

Peru

Status Index (Democracy: 6.85 / Market economy: 6.29) 6.57		Management Index 5.28	
HDI	0.762	Population	27.2 mn
GDP per capita (\$, PPP)	5,260	Population growth¹	2.1 %
Unemployment rate	N/A	Women in Parliament	18.3 %
UN Education Index	0.88	Poverty²	18.1 %
		Gini Index	49.8 (2000)
Source: UNDP: Human Development Report 2005. Figures for 2003 unless otherwise indicated. ¹ Annual growth between 1975 and 2003. ² Population living below \$ 1 (1990-2003)			

A. Executive summary

In the last two years, Peru's transformation was marked by deepening political instability on the one hand and macroeconomic stability on the other. Although some indicators point to strengthened economic stability, the main problems of economic development in Peru, such as extreme poverty, the extended informal sector, and the lack of job-creating growth, remain. For the most part, these shortcomings are associated with the incompetence of the political elite, which missed the opportunity for a new start that was present after the end of the Fujimori regime in 2000 and its successor, the interim government of Valentín Paniagua (2000–2001).

In July 2001, Alejandro Toledo was elected president in a run-off election. Lacking a solid majority in Parliament and faced with high popular expectations, Toledo had to shore up the eroded foundations of democracy and deal with an incompletely reformed, unstable economic system. An assessment of the status of Peru's democratic transformation over the past two years (January 2003 to January 2005) indicates that the advances that had been made immediately after the Fujimori era, such as regaining the ground lost in the 1980s and 1990s, could not be deepened. Compared with Peru's start in the 1980s when democracy was restored after the military regime, political development has merely stagnated.

Instead of good governance, during the period of review Peru came closer to a state of non-governance, or *desgobierno* in the words of Mario Vargas Llosa. Despite some efforts in strengthening the rule of law, fighting corruption and extending political participation, the Toledo government and especially the president himself faced a steadily declining authority. The president's approval rating has remained below 10% since 2003; frequent cabinet changes have taken place; and the president and his associates have been charged with corruption. Violent political protest, sporadic resurgence of the Sendero Luminoso (Shining Path) guerrillas, lynching in the Andean region, and the upsurge of a new radical indigenous movement show the difficulties Peruvian democracy still faces. In

January 2005, with 18 months still to go in Toledo's term, the country is closer to instability than two years ago.

The evaluation of Peru's economic transformation in the last two years is somewhat more favorable. Peru's economic institutions were strengthened in recent years, while economic performance since 2002 shows surprising success, at least at the macroeconomic level. However, the core problems of the Peruvian market economy, such as its social embedding, are far from being solved and are a major cause for the growing dissatisfaction among the Peruvian population. The political elite could not use the macroeconomic success to deepen the economic transformation.

After the military defeat of Sendero Luminoso in the 1992 to 1993 period, political extremism as well as major political violence seemed to have ended in the middle of the 1990s, although splinter groups of Sendero and the Marxist guerrilla group Movimiento Revolucionario Tupac Amaru (Tupac Amaru Revolutionary Movement, MRTA) remained and undertook violent actions until recently. The growing political instability of the last years, however, which is accompanied by a growing distrust in state institutions and their capacities, has fostered a trend toward extra-institutional political action. There are signs of a new political extremism that finds its basis in the bad transformation performance, and which is a result of the weak representation structures of the political system. Political extremism as well as political violence are likely to increase dramatically in 2005 and 2006.

B. History and characteristics of transformation

As in the other transformation countries of Latin America, the political and economic transformation processes in Peru did not unfold concurrently during the last two decades. The political transformation to a third wave democracy began in the middle of the 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 that was accompanied by accelerated socio-structural change, a played-out development model, a debt crisis, hyperinflation and terrorism.

It culminated in Fujimori's "self-coup" (autogolpe) of April 1992 and did not end until authoritarian "fujimorismo" collapsed in autumn 2000. With the autogolpe, the constitution was suspended, Parliament dissolved, the judiciary obstructed. Under international pressure, Fujimori partially restored constitutional processes. A constitutional convention was elected, which until 1995 also functioned as the legislature. In fact, a triumvirate ruled Peru; the president, the chief of the

intelligence service and the commander of the armed forces determined the course of Peruvian politics even after the 1995 elections.

The 1993 constitution was tailored to support Fujimori's claims to power and authority. Together with the political developments of the 1994 to 1995 period, this produced a concentration of power in the hands of the president, coupled with privileged status for the military, weak representation structures and government domination of the media. Fujimori began to engineer his reelection in 2000 in spite of its disputed constitutionality, a goal that increasingly shaped the regime's course. When the Constitutional Tribunal in 1997 declared that the law on the "authentic interpretation" of the constitution, instigated by Fujimori and his followers in parliament, was inapplicable, Fujimori gutted the Tribunal, completely suspending the separation of powers.

From that time until Fujimori resigned, a second wave of authoritarianism brought subtle infringements of freedom of the press, selective violations of individual civil liberties, and ultimately electoral manipulation, which secured Fujimori another presidency in July 2000. While civic protest against reelection was growing from 1996, the uncovering of Montesinos' corruption network in 2000 finally accelerated the erosion of the regime's legitimization and forced Fujimori to flee to Japan. After the collapse of the Fujimori regime in November 2000, the transitional government under Valentín Paniagua and Toledo's election in May 2001, 20 years after the end of military rule, Peru returned to the starting point of its democratic consolidation. The Toledo government, however, did not succeed in strengthening democracy, with the last two years showing a sort of exhaustion and greater political instability.

In its market economy transformation, Peru turned away from the outmoded development model of import-substituting industrialization; this model had been typical for Latin America since the 1930s but came late to Peru. Peru's pursuit of this model - with insulation and regulation of the domestic market and expansion of the public sector - began in the early 1960s and it 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. In addition, the following democratic governments of the 1980s failed to embark upon fundamental reform. Neither the austerity policy of the conservative Belaúnde nor the heterodox economic policy of the leftist, populist García Pérez could curb the deepening economic crisis; instead, they accelerated it to the point of hyperinflation in 1990.

