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**The Limits of Democracy and Economic Growth:  
Institutionalized Inequality in Peru**

BY

Elizabeth Kyriacou  
BA in Political Science and International Affairs, University of New Hampshire, 2007

THESIS

Submitted to the University of New Hampshire  
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in

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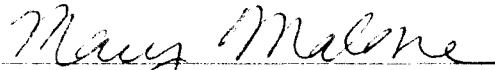
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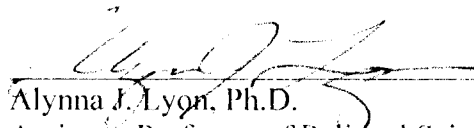
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## DEDICATION

To Juan Alito, Marisol, Lisbet, Johana, Maria, Merica, Sofia, and Gabriela. I hope your paths in life will reflect your every dream and aspiration.

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## ABSTRACT

### THE LIMITS OF DEMOCRACY AND ECONOMIC GROWTH: INSTITUTIONALIZED INEQUALITY IN PERU

by

Elizabeth Kyriacou

University of New Hampshire, May, 2009

The gap between the rich and the poor is widening at the global level, and at national level in many Latin American states. The poor distribution of assets and resources serves as an obstacle to overall economic development and threatens political and social stability. Such inequality has persisted despite substantial economic and political change in many Latin American states, fueling a development debate among theorists, economists, social scientists, and policymakers. How can persistent inequality be explained? As a nation with high inequality, economic growth, and democracy Peru serves as a pertinent case study. A qualitative analysis of regime type, economic policy, and institutions in the 1980s, 1990s, and 2000s reveals that exclusive institutions guiding the executive, political parties, military, and judiciary have perpetuated the inequality problem. The findings highlight the importance of institutional reform in economic development.

## INTRODUCTION

Over the course of the last century the world has become more modern and globalized. Advancements in everything from medicine to computer technology have changed the daily lives of billions of people. Innovations such as polio and smallpox vaccinations, cancer and AIDS treatments, water sanitation systems, and modernized critical infrastructure, have contributed to a more prosperous and healthy global community. In turn the overall quality of life for a large proportion of the world's population has improved. In 1962, the GNI per capita for the world was \$468; in 2006 that figure reached \$7,448.<sup>1</sup> In addition, there has been progress in other development indicators. Since 1950, the world average for life expectancy increased by almost 20 years, and global infant mortality rates decreased from 153.1 deaths per 1,000 live births in 1950, to only 53.9 deaths in 2005.<sup>2</sup>

Despite these global level advancements, close to half of the world's population continues to live in poverty. Nearly 2.5 billion people, 40 percent of the entire global population live on less than \$2 a day (*Human Development Report 2005*, 4). The destitute conditions, under which so many live, coupled with the progress that has reached some sectors, reveal an incredibly unequal world. In fact, substantial empirical data reveal that the gap between rich and poor nations is not decreasing, but rather increasing. "In 1950 the average per capita income (in 1980 US dollars) of low-income countries was \$164, whereas per capita income of industrialized countries averaged \$3,841, yielding an absolute income gap of \$3,677" (Seligson and Passé-Smith 2003, 1). This figure has only

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<sup>1</sup> Data from the World Bank Group World Development Indicators database. Available: <http://ddp-ext.worldbank.org/ext/DDPQQ/member.do?method=getMembers&userid=1&queryId=135>

<sup>2</sup> Data from the United Nations Population Division Population Database. Available: <http://esa.un.org/unpp/index.asp>.

increased in the last 60 years. By 1980, the absolute income gap had almost tripled to \$9,648, and in 2001 the figure had reached \$26,280 (Seligson and Passé-Smith 2003, 1-2). These statistics underscore the rise in inequality that has occurred in the last half century despite economic growth.

In addition to inequality at the global level, national level economic disparities are prevalent. As Seligson and Passé-Smith note, “Many poor people who live in poor countries are falling further behind not only the world’s rich, but also their more affluent countrymen” (2003, 2). These discrepancies exist not just in developing nations but in wealthy states as well. In fact, the poorest twenty percent of the population in the United States shares only 5.4 percent of total income, while the richest twenty percent of the population shares 45.8 percent. These numbers are comparable to those of Nicaragua, one of the poorest countries in Latin America.<sup>3</sup>

The increase in the international and domestic gaps has challenged an extensive body of literature and policies advocated by several economists, scholars, social scientists, and policy makers. Many claim that the gap between the rich and the poor will dissipate with economic growth and development, and others argue that the gap is not a cause for concern. Some, primarily neoclassical or neoliberal scholars, promote the free market and argue that the key to lessening the gap is the adoption of laissez faire and capitalistic policies (Friedman 1962). Others point to the modernization process, in which each state passes through a set of evolutionary stages. Once every state has passed through each stage, and become modernized the gap between the rich and poor will disappear (Rostow 1990). Support for and subscription to these theories can be seen in

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<sup>3</sup> Data from Human Development Report 2007 Data. Available: <http://hdrstats.undp.org/buildtables/#>.

outwardly oriented economic policies, particularly those supported by the U.S. and adopted by Latin American nations during the 1980s and 1990s. These neoliberal reforms were promoted as the optimal way to “solve the nation’s social and economic problems” (Massey 2006, 11). For decades these theories, policies, and the general conviction that the gap will disappear have had widespread support.

The aforementioned theories and policies have been widely challenged, yet most significantly by Latin America, the region in the world with the largest gap between the rich and the poor. In fact, 48 percent of the total income is earned by the richest ten percent of the population in the region, and a mere 1.6 percent is earned by the poorest ten percent (De Ferranti 2004, 1). Again, this unequal distribution of resources manifests itself domestically. In fact, “the country in the region with the least income inequality is still more unequal than any Organization for Economic Cooperation and Development (OECD) or Eastern European Country” (De Ferranti 2004, 1).

These state level economic divisions in turn contribute to discrepancies in access to goods and services, such as health and education, creating vastly different standards of living. “In Mexico, the average person in the poorest fifth of the population has 3.5 years of schooling, as compared with 11.6 years for the average person in the richest fifth” (De Ferranti 2004, 17). Critical health services are also absent or inadequate in poor communities. For example in Guatemala, only nine percent of births among the poorest 20 percent of the population are attended by skilled health professionals, whereas 92 percent of births among the richest 20 percent of the population are attended.<sup>4</sup> These inequities inhibit large sectors of society from attaining the quality of life and opportunities that are readily available to their wealthy counterparts. In addition to the

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<sup>4</sup> Data from Human Development Report 2007 Data. Available: <http://hdrstats.undp.org/buildtables/#>.

social ramifications—poor health, lack of education, unemployment—there are also political implications, such as increased public discontent with government, democratic failure and sometimes even violence. Yet such detrimental socio-economic disparities persist in the region despite major economic and political change, from democracy, free market economics and institutional reform, to authoritarianism and state led development. How then can such persistent inequality be explained in Latin America despite these political and economic changes?

### **Literature Review**

Numerous theories have been used to explain how politics, economics, and institutions in Latin America influence inequality. The relevance of such theories however are best understood when supplemented with a general comprehension of inequality in the region. The prevalence of inequities in Latin America has been attributed to several factors. History is one of the major variables examined with relation to inequality. Colonialism, clientelism, and patronage have played a major role in Latin America for decades, and essentially established and contributed to the divisions along social, ethnic, and economic lines that can still be seen today (De Ferranti 2004). As a result, exclusion has become a reality deeply entrenched in Latin American societies, and one which persists in the twenty-first century despite economic, political and institutional reform.

This understanding of Latin American inequality and its endurance provides an important foundation for identifying and testing the most relevant theories. Scholars, economists, social scientists, and policy makers alike have contributed to the expansive body of literature that helps to explain the gap. The following review is divided into two

sections: the first section evaluates the more traditional literature that uses economics to explain inequality, while the second focuses on the impact of regimes, policies, and institutions on inequality.

### **Economics**

The economic literature can be separated into two schools of thought. One body of literature maintains the general assertion that there is a positive correlation between industrialization, market economics, and growth and lessening inequality (Friedman 1962; Rostow 1990). The theoretical belief that the free market would “solve the nation’s social and economic problems” manifested itself in the Washington Consensus and economic policy in Latin America in the late 1980s and early 1990s (Massey 2006, 11).<sup>5</sup> Yet the limitations of the Washington Consensus and the reality of inequality in Latin America have challenged neoliberal economic policies and the theory behind them. It is therefore the second school of thought, which essentially counters neoliberalism and modernization, that is perhaps more useful in understanding Latin American inequality.

Simon Kuznets, Nobel Prize Laureate, provided some of the most groundbreaking and influential work on economic growth and inequality. In *Economic Growth and Income Inequality* (1955), Kuznets examines trends in the distribution of income that occur with economic growth. He argues that during the early phases of urbanization and industrialization, developed nations—namely the United Kingdom, the United States, and Germany—experienced an increase in income inequality. It was not until the later phases

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<sup>5</sup> In the late 1980s and early 1990s U.S. policy makers and financial institutions came to the consensus that the best way to achieve economic development was through free market reforms. In light of the Asian tigers’ development successes, the fall of the Soviet Union, and the rise of the U.S. as an economic power, policy makers began to promote neoliberal reforms throughout the developing world. In advocating the Washington Consensus, special emphasis was placed on Latin American countries which had previously used the ISI approach and which were suffering from tremendous financial crises.

of these processes that inequality in income distribution declined. He utilizes an inverted U curve to show these trends, ultimately challenging traditional theories of economic growth.

Kuznets also provides significant evidence concerning income inequality within underdeveloped states. He argues that the inverted U curve does not adequately depict income inequality trends in these states. Not only are income levels significantly lower than those seen in the pre-industrial societies of developed countries, but the income gaps are much wider and there is virtually no middle class in many developing societies (23-24). Furthermore, inequality in African, Asian, and Latin American countries has been in place for centuries and is thus deeply entrenched in society. Ultimately, economic growth in developing countries will not necessarily lead to more equality in the distribution of income. Inequality is not simply a temporary phenomenon that will dissipate with economic development.

The body of literature that has developed since Kuznets and also in response to free market economics is extensive. World system theory in particular serves as a direct criticism of neoliberalism and economic growth's capacity to eliminate income inequality. According to this theory, global inequality is a byproduct of the modern world system. The capitalist international system consists of core and peripheral states, where the rich core countries essentially drain resources from the poor peripheral nations (Wallerstein 1974). The same relationship may exist within states as well. Certain sectors of society, such as business elites, take advantage of or manipulate other sectors, such as the rural indigenous, ultimately creating and contributing to socioeconomic inequality.

While this school of thought provides insightful criticism of the capitalist economic system, it too has been confronted with limitations.

The international level of analysis utilized by World System theory is particularly problematic for understanding inequality. First it fails to explain why inequality persists or has persisted in Latin American economies that do not subscribe to the international capitalist system and policies, that is those states' that have engaged protectionism and inward oriented economic policy. Secondly, it does not adequately or comprehensively explain domestic inequities or differences in inequality across the developing world.

Why do some developing states have high inequality while others do not? Why is the gap widening in some nations?

The limitation and generality of the aforementioned theory is addressed by dependency theory. Similar to World Systems theorists *dependentistas* (Prebisch, 1950; Cardoso and Falleto, 1969; Dos Santos, 1970) cite the structure of the global economy as a cause of inequality, yet they also place emphasis on the historical context, domestic political and social structural limitations that inhibit a nation's capacity to reduce poverty and inequality. Factors like colonialism, the presence of multinational corporations, and an export market of raw materials, has ultimately fueled dependency of peripheral states on the center. Dependency relations are further encouraged by class and economic based divisions within states. This thought, which is Leninist and Marxist in nature, also serves as a direct criticism of neoliberalism, and development institutions, such as the IMF and WB, and governments that utilize and promote that approach. In other words, development and economic policies that have been successful in highly industrialized countries are not necessarily appropriate for developing nations. Until these dependency



relationships, which are cultural, political, economic, and which exist at both the international and domestic levels are better understood and integrated into development, the gap will not shrink.

### **Politics and Institutions**

Dependency theory essentially emphasizes the need to look at variables other than mere economics in order to understand the gap. The literature in this section accomplishes this by assessing the explanatory capacity of political systems and institutions within states to explain socio-economic exclusion.

