

# BTI 2008 | Peru Country Report

<b>Status Index</b>	1-10	<b>6.60</b>	# 38 of 125	
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Market Economy	1-10	6.61	# 42 of 125	➔
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scale: 1 (lowest) to 10 (highest)    score    rank    trend

This report is part of the Bertelsmann Transformation Index (BTI) 2008. The BTI is a global ranking of transition processes in which the state of democracy and market economic systems as well as the quality of political management in 125 transformation and developing countries are evaluated.

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## Key Indicators

Population	mn.	28.0	HDI	0.77	GDP p.c.	\$	5,373
Pop. growth <sup>1</sup>	% p.a.	1.5	HDI rank of 177	82	Gini Index		52.0
Life expectancy	years	71	UN Education Index	0.87	Poverty <sup>3</sup>	%	30.6
Urban population	%	72.6	Gender equality <sup>2</sup>	0.58	Aid per capita	\$	14.2

Sources: UNDP, Human Development Report 2006 | The World Bank, World Development Indicators 2007 | OECD Development Assistance Committee 2006. Footnotes: (1) Average annual growth rate 1990-2005. (2) Gender Empowerment Measure (GEM). (3) Percentage of population living on less than \$2 a day.

## Executive Summary

In the last two years, Peru's transformation continued to be marked by severe weakness of political institutions on the one hand and macroeconomic stability on the other. Although some indicators point to strengthened economic stability, the main problems of economic development in Peru, such as extreme poverty, informality, and the lack of job-creating growth, remain. For the most part, these shortcomings are associated with weak governance capabilities of the political elite, which failed to seize opportunities for a new start both with the end of the Fujimori regime in 2000 and its successor, the interim government of Valentín Paniagua (2000 – 2001). The Toledo government (2001 – 2006) proved incapable of introducing the necessary reforms of political and economic institutions. The García government (2006 – ) has begun to tackle these problems, but major reform steps have yet to be taken. The state of Peru's democratic transformation during the review period (January 2005 to January 2007) shows that the advances made immediately after the Fujimori era, which regained ground lost in the 1980s and 1990s, could not be furthered. Compared with the early 1980s, when democracy was restored in Peru in the wake of a military regime, political development has merely stagnated. However, the worst case scenario outlined in the 2006 BTI report – political stalemate, crisis and a military coup – did not materialize, precisely because the political elites acted in fear of such outcomes. Nevertheless, transformation management was ineffective under these circumstances, thus continuing, in the words of Mario Vargas Llosa, the “desgobierno” – erratic, inappropriate or incompetent behavior on the part of the government. Despite some efforts to strengthen the rule of law, fight corruption and expand political participation, the Toledo government and especially the president himself faced a steady decline in their respective authority. This has aggravated Peru's stateness problems, thus outweighing the efforts to stabilize democracy. The return of Alan García, who had led the country into its deepest crisis ever in the late 1980s, met a population regarding him with mixed feelings at best and

as the lesser of two evils at worst. García's first six months were characterized by his intent to regain reform impetus and leadership in order to better tackle the urgent problems Peru is facing, but has until now shown a mixed record. The evaluation of Peru's economic transformation in the last two years is clearly more favorable. Peru's economic institutions were strengthened in recent years by the efficient use of external support, while economic performance since 2002 has shown surprising success, at least at the macroeconomic level. However, the Peruvian market economy's core problem, namely its lack of social embeddedness, is still far from being overcome. It is a major cause for growing dissatisfaction among the Peruvian population. The political elite proved incapable of using macroeconomic success to deepen economic transformation. The new administration of President Alan García seems to have a clearer picture of Peru's essential problems and a more realistic agenda to tackle them. However, time is running short to counter the rather explosive – or implosive – social and political situation, given the merely anomic tendencies affecting Peruvian society. Foreign as well as domestic actors – the World Bank, IMF, UNDP, part of the media and NGOs, and not the least the government itself – agree upon the urgency of this dilemma.

## History and Characteristics of Transformation

As in the other transformation countries of Latin America, political and economic transformation in Peru did not unfold concurrently over the past two decades. Political transformation to a third-wave democracy began 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 under the presidents Fernando Belaúnde Terry (1980 – 1985) and Alan García Pérez (1985 – 1990), a process accompanied by accelerated sociostructural change, an outmoded development model, the debt crisis, hyperinflation and terrorism.

This deterioration culminated in Fujimori's "self-coup" (autogolpe) in April 1992 and did not end until authoritarian fujimorismo collapsed in autumn 2000. After the autogolpe, the constitution was suspended, parliament dissolved and 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 re-election in 2000 in spite of its disputed constitutionality, a goal that increasingly shaped the regime's course. When the Constitutional Tribunal in 1997 declared as inapplicable the law on the "authentic interpretation" of the constitution, instigated by Fujimori and his followers in parliament, Fujimori gutted the Tribunal and completely suspended the separation of powers.

From that point until Fujimori's resignation, 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 presidential term in July 2000. While civic protest against re-election had been growing since 1996, it was the uncovering of Montesinos' corruption network in 2000 that 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 passing of 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 the democratic consolidation it had begun in 1980. The Toledo government, however, did not succeed in strengthening democracy, with the last two years showing a sort of exhaustion and greater political instability, and not the least the upsurge of Ollanta Humala's leftist nationalist movement. The elections in 2006 – both presidential and parliamentary in April and May (ballotage) and regional and local elections in November 2006 – show the politicization of deepening social cleavages in contemporary Peru. The population regarded the victory of former President Alan García Pérez with mixed feelings, and after the first six months of his tenure in office, at the end of January 2007, the main problems in deepening democratic transformation continued unabated.

In terms of market economic transformation during the Fujimori administration, Peru turned away from the 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. With its crisis in the second half of the 1970s, the military regime lost legitimacy, but reforms were not pursued. However, the following democratic governments of the 1980s also 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.

Fujimori's administration finally tackled needed structural reforms in 1990 – 1991, at first with support from the opposition in parliament. Fujimori initiated an orthodox policy of recessive stabilization combined with aggressive structural reforms that included a package of drastic measures ("fujishock") aimed primarily at fighting inflation. These measures included revising collective bargaining agreements, reducing

subsidies, budgetary discipline and a restrictive monetary policy. In 1991, 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 crises 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 and underemployment. In part because of social policy shortcomings, the latter have become even more structurally entrenched. Under the Toledo government, and especially since 2002, surprising macroeconomic success was recorded, but without major structural improvements. The 2005 – 2007 period saw only a modest decline of poverty, inequality and informality. The new García government tries to continue with nearly the same economic policies, which can prosper as long as the country can benefit from the windfalls of international economic growth. Reform steps aim to strengthen the efficiency of economic as well as welfare institutions.

