the catch-up growth of 1993–1997 (averaging 7 %), less favorable external conditions, stalled reforms and turbulent domestic politics brought a downturn in Peru's macroeconomic fundamentals at the start of the period under study. The growth rate averaged 1 % for 1998–2001 and did not improve until 2002. Peru is now gradually returning to a moderate growth rate and macroeconomic stabilization.

Inflation steadily decreased through the years studied, and certain other data also showed improvement. Currency reserves grew, budget and current accounts balance deficits became manageable, short-term debt declined and state coffers were less dependent on the financial markets. There were negative aspects as well. In addition to the problems already noted (dollar dependency, national debt, decentralization, tax revenues), the formal sector remains limited, which inhibits viable, dynamic economic development. Since the drastic pre-1992 slump, the country's level of development remains low and the poverty rate remains high.

3.2.7 Sustainability

Environmental awareness in society at large and among lawmakers has grown in recent years, but it is still slight. Environmental concerns tend to take a back seat to growth considerations. Ecologically sustainable growth gets only scarce attention and is not reflected in the institutional framework. Worsening ecological problems—especially soil erosion and the contamination of rivers and lakes—primarily affect the highlands and the Amazon basin. Education and training facilities are available in important segments, but they vary widely in quality.

Definite shortcomings exist in research and development. Quantitatively and qualitatively, investment in education, training, research and development is rather low. The state's expenditures for education since the 1990s have idled at about 2.9 % of GDP, with a slight drop since 2000. Modern infrastructure does not extend nationwide, but is limited to certain segments and enclaves (major cities, modernized economic sectors).

4. Trend

(1) *Democracy*: During the period under study, Fujimori's authoritarian and corrupt regime was replaced by democracy. As a result, Peru's political order shows improvement in nearly all performance indicators, though some aspects are not yet fully functional. In particular, the rule of law still falls short of democratic standards. Similarly, while the process of democratic consolidation has gained ground compared to 1998, few advances can be noted since 2001.

The parties have made no progress in their capacity for political and social integration. Efforts to develop cooperative and consensus-oriented patterns of interaction between labor and capital have languished. The landscape of civic interest groups and organizations shows sustained positive development, although weaknesses exist in terms of the breadth of citizen participation. There is backsliding in the development of a civic culture to support democracy. Survey results for the period under study indicate a crisis of support and satisfaction that has recently intensified.

(2) *Market economy*: Peru's development status as a middle-income country (UNDP, IMF) has not significantly improved in the past five years. The poverty rate has not declined at all, and the Gini index shows no reduction in income disparity.

The institutional environment for progress toward a market economy has not changed significantly. Deficiencies remain in the organization of the economy and competition; the pace of reform slowed significantly during the period under study. The main positive note is that banking oversight has improved somewhat.

Measured in terms of macroeconomic data, overall economic development has lost momentum; key factors here were domestic politics, the international environment and natural disasters. Some momentum was regained in 2002.

Table: Development of socioeconomic indicators of modernization

	HDI	GDI	GDP Index	Gini Index	UN Education Index	Political representation of women ^a	GDP per capita (\$, PPP)
1998	0.737	0.723	0.63	44.9	0.86	-	4,282
2000	0.747	0.729	0.65	44.6 (2001)	0.87	18.3 (2001)	4,799

^a Percentage of women delegates in Parliament after 1996 and 2000 elections.

Sources: UNDP, Human Development Report, 2000, 2002; Gini index: IMF (2003), Country Report 03/73

Table: Development of macroeconomic fundamentals (1998–2002)

	1998	1999	2000	2001	2002
Growth of GDP in %	-0.4	0.9	3.1	0.2	4.5
Export growth in %	- 15.7	6.2	14.6	10.0	5.8
Import growth in %	- 3.9	- 18.1	10.0	1.4	6.0
Inflation in % (CPI)	6.0	3.7	3.7	-0.1	1.5
Unemployment in %	8.5	9.1	8.5	9.3	9.4
Budget deficit in % of GDP	1.1	3.1	2.7	2.8	2.3
Current account balance in bn \$	-3.4	-1.5	-1.6	-1.1	-1.2

Sources: CEPAL (2003): Balance preliminar 2002; IMF: Country Report 03/73; Dresdner Bank Lateinamerika: Perspektiven 3/2003.