Democracy has been at the forefront of the development debate, and is considered by many to be the ideal political system for social and economic stability and growth. In his infamous work, Lipset (1960) asserts a positive correlation between democracy and economic growth. The idea that democracies are more likely to be found in economically developed states is further supported by Cutright (1963), Smith (1969), Arat (1988), and Helliwell (1994). Still others purport the opposite, arguing that economic growth occurs more rapidly under authoritarian regimes (Marsh 1979; Weede 1983; Landau 1986).

In terms of democracy and inequality, the theory is also divided. Bollen and Grandjean (1981) and Lipset and Lakin (2004) maintain that the relationship between democracy and inequality is nonexistent. While Stack (1978) and Weede (1982) argue that the level of democracy in a state negatively affects income inequality. This argument is further supported through Salgado's (2006) analysis. In theory a decentralized democratic system that allows for a public voice and participation could lead to improved socio-economic conditions for an excluded population, which in turn has the potential to reduce inequality. In contrast, a restrictive political system in which citizens do not have

a voice and are unable to participate could perpetuate or worsen exclusion and inequality (Salgado 2006, 45). Therefore societies with longstanding preexisting inequality (such as those in Latin America) may also hinder the success and consolidation of democracy (Kapstein 2008, 61-62). That is “economic inclusion is closely related to political inclusion, and, thus to democratic deepening” (Diamond 1999, 85). Generally speaking then, inequality serves as an obstacle to democracy, and democracy serves as a catalyst for equality.

Theory relating to democracy and socio-economic inequality has expanded tremendously to more micro analytic works that focus on everything from democratic elections and policy making, to state institutions. The following theories examine how the role of each of these variables in a democratic system impact inequality.

Hiskey (2003) looks specifically at democratic practices occurring at the local level. He argues that antipoverty programs in Mexico are more efficient and successful in communities that have strong democracies or more specifically competitive elections. In communities where there are meaningful elections and citizens are more participatory, there is a greater chance of these programs succeeding. Hiskey’s work calls into question the role and nature of sub national politics and participation and their impact on local development and national inequalities.

Still other scholars utilize a more individual and policy based analysis in explaining inequities. For example, Lipton (1977) looks specifically at the role of governing elites. He argues that there exists an “urban bias” in developing nations, where elites focus development resources and efforts in urban areas as opposed to the rural

regions where poverty is the most prevalent. As a result, inequality endures and may even worsen.

Birdsall and Sabot (1994) draw similar conclusions in their examination of how government behavior affects inequality. However, their analysis relates to governments' direct investment in the population, and like Kuznets, they directly challenge the belief that growth and lessening inequality go hand in hand. In a comparison of East Asian and Latin American nations, the scholars argue that a lack of investment in human capital by the latter has contributed to slow growth and high inequality. Yet in Asian countries, governments' support of education has increased productivity, which in turn has contributed to higher growth and improved the lives of the poor. In order to overcome high inequality and slow growth, it is therefore essential that governments invest in the poorest sectors of society.

The importance of recognizing the role of democracy and factors like competitive elections, urban biases, and investment in human capital cannot be underestimated, for all of these variables play a role in creating or perpetuating socio-economic exclusion and inclusion. Such theories also bring forth important questions that are vital to understanding inequality. What political, social or economic variables lead to the allocation of resources in urban sectors as opposed to rural? What factors help strengthen local democratic practices that improve poor communities? Why do some societies invest in the entire population, while others neglect the poor and marginalized? Such questions are explored by the following theories.

Lewis (1966) argues that there exists a "culture of poverty" within developing countries. This subculture ultimately represents a lifestyle for the most impoverished

sectors of society, and is characterized by economic exclusion and unemployment, lack of community organization, unstructured family life, and feelings of helplessness and vulnerability. These characteristics can be found in poor urban and rural neighborhoods throughout the developing world, and this subculture is passed down from generation to generation. While Lewis' analysis is somewhat unconvincing due to a lack of supporting quantitative or qualitative research, he does provide interesting insight into why such a subculture exists. A "lack of effective participation and integration of the poor in the major institutions of the larger society" essentially perpetuates the cycle and thus also inequality (252). The role of institutions is further examined in the following literature.

Theorists in the institutionalist and structuralist school, the latter are Latin American experts, argue that internal socio-economic factors—political, economic, and social institutions, structures, and traditions—influence inequality. It is an examination of the character and nature of these structures and institutions that provides important insight into a nation's capacity to promote equality (Dietz and Street, 1987).

Inequality is also useful in explaining the failures of democracy in Latin American nations during the 1980s and 90s. Despite democratic transitions and the onset of seemingly free and fair elections, state institutions remained virtually unaltered. In order for there to be substantial economic and social change democracy must be accompanied by inclusive and representative institutions and the abandonment of the corrupt and self-interested political parties, government elites, judiciaries, and other organizations that are common in Latin America (De Ferranti 2003, 123-147). For this to occur, states must recognize that exclusion is essentially "institutional, hegemonic, legitimizing" and "normalized" (Drinot 2006, 19).

Engerman and Sokoloff (1997) provide historical context for understanding how and why exclusion in “institutionalized” through an examination of the development paths of New World countries. They argue that Latin American economies have not been as successful as the North American economies because of differences in initial factor endowments, such as land and human capital, that essentially helped to establish “inequality in wealth, human capital, and political power” (289). Those inequities which were essentially sustained through state institutions for centuries, are useful in understanding the current divergence between economies in the New World.

The importance of institutions is further emphasized by Olson Jr. (1996) who determines that vast differences in wealth across nations, and within nations can be attributed to “worse” economic policy and government institutions. Olson Jr. confronts theorists that claim access to capital, land, and labor, as well as other economic factors explains wealth discrepancies across societies. Many poor societies have the capacity to earn a tremendous amount of capital from their natural and human resources. However the actual benefits reaped are determined by economic policy, institutions, “the legal systems that enforce contracts and protect property rights”, “political structures”, “constitutional provisions”, and “special-interest lobbies and cartels” (384-385).

De Soto’s (1989) revolutionary work offers a more in depth case study of the institutional problems that underlie a state’s ability to utilize its human capital, natural resources, and economic assets, and to essentially reduce poverty. He asserts that the expansive informal sector that developed in Lima, Peru is composed of communities that are not unlike any other economically driven people, but rather they have been forced to

act outside the law, due to the state's neglect and failure to incorporate them into the capitalist system. The substantial informal housing, transportation, and businesses that have developed as a result of such exclusionary practices, reveal a dire need for state institutional reforms that would enable citizens to participate in such activities formally. Ultimately the nature of the state and its institutions has obstructed access to capital and overall development, which in turn contributes to inequality. The solution he argues is to reform the institutions, laws, policies, and regulations that are inhibiting many Peruvians from participating in the economy.

The focus on institutions and domestic factors as emphasized specifically by De Soto, and more generally by structuralists and institutionalists, is pertinent and convincing in understanding Latin American inequality. It is also important to recognize the relevance of the theories that examine democracy, as a free and open political system is necessary for socio-economic inclusion. However, in order for true democracy and thus equality to succeed, it is theoretically logical that there must also be inclusive institutions. A framework that subscribes to institutional theory, and that takes into consideration domestic factors, like regime type, is most convincing. It is through such a framework that the persistence of inequality and limiting domestic factors can be best understood in the case of Peru.

### **Methods**

This study will utilize qualitative research methods to examine the relationship between the independent variables and inequality. Peru serves as a pertinent case study within Latin America, as its economy has been studied extensively and inequality persists as a major problem. The nation has experienced numerous development policies and

programs, from state led privatization and De Soto's call for institutional reforms, to Import Substitution (ISI) and bureaucratic authoritarianism.<sup>6</sup> In addition, the country's economy has progressed tremendously with regards to inflation, growth, and GDP within the last two decades. Since 1990, with the exception of 1997 to 2000, Peru has experienced positive growth and the GDP has increased from less than \$1,500 per capita in 1990 to over \$2,500 per capita in 2005.<sup>7</sup> GNP growth rates, which increased from an annual 3% in 2000, to 8% in 2006, further attest to this economic progress.<sup>8</sup> Yet economic and social disparities persist in the high-inequality country.

The research will encompass three within case studies including the 1980s, 1990s, and 2000s. During each decade Peru had distinct economic policies and regime types. A state led economy and democracy characterize the 1980s, neoliberalism and authoritarianism in the 1990s, and free market economics and democracy have come to distinguish the current decade.<sup>9</sup> In addition, there have been institutional reforms, particularly in the last decade. Such variation within the Peru case will ultimately allow for hypothesis testing. The dependent variable is inequality and the three independent variables to be examined include political regime, economic policy and institutions across the three time periods. Independent variables such as the world economy, natural

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<sup>6</sup> The primary concepts within this study, such as inequality, neoliberalism, and democracy, are complex and present measurement challenges. A case study will facilitate the measurement process, as well as allow for an in depth examination of the causes and characteristics of these concepts. For further studies on the benefits and significance of case studies refer to Bennett and Elam, "Recent Developments Case Study Methods," *Annual Review of Political Science* 9:2006, and Alexander L. George and Andrew Bennett, "Case Studies and Theory Development in Social Sciences," (2005) Ch. 1.

<sup>7</sup> "GDP per capita, current prices, US\$ (UN estimates)", *United Nations Statistics Division*, available from <http://unstats.org>.

<sup>8</sup> "Peru Data Profile", *The World Bank Group*, available from <http://devdata.worldbank.org>.

<sup>9</sup> The use of three different time periods further justifies case selection as it is not just geographical, but also temporal.

disasters, and internal violence will also be controlled for, as they may contribute to the nature and persistence of inequality in the country.

## **Measurements**

### **Regime**

Political regime is operationalized according to the level of democracy present under each presidential administration. Lipset, Linz, and Diamond (1988) provide a useful definition of democracy that will guide the qualitative analysis of Peru's regimes since 1980.

Democracy is a political system that meets three essential conditions: meaningful and extensive competition among individuals and organized groups (especially political parties), either directly or indirectly, for the major positions of government power; a 'highly inclusive' level of political participation in the selection of leaders and policies, at least through regular and fair elections, such that no major (adult) social group is excluded; and a level of civil and political liberties—freedom of expression, freedom of the press, freedom to form and join organizations—sufficient to insure integrity of political competition and participation (3).

Components of this comprehensive definition, including political parties, civil society, and participation are used to measure the level of democracy. In addition, Freedom House rankings provide insight into the Peruvian political system.<sup>10</sup>

### **Economic Policy**

Economic policy is operationalized with respect to the degree of state involvement and intervention in the economy. More specifically it is defined as *market based* or *command based*. Command based economic policies are those found in

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<sup>10</sup> Freedom House is a nonpartisan nongovernmental organization that promotes economic and political freedom and democracy throughout the world. The organization publishes annual survey rankings of political rights and civil liberties in 193 countries. "The survey operates from the assumption that freedom for all peoples is best achieved in liberal democratic societies." These reports are widely utilized by policymakers, numerous organizations, the media, and scholars as accurate and appropriate measures of freedom and democracy throughout the world.



command economies which are defined as “national economies characterized by administrative direction of economic activity via a central bureaucracy” (Goodwin et. al. 2005, 419).<sup>11</sup>

In this context, command based policies were widely utilized by Latin American governments during the twentieth century and have been characterized by numerous scholars as state-led development. Sheahan (1999) associates “public investment, extensive public enterprises, pervasive regulation, selective subsidies, and high degrees of protection against competition from imports”, as well as the tendency “to disregard fiscal and monetary constraint” with such economic programs (132). Wise (2003) goes further linking command based policies with patterns of behavior, such as “high levels of external financing to support the state’s endeavors” and “the perpetuation of an ambiguous relationship with crucial domestic private investors” (150).

In contrast, market based economic policies can be seen in market economies which are defined as “national economies in which decentralized exchange plays a substantial organization role” (Goodwin et. al. 2005, 419). In societies with market based economic policies the state plays a minimal part in regulating and controlling the economy. In Latin America market based policies, such as privatization, tax reform, public expenditure priorities, deregulation, the promotion of foreign direct investment (FDI) and property rights, were advocated and implemented in the 1990s as the Washington Consensus.<sup>12</sup>

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<sup>11</sup> It is important to note that while command based policies and economies are often associated with communism and the former Soviet Union and Eastern European states, this operationalization is appropriate as it highlights the degree of state involvement in the economy of Peru, which has been one of the defining characteristics of economic policy in the country.

