

BTI 2010 | Peru Country Report

Status Index	1-10	6.74	# 36 of 128	
Democracy	1-10	6.70	# 43 of 128	➔
Market Economy	1-10	6.79	# 33 of 128	➔
Management Index	1-10	5.65	# 46 of 128	

scale: 1 (lowest) to 10 (highest) score rank trend

This report is part of the Transformation Index (BTI) 2010. 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 128 transformation and developing countries are evaluated.

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Key Indicators

Population	mn.	28.5	HDI	0.81	GDP p.c.	\$	7668
Pop. growth	% p.a.	1.2	HDI rank of 182	78	Gini Index		49.6
Life expectancy	years	73	UN Education Index	0.89	Poverty ²	%	18.5
Urban population	%	71.3	Gender equality ¹	0.63	Aid per capita	\$	9.4

Sources: UNDP, Human Development Report 2009 | The World Bank, World Development Indicators 2009.

Footnotes: (1) Gender Empowerment Measure (GEM). (2) Percentage of population living on less than \$2 a day.

Executive Summary

Peru's process of democratic and economic transformation during the last two years under the government of President Alan García (in office since July 2006) has been marked by progress as well as stagnation. One of the main problems the government faces is the gap between citizens' expectations and the (perceived and/or actual) performance of the García administration. Economic progress and social unease characterize Peru's social and political climate after the administration's two and a half years in office. The president's disapproval rates have climbed steadily, though they are not as disastrous as they were for his predecessor Alejandro Toledo. Peru still has not overcome the political heritage of the Fujimori era (1990 – 2000) when widespread corruption and an anti-political campaign severely damaged public morale and the state's administrative performance. The poor performance of the entire political elite contributes to the lack of democratic leadership. In sum, Peru's transformation problems are political and socioeconomic in nature.

Despite somewhat more favorable socioeconomic conditions, Peru's democratic transformation did not proceed and even suffered some setbacks over the past two years (January 2007 to January 2009). While the García government tried to strengthen its legitimacy by economic modernization, it missed the opportunity to deepen the advances that had been made in 2000 – 2001 immediately after the Fujimori era. Peru's main problems include its weakened stateness, the precarious structure of political representation, lack of adequate checks and balances, and above all a weak judiciary.

Peru's economic transformation in the last two years was more favorable than its political reform. Peru's economic institutions were strengthened in recent years, thereby better enabling the country to efficiently use external support. Since 2002, Peru's economic performance has shown surprising success on both the macroeconomic level and in terms of poverty reduction. However, the core problems of the Peruvian market economy, such as its social embeddedness,

are still far from being solved and are a major cause for the growing dissatisfaction among the Peruvian population. Though President Alan García's administration has a clearer picture of Peru's essential problems and a more realistic agenda to try to solve them than the previous government, its strategies do not always aim at advancing economic opportunities for all Peruvians. While promoting the deepening of Peru's economic transformation with its strong and prudent macroeconomic management, the García administration has provoked protests in some segments of society, whom the president himself labeled as "perros del hortelano" (dogs in the manger). The gap between the government and the people thus widened and casts a shadow on Peru's future development.

History and Characteristics of Transformation

Since Peru's return to democracy in 1980, the country's transformation has been marked by abrupt and even erratic changes. The courses of political and economic transformation have not unfolded concurrently over the past three 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 – showed the politicization of deepening social cleavages in contemporary Peru.

The population regarded the victory of former President Alan García Pérez with mixed feelings – he referred to himself as the “lesser evil” compared to Ollanta Humala – while demonstrating stronger political leadership than Toledo. The economy's boom continued, while García – formally a social democrat, as his APRA Party is affiliated with the Socialist International – increasingly adopted right-of-center (fiscally liberal) positions. Nevertheless, after the first half of his 5-year term, many of Peru's political transformation problems remain unresolved, above all those concerning stateness and the judicial system. President García's approval rates fell to 19% in 2008 because many Peruvians felt excluded from the economic boom. A major corruption scandal in November 2008 involving his cabinet chief, Jorge del Castillo, and other members of the cabinet resulted eventually in Castillo's resignation. In a surprising move to regain leadership, García nominated as cabinet chief Yehude Simon – a leftist politician imprisoned during the Fujimori era and who had been successful as a governor of the Lambayeque department. (In July 2009, after the end of the review period, President García replaced Yehude Simon with Javier Velásquez from his APRA party in response to a government crisis caused by violent confrontations between protest movements and security forces.)

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. Whereas the 2005 – 2007 period saw only a modest decline in poverty, inequality and informality rates, beginning in July 2006 and until the financial crisis of 2008, the García government was rather successful in maintaining high growth rates, which contributed to a remarkable reduction in poverty – albeit without reducing informality nor inequality. In the context of the Free Trade Agreement with the United States, which President García pushed hard for, the government introduced several legal norms to strengthen the institutional framework of Peru's market economy. Their success, however, will depend on the impact of the global crisis as well as on careful implementation.

Transformation Status

I. Democracy

1 | Stateness

The issue of illegitimate violence is one of the core problems hindering Peru's political and economic transformation. This violence also affects transformation management, and it highlights the contradictory nature of a society faced with profound change. The state's monopoly on the use of force showed some improvements without, however, undergoing any fundamental change. In principle, the state's monopoly on the use of force is in place, but is still challenged in some areas. The further weakening of the Maoist rebel movement Sendero Luminoso (Shining Path), the once powerful guerrilla group now tied to the coca production and trade, indicates an advance toward increased state sovereignty. In 2007, the state arrested 189 members of Sendero Luminoso, most of whom were inactive. Military and police actions were especially successful in the districts of the valley of the Rivers Apurímac and Ene (VRAE), where Sendero Luminoso has one of its last bastions. This territory is coming increasingly under the government's control. Though reduced, Sendero's capacity to act remains, especially in the drug production district of Alto Huallaga.

Monopoly on the use of force

The state was less successful in its fight against drug-related crime and especially the drug mafia. The internationalization of the Latin American drug economy has made the situation in Peru even worse. In December 2008, President García warned that the Mexican drug cartels were expanding throughout the continent. García held the Mexican Tijuana cartel responsible for a wave of attacks on security forces in late 2008 in which armed men killed about 20 policemen and soldiers. The president believes that the Tijuana cartel produces drugs in the Peruvian jungle and that it has combined forces with the remnants of Sendero Luminoso. Thus, while the government has weakened Sendero's strength as a guerrilla political organization, it has failed to hinder the rebel group's increasing connection with the drug cartels. The Mexican drug cartels are seemingly targeting weak states like Peru for their expansion.

Despite the government's ongoing efforts to fight drug trafficking and to destroy coca plantations, Peru's drug economy remained strong and expansionist. After Colombia, Peru is the second most important coca producer in the world. Coca plantations grew an estimated 54,000 hectares in 2007, the biggest share of it (90%) used by the drug traffickers to produce cocaine. In 2008, the plantations grew an estimated 4% in Peru, 5% in Bolivia and 27% in Colombia, according to the International Narcotics Control Board. The United Nations Office on Drugs and Crime estimates cocaine production in Peru at 290 tons in 2008. In addition, the government's fight against drug producing and trafficking led to conflicts with the coca farmers (cocaleros) in 2007 and 2008, who conduct protests, strikes and road blockades in order to pressure the government into changing these policies. The cocaleros, whose number is estimated at 70,000 persons, are well organized in two unions – the Confederación Nacional de Cuencas Cocaleras del Perú (CONPACCP), which represents about 70,000 members, and the Central Nacional Agropecuaria Cocalera del Perú (Cenacop), which represents another 8,000 members in the Monzón valley. In 2008, the government continued its activities to further eliminate coca plantations, especially in the regions of Alto Huallaga, San Martín and Huánuco. These activities provoked violent reactions by the cocaleros and the drug traffickers in order to stop the eradication.

Though the García administration made serious efforts to contain violent social conflict, the acceptance of non-state violence persisted. As in the previous review periods, the Ombudsman Office (Defensoría del Pueblo) reported several latent and open conflicts in a number of provinces. These conflicts occur mostly on the local level and occasionally turn violent, because the state lacks the capacity to settle them. Moreover, the country's high crime rates were a permanent topic on Peru's public agenda despite the government's efforts to fight ordinary crime. As in other Latin American countries, crime in Peru is not only a problem of the rule of law but reveals an inability of the state to fulfill its most essential function. Private firms fill this gap by providing security for those who can pay for it. As a former chief of the Joint Command of the Armed Forces stated, however, 452 security firms operates in Peru without the necessary oversight.

Should the overall diminishment of stateness continue, the state could become a mere competitor with other forces, leaving the majority of Peruvians without essential protection.

Despite being a multiethnic nation composed of whites, mestizos, indígenas, blacks and Asians, defining citizenship and who qualifies as a citizen has not been a politically relevant issue in Peru. 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

State identity

are growing as they learn from the experiences in the neighboring countries Bolivia and Ecuador. All citizens formally have the same civic rights and widely accept the nation-state as legitimate.