## Transformation Status

### I. Democracy

Two major developments have marked Peru's political transformation in the last two years. On the one hand, similar to other Andean countries, Peru saw the upsurge of a leftist-nationalist movement with a strong ethnicistic touch, leading to the formation of the Peruvian Nationalist Party (Partido Nacionalista Peruano) under the leadership of former military officer Ollanta Humala. Despite his defeat in the ballotage of the presidential elections, his movement-party has evolved into a decisive factor in Peruvian politics. On the other hand, below the level of the Lima-dominated national political scenery, the political landscape has become even more diffuse through the emergence and reinforcement of localist phenomena. The two elections held in 2006 – presidential and parliamentary elections in May and June 2006 and regional and local elections in November 2006 – are showing this old and new divide and presage the upcoming cleavages in Peru. While electoral democracy seems to have been strengthened by the orderly, managed, free and fair elections, the underlying centrifugalism and the accompanying turmoil are a challenge for the democratic institutions. Deficiencies in transformation remain, especially regarding the rule of law and the channels of representation. Democratic stability is impaired by a weak party system, a weak civil society and meager social capital. While civil society has become more diverse and demanding, part of it is eager to opt for means of expression and participation outside of institutions. Though the mentioned impairment still does not threaten the system at present, the next two years will be decisive for Peru's future development. Depending on the new García government's as well as the resting political elite's capacity for reforms, the country may either follow a social democratic route to transformation like Brazil or one that leads to even greater instability like Bolivia.

#### 1 | Stateness

The problems related to stateness grew during the Toledo administration and could not be resolved in the last two years. In principle, the state's monopoly on the use of force is in place, although remnants of the once virulent guerrilla movements – especially those of Sendero Luminoso (Shining Path), which are tied to the coca economy – remain. Also, the drug mafia still has an important

Monopoly on the  
use of force

influence, especially in the drug production districts and near the borders with Bolivia. In large parts of the valley of the Rivers Apurímac and Ene, which is also seen as the last bastion of Sendero Luminoso, the state's monopoly on the use of force is not guaranteed. In addition, the acceptance of non-state violence related to the weakness of state institutions and an unskilled political class has persisted. As in the period from 2003 to 2005, this led again to nearly anarchic political protest and to several extra-judicial killings or killing attempts by civilians (lynching). Furthermore, as the Defensoría del Pueblo (Ombudsman Office) reported, a large part of social conflict in Peru today stems from inter- and intra-communal conflicts, especially in rural areas. Occasionally these conflicts turn violent, due to the state's incapacity to settle the conflict. Moreover, the state's tenuous monopoly on the use of force is aggravated by the high crime rates. As in other Latin American countries, and combined with the abovementioned tendencies, crime is not only a problem of the rule of law but reveals an absence of the state in its most essential function. On the whole, Peru is in danger of declining from a weak state into a failing state, especially due to the population's loss of confidence in state authority and state institutions at every level.

Defining citizenship and who qualifies as a citizen is still not a politically relevant issue. Until recently, the politicization of Peru's ethnic diversity – particularly concerning the indigenous population – has been of minor political significance, but indigenous movements and self-confident mobilization are growing. All citizens formally have the same civic rights, and widely accept the nation-state as legitimate. Exceptions include the historically grown racism against the indigenous population, the growing influence of ethnicism in Peruvian politics and the emerging political salience of the center-periphery cleavage. Combined with the growing acceptance of leftist-nationalist ideas there are signs that the existing concept of nationhood is eroding. Existing and new political entrepreneurs might utilize the citizenship issue to undermine further the weak acceptance of the state as legitimate.

State identity

The state and its legal matrix are largely defined as a secular order. Religious dogmas have no noteworthy influence on politics or law. However, the preferential treatment given to the Catholic Church in education, tax benefits, and other areas has continued to raise concerns about potential infringements of religious liberties of non-Catholics. In addition, the upsurge of evangelical groups in the last 20 years presents an ambivalent development for Peru's legal culture. While providing for greater religious diversity in the country, evangelism brings with it a new fundamentalism that may have severe effects upon jurisprudence.

No interference  
of religious  
dogmas

The state's basic infrastructure extends throughout the territory of the country, but its operation is still deficient. It suffers especially from widespread corruption, low technical skill of its employees, and a lack of accessibility for most of the poor. The ongoing process of decentralization is still not accompanied by a solid

Basic  
administration

funding of the administrative structures, thus resulting in a weak presence of functional state institutions in some provinces. This leads not only to the aforementioned inability to settle conflicts, especially in the countryside and among the poor, but also to the weakened legitimacy of regional and local authorities. As the state cannot fulfill its proper function of jurisdiction in all parts of the country, a Peace Justice system has been established for minor cases. It operates all over the country, but is especially relevant in the poor provinces and in the Andes region. Though it is working rather effectively, there are frictions between it and the official judicial system.

## 2 | Political Participation

In principle, there are no important constraints on free and fair elections. 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 governments of Alejandro Toledo and Alan García as well as other power groups observed the principles of open and competitive elections. The national, regional, provincial and municipal elections in 2006 demonstrated this once more. But while the national elections for presidency and the National Assembly in April and May 2006 were widely accepted as free and fair, more problems arose during and after the regional and local elections in November. In some communities, especially in the countryside, but also in some urban districts, severe post-electoral conflicts arose over the electoral results, leading to violent acts like the burning of documents, destruction of public buildings, intimidation of candidates or authorities and aggressive mobilizations. This turmoil reflects the underlying problems of weakened state legitimacy, political particularism and deficient civic culture in large parts of Peruvian society.

Free and fair  
elections

In principle, elected rulers have the effective power to govern as far as the classical veto powers (armed forces, landowners, business groups, etc.) are concerned. While Peru's real governance problems stem from other factors, some minor problems arise with individual power groups that can set their own domains apart or enforce special-interest policies against the state. However, after decades of different features of military autonomy, the main problem – concerning civilian supremacy over the armed forces -- has been resolved for the most part. After cleansing the Fujimori political mafia from the military, the intelligence service (SNI) and the judiciary, the Toledo government largely regained the effective power to govern, strengthened through further reforms to consolidate civilian control over the military and by reorganizing the intelligence service (now known as CNI). The military no longer holds veto or other political powers. One of the remaining lacunae in civil-military relations is corruption within the military, although its degree is still unknown. Another problem of

Effective power  
to govern



military autonomy concerns the realm of military justice. The political and judicial struggle to confine military justice to a narrow range of genuine military affairs is ongoing, although some sectors of the military and political society advocate keeping cases of human rights violations perpetrated by members of the armed forces within the judicial authority of the military. Nevertheless, efforts to include military justice under the auspices of the national justice system continue. Apart from these cases, the effective power to govern is undermined by a few interest groups, which act as functional equivalents to veto powers. One problem arises from drug trafficking and drug producing. While the drug mafia can be seen as a mere problem of stateness or rule of law, there are problems with the coca producing peasants and their organizations in some provinces. This “cocalero civil society” effectively opposes the national anti-drug policies and tends to object to state interference in their affairs. An estimated 300,000 and 500,000 Peruvians are dependant on the coca economy.

The rights of political organization and communication are respected, though governance problems seem to make politicians more inclined toward increased restrictions given the high level of conflict in the country. The freedom of association and assembly is almost unrestricted within the basic democratic order. Political and civic organizations can form freely, but union activity is still subject to certain regulations (as a result of neoliberal 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 still erects barriers for parts of the indigenous population. In addition, in some parts of the country such as drug-production districts like Alto Huallaga and VRAE, the population is cautious about exercising constitutional political rights. The abovementioned cocalero movement shows one of the dark sides of civil society in Peru. In November 2006, Congress passed a law regulating the formation and activities of NGOs, which shows a tendency toward state control over civil society activities. Approved by the majorities of the governing American Popular Revolutionary Alliance (APRA), also known as the Peruvian Aprista Party (PAP), the Fujimorista Alliance for the Future (AF) and liberal-conservative National Unity (UN), the law is intended to contain the high level of conflict in Peruvian society and to allow for enhanced public security. Actors mainly from civil society and the media criticize the law as an act of state control over civil society, which might lead to arbitrary state intervention and even to charges of terrorism. The law still has to be signed by President García to enter into force.