The necessary structural reforms were finally tackled in 1990–1991 under Fujimori, at first with support from the opposition in Parliament. Fujimori initiated an orthodox policy of recessive stabilization combined with aggressive structural reforms, which included a package of drastic measures (fujishock) that aimed primarily to fight inflation. Among these were revision of collective bargaining agreements, reduction of subsidies, budgetary discipline and a

restrictive monetary policy. In 1991, most state companies were privatized; the state withdrew from the financial sector; an independent central bank was established; foreign trade was deregulated; the exchange rate was allowed to float; and restrictions on the movement of capital were lifted.

As supplementary measures, the labor market was drastically deregulated and the market for agricultural land liberalized. Fujimori's reforms brought relatively rapid macroeconomic stabilization and, until the Asian and Brazilian crisis of 1998, a very strong economic recovery. However, the reforms stopped short of redressing the decades-old structural imbalances. Of the deficiencies Fujimori left behind, the most serious were (and still are in 2005) 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 structural improvements.

C. Assessment

1. Democracy

When the Fujimori regime collapsed, Peru's political order changed from one in which democracy was a mere façade to one in which the minimal rules of political democracy applied. During the review period, however, no further progress was made towards democratic consolidation. Transformation shortcomings remain, especially with respect to the rule of law. Democratic stability is impaired by a weak party system, a weak civil society and meager social capital, but these impairments do not threaten the overall democratic system.

1.1. Stateness

As in the early 1980s, Peru again faces growing problems related to stateness. In principle, the state maintains its monopoly on the use of force, although remnants of the once virulent guerrilla movements remain, the MRTA and the Shining Path (the latter reputedly tied to the coca economy). There is growing acceptance of non-state violence related to the weakness of state institutions and an unsophisticated political class, which has led repeatedly to nearly anarchic political protests and to extra-judicial killings by civilians (lynching). The influence of the drug mafia has grown, especially in the drug production districts and near the border with Bolivia.

Citizenship definitions are not politically relevant. Until now, the politicization of Peru's ethnic diversity – particularly concerning the indigenous population – has been of minor significance, though the increasingly self-confident mobilization of a growing indigenous movement can be observed. All citizens formally have the same civic rights.

Church and state are separate; the political process is secularized.

A basic, functioning administrative system and public security are assured, with some limitations, throughout the country. Public authorities suffer, however, from widespread corruption, low technical skill, and poor political leadership.

1.2. Political participation

After the electoral manipulations of the Fujimori decade, Peru has restored universal suffrage and the right to campaign for office; elections are again free and fair. The Alejandro Toledo government, elected in 2001, and other political actors observe the principle of open and competitive elections. This was demonstrated in regional elections conducted for the first time in 2002, in which the opposition scored clear successes, as well as in the municipal elections in 2003. However, doubts have repeatedly surfaced that signatures have been falsified to achieve the quota for elections for the president's party, *Perú Posible*.

After cleansing the Fujimori political mafia from the military, the intelligence service (SNI) and the judiciary, the government mostly regained the effective power to govern, strengthened through further reforms to consolidate civilian control over the military and by reorganizing the intelligence service (now known as CNI). The military no longer holds veto or other political powers, although vestiges lingered and rumblings were occasionally heard in response to drastic personnel and financing cutbacks. New tendencies in late 2003 and in 2004, however, give contradictory signals for the future of civil-military relations. On the one hand, efforts have been made to make military justice part of the national justice system. On the other hand, in December 2003 a former Commander General of the army was named Minister of Defense. Moreover, there are plans to create a special budget for the military and the police, which could be the nucleus for new military autonomy. This leads one to question the maturity of civilian supremacy over the armed forces. On the other hand, repeatedly there are rumors that the Montesinos network continues to corrupt mass media, the judiciary and other realms of Peruvian political life, though clear evidence seems to be difficult to prove.

The rights of political organization and communication are respected. The state-run and private media are mostly free of government influence, though there has been some pressure from parts of the political establishment during the survey

period related to media coverage of corruption cases. Political and civic organizations can form freely, but union activity is still subject to certain regulations (resulting from the neo-liberal reforms) that violate international conventions on labor rights.

Despite Peru's ethnic diversity, ethnic cleavages as such do not represent a fundamental obstacle to the dynamics of association in civil society. However, the combination of geographic and social marginalization erects barriers for parts of the indigenous population, barriers that in some cases even cause them problems exercising their right to vote. In addition, in some parts of the country such as drug-production districts like Alto Huallaga, there is cautiousness about exercising constitutional political rights.

The decentralization process initiated in 2002 established elected governments in Peru's 25 regions (departamentos), allowing greater public participation than that afforded by the central government in Lima. However, the competences – and the financing – of the regional governments are still largely undefined. The expected strengthening of Peru's weak national representation system has not yet occurred.

1.3. Rule of law

Rule of law in Peru was in even more lamentable condition after the Fujimori regime than before. Since then, the functioning of checks and balances and respect for civil liberties has improved, although they do not meet the basic standards of a constitutional democracy. Necessary reforms of the judiciary and the fight against corruption have not been progressed during the period under review. The judiciary remains the most precarious element of democratic institutions in Peru.

While Paniagua's transitional government had its origin in Parliament and few conflicts arose between the two, President Toledo does not have an absolute majority in Parliament; a governance pact proposed by APRA leader Alan García was rejected by Toledo. So far, the president has relied on coalitions and consensus to secure his ability to govern, although he also had to scale down his political agenda. Despite this divided government, there has been no attempt to suspend the division of powers by issuing decrees. Political stalemates have been rare; as a result, Parliament has gained a somewhat greater voice in the political decision-making process. The system of checks and balances, however, suffers from the low degree of professionalism in all branches of the state.

The government respects the constitutional authority of the judiciary, from which the Paniagua administration has begun to purge links to Montesino's mafia-like network. The role of the highest courts has developed positively; in particular, the Constitutional Tribunal, inoperative since 1997, has been completely reinstated and it has asserted its newfound independence in several decisions. Nevertheless,

it will be years before the essential institutions and personnel of Peru's judicial system can operate on a solid footing. The main problems remain the presence of corrupt judges at all levels of the justice system and the low professionalism of personnel. The latter is in part a consequence of the high number of provisional judges and prosecutors who came into office under the Fujimori regime, and who still have not been completely removed (their numbers have declined from 75% to approximately 30%). Even more disappointing in this regard, however, are the inadequate selection mechanisms of judges and prosecutors. Instead of using this opportunity for a qualitative renewal of three-quarters of the personnel, the crisis of the judiciary is perpetuated.