<sup>12</sup> In 1989, John Williamson outlined ten policy instruments that Washington (financial institutions such as the WB and IMF, US government agencies, and the administration) had consensus on, and agreed should be an integral part of developing countries’ economic reforms.

## **Institutions**

Institutions are conceptualized in accordance with North's (1992) definition.

Institutions are the rules of the game of a society or more formally are the humanly-devised constraints that structure human interaction. They are composed of formal rules (statute law, common law, regulations), informal constraints (conventions, norms of behavior, and self imposed codes of conduct), and the enforcement characteristics of both (4).<sup>13</sup>

In addition to this definition and in keeping with the state level of analysis, this study seeks solely to examine the institutions in a selection of major state organizations in Peru. More specifically it looks to the institutions that guide the executive, political parties, military and judiciary. The aforementioned measurements, methods, and theoretical framework will guide this study on inequality in Peru.

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<sup>13</sup> It is important to note the difference between institutions, as defined above, and actual organizations. North identifies organizations, such as political parties, trade unions, and universities, as the "players" of the game (North 1992, 6). It is through such organizations that the "rules" or institutions are carried out.

## CHAPTER I

### BACKGROUND ON PERU

Economic and political development in Peru has been shaped by the nation's colonial history, cultural and environmental diversity, and longstanding social and economic divisions. Unlike in the United States and Europe where "capitalism, liberalism, and democracy...have been part of a single, endogenously generated historical process", in Peru these processes can be characterized as "fragmentary and uneven" (Silva 1988, 82).

Development in Peru, like other Latin American nations, began in the nineteenth century following independence from Spain. Yet, prior to 1821 independence, the Spanish established a society in which the natives were socially and politically segregated and subjugated. Such exclusionary practices have contributed to the nation's fragmented development and to the socioeconomic and ethnic divisions that can still be seen today.

Throughout the latter half of the twentieth century, various economic policies and reforms implemented in Peru have been met with numerous challenges. From 1963 through the 1980s the state led the economy, primarily under military and authoritarian leadership.<sup>14</sup> In 1963, President Fernando Belaúnde Terry was elected to office under a reformist program, with a focus on ISI and nationalization. The attitudes and policy of the administration are adequately described in this comment made by the President: "I cannot embrace laissez-faire...the result are constant hunger and misery...planning is necessary in this environment and government must be the promoter" (Champion 2001, 519).

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<sup>14</sup> Economic and political developments that have occurred in 1980s, 1990s, and 2000s are omitted from this section as they will be examined in detail in the case study.

While Belaúnde was successful in initiating ISI and protectionist measures, his policies did not meet the electorate's demands for radical economic change and further state intervention into the economy.

As a result, in 1968, Belaúnde was removed from office by General Alvaro Velasco, a military dictator whose policies some associated with socialism. The Velasco period in turn saw numerous radical reforms aimed at strengthening the economy, providing a more efficient strategy, reducing class conflict and inequality, and decreasing foreign ownership of business (519). Land reform and the nationalization of sectors, including oil and copper, were two of the major achievements of the administration. While these reforms were useful in redistributing income within sectors, they were ineffective in addressing inequality across sectors and society, and the regime became increasingly more authoritarian. Furthermore, the government took part in irresponsible public spending that increased the deficit to dangerous levels and reduced foreign confidence in and lending to the Peruvian economy (Sheahan 1999, 135).

In response to these economic issues the military removed Velasco from government and the more conservative General Morales Bermudez became president in 1975. Under Bermudez economic policy shifted slightly as some of the established protectionist measures were abandoned. A return to foreign investment, a decrease in import restrictions, and spending on major projects to revamp Peruvian society were characteristic of the administration (139). Yet Bermudez was unable to overcome the economic turmoil left by his predecessors, and his term in office was met with high profile national strikes and movements by the discontented lower classes. With a demand for civilian rule, Peru transitioned to democracy in 1980 with the election of Belaúnde to

a second term. Yet the transition has been neither smooth nor quick. From 1980 until 2003 there have been democratic, semi democratic, and authoritarian regimes, all of which have “failed to promote growth, reduce poverty, ameliorate inequalities, and address rampant crime” (Hagopian and Mainwaring 2005, 1). The socioeconomic realities, seen in the following section, further attest to the challenges facing democracy and development in Peru.

### **Inequality**

Historically, and still today, political, cultural, and economic exclusion plague Peruvian society. This reality is seen through the large concentration of economic assets, the presence of political hierarchies based on class, and the marginalization of indigenous populations that remain in the rural Andes (UNDP). Furthermore, in the last ten years economic inequality has increased within the South American country. As Table 1 illustrates, the richest segment of the population shares a very high percentage of the income and since 1985 the richest 20% of the population’s share, which represents more than half of entire income, has increased.

**Table 1: Inequality in Income<sup>16</sup>**

Survey Year	Share of Income or Consumption (%)			
	Poorest 10%	Poorest 20%	Richest 20%	Richest 10%
1985 <sup>15</sup>	--	4.4	51.9	35.8
1996	1.6	4.4	51.2	35.4
2000	0.7	2.9	53.2	37.2
2003	1.3	3.7	56.7	40.9

These economic disparities are also seen in access to critical public services.

Table 2 reveals a three decade trend where close to half of the entire Peruvian population is without electricity, running water, or plumbing. In addition to utilities, access to

<sup>15</sup> 1985 data from World Bank, *World Development Report, 1990*, World Bank, 1990, 236. The UNDP’s Human Development Reports do not provide 1980s inequality in income and consumption data for Peru.

<sup>16</sup>Data from UNDP’s *Human Development Reports*

healthcare, education, and other social services is also restricted among the poor population. For example, in the lowest wealth quintile only 13% of births are attended by a skilled professional, while in the highest wealth quintile 87.5% of births are attended by a skilled professional. Similarly, the under-5 mortality rate in the highest wealth quintile is 17.6, and in the lowest wealth quintile it is 92.6.<sup>17</sup> This ultimately contributes to very different standards of living among the rich and the poor.

**Table 2: Access to Utilities<sup>18</sup>**

Year	Electricity (% of total population)		Indoor Running Water (% total population)		Indoor Plumbing (% total population)	
	with	without	with	without	with	without
1981	38	62	31	69	22	78
1993	48	52	36	64	28	72
2005	66	33	54	46	38	62

In addition to the aforementioned inequities, it is important to highlight that such drastic disparities also exist between rural and urban areas, and across different geopolitical regions within Peru's borders. In fact, in 2006, the incidence of poverty was 31.3% in urban areas, and as high as 69.3% in rural areas (Perú 2007, 9). Ultimately the concentration of poverty in rural regions has contributed to much of the internal out migration that has occurred throughout the last few decades, and furthermore is indicative of the underdevelopment that has essentially perpetuated the inequality problem.

The geographic inequities are equally disturbing. Table 3 provides poverty rates for the three richest and three poorest departments of Peru. Not only do the vast differences in departmental level poverty attest to the economic exclusion of large segments of the Peruvian population, but Table 4 further highlights the consequences of

<sup>17</sup> Under-5 mortality rate is the probability of dying aged less than five years per 1,000 live births. 2000 data from the World Health Organization's "Core Health Indicators" database. Available: [http://www.who.int/whosis/databsase/core/core\\_select.cfm](http://www.who.int/whosis/databsase/core/core_select.cfm).

<sup>18</sup> Data from the 1981, 1993, and 2005 censuses from El Instituto Nacional de Estadísticas e Informática (INEI), an institution of the Peruvian government.

exclusionary development. Infant mortality rates (IMR) and total fertility rates (TFR), which are key indicators of development, have decreased tremendously at the national level (30.3 and 2.7 respectively from 2000-2005), and within rich areas in Peru over the latter half of the twentieth century. The same however cannot be seen in the poor rural areas of the country, where those rates remain extremely high.

**Table 3: Poverty by Department (2006)<sup>19</sup>**

Poorest Departments	Poverty Rate	Wealthiest Departments	Poverty Rate
Huancavelica	88.7	Tumbes	15.8
Ayacucho	78.4	Tacna	19.8
Puno	76.3	Madre de Dios	21.8

**Table 4: IMR and TFR by Poorest and Wealthiest Department (2000)<sup>20</sup>**

Department	Infant Mortality (per 1,000 live births)	Fertility (average # of children born per woman)
Huancavelica (poor)	71	6.1
Tumbes (wealthy)	35.6	2.3

Socioeconomic inequality has proven to be one of the most persistent development obstacles hurting the Peruvian population and confronting the government, its policymakers and organizations. It is with consciousness of the detrimental effects of inequality that this study seeks to test the ability of political, economic, and institutionalist theory to explain these trends with the goal of informing policy.

<sup>19</sup> Poverty Rate is percent of total department population living below the national poverty line. Data from "Perú: Perfil de Pobreza según departamentos 2004-2006," Publication of INEI, Lima, 2007, 9.

<sup>20</sup>IMR and TFR data from "Encuesta Demografica y de Salud Familiar 2000," reports on each department published by INEI and UNICEF.

## CHAPTER II

### THE 1980s

#### Political Change, Economic and Institutional Consistency

In 1980, Peru, not unlike the majority of Latin American nations at the time, experienced a transition to democracy during what Samuel Huntington has coined the Third Wave of Democratization. The dramatic political change signified a break with the longstanding authoritarian practices that had come to characterize Peru and the region. Despite this significant political shift, however, institutions, at their core, saw very little reform or alteration. Similarly, the Peruvian state maintained its control and direction of the economy as it had done throughout the 1960s and 1970s. The following sections examine the political regimes, economic policies, and institutions of the 1980s and the trends in inequality.

#### **Democratic Transition**

Peru's transition to democracy was much the response to public discontent with the political and economic situation that had prevailed under military rule for close to three decades. High profile strikes in 1977 and 1978, mobilized primarily by the labor sector, resulted in "the retreat of the generals to their barracks and the return of civilians to the government by means of democratic elections" (Silva 1988, 80). The general elections—the first in which illiterates were granted the right to vote—of 1980 returned Belaúnde to the presidency until 1985 when García was elected to office (Silva 1988, 85). The following examination of the two regimes attests to this dramatic political change, and the level of democracy present. Freedom House scores reveal relatively high levels of



freedom in Peru from 1980 to 1989. Table 5 shows high scores for both political rights and civil liberties under Belaúnde and García. The score of 2 indicates the strong presence of political rights, yet factors such as “political corruption, violence, political discrimination against minorities, and foreign and military influence” may exist and weaken democracy. A score of 3 and 4 for civil liberties suggests that oppression is present in areas such as “censorship, political terror, and the prevention of free association.” Peru’s status during both administrations was free, however in García’s last years in office the status dropped to partially free.<sup>21</sup> Overall the Freedom House scores for this period highlight relatively strong democracy, comparable to most countries in the region at the time and only slightly lower than those scores found in highly developed countries.

**Table 5: Freedom House Scores (1980-1989)**

1980 – Nov. 1988			Nov. 1988 – Dec. 1989		
Political Rights	Civil Liberties	Status	Political Rights	Civil Liberties	Status
2	3	Free	2	4	Partially Free

In addition to the relatively high Freedom House scores, several scholars have found Peruvian democracy and prospects for consolidation strong under Belaúnde and García. McClintock (1989, 144) characterizes democracy in Peru as “extraordinarily open, inclusive, and seemingly resilient” under Belaúnde and García. A relatively strong

<sup>21</sup> Freedom House conducts survey research and analysis in order to determine each country’s civil liberties and political rights scores. “Political rights enable people to participate freely in the political process, including the right to vote freely for distinct alternatives in legitimate elections, compete for public office, join political parties and organizations, and elect representatives who have a decisive impact on public policies and are accountable to the electorate. Civil liberties allow for freedoms of expression and belief, associational and organizational rights, rule of law, and personal autonomy without interference from the state.” Scores are on a scale of 1 to 7, with 1 representing the highest degree of freedom, and 7 the lowest degree of freedom. Status (Free, Partially Free, and Not Free) is established through the civil liberties and political freedom scores. For more in depth information on the methodology see [http://www.freedomhouse.org/template.cfm?page=351&ana\\_page=341&year=2008](http://www.freedomhouse.org/template.cfm?page=351&ana_page=341&year=2008).

party system, mobilization, commitment to democracy, and two genuine presidential elections and three municipal elections have contributed to the success of the political system over the course of the 1980s (McClintock 1989, 134-140).