However, as Peruvians widely acknowledge, the country suffers from a historically grown racism against the indigenous population, which might lead to a growing influence of ethnicism in Peruvian politics. The weak performance of former presidential candidate Ollanta Humala's leftist-nationalist movement occurred during a period of impressive economic growth, which counterbalanced the deeply rooted sentiments against the "white" and "centralist" state. Existing and new political actors might utilize the citizenship issue to further undermine a generally weak acceptance of the state as legitimate among the indigenous population.

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 non-Catholics' religious liberties. 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 profoundly affect jurisprudence. Although Catholics currently make up the majority (82.3%), the number of evangelicals may double by 2020 (projected increase from 12.5% to 25%).

No interference of religious dogmas

The state's basic administrative infrastructure extends throughout almost the whole 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 weak presence of the central state's administration in large parts of the country has always been a core problem for Peru's political and economic development. The extension of the administration improved since the end of the military regime and especially since the end of the Fujimori regime, but important structural problems remain. These problems are not confined to the drug producing areas. All relevant political forces supported the process of decentralization initiated under the Toledo government, which sought to bring the state closer to the people. However, the government implemented decentralization in a rather uncoordinated fashion. Decentralization itself, in turn, became a source of political instability because the process fragmented the political landscape and exposed unskilled local administrations to growing popular demands. World Bank analyses suggest that Peru's limited capacity to effectively use public resources hinders social and economic development.

Basic administration

The funding of regional and local administrative structures remains a problem and provokes sharp conflicts over the distribution of resources. In 2008, the government's plan to redirect the revenues of the mining tax (canon minero) from

the Tacna department in favor of the Moquegua department led to a violent upheaval in Tacna during October and November. In sum, the weak presence of functional state institutions remains unresolved in some provinces. This leads not only to the inability to settle conflicts, especially in the countryside and among the poor, but also to the weakened legitimacy of regional and local authorities. The government went as far as to declare a state of emergency in some provinces during the period under review, such as in Tacna in November 2008. Since the 1980s, a Peace Justice system existed for the adjudication of minor cases, another legacy of the historically grown incapacity of the state to fulfill its proper function of jurisdiction in large parts of the country. The system operates throughout the country but is especially relevant in the poor provinces and the Andes region. Though it is working rather effectively, frictions continue between it and the official judicial system.

2 | Political Participation

After widespread electoral manipulation during the Fujimori decade, Peru has restored universal suffrage and the right to campaign for office. State agencies have once again conducted elections properly. No elections have taken place in Peru since 2006 with the exception of re-call referenda on the regional and local level in December 2008 in order to confirm or withdraw elected officials. In principle, Peru places no important constraints on free and fair elections. In 2006, the government as well as other powerful groups observed the principles of open and competitive elections in the country's national, regional and local elections. However, 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. The re-call referenda in December 2008, however, were held without major disturbances. All citizens and the political elites involved accepted the results.

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) are concerned. The military had played a prominent role as a veto power since the return to democracy in 1980 and especially under the Fujimori regime when they formed part of the power coalition, which de facto governed the country. Though the military is now under civilian control, it remains in a strong position. After cleansing the military, the intelligence service (SNI) and the judiciary from the Fujimori political mafia, the Toledo government largely established an effective power to govern. The government strengthened its power through further reforms to consolidate civilian control over the military and by reorganizing the intelligence service (now known as CNI). President García showed great mistrust and even disregard towards the

Effective power to govern

military during his first term in the 1980s – when terrorism by Sendero Luminoso intensified and politicians were unable to address it – but now seems to be cultivating a closer relationship with military leaders.

In fact, the García administration appears to back the new “self-confidence” of the armed forces, which is manifest in the military’s impunity and the government’s support for the law of military justice that permits active military officers to serve as military justices. The military is trying to increase its budget and to strengthen its position vis-à-vis Human Rights groups by searching for support from governing apristas, nationalists and fujimoristas. To justify their position, the military refers to the extant security problems (see “monopoly on the use of force”) and the fact that Peru faces border disputes with Chile and a perceived armament of the Chilean military.

Individual power groups in Peru are able to successfully push their interest against the interests of the state. Public rumors persist about the existence and malfeasance of a mafia fujimori-montesinista, in other words a clandestine network stemming from clientelistic relationships originating in the era of President Fujimori and his advisor Montesinos. These rumors have yet to be substantiated or disproved. 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 such veto power comes from the interest involved in drug producing and trafficking. While the drug mafia can be seen as a problem of stateness or rule of law, the coca producing peasants and their organizations in some provinces present a real check on the state’s effective power of govern. This “cocalero civil society” effectively opposes the national anti-drug policies and tends to object to state interference in their affairs (see “monopoly on the use of force”).

The state generally respects the rights of political organization and communication, though governance problems and the high level of violent conflict seem to make politicians and the police more inclined toward increased restrictions. 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 in the 1990s) 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 creates 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 cocalero movement, for example, shows one of the dark sides of civil society in Peru.

Association /
assembly rights

The most prominent example of the state's intervention in civil society during the period under review was the new NGO law. In November 2006, Congress passed a law regulating the formation and activities of NGOs. The law showed 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 the liberal-conservative National Unity (UN), the law was intended to contain the high level of conflict in Peruvian society and to allow for enhanced public security.

Among other things, the new law obliged NGOs to register and agree to extensive government control. It also gave the government the power to punish NGOs when – in the government's eyes – they disturbed the public order or damaged private or public property. The potential penalties included revoking the NGO's license and prohibiting its directors and legal representatives from participating in another NGO for five years. Actors mainly from civil society and the media criticized the law as an act of state control over civil society. Though President García signed the law in 2007, the Constitutional Tribunal subsequently ruled some of its key articles were unconstitutional. The tribunal formally initiated an *accion de inconstitucionalidad* following the submission of two petitions challenging the law – one by the NGO sector supported by over 8,700 signatures and one by 30 members of Congress. The international community applauded the decision. The threat that the Peruvian government will enact similar laws remains.

With regard to assembly rights, the human rights organization *Coordinadora Nacional de Derechos Humanos (CNDH)* reports that in 2007 the Peruvian police repeatedly arrested participants of demonstrations. Though not backed by the constitution, the police argue that participants of demonstrations that are not authorized by local authorities can be arrested. This situation is more frequent in rural areas, where protesting peasants and their leaders are arrested without proof that they are disturbing the public order. The same occurred in Lima where police arrested protesting teachers and their leaders from the *SUTEP* union for several hours without judicial order.

Freedom of expression is almost unrestricted in Peru, though at times state agencies and private and criminal powers exert pressure on individual members of the media who report on critical issues. Both state-run and private media are mostly free of government influence. Pressure from parts of the political establishment during the last two years has occurred in relation to media coverage of critical issues or corruption cases. Offenses against journalists are more frequent at the local level where authorities feel free to take action against their critics. The Human Rights Organization (CNDH) reports that pressures on local media rose in 2007, either because these media outlets criticized police actions or because they did not

Freedom of
expression

transmit the desired information. The stateless problems in the Alto Huallaga and VRAE regions, including the growing importance of drug traffickers, undermine press freedom in these provinces. Finally, the weak and corrupt judiciary does not adequately protect the freedom of expression and even engages in dubious rulings, such as the libel suit against the editor of the newspaper *La República* and its well-known journalists Ángel Páez and Edmundo Cruz, who were sentenced for aggravated defamation in September 2007.

3 | Rule of Law

As in many other presidential systems in Latin America, the separation of powers in Peru is partially restricted and leads to a concentration of power in the executive. The judiciary and to a lesser extent the parliament, however, seek a restoration of balance. Since the breakdown of the autocratic Fujimori regime, monopolization of power has not occurred. This absence may be interpreted as important progress toward a functional system of checks and balances. Overall, Peru's system of checks and balances is weak and remains fragile because of frictions between state powers and a low degree of administrative and political professionalism, especially in Congress.

Separation of powers

President García, who governed by decree excessively during his first term in the 1980s, now seeks to cultivate parliamentary majorities to back his policies. Like his predecessor, García has to confront the problem of divided government but has more successfully avoided institutional gridlock between the executive and Congress. As a result, the government was rather active. Between July 2006 and 31 January 2009, the President promulgated 8,307 legal norms, including 331 ordinary laws (passed by the parliament), 100 legislative resolutions, 130 legislative decrees and 139 urgency decrees. From a total of 478 legal initiatives by the executive, 278 have been approved by Congress.

Nonetheless, the president used his delegated decree power to legislate on substantive matters such as combating organized crime and state modernization in the context of implementing the free trade agreement with the United States. Article 104 of the constitution determines that the Congress may delegate to the executive branch the power to legislate by means of legislative orders on the specific subject and for the term established by the authoritative law. In terms of their promulgation, publication, enforcement and effects, legislative decrees are subject to the same standards as the law. The president of the republic has to report every legislative decree to Congress or the Standing Committee for approval.

However, some of the legal norms introduced by these decrees seem to exceed the president's delegated authority or even to contradict the constitution. In addition, Congress did not always fully comply with its duty to approve or reject the

presidential decrees. In April 2007, Congress delegated decree power to the president to legislate on issues of organized crime. Some of the president's decrees, such as decree 982 (on the accountability of the police) or decree 983 (preventive arrest up to 144 months) were of dubious constitutionality. Other issues, like the creation of the Ministry of Environment or the reform of the Ministry of Agriculture, belong to legislature's domain. The same holds for some of the 99 decrees issued in the context of implementing the 2007 free trade agreement with the United States. Though the president justified these decrees in the name of Peru's progress, some observers voiced sharp criticism concerning the wide range of policy issues – indeed a kind of state modernization unilaterally from above – as well as of some particular regulations.