After the Fujimori and Montesinos era, political society, civic actors and the public are highly sensitized to political corruption. The public views fighting corruption as the most urgent problem of good governance; it also ranks high on the political agenda, as demonstrated by the establishment of parliamentary investigation committees and the National Commission to Fight Corruption. Hundreds of people have been prosecuted for corruption, including many former government officials, business people, mass media owners and high-ranking military officers.

Although it is crucial to bringing about a change in Peruvian political and judicial culture, over the period of this review there has been next to no progress in establishing and developing an anti-corruption framework that might also support democratic consolidation. Instead, the government, along with other political actors and elements of the judiciary, showed no interest in extending the incipient anti-corruption measures, thus maintaining a system from which the mostly corrupt Peruvian political elite obviously profits. As a result, corruption charges, especially against the president and his political associates, were only debated by the public and they did not lead to judicial prosecution until spring 2005.

Civil liberties are in principle respected, but could not be further strengthened, as the reform of the judiciary has not continued. Civil rights are sometimes compromised by the discrepancy between government behavior and legal norms, as well as by the authorities' selective application of established law. In Peru's ethnically diverse and pervasively discriminatory society, this means "low-intensity citizenship" for some segments of the population, such as indigenous peoples and Afro-Peruvians. There are instances of torture and abuse at the hands of the state security forces. Furthermore, the weakness of state institutions leads to a tendency toward vigilante justice, which further undermines the role of the judiciary as a protector of civil liberties. The most positive sign in the human rights realm was the establishment of the Truth and Reconciliation Commission in 2002. However, the commission's recommendations have not been carried out.

1.4. Stability of democratic institutions

After the collapse of state institutions in the 1980s and their dismantling in the 1990s, democratic state institutions have not regained a solid footing. Beyond the question of a new constitution, this applies especially to the rule of law, where the necessary reforms, which would anyway have taken several years to mature, have not proceeded. The same relates to the still incipient process of decentralization, although recent legislation like the February 2004 Law on Fiscal Decentralization aims at its solidification. Overall, the expected institutional consolidation did not proceed, and the prospects are not promising, as it is still common practice for the government to circumvent formal political procedures.

Despite these problems, all influential political actors accept, and regard as legitimate, democratic institutions. However, the climate created by the 2001 National Agreement on Governance (Acuerdo Nacional) – a carefully prepared master plan, supported by all important political and social forces, to shape the longer-term course of politics in Peru – did not lead to a compromise that would further strengthen democratic institutions, above all the judiciary. Instead, the competing political majorities in Parliament and the weak government lapsed into institutional inefficiency and a *de facto* blockade of further reforms. Though supporting democratic values, many civil-society actors, such as the teachers' union, do not have great confidence in political institutions or even disregard them, which consequently also affect the institutions themselves. This effect is even more noticeable at the regional and local level.

1.5. Political and social integration

Problems with institutional stability and efficiency include unstable structures of political representation, which cannot adequately mediate between the state and a highly heterogeneous and segmented society. The established party system broke down in 1990–92; since then, it has been unable to regain organizational stability or anchor itself in society, perhaps with the exception of the APRA Party (PAP). The party system is plagued by severe fragmentation – the effective party number is 4.36 – and has little ability to formulate programmatic objectives, strong tendencies to focus on personalities and patronage, and a high level of voter volatility. The party system remains one of the greatest obstacles to the consolidation of democracy. The hope that the 2002 regional elections, instituted as part of the decentralization effort, would bring the parties closer to society was too optimistic. Instead, it led to further fragmentation of the political landscape, and the strong showing of regional groupings aggravated the problems of interest aggregation in the Peruvian political system.

Peru's civil society is relatively well differentiated, but highly fragmented. On occasion, interest groups can make their voices heard. The employers'

associations still wield great influence, while the unions – in the wake of neo-liberal reform and massive impoverishment since the end of the 1970s – have lost almost all their political weight. The problem is, however, that the growing weakness of the government led to an inflation of particular demands, which cannot yet be met. Civic organizations have little willingness to work cooperatively and strategically because higher-level organizations lack adequate capacity to respond, resulting in fragmentation. This has repeatedly led to explosive political protests followed by government crises – for example, when plans to privatize certain public utilities were launched in 2002, during the teachers' protests in 2004 or the cocalero protests. On the other hand, repeated mobilizations such as the protests of campesino communities against transnational mining firms, while clamoring for work, services or environmental attention, affect the competitiveness of the sector and of the entire country.

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

While the dynamics of civic organizations are fairly positive, since 2002 a sharp drop in satisfaction with democracy and citizens' trust in the institutional underpinnings of democracy has been observed. Despite experiences under the Fujimori regime, approval of democracy has declined since then. Half of the population is at least ambivalent about democracy as a form of government; less than one fifth is satisfied with the performance of democracy. Thus, Peruvians' approval of democracy is among the lowest in Latin America, with a decline from 63% in 1996 to only 45% in 2004 (Latinobarómetro 2004).

2. Market economy

After the drastic neo-liberal reforms in the first half of the 1990s, Peru has made little progress in transforming its economic order. Major shortcomings remain with respect to competition, restoring the health of the banking and capital markets, combating market concentration and the formation of oligopolies, and particularly promoting sufficient inclusion of additional population strata in formal economic life. A large number of Peruvians connect the neo-liberal reforms of the 1990s with the corrupt regime of Fujimori, a circumstance that complicates further economic reforms. In the last two years, the Toledo government made only minor steps towards strengthening the market economy. The most positive development is the surprisingly positive macroeconomic balance after 2002.

