CHAPTER 6

Neoliberalism and State Reconstruction

Another About-Face: Peru Joins the "Washington Consensus"

With the country having defaulted on service payments for its public and private external debt during the García years, it took President Alberto Fujimori just ten days after his inauguration in July 1990 to realize that he had, in fact, zero room to maneuver in implementing a gradualist reform strategy. Fujimori's campaign platform, for example, had originally called for administered prices, a downsized but activist state, and an economic strategy geared toward fostering labor-intensive microindustries (Stokes 1996a, 61). But like other leaders elected at this time on similar platforms, such as Venezuela's Carlos Andrés Pérez and Argentina's Carlos Menem (Corrales 2000a), both of whom moved immediately in launching market-shock programs, Fujimori followed suit. Hence, Peru quickly adopted the package of stabilization and adjustment measures based on liberalization, privatization, and deregulation that had come to be coined the "Washington Consensus" (Williamson 1990). Seemingly overnight, the country went from rogue state to model reformer.

The president's initial success in conquering inflation and restoring growth under a market strategy went a long way toward securing support for him among voters of all political persuasions. Add to this the capture and imprisonment of Sendero's core leadership by late 1992, and the stage was set early on for Fujimori's election to a second term. However, in contrast to other leaders, such as Argentina's Carlos Menem and Brazil's Fernando Henrique Cardoso, Fujimori went so far as to suspend congress and the constitution in April 1992 rather than negotiate his reform measures through the democratic channels upheld by these other civilian presidents. Although formal democratic rule had been restored by the time of Fujimori's 1995 reelection bid, it was, ironically, these heavy-handed politics, bolstered by the economic recovery of the early 1990s, that won the president his second term.

Throughout his tenure in office, Fujimori resorted to the selective distribution of subsidies and other economic incentives (Graham and Kane 1998) and to the masterful use of public-opinion polls to maintain his following (Conaghan 1995). While military backing, a risk-averse civil society, and the president's own political cunning all go a long way toward explaining the

Fujimori phenomenon, less obvious are the factors that contributed to the comparatively successful economic trends that were discussed in the introduction to this book. As table 1 shows, Peru held its own along with Argentina and Chile during the 1990s in terms of its annual average rates of growth of GDP and gross domestic investment. Similarly, Peru's annual rates of growth in employment and real wages outpaced those of much larger and more developed economies, such as Brazil and Mexico.

As tempting as it may be to attribute this impressive turnaround to free markets and quasi-authoritarian rule, this chapter points to a quiet process of state reconstruction and institutional reform that occurred over the course of the 1990s. This explanation may seem paradoxical, given that Fujimori had become best known for his fierce independence and resistance to institutionalizing his own support base or the state's ties with civil society (Roberts 1995). However, having inherited Latin America's most volatile political economy in 1990, the president had little choice but to overhaul those state institutions that were crucial for economic recovery and hence his own political survival. Included in these renovations, for example, were longstanding financial entities like the BCRP and the MEF, which were essential for the successful completion of the macroeconomic stabilization effort.

Another key aspect of institutional reform in the early 1990s was the reinvention and/or creation of new state entities geared toward achieving the longer-term goals of economic restructuring along market lines. The purposes of these longer-term institutional goals were, first, to modernize and sustain the state's revenue stream at levels that would allow for the proper provision of essential public goods while at the same time reducing the prohibitive levels of government-held debt; and second, to rationalize the new market-based development strategy through the design of institutions that sought to guarantee property rights and to promote a competitive business environment. In essence, Peru's economic turnaround is testimony to a pattern of "autonomous" institutional reform that has entailed the siphoning off of strategic pockets of the public sector and the management of these units as if they were private entities (Nuñes and Geddes 1987; Keefer 1995).

Over time, it was precisely the autonomous nature of these state agencies that would put them at odds with the office of the executive.[1] In other words, the institutional underpinnings of Peru's economic recovery were as much inadvertent as they were a purposive part of the designated economic strategy under Fujimori.[2] Just as the RGAF was directly responsible for organizing

1. Having created these agencies, the president was steadfast in resisting further reforms that would diminish his direct control over them—for example, the staggering of agency directorships such that the time line of appointments did not coincide exactly with the executive's own five-year term.