Peru's judiciary is established as a distinct branch of government and operates – at least in important sections – relatively independently. However, its functions are severely restricted by corruption, inefficiency, and insufficient territorial and functional penetration. Since the end of the Fujimori regime in 2000, the judiciary has made notable progress toward independence, including improved nomination procedures for judges and the strengthening of several courts and oversight agencies. Major judicial deficits include legal education, jurisprudence, regulated appointment of the judiciary, rational proceedings, professionalism, channels of appeal and court administration.

Independent
judiciary

During the period under review, the judiciary remained one of the weakest institutions of Peru's democracy. This weakness continues to foster corruption, illegal action and impunity. Compared to BTI 2008, the state's reform of the judiciary has made no major progress. The Toledo administration had already established a reform commission in 2003 (Comisión Especial para la Reforma Integral de la Administración de Justicia, Ceriajus), which elaborated a comprehensive reform program designed to introduce long-desired changes (Plan Nacional de Reforma Integral de la Administración de Justicia). The unwillingness of political actors combined with a lack of interest within large parts of the judiciary, however, has prevented any reform agenda from being implemented.

Notwithstanding, some islands of excellence exist 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. The trials against Fujimori and his advisor Montesinos are also signs of some positive developments in Peru. Nevertheless, an ongoing struggle continues over the independence of the judiciary. Political actors see the judiciary more as an obstacle to their decision-making rather than as a necessary counterweight to guarantee sound democratic procedures.

Similarly, the political and judicial struggle to confine military justice to a narrow range of genuine military affairs remains ongoing. 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, thus even disregarding the sentences of Peru's Constitutional Tribunal. By passing Law 29182 in January 2008, the government again showed its disregard for the Constitutional Tribunal by establishing rules and procedures for the establishment, composition and competencies of the Supreme Council of Military Justice (Consejo Supremo de Justicia Militar) that undermine the supremacy of an independent civilian judiciary. Nevertheless, efforts from civil and political society as well as from the judicial branch to include military justice under the auspices of the national justice system continue.

While corrupt officeholders are increasingly prosecuted under established laws, they can still slip through political, legal or procedural loopholes. Impartial prosecution and penalties for abuse of office are not generally practiced in Peruvian politics. These problems are even more pronounced at the subnational levels of administration. Nevertheless, since the Fujimori and Montesinos era, political society, civic actors and the public have become highly sensitized to corruption in politics. Hundreds of people have been prosecuted for corruption, including many former government officials, businessmen, mass media owners and high-ranking officers. The public considers the fight against corruption to be the most crucial aspect of good governance. Survey data from LAPOP reveal that about 76% of Peruvians interviewed conceive corruption as high, while 27% report to have been a victim of corruption.

These results are confirmed by the 5th National Survey on Corruption presented by the National Council for Public Ethics (Proética) in December 2008, which is approvingly cited in the government's National Plan to Fight Corruption from late December 2008. According to the survey, 57% of those interviewed in Lima and 52% in the provinces consider corruption to be the principal hurdle to development in the country. The primary forms of corruption are: bribery (39%), theft (13%), illicit acts in general (10%), acting for own profit (6%), embezzlement (6%), and the misuse of power and authority (5%). Respondents view the most corrupt institutions to be the judiciary (61%), the national police (53%), and Congress (47%) – only 8% consider the armed forces to be the most corrupt. When asked to evaluate the effectiveness of the state's anti-corruption system, 49% of respondents deemed it ineffective, 38% sparsely effective, and only 11% stated it is somewhat or very effective. An overwhelming majority of respondents (92%) claim that they do not file charges in cases of corruption. The reasons stated include fear of retribution (24%), belief that doing so is pointless (20%), or an inability to prove the case (15%). Peruvians also see a general lack of respect for the law as a factor fostering corruption: 79% believe that laws are not obeyed in Peru, while only 16%

Prosecution of
office abuse

believe that they are followed. The government itself claims that the lack of citizens' faith in the fight against corruption will in the end destroy public institutions.

But the government itself failed to give top priority to anti-corruption measures until November 2008, when a major corruption scandal broke out involving licensees in the petroleum sector (Petroperú) in which Garcia's cabinet chief and other members of the government have been implicated (see "anti-corruption policy"). While the politicians involved have been forced to resign and are now under investigation, and even though parliament decided to investigate all licensee processes that have been initiated during the Garcia government, the fact of such high-level corruption must be seen – at the very least – as an indication of stalled efforts to control corruption. However, it should be noted that within the context of an ineffective bureaucracy, many Peruvians see corruption as a necessary means of "greasing" the wheels of an otherwise sclerotic system in which services are not delivered in a timely or duly manner. The allocation of reconstruction funds in the wake of the 2007 earthquake in the Ica and Pisco regions constitutes a particularly disturbing example of this kind of corruption during the period under review.

The state respects civil liberties in principle but failed to further strengthen them during the review period, because judicial reform failed to proceed and the state's authority weakened further. As a result, civil rights are violated or discouraged 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.

Civil rights

Equal access to justice is still severely restricted for the poor, notwithstanding programs like PROJUR (Programa de Acceso a la Justicia en Comunidades Rurales) and efforts in some provinces to exempt poor people from court fees. Almost one-third of the population has no access to judicial services. Data from Latinobarómetro 2008 indicate that only 15% of Peruvians interviewed think that the state guarantees equality before the law – the smallest percentage in Latin America (average 30%). The National Human Rights Commission (CNDH) reports that access to justice is hampered by economic, cultural, geographic and lingual barriers, as well as by the lack of documents.

During the last two years, instances of torture and abuse at the hands of the state security forces have taken place. CNDH has criticized the government for failing to take actions to prevent or prosecute these cases, and for providing inadequate assistance for the victims and their relatives. 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. With regard to the civil rights of women, the problem is mainly 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 toward female victims has aggravated abuses. Racism is still widespread, though civil society organizations and the Ombudswoman office are engaged in campaigns to keep this issue on the public agenda. CNDH also criticized the government for its lack of concern for that issue.

The state has made only minor progress in addressing questions of past justice. Considered an historic judgment, in April 2009 the courts sentenced former President Alberto Fujimori, who had been extradited to Peru from Chile in September 2007, to 25 years in prison. He faced charges including the killing of 15 people in 1991 and the enforced disappearance and killing of nine students and a professor in 1992. Apart from this major case, however, prosecution of human rights violations between 1980 and 2000 is still difficult and even a matter of struggle between the state powers (see “reconciliation”).

4 | Stability of Democratic Institutions

Peru’s democratic institutions perform their basic 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 continue to lag and the struggle between judicial independence and political influence remains ongoing. Likewise, the process of decentralization, which began in 2003, was hastily driven and has led to ambivalent results. Though the decentralization process has resulted in more democracy, it has decreased the state’s efficiency and led to a more difficult aggregation of demands. Though the García government tried to re-direct this process in order to strengthen the efficiency of the state administration, it has not been very successful. The relations between executive and legislative are more stable now but suffer from the asymmetry between the powers and above all from the Congress’ lack of professionalism. In other words, democratic consolidation did not advance much in terms of institutional stability.

At present, nearly all of the 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 the reforms needed in order to strengthen democratic institutions. Judicial reform remains stalled since almost five years, despite the acknowledged need for reform. The decentralized political institutions are often instrumentalized for narrowly defined interests. Political actors see the judiciary more as an obstacle to their decision-making than as a necessary counterweight to guarantee sound democratic procedures. The failure to subordinate

Performance of
democratic
institutions

Commitment to
democratic
institutions

military justice to civilian rule is just another example of explicit disregard for the democratic rule of law and open defiance of the rulings of the Constitutional Tribunal.

5 | Political and Social Integration

Problems with institutional stability and efficiency are connected to the 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 between 1990 and 1992; since then, it has been unable to regain organizational stability or anchor itself in society, with the possible exception of the APRA Party (PAP). At least the severe fragmentation of the party system was contained after passing the Law on Electoral Barriers in September 2005. The law established that in order to be elected to Congress 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% and 5 elected representatives were accorded). The effective number of parties in parliament declined from 4.36 to 3.78 in 2006, when the last national elections took place.

Party system

The trend toward 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 Peruvian Nationalist Party (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.

Since the 2006 elections, no electoral contest apart from the recall referenda in December 2008 has taken place. Thus, it is unclear what direction the Peruvian electorate with a high level of voter volatility might take. More recent surveys indicate that Peruvians share a widespread distrust in political parties: Though almost 50% think that political parties are necessary to make democracy work, only 15% say that they are doing a good job, and only 11% have confidence in the existing political parties. Given the high dissatisfaction among those who are not profiting from the economic boom, observers expect a new rise of populism in the upcoming elections. In addition, Peru's parties still have little ability to formulate programmatic objectives and are therefore unable to present clear reference points to aggregate the multiple and disperse interests within Peruvian society. Instead, they show strong tendencies to focus on personalities and patronage. In sum, Peru's

party system is still plagued by fragmentation, high volatility and now – at least at the national level – sharpening polarization.