2.1. Level of socioeconomic development

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

During the survey period, Peru failed to reduce social disparities, high poverty rates and income disparities. Furthermore, economic development flagged from 1997 until mid-2002. Economic performance improved after 2002 but did not lead to a significant increase in employment. Existing development imbalances among the various regions, especially between the coast and the highlands, were not reduced and thus they still represent a form of dual economy in Peru, in addition to the large informal sector. A relatively modern industrial and service economy concentrated on the coastal plain stands in sharp contrast with the subsistence agricultural economy in the interior. A factor that alleviates the development problems of Peru is the still-dynamic coca economy.

2.2. Organization of the market and competition

The foundations of a competitive market economy are largely assured. Dense regulation of the economy was greatly reduced after 1990. Price controls, subsidies and restrictions on foreign investment were lifted. However, although the relevant public institutions are in place, they suffer from widespread corruption, and deficient rule of law. Moreover, about half of Peru's economic activity takes place in the informal sector. The IMF notes that agricultural production is below potential, mainly because of inadequate infrastructure and lack of well-defined property rights in rural areas.

Anti-cartel legislation has existed since 1991, but it relates almost exclusively to anti-competitive behavior such as price fixing or market sharing. The competition agency Indecopi has been strengthened over the last decade in order to sanction abusive acts because of a dominant position and restrictive market practices. However, laws are applied only sporadically, bureaucratic corruption still takes its toll, and the desired market dynamics definitely have priority. Controls on mergers exist only in the electricity sector.

Foreign trade has been extensively deregulated, and there is no fundamental state intervention in free trade. This particularly applies to the treatment of foreign investments and stockholding. There are no restrictions or controls on payments, transactions, transfers, or repatriation of profits.

The banking and financial sector underwent both internal and external deregulation in the 1990s and now rests on a more solid foundation. Further measures to strengthen bank supervision are being implemented according to IMF recommendations, but they are still not up to the highest international standards. The high “dollarization” of the banking and financial sector still presents an unresolved question, but the Superintendency of Banks (SBS) is introducing new norms in order to control this problem in the future. A main problem for Peru’s economic development remains in the high costs of credit for medium- and small-sized firms.

2.3. Currency and price stability

The Toledo government is continuing its predecessor’s consistent policy on inflation and currency. The inflation rate, which returned to single digits in 1997, has been kept low. The central bank has been independent since the middle of the 1990s. However, the heavy dollar dependency of the banking and financial sector and the resulting dependence of private debt on the exchange rate are problematic. According to some estimates, 50% to 60% of loans in foreign currency are exposed to exchange-rate risk. So far, negative consequences have not appeared, in part because the exchange rate has remained relatively stable during the period under review.

After the boom of the 1990s, the government’s fiscal and debt policies appear to be less stability-oriented. During the survey period, the Toledo government managed to reduce the budget deficit from 2.8% of the GDP in 2001 to 1.3% in 2004. However, the political situation may challenge this budgetary discipline by bringing demands for an extension of public policies, the possible costs of decentralization, or a further drop in revenues because of an inconsistent tax regime. The administration stabilized the foreign debt, which had risen continuously since 1992, but the total national debt and the public debt hover at a high level. Foreign currency reserves have stabilized at a favorable level and can cushion some of the risks noted here.

2.4. Private property

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

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

2.5. Welfare regime

Peru's hybrid welfare regime is limited to certain sectors and reaches only part of the population. Even before the deep crisis of the 1980s, the social insurance system – prescribed by the 1933 constitution– offered scant coverage and excluded the rural population. Since then, lack of funds and the expansion of informal employment have further eroded its effectiveness. The insurance system, which covers about 30% of the population, provides payments in case of illness, pregnancy, disability, old age and death. Since 1992, the pension scheme has included private plans (following the Chilean model), but it falls far short of the intended complete conversion. As the social situation deteriorated, state social programs became more important; under Fujimori, they were increasingly linked with patronage practices. Under Toledo, the system's main deficiency is corruption and the lack of efficiency; not all the social policy programs reach the targeted population.

About half the population lives in poverty; in rural areas, the rate is uniformly above 60%. The disparity of income distribution in Peru is severe, although more moderate than in Brazil or Chile. The Toledo administration has introduced a new social welfare program that is supposed to create more than 400,000 jobs, but it has fallen far short of expectations. Equal opportunity and equal access to public services do not exist. There are few mechanisms to promote the advancement of women, persons with disabilities or the socially disadvantaged. Discrimination against women also consists in their limited access to post-secondary education, income and public office.

2.6. Economic performance

After the catch-up growth of 1993–1997 (averaging 7%) less favorable external conditions, stalled reforms and turbulent domestic politics brought a downturn in Peru's macroeconomic results, and the growth rate averaged 1% for 1998–2001. Since 2002, however, performance improved notably, leading to macroeconomic stabilization. This stands in sharp contrast to developments in other policy areas. Along with an average growth rate of 4.4%, inflation could be kept low during the years studied, and most other data also showed improvement. Currency reserves

grew, budget and current accounts balance deficits became manageable, short-term debt declined and state coffers were less dependent on the financial markets.

On the negative side, in addition to problems already noted (dollar dependency, national debt, decentralization, tax revenues still only 12% of the GDP, although improving) the formal sector remains limited, which inhibits viable, dynamic economic development, especially concerning new-job creation. Since the drastic pre-1992 slump, the country's level of development remains low and the poverty rate remains high.

2.7. Sustainability

Deforestation, overgrazing, desertification, and air and water pollution are the nation's primary environmental problems. Environmental awareness in society and among lawmakers has grown in recent years, but it is still at a low level. Environmental concerns generally take a lower priority than economic growth considerations. Ecologically sustainable growth receives only scant attention and it is not reflected in the institutional framework. Worsening ecological problems – especially soil erosion and the contamination of rivers and lakes – primarily affect the highlands and the Amazon basin, especially in times of the El Niño phenomenon.

Education and training facilities are available in important segments, but they vary widely in quality. Overall, the education sector has remained backward. Necessary reforms were not undertaken and the sector is a significant obstacle to Peru's further development in all areas considered here. In some indicators, such as school attendance, the record is even worse than under the Fujimori regime. Definite shortcomings exist in research and development. Quantitatively and qualitatively, investment in education, training, research and development is low. The state's expenditures for education since the 1990s have stalled at about 2.9% of GDP, with a further drop since 2000. Modern infrastructure does not extend nationwide, but is limited to certain segments and enclaves (major cities, modernized economic sectors). In the view of IMF, this is a major obstacle to further development especially in the agrarian sector.