Association /  
assembly rights

The state-run and private media are mostly free of government influence, though there has been some pressure from parts of the political establishment during the last two years related to media coverage of corruption cases. Offenses against

Freedom of  
expression

journalists are more frequent now at the local level where authorities feel free to take action against their critics. The stateness problems in the Alto Huallaga and VRAE regions, including the growing importance of drug traffickers, undermine press freedom in these provinces.

### 3 | Rule of Law

Though the working of checks and balances has not improved much during the last two years, the feared institutional deadlock did not occur. This mainly owes to the tacit agreement between the political elites not to undermine a weakened President Alejandro Toledo, as they feared a complete deterioration of the democratic framework. Despite initiatives to investigate the government's conduct, in the end the opposition declined to impeach Toledo. Thus, a rather fragile system of checks and balances between executive, legislative and judiciary was maintained until the end of his term. However, this game was driven rather by power rationales than by commitment to the proper functioning of democratic institutions. On the other hand, because of his weak position, which derived mainly from his weak governance capacities, Toledo did not have any opportunity to seize legislative powers as has become habitual in other Latin American countries like Argentina, Venezuela and Bolivia. The working but fragile system of checks and balances continues under the presidency of Alan García, who also confronts the problem of divided government. Thus far, there has been no further friction between the state powers. García, who had governed by decree excessively during his first term in the 1980s, is now instead looking for majorities in parliament to gain support for his policies. This kind of normalization is a good sign despite the fact that the system of checks and balances still suffers from a low degree of professionalism in all the state's branches.

Separation of powers

The judiciary is established as a distinct profession and operates relatively independently, but corruption and insufficient territorial or functional penetration restrict its functions. Nearly all relevant actors in Peru agree that the judiciary is the most fragile of Peru's democratic institutions. After years of interference by the other branches, the judiciary's independence suffers nowadays more from its historically grown disfunctionality than from political subordination and disregard. Major deficits include legal education, jurisprudence, regulated appointment of the judiciary, rational proceedings, professionalism, channels of appeal and court administration. While the government respects in principle the constitutional authority of the judiciary, it has done little to strengthen its countervailing powers. Intended reforms did not prosper, partially due to their complexity, but also because of the elite's incapacity for consensus building. A special commission (Comisión Especial para la Reforma de la Administración de

Independent judiciary

la Justicia, Ceriajus) has elaborated a promising reform proposal, but it still awaits serious discussion and implementation. The same holds for the Law on Judicial Career – aiming at the creation of a meritocratic system – of which the treatment parliament is still delaying. Meanwhile, the overwhelming problems of corruption at all levels of the judicial system have made the supervision office (OCMA) one of the most active dependencies of the judiciary. Notwithstanding, there are some islands of excellence within the judicial system, such as the Constitutional Court and the Ombudsman Office. In their struggle for the essentials of constitutional democracy, they have shown their professionalism in interpreting and reviewing norms and pursuing their own reasoning, free from the influence of the political leadership, or of powerful groups and individuals.

While corrupt officeholders are increasingly prosecuted under established laws, they can still slip through political, legal or procedural loopholes. In brief, an impartial prosecution and penalties for abuse of office cannot be seen as rules in Peruvian politics. These problems are even more present at the subnational levels of administration. After the era of Fujimori and Montesinos, political society, 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 have been prosecuted for corruption, including many former government officials, businessmen, mass media owners and high-ranking officers. This process, however, has been stagnating during the past two years. Neither the Toledo nor the García administrations, nor many other political representatives and parts of the judiciary, showed interest in extending the incipient measures.

Prosecution of  
office abuse

Civil liberties are respected in principle, but could not be further strengthened during the review period, as judicial reform failed to proceed and the state's authority weakened further. As a result, civil rights are violated or not implemented in some parts of the country. 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. Equal access to justice is severely restricted for the poor, notwithstanding the efforts in some provinces to exempt poor people from court fees. Almost one-third of the population has no access to judicial services. There are instances of torture and abuse at the hands of the state security forces. Furthermore, the weakness of state institutions leads to a tendency toward vigilante justice, which further undermines the role of the judiciary as a bulwark of civil liberties. Concerning the civil rights of women, the problem focuses mainly on the state's insufficient protection of women and girls against violence, including rape and spousal abuse. Insensitivity on behalf of law enforcement and judicial authorities

Civil rights

toward female victims has aggravated abuses. Though political discourse is changing, the situation has not. The most positive development in human rights during the last years has been the establishment of the Truth and Reconciliation Commission (CVR) in 2002. In 2003, it delivered its Final Report (Informe Final) on human rights violations between 1980 and 2000. As already stated in the 2006 report, however, the recommendations of the CVR-report, especially concerning the prosecution of human rights violations, have not been fulfilled (see 16.5 below). Regardless, the good sign is that important parts of Peruvian civil society insist on these demands, as they do with other essential human rights issues.

#### 4 | Stability of Democratic Institutions

Peru's democratic institutions fundamentally perform their functions, but much waste occurs because of friction between them. After the collapse of state institutions in the 1980s and their dismantling in the 1990s, they have yet to regain a solid footing in the new democratic state. This applies especially to the rule of law, where the necessary reforms did not transpire. The same relates to the process of decentralization, which was hastily driven and has led to ambivalent results. All in all, the expected institutional consolidation did not advance, and the prospects are not promising, as circumventing the formal political procedures is still frequent.

Performance of  
democratic  
institutions

At present, nearly all influential political actors accept the democratic institutions and regard them as legitimate. However, a few players do not fully accept individual institutions of the democratic state. The climate of the 2002 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 – did not lead to a compromise further strengthening democratic institutions (above all the judiciary). Instead, the competing political majorities in parliament and in the weak government lapsed into a de facto blockade of reform. The upsurge of the leftist-nationalist movement as well as the disregard of institutional procedures by numerous organized groups hint at the possibility of further instrumentalization of institutions for narrowly defined interests.

Commitment to  
democratic  
institutions

#### 5 | Political and Social Integration

Problems with institutional stability and efficiency are connected to the still unstable structure of political representation, which cannot mediate adequately 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, with the possible

Party system

exception of the APRA Party (PAP). It remains to be seen if the changes in electoral legislation during the past years will strengthen the party system. At least the severe fragmentation of the party system was contained after passing the Law on Electoral Barriers in September 2005. In order to be elected to Congress, it established that parties have to obtain 5% of the votes or at least 6 elected representatives in more than one constituency (for 2006 Congress elections, a barrier of 4% resp. 5 elected representatives were accorded). As a consequence, the effective number of parties in parliament declined from 4.36 to 3.78. However, the parties still have little ability to formulate programmatic objectives, as well as strong tendencies to focus on personalities and patronage, and confront a high level of voter volatility. The tendency towards a more stable party system in the wake of the national elections in 2006 did not hold. On the one hand, the formation of stronger center-right and center-left forces around APRA, UN and Frente del Centro was undermined by the strong performance of newcomer Ollanta Humala and his PNP, which implied the danger of a Bolivian or Ecuadorian mode of political development. On the other hand, the regional, provincial and local elections in November 2006 revealed a further fragmentation of the political landscape below the national level. The strong showing of regional groupings aggravated the issue of interest aggregation in the Peruvian political system. All national parties including PNP demonstrated their inability to establish more stable relationships with voters. In sum, Peru's party system is still plagued by fragmentation, high volatility, and now – at least at the national level – sharpening polarization. The deficient party system remains one of the greatest obstacles to the consolidation of democracy.