Peru's landscape of interest groups continues to be relatively well differentiated but highly fragmented and without an idea of the "common good." On occasion, interest groups are able to make their voices heard or even utilize extra-institutional pressure to push their interests. This has been repeatedly the case during the period under review, as exemplified by the violent demonstrations in Tacna in October and November 2008. Employers' associations and their views wield great influence and gained even more dominance under the García administration, which favors a development model of growth-led trickle down processes and firmly supports private sector investment. As a consequence, the unions, which were severely weakened in the wake of neo-liberal reform and massive impoverishment since the end of the 1970s, have lost almost all of their political weight. One exception is the still powerful teachers' union SUTEP, which is allied with the Maoist party Patria Roja. SUTEP has repeatedly demonstrated its ability to oppose the government's policies. Another exception – albeit on the "dark side" of civil society – is the strong cocalero unions (see "monopoly on the use of force"). In sum, interest groups in Peru focus on their own narrow demands and are unable to mediate between society and the political system.

Interest groups

Dissatisfaction among Peruvians with the functioning of the democratic system has affected their support for democracy as such. Data of the 2008 Latinobarómetro survey show that 40% of the population – the highest percentage in Latin America – think that Peru's democracy works worse than democracy in the rest of Latin America. Asked if the country is governed for a few powerful groups or for the common good, only 8% – the lowest percentage in the region – said it acts in the interest of the common good (Latin American average 25%). Only 16% of Peruvians are satisfied with the working of their democracy (Latin American average 37%), and only 14% are satisfied with their government's performance (Latin American average 57%). As a result, consent to democracy is rather low in comparison to other countries in Latin America. Only 45% agree that that democracy is preferable to other forms of government, only Guatemalans agree significantly less (Latin American average 57%). Since 2002, Peru has witnessed a sharp drop in satisfaction with democracy and citizens' trust in democratic institutions. Despite experiences under the Fujimori regime, approval of democracy declined from 64% in 2000 to 45% in 2008. Political protests, though not ideologically motivated (i.e., anti-system protests) but stemming from particular demands, occasionally call the constitutional framework de facto into question.

Consent to democratic norms

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, a wide range of autonomous, self-organized groups, associations and organizations exist in

Associational activities

the county, 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 cocalero movement shows one of the dark sides of civil society in Peru by – directly or indirectly – supporting drug trafficking. According to the America's Barometer 2008 of the Latin American Public Opinion Project (LAPOP), the level of interpersonal trust in Peru is very low and even far below the already low Latin American average – only Haitians trust themselves less. When asked about the confidence they had in the people in their community, only 44% of those interviewed answered they would be "very trustworthy" or "somewhat trustworthy."

II. Market Economy

6 | Level of Socioeconomic Development

The level of socioeconomic development in Peru slightly improved during the last two years because of windfalls from international economic growth and some domestic policy measures. Per capita income rose from \$2,390 in 2005 to \$2,864 in 2007, though it still lags behind the Latin American average of \$4,754. The most important positive trend was a further reduction of poverty rates. From 54.7% in 2001, poverty declined to 48.7% in 2005, 44.5% in 2006 and 39.3% in 2007. It is expected to have declined further in 2008 without, however, further reductions in extreme poverty. Extreme Poverty declined from 24.4% in 2001 to 16.0% in 2006 and 13.7% in 2007, but in 2008 stagnated due to the rise of food prices, which especially hurt the poor. In addition, data from the National Institute of Statistics (INEI) show that this development has been very uneven. While poverty declined impressively in urban and coastal areas as well as in the Amazon region (more than 11%), rural areas and the Andean highlands (Sierra) lagged significantly behind, reflecting the different economic endowments and structures. Regional disparities, in other words, remained stagnant or even increased. Out of the 24 departments, widespread poverty as a structural impediment of socioeconomic progress is very pronounced in the departments of Huancavelica (above 80%), Huánuco, Puno, Loreto, Cajamarca, Ayacucho and Apurímac (all above 60%), while Tumbes, Tacna (15%) and Lima (25%) are much better off (all data for 2007 from Peru's National Institute of Statistics). While extreme poverty in urban areas declined to 3.5%, in rural areas nearly one third (32.9%) of the population is still affected by this so-called "indigencia."

Socioeconomic
barriers

In sum, key indicators show a medium level of development for Peru. In UNDP's Human Development Index 2007/2008, the country ranks 87th among 177 countries with an index value of 0.773 (compared to 0.743 for the world and 0.691 for developing countries; data for 2005). Because of social imbalances, however, this economic development does not permit adequate freedom of choice for a considerable part of Peruvian citizens. Apart from poverty-induced disparities, social exclusion and marginalization based on the education gap and gender discrimination are still widespread, particularly in the highlands and the Amazon basin, where most of the indigenous population lives. The percentage of people living in shantytowns is very high in comparison to the Latin American average. The imminent economic slowdown resulting from the stagnation of the world economy will likely affect workers in the informal sector the most, because they are the least protected against the risks of a market economy (see "market-based competition" and "social safety nets").

Economic indicators		2004	2005	2006	2007
GDP	\$ mn.	69725	79385.1	92319.8	107291.2
Growth of GDP	%	5.0	6.8	7.7	8.9
Inflation (CPI)	%	3.7	1.6	2.0	1.8
Unemployment	%	7.4	7.5	7.2	6.7
Foreign direct investment	% of GDP	2.3	3.2	3.8	5.0
Export growth	%	15.2	15.2	0.8	6.2
Import growth	%	9.8	10.9	13.1	21.3
Current account balance	\$ mn.	19.3	1147.6	2754.6	1505.1
Public debt	\$ mn.	24676.9	22497.7	22111.2	19669.4
External debt	\$ mn.	31558.9	28932.7	28459.9	32154.4
Total debt service	% of GNI	4.2	7.8	4.4	8.9
Cash surplus or deficit	% of GDP	-1.2	-0.8	1.8	2.0
Tax Revenue	% of GDP	13.1	13.5	15.0	15.6
Government consumption	% of GDP	10.0	10.1	9.5	9.1
Public expnd. on edu.	% of GDP	2.8	2.7	2.5	2.5
Public expnd. on health	% of GDP	2.5	2.6	2.6	-
R&D expenditure	% of GDP	0.1	-	-	-

		2004	2005	2006	2007
Military expenditure	% of GDP	1.4	1.5	1.3	1.2

Sources: The World Bank, World Development Indicators 2009 | UNESCO Institute for Statistics | International Labour Organization, Key Indicators of the Labour Market Database | 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 largely assured. In addition, the García government has markedly improved the market economy's legal framework. The Fujimori government already rolled back dense regulation of the economy in the 1990s by lifting price controls, subsidies and restrictions on foreign investment. In the formal sector of the economy, market competition thus has a solid institutional framework. However, compared to countries like Chile, slow and costly business registration still poses an entry barrier. The private sector continued to face several constraints that hamper growth, including contract enforcement and problems starting a business, dealing with licenses and trading across borders. Despite the efforts made, the Global Competitiveness Index of the World Economic Forum ranked Peru on position 86 among 131 countries in its 2007/2008 report, identifying the country's weakest pillars as its institutions, infrastructure and innovation capabilities.

Market-based
competition

The García government has reacted to this well-known situation. After approval of the free trade agreement with United States in December 2007, parliament conceded decree power to the executive – limited to the period from 1 January 2008 to 28 June 2008 – to implement the necessary regulations to modernize the competition framework and to promote the competitiveness of the economy. In this context, the García administration issued a series of 99 legislative decrees to enhance competition, among them statutes to strengthen state capabilities, infrastructure, education, and to address the structural imbalances caused by the large informal sector. Given the magnitude of problems, the past experiences with inefficient laws and the possibly disturbing impacts of the global economic crisis, it remains to be seen what the effects of these decrees will be.

Peru's informal sector remains one of the most important impediments to enhancing the quality of competition and to bringing about greater social equity. Data from the National Household Survey (ENAH) in 2006 shows that 60% of the Peruvian labor force works in enterprises with less than 50 workers. Many of them operate informally and thus impede access to social benefits. A law approved in 2003 to address this problem did not yield the expected results, because workers or employers did not find it attractive. The government has addressed this informality

problem with a legislative decree in June 2008 targeting the incentive framework of small and medium-sized enterprises (e.g., affiliation to a health system will continue to be compulsory but co-financed in equal amounts by the employer and the government; similarly, affiliation to the pension insurance will be subsidized by the state).