3. Management

Poor governance and political leadership is one of the core reasons for Peru's current blocked transformation. Management problems among the political elite have been the Weakness of Peru's transformation since 1980. The interim government under Valentín Paniagua gave Peru the opportunity to resume its transformation. The Toledo government as well as the political elites did not use this window of opportunity. Instead, they fell back into the old syndrome of

intransigence, incompetence, short-term political gains and the lack of accountability. The idea of serving the people has still not taken root in Peru.

3.1. Level of difficulty

In terms of structural socio-economic conditions that shape the political process in the long term, the difficulty level of the post-Fujimori transformation should be regarded as medium. The current presents a mix of positive and negative aspects.

Negative factors include Peru's relatively low level of economic and social development, widespread poverty, inefficient state administrative and rule-of-law institutions, significant ethnic and social heterogeneity, weak political and civil society and vulnerability to external economic forces. On the other hand, the state has reestablished its monopoly on the use of force; heterogeneity has not bred ethnic or religious conflict; social tensions have not dramatically escalated, despite social segmentation; and the society has a basic level of education, despite severe problems. Furthermore, much of the needed economic structural reform had already been accomplished in the 1990s, with relatively broad consensus. There was also a relatively clear basic consensus about democracy and core democratic rules when the new regime took over. However, the task of stabilizing and broadening Peru's democratic transformation is also made more difficult by situational factors, chiefly President Toledo's uncertain majority in Parliament, the new political elite's low level of professionalism, and, not least, high expectations among the population that coincide with an aversion to Fujimori-style neo-liberal reforms.

Profile of the Political System

Regime type: <i>Democracy</i>	Constraints to executive authority:	2
System of government: <i>Presidential</i>	Electoral system disproportionality:	18.6
	Latest parliamentary election:	08.04.2001
	Effective number of parties:	4.4
1. Head of State: <i>Alejandro Toledo</i>	Cabinet duration:	07/01-present
Head of government: <i>Alejandro Toledo</i>	Parties in government:	2
Type of government: <i>divided government</i>		
	Number of ministries:	15
	Number of ministers:	16
<p>Source: BTI team, based upon information by country analysts, situation in July 2005. Constraints to executive authority (1-6 max.) measures the institutional constraints posed by a federal or decentralized state, a second parliamentary chamber, referenda, constitutional and judicial review and the rigidity of the constitution. Electoral disproportionality (Gallagher index) reflects the extent to which electoral rules are majoritarian (high values) or proportional: $\sqrt{\frac{1}{2} \sum (v_i - p_i)^2}$; v_i is the share of votes gained by party i; p_i is the share of parliamentary mandates controlled by party i. For presidential/semi-presidential systems, the geometric mean of presidential election and parliamentary election disproportionality is calculated. Effective number of parties reflects the political weight of parties (Laakso/Taagepera index) = $1 / (\sum p_i^2)$; p_i is the share of parliamentary mandates controlled by party i. Number of ministries/ ministers denotes the situation on 1 January 2005.</p>		

Civil society traditions, which began to emerge at the end of the reformist military regime (1968-1980), are still weak. Notwithstanding an increase in non-governmental organization (NGO) activity, the landscape of voluntary organizations is still meager and plagued by scarce organizational resources. Although Peruvian society is split into social classes and ethnic communities, until now this has not led to similar splits in the political landscape, due to weaknesses in political representation. Mobilized groups and protest movements have become stronger during the survey period. Violent incidents have occurred in Lima as well as in the Andes region. According to recent data from *Latinobarómetro*, trust in institutions and social trust are low. (Although Peru takes a middle position in Latin America concerning interpersonal trust, the continent as a whole has the world's lowest average indices in this area.) Finally, there is no civic culture of moderate participation in public life.

3.2. Steering capability

The Toledo government did not manage reforms effectively and could achieve only a small part of its policy priorities. Only to a limited extent, could the political leadership prioritize and organize its policies according to strategic aims beyond immediate concerns of political competition. The main transformation goals – strengthening the rule of law and the state, job-creating growth – have increasingly been lost from view during the period. Confronted with the huge gap between campaign promises in 2001 and the real policies when in office, the president saw his authority to govern diminishing from month to month, with an approval rating falling below 10% in 2004–2005.

The Toledo administration has demonstrated very little reliability in achieving or even pursuing its goals. The platform of basic principles about the course of transformation and a market economy, laid out and accepted in 2001 by all parties in the *Acuerdo Nacional*, did not proceed. Concrete reform policies are neither fully developed nor particularly coherent. This failing pervades the ranks of the entire political elite and reflects the weakness of the party system. In the eyes of many Peruvians as well as in the opinion of many neutral observers, President Toledo has not met the challenge of his office. The shortcomings are most evident in the administration's unclear strategic priorities. Apart from the political management of current problems, the government often defers long-term goals for the sake of short-term political gain to maintain the minimum support necessary to stay in office.

The political leadership claims to pursue long-term aims – and in the beginning it really did – but these are regularly replaced by short-term interests of political bargaining and office seeking. Thus, only a small part of its long-term goals like decentralization are pursued over time. Although the leadership seeks to build democracy and a market economy, its strategic aims are not related to the

country's situation, problems and needs. In the economic arena – where the Peruvian government continued neo-liberal policies, but tried to give greater weight to social considerations – the overall strategy for reform has been pursued only tentatively. Despite some positive signs in the beginning, the government showed even less resolve in continuing the transitional government's political work. Positive gains such as reining in the military, expanding the Truth Commission, pursuing decentralization and combating corruption, could not be deepened.

In part because of the president's weak leadership, the heterogeneity of his coalition cabinet and the unstable majority in Parliament, the consistency and coherence of reform policies is limited. For example, the government has made only sporadic progress in implementing the reform measures in Peru's agreement with the IMF. The government meets basic expectations of security in terms of life, law and the economy, but it is vulnerable to unexpected reversals and changes of course, for example, in its privatization policies. Therefore, societal and economic actors must expect politically induced uncertainties; these could increase because of shifting political alliances. The badly needed stronger investment, from within as well as from abroad, did not occur in the last two years because of low reliability of state and government agencies.