One primary indication of the potential success of democracy is the party system that emerged following the transition (Tanaka 2005, 262). The party system consisted of three major blocks including Izquierda Unida (the United Left, IU), Partido Popular Cristiano (Popular Christian Party, PPC) and Acción Popular (Popular Action, AP), and Alianza Popular Revolucionaria Americana (American Popular Revolutionary Alliance, APRA). Not only were the blocks representative of the left, center, and right of the political spectrum, but they were also rooted in ideologies and important “political and intellectual traditions” that dated back to the early twentieth century (Tanaka 2005, 264). In addition to their ideological diversity, the parties also “offered a degree of social penetration” ultimately allowing for more participation (Crabtree 2006, 28).

The influence and scope of civil society increased during the 1980s as well. Longstanding labor organizations and new popular sector social groups became more vocal and influential, and were widely supported by IU. Business groups began to organize and operate within the political system with the support of PPC and AP (Tanaka 2005, 269). Such “popular sectors and their organizations showed high degrees of political consciousness” and the beginning foundations for a new more open political order (Tanaka 1998, 230). The rise of civil society groups, the presence of free elections and the party system attest to the democracy present in the years following the transition.

## **Command Based Policy**

During the 1960s and 70s the Peruvian state maintained primary control of the economy. Land reform, the nationalization of various sectors, price controls, and import substitution industrialization were major policy components under Belaúnde and Velasco. Market and laissez faire policies held little merit under the aforementioned regimes. Instead, state intervention and protectionist measures were believed to be the source of economic prosperity and growth. The “governments either initiated or maintained relatively active forms of intervention, on the premise that the state had responsibility for shaping the character of the country’s development” (Sheahan 1999, 133). This legacy of command based economic policy persisted throughout the 1980s, both under Belaúnde during his second term, and García.

Economic policy under the Belaúnde administration initially followed the neoliberal trends of his predecessor Bermudez. Since the late 1970s the state gradually began to move away from the nationalist economic programs that had dominated Peru since Velasco’s radical reforms in the 1960s. In response to a balance-of-payments crisis, Bermudez sought loans from international banks and eventually the IMF (Arce 2005, 32). Essentially this opened the door to adjustments and reforms that were more market oriented. Belaúnde continued, or at least claimed his administration would further such reforms. In reality however, the only substantial market based policies implemented were related to trade. The government eliminated restrictions on imports, cut tariffs, and encouraged import competition (Sheahan 1999, 139).<sup>22</sup> The majority of other economic

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<sup>22</sup> There was a slight neoliberal shift in economic policy or at least intentions, yet the extent to which policies were market based and the administration’s commitment to neoliberal reforms were small, and therefore do not discount this study’s classification of the government’s economic policy during this period as predominantly command based. For further studies on this topic see Chapter 4 in Carol Wise,

policies under Belaúnde were command based and the state maintained its role in the economy.

Fiscal policy during the early 1980s was expansive. In accordance with Sheahan and Wise's characterizations of state-led development, government spending and external borrowing under Belaúnde were excessive. The state planned to spend US\$2.3 billion annually over a five year period with 40 percent allocated to productive-sector projects, 35 percent to economic infrastructure, and 25 percent to social-sector projects. Although the government did not meet these ambitious monetary goals and many projects went unfinanced, or partially financed and poorly managed, public spending was at its highest since 1950 (Wise 2003, 137). The public sector's expenditures totaled 40 percent of the GDP from 1980-82, and 41.1 percent during the 1983-85 period (Wise 1994, 80). In addition, many of the projects were funded by external borrowing, a practice which had been relied upon heavily since the 1960s (Wise 1994, 82).

The tax structure was also similar to that which had existed under Velasco, when command based economic policies were at their height. The government utilized "indirect taxes" in order to fund their expansive projects and actual direct taxes, such as income tax, totaled only 25 percent of state revenue. A figure which reached 60 percent in 1950 under a market based economic program (Wise 2003, 150).

Privatization represents another policy area, where the Belaúnde government's role was clear and the influence of the state was strong. In accordance with neoliberal reforms, the Belaúnde administration made it a goal to invest in the private sector and to

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*Reinventing the State: Economic Strategy and Institutional Change in Peru* (The University of Michigan Press, 2003), pp. 119-151; A. Javier Hamann and Carlos E. Paredes, "The Peruvian Economy: Characteristics and Trends," in *Peru's Path to Recovery* (The Brookings Institution, 1991), pp. 41-80; chapter 2 in Moisés Arce, *Market Reform in Society: Post-Cris Politics and Economic Change in Authoritarian Peru* (The Pennsylvania State University Press, 2005), pp. 31-53.

expropriate several of the numerous enterprises that had come under the state’s control in the previous decades. This did not occur however. In fact, “Belaúnde ended his second term with just a few substantial liquidations to his credit and with private investment at an all-time historical low of 12% of GDP” (Wise 1994, 91). SOE sales under the administration totaled only 1 to 3 percent of GDP (Wise 2003, 133). Furthermore, “the state firms actually expanded their presence in the economy, as public officials openly employed them for personal gain” (Wise 2003, 150). Table 6 reveals a significant decrease in private investment throughout Belaúnde’s term in office, and also under García. Although Belaúnde claimed to embrace and support neoliberal reforms, the trends in privatization further attest to the state’s inability or unwillingness to actually limit the state’s role in the economy.

**Table 6: Private Investment as Percentage of GDP (1980-1989)<sup>23</sup>**

<b>Year</b>	<b>1980</b>	<b>1981</b>	<b>1982</b>	<b>1983</b>	<b>1984</b>	<b>1985</b>	<b>1986</b>	<b>1987</b>	<b>1988</b>	<b>1989</b>
<b>Private Investment</b>	21.5	24.4	23.4	15.1	12.8	12.3	14.7	15.8	18.3	14.4

Economic policy under Belaúnde was undoubtedly inconsistent. The influence of the IMF and market based pressures were undeniable as they manifested themselves in trade policy and debates between the political right and left in Peru. However, the tradition of state involvement in the country’s economy did not wane during this time period as the aforementioned policies suggest (Wise 2003, 146-147). In 1983, the economic debt crisis, coupled with turmoil in the international financial market, an earthquake, and internal leftist revolutionary violence, fueled backlash against any hint of market based policies and garnered support for García’s economic program.

<sup>23</sup> Data from Banco Central de Reserva de Perú, Cuadros Anuales Históricos.

García was elected in 1985 and even more so than Belaúnde, his administration maintained the status quo established in the 1960s and 70s with regards to state involvement in the economy. His heterodox economic program involved direct state control of wages, prices, interest rates, and exchange rates. One of the first actions taken by García was to stop inflation by “direct price administration and the control of imports and foreign exchange” (Wise 2003, 160). He promised to increase state control of the financial market, and used two major reforms to do so. The first was to increase credit to the agricultural sector, in hopes of addressing rural underdevelopment and the excluded population. This was further supported by substantial subsidies (Wise 2003, 161). The second was to increase wages, while simultaneously controlling prices (which was possible by the state’s interest rate cuts) (Sheahan 1999, 139). These policies ultimately required and embodied state intervention and direct action.

In addition, García implemented a series of protectionist measures limiting Peru’s role in the international market. The administration also reduced “foreign debt service to no more than 10 percent of export earnings, thus isolating the Peruvian economy from the international lending community” (Arce 2005, 35). Similar to Belaúnde, attempts were made to improve the relationship between the public and private sector; however, there was no real progress. The public sector maintained its size and at the end of his term García planned to nationalize banks and insurance firms, a move which completely jeopardized any hopes of a more active and large private sector (Wise 2003, 161).

The aforementioned state actions aimed to control the economic crisis left by Belaúnde and his predecessors and to revamp the Peruvian economy. While in the short term the command based policies contributed to a fall in inflation, GDP growth and real

wage increases, particularly within the first two years of the administration, in the long term they were incredibly costly and left inflation at an all time high. The command based economic policies of the 1980s and the previous two decades left the Peruvian economy in shambles.

### **Institutional Continuity**

#### **Executive**

Under both Belaúnde and García administrations the executive was undemocratic in nature demonstrating overarching power. Not only was the president given the power to make decisions regarding government expenditures without approval from Congress, but the creation and implementation of legislation was often times the result of executive decrees, rather than a democratic process. In allowing the executive to rule by decree when it was necessary and in the national interest, the Constitution greatly restricted the power of Congress. There were numerous instances under Belaúnde where Congress relinquished its legislative power to the executive. In fact the “Belaúnde administration used this short-cut to law-making as the principal form of enacting the central planks of its economic policy” (Crabtree 1985, 82-83). In general, this form of law making was welcomed and advocated by many government officials as it expedited the lawmaking process and allowed for the modification of “inconvenient” legislation (Crabtree 1985, 82).

Under García there were very few changes in the legislative process, instead clientelism, patronage, and corruption were widely utilized. In fact, “decision-making within the García government took place in a very personalist context. García, like his predecessor, made decisions in consort with a small group of personal advisers...”

(Mauceri 1997, 31). This style of policy making suggests that major decisions saw very little input from the political parties at large, and the citizenry. Although the elections and transition to democracy offered hope for a more inclusive and free society, the “reluctance of the Belaunde and García administrations to abandon the elitist and exclusive state” served as a major institutional obstacle to democracy (Salgado 2006, 47).

### **Political Parties**

Despite its size and diversity following the democratic transition, the Peruvian party system had numerous institutional problems and weaknesses. In general the political parties tended to be run in a top-down fashion with limited transparency and oversight. In fact, all parties “were, to varying degrees, hierarchical and undemocratic in their internal workings, reflecting the social, regional and ethnic prejudices of the society from which they emerged” (Crabtree 2006, 27). Leadership in the parties was determined not by free and fair elections, but instead it was established and maintained by the authoritarian practices also utilized in policy and organization. “Party leaders, including many from the Left, were generally from the *criollo* elites in Lima. In this respect, the parties were virtually unchanged from what they had been in the pre-1968 period” (Mauceri 1997, 32).

### **Military**

The military played an important role and was incredibly powerful in Peruvian politics for decades prior to 1980. To suggest that such influence simply dissipated with the transition to democracy is naïve. In fact, the role of the military, particularly under the Belaúnde administration, was very influential. This was primarily due to the rise in insurgency violence that occurred in accordance with the democratic transition. As a



result of this violence the military was granted overarching powers in what was called the Emergency Zone, an area encompassing three departments and large parts of four others.<sup>24</sup> In fact, “all political as well as military authority in this area was vested in a military commander” and “beneath him military officers replaced civilian authorities” (Crabtree 1985, 79). In these geographic regions, political and civil freedoms were greatly restricted. In addition, the military maintained control over its budget and funding, and required that the new democratic administration refrain from investigating claims of military corruption (Crabtree 1985, 77).

Following his election, García made a concerted effort to cut back the military’s influence and power. While the president’s initial efforts resulted in major cuts in defense spending and the dismissal of officers involved in human rights abuses, the military maintained its control over its finances and physical presence in violence prone areas (Mauceri 1997, 33). Institutionally the military continued to operate in an authoritarian fashion.

The violence that occurred throughout the 1980s and specifically the state’s counterinsurgency against Sendero Luminoso, is perhaps most indicative of the military’s repressive role in Peruvian society, and thus also the institutional shortcomings of the new democracy. In fact, “allegations that the military was systematically using torture, disappearances, and extrajudicial executions to pacify the indigenous communities and suppress Sendero Luminoso activities” were common in the early 1980s (Cornell and Roberts 1990, 536). Initially García pledged and succeeded to crack down on military abuses, however, this changed two years into his term with the economic crisis and

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<sup>24</sup> Sendero Luminoso, the violent revolutionary organization, gained support among the most impoverished and neglected communities in Peru. The revolutionary movement calling into question the legitimacy of the Peruvian state, attracted those who had been victims of socio-economic exclusion for decades.

Sendero's expansion. The administration enacted legislation that broadly redefined terrorism essentially granting the military more discretionary power. In addition, following prison uprisings the government transferred investigative powers to police forces (who had been previously accused of using torture against prisoners) ultimately threatening detainees legal rights and protection (Cornell and Roberts 1990, 538). The military institution proved to be one of the most undemocratic and distrusted by Peruvian citizens, and particularly the indigenous during the 1980s.