Though the formation of monopolies and oligopolies is still regulated inconsistently, the institutional framework has slightly improved due to the growing awareness of the dangers of market distortions. In the course of neoliberal reforms in the early 1990s and the implementation of competition policy, anti-cartel legislation was introduced in 1991 in the form of Legislative Decree 701, which established ex-post controls for dominant position abuses and collusive practices. The aim was to eradicate monopolistic practices, controls and restraints on competition in the production and marketing of goods and in the provision of services. In June 2008, the government issued a new competition law (Legislative Decree 1034) in order to clarify anticompetitive conduct, strengthen the state's investigative powers and assure its independence. The law does not have any provision for mergers that may produce anticompetitive effects and, generally, Peruvian law does not provide for pre-merger notification, except in the electrical sector (Law no. 26876, Antimonopoly and Antioligopoly of the Electrical Sector Law). Nevertheless, governmental authorities do follow up on mergers especially in sensitive economic sectors. The government has strengthened the competition agency Indecopi (Institute for the Defense of Competition and Protection of Intellectual Property) over the last 15 years in order to sanction abusive acts as a result of a dominant position and restrictive market practices. Created in 1992, Indecopi is an organization with autonomy at the technical and jurisdictional level. Among its jurisdictional bodies, it includes the Free Competition Commission, Consumer Protection Commission, Unfair Competition Commission and the Market Access Commission. These governmental commissions, however, apply the law only sporadically. Bureaucratic corruption still takes its toll, and the desired market dynamics continue to have priority.

Anti-monopoly
policy

The state has extensively deregulated foreign trade. No fundamental state intervention in free trade remains. This particularly applies to the treatment of foreign investments and stockholding. The government has eliminated all restrictions or controls on payments, transactions, transfers or repatriation of profits. A step forward in this direction was the free trade agreement with the United States, which was approved by the Peruvian Congress in 2006 and by the U.S. Congress in 2008. It entered into force on 1 February 2009. Peru also signed a free trade agreement with Chile, which entered into force in March 2009. During the 2008 APEC Summit, Peru made important progress towards a free trade agreement with China. In addition, Peru took further steps toward bilateral negotiations with Mexico, Singapore, Thailand, the European Free Trade Association (EFTA), and

Liberalization of
foreign trade

the European Union. Almost two-thirds of external trade (exports) is covered under bilateral free trade agreements.

With the opening to foreign institutions in the early 1990s, the Peruvian financial system modernized rapidly and became more competitive. It now rests on a more solid foundation. The government is implementing measures to strengthen bank supervision following the principles of the Basel II accord, but these measures are still not up to the highest international standards. In June 2008, an amendment to the General Banking Law was submitted to Congress to allow the Superintendency of Banks (SBS) the introduction of capital requirements for exchange-related risk in line with the Basel II accord. In August 2008, after some delay, the government submitted another amendment to Congress to raise the minimum capital requirement for microfinance institutions. In line with Basel II, capital requirements for all types of risks, including credit, market and operational risks have been introduced.

Banking system

Until now, Peru's banking system has been remarkably resilient in the face of the international financial crisis. This is not only on account of its weak ties with the problematic operations of the international financial system, but also a result of the successful coordination between the Ministry of Finance, the Central Reserve Bank (BCRP) and the Superintendency of Banks and Insurance (SBS). Together – at least until now – they managed to ensure liquidity to the financial sector and capital markets and to minimize systemic risks. Large official reserves and strong financial soundness indicators for the banking system, along with banks' limited reliance on external capital have helped preserve stable liquidity conditions. In sum, Peruvian banks can better withstand currency-related shocks but remain subject to dollarization risks. The long-standing problem of high "dollarization" of the banking and financial sector – with a large amount of outstanding bank loans denominated in U.S. dollars while most personal and corporate income is in Peruvian soles – has been tackled in the period under review but still might pose problems. According to the IMF, dollarization has rebounded in the last months of 2008 after declining markedly in the two years before.

8 | Currency and Price Stability

Peru has an adequate institutional framework, which is supported by the authorities, for the stability of currency and prices. Peru's central bank has been independent since the middle of the 1990s. The García government thus continued its predecessor's consistent policy on inflation and currency. The inflation rate, which returned to single digits in 1997, has been kept low, although it climbed to 3.9% in 2007 and 6.7% in 2008. These rates are clearly above the official 2% target but still lower than the regional average. The main factors behind this rise are higher fuel and food prices. In 2009, inflation might settle below 3% in the course of the

Anti-inflation /
forex policy

economic slowdown. 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, between 50% and 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.

The Peruvian economic authorities have been successful in constructing policies of macroeconomic stability. The government's fiscal and debt policies have been extraordinarily stability-oriented. In contrast to the skeptical views of the 2008 BTI report on Peru, the García administration maintained solid macroeconomic management and did not cut its budgetary discipline. Instead, the public sector surplus was at 3.1% of GDP in 2007 and an estimated 2.1% in 2008. Public debt has been reduced from about 33% of GDP in 2006 to 25% of GDP in 2008. The share of foreign currency denominated public debt has declined to almost 60%, the public sector has become a net external creditor, and Peru was granted investment grade by Fitch and Standard & Poor's in April and July 2008, respectively. Foreign reserves stood at \$31 billion at the end of December 2008. Thus, the government continued with the respective policies of its predecessors. President Toledo (2001 – 2006) and President Alan García both followed President Fujimori in putting strong emphasis on a solid macroeconomic framework. While Peruvian critics called President Toledo's economic policy "Fujimorism without Fujimori," the policy of the García government now is called "Toledismo without Toledo," showing, for better or for worse, this remarkable continuity. This contrasts importantly with earlier periods, when economic policies were not based on solid foundational principles and economic decisions were made erratically, not least during President García's first term in office (1985 – 1990).

Macrostability

Despite widespread domestic criticism, however, these continuing policies of stability are a main factor in the improvement of Peru's economic climate and its impressive growth rates during the last years. In view of the upcoming recession and to shield the economy from the global crisis, the government designed a stability plan to buttress business confidence and to protect the economy from probable external shocks. It amounts to 2.5% of GDP and includes measures targeted to maintain public support for construction, micro and small enterprises, exporters, and social programs. These programs will be financed with public sector deposits.

9 | Private Property

In general, property rights and property acquisition are adequately defined and protected as civil rights. Exceptions occur in some areas inhabited by the indigenous population, where land titles are not defined at all, not clearly defined,

Property rights

or defined in a way that is incompatible with indigenous value. This incompatibility, for example, has created 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.

Private enterprise not only forms the backbone of Peru's economic system but was also the driving force behind Peru's economic recovery during the last 15 years. The private sector is viewed institutionally as the primary engine of economic production and is given appropriate legal safeguards. 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. Some members of parliament have also resisted further privatization, but so far this has not led 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 varied both regionally and in terms of one's social stratum. Peru's hybrid welfare regime is limited to certain sectors and reaches only part of the population. Deficiencies are 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. The World Bank's World Development Indicators show that nearly 80% of Peruvian labor force does not contribute to the pension system.

Social safety nets

As the social situation deteriorated and poverty grew steadily, state social programs became more important. They intend to cover some of the basic needs of the poor, such as malnutrition and essential care for children under 5 years old. Under Fujimori, these programs were increasingly linked to patronage practices. Under Toledo, the system's main deficiencies were corruption and the lack of efficiency. The García administration began to address these deficiencies by instituting new social programs or extending existing ones and by taking measures to enhance the equalizing effect of transfers on local administrations. In addition, the García

administration reduced the number of relevant multisectoral programs from 82 to 26, thereby improving their efficiency and effectiveness. In July 2007, the government created its anti-poverty strategy “Crecer” (i.e., Grow). It is directed at fighting poverty and chronic malnutrition of children and tries to integrate all the relevant public and private players concerned with specific measures. “Crecer” explicitly tries to coordinate and execute social programs emphasizing the restitution of fundamental rights, the promotion of productive development, and those belonging to the social safety net.

However, the president’s so-called neoliberal turn made the policy of growth-led “trickle-down” the prevailing development model guiding the government’s social policies. Deficiencies in social programs, like their low efficiency and narrow coverage (especially in the area of health care), did not receive adequate attention until the end of 2008 when a new cabinet chief came into office. Notwithstanding, some new measures might help reduce poverty and/or extend the coverage of the social system in the medium-term. The program to reform the informal sector, which aims at re-integrating workers into the formal economy and thus into the welfare system, seems promising even if its effects will not be seen in the short term.

Other programs, like “Juntos” (Together), have been implemented in spite of not rewarding short-term political benefits because of their medium or even long-term impact. “Juntos” is a so-called “conditional cash transfer (CCT)” program initiated in 2005. It is working like similar CCT programs in Mexico (Oportunidades) or Brazil (Bolsa Familia). Families receive about \$30 per month on the condition that they make pre-specified investments in their children (health and education). The state extended this program during the period under review. By January 2009, the program covered about 420,000 households, from 14 of Peru’s 24 departments, who lived in extreme poverty. In total, the program covered an estimated three million Peruvians living in poverty. “Juntos” became part of the “Crecer” strategy in 2007. Like many other issues in Peru, the success or failure of “Juntos” is heavily debated with respect to efficiency and corruption. In March 2009, a study by the Institute of Peruvian Studies (IEP), UNICEF and UNFPA showed that “Juntos” works rather well despite some important deficiencies.

Peru has institutions to compensate for gross social differences, but relative to the magnitude and broad range of inequalities they are still limited in scope and quality and suffer from inefficiencies in the state’s bureaucracy. Social services to help eradicate poverty and inequalities repeatedly fail due to poor planning and corruption. Despite continuing strong economic growth during the last years, about 40% of 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 coefficient of 0.43 in 2004), although more moderate than in Brazil or Chile. Equal opportunity

Equal opportunity

does not exist in Peru, and access to public services is not equal. This inequality is often combined with discrimination against indigenous people.