Peru's landscape of interest groups continues to be relatively well differentiated, but highly fragmented. In sum, it cannot fulfill the function to mediate between particular and public interests. On occasion, interest groups can make their voices heard or even utilize extra-institutional pressure to push their interests. Employers' associations 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 weight. An exception is the still powerful teachers' union SUTEP, which is allied with the Maoist party Patria Roja and has repeatedly demonstrated its ability to oppose the government's policies. The weakness of the government contributed to the exaggeration of particular demands, which can neither be channeled nor met.

Interest groups

While the dynamics of civic organizations are fairly positive, consent to democracy is rather low, though Latinobarómetro data showed an increase in 2006. Political protests, though not ideologically motivated (i.e., anti-system protests), occasionally call the constitutional framework de facto into question. Since 2002, there has been a sharp drop in satisfaction with democracy and citizens' trust in democratic institutions. Despite experiences under the Fujimori

Consent to  
democratic  
norms

regime, approval of democracy declined from 64% in 2000 to 40% in 2005. 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.

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. This development, however, is ambiguous. In principle, there is a wide range of autonomous, self-organized groups, associations and organizations, despite political, cultural and socioeconomic barriers. Due to the country's social segmentation and diversity, however, there is a split between more "liberal" and more "participative-demanding" currents inside civil society. The abovementioned cocalero movement shows one of the dark sides of civil society in Peru. According to surveys, the level of interpersonal trust is below the already low Latin American average. On the other hand, the broad-based campaign to deal with human rights violations has helped to strengthen social consensus in Peru.

Associational  
activities

## II. Market Economy

Peru's political authorities were able to maintain macroeconomic stability and partially to consolidate the prevailing economic model. Despite the observably poor management in reforming and strengthening political institutions, the opportunities for a solid economic transformation process still exist as Peru has profited from the world economy's good performance. The World Bank even concedes a slight improvement in the institutional framework. Major shortcomings remain with respect to competition, restoring the health of the banking and capital markets, combating market concentration and the formation of oligopolies and, most importantly, promoting sufficient inclusion of additional population strata in formal economic life. The most positive development is the surprisingly positive macroeconomic balance, which continued until 2007.

### 6 | Level of Socioeconomic Development

Key indicators show a medium level of development for Peru. Measured in terms of the HDI, however, the country's level of development does not permit adequate freedom of choice for a large part of its citizens, due to the segmentation of Peruvian society. Social exclusion and marginalization based on poverty, the education gap and gender discrimination are evident, particularly in the highlands and the Amazon basin, where most of the indigenous population lives. The Gini Coefficient remained invariant, indicating a mere stagnation of development.

Socioeconomic  
barriers

During the survey period, Peru failed to reduce social disparities, high poverty rates and income disparities. Despite continued GDP growth of 5%, poverty declined more slowly than expected. Economic performance also did not lead to a significant increase in employment, at least in the formal sector of the economy. Existing development imbalances among the various regions, especially between the coast and the highlands, were not reduced and thus they still represent a form of dual economy in Peru, in addition to the large informal sector. A relatively modern industrial and service economy concentrated on the coastal plain stands in sharp contrast with the subsistence agricultural economy in the interior. The still-dynamic coca economy alleviates development problems in Peru.

Economic indicators		2002	2003	2004	2005
GDP	\$ mn.	57,056	61,494	69,686	<b>79,379</b>
Growth of GDP	%	5.2	3.9	5.2	<b>6.4</b>
Inflation (CPI)	%	0.2	2.3	3.7	<b>1.6</b>
Unemployment	%	9.7	10.3	10.5	-
Foreign direct investment	% of GDP	3.8	2.2	2.6	<b>3.2</b>
Export growth	%	6.9	6.3	14.7	<b>14.9</b>
Import growth	%	2.8	3.6	10.6	<b>10.6</b>
Current account balance	\$ mn.	-1062.8	-934.7	-11.0	<b>1029.9</b>
Public debt	\$ mn.	20,410.5	22,530.8	24,199.1	<b>22,222.0</b>
External debt	\$ mn.	28,067.9	29,640.5	31,218.3	<b>28,652.6</b>
External debt service	% of GNI	6	4.3	4.1	<b>7.5</b>
Cash surplus or deficit	% of GDP	-1.4	-1.7	-1.2	<b>-0.8</b>
Tax Revenue	% of GDP	12	12.8	13.1	<b>13.5</b>
Government consumption	% of GDP	10.1	10.2	10.0	<b>10.1</b>
Public expnd. on edu.	% of GDP	3.0	2.8	2.9	<b>2.4</b>
Public expnd. on health	% of GDP	2.4	2.0	1.9	-
R&D expenditure	% of GDP	0.1	0.1	-	-
Military expenditure	% of GDP	1.3	1.3	1.2	<b>1.4</b>

Sources: The World Bank, World Development Indicators 2007 | UNESCO Institute for Statistics | Stockholm International Peace Research Institute (SIPRI), Yearbook: Armaments, Disarmament and International Security

## 7 | Organization of the Market and Competition

The foundations of a competitive market economy are by and large assured. Dense regulation of the economy was largely rolled back after 1990. Price controls, subsidies and restrictions on foreign investment were lifted. In the formal sector of the economy, market competition thus has a solid institutional framework. Although the relevant public institutions are in place, they still suffer from widespread corruption and deficient rule of law. In addition, slow and costly business registration still poses an entry barrier. The private sector continues to face several constraints that hamper growth, including contract enforcement, starting a business, dealing with licenses and trading across borders. Equally important, about half of Peru's economic activity takes place in the informal sector. According to the World Bank, the high levels of informality and low levels of formal permanent employment creation are to be attributed to slow and costly business registration procedures, complex tax filing procedures for businesses, and inflexible labor regulation. It estimates the net loss of jobs caused by rigid labor legislation in the vicinity of 5% of urban formal private employment (i.e., as much as 200,000 wasted job opportunities), for a very limited benefit in terms of worker protection because of weak enforcement capacity at the Ministry of Labor. Diminishing informality is a major and necessary task in advancing Peru's economic transformation. Agricultural production is still below potential, mainly because of inadequate infrastructure and lack of well-defined property rights in rural areas.

Market-based  
competition

The formation of monopolies and oligopolies is regulated inconsistently, though the institutional framework has slightly improved due to the authorities' growing awareness of the dangers of market distortions. Anti-cartel legislation has existed since 1991, but it relates almost exclusively to anti-competitive behavior such as price fixing or market sharing. The competition agency Indecopi has been strengthened over the last decade in order to sanction abusive acts as a result of a dominant position and restrictive market practices. However, 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 and to some extent in the financial sector.