Although the government is in principle committed to democracy and a market economy, it has had only limited success in implementing its announced reforms. Thus, the Toledo government has demonstrated weak organizational capability. It was unable either to manage reforms astutely or to establish consistent priorities among needed reforms. The fault lies partly in the managerial capacity of the president himself, but partly in the relatively low professionalism of Peru's political elite as a whole.

Furthermore, the government has squandered whatever trust the public accorded it at the start of President Toledo's term – a reservoir already limited by skepticism toward the political class. The most obvious indicator is the dramatic drop in Toledo's own approval rating since he took office, primarily because he failed to carry out his campaign promises and because of growing corruption. As a result, the government only partially retains the political authority to initiate or implement needed reforms. Instead, a further explosion of demands from interest groups looms on the horizon, calling to mind the governability problems that beset Bolivia. Further complicating this scenario is that the government has not always managed to avoid misdirecting economic resources, especially concerning the social policies. Politically it has encountered difficulties in further improving the distributive efficiency of the markets. This is shown by the unresolved budget problems (decentralization, tax policy), resistance to privatization and inadequate control over monopolies.

Frequent cabinet shuffles are another sign of the unclear priorities guiding government policies. Only during a short period in 2003 could Peruvians hope for more coherent reform policies. Beatriz Merino, Peru's first female prime minister, resolutely tackled the main problems with first effective steps towards tax reform and state reform. Her poll ratings were astonishingly high, in times of great popular distrust for politicians. Merino, however, was dismissed after five months despite her relative success. The official charge was nepotism, but the independent Merino was dismissed due to pressures from leaders of the president's party, *Perú Posible*, who feared the complete loss of visibility and relevance in Peruvian politics. Furthermore, the credibility of the government was undermined by corruption charges.

Although the political leadership tries to respond to mistakes and failed policies with changes, its policy frequently remain stuck in the same routines. Over time, it has shown little ability to learn. Learning processes occurred only sporadically, and they rarely contribute to the knowledge base or cognitive framework on which policies are based. Although the president and the government did react to missteps and failed policies – such as the privatization plans that sparked regional protests – with changes, these have generally been marginal and do not touch the substance, such as reshuffling the cabinet or appeals to the nation. In some cases, the ministers dismissed were the most capable in the cabinet. Thus, many policy measures lacked careful preparation or planning, and often they even created more chaos and confusion (e.g. the deactivation of the secret service (CNI) in early 2004). Overall, Toledo's strategy presents no clear roadmap of forward-looking reforms. This has become even more difficult as the political landscape became more differentiated via regional governments where the opposition has scored successes.

As the government stepped from one crisis to another, the conditions for learning processes deteriorated. Overall, the current president and his administration, along with the rest of the political elite, tend to overestimate their own abilities and misjudge the challenges they face – tendencies that became apparent when the Fujimori regime collapsed, but that had already existed in the 1980s. One manifestation of this was Toledo's promise of economic and social improvements, which he continued making even after he was elected president. Another refers to the ignorance towards the growing tendencies of anarchy and informality that extend over the country. After the lynching of a small town mayor near Lake Titicaca, the reaction was not a discussion how to strengthen the rule of law or to change impeachment procedures on the local level. Instead, Toledo dismissed his minister of domestic affairs, who had been rather severe in his job but was sharply criticized among radical opposition groups.

A positive sign instead can be seen in the Law on Fiscal Decentralization, which binds further decentralization (competences, finance) to the formation of five new regions (out of 16 from the 25 departamentos). The government has learned from

the mistakes of a too-hastily initiated decentralization process, and to avoid the negative experiences of other Latin American countries where decentralization led to the loss of control of public finances. Consequently, however, the decentralization process might be in danger, as the formation of regions is not very popular, but must be approved by referendum in October 2005.

3.3. Resource efficiency

The Toledo government does not make optimum use of available economic, cultural and human resources to pursue its transformation policy. Efficiency has declined during the period of this evaluation.

One reason is that Peruvian reform policies do not always have clear goals. Concerning state resources, the primary weaknesses are the high level of public debt and the budget deficit (despite the improvement in the last two years). Added to this are unpredictable state revenues that are a legacy of repeated tax amnesties, which perpetuate noncompliance and fail to bring in the revenues needed to combat poverty. Tax revenue is only 13% of the GDP.

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

The government bureaucracy is not small and lean enough, and personnel expenses are still too high. Furthermore, government weakness has led to a climate that fosters demands for more rather than less state action. Public service is neither reliable nor of good quality, and public administration lacks professionalism. Regional decentralization put in place in 2001, followed by regional elections in 2002, is still underdeveloped. Efforts to more clearly define regional autonomy, which were undertaken in the short term of Prime Minister Merino, did not prosper. Consequently, regional administrations are also ineffective. In addition, decentralization has multiplied problems of accountability, which are difficult to review, as a growing number of corruption scandals has shown.

Initially, the government tried to coordinate conflicting objectives and interests, but has had only limited success. Intra-governmental friction has been a growing problem in the period under investigation. In addition, the resulting coordination problems were increasingly aggravated by the frequent cabinet reshuffles in order

to keep up at least a minimum of governance capacity. Conflicting goals like creating new jobs – which itself requires either more private investment or additional state resources – and maintaining macroeconomic stability could not and cannot be coordinated into a coherent and credible policy. Again, the only exception was the brief period under Beatriz Merino as prime minister, who in the end was abandoned even by President Toledo in order to relieve pressures from the public and his own party.

The poor record of the Toledo government continues in the fight against corruption. Although progress was initially made, in the end government efforts focused exclusively on the offenses of the Fujimori era. “Normal” corruption, on the other hand, was not attacked in the same way. Indeed, the survey period has seen a reversal in the corruption record. To date, the government has not made adequate attempts to provide the necessary integrity mechanisms. Even worse, when corruption charges surfaced against the president and other government members, these persons changed their attitude vis-à-vis an efficient anti-corruption system. Thus, although the government established a National Commission to Fight Corruption and Promote Ethics and Transparency, in 2004 it put more and more obstacles in the way of the ad hoc attorney’s office occupied with major corruption cases.