2. I owe this insight to Richard Webb.

those base groups within civil society that later emerged as the main catalyst for the transition to democracy in the late 1970s (Sanborn 1991), so too did the Fujimori administration infuse new technocratic vigor and professional life into state agencies that could carry the reform project forward into the post-Fujimori era. Because this modernization process has yet to fully penetrate the sectoral ministries, the state bureaucracy at large, or the legal-juridical apparatus, the degree of institutional reform achieved thus far constitutes a necessary but not entirely sufficient condition for more dynamic, equitable, and sustainable growth in Peru.

This latter set of challenges goes to the very heart of the reform tasks inherited by the administration of President Alejandro Toledo in June 2001. As economic growth tapered off in 1998 and 1999, Peru arrived at the same crossroads that other emerging-market countries like Argentina, Chile, and Mexico had arrived at somewhat earlier: full economic revival would require deeper institutional reform in numerous areas (tax collection, the financial system, social policy, the administration of justice, and respect for the rule of law), as well as a more inclusive and encompassing development coalition to move these policies forward.

Yet, rather than broaden the reform coalition in ways that would facilitate the wider participation and input demanded by second-phase reforms, the Fujimori cohort closed ranks in the guise of offering apolitical technical solutions to these more recent patterns of economic stress. A deeper problem was that the everyday concerns of political survival and the burden of constantly defending a decade-long incumbency distracted the ruling coalition from articulating a cohesive development strategy for the longer term. Whereas this very coalition was once a source of confidence in the country's improved investment ratings, and a signal to the electorate that things were on track, it increasingly came to be perceived by domestic and international observers alike as a main source of uncertainty.[3]

The following sections of this chapter chart the progress of Peru's political-economic turnaround in the 1990s from three angles: the rise and fall of the Fujimori coalition; the timing and sequencing of market reforms; and the institutional transformations that underpinned the reform process. The analysis will show that, in all but the distributional arena, those most pressing problems related to state-led development inherited from the 1960s, 1970s, and 1980s have basically been resolved. Moreover, Peru's "first phase" of market reform based on liberalization, privatization, and deregulation has been completed. With the inauguration of the Toledo administration in July

3. Alfredo Thorne, "Peru after the Presidential Election," *Global Data Watch,* Banco de J. P. Morgan, S.A., June 2, 2000, 17–18.

2001 an essential round of "second-phase" market reforms remained to be tackled, along with a more penetrating effort at institutional modernization. The final sections of this chapter speak directly to these tasks and to the kinds of political coalitions that are now necessary to achieve them.

The Political-Economic Backdrop: Military Resurgence and Market Reforms

Just as the magnitude of the prevailing social violence and economic collapse would have been unthinkable a decade earlier, so too would the election of a candidate like Fujimori who had virtually no ties to the country's established political parties and *criollo* elite. Indeed, the coalition of traditional conservative parties that had rallied around Mario Vargas Llosa was stunned by its defeat at the hands of an outsider who had been outspent by a ratio of more than sixty to one (Marcus-Delgado 1999).[4] The final tally in the second round of voting, which gave Vargas Llosa 37.6 percent to Fujimori's 62.4 percent, suggested an even more profound political realignment than had occurred in 1983. However, the partyless nature of this political shift, Fujimori's lack of clearly stated positions, and the unexpected tenacity of the newly elected president would pose new opportunities and constraints for political-economic management in the 1990s.

At face value, Fujimori drew most of his support from the country's silent majority: low-income voters, small-business owners, workers in the informal economy, and evangelical Protestants. In all, Fujimori captured the majority of the country's poorest districts in both the urban and the rural areas, while Vargas Llosa mainly carried the middle- and upper-class districts within Lima and the other major cities (Roberts and Arce 1998; Marcus-Delgado 1999). Given the trauma of hyperinflation and an all-out civil war, this electoral triumph of poor over rich and countryside over city should perhaps not have been such a surprise. Rather, it was further confirmation of the widening chasm between the state and civil society (Crabtree 1998, 20) and a wake-up call concerning the utter failure of the standing political parties to properly mediate between the two.