### **Judiciary**

Historically the Peruvian justice system has been characterized by corrupt and ineffective institutions. The poorer populations in particular have had very little trust in the judiciary and the public prosecution service (Ministerio Público) due to discriminatory practices and the expensive cost of services (Bocanegra 2006, 136-137). Despite the transition to democracy and the promise for more accountable institutions, the judiciary was left unreformed throughout the 1980s.

Instead, economic chaos and internal violence fueled the judiciary's ineffectiveness. The economic crisis and the substantial decrease in government salaries that ensued encouraged corruption among judges and officials (Bocanegra 2006, 139). The violence and human rights violations against citizens, and particularly the poor indigenous, attest to the institutional failures of the courts to provide the rights and freedoms typically granted under democracy (Bocanegra 2006, 139). For example in the emergency zones, judicial power was vested primarily in the military. Even in those areas where the "ineffectual" judiciary maintained its powers "few individuals even tried to take advantage of streamlined procedures to file writs of habeus corpus" (Roberts and

Peceny 1997, 204). Often times the courts either rejected individuals' writs of habeus corpus or transferred jurisdiction from civilian to military courts (Roberts and Peceny 1997, 205). The corrupt and ineffective institutions that guide the Peruvian judicial system persisted despite political change.

### **Trends in Inequality**

The economic crises that plagued Peru in the 1980s were accompanied with worsening living conditions for a large majority of the Peruvian population, and particularly the most impoverished sectors of society. Several indicators reveal that inequality increased slightly during Belaúnde and García's terms in office. The lowest wealth quintile's share in income decreased, while the highest wealth quintile's share increased over the course of the 1980s. In 1983, three years into Belaúnde's second term, the low income groups, representing fifty percent of the entire population, shared only 7.3 percent of total national income, while the high income groups making up only ten percent of the population shared an astounding 62.1 percent of the national income. In addition, these numbers are comparable to the 1971 levels which were 8.2 and 58.3 percent respectively, and those which persisted under command based economic policy throughout the 1970s (Figueroa 1988, 158). Similar trends can be seen during García's term in office. The Gini Coefficient, a widely used measure of inequality in income, increased from 0.47 in 1985 to 0.50 in 1988.<sup>25</sup> Therefore, income was not redistributed

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<sup>25</sup>It is important to note that in 1986 the Gini coefficient decreased significantly to 0.41, indicating improvements in inequality, however, its increase in 1988 reveals that any improvements in inequality in the late 1980s were not sustained. The Gini coefficient is a commonly used measure of inequality between 0 and 100, with 0 indicating complete equality (everyone has the same income) and 100 indicating high inequality (richest person has all of the income). Data from INEI, *Evolución de la economía Peruana*, Lima: INEI, 1989.

more equally instead it became even more concentrated in the wealthier groups. These worsening living conditions are further seen in the following indicators.

Overall poverty levels decreased over the course of the 1980s. In 1985, 41.6 percent of the total population was living in poverty, by 1989 that figure jumped to 53.6 percent (Figueroa 1998, 136). While these figures reveal that more people were living in poverty following García's term, poverty rates by geographic area also highlight worsening inequality. Table 7 reveals that poverty and extreme poverty increased in the urban sierra and the rural sierra from 1986 to 1991. Yet those rates increased more (23.5 percentage points for poverty and 22.2 percentage points for extreme poverty) in the rural highlands than in the urban highlands (16.8 percentage points for poverty and 7 percentage points for extreme poverty).<sup>26</sup> Therefore not only were more Peruvians living in poverty in the rural highlands following García's term, but the discrepancy in poverty levels between the rural and urban areas also increased.

**Table 7: Poverty Rates by Geographic Area, 1986 and 1991 (% of total population)<sup>27</sup>**

	1986		1991	
	Poverty	Extreme poverty	Poverty	Extreme Poverty
<b>Urban Sierra</b>	36.4	15.4	53.2	22.4
<b>Rural Sierra</b>	49.2	32.3	72.7	54.5

In addition to income distribution and poverty rates, critical social indicators are telling of the inequities during this period. A comparison of IMRs suggests a large discrepancy in access to adequate health services. As of 1990, the IMR in wealthier departments was as low as 53 deaths per 1,000 live births, while in the poorest departments that figure was as high as 150 (Abugattás 1991, 153). The latter is

<sup>26</sup> Out of the three main geographic areas, the highlands, coast, and jungle, the highlands have the highest concentration of poverty in Peru. Rural areas also have a greater concentration of poverty than urban areas. See "Perú: Perfil de Pobreza según departamentos 2004-2006," Publication of INEI, Lima, 2007.

<sup>27</sup> Data from "Informe Sobre Desarrollo Humano Perú 2002: Aprovechando las Potencialidades," Lima: UNDP, 2002, p. 18.

comparable to the current IMR in India, while the former is close to Afghanistan's IMR, a comparison which further highlights the vast difference in the levels of development and access to services among the rich and the poor in Peru.<sup>28</sup> These trends in poverty, income distribution, and access are indicative of worsening inequality from Belaúnde's election to the end of García's term in office.

### **Conclusion**

Peru experienced political change in the 1980s, yet economic policy and the institutions remained virtually unaltered. In light of these experiences, inequality worsened over the decade. First, it is this reality that confronts theory on democracy and development. The 1980 transition to democracy, improved Freedom House rankings, increased presence of parties, and strengthened civil society are indicative of a more inclusive political system in which the government was held more accountable to the entire citizenry. Such political change could and should in theory translate to more inclusive policies that help to end the exclusion that plagues society. However the inequality trends reveal how inconsequential the democratic transition was for Peru's most marginalized.

Similarly, 1980s economic policy failed to promote inclusion. In fact, the abovementioned trends, as well as the persistence of inequality throughout the 1960s and 70s attest to the failure of command based policies to ameliorate longstanding socio-economic disparities. From Velasco to García, state intervention in the economy has failed to redistribute income and resources, contributing to the perpetuation of and rise in inequities. Despite the governments' excessive spending, intentions to increase social spending, and appeals to the poor, Belaúnde, García and their predecessors failed to

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<sup>28</sup> India and Afghanistan's IMRs from United Nations Population Division.

promote positive change through state intervention in the economy.<sup>29</sup> In fact the “various redistribution policies implemented since the 1960s—from reforms in the structure of ownership to generalized price subsidies—in practice excluded the poor” (Hamann and Paredes 1991, 77). Peru’s version of command based policies failed for more than two decades to reduce inequality, ultimately paving the way for an alternative approach to the economy and state involvement.

The failure of these two variables to lessen and even explain inequality is perhaps more a consequence of the state’s institutional flaws than a direct reflection of Peruvian democracy and command based policy. The alternative, that is to attribute the 1980s’ rise in inequality to either democracy or command based policy, or both, is theoretically illogical for the latter and ill supported for the former.

The institutional weaknesses that embody the Peruvian state have been detrimental to the excluded. Historically the poor have been neglected by the people and the rules that govern state organizations, a reality which is accurately described by Crabtree (2006).

Many Peruvians, I would suggest, perceive organizations such as the judiciary or political parties to be illegitimate because they are inefficient and corrupt, but also, and perhaps more importantly, because they are seen to be the expression of an institutional system that they have come to understand, and for good reason, as responsible for, and dependent on, their exclusion from full citizenship (21).

The failure of the new democratic regimes to reform these institutions and the “rules of the game,” and thus also major state organizations, has resulted in the perpetuation of

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<sup>29</sup>Belaúnde’s failure to commit the intended resources to the social service sector is one such policy that did nothing for the poor. “Realized investment in the social-sector also fell 40 percent short of the 1981-85 plan, leaving few resources for health, education, and other basic necessities felt most keenly in the traditional sectors” (Sheahan 1999, 137).

socio-economic exclusion. This is evident in virtually every area of the state, from the judiciary to political parties.

However, the organizations that were responsible for responding to Sendero Luminoso provide the most telling and significant examples of institutional failure and its consequences. Not only does Sendero Luminoso's presence in the poorest regions attest to the continued plight of the excluded, but the military, police, and administration's grave human rights abuses and neglect for these citizens' constitutional rights confirms the vast exclusion that permeates Peru's institutions. It is important not to underestimate the influence of such institutions, as they are the foundation upon which the state is built and through which the true potential of democracy and economic policy can be understood. The following chapters provide further insight into the influence of institutions in light of political and economic change.

## CHAPTER III

### THE 1990s

#### Authoritarianism, the Washington Consensus, and Institutional Collapse

At the end of the 1980s Peru was in shambles. Institutional weaknesses limited the newfound democracy's capacity to create change, command based economic policies left a massive crisis, and internal violence threatened the stability of the nation. Such circumstances essentially paved the way for a new face in Peruvian politics, a dramatic shift in economic policy, and damaged hopes for institutional reform.

#### **Democratic Breakdown**

In 1990, Alberto Fujimori, an agricultural engineer of Peruvian and Japanese decent and foreigner to the political scene, ran as an independent in the presidential election. His campaign promised long-awaited gradual reforms that would put an end to the economic turmoil that the García administration, and those before him, had left. The public's response to the presidential hopeful was an upset competitive national election in which Fujimori beat the staunch neoliberal, Mario Vargas Llosa (Sheahan 1999, 156). It took only a matter of days however, for the new president to enact policies that were far more radical than promised in his campaign, and even more drastic than those of Llosa. Within two years the regime abandoned virtually all democratic practices through a coup. Under the "Government of Emergency and National Reconstruction" Congress was dissolved, the Constitution was rewritten, and Peruvian politics reverted back to authoritarianism (Taylor 2005, 568).



The decrease in the level of democracy can be seen in the change in Freedom House scores from the 1980s to the 1990s. Table 8 gives scores for 1992, the year of the coup, and 1999, Fujimori’s last term in office. Scores for both civil liberties and political rights increased from their 1980s levels indicating a decline in freedom. In fact, the 1992 scores are comparable to Freedom House scores for Iran in the early 1990s. The political rights scores of 5 and 6 reveal concentrated power in the hands of an individual or small minority, and very limited rights. Similarly, scores of 5 and 4 for civil liberties indicate the presence of oppression which ultimately further restricts freedom.<sup>30</sup>

**Table 8: Freedom House Scores (1992 and 1999)**

1992			1999		
Political Rights	Civil Liberties	Status	Political Rights	Civil Liberties	Status
6	5	Partially Free	5	4	Partially Free

The declining role of political parties during the 1990s is further indicative of the democratic breakdown and the destruction of political rights. By the end of the 1980s the major political parties in Peru and the system as a whole was viewed by most as “irresponsible, incompetent and corrupt” (Crabtree 2006, 28). Fujimori used the public’s negative perceptions of the party system to his advantage, essentially cutting out “the parties as intermediaries between state and society” and legitimatizing the executive’s direct use of power (Crabtree 2006, 29). It became increasingly difficult for citizens to participate in such formal political organizations and the fragmented parties essentially lost their influence and presence they had established early in the previous decade.

The weakened role and presence of civil society organizations is also indicative of the democratic breakdown and the suppression of political rights. The national and local

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<sup>30</sup>The suppression of political rights and civil liberties under the Fujimori administration is examined further in the Institutional Setbacks section of this chapter.

organizations, from trade unions to grassroots NGOs, that had begun to redefine state-society relations virtually disappeared in the 1990s (Tanaka 1998, 230). This decline in civil society, which was a byproduct of the governments' direct demobilization efforts and actions, helped to suppress any public opposition or collective action that would challenge Fujimori's authority (Taylor 2005, 570). The change in civil society, political rights, civil liberties, and parties attests to the decrease in the level of democracy in the 1990s.

### **Market Based Policy**

The aforementioned political changes were accompanied by significant market based reforms under the Fujimori administration. The new economic programs encompassed major neoliberal restructuring and market based policies in complete accordance with the Washington Consensus.

The 1992 civilian coup was in part a result of Fujimori's frustration with Congressional opposition to his staunch economic policy plans. Under the new Constitution command based policies were limited and new doors opened to market reform.

Privatization was one such policy implemented by the new administration. For example under the new Constitution, "Article 60 prohibited almost totally the entrepreneurial activity of the State, unless authorized by law as being in the public interest" (Champion 2001, 527). It was primarily through the creation of COPRI, a privatization commission that state assets were quickly and more efficiently sold off. In fact, more than 220 state run companies were privatized, and by 2000, \$9.1 billion in state assets had been sold. Both small businesses and large SEOs were privatized (Wise

2003, 192). Everything from, telecommunications, banks, airports, electricity, and water, to mining, railroads, fishing corporations, and oil refineries were made available to private investors.