Anti-monopoly  
policy

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. There are no restrictions or controls on payments, transactions, transfers, or repatriation of profits. However, Peru still suffers from insufficient integration into the world market and is considered a relatively closed economy by the World Bank. Exports and imports are not much higher today than they were thirty years ago (about 40%), and exports now account for about 0.1%

Liberalization of  
foreign trade



of world exports, compared with 0.3% in 1970. A Free Trade Agreement with the United States was approved by the Peruvian Congress, but still awaits approval in the U.S. Congress. In addition, further steps were taken toward bilateral negotiations with Mexico, Singapore, Thailand, and the EU. President García continues the free trade policies of his predecessors, and is especially lobbying for the Free Trade Agreement with United States.

With the opening to foreign institutions in the early 1990s, the Peruvian financial system modernized rapidly and became very competitive. It now rests on a more solid foundation. Further measures to strengthen bank supervision following the principles of the Basel II accord are being implemented, but they are still not up to the highest international standards. The banking and financial system includes 14 commercial banks, 40 municipal and rural saving banks and microfinancial institutions, four government-owned entities, and three dozen finance, leasing, insurance and pension administration companies. The Superintendency of Banks and Insurance (SBS), which regulates the banking system, generally follows the internationally accepted regulatory guidelines set by the Basel accord or, when not applicable, the standards set by the (U.S.) Financial Accounting Standards Board. SBS regulations include periodic compulsory assessments of all deposit-taking institutions by at least two independent credit rating agencies, whose capacity to perform is assessed by the SBS. Customer deposits carry deposit insurance financed by commercial bank contributions to an insurance fund. The high “dollarization” of the banking and financial sector – with three quarters of outstanding bank loans denominated in U.S. dollars while most personal and corporate income is in soles – still presents an unresolved question. Despite the new norms introduced by the Superintendency of Banks (SBS) in order to control this problem, it could not be resolved until now. Another major problem for Peru’s economic development remains the high costs of credit for medium- and small-sized firms as well as the still limited access to microfinance.

Banking system

## 8 | Currency and Price Stability

The García government is continuing its predecessor’s consistent policy on inflation and currency. The inflation rate, which returned to single digits in 1997, has been kept low. The central bank has been independent since the middle of the 1990s. However, 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. So far, negative consequences have not appeared, in part because the exchange rate has remained relatively stable during the period under review.

Anti-inflation /  
forex policy

The García government inherited a stable macroeconomic situation from the Toledo administration. This is mainly due to the external economic context, but partly the result of the authorities' sound economic policies. During the survey period, the Toledo government managed to further reduce the budget deficit from 1.0% of the GDP in 2004 to 0.3% in 2005; for 2006 there is an expected surplus of between 0.2 and 0.6% of GDP. The government's fiscal and debt policies have also been mostly stability-oriented. Despite García's solid macroeconomic management during the first six months, the political situation may challenge this budgetary discipline by bringing demands for an extension of public policies, the possible costs of decentralization, or a further drop in revenues resulting from an inconsistent tax regime. The administration stabilized and, since 2005, was able to reduce foreign debt, which had risen continuously since 1992, but the total national debt and the public debt hover at a high level. Debt management has been modernized, which is reflected in the publication early in 2006 of the government debt management strategy aiming to strengthen transparency and accountability. Foreign currency reserves have stabilized at a favorable level and can cushion some of the risks noted here.

Macrostability

## 9 | Private Property

In general, property rights and property acquisition are adequately defined and protected as civil rights with regard to the acquisition, use, benefits and sale of property. Exceptions occur in some areas inhabited by the indigenous population, where land titles are not defined at all, not clearly defined, or defined in a way that is incompatible with indigenous value, which creates recurring conflict between the population and petroleum companies. The main problem, however, lies in the fact that property rights are not adequately protected in practice, because the judicial and administrative systems are still flawed.

Property rights

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 continued at a slower pace under the Toledo administration. The privatization of two electricity companies in southern Peru was suspended in the wake of sometimes-violent protests. There is also resistance in parliament to further privatization but so far, this has not lead to a reversal of privatization policies. In contrast to his state-interventionist policies during his first term (1985 – 1990), President García is now committed to the pivotal role of private enterprise and continues his predecessor's economic strategies (e.g., Public-Private-Partnerships) for accelerated and solid growth.

Private  
enterprise

## 10 | Welfare Regime

Welfare institutions to avert social risks exist, but are extremely segmented in terms of territory, social stratum and sector. The country still cannot combat poverty systematically on its own. Peru's hybrid welfare regime is limited to certain sectors and reaches only part of the population. Deficiencies are rather severe in rural areas. Even before the deep crisis of the 1980s, the social insurance system – prescribed by the 1933 constitution – 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 to patronage practices. Under Toledo, the system's main deficiencies were corruption and the lack of efficiency: not all the social policy programs reached the targeted population. This is especially evident in the case of malnutrition, which extends to 25% of children under 5 years. Despite spending \$250 million a year the situation has worsened during the last decade. The García administration has begun to address these deficiencies, e.g. by efforts to improve efficiency and effectiveness of the relevant multi-sectoral programs. It is too early, of course, to judge the outcomes of these policies.

Social safety nets

There are institutions to compensate for gross social differences, but they are limited in scope and quality. Social services to help eradicate poverty and inequalities repeatedly failed due to misconception and corruption. Despite continuing strong economic growth during the last six years, about half the population still lives in poverty; in rural areas the rate is uniformly above 60%. The disparity of income distribution in Peru is severe (Gini Index of 0.43 in 2004), although more moderate than in Brazil or Chile. There is no equal opportunity, and access to public services is not equal. There are few mechanisms to promote the advancement of women, persons with disabilities or the socially disadvantaged. Discrimination against women also limits their access to post-secondary education, income and public office. As a consequence of the salient political polarization during the 2006 election campaign, the García government has begun to address these problems. Clear-cut policies, however, are not apparent yet.

Equal opportunity

## 11 | Economic Performance

Measured by most of the macroeconomic data, Peru was among the four best performers in the region during the last years. As the World Bank rightly concludes, “growth has been well-balanced between primary and non-primary sectors, and has been particularly strong in agriculture, construction, manufacturing, and mining. Unlike previous decades, growth has reached non-traditional sectors beyond commodities, has been led by rapidly -growing exports, and has been accompanied by improvements in productivity. Moreover, the economy grew despite recurrent internal political instability in 2003 and 2004.” In sum, the political authorities managed economic affairs prudently using the favorable external conditions. This obviously stands in sharp contrast to developments in other policy areas. On the negative side, in addition to problems already noted (dollar dependency, national debt, decentralization, tax revenues still only around 14% of the GDP, although improving) the formal sector remains limited, which inhibits viable, dynamic economic development, especially concerning new job creation. Since the drastic pre-1992 slump, the country’s level of development remains medium to low and the poverty rate remains high. Thus, reducing vulnerability to external shocks and integrating more than half of the population into the expanding economy remain the two major tasks for the García government.

Output strength

## 12 | Sustainability

Deforestation, overgrazing and overfishing, desertification, and air and water pollution are the nation’s primary environmental problems. Worsening ecological problems – especially soil erosion and the contamination of rivers and lakes – primarily affect the highlands and the Amazon basin, especially in times of the El Niño phenomenon. In addition, there is a looming threat of an accelerated retreat of glaciers in the Andes, which would have dramatic economic, ecological, and even cultural effects. Until recently, ecologically compatible growth received only sporadic consideration, and it has still no adequate institutional framework. Not at least due to the recurring El Niño phenomenon and the radical protest against pollution by mining firms, environmental awareness in society and among lawmakers has grown in recent years, but remains low. Environmental concerns generally take a lower priority than economic growth considerations. Environmentally sustainable growth receives minimal attention and is not reflected in the institutional framework. The lack of financial support aggravates the weak institutional capacity for environmental management. Both public and private environmental expenditures amount to about a quarter of a percent of GDP, low by international standards.