In hindsight, the transformation that had occurred within the Peruvian military over the course of the 1980s also lent momentum to the Fujimori phenomenon. By virtue of the increased role that the various branches of the

4. In his memoir Vargas Llosa (1994, 434) reflects back on this phenomenon: "I asked who this Alberto Fujimori was, who now, only ten days before the election, seemed to begin to exist as a candidate, and where he came from. Up until then I don't believe I'd given a single thought to him, or ever heard anyone mention him in the analyses and projected results of the election."

armed forces had come to play in combating the country's guerrilla insurgencies and exploding drug trade (Mauceri 1996, 136–41), a new generation of military leaders sought a more active role in domestic politics. Prior to the 1990 presidential race the military had drawn up the "Green Book," its first sweeping plan of action since the early days of the RGAF (Maxwell Cameron 1997, 51). But in contrast to the RGAF's nationalist-reformist project, military leaders of the late 1980s called for the implementation of market reforms with solid backing from business, government, and the military, as well as "a strong government that would last 20 years if necessary" (Crabtree 1998, 21–22; Obando 1998). While Fujimori's last-minute ascendance in the 1990 race took everyone by surprise, including the military, the armed forces could not have found a better candidate to fulfill their newly articulated vision for Peru.

The "First Phase" of Market Reform

As seen in table 14, by 1990 the arrows on growth, investment, and inflation had all moved radically in the wrong direction. Similarly, Peru's current account deficit continued to hover at an all-time high, and the overvaluation of the exchange rate exacerbated this trend. Public finances had literally collapsed under the thrust of the heterodox program, and the assessments on the damage inflicted by the country's various guerrilla insurgencies were now running in the range of US$22 billion (Manzetti 1999, 232). At the outset of the Fujimori administration more than 50 percent of the population was classified as living in poverty, and half of those fell into the category of "chronic and extreme" poverty (Sheahan 1999, 108). With the greater infiltration of patronage appointments from the ranks of the main political parties during the 1980s, Peru's available pool of public-sector expertise had also hit an all-time low.

Thus, similar to the other market reformers discussed in chapter 1, once the decision was made to finally buckle down with a strict stabilization program, the policy package moved forward with little debate and just a handful of advisors. To the extent that a policy debate did occur, it was in the form of a "Plan for Economic Stabilization and Growth" that was generated by a group of the country's most talented economists in conjunction with Professor Jeffrey Sachs of Harvard University (Paredes and Sachs 1991). Although academic economists and private-sector consultants had actively shaped the policy-reform debate in Argentina, Brazil, Chile, and Mexico during the 1990s, in Peru such links between the government and the professional economics community were still comparatively weak (Conaghan 1998). Hence,

the Fujimori team paid little heed to these proposals and instead opted for the Washington Consensus blueprint (Gonzáles 1998), as this was deemed the quickest way to reduce inflation and entice desperately needed foreign capital back into Peru. It is interesting to note that the Paredes-Sachs plan also fell firmly within the Washington Consensus camp, but it raised additional issues concerning the exchange-rate regime, the proper sequencing of market-reform measures, and the need to provide an adequate social cushion for adjustment.

On the stabilization front, the main challenge was to rationalize macroeconomic policy making after years of haphazard management. The first crucial step was to purge the country of hyperinflation; this was approached by way of a tight monetary policy, draconian spending cuts aimed at reducing public-sector deficits, and the unification of the multitiered exchange rate. Virtually overnight, government-controlled prices and subsidies were lifted on everything from gasoline and utilities to sugar, rice, and medicines. Between August 1990 and February 1991, emergency taxes were introduced, a new managed floating-exchange-rate system was established around the unified rate, domestic credit was tightened, and interest-rate ceilings were basically lifted (Paredes 1991, 301).