In accordance with extensive privatization, public investment also fell substantially in comparison to the levels sustained in the 1980s. “Between 1991 and 1996, it represented only 3.5% of GDP, whereas in previous decades it had varied between 5% and 10% of GDP” (Kisic 1998, 50). Overall government spending was also reduced and reallocated. Following pressure from international agencies, the government decreased subsidies dramatically, and increased social expenditures from 2.1% of the GDP in 1990 to 40% in 1995.<sup>31</sup> State funding allowed local community based organizations to allocate resources and services to alleviate poverty and improve healthcare, ultimately decreasing the government’s role (Arce 2006, 45).

In addition to extensive privatization, the fall in public investment, and reallocation of expenditures, the government promoted FDI, also one of the major market based policies advocated by Washington at the time. Numerous reforms were implemented that aimed to reduce barriers preventing investment, and to aggressively encourage foreign participation in the Peruvian economy. The most significant of these was Article 63 of the new constitution that allowed for both domestic and foreign businesses to “operate under equal conditions” (Champion 2001, 529).<sup>32</sup> In addition, the Foreign Promotion Investment Law (Decree 662) further facilitated foreign investment

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<sup>31</sup> Proponents of the Washington Consensus argue that subsidies should be decreased or eliminated, and instead resources should be allocated to education, health, and public infrastructure, and measures aimed at improving productive. “Alternatives to traditional measures of support for the poor, measures that involve interference with markets, such as subsidized public utility rates, intervention to raise wages, or generalized food subsidies” should be eliminated (Williamson 1990, 11).

<sup>32</sup> Prior to this amendment, and under the former constitution, domestic businesses were given tremendous advantage over external companies which had been restricted from the Peruvian market.

by creating “mechanisms aimed at guaranteeing foreign investors tax and legal stability, availability of foreign currency and non-discriminatory treatment” (“Peru Normas Legales”). The government signed numerous investment protection agreements with countries throughout the world, from Bolivia and Colombia, to China and Thailand (“Peru Normas Legales”). The FDI that resulted from the aforementioned policies was substantial. FDI rose from nothing in 1991 to \$519 million in 1993 and to \$1,885 million by 1997 (Sheahan 1999, 162).

Economic policy under Fujimori represented a complete turnaround from that which existed in the 1980s. The role of the state was completely redefined, and under the new market based policies the economy recovered from inflation, instability, and repaired its relations with the international community. In addition, there was substantial economic growth and the GDP per capita increased from less than \$1,500 in 1990 to close to \$2,500 by 1997.<sup>33</sup>

### **Institutional Setbacks**

#### **Executive**

The low level of democracy during the Fujimori years attests to the concentration of power in the executive. Fujimori led the nation in an authoritarian fashion and took many steps to expand his power.

[Fujimori] made direct appeals to Peru’s poor, particularly the unorganized masses; he made heavy use of an ‘anti-system’ or ‘anti-political’ rhetoric that lambasted the political class for causing the nation’s many problems; he manipulated the institutions of government to concentrate power in the executive office, thereby facilitating his use of state resources for personal political gain...(Barr 2003, 1162)

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<sup>33</sup> Data from United Nations Statistics Division.

Such practices, coupled with the president's initial control of the economy and insurgency violence, not only fueled public approval for the administration but also allowed for Legislative Decree 25418. The 1992 autogulpe that ensued further consolidated power within the executive. Opposition dissipated and "coalition building, policy debate" and the "legislative process", democratic practices which had been utilized in the previous decade, vanished (Wise 2003, 187). A new constitution increased the president's powers to dissolve congress, rule by decree, and to be immediately reelected to consecutive terms (Wise 2003, 188). In addition, corruption was an incredibly common practice among government officials (as well as military officials). In fact "recent estimates reveal that \$1.8 billion was stolen from state coffers during the Fujimori government" (McClintock 2005, 97). Institutionally the executive was manipulative, powerful, and authoritative under Fujimori and represented a significant break with the democratic institutions (however weak) that had begun to take root in the 1980s administrations. This concentration of power in the executive is further apparent in administration's control over and manipulation of the following organizations.

### **Political Parties**

The party system began to fall apart in the last years of the Garcia administration, yet it was not until the early 1990s that the organized parties and coalitions became fragmented, powerless, and illegitimate.<sup>34</sup> Following the dissolution of the Congress in 1992, several loosely organized parties and movements took shape, however, they held

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<sup>34</sup> The weakening of the party system that began in the late 1980s has been attributed to several factors including urban migration, expansion of the urban informal sector, the appeal of and the state's inability to control the violence related to Sendero Luminoso, social unrest and the rise of new independent political movements (Levitsky and Cameron 2003, 5-7). As a result, at the end of Garcia's term the traditional parties were "seen not as channels for representation but as vehicles for the political ambitions of corrupt politicians and self-serving interests" (Cameron 1997, 69). Understanding how and why the party system began to fall apart at the end of the 1980s is helpful in understanding what occurred to the system under Fujimori.

no political sway or bearing in agenda setting or policymaking. Even the president's loosely established party, Cambio-90, was more a tool used to gain electoral support than a legitimate organized political party. The institutional weaknesses that came to characterize the party system under Fujimori are perhaps best explained and understood by the president himself, who once said "En el Perú no existen partidos...El poder soy yo. Pero en un poder que me fue dado por el pueblo. Yo lo represento" (Panfichi and Sanborn 1995).<sup>35</sup>

### **Military**

The military's presence and influence had increased in accordance with the rise in violence and drug trafficking; yet under Fujimori the organization became even stronger. Military courts were given tremendous power with no oversight in the trying of terrorist suspects and officials operated autonomously with virtually no checks on their power.

In addition, as the presence and influence of party coalitions dissipated, the military stepped into the political arena. Fujimori appointed top military officials to key political roles breaking down the barrier that had upheld civilian government since Velasco. Vladimiro Montesinos and General Nicolás Hermoza Ríos, both prominent military leaders, became Fujimori's closest political advisers (Wise 2003, 187). These appointments and the close ties between the executive and the military is not only a testament to the general collapse of democratic norms but such political moves resulted in substantial institutional change within the military. Prior to Fujimori, the Peruvian military had been highly regarded as one of the most professional in the region with a "time-honored system of merit-based promotions and rotating appointments" (Wise 2003,

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<sup>35</sup> "In Peru, there are no political parties...I am the power in the land. But it is a power conferred on me by the people. I represent it."

209). Instead under the Fujimori administration “military personnel who displayed loyalty to the Fujimori-Montesinos-Hermoza Ríos triumvirate were rewarded with job security, promotions, and pay raises” (Wise 2003, 209).<sup>36</sup> Any military opposition to the executive was met with intimidation, threats, and blackmail.

Furthermore, there was no distinction between intelligence, the military, or the national police. Intelligence operations and organizations were directed by Montesinos, and therefore only served to consolidate the executive’s political and manipulative powers (Costa 2006, 216). The institutions that guided the military under Fujimori were corrupt, power hungry, and politically oppressive.

### **Judiciary**

Fujimori, well aware of the public’s discontent with the judiciary and its legacy of institutional inadequacy, enacted several reforms. Many of these reforms were administrative in nature, aiming to make the judiciary more efficient. One major institutional modification came with changes in the Consejo Nacional de la Magistratura (National Magistrates Council, CNM). The CNM, a body made up of seven officials who were neither members of Congress nor the executive, became responsible for appointing judges (Bocanegra 2006, 141). The move helped to eliminate the selection of judges for political purposes, a practice which had become increasingly common. In addition, the new Constitution created the Academia de la Magistratura which provided training to judges and recognized judicial authorities and laws that had been established in rural

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<sup>36</sup> This change was the byproduct of a military law enacted in November 1991 that not only vested the power of military appointments in Fujimori, but it indirectly eliminated the chance of officials acting unilaterally and in opposition to the executive’s interests. See Enrique Obando, “Fujimori and the Military,” in *Fujimori’s Peru: The Political Economy*, eds. John Crabtree and Jim Thomas (London: University of London, 198-204). This selection also examines the relationship between Fujimori, Hermoza, and Montesinos and the accusations of corruption against the three.

communities (de Belaúnde 1998, 179). These reforms aimed to curb the corruption that had permeated the judiciary for years, yet accompanying such reforms were institutionally detrimental changes.

Despite these reforms, the judiciary actually lost much of its autonomy and jurisdiction under Fujimori. The military and the government became directly and indirectly more involved in the activities of the judiciary. Not only did Article 173 in the 1993 Constitution allow military courts to try civilians accused of treason or terrorism, but it enabled the military to intervene in various cases throughout the 1990s. In 1998 the government extended “the use of military to judge cases of common criminality in response to a growing crime wave” (de Belaúnde 1998, 191).<sup>37</sup> This loss of autonomy and subordination to the military and government is further seen in congress’ use of its legislative authority to change and issue laws related to the judiciary’s activities. Congress even became involved in specific court cases and revoked the judiciary’s ability to declare a law unconstitutional. The rulings, appointments, and activities that took place within the judiciary were closely monitored and were never in opposition to the executive and military’s interests (de Belaúnde 1998, 179-189). As a result the judiciary and its weak institutions were incredibly undemocratic and served only an elite few.

### **Trends in Inequality**

The economic, political, and institutional changes implemented under Fujimori did little to ameliorate inequality. In fact, the Gini Index increased from 43.87 in 1990 to 49.82 in 2000, revealing that the distribution of income actually worsened.<sup>38</sup> This is further seen in the total share in income as a percent. As of 1996, the poorest twenty

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<sup>37</sup> De Belaúnde highlights three very specific and telling instances in which the government and military directly intervened in the judiciary’s activities to change the outcomes of the cases (188-190).

<sup>38</sup> Data from “PovcalNet,” *The World Bank Group*.



percent of the population shared in 4.4 percent of total income, while the richest twenty percent shared in 51.2 percent of total income.<sup>39</sup> By 2002, the share decreased for the poor (3.2 percent of total income) and increased for the wealthy (58.7 percent of total income) indicating a rise in inequality over the course of the 1990s.<sup>40</sup>

In addition the informal sector, which is made up primarily of rural migrants seeking better wages, employment opportunities, and higher education, grew from 46.6% of the labor force in 1990 to 51.5% by 1994 in Lima (Sheahan 1997, 22). Discrepancies in healthcare access are seen in Table 9. Key health indicators like under-5 mortality rates and the percentage of births attended by skilled health care professionals, attest to the shortcomings of social spending under Fujimori’s market based economic policy. There are huge discrepancies for these indicators between the lowest and highest wealth indicators, as well as between the rural and urban populations.

**Table 9: Inequities in Health (2000)<sup>41</sup>**

<b>Indicator</b>	<b>Lowest Wealth Quintile</b>	<b>Highest Wealth Quintile</b>	<b>Rural</b>	<b>Urban</b>
under-5 mortality rate (per 1,000 live births)	92.6	17.6	85.3	39.0
births attended by skilled health professional (%)	13.0	87.5	25.3	84.6

### **Conclusion**

The demise of democracy had harmful effects on state and society relationships. The executive’s power and control excluded virtually all actors, from political parties and the judiciary, to civil society and individual citizens. It is essential to recognize that the citizenry’s incapacity to affect more inclusive economic and social policy under an

<sup>39</sup> Data from 2003 Human Development Report.

<sup>40</sup> Data from 2006 Human Development Report.

<sup>41</sup> Data from World Health Organization’s “Core Health Indicators” database.

authoritarian regime could in theory result in worsening inequality. Although inequality increased over the course of the 1990s, these changes were perhaps too minimal to attribute to such a significant regime change.

On the other hand the impact of substantial economic change—the shift to market based policies—on the excluded is more apparent. Privatization and FDI contributed to a decrease in the lower class' capacity to be economically active. This can first be seen in the sheer numbers related to foreign investment and privatization. With privatization and the elimination of restrictions on FDI, foreign investors became the sole shareholders of companies that had previously been nationalized. From 1990 to 1995, 76.6% of receipts from privatization were from FDI, representing a huge majority of the new private sector. This was primarily due to the fact that multinationals had greater resources and capabilities to invest unlike their Peruvian counterparts.