Few mechanisms promote the advancement of women, persons with disabilities or the socially disadvantaged. Discrimination against women limits their access to post-secondary education, income and public office. The Ministry of Women and Social Development (MIMDES) is responsible for special programs on gender equality. Its mission is to fight inequality, poverty and exclusion and to raise equality of opportunities for all disadvantaged in Peruvian society. It has offices and programs specifically devoted to helping women, especially those suffering most from exclusion and poverty. Among the various sections of the MIMDES devoted almost exclusively to Women is the National Program against Family Violence and Sexual Abuse (PNCVFS), which receives regular funding. Another MIMDES program that devotes a significant portion of its resources to the advancement of women is the Program to Support Resettlement (PAR), which works with people affected by violence. The Wawa Wasi Program also dedicates most of its resources toward helping women. It seeks to provide a safe environment and to develop skills for the children of poor and working mothers, and at the same time to make it easier for women to work, recognizing that they often lose their jobs or must give them up in order to look after their children. The MIMDES is also the institutional framework for the PRONAA, the National Food Aid Program, which, while not targeted directly at women, provides training that benefits them.

A report issued by the Ombudswoman's Office in 2007 highlighted the continuing economic and geographic barriers faced by women in rural areas to accessing health care, accessible information on health services and culturally appropriate health provision. Also in 2007, the UN Committee on the Elimination of Discrimination against Women recommended that Peru ensure that all women were provided with identity documents, including birth certificates, and in particular that women from rural, indigenous and minority communities had full access to justice, education and health services.

11 | Economic Performance

Until the slowdown of the world economy Peru showed one of the strongest economic performances worldwide. The country's growth rates were the highest in Latin America in the period under review. On the global level, only China outperformed Peru between 2006 and 2008. In 2007, the economy grew at 9.0% and during the first three quarters of 2008 at 10%. Due to the global economic slowdown, growth decelerated to about 7.5% in the last quarter, thus totaling 9.4% for 2008. For 2009, the IMF estimates a growth rate of 6%. Inflation climbed to 3.9% in 2007 and 6.7% in 2008, which is clearly above the official 2% target but still lower than the regional average. For 2009, observers estimate that inflation

Output strength

might be controlled at a level below 3% in the course of the economic slowdown. Exports grew at 18% in 2007 and 2008, but imports grew even faster at about 38%. Nevertheless, the trade balance was rather favorable during the period under review (2006: 3.0% of GDP; 2007: 1.4%; 2008: -0.6%). The deterioration of Peru's terms of trade, however, indicates some problems for 2009 and possibly early 2010. The public sector surplus was at 3.1% of GDP in 2007 and an estimated 2.1% in 2008, while public debt has been reduced from about 33 percent of GDP in 2006 to 25 percent of GDP in 2008. Foreign reserves stood at \$31 billion at the end of December 2008. Large portions of the population, however, did not benefit from Peru's macroeconomic success story. Peru's informal sector remains large, urban unemployment remains high (2006: 8.5%; 2007: 8.4%) and poverty reduction was less than the government expected.

12 | Sustainability

Sustainability still remains an Achilles heel of Peru's economic transformation. Until recently, the Peruvian government has given environmentally sustainable growth only sporadic consideration. Environment policy still lacks an adequate institutional framework. Deforestation, overgrazing and overfishing, desertification, and air and water pollution are the nation's primary environmental problems. Worsening environmental 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, environmental and even cultural consequences.

Environmental
policy

Though change is slow, Peru has seen a slowdown in environmental degradation in recent years. For example, according to information by the Environment Ministry, 55 million hectares of Peruvian woods are now under protection in 63 nature protection areas. This land is under the dual supervision of the Environment Ministry and the National Service for Nature Protection Areas (SERNANP). Deforestation seems to have slowed significantly between the 1980s (260,000 hectares per year) and 2005 (117,000 hectares per year). Environmental awareness in society and among lawmakers has grown in recent years, not least because of the recurring El Niño phenomenon and the radical protest against pollution by mining firms. In general, however, public and political awareness remains low. Environmental concerns generally take a lower priority than considerations of economic growth. The lack of financial support aggravates the weak institutional capacity for environmental management.

However, Peru must make institutional changes with regard to environmental policy and implementation in order to comply with the provisions of the 2007 free trade agreement with United States. As a first step, in May 2008 President García created

the Environment Ministry by legislative decree. The president's move to form the ministry without approval from Congress angered legislators, who argued that by law it is exclusively Congress' responsibility to approve the creation of a new ministry. Congress then purportedly failed to make the 12 million soles necessary to make the ministry work. In response, President Garcia enacted an emergency legislative decree to transfer the necessary \$4.2 million to the Environment Ministry. In July and August 2008, new standards for the quality of water and air were introduced by decree. It remains to be seen if they are enforced.

Though the García government is conscious of the structural problems of Peru's educational system and has initiated reforms, the performance of the education sector has remained low. Education and training facilities are available in important segments, but they vary widely in quality. Despite increasing school enrollment numbers, the sector remains a significant obstacle to Peru's further development in all areas. The state's expenditures for education since the 1990s have stalled at about 3% of GDP (2.8% in 2007 and 3.1% in 2008). A 2007 report of the World Bank, which evaluated its own assistance programs between 1990 and 2005, confirmed the low quality of Peru's educational services and highlighted the challenges facing the García government. The report concludes that while Peru has reached high levels of incorporating its population into primary education and rather high completion rates for marginalized urban and rural youth, it spends relatively little on its primary education system. The costs per pupil are among the lowest in Latin America; Peru's teachers are paid among the lowest in the region relative to per capita income and compared to other public servants; and Peruvian students score very low on international achievement tests.

The García government intends to reform the entire education sector, but progress is slow. One important step had been the evaluation of all teachers in 2007 and 2008 in order to assess the quality of Peruvian schools. This led to conflicts with the powerful teachers' union SUTEP, but in the end the government carried out its plan. Another step in the reform process was the modification of the distribution key for budgetary funds, which until 2007 were allocated to Peruvian schools on the basis of teacher numbers alone. This meant that schools in rich areas always received more money – a practice that only exacerbated the country's education gap. Following the example of its neighbor Ecuador, the government boosted funding for the primary school sector to \$90 million in a supplementary budget for 2008. In addition, criteria such as population figures, the region's poverty rate, the condition of school facilities and the number of classes and pupils are now the key factors in allocating funds. By the end of June 2008, over 40,000 schools set to benefit from this program. The funds are now transferred directly to a school's head teacher, who is responsible for how they are used. Two newly established committees, consisting of representatives from parents' associations and the mayor's office, work to ensure that the allocation of funds is carried out appropriately.

Education policy /
R&D

Definite shortcomings continue in research and development, with expenditures at around 0.1% of GDP. 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 technology 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. The scale and impact of these initiatives 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). This deficit is particularly severe in transportation, electricity and water and ranks as a major obstacle to further development, especially in the rural and agrarian sectors. The Andes and Amazonas regions are most significantly affected. Because of its solid macro-economic management and budgetary policy, the government was able to boost public investment in infrastructure, which had been low for years. It initiated some infrastructure projects like electrification in the Andes region, which will show its effects in the long run.

Transformation Management

I. Level of Difficulty

In terms of the structural socioeconomic conditions shaping the political process in the long-term, post-Fujimori Peru faces a medium level of difficulty, with both positive and negative factors to be considered. The 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; severe infrastructural deficiencies in the Andes and the Amazon regions; weak political and civil societies; a large informal sector; and a growing dependency on the international economy. The positive factors include: the fact that in the 1990s, the state re-established its monopoly on the use of force (though it has deteriorated slightly in the past few years); heterogeneity has not bred severe ethnic or religious conflict; social tensions have not dramatically escalated despite social segmentation; and despite the educational system's problems, Peruvians enjoy a basic level of education. Furthermore, most of the needed economic structural reforms were achieved in the 1990s and with relatively broad consensus.

Structural
constraints

Despite frequent civil mobilizations and the active engagement of pressure groups, traditions of civil society, which began to emerge toward the end of the reformist military regime (1968 – 1980), are weak to moderate. Despite an increase in NGO activity, the landscape of voluntary organizations is not robust and is plagued by scarce organizational resources (see “political participation”). The most important obstacle for democratic governance, however, is the low level of interest aggregation at the civil society level. In other words, Peru suffers from the absence of strong actors able to channel the diversity of social demands. There have been two developments relating to the culture of civil society in recent years. For one, a more liberal wing within civil society has intensified its work in monitoring issues such as human rights performance or the government's reform agenda. In another, participation in civil society has grown, leading to a diverse landscape of activist groups and a major increase in the voicing of particularist demands at the national, regional, provincial, local and communal levels. According to recent data from Latinobarómetro and LAPOP (see “consent to democracy” and “associational activities”), social trust as well as trust in institutions are rather low, including strong resentment toward the “central state” in regional pockets.