Environmental policy

Education and training facilities are available in important segments, but they vary widely in quality. Despite increasing school enrollment numbers, necessary reforms were not undertaken and the sector is still a significant obstacle to Peru's further development in all areas considered here. In some indicators, such as school attendance, the record is even worse than under the Fujimori regime. The World Bank accurately observes that the education sector is locked in a low level equilibrium of low compensations, low expectations, and low performance. The state's expenditures for education since the 1990s have stalled at about 3% of GDP. Definite shortcomings continue in research and development, with expenditures at around 0.1% of GDP. The World Bank concludes that, "except for a few extractive industries, Peru's technology standards – and, thus, its productivity – are low. This is the result, in large part, to the low quality of its tertiary education system and the relatively small number of technology specialists. Most knowledge transfer comes from imports of machinery and equipment. Only a small (albeit growing) portion of local firms acquire technology through licensing, turnkey projects or technical specifications embedded in export contracts. As part of its national export strategy the government has launched various initiatives to raise technological standards in specific sectors such as textiles, jewelry, aquaculture, and fisheries. However, the scale and impact have been limited thus far. "A modern infrastructure does not extend nationwide, but is limited to certain segments and enclaves (major cities, modernized economic sectors). Its deficit is particularly severe in transport, electricity and water, affecting the Andes and Amazonas regions significantly, thus being a major obstacle to further development especially in the rural and agrarian sectors. Public investment in infrastructure is below 1% of GDP, with low participation from the private sector.

Education policy  
/ R&D

# Transformation Management

## I. Level of Difficulty

In terms of the structural socioeconomic conditions that shape the political process in the long term, the difficulty of the post-Fujimori transformation is medium. The setting presents a mix of positive and negative aspects. Negative factors include Peru's relatively low level of economic and social development, widespread poverty, inefficient state administrative and rule-of-law institutions, significant ethnic, regional and social heterogeneity, weak political and civil society and vulnerability to external economic forces. However, in the 1990s, the state re-established its monopoly on the use of force, though it has deteriorated slightly in the past years; heterogeneity has not bred severe ethnic or religious conflict; social tensions have not dramatically escalated, despite social segmentation; and the society has a basic level of education, despite severe problems. Furthermore, much of the needed economic structural reform had already been accomplished in the 1990s, with relatively broad consensus.

Structural  
constraints

Despite frequent civil mobilizations and active engagement of pressure groups, traditions of civil society, which began to emerge in the end of the reformist military regime (1968 – 1980), remain weak. Notwithstanding an increase in NGO activity, the landscape of voluntary organizations is still meager and plagued by scarce organizational resources (see political participation). Two different cultures of civil society have emerged and consolidated. On the one hand, a more liberal part has intensified its work, such as monitoring human rights performance or observing the government's reform agenda. On the other hand, a more participative part of civil society also has gained strength, leading to a diverse landscape of activist groups and the explosion of demands – be it at the national, regional, provincial, local or communal level. According to recent data from Latinobarómetro, trust in institutions and social trust are rather low. (Although Peru takes a middle position in Latin America with regard to interpersonal trust, the continent as a whole has the world's lowest average indices in this area.) Finally, there is no civic culture of moderate participation in public life.

Civil society  
traditions

Although Peruvian society is split into social classes and ethnic communities and is plagued by racism, until now this has not led to an accordingly split political scenery, nor to major violent conflict. However, diverse mobilized groups and protest movements have become stronger in recent years, and radical political actors like Ollanta Humalas and his Peruvian Nationalist Party or the strong teachers' union SUTEP show increasing interest in mobilizing ethnic or social groups. Especially the "ethnicization" of Peruvian politics obscures the prospects for coherent transformation management, as has been the case in neighboring countries Bolivia and Ecuador. Violent incidents have occurred in Lima as well as in the Andes region.

Conflict intensity

## II. Management Performance

With the new García government, Peru has the opportunity to overcome political stagnation, which characterized nearly the entire Toledo era. Under the Toledo government, poor governance and political leadership were core reasons for Peru's blocked transformation. Management problems among the political elite have been the weakness of Peru's transformation since 1980. The interim government under Valentín Paniagua (2000-01) gave Peru the opportunity to resume its transformation. The Toledo government as well as the political elites did not use this window of opportunity. Instead, they fell back into the old syndrome of intransigence, incompetence, short-term political gains and the lack of accountability. The García government announced his policy for a "responsible change" to address the salient problems affecting Peru. After six months in office, however, doubts are growing as to whether it can manage this paradigmatic change. The following assessment concentrates on the transformation management of the García government. With only six months in office at the time of evaluation, assessments of this government appear tentative in some aspects. Nevertheless, they confirm that paradigmatic changes in defective (and not so defective) democracies remain difficult and require an extraordinary effort to be realized. From that point of view, this report evaluates the government's actions until February 2007 as insufficient to inaugurate the intended awakening.

### 14 | Steering Capability

The García administration has to deal with all the needed reforms and the whole range of political, economic and social problems its predecessor left. Its steering capability suffers mainly from a lack of programmatic clearness to set the reform agenda and from a lack of policy coordination. This failing, however, pervades the ranks of the entire political elite and reflects also the weakness of the party

Prioritization

system. The political leadership claims to pursue long-term aims but until now has not been able to demonstrate how it would achieve its goals. In addition, it seems to be inclined to replace the long-term aims by short-term interests of political bargaining and office-seeking. This assessment refers to the entire political elite, that is, not only the administration but also the parliament. In the latter, no effort has been made either by the ruling or the opposition parties to propose alternative projects despite the advanced state of discussion, as is the case with the needed judicial reform. On behalf of the government, which clearly prioritizes setting the reform agenda, only a very few of its pronounced long-term goals have been pursued as of yet, although it has had limited time. Although the leadership seeks to build democracy and a market economy, its strategic aims are unclear after six months in office. The government's Immediate Action Plan for the first 180 days demonstrates the leadership's consciousness of the wide range of problems, but also the lack of coherent and concrete reform measures. Though this plan could also be labeled as an emergency plan to tackle some of the most urgent problems – like the lack of security – and demonstrate leadership, the government should have developed its components into a more comprehensive policy. Besides failing to fulfill its Immediate Action Plan, the García government seems to rely on a strategy that seeks first to maintain macroeconomic stability, and second to use the positive windfalls to a politics of “muddling through.” Instead of elaborating a reform agenda for the next 5 years, the leadership – and above all President García himself – tries to distract criticism and maintain his relatively high approval rating even by turning to populist strategies. This was the case in his attempt to re-establish the death penalty in cases of terrorism or child abuse and murder. Similarly, García publicly offended the Interamerican Court of Human Rights (CIDH) and proposed Peru's withdrawal from the Court. (The CIDH had ruled that the relatives of the terrorists who were killed in the Castro-Castro prison in 1992 had to be compensated by the Peruvian state.) Moreover, García's maneuver resembles that of Fujimori in 1999 when the CIDH had demanded that Peru respect the rights of due process for suspected terrorists. The assessment of pursuit of long-term aims is somewhat better in the realm of economic transformation. As noted above, the government continues with the economic policies of austerity and macro-economic stability of its predecessor. Thus, García chose an economic team of renowned technocrats who can design and implement economic policies nearly without interference. However, after six months declarations of intent have mainly concerned deeper economic reforms, although they are ambitious, as the Letter of Intent to the IMF in January 2007 shows. The reforms envisioned therein intend to strengthen the institutional framework of Peru's market economy. They are likely to prosper if the relative insulation of the economic team can be maintained and if better coordination – especially with social policies – can be managed.