5. Transformation management

Management problems among the political elite have been the Achilles' heel of Peru's transformation since 1980. Economic reforms had flagged even before the regime change in 2000, while political institutions increasingly came under the authoritarian thumb of the Fujimori/Montesinos regime. The interim government under Valentín Paniagua gave Peru the opportunity to resume its transformation. The following analysis and assessment refers primarily to transformation management under the Toledo government.

5.1 Level of difficulty

In terms of structural socioeconomic conditions that shape the political process in the long term, the difficulty of the post-Fujimori transformation is to be regarded as considerable. The setting presents a mix of positive and negative aspects. Less positive factors include Peru's relatively low level of economic and social development, widespread poverty, inefficient state administrative and rule-of-law institutions, significant ethnic and social heterogeneity, weak political and civil society and vulnerability to external economic forces. On the other hand, the state has reestablished its monopoly on the use of force; heterogeneity has not bred ethnic or religious conflict; social tensions have not dramatically escalated, despite social segmentation; and the society is relatively well educated, despite severe problems.

Furthermore, much of the needed economic structural reform had already been accomplished in the 1990s, with relatively broad consensus. There was also a relatively clear basic consensus about democracy and core democratic rules when the new regime took over. However, the task of stabilizing and broadening Peru's democratic transformation is also made more difficult by situational factors, chiefly President Toledo's uncertain majority in Parliament, the new political elite's low level of professionalism, and, not least, high expectations among the population which coincide with an aversion to Fujimori-style neo-liberal reforms. Finally, the stagnant global economy presents an unfavorable environment for further steps toward transformation.

5.2 Reliable pursuit of goals

The Toledo administration has demonstrated very little reliability in achieving goals. Granted, a platform of basic assumptions about the course of transformation and a market economy was laid out and accepted by all parties in the *Acuerdo Nacional*. However, concrete reform policies are neither fully developed nor particularly coherent. This failing pervades the ranks of the political elite and reflects the weakness of the party system. In the opinion of many neutral observers, President Toledo has not met the challenge of his office. The shortcomings are most evident in the administration's unclear strategic priorities. Apart from the political management of current problems, the government also pursues long-term goals, but it often defers these for the sake of short-term political gain.

In the economic arena—where the Peruvian government continued neo-liberal policies, but trying to give greater weight to social considerations—the overall strategy for reform has been pursued tentatively. The government has shown greater resolve in continuing the transitional government's political work

including reining in the military, expanding the Truth Commission, pursuing decentralization and combating corruption.

Against this backdrop—and in part because of the president’s weak leadership, the heterogeneity of his coalition cabinet and the unstable majority in Parliament—the consistency and coherence of reform policies is limited. For example, the government has made only sporadic progress in implementing the reform measures in Peru’s agreement with the IMF. The government meets basic expectations of security in terms of life, law and the economy, but it is vulnerable to unexpected reversals and changes of course, for example, in its privatization policies. Therefore, societal and economic actors must expect politically induced uncertainties; these could increase because of shifting political alliances.

5.3 Effective use of resources

The Toledo government’s use of available economic, cultural and human resources to pursue its transformation policy is not optimal. One reason is that Peruvian reform policies do not always have clear goals. In regard to state resources, the primary weaknesses are the budget deficit, which is still too high, and the high level of public debt. Added to this are unpredictable state revenues as a result of repeated tax amnesties that, in a way, perpetuate noncompliance and fail to bring in the tax revenues needed to combat poverty. The tax burden is still at only 12% of GDP. The job creation program has fallen far short of expectations because of inadequate information management.

With regard to human resources, the government’s efficiency suffers from frequent ministerial changes and, not least, from Toledo’s failure to maintain his approval rating as president and wield the authority essential for long-range reforms in the personality-dominated arena of Peruvian politics. The administration does not operate as efficiently as it should, and the ill-defined and hastily implemented decentralization program has only made matters worse. Overall, the government carries out only some of its announced reform projects and cannot keep to its plans.

The public services provided by the government make advances in development or transformation possible, but there are shortcomings, especially in the areas of infrastructure and human resources. One positive program that stands out here is a nationwide initiative to equip schools with computers and Internet access. Progress has also been made in combating corruption, though efforts have focused on the offenses of the Fujimori era. To date, the government has not made adequate attempts to provide the integrity mechanisms that are lacking. However, it did establish a National Commission to Fight Corruption and Promote Ethics and Transparency.