Civil society
traditions

Although Peruvian society is plagued by racism and split into social classes and ethnic communities, this has not yet led to an accordingly split political landscape, 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 have demonstrated an increasing interest in mobilizing ethnic or social groups. The “ethnicization” of Peruvian politics casts a dark shadow over 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

14 | Steering Capability

When starting its term in July 2006, the García administration faced a wide range of political, economic and social problems left by its predecessor. After two and a half years, however, its steering capability suffers mainly from a lack of programmatic clarity in setting the reform agenda as well as from a lack of policy coordination. While these failings pervade the ranks of the entire political elite and reflect also the weakness of the party system, the government has yet to present a national development strategy (such as the Acuerdo Nacional of 2002) or to communicate clearly any such strategy to its citizens.

Prioritization

Given the state of affairs, assessing Peru’s political leadership concerning prioritization is somewhat complicated. Though the leadership is generally committed to constitutional democracy and a market economy guided by principles of social justice, these aims are not always given the appropriate priority. First, they are sometimes postponed in favor of short-term crisis management and gains. Second, the general aims are only partially – especially in the economic realm – translated into items on a specific agenda. Third, there are conflicting objectives, such as the pursuit of security vs. civil liberties or attempts to cultivate a good relationship with the armed forces vs. the need for an independent judiciary, which the government cannot translate into a sound strategy. Fourth, the government clearly prioritizes economic development over the strengthening of democratic institutions. Fifth, in terms of principles of social justice guiding economic development, the government pursues a strategy that seeks first to maintain macroeconomic stability and then to apply windfalls to “trickle down” policies.

Thus, while subordinating democratic reforms, the government and above all President García, have pursued the deepening of Peru's economic transformation. Examples include the Free Trade Agreement (FTA) signed with the United States, which García vehemently defended before the Peruvian public and which finally entered into force in February 2009. Aware of the consequences implied by the implementation of the FTA, the government issued a wide range of decrees mentioned above (see "separation of powers"). In addition, informal sector reforms fit into this modernization strategy and even tackle some of the underlying problems of Peru's economy and welfare regime. However, this kind of economic transformation seems not always commensurate with the country's situation, problems and needs, as the persisting inequality gap and the tremendous disapproval of the government's performance illustrate. In addition, the government to date has not been able to demonstrate how it would achieve many of the long-term aims on the political agenda, and it was at times inclined to replace long-term aims by short-term interests of political bargaining. With his frequent public appearances, Alan García seemingly tried to distract criticism and to counter the declining approval ratings, albeit without success.

Given the fragmented reform agenda, the García government has had only partial success in implementing its announced reforms. While the economic agenda and also some social policy programs such as "Juntos" could be implemented, albeit with some difficulties, other agenda goals were not implemented successfully, falling victim to postponement or abandonment. Implementation not only suffered from programmatic incoherence, but also from the lack of coordination and competence, bureaucratic procedures and an inefficient state administration. 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, even some of these reform steps suffer from hasty implementation and lack of coordination. Important initiatives, such as the judicial reform as well as the law to reform the civil service, have either not been addressed 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.

Although the political leadership tries to respond to mistakes and failed policies with changes, it mostly lacks the ability of complex learning. The pace of government actions is mostly set by the president alone, resulting in a president-centered, nearly unilateral decision-making process. Though García has learned from the disastrous performance of his first administration in the 1980s, he continues to show only modest flexibility, innovation and policy learning. The government either "administrates" the transformation initiated before – as is the case for solid macroeconomic management or the FTA with the United States – or is driven by an agenda set outside the government and to which it mostly reacts

Implementation

Policy learning

(e.g., the frequent social turmoil or the corruption scandals). To be sure, the constraints outlined in “level of difficulty,” and above all, the atomized state of civil society and the magnitude of social demands, constitute severe obstacles to innovation and flexibility. However, these problems are well-known features of Peru’s governance problems and should be part of any implementation strategy. Instead, the García government has continued its strategy of unilateral action, disqualifying critics and governing by decree. García remains convinced that his government will lead the country into a process of rapid modernization, as he announced when responding to massive criticism towards some of the 99 decrees issued to implement the FTA with the United States.

In sum, the leadership remains stuck in the same routines. 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.

15 | Resource Efficiency

The García government does not make optimum use of available economic, cultural and human resources to pursue its transformation policy. Nevertheless, compared to the Toledo government, significant improvements have been made. The government is not only committed to an austerity policy and a carefully balanced budget, but it has also managed the state’s surpluses well in order to be able to address the imminent difficulties caused by the financial crisis. During the review period, it also took steps to streamline public administration and to improve coordination between agencies and programs. In addition, the government sought to improve effectiveness in fiscal management by continuing with the considerable advances made in the past years. Examples include the consolidation of the financial management system SIAF, the reform of budget classification systems, and the provision of monitoring and evaluation systems for different public programs. Some of the regulations implemented in the wake of the FTA with the United States target an improved use of financial resources. Examples here include: (1) the Framework Law on Public Private Associations to enhance private investment in public infrastructure (or the provision of public services in association with the state); (2) the legislative decree approving the new Law on Contracts by the State, which aims at maximizing investments by public institutions while ensuring improved efficiency and quality; (3) and the legislative decree approving the General Customs Law, which aims to improve efficiency by expediting the delivery of exports. However, due to the inefficient bureaucracy apparatus whose reform is still pending many of the initiated reforms, policies and measures which go beyond some core areas (macroeconomic management,

Efficient use of assets

management of state resources) did not proceed. Well-intended social programs remained inefficient, but the government has tried to improve the situation.

Important deficits remain in efficiency concerning human resources. The government's efficiency still suffers from a low-skilled state apparatus, and politically motivated staff changes remain frequent, though not at the cabinet level, which was common under Toledo. The administration does not operate as efficiently as it should, and the government did not proceed with its public sector reform. In 2006, it introduced a rather populist measure by cutting the wages of all public employees in order to show the government's compromise with its austerity policy. Due to criticism this would foster inefficiency and corruption, this measure was ended in 2008. Although recruiting procedures have been made more competitive, they remain suboptimal. Nearly all these deficits are targets of the government's program of state reform and modernization underway since 2008.

The García government tries to coordinate conflicting objectives and interests, but has either had only partial success or decidedly plays a zero-sum game, that is, it sometimes sets rigid priorities, as was the case with the NGO law and its military policies (security/efficiency vs. liberal principles). President García has imposed a hierarchy on the cabinet and therefore achieves a certain policy coherence, at least in his eyes. The more technocratic *équipe* in the Ministry of Economy and Finance is proven capable of at least outlining conflicting goals in its agenda. 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.

Policy
coordination

From its beginning, the García administration has been confronted not only with extensive corruption in politics and society, but also with a public very critical of officeholders who abuse their positions. During the period under review, although the government has been generally committed to fight corruption, it has delivered a rather ambiguous performance. As of the time of this writing (end of 2008), it has not made adequate attempts to provide the necessary integrity mechanisms. Though some integrity mechanisms have been implemented, they remain largely ineffective and private interests impede their operation. Even worse, the government's 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 sincerity. The government's somewhat dubious commitment may have changed since the corruption scandal in November 2008 and the introduction of Yehude Simon as cabinet chief. Already in December 2008, Simon presented a detailed national plan to fight corruption that builds upon earlier suggestions from commissions and civil society organizations. The measures outlined – seven major objectives and detailed strategies for the state, private sector, media, citizens' involvement and international cooperation – are to be implemented between 2009 and 2011.

Anti-corruption
policy

16 | Consensus-Building

Apart from the illegal actors (i.e., guerrillas and mafias), nearly all the significant political and social actors agree in principle on a stable democracy and market economy as reform goals, though there is a lack of consensus on the means of reaching these goals. In addition, serious doubts persist about the political orientation of Ollanta Humala's PNP, particularly in terms of its economic policies as well as Humala's stance vis-à-vis democracy. Given the widespread dissatisfaction with the democratic government, observers fear that PNP or another populist organization might win the 2011 elections and set the stage for a different development model, as has been the case in neighboring Bolivia and Ecuador. In addition, the government does not do enough to strengthen consensus on goals, and is more inclined to act unilaterally or to rely on the backing of some strong actors like the employers' organizations or the Armed Forces. Consensus could have been strengthened by referring to 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. Though its implementation failed due to the political stalemate, it is still seen as a blueprint for the course the country must take. Even the government refers occasionally to the Acuerdo, but it could do so more systematically and integrate the political forces backing the Acuerdo.

Consensus on goals

In narrowly defined terms, the government successfully incorporates or integrates potential veto powers such as the military and the business community. The military in particular seems to be kept under control, and the government fosters the improvement of civil-military-relations. However, in the case of the military, the government and the supporting APRA party seem to have entered a new alliance with the armed forces, as evidenced by the law on military justice and the bills to provide amnesty (or pardons) for perpetrators of human rights violations between 1980 and 2000. There are severe problems with illegal actors, be they Sendero Luminoso, the coca mafia or the clandestine groups of the so-called mafia fujimori-montesinista. A special case are the cocaleros and their unions, who openly demand the cancellation of the coca eradication policy continued by the García government. They therefore pursue illegal aims, but do so legally and in public.