Furthermore privatization excluded a large majority of Peruvians from participating in the new private sector, and the process resulted in hundreds of thousands of layoffs and higher unemployment in the formal sector. By 1999, 120,000 employees had lost their public sector jobs as a result of privatizations, and only 36% of those people were able to reenter the formal economy. In two companies alone, Pesca Perú and Hierro Perú more than 6,000 employees lost their jobs (Fraser 2003, 41). Although in theory the market should absorb these workers, this was not the case for the large majority who were from the lower classes of society and tended to be lower skilled and less educated. Economically, Fujimori's market based policies did nothing to lessen inequality and attest to criticism of the Washington Consensus in Latin America. The viability of such an economic program in high inequality countries has been widely contested by theory

and reality. However, the success of market based policies in more equal societies suggests that alternate state level variables, such as institutions, may serve as the key obstacle to all-inclusive development in Peru.

The corrupt institutions that operated under Fujimori were perhaps the most anti-democratic that Peru has ever seen. Yet just like in the previous decade, key state organizations operated in order to serve the interests of a small elite, and any attempted reforms or changes were merely skeletal. There was virtually no inclusion of the large majority of Peruvians, and particularly the poor and rural populations, in the political process or policymaking. Such institutions essentially catered to and encouraged the exclusion that has permeated society for centuries. It is therefore no surprise that the socio-economic inequities should persist in a society where key institutions continue to exclude. Understanding Peru's institutions has proven useful in explaining inequality in the 1980s and 1990s, yet does this variable's relevance extend to the current decade?

## CHAPTER IV

### THE 21<sup>ST</sup> CENTURY

#### Democracy, the Free Market, and Institutional Hope?

By the end of Fujimori's reign Peru had suffered huge democratic setbacks, and the nation's institutions were more corrupt, backwards, and exclusive than under Belaúnde and García. Economic policy, however, had reached a new juncture. The Andean economy was no longer controlled by the government, but rather was directed by the market. While the market based policies proved advantageous to growth, their ability to curb exclusion remain to be seen. The democratic changes that have occurred in the last decade have tested the inclusionary capacity of market based policy and reemphasized the importance of institutions.

#### **Return to Democracy**

In 2000, President Fujimori ran for a highly contested third term in office. In the election however, the President's main competitor, Alejandro Toledo brought forth allegations and the exposure of electoral corruption within the Fujimori administration. In response the president called for new elections in 2001, in which he would not participate, and Valaentín Paniagua became interim president. In July, Toledo took office following his win in a competitive, free and fair election and five years later García returned to the presidency.

The increase in the level of democracy which has occurred over the last decade is seen in the change in Freedom House scores from the 1990s to the 2000s. Table 10 gives

scores for 2002 and 2008.<sup>42</sup> Scores for both civil liberties and political rights decreased from their 1990s levels indicating an increase in freedom. The political rights score of 2 represents a significant positive change in the distribution of power. Yet unlike in countries with a rating of 1, “political corruption, violence, political discrimination against minorities, and foreign or military influence on politics” may still be present in Peru.<sup>43</sup> On a more positive note, however, prior to the 2001 national elections the Constitution was reformed granting more political rights to underrepresented Peruvians.

In preparation for the 2001 vote, congress reformed the constitution, replacing a single nationwide district for congressional elections with a system of multiple districts based on the departments (provinces)... The move provided fair representation for the almost 50 percent of the population who live outside the four largest cities and guaranteed them at least some attention from the state and from political parties, which traditionally have ignored them (Freedom in the World 2008).<sup>44</sup>

The score of 3 for civil liberties indicates a level of oppression that may restrict some freedoms; however, this score represents a significant improvement from the 1990s.

**Table 10: Freedom House Scores (2002 and 2008)**

2002			2008		
Political Rights	Civil Liberties	Status	Political Rights	Civil Liberties	Status
2	3	Free	2	3	Free

As the level of democracy increased the parties that had all but disappeared under Fujimori reemerged. In the first round of 2001 Congressional elections, fourteen formal political parties and groups were listed on the ballot. Of those, Perú Posible and APRA, both previously strong parties, received a small majority of the seats (45 and 28 respectively). The presence, however small, of previously recognized and politically

<sup>42</sup> It is important to note that there were no changes in the Freedom House scores for either political rights or civil liberties from 2002 to 2008.

<sup>43</sup> [http://www.freedomhouse.org/template.cfm?page=351&ana\\_page=341&year=2008](http://www.freedomhouse.org/template.cfm?page=351&ana_page=341&year=2008)

<sup>44</sup> <http://www.freedomhouse.org/template.cfm?page=22&year=2008&country=7469>

active parties like Unidad Nacional, Acción Popular, and Unión por el Perú attests to their ability to reinsert themselves in the political scene (Taylor 2005, 578). Furthermore, unlike in the 1980s and 1990s, fighting among parties and legislative gridlock has been far less common. Instead the opposition pursues its agenda in a more productive fashion that aims to “strengthen the democratic order” rather than obstruct it (Taylor 2005, 589).

Direct efforts to decrease party fragmentation and to also “promote transparency and internal democracy within parties” manifested themselves in the Law on Political Parties (Crabtree 2006, 34). The Law was approved in October of 2003 after much debate and discussion among political parties, civil society groups, international agencies, and electoral authorities, and represented a major step towards a more democratic party system (Crabtree 2006, 33). Among other conditions, the legislation required parties to have a national presence, gender quotas, and to subject their finances to audits.<sup>45</sup> The abovementioned developments represent a significant break with the party behavior, corruption, and fragmentation that was common in the 1980s and therefore also a major step towards a higher level of democracy.

Civil society suffered tremendously during the Fujimori years and as a result NGOs, trade unions, and community groups have struggled to become a strong force in Peruvian society. Yet at the same time the human rights abuses and government oppression of the 1990s led to human rights investigations, the exposure of government corruption and the return of democracy, which has consequently greatly empowered civil society to confront state institutions. In addition, since 2001 Vigilancia Ciudadana (Citizen Watch) groups, which educate citizens about their civil and political rights, have become very common in both urban and rural areas. The groups “aim to advance good

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<sup>45</sup> See Ley 28094 available at <http://www.onpe.gob.pe/partidospoliticos/ley6.htm>.

governance through monitoring state activities at the national and local level, denouncing corruption and pressurizing the authorities to respond to popular social, economic and cultural needs” (Taylor 2005, 593). Although such civil society groups have had to reassert themselves since Fujimori, their activity and ability to influence the state has proven far stronger than in any previous decade.

In addition to the reemergence of the party system and civil society, political, civil society, government, and business organizations established the Acuerdo Nacional (National Accord). The Accord encompassed state policies intended to improve the relationship and increase dialogue between civil society, businesses, and political parties, and thus to also ameliorate the conflict and institutional problems that had plagued these actors in the 1980s and 90s. More specifically the policies “are directed towards achieving four large objectives: Democracy and Rule of Law, Equity and Social Justice, Country Competitiveness, and Efficient, Transparent and Decentralized State.”<sup>46</sup> The Acuerdo Nacional, coupled with the Freedom House rankings, the Law on Political Parties, and the return of civil society indicate a dramatic political shift from not only the 1990s but from any previous decade in Peru. These attest to an increase in the level of democracy and also a true commitment to a more open and free political system that ran deeper than just political discourse or electoral interests.

### **Market Based Policy**

President Toledo has been characterized as a neopopulist, attempting “to build personalistic ties to the impoverished masses while pursuing neoliberal economic policies” (Barr 2003, 1161). In reality however, the administration’s capacity to achieve

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<sup>46</sup>To see the actual policies agreed upon refer to the Acuerdo Nacional at [http://www.acuerdonacional.gob.pe/DocumentosAN/2008/E\\_3.pdf](http://www.acuerdonacional.gob.pe/DocumentosAN/2008/E_3.pdf)

the former was hindered by the latter. Market based policy has dominated in the twenty-first century as it had in the previous decade under Fujimori.

Toledo's political campaign reflected his neopopulist character, as he promised to end privatization, decentralize the government, achieve GDP growth, and increase social spending, while simultaneously promoting free trade agreements and maintaining and building foreign economic relations (Taylor 2005, 582). The overall orientation of economic policy remained focused on the market, and no attempt was made to revert back to the command based policies that dominated prior to the 1990s. Instead, the administration enhanced foreign confidence and participation in the Peruvian economy through free trade agreements with several countries including its Andean neighbors, South Korea and the United States (Barr 2003, 1166). In addition, net inflows from FDI increased from \$810 million in 2000 to \$2,579 million by 2005, and privatization remained around 15 percent of GDP throughout Toledo's term.<sup>47</sup> The importance of privatization and foreign investment to the administration is further seen in the attempt to sell off state owned energy companies to foreign investors despite promises to halt privatization altogether (Barr 2003, 1166).<sup>48</sup>

Similar to the spending policies adopted by Fujimori, the Toledo administration increased spending in the social sector. Policies aimed at improving access to health care and drinking water, increasing employment and wages, and providing rural education and overall development were initiated by the government through external and increased

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<sup>47</sup>FDI data from World Bank's "Key Development Data and Statistics." Private Investment Data from Banco Central de Reserva de Perú, Cudros Anuales Históricos.

<sup>48</sup>High profile protests broke out in the city of Arequipa as a result of a proposed sale of two publicly owned electricity-generating companies. The government negotiated a settlement with the local government and the privatization program ceased. See Rafo Le'n, "Peru's Globalization Problem," *Foreign Policy*, 23(115): 2002, 90.



state funding. In 2002, social expenditures were more than seven percent higher (as percentage of GDP) than in Fujimori's last year in office (Barr 2003, 1166).

Toledo's market based policies contributed to substantial economic growth and stability. GDP growth increased from 0.18 percent in 2001 to 5.14 percent by 2005 (Weisbrot 2006, 3). During Toledo's term inflation decreased, there was a trade surplus, the exchange rate was stabilized, and tremendous expansion in mining, agriculture and manufacturing contributed to the creation of thousands of jobs (Taylor 2005, 583). In addition, national poverty rates decreased from 54.3 percent of the population in 2001 to 51.6 percent in 2004 (Weisbrot 2006, 3).

Despite the economic success of the Toledo administration, public protests and government corruption led to the election of a new president in 2006. García was elected for a second term. Promising a dramatic shift from his previous policies, García has maintained the market based programs implemented by his predecessors (Villarreal 2007, 9). Not only has García promoted the U.S.-Peru Trade Promotion Agreement and worked closely with financial institutions to ensure Peru maintains its relationship with the global financial community, but the government has also aimed to cut back on longstanding corruption by reducing government salaries and reallocating resources to the marginalized sectors (Villarreal 2007, 9). Economically speaking García's continuation of market based policies has been very successful. Not only has there been tremendous growth, but as of 2007 "high rates of growth in private consumption and private investment, consumer and business optimism, a higher disposable income, increased employment, high prices for our main exports, and the expansion of credit" have come to characterize the economy (BCRP Annual Report 2007, 1). Peru has seen

unprecedented economic growth in the twenty first century and the future benefits of market based policies are predicted to be great.

### **Institutional Hope?**

#### **Executive**

Toledo took great strides to correct the corrupt behavior that was common under Fujimori's executive, and the major democratic reforms that occurred as a result of collaboration between the executive and Congress attest to this reality. Toledo worked hard to bring officials of the Fujimori regime to justice in corruption and human rights cases, to decentralize the state, and to enact institutional reforms (McClintock 2006, 98). However, several aspects of Toledo's own personal life were viewed as undemocratic. The president lived extravagantly taking expensive, luxurious vacations and raising his salary to over 200,000 dollars a year (McClintock 2006, 98).<sup>49</sup> In addition, Toledo was "criticized for beginning his workdays late, accused of nepotism, and chastised for refusing to take DNA tests relating to a paternity suit" (Barr 2003, 1164). Many viewed the President's lifestyle as inappropriate and undemocratic considering the poor socio-economic situation for many Peruvians.

García's executive has also been subjected to public criticism. In 2007 the government enacted several decrees in response to protests throughout the country. These decrees and the nature in which they were issued were seen "as impinging on the right to protest, particularly by threatening to strip government officials of their posts if they participated in protests (Freedom House 2008)." Such measures are reminiscent of the wide use of executive decrees in the previous decades. Yet perhaps even more telling of

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<sup>49</sup> "Due to popular protest, it was reduced to roughly \$144,000 a year, though Peruvians still considered this excessive (McClintock 2006, 98)."

the institutional flaws that still permeate the executive, are recent corruption accusations. In October 2008, García's entire cabinet resigned following charges of "corruption in the granting of oil concessions" (*Financial Times* 13 Oct. 2008). According to polls corruption at the top level of government is one of the most common complaints among citizens (*BBC News Online*, 11 Oct. 2008).