While similar measures had brought a swift end to Bolivia's hyperinflation several years earlier (Pastor 1992), table 15 shows that this was not the case with Peruvian hyperinflation. A main difference between Peru's approach and Bolivia's was the Fujimori team's insistence on moving to a floating-exchange-rate system at the outset.[5] Whereas the Bolivian program had relied on devaluation and the initial fixing of the exchange rate to the U.S. dollar in order to provide a nominal anchor for price stabilization, the fate of Peru's stabilization depended on the ability of the financial authorities to properly manage the new floating-exchange-rate regime. As table 15 shows, the combined reliance on a floating exchange rate, tight credit, and market-driven prices and interest rates created further pressures for inflation and exchange-rate appreciation. The BCRP's attempts to reverse these trends through intervention in the foreign-exchange market turned out to be part of the problem: a haphazardly managed "dirty float" greatly increased the recessionary costs of the program without fully rectifying the basic problems.

In order to quicken the pace of economic adjustment Fujimori brought in Carlos Boloña as minister of economy and finance in February 1991. Boloña was a Ph.D. economist with strong neoliberal credentials who forged ahead

5. As Paredes (1991, 309) notes, "The alternative of correcting the initial overvaluation of the currency through a large nominal devaluation and then using a fixed and fully convertible exchange rate as a nominal anchor . . . was disregarded from the start without a consistent and convincing argument."

TABLE 15. Macroeconomic and External Indicators in Peru: 1991–2000 (Fujimori's two terms)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
GDPGRO	7.1	–1.8	6.4	13.1	7.5	2.5	6.8	0.3	1.4	3.6
GNPPCGRO	19.1	–9.0	4.5	11.2	5.8	0.8	5.0	–3.3		
INF	409.5	73.5	48.6	23.7	11.1	11.5	8.6	7.2	3.5	3.8
PRIVGDP	11.7	12.0	13.4	16.8	19.6	18.8	20.8	20.7		
PUBIGDP	2.7	3.1	3.4	4.2	4.3	3.8	3.8	3.8		
INVEST	14.5	15.2	16.8	21.0	23.9	22.6	24.6	24.5		
RER	79.8	75.0	81.6	73.8	70.4	70.3	70.3	70.4	79.2	83.3
TRADEBAL	–188	–341	–605	–999	–2,166	–1,987	–1,723	–2,463	–617	–335
CURACCT	–1,500	–2,087	–2,287	–2,555	–4,117	–3,429	–3,056	–3,638.0	–1,822	–1,648
FDI	–7	150	687	3,108	2,048	3,242	2,697	1,881	1,969	558
PORT			201	492	159	181	156	–348	–372	–423
DEBT	20,716	20,338	23,573	26,528	30,852	29,328	30,523	32,397	29,100	30,300

Source: GDP, GNP, and debt are from World Bank, *World Tables, CD-ROM,* 2000, except 1999 and 2000 GDP growth and debt are from Economist Intelligence Unit Country Reports (March and April 2001) and GNP per capita data are from the Inter-American Development Bank Web site (<www.iadb.org>). Data on investment are from Bouton and Sumlinski 2001 <www.ifc.org/economics/pubs/discuss.htm>. Inflation, exchange rates, and payments are calculated from IMF 2001, 1998 current account data and Peruvian FDI and portfolio investment are from Inter-American Development Bank Web site (<www.iadb.org>).