The García government announces its commitment to democracy and a market economy, but has had only partial success in implementing its announced reforms. Success suffers, first of all, from the lack of a coherent reform agenda as described above. Secondly, there is a lack of coordination and competence, as the poor achievement of the short-term goals outlined in the Immediate Action Plan demonstrates. Only a limited number of these goals have been accomplished, provoking sharp criticism among political and civil society actors. From the 30 measures outlined in the plan, only four have been fully realized: the 50% reduction of the salaries of all officeholders (including parliament and local level officials), the 80% cutback of its public relations expenditures, the Water-for-All program, and the strengthening of the Agrarian Bank (Banco Agrario) by duplicating its capital stock. 13 measures, however, were only partially realized (including the elimination of superfluous administration levels, merging of state agencies with similar functions and strengthening public security), while the remaining 13 were not realized at all (a number of social programs). Some progress was made concerning the reform of the education sector, where the government implemented its measures and thereby successfully confronted the teachers' union SUTEP. Overall, thus far, the García administration has achieved only a few minor reform goals, most noticeably where regulations can be issued by decree and where consensus building is unnecessary. However, important steps like the judicial reform as well as the law to reform the civil service have either not been tackled or did not proceed. While some agencies of the government's *équipe* can develop clear policies and suggest effective implementation, other branches demonstrate weak organizational capability.

Implementation

Although the political leadership tries to respond to mistakes and failed policies with changes, it mostly lacks the ability of complex learning. Though a period of six months seems rather short for such an assessment, signs indicate that the style of government repeats well-known features of Peruvian politics. Thus, the leadership remains stuck in the same routines. Among these signs are the return to a populist style of politics, the president-centered, nearly unilateral decision-making process in government, and not the least the president's authoritarian attitude. From that point of view, Alan García performs much like most of his predecessors. Lamentably, the political culture in Peru accepts this, so there is no strong demand on the country's leader to govern in a more illustrated and sophisticated manner. Though the García administration performs somewhat better than the Toledo government, it is not able to replace failed policies with innovative ones. Learning processes occur only sporadically, and they rarely contribute to the knowledge base or cognitive framework on which policies are based. An example of "negative" learning can be observed in García's initial strategy to form his cabinet not only from members of his own party, but also from well-respected technocrats. While this has contributed to a greater

Policy learning

professionalism of the cabinet, there seems to be a reversal now, which might again lead to greater influence of party politics (and thus less professionalism).

## 15 | Resource Efficiency

The García government does not make optimum use of available economic, cultural and human resources to pursue its transformation policy. However, a significant amelioration has taken place in comparison to the Toledo government. Thus, the government is not only committed to austerity and a carefully balanced budget, but also makes serious efforts to streamline the public administration as well as to avoid wasting of money with un-coordinated agencies and programs. In addition, it integrated the inefficient National Decentralization Council (CND) into cabinet structure. In its new form as the Secretaría de Descentralización, it is now dependent on the cabinet chief (or President of the Council of Ministers, Jorge del Castillo). This reorganization seems necessary to coordinate the envisioned “new” decentralization policy, which also includes the transfer of education and health services. However, the measure can also be interpreted as a re-centralization, and the more direct contact to regions and provinces can also be used to foster clientelistic ties. On the positive side, the government is also inclined to improve effectiveness by continuing the considerable advances in the area of fiscal management which were made in the past years, like the implementation of the financial management system SIAF, the reform of budget classification systems, and providing monitoring and evaluation systems for different public programs. Countering these positive developments, huge deficits remain in efficiency concerning economic and, above all, human resources. Concerning state resources, one major weakness is the persistent high level of public debt, despite amelioration in the last years. Added to this are unpredictable state revenues (a legacy of repeated tax amnesties), high tax rates, and perpetuated tax evasion. Though tax revenue has climbed to nearly 14% of GDP, it is still low compared even to other Latin American countries. As changes are gradual, these deficiencies will continue to undermine attempts to bring in the revenues needed to combat poverty. In human resources, the government’s efficiency still suffers from an oversized state apparatus, and politically motivated staff changes are still frequent, though not at the cabinet level as was endemic under Toledo. The administration does not operate as efficiently as it should, and the government did not proceed with its public sector reform.

Efficient use of assets

The García government tries to coordinate conflicting objectives and interests, but has had only partial success. As the government’s reform agenda is still not clearly pronounced, the first six months in office did not produce conclusive results. Therefore, the necessity to coordinate severely conflicting policies has

Policy coordination

not been urgent until now. However, there have been signs that the government, and above all President García himself, will have greater problems with coordination in the near future. Meanwhile, García has imposed a mostly hierarchic leadership in the cabinet and thus is achieving a certain policy coherence, at least in his own view. The more technocratic *équipe* in the Ministry of Economy and Finance is proven capable of at least outlining conflicting goals in its agenda. However, the abovementioned initiative to re-introduce the death penalty not only conflicts with the country's democratic development, but also with its international duties (i.e., the Pact of San José). Observers note that García's sometimes-erratic style of governance owes to his lack of clear principles, which he compensates with political maneuvers. There is therefore some doubt as to whether the leadership can ensure that its overall policy is coherent.

The new administration is not only confronted with extended corruption in politics and society, but also with a public very critical of officeholders who abuse their positions. To date, the government has not made adequate attempts to provide the necessary integrity mechanisms. Though some integrity mechanisms are implemented, they remain largely ineffective and private interests impede their operation. Moreover, the government's motivation and capacity to implement reforms is ambivalent. Its alliance in Congress with the party of former president Fujimori – who is seen as a symbol of corruption in Peru – has cast some doubts over the government's seriousness in that realm. Accordingly, during 2006 there were no systematic policies to strengthen the integrity mechanisms against corruption. However, corruption cases inside the government were sanctioned. The same held for a major corruption scandal inside the military, which was tackled by the minister of defense, Allan Wagner Tizón.

Anti-corruption  
policy

## 16 | Consensus-Building

In principle, nearly all the significant political and social actors agree on a stable market-based democracy as the goal of reforms, though there is a lack of consensus about how to reach that goal. In addition, there are serious doubts about the political orientation of Ollanta Humala's PNP, as concerns economic policies as well as Humala's stance vis-à-vis democracy. Apart from PNP, the Acuerdo Nacional, which was launched by President Toledo and his team in 2002 and encompassed all of Peru's important parties and social forces, remains a valid compendium of the basic consensus among relevant actors. Though its implementation failed due to the political stalemate, it is still seen as a blueprint for the course the country must take.

Consensus on goals

Anti-democratic veto powers no longer exist in Peru, if one excludes the remnants of the Shining Path. The military seems to be kept under control, and the government fosters the improvement of civil-military-relations. A problem might arise through the cocaleros and their unions, who openly demand the cancellation of the coca eradication policy continued by the García government.