### **Political Parties**

The state has recognized and addressed the flaws that plagued Peru's parties, yet have these efforts truly altered the institutions that guide the political organizations? Despite the Law on Political Parties there remain several core institutional problems within the party system. The most pressing and significant issue stems from parties' capacity to establish a base of support not just in major urban areas, but throughout the country. Historically it has been very difficult for national parties to integrate themselves within the local political scene, and although legislation and elections have provided more opportunity for expansion in rural and poor communities, this remains the case.

Voters are likely to remain skeptical until parties prove their worth in fighting their battles and opening up to participation in an inclusive and democratic manner. Such inclusiveness would probably be harder to achieve, for instance, among marginalized peoples of the highlands and jungle than among more traditional areas of party support. Large numbers remain effectively outside the ambit of the franchise, in spite of universal suffrage" (Crabtree 2006, 38).

Voters' skepticism is further apparent in high electoral volatility and the selection of candidates from outside the political system.<sup>50</sup> "In Peru in 2004, independent regional movements controlled 13 of the 25 regional governments and 1,634 of the 2,281 jurisdictions" (Mainwaring 2006, 16). This is indicative of a general disconnect between

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<sup>50</sup> Mainwaring defines electoral volatility as "the net share of votes that shifts from one party to any other party from one election to the next" and a useful measure of voter disapproval of political parties (2006, 16).

local and national level politics, and again parties' inability to bridge that gap (Crabtree 2006, 39). Although significant steps have been taken to improve the party system, underlying institutional issues remain.

### **Military**

Major reforms aimed at changing both the organization and operations of the military have occurred since 2000. In 2001, the Comisión para la Reestructuración Integral de las Fuerzas Armadas (Commission for the Comprehensive Restructuring of the Armed Forces) was created. The Commission set forth recommendations for military reforms that would make the organization more democratic. The proposed reforms included everything from the creation of a defense ministry that would oversee military policy, spending, and operations, to the reorganization of the entire armed forces (Rospigliosi 2006, 67-69).

The main objective of these reforms was to transfer control of the armed forces from the military itself to the elected government. One of the leading obstacles preventing the proposed reforms from materializing was the military's opposition and government officials, particularly Toledo's, failure to follow through.<sup>51</sup> Even the Ministry of Defense Act, which passed in 2002 and created the Ministry of Defense, was limited in its capacity to transfer leadership and direction of the armed forces from military to civilian hands, and military officers remained in control (Costa 2006, 221).

The military itself was also greatly opposed to the reforms and wanted to maintain as much autonomy as possible. In several areas they were able to do so; however one of

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<sup>51</sup>Instead of endorsing and implementing the reforms, Toledo appointed military officials to defense ministry posts in hopes of protecting his administration from a potential coup. In addition, on several occasions he used military state of emergencies to respond to violent public protests throughout the country (Rospigliosi 2006, 72-73).

the most significant was through a Defense Fund secured in 2005. The Fund ultimately allowed the military greater control over their finances and expenditures (Rospigliosi 2006, 75).

Another area in which the military upheld its control despite reforms was in the intelligence sector. For decades the military had control over intelligence, and more specifically the Servicio de Inteligencia Nacional (National Intelligence Service, SIN), however in October of 2000 the body was dismantled under Law 27351 (Weeks 2008, 54).<sup>52</sup> SIN was replaced with the Consejo Nacional de Inteligencia (National Intelligence Council, CNI) through Law 27479. Yet the new organization maintained many of the undemocratic traits present in its predecessor, operating unilaterally, without Congressional input and under the Presidential appointment of “military officers and political cronies” (Weeks 2008, 55). As a result of public disapproval the organization was finally dismantled and replaced with the Dirección Nacional de Inteligencia (Directorate of National Intelligence, DINI), a body within the greater Sistema de la Inteligencia Nacional (System of National Intelligence, SINA). Congress was given more authority with regards to SINA, however, the Joint Command of the Armed Forces retained control over its intelligence activities (Weeks 2008, 56).

Military developments in the current decade suggest that a newfound commitment to democratic institutions is present in Peru. Specific commissions have been created, and

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<sup>52</sup> The SIN was controlled by the military, however, in the 1990s it served as more of a puppet for the executive. “It was unilateral, personal and autonomous, and it operated extensively within the country to attack and intimidate domestic political enemies under the guise of national security. Montesinos reported only to the president without any restrictions on his activities. There were few restraints placed on the military’s actions, as it had wide latitude to do what was necessary to carry out the goals set forth by Fujimori and Montesinos” (Mainwaring 2006, 54).

recommendations and proposals have been numerous. Yet the institutional foundation and the role of the military remain substantially unchanged.

### **Judiciary**

The judiciary has seen several institutional changes in the last decade. Not only has the judiciary become more independent, but the military courts have dissipated and the judiciary is more equipped to independently deal with local legal matters (Bocanegra 2006, 150-151). In addition, the Comisión Especial para la Reforma de la Administración de Justicia (Special Commission for Reforming Judicial Administration, Cerijas) was created and proposed more than 170 reforms (Bocanegra 2006, 153). Despite these efforts however, the government gave virtually no support for the reforms and members of the judiciary presented opposition. As a result the judiciary's institutions have seen only minimal changes within the last decade.

Access to justice in many parts of Peru is unavailable, and where this is not the case the cost of justice is such that it is effectively unavailable to those on low incomes. The service provided is in any case low-quality, lengthy and riddled with bureaucratic red tape...Such criteria as wealth, social status, political contacts and race are determinant in the way in which institutions relate to citizens (Bocanegra 2006, 137).

The Peruvian judiciary remains a very exclusive organization in the twenty-first century.

### **Trends in Inequality**

Peruvians' dissatisfaction with the Toledo administration despite economic prosperity is a telling sign of the underlying problems associated with market based policies and institutions in Peru and their failure to meet the needs and wants of the entire population. In terms of income distribution there has been little change. As of 2007, the poorest twenty percent of the population's share of income was 3.7 percent, while the

richest twenty percent's was 56.7 percent.<sup>53</sup> As of 2003, the Gini Index was as high as 52.03.<sup>54</sup> In addition, unemployment increased from 7.8 percent in 2000 to 10.5 percent 2004, representing a large increase for a period of only four years (Weisbrot 2006, 3).

Discrepancies are also present in access to critical services. In 2004-05, only thirty-four percent of births among the poorest twenty percent of the population were attended by a skilled health professionals compared with one hundred percent of births among the richest twenty percent of the population.<sup>55</sup> The latter percentage is comparable to Nigeria, and the former is equal to the United States of America.<sup>56</sup>

### **Conclusion**

The persistence of inequality in the twenty-first century is telling of democracy, market economics, and institutions. The reemergence of democracy, in fact a fairly strong democracy, has done nothing to lesson exclusion. Market based economic policy remains limited, as economic growth and progress have yet to trickle down to the poorest sectors of society. Public opposition to privatization, international economic relations, and market policies more generally has been widespread in the last eight years. While it is theoretically and factually supported to argue that market based policies have done nothing to provide opportunity for Peru's poorest or to promote equality, it is more useful to look to the institutions. Although society has been open to democratic reforms and there have been some changes in the state's major organizations, substantial institutional

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<sup>53</sup>Data from 2007 Human Development Report

<sup>54</sup> Data from "PovcalNet." *The World Bank Group*

<sup>55</sup>Data from 20007/2008 Human Development Report  
[http://hdrstats.undp.org/countries/data\\_sheets/cty\\_ds\\_PER.html](http://hdrstats.undp.org/countries/data_sheets/cty_ds_PER.html)

<sup>56</sup> For more data on inequality in the twenty-first century please refer to the Inequality section in Chapter 1, pp 19-21.

modifications remain to be seen. The corruption, self interest, and exclusion embedded in these institutions in the 1980s remains in the twenty-first century.

It is these institutional weaknesses and limitations that have persisted alongside inequality for the last three decades. The constancy of this variable and inequality trends attests to the importance of institutions in explaining inequities. Inequality has persisted despite vast economic and political change, yet the way in which state organizations operate remains unchanged. This institutionalized exclusion is a leading obstacle to all inclusive development and to a strong and prosperous democracy.



## CONCLUSION

Peruvian inequality has proven to be resistant to regime and economic policy changes. The transitions to democracy that occurred in 1980 and 2000 were accompanied by free and fair elections, and an increase in civil society organizations, political rights and civil liberties. The more open and free political systems did not however give way to economic inclusion, as close to half of the state's income remains concentrated in ten percent of the population. The failure of the Belaúnde, García, and Toledo regimes to promote equality calls into question Stack (1978), Diamond (1999) and Salgado's (2006) correlation between democracy and inequality. In the case of Peru, democracy alone, and regime type more generally, are not sufficient in explaining the exclusion problem.

The independent variable, economic policy, also fails to adequately explain inequality. The state's control over the economy in the 1980s did not result in redistributive policies or more equality, and ultimately left the state in shambles. Extensive privatization, an increase in FDI, bilateral and multilateral trade agreements, and the adoption of other market based economic policies in the last two decade have led to substantial economic prosperity and growth. The benefits of such policies however, have yet to trickle down to the poorest sectors of society, as neoliberal theorists would argue. Such findings support Kuznet's argument, and Cardoso and Falleto's emphasis on dependency relationships within states that obstruct equality.

The limited explanatory capacity of regime type and economic policy not only confront prominent theories on inequality but they highlight the importance of examining alternate state level variables. This research does not aim to discredit the importance of

either democracy or economic policy or to suggest that these variables are inconsequential in explaining and overcoming inequality. The relationship between the two and inequality is far too important as former President Toledo points out. “If we’re not able to reduce those levels of poverty and inequality, we’ll not only truncate growth, we’ll not only undermine democracy, but we might be stimulating the expansion of authoritarian populism” (Matthews 2008). Instead the findings highlight the importance of more in depth analyses of those factors that influence the economic policies and the nature of the political regimes.

### **The Importance of Institutions**

Unlike regimes and economic policies, state institutions have remained virtually unchanged since the 1980s. Corruption continues to plague the executive, strong political parties have yet to gain a broad base of support especially among the marginalized, the military operates unilaterally and independent of other government branches, and access to the justice system remains limited. The obstacles facing inclusive economic development and political stability are domestic organizations and the “rules” they abide by.

Such findings suggest that it is through institutional reform that more equality can be achieved. More accountability and checks and balances within and between government branches may not only curb corruption, like that which occurred just last year and resulted in the resignation of the President’s entire cabinet, but it may also increase trust and in turn public participation. If political parties are required to have a national presence then perhaps the excluded will be represented in the policymaking process. Legislation further limiting the military’s power may help mitigate the

indigenous population's well founded mistrust of the organization. Finally, judicial reform has the potential to greatly transform the public's perspective of and use of the legal system and could result in more inclusive social, political and economic laws.

Such institutional reform is not only supported by the findings in this research, but also by De Soto's work. While the emphasis here is on political institutions, similarities can be drawn to De Soto's call for economic legal reforms. De Soto argues that institutional reform is an alternative to revolutions, like the Shining Path. It is this "other path" that will incorporate the excluded into the economy and political sphere in Peru. This idea has manifested itself not only in the reforms that have occurred in Peru since De Soto's work, but also in contemporary Latin American politics, and specifically in a comparison of Venezuela and Brazil.

Venezuela's Hugo Chavez has taken the revolution approach to the inequality problem, engaging populist rhetoric and policies. While Chavez may be mitigating the economic inequality problem in the short run, his policies are doing nothing to improve the relationship between the included and the excluded. The sustainability of his solution thus remains to be seen. In contrast, Brazil's Luiz Inacio "Lula" da Silva has taken De Soto's "other path", recognizing the exclusion that plagues the country through economic, judicial and social reforms that take into consideration Brazil's excluded like Afro-Brazillians and women.

The reformist path taken by Lula and promoted by De Soto serves as a new and seemingly appropriate approach to the inequality problem in Latin America. The Truth and Reconciliation Commission, the National Accord, the Law on Political Parties, and military reform attest to a newfound commitment to democratic reform and to the

inequality problem in Peru. Yet perhaps the benefits of such institutional change have yet to be seen considering the lofty goal of reversing centuries of exclusion. Regardless the reformist path appears to be a well supported and viable approach to the inequality problem that plagues Peru.

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