Note: GDPGRO = growth of real GDP; GNPPCGRO = growth of real per capita GNP; INF = Dec.–Dec. inflation; PRIVGDP = private investment as % of GDP; PUBIGDP = public investment as % of GDP; INVEST = total domestic investment as % of GDP; RER = real exchange rate (1990 = 100), calculated using period average exchange rate, U.S. WPI, and domestic CPI; TRADEBAL = trade balance (mil$) = merchandise exports – merchandise imports; CURACCT = current account (mil$); FDI = foreign direct investment (mil$); PORT = foreign portfolio investment (mil$); DEBT = total external debt (mil$).

with the implementation of deeper structural reforms and the renegotiation of the country's external debt. During the first half of 1991, tariffs on trade were reduced to a maximum of 25 percent; the capital account of the balance of payments was liberalized; numerous labor-market regulations left over from the military regime were eliminated; land-tenure laws were amended to offer a broader scope for private initiative; the tax code was broadened and simplified; and the sale of some twenty-three SOEs was announced (Paredes 1991, 313–15; Boloña 1996). By 1990 there had been a general consensus in the policy community that the adoption of structural reforms of this magnitude in the midst of the initial stabilization plan could detract from achieving the goals of the plan (Edwards 1990). Nevertheless, the economic team proceeded apace, apparently convinced that the benefits of launching the entire range of structural reforms simultaneously, along with mending Peru's relations with its external creditors, would outweigh the potential threat to the stabilization effort.

After unilaterally resuming payments to service the debt, the government initiated negotiations for settling the arrears it had run up with all the main multilateral lenders. This was a hurdle that had to be overcome before Peruvian policy makers could reschedule some US$8 billion in debt with the consortium of Western country debtors known as the Paris Club, not to mention another US$9.2 billion in commercial-bank debt. However, the president's decision to take matters into his own hands in April 1992—by closing the congress, suspending the constitution, and dismantling the judiciary—threw a quick wrench into any of the planned debt rescheduling. The Paris Club, in particular, insisted on a credible timetable for the restoration of democratic rule as a precondition for the rescheduling of Peru's debt.

The Civilian Coup and Its Aftermath

As the economic program moved into its second year, there was still some question as to whether the particular strategy in place would be the one to stabilize inflation and trigger an economic recovery.[6] At the same time, the various guerrilla insurgencies and violent civil-military confrontations that had endured for more than a decade still showed no signs of abating: estimates suggested that more than twenty-six thousand lives had already been claimed. It was ostensibly this security threat that prompted the April 1992 civilian coup and the heightened tensions between the executive and the legislature over the former's effort to further increase the military's role in eradicating the guerril-

6. This section draws on Cotler 1995; Stokes 1996a; Maxwell Cameron 1997; Crabtree 1998; and McClintock 1989.

las. But Peru's democratic rupture also had to do with the president's attempt to carve out a role for himself as an almost purely "managerial executive."[7]

Having launched his presidency with a fairly eclectic cabinet and group of advisors, Fujimori switched within the first year to surrounding himself with independents who were nonthreatening and readily amenable to his point of view. This was especially so when it came to ministerial appointments. Simultaneously, the president forged an ever stronger political alliance with the armed forces and with the National Intelligence Service (SIN) in particular. By early 1992, it had become apparent that the president had a low threshold for the usual congressional checks on executive power. Although both Belaúnde and García had taken full advantage of their constitutional privilege to legislate by executive decrees during set periods specified by congress, both also had promoted their policy proposals through the majority party coalitions that each held at the time. Fujimori, in contrast, showed little interest in coalition building, policy debate, or the legislative process.

The president's preference for ruling by executive fiat was confirmed in April 1992, when he issued Legislative Decree 25418, which announced that he would do just that. The decree, which officially dissolved congress, the 1979 constitution, and the court system, also created the "Government of Emergency and National Reconstruction." Although it was a shock to international observers, hindsight shows that the warning lights concerning this radical decision had actually been blinking for several months prior to the coup. In late 1991, for example, congress resisted executive orders that sought to limit the freedom of the press and to greatly extend the military's power in fighting the counterinsurgency effort in the country's numerous emergency zones. These unresolved conflicts, combined with the president's rejection of social-expenditure requests put forward by congress, prompted the latter to pass a February 1992 law geared toward limiting the executive's powers. Thus, with the April 1992 coup the president showed his true political colors: a preference for military cronies and a stronger sense of obligation to the armed forces than to upholding democratic principles.