5.4 Governance capability

The Toledo government has demonstrated rather weak organizational capability. It was unable either to manage reforms astutely or to establish consistent priorities among needed reforms. The fault lies partly in the managerial capacity of the president himself, but partly in the relative inexperience of Peru's political elite as a whole. Although the president and the government did react to missteps and failed policies—such as the privatization plans that sparked regional protests—with changes, these have generally been marginal, such as reshuffling the cabinet or appeals to the nation. Toledo's strategy presents no clear roadmap of forward-looking reforms. Accordingly, learning processes have not extended as far as the knowledge base or cognitive framework of policies. This will become even more difficult as the political landscape becomes more differentiated via regional governments where the opposition scores successes.

Furthermore, the government has squandered whatever trust the public accorded it at the start of Toledo's term—a reservoir already limited by skepticism toward the political class. The most obvious sign of this is the dramatic drop in Toledo's own approval rating since he took office, primarily because he failed to carry out his campaign promises. As a result, the government only partially retains the political authority to initiate or implement needed reforms. Instead, a further explosion of demands from interest groups looms on the horizon, calling to mind the problems of governability that beset Bolivia. A positive point in this scenario is that the government has largely managed to avoid misdirecting economic resources. Politically, however, it has encountered difficulties in further improving the distributive efficiency of the markets. This is shown by the unresolved budget problems (decentralization, tax policy), resistance to privatization and inadequate control over monopolies.

On the whole, the organization and management of transformation during this period were only prudent and astute under the transitional government, when the pursuit of economic stability was resumed and essential political reforms were initiated. The current president and his administration, along with the rest of the political elite, tend to overestimate their own abilities and misjudge the challenges they face—tendencies that became apparent when the Fujimori regime collapsed but had already existed in the 1980s. One manifestation of this was Toledo's promise of economic and social improvements, which he continued making even after he was elected president.

5.5 Consensus-building

The Toledo government earns somewhat better marks in consensus-building. All the significant political and social actors agree on a stable market-economy

democracy as a goal for reform, although their ideas of how to reach that goal vary considerably. This framework of consensus was documented in the *Acuerdo Nacional* of March 2002, which was launched by Toledo and his team under the banner of necessary reconstruction. It encompasses all of Peru's important parties and social forces. It has yielded little in the way of concrete measures, and will proceed further only if competition between the parties does not revert to confrontation. However, antidemocratic veto powers no longer exist in Peru, notwithstanding occasional speculation about a revival of the Shining Path.

The verdict is more mixed regarding the political management of social cleavages, which—because of the weaknesses of civil and political society, especially after the Fujimori era—are not clearly articulated. On the one hand, the key political actors are not able to mitigate the latent fault lines of ethnic and socioeconomic conflict. On the other hand, political fragmentation has made it easier for political leaders to keep structural conflicts from escalating.

In regard to Peru's regional heterogeneity, political decentralization could bring progress, in that now these divergences are represented by institutions. However, this presupposes a careful delineation of political and fiscal responsibilities that has barely come to pass. If decentralization is not better managed in the future, local and regional divergences may also develop into political forces that burden democratic institutions rather than relieving them.

The government encourages solidarity among citizens and societal groups, but is ineffective due to incoherent policies. Openness to solidarity is influenced by the anti-Fujimori sentiment, which the political actors have been able to keep alive, but this will be depleted before long. In contrast, the initiatives to address the human rights violations of 1980–2000 may have a positive effect in the long term; so far, they have been relatively purposeful and comprehensive.

5.6 International cooperation

The Toledo government has made an effort to achieve full reintegration into the international community and to improve Peru's battered image as a reliable, democratically oriented partner. It works closely with international donors and generally uses international support to improve its policies. On the whole, the political actors actively strive to build and expand international cooperative relationships.

The Toledo government's stabilization strategy relies on coordinating its reforms closely with the International Monetary Fund, the World Bank, and the Inter-American Development Bank; it earns guardedly positive marks from these institutions. The government shows a steadfast willingness to meet requirements and for the most part it makes effective use of the resources provided by

international partners. By contrast, the role of outside actors in the democratic transformation process is minimal. Before the regime change, the OAS tried to mediate between the government and the opposition, but only half-heartedly and without real consistency. The United States appears to have played a significant role in toppling secret intelligence chief Montesinos.