On the other hand, although Peruvians’ perception of corruption has grown in recent years, this has to be carefully evaluated. Uncovering the corrupt network installed by the Fujimori regime has led to high sensitivity within the Peruvian public and to an intense awareness in the mass media of new corruption cases. Thus, perception of corruption has grown every year while other data suggest that the level of corruption remained more or less the same. That level is bad enough. The Transparency International scores for Peru were 4.0 in 2002, 3.7 in 2003, and 3.5 in 2004.

3.4. Consensus-building

In contrast to its first 18 months in office (July 2001 to January 2003), when the Toledo government had earned somewhat better marks in consensus-building, following two years showed a steady decline in this regard.

In principle, all the significant political and social actors agree on a stable market-based democracy as the goal of reforms, although specific ideas for how to reach that goal vary considerably. This framework of consensus was documented in the Acuerdo Nacional of March 2002, launched by Toledo and his team under the banner of necessary reconstruction. It encompassed all of Peru’s important parties and social forces. However, the accord yielded little in the way of concrete measures, and did not proceed further because of the tendency to confrontational politics and, more importantly, because of the government’s inability to develop

consistent policies. In addition, both the government and the rest of the political elite failed to establish a broad consensus about reform with other major actors in society. During the review period, dissent has grown within civil society about the role of the state in the economy and even about the preference for democracy. It is not impossible that new political forces such as so-called “outsiders” – i.e. populist newcomers without ties to existing political parties – will try to capitalize on these tendencies for political gain.

Anti-democratic veto powers no longer exist in Peru, notwithstanding occasional speculation about a revival of the Shining Path guerrilla movement. In addition, ambiguous government policies in 2004, such as the creation of a special fund for the military, suggest that there could be new forms of military autonomy in the near future. It should also be noted that only 40% of Peruvians think that a military regime would be less able to resolve problems than a democratic government.

The record is similarly mixed with respect to the political management of social cleavages, which – because of the weaknesses of civil and political society, especially after the Fujimori era – are not clearly articulated. On one hand, key political actors are not able to mitigate the latent divisions of ethnic and socio-economic conflict. On the other, political fragmentation has made it easier for political leaders to prevent structural conflicts from escalating. This might change, however, if state institutions were to weaken and better-organized political movements were to surge.

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

Against these tendencies, the government has tried repeatedly to invoke national unity and to foster “integration” with populist promises. However, these promises are not sufficient and they have even become counter-productive, as the low approval rates for Toledo and the state’s institutions show. Thus, although the government tries to encourage solidarity among citizens and societal groups, it is ineffective because of its incoherent policies. Openness to solidarity is influenced by the anti-Fujimori sentiment, which political actors have been able to keep alive, but this will be depleted before long. Finally, the government does little to reduce existing divisions within the country and is unable to bridge the various social, regional and ethnic cleavages.

The political leadership shows more inclination to ignore civil-society actors than to consider them. This assessment, of course, is somewhat ambiguous, given the

tendencies in Peruvian civil society and the Toledo government's reactions to them. However, although the government tries to enable participation of civil society and even had a few successes, its inability to formulate consistent policies or to organize an adequate process of policy formulation leads it to disregard true participation from civil society. This is of course exacerbated by the low level of organization in civil society itself, which is essentially comprised of a conglomerate of particularistic interests without any channels to accumulate them.

In contrast, the initiatives to address the human-rights violations of 1980–2000 may have a positive effect in the long term. Largely and particularly compared with other cases in Latin America, they have been relatively purposeful and comprehensive. Above all, the establishment of the Truth and Reconciliation Commission in 2002 led to intensive work collecting testimonies, making a new record about the victims of the human rights violations (70,000 instead 30,000 killed, as had previously been presumed), and clarifying the responsibility for them. However, after these successes, the impetus for a true reconciliation was lost. By August 2004, only 10% of the Commission's recommendations had been fulfilled. There is great "slowness" especially concerning trials against members of the military and the police, who, along with the Sendero Luminoso guerrillas, were the main perpetrators of past injustices.

3.5. International cooperation

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

The political leadership works with bilateral or multilateral international donors and tries to make use of international assistance, but this does not facilitate significant policy learning and improvement. The Toledo government's stabilization strategy relies on coordinating its reforms closely with the International Monetary Fund, the World Bank, and the Inter-American Development Bank; it earns guardedly positive marks from these institutions. The government shows a steadfast willingness to meet requirements and for the most part it makes effective use of the resources provided by international partners. The Toledo government also worked toward closer cooperation among the Andean Pact countries.

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

toppling secret intelligence chief Montesinos. After the regime change, cooperative efforts – for example, with the IADB or the EU – have focused primarily on improving the rule of law, supporting national reconciliation and implementing decentralization. In its relationship with the United States, the government aims to continue the strategic cooperation in the war on drugs, for example by replacing the coca economy, on which an estimated 200,000 Peruvian jobs depend. However, this policy encounters resistance, sometimes massive, from coca farmers.

In general, the government acts as a credible and reliable partner in its relations with the international community. However, during the period of review, there has been one noteworthy exception that might be the nucleus of a paradigm change. In the wake of the dramatic political turbulence in Bolivia, which led to the resignation of President Sánchez de Lozada, revived tensions between Bolivia and Chile also had some repercussions in Peru. While Peru confirmed a closer relationship with Bolivia, it distanced itself somewhat from Chile. Overall, there is a danger that new, or old, nationalism will surge in Peru and be instrumentalized for domestic political gains.

4. Trend of development

4.1. Democratic development

The political system in Peru, which in 2000–2001 changed from Fujimori's authoritarian and corrupt regime into a democratic one, meets the minimum requirements of a democracy under the rule of law. It is to be labeled as a defective democracy with precarious stability.