After turning to the likes of SIN director and former army captain Vladimiro Montesinos and General Nicolás Hermoza Ríos, head of the Joint Command of the Armed Forces, as his closest advisors, Fujimori created a quasi-authoritarian civilian-military regime that would dominate politics throughout the decade. Again, international actors did not take kindly to the notion of a coup, civilian or otherwise, and it was external pressure that most

7. Although the New Public Management school uses this phrase in reference to managers who are more public-service and results oriented (Pollitt 1990), the Fujimori rendition of the managerial executive was quickly warped by the 1992 coup. At this point, it became difficult to distinguish between public service and executive maneuvers that privileged management itself.

compelled Fujimori to begin going through the motions of restoring democratic norms. At this point, politics and economics entered into an even more complicated dance, which entailed three sets of elections between April 1992 and November 1993, as well as a third wave of executive decrees that sought to deepen the process of structural reform (Boloña 1996; Gonzáles 1998). In November 1992 delegates were selected for a Democratic Constitutional Congress (CCD), which produced a new constitution that the country voted on by referendum exactly a year later. In the midst of the CCD, nationwide municipal elections were held in January 1993.

Although public opinion echoed resounding support for the president and his rash actions, the vote in each of these elections was considerably more cautious. The Fujimori coalition won just over half of the eighty seats that had been put forth for the CCD, and the 1993 constitution passed by just over 52 percent of the vote. Despite the capture of Sendero's leader and mastermind, Abimael Guzmán, by a small, elite counterterrorist squad in a Lima hideout in September 1992, the Fujimori forces received little bounce from this victory in the January municipal elections. In fact, after sinking like a stone in the public-opinion polls, Fujimori's candidate for mayor of Lima withdrew from the race just prior to the election.

Thus, the neoliberal strategy was quickly pushed forward against a highly ambivalent political backdrop. The president garnered broad public support by hammering away at the moral corruption of the country's traditional legal and political institutions. But subsequent voting patterns suggest that the results of his political reform were not entirely embraced. The new constitution itself cast doubts in that it expanded the president's powers to dissolve congress, to declare national states of exception, and to promote military personnel without congressional oversight (Stokes 1996a, 66; Gonzáles 1998, 44–45). Even more telling, in terms of the president's personal ambitions, was a new constitutional clause that allowed for the executive's immediate reelection to a consecutive term and then further reelection after the lapse of one term. Thus, as of late 1993, President Fujimori also became incumbent Fujimori, a turn of events that rendered solid economic performance and favorable public-opinion ratings of the utmost importance for the president's political survival.

Economic Recovery and the Deepening of Structural Reforms

As can be seen in table 15, the first convincing signs of economic recovery appeared in 1993, as growth rates and investment (both private and public)

began to recuperate from the rock-bottom levels to which they had fallen during the García era. Moreover, for the first time in a decade, the annual inflation rate was below 50 percent. On the upside, because of the steep losses in personal income and the high levels of idle capacity that prevailed at the outset of the reform effort, there was considerable room for economic expansion. On the downside, the combination of rapid unilateral trade liberalization, tight monetary policy, and the continued appreciation of the exchange rate threw Peru's external accounts into disequilibrium (Gonzáles 1998).

While capital repatriation and a burst of privatization-related FDI helped to finance the current account deficit, the external gap increased nearly threefold between 1991 and 1995. Peruvian policy makers thus found themselves in similar straits as other market reformers in the region. Policy makers in Chile, and eventually Mexico and Brazil, moved to rectify these problems—for example, by adopting a more flexible and competitive exchange-rate regime and by more aggressively promoting an export-led model of growth (Wise 1999). In contrast, the Fujimori administration stood out for its insistence on a hands-off strategy and chose instead to assign the task of economic adjustment primarily to market forces.

Although this theme holds steady across the main components of the structural-reform program reviewed later, it does not detract from the integrity of this early stage of market restructuring in Peru. Rather, the problem of policy inflexibility reared its head later, when challenges from the external sector demanded a more nuanced or hands-on approach to market reform but policy responses moved in the opposite direction. In other words, although the institutional bases necessary to orchestrate a cohesive and effective economic policy response were finally being laid, an increasingly dominant president and his inner circle apparently came to associate political survival with a strict adherence to the economic laissez-faire that had marked this first phase of market reform in Peru.