After the regime change, cooperative efforts—for example, with the IADB or the EU—have focused primarily on improving the rule of law, supporting national reconciliation and implementing decentralization. In its relationship with the United States, the government aims to continue the strategic cooperation in the war on drugs, for example in replacing the coca economy, on which an estimated 200,000 jobs in Peru depend. However, this runs up against resistance, sometimes massive, from the coca farmers. In the past two years, Peru proved itself a reliable, cooperative partner in its dealings with other regional powers, especially Chile and Ecuador, and with regional and international organizations. The Toledo government also worked toward closer cooperation among the Andean Pact countries.

6. Overall evaluation

In view of the starting conditions, current status and progress achieved, as well as the players' political achievements (management), this assessment arrives at the following evaluation:

(1) Starting conditions: The starting conditions for the recent transformation (after 2000, when the Fujimori era ended) were in part favorable but in part adverse. Even before 1998, the economic order had undergone fundamental reforms; the country had functional and in part effective market-economy structures. However, the formal sector of the economy covered only half the population, and the poverty rate remained consistently high. Expectations that the Toledo government would deliver very rapid socioeconomic progress were correspondingly high.

Government institutions were more stable and consolidated than they were in 1980 or even 1990, but they were still limited in their efficiency and performance. Furthermore, traditions favoring the rule of law, civil society and democracy had eroded during the Fujimori era; in particular, the party system was weak as a mediator between the state and society. On the other hand, further political transformation benefited from what had become a broad consensus in favor of democracy as well as from the rejection of corruption and authoritarianism.

(2) Current status and evolution: Naturally, because of the regime change, Peru made relatively great progress in its democratic transformation during the last five years. But after the transitional government, the political decision-makers were not very successful in broadening the democratic transformation. With scattered

exceptions, the overall course of consolidation has stalled. Significant shortcomings remain, above all in political representation and integration, the institutional efficiency of the governmental system, the rule of law and citizens' support for the democratic system.

In the economic transformation, significantly less ground was gained—in part because of what had already been achieved. True, the political decision-makers were able to stabilize macroeconomic development; but the framework for market-economy organization was hardly improved at all. Thus, the economic transformation to a functional social market economy is far from complete and lags behind the democratic transformation. The most important structural reforms all remain unfinished, e.g. establishing a healthy banking system and capital market, developing an effective policy to combat monopolies and encourage competition, and padding the free market economy with social state elements.

(3) *Management*: On the whole, the verdict on the actors' management performance is more negative than positive. Compared with the previous period, the transformation process did not gain purposefulness, momentum or power during this period, although the actors deserve credit for achieving stabilization in the midst of political turbulence. After the transitional phase, the lack of a consistent reform strategy, inadequate leadership and an unstable political setting combined to slow the transformation process to one of relative stagnation. On the other hand, partially successful management strategies can be observed in some policy areas such as decentralization, national reconciliation and combating corruption. It remains to be seen whether Toledo's strategy of consensus and concerted action, especially the national agreement on medium- to long-term guidelines for transformation, yield success.

7. Outlook

Although the overall picture of transformation in Peru is mixed, the fact remains that historical comparison reveals progress, albeit halting; opportunities for further advances exist. The key strategic tasks for democratic and market-economy reforms over the medium term lie in consolidating the rule of law, improving the institutional efficiency of the government system, stabilizing democratic patterns of representation and attitudes, continuing to reform the organization of the market and competition, and buttressing economic development with sociopolitical measures that assure sustainable social integration.

Strengthening the rule of law and civil liberties will require not only legal reforms but also, above all, a professional nationwide development of the judiciary's administrative systems—a task that is hardly feasible without external support.

Another open question is how successful the high courts will be in asserting and maintaining their authority in the face of delegative styles of governing.

Any effort to increase the government's institutional efficiency must not only tone down presidential power but, above all, reform the state administrative systems. A reform of the electoral system and party financing would also be advisable in order to improve the organizational stability of parties and combat illegal party financing. However, these reforms can be accomplished only through consensus among the political forces. The managerial achievements of the political elite will ultimately determine whether Peruvian democracy can solve its most urgent problems—inadequate representation, the crisis of support and deficiencies in the rule of law.

The challenge lies in strengthening the intermediary structures to articulate and aggregate societal interests as well as in overcoming the short-sighted strategies of the political elite—strategies that often are oriented toward particular interests and short-term gain. In the future, international donors should give as much weight to these goals as to Peru's economic development.