Anti-democratic
veto actors

Given the potential for severe conflicts due to unattended demands, the leadership has been 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 created a conflicts unit in the Council of Ministers to facilitate dialogue with disaffected groups and provide for conflict settlement. However, as the new Chief of Cabinet Simon recognized when entering office in November 2008, many conflicts result from the state's reluctance to fulfill its promises. As a consequence, the government has been

Cleavage /
conflict
management

often surprised by the outburst of conflict, able only to react. In other words, instead of pursuing ongoing crisis management, it could have placed greater emphasis on genuine consensus-building by explicating its governance strategy.

In addition, key political actors have not been able to mitigate the latent divisions of ethnic and socioeconomic conflict. However, political fragmentation has made it easier for political leaders to prevent structural conflicts from escalating. In May 2008, the government faced its first general strike. As observers noted, however, the strike, which was comprised of dozens of smaller strikes with diverse objectives, underscored a sense of general discontent among Peruvian citizens but did not pose a real problem to the government. Concerning Peru's regional heterogeneity, the government's strong focus on 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, though the government is continuing its streamlining process.

In terms of a long-term political strategy, the political leadership tends to ignore civil society actors and formulates its policy autonomously. Some actors, such as the employers' organizations and the armed forces, are involved behind the scenes in identifying political priorities and formulating policies. This assessment, of course, is somewhat ambiguous, given the fragmentation and the centrifugal tendencies in Peruvian civil society which makes it difficult to find adequate counterparts in civil society who are interested in sound national policies beyond particularistic goals. As Prime Minister Simon stated when entering office, one of the problems Peruvian politics faces is the neglect of many social demands and the failure to deliver on promises made. As a consequence, when addressing demands from civil society, the government mostly reacts to the outburst of conflicts. The abovementioned law on NGOs (see "association/assembly rights") illustrates this ambiguity nearly perfectly. While the state is interested in containing excessive conflict, its measures might run counter to democratic principles. 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.

Civil society
participation

Like its predecessors, the current political leadership recognizes in principle the need to deal with historical acts of injustice, but the process of reconciliation stagnated or even suffered some setbacks during the period under review. The progress made over the last years was mainly driven by civil society actors rather than by politicians. However, the initiatives to address the human-rights violations committed from 1980 to 2000 will have a positive effect in the long term. Particularly as compared to other cases in Latin America, these initiatives have been relatively purposeful and comprehensive.

Reconciliation

The establishment of the Truth and Reconciliation Commission in 2002 has led to intensive work collecting testimonies, compiling a new record of the victims of human rights violations (70,000 – not the previously presumed total of 30,000 – were killed), and determining the perpetrators of crimes committed. However, the impetus for a true reconciliation was lost in the wake of these successes and most of the Commission's recommendations have not been carried out. In 2007, the National Council for Reparations began its work monitoring reparations given to victims of human rights abuses documented by the Commission.

The García administration has not demonstrated 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. In November 2008, two new bills were introduced in the Peruvian Congress proposing measures to grant amnesties, commutation of sentences and pardons to alleged perpetrators of human rights violations. The bills enjoy the support of a significant number of members of the Congress from a variety of parties, including the president's party. One of the bills would create a commission empowered to propose amnesties for any military or police personnel under investigation, prosecution or trial for any military crime or human rights violation. No effective program for the protection of those who survived human rights abuses during the 20-year armed conflict, their relatives as well as witnesses and lawyers has been implemented.

17 | International Cooperation

The political leadership works with bilateral or multilateral international donors and tries to make efficient use of international assistance. In important sectors it makes well-focused use of international aid in order to implement its long-term strategy of development. As outlined above, this strategy aims predominantly at economic and social development and to a lesser degree at strengthening the institutional framework of democracy. For that purpose, the government relies on coordinating its reforms closely with the International Monetary Fund, the World Bank, and the Inter-American Development Bank, and 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 IADB or the EU – have focused primarily on improving the rule of law, supporting national reconciliation and implementing decentralization. In its relationship with

Effective use of support

the United States, in addition to the FTA, the government aims to continue strategic cooperation in the war on drugs. However, this policy encounters (sometimes massive) resistance from coca farmers.

In general, the García government acts as a credible and reliable partner in its relations with the international community and could build further confidence in its reform policies. Indeed, there is a huge gap between its credibility within the country and its credibility internationally. Apart from the close relations with bilateral and multilateral donors, the web of Free Trade Agreements all over the world is also a sign for this trust in Peruvian leadership. Tensions with Chile concerning the maritime borderline between the two countries, which arose under the Toledo presidency, could be tempered and were brought before the International Court of Justice in The Hague. The country thus demonstrated its willingness to adhere to international norms of peace and justice. Commercial risk ratings such as Standard & Poor or Fitch give Peru a relatively good score of BBB-, which is the same given to Brazil (but worse than that given to Chile). The rise in ratings is attributed to the significant decrease in Peru's fiscal and external vulnerabilities, its broad and diversified sources of growth, low level of inflation and strengthened macroeconomic fundamentals. There is a caveat to consider concerning the transformation to democracy, as the above-mentioned NGO law has cast some doubt among the NGO community regarding the government's commitment to liberal principles.

Credibility

The political leadership cooperates with many neighboring states and complies with the rules set by regional and international organizations, though in some issues president García did not hesitate to criticize neighboring countries. The government works toward closer cooperation among the Andean Pact countries, which, however, is at times rather difficult given the political changes in Bolivia, Ecuador and Venezuela. While the relations to neighboring Ecuador still remain normal, there have been frictions with Bolivia and Venezuela on behalf of the political and socioeconomic model in the region. An important step has been the Free Trade Agreement with neighboring Chile. In 2007, Chile extradited former President Fujimori to Peru, a clear sign of confidence into Peru's democratic capabilities. Nevertheless, the political future may also be marked by more tense relations because of the still unresolved issue of maritime demarcation and Chile's fear that a nationalist military like Humala might come to power.

Regional
cooperation

Strategic Outlook

The return of Alan García to the Peruvian presidency in 2006 gave rise to high expectations as well as great skepticism. After the first half of his term, many, if not most, Peruvians believe that their government does not govern for the common good and disapprove of its performance. This lack of trust in government overshadows the government's relative successes. Although it has not managed the country's transformation as well as it could have, progress remains within the García government's reach, and some of its policy measures point into the right direction. Peru's existing problems can only be surmounted by a continuation of strong policy and key reforms; progress also requires a strong political consensus. In other words, one of the great challenges García faces for the rest of his term (until July 2011) is to transform his own governance style. García must communicate his policies more effectively and regain the confidence of Peruvian average citizens as well as the elite in the government and the state as a whole.

The initiated reforms are scheduled to continue for many years, though future political turbulence could interrupt them. The sustainability of reforms is thus dependent on the willingness of the political elites to maintain the course of reform over time. The political elite should provide an update of the 2001 National Agreement on Governance (Acuerdo Nacional), which should articulate a stronger commitment to concrete reforms. This would require a shift in the behavior of the entire political elite, who in the past have pursued shortsighted and particularistic strategies over long-term planning and the common good.

Over the next few years, Peru's leadership will have to continue the country's economic consolidation and make its economy more resistant to external shocks. Although social and economic development have been insufficient to date and need to be addressed in the near future, Peru's main transformation problems lie in the realm of politics and political management. A new transformation strategy should focus on four key elements, which thus far the Peruvian government has not adequately addressed:

- **Securing stateness:** Though the García government is confronting the problem of stateness more thoroughly than the Toledo government, it would still greatly benefit from increased international cooperation with its neighbors aimed at containing the erosion related to the drug trafficking mafia. Because the problem is multifaceted – reaching from guerrilla actions to urban crime and from anomic tendencies to mafia organizations – the leadership should also develop a national master plan that more effectively combines the legitimate use of force with softer strategies like prudent conflict management, socioeconomic measures and – in the case of coca producers – the offer of alternative production. Above all, the state should draw a clear line between (sometimes) violent social protest and crime or organized crime.
- **Strengthening the system of political representation:** Peru's party system remains weak and does not fulfill the function of aggregating interests and channeling the diverse demands of

Peruvian citizens, which thus contributes to the recurrent political turmoil in different parts of the country. In order to strengthen the party system, the political elites need to initiate a process of improving the functioning and internal democracy of the Peruvian political parties. More adequate party legislation is necessary, above all concerning the regional and local levels where tendencies of centrifugalism are undermining the still weak representation structures between society and the state. This legislation also needs to be coordinated with the ongoing decentralization process.

- **Strengthening the rule of law and the judiciary:** All of Peru's political actors need to demonstrate a stronger commitment to systemic judicial reform. As the successful Chilean example shows, a state requires both committed reformers and the capacity to identify and break anti-reform interests (inside the judiciary, inside the state apparatus and among parts of the political elite). The use of international advice and support will be crucial in implementing the daunting but necessary reform measures.
- **Reforming education:** Although some educational standards such as literacy have made progress, Peru's education system is still hamstrung by low compensation, low expectations and low performance. This is a severe obstacle not only to social and economic development, but also to developing civic virtues and thus strengthening democracy. The García administration is right to prioritize this problem and has taken the first successful steps toward reform. The task remaining for the administration is to develop and communicate a long-term reform strategy, which recognizes the country's regional and cultural diversity.