Anti-democratic veto actors

Until now, the leadership was more or less successful with respect to the political management of social cleavages. Social tensions have been an issue in many parts of the country, and the government is taking actions to address them. The leadership thus created a conflicts unit in the Council of Ministers to provide for conflict settlement as well as for dialogue with disaffected groups. The real test for the government's ability for conflict management however is yet to come, as expectations are high and progress is slow. In addition, until now the key political actors have not been able to mitigate the latent divisions of ethnic and socioeconomic conflict. On the other hand, political fragmentation has made it easier for political leaders to prevent structural conflicts from escalating. Concerning Peru's regional heterogeneity, the government's strong focus on fostering political decentralization might bring progress, as institutions now better represent these differences. However, this presupposes a careful delineation of political and fiscal responsibilities that has not yet occurred. A plebiscite on a law intended to create new macro-regions and enhance the efficiency of a decentralized Peru failed in 2005. If decentralization is not better managed in the future, local and regional differences may also develop into political forces that burden democratic institutions rather than relieving them.

Cleavage / conflict management

The political leadership shows more inclination to ignore civil-society actors than to consider them. This assessment, of course, is somewhat ambiguous, given the centrifugal tendencies in Peruvian civil society and the Toledo government's reactions to them. The abovementioned (2.3) law on NGOs illustrates this ambiguity nearly perfectly. While the state is interested in containing excessive conflict, its measures might run counter to liberal principles – that is, Hobbes is (again) fighting with Locke in contemporary Peru. In addition, both the government and the rest of the political elite failed to establish a broad consensus on reform with other major actors in society. During the review period, dissent has grown within civil society over the role of the state in the economy and even over the preference for democracy. It is not impossible that populist political entrepreneurs will try to capitalize on these tendencies for political gain.

Civil society participation

Like its predecessors, the new political leadership recognizes in principle the need to deal with historical acts of injustice. However, the progress made over the last years was mainly driven by civil society actors rather than by politicians. Notwithstanding, the initiatives to address the human-rights violations of 1980–2000 will have a positive effect in the long term. Particularly as compared to

Reconciliation

other cases in Latin America, these initiatives have been relatively purposeful and comprehensive. The establishment of the Truth and Reconciliation Commission in 2002, leading to intensive work collecting testimonies, making a new record of the victims of human rights violations (70,000 killed instead 30,000, as had previously been presumed), and clarifying the responsibility for them. However, after these successes, the impetus for a true reconciliation was lost and most of the Commission's recommendations have not been fulfilled. Until now, the García administration has not shown great interest in this issue. The process is slow, especially concerning the trials of members of the military and the police, who, along with the Sendero Luminoso guerrillas, were the main perpetrators of past injustices. According to the abovementioned "Hobbesian" vision of political transformation, President García seems to be inclined to back unconditionally all members of the security forces that will be accused of human rights violations.

## 17 | International Cooperation

The political leadership works with bilateral or multilateral international donors and tries to make use of international assistance, but this has not yet facilitated significant policy learning and improvement. The García government's stabilization strategy relies on coordinating its reforms closely with the International Monetary Fund, the World Bank, and the Inter-American Development Bank; like the Toledo government, 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. In contrast, the role of outside actors in the democratic transformation process is minor. Cooperative efforts – for example, with the Interamerican Development Bank or the European Union – 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. However, this policy encounters resistance, sometimes massive, from coca farmers.

Effective use of support

In general, the government acts as a credible and reliable partner in its relations with the international community. Tensions with Chile, which arose under the Toledo presidency, have been kept low. Differences between the two countries, however, persist, above all concerning the borderline in the Pacific Ocean.

Credibility

The political leadership cooperates with many neighboring states and complies with the rules set by regional and international organizations. A possible exception is the case of introducing death penalty, which contradicts the Pact of San José. The government works toward closer cooperation among the Andean Pact countries. Currently Peru is one of the elected members of the U.N. Security Council.

Regional cooperation

## Strategic Outlook

The return of Alan García to the Peruvian presidency gave rise to high expectations as well as great skepticism. Though transformation management has not been as decisive as it could have been, major steps forward can still be taken and some of the García government's policy measures point in the right direction. However, continued strong policies and key reforms are needed to tackle the challenges faced by Peru. The next three to four years will be critical in achieving these goals, which will require a strong consensus among the political elites as well as within Peruvian society.

In the medium-term, Peru's leadership will have to continue economic consolidation and make its economy more resistant to external shocks. In the long term, overall reforms are needed and must balance entrenched and at times conflicting political and economic interests, which are not easy to reconcile. Peru's main transformation problems lie in the realm of politics and political management. In addition to ongoing economic cooperation, a new transformation strategy should focus on five key elements:

**Securing stateness:** Like most other Latin American countries, Peru is confronted with further erosion of the state's monopoly on the use of force. The García government has begun to confront this problem more thoroughly than the Toledo government. However, as the problem is multifaceted and ranges from guerrilla actions to urban crime, from anomic tendencies to mafia organizations, the leadership should develop a master plan that combines the legitimate use of force more effectively with softer strategies like prudent conflict management and socioeconomic measures. In addition, the government should, in the case of coca producers, offer alternative production opportunities.

**Strengthening political representation:** Interest aggregation and the channelling of demands are still major problems in Peru's political system. They must be addressed in order to avoid political and social turmoil and to develop sustainable programs for at least the medium-term. Though some efforts have been made at the national level, the democratic operation of Peru's parties needs to be addressed. Accordingly, more effective party legislation is necessary to combat the centrifugal tendencies at regional and local levels, which undermine the still weak representation structures between society and the state. This must of course be coordinated with the ongoing decentralization process; new decentralization policies should allow for more effective monitoring of sub-national entities.

**Strengthening the rule of law and the judiciary:** Although there are specific reform proposals on the books, greater commitment from all political actors is needed to effectively implement systemic reforms. All too often, systemic reform is seen as a merely technical issue. However, as reform in Chile has shown, stringent advocates of reform are needed, as is the capacity to identify and break anti-reform interests within the judiciary, the state apparatus and among members of the political elites. Using international advice and support wisely will be crucial for the success of such a reform.

**Reforming education:** Although some educational standards, such as literacy, have progressed, Peru's education system is still locked into a low level equilibrium of low compensations, low expectations and low performance. This is a severe obstacle not only to social and economic development, but also to the development of civic virtues that embolden democracy. While the García administration is right to address this problem as a priority, it must go further to develop a long-term reform strategy that recognizes the country's regional and cultural diversity.

**Strengthening political consensus and enhancing the capabilities of the political elite:** All the reforms mentioned above will last many years and, once under way, might be interrupted by government change or even by political turbulence. The sustainability of all reforms will thus be dependent on the ability of the political elites to agree upon the basic reforms. This means that the political elite should provide for an update of the 2002 National Agreement on Governance (Acuerdo Nacional) combined with a stronger sense of commitment to ensure the viability of concrete reforms. This of course requires that the entire political elite demonstrate a learning curve. In the past, the political elite was more likely to return to short-sighted and particularistic strategies and to lose sight of the long-term benefits of political cooperation. External actors such as German party foundations should focus on this problem more rigorously to promote a new political culture within Peru's political elite.