In contrast to those promising changes, however, from 2001 to 2004, Peru's political order showed no improvement or even some decline concerning the relevant performance indicators. In particular, while stateness has deteriorated slightly concerning the state's monopoly on the use of force and the capabilities of the state administration, the rule of law still falls short of democratic standards and even declined in some aspects, such as the fight against corruption. Similarly, while the process of democratic consolidation seemed to gain ground in 2000–2001, there has been a process of growing instability since then, due to weak political leadership and stagnation of political reforms. Above all, the political parties have made no progress in their capacity for political and social integration. Efforts to develop cooperative and consensus-oriented patterns of interaction between labor and capital have languished. The landscape of civic interest groups and organizations shows sustained positive development, although weaknesses exist in terms of the breadth of citizen participation. There is backsliding in the development of a civic culture to support democracy. Survey results for the period

under study indicate a crisis of support and satisfaction that has recently intensified.

4.2. Market economy development

From 2001 through 2004, Peru has not made much progress in the direction of a socially responsible market economy. The main shortcomings persist in the absolute level of socio-economic development, the organization of the market and competition, in private property, the welfare regime, and in sustainability.

Peru's development status as a middle-income country (UNDP, IMF) has not significantly improved during the survey period. The poverty rate has not declined at all, and the Gini Index shows no reduction in income disparity. Measured by changes in HDI, Peru's level of development improved only slightly, by 0.015 from HDI 2000 (data for 1998) to HDI 2004 (data for 2002).

The institutional environment for progress toward a market economy has not changed significantly. Deficiencies remain in the organization of the market and competition. The pace of reform slowed significantly during the period under study, as a great part of the Peruvian population and also a growing part of the political elite are at least ambiguous vis-à-vis further "neo-liberal" reforms. The main positive note is that banking oversight as well as the solidity of the banking system improved somewhat.

Measured in terms of macroeconomic data, overall economic development has regained momentum after 2001 because of a more favorable international environment. However, measures to use the macroeconomic honeymoon of the last two years for a better social embedding of Peruvian market economy have not been undertaken. Instead, performance in education and health has worsened compared with the Fujimori era. Unemployment remains relatively high, and the size of the informal sector could not be reduced.

Table: Development of macroeconomic fundamentals (2000- 2004)

	2000	2001	2002	2003	2004
Growth of GDP in %	2.8	0.1	4.9	3.8	4.6
Export growth in % (IMF)	14.3	0.8	9.1	17.1	22.9*
Import growth in % (IMF)	9.1	-1.8	2.2	10.8	8.0*
Inflation in % (CPI)	3.7	-0.1	1.5	2.5	4.1
Investment in % of GDP (IMF)	20.1	18.6	18.4	18.5	18.2*
Tax Revenue in % of GDP (IMF)	12.0	12.2	11.9	13.0	13.3*
Unemployment in %	8.5	9.3	9.4	9.4	9.5
Budget deficit in % of GDP	-2.8	-2.8	-2.1	-1.8	-1.3
Current account balance in billion \$	-1,57	-1,10	-1.13	-1.06	-0.01

* preliminary

Source: CEPAL: [Estudio Económico de América Latina y el Caribe, 2004-2005](#); IMF: Country Report 04/226.

D. Strategic perspective

Despite favorable conditions, Peru has again entered a slippery slope, which might end in social, political and economic turbulence before the end of president Toledo's five-year term in July 2006. This worst-case scenario, which would presumably lead to a seizure of power by the armed forces, might happen if the government does not manage to communicate a clear political plan for its last 18 months and if social discontent finds new stimuli. The turbulence, then, would consist more of sporadic, spontaneous and initially uncoordinated political protest, than intentional political turmoil. This scenario becomes even more probable if economic development cannot be kept stable.

A more optimistic, and perhaps more realistic scenario takes into account that the opposition political elites do not at present have great interest in destabilizing the Toledo government, as this would probably mean the breakdown of democracy itself, and thus the end of their chance to come to power. Under these conditions, and with a more or less favorable economic performance, Toledo will likely be able to finish his term in July 2006. New steps in necessary reforms, however, are not to be expected. Moreover, it is very unclear whether the 2006 elections will lead to a new chance for good democratic governance, or if a populist outsider will come to power. Although not relevant for coming elections, it is significant that in 2004 the former newcomer Fujimori was leading the president election polls, with 20% in favor.

There will be no major changes in economic transformation through 2005. Although some minor reforms will probably happen, the overall design of Peru's economic system would need a consistent program of reform for years. In addition to a strengthening of the institutional realm, this would require a strong consensus between the political elites as well as within Peruvian society.

Seen from a strategic perspective, one has to distinguish between medium- and long-term strategies. In the more immediate perspective, it seems necessary to stabilize president Toledo so that he may finish his term in 2006. Although perhaps not everyone feels comfortable with this idea, the alternatives are even worse for the continuation of Peruvian transformation. However, further mistakes and a further decline of the basis for transformation have to be avoided.

A long-term perspective has to take into account that overall reforms are necessary and have to balance entrenched interests in politics and the economy, which are not easy to confront. However, 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. Thus, in addition to the ongoing economic cooperation, a new transformation strategy should focus on four key elements:

- Representation: One of Peru's major problems is to channel demands in order to avoid political eruptions and to develop at least medium-term political programs. Though some efforts have been made, such as the 2003 law on political parties, the functioning and the internal democracy of the Peruvian parties should be addressed. Accordingly, new and more adequate party legislation is necessary.
- Rule of law and the judiciary: Although programs exist, for instance from the European Union, there has to be a stronger conditionality concerning resources for judicial reform. The usual mistake is to see such a reform as a merely technical issue. However, as the successful Chilean example shows, there have to be strict reformers as well as the capacity to identify and break anti-reform interests (inside the judiciary, inside the state apparatus and as well as among the political elites).
- Education: Although some educational standards such as literacy have made progress, Peru's education system is outmoded, inefficient, unprepared for the future and often - especially in some provincial universities - plagued by old ideologies. This is a severe obstacle not only to social and economic development, but also to developing civic virtues and thus strengthening democracy.
- Quality of the political elite: All these reforms will last many years and once under way might be interrupted by government change or even by political turbulence. The fourth main problem, however, will not only last even longer, but cannot easily be solved or mitigated from outside, that is the deplorable moral and cognitive capabilities of nearly the entire political elite at all political levels. Reformers from inside and outside the country have to bear this in mind in all their efforts. One measure might be special training programs, another, perhaps more effective measure is a new kind of conditionality that considers this.