Trade Liberalization

In setting the baseline for this study, chapter 2 showed that until 1963 Peru's economy had been far more open than that of the other top countries in the region. By 1990, the reversal of this liberal trade stance was such that the tariff structure had splintered into fifty-six different rates ranging from 10 to 110 percent; within this framework, 539 import items were banned outright (Rossini and Paredes 1991, 284–85). Thus, the trade regime inherited by the Fujimori administration fit the classic Latin American mold under ISI: commercial policy had largely fallen prey to those special interests that stood to lose most from the lowering of tariffs. The damage over the long run was a

policy bias that favored industry over agriculture, fostered a distorted and inefficient manufacturing structure, and caused exports to stagnate. Between 1988 and 1990, Peru's industrial production had contracted by 30 percent (Abugattas 1998, 64), and the country's exports per capita were lower overall than they had been in the 1950s (Rossini and Paredes 1991, 285).

Despite steady pressure from the multilaterals to reduce trade barriers, policy makers had departed from this highly protectionist strategy just once—between 1978 and 1982—during the transition to civilian rule. By 1981, the average nominal tariff had been brought down to 32 percent, and 98 percent of all registered items could be imported freely (World Bank 1985, 48). On the export side, under the thrust of a depreciating exchange rate, export incentives applied through the CERTEX system, and increased participation in the Andean Pact, this period saw a fifteenfold increase in manufactured exports (Sheahan 1999, 50). However, with the advent of the 1982 debt shocks and the gradual appreciation of the exchange rate, protectionist interests again prevailed, and this brief experiment in trade liberalization came to an end.

In the wake of 1990s shocking hyperinflation, Peru, having once set the pace for protectionist trade and investment norms within the Andean Pact, now led the way as a champion of liberalization. By March 1991, nontariff barriers had been dismantled, and a dual tariff structure had been established under which 87 percent of tariff items were subject to a 15 percent tariff and the remainder to a 25 percent tariff (Boloña and Illescas 1997). In this sense Peru had quickly joined step with other emerging-market countries in the region, where unilateral trade liberalization had similarly been embraced both as a tool for promoting macroeconomic stabilization and as a means of forcing competitive changes at the microeconomic level (Wise 1998). But unlike these other reformers, who were more aggressive in coordinating macroeconomic policy with export promotion, Peruvian policy makers remained steadfastly committed to a hands-off economic policy.

Fiscal Shock

The data reviewed in chapter 1 on the Latin American state sector showed that by the mid-1990s Peru had recuperated from the outright fiscal collapse that had occurred a decade earlier. The rationalization of public finances was such that tax revenues had doubled from the depths of the García administration, when they had fallen to just 7 percent of GDP, reaching nearly 16 percent by the end of Fujimori's first term. At the same time, public expenditures were brought more realistically in line with tax revenues: the government deficit was less than 1 percent of GDP from 1990 to 1994, and public debt as

a percentage of GDP—while still high by regional standards—had been reduced from nearly 50 percent in the mid-1980s to 32 percent in the mid-1990s. Three underlying factors contributed to Peru's fiscal overhaul, which was considered by some to be the most successful component of this first wave of structural reforms under Fujimori (Durand and Thorp 1998).

First, there was a recognition, once and for all, of the essential role that fiscal adjustment plays in sustaining a macroeconomic stabilization program to the extent that it is credible at home and abroad (Baca 2000). In the wake of hyperinflation, fiscal soundness was all the more important, as policy makers and economic agents could no longer hide behind inflation in the setting of completely unrealistic revenue targets. Second, deep institutional changes underpinned the tax reform that was carried out between 1991 and 1994, including a complete revamping of the national tax agency (SUNAT) and a strengthening of its capabilities in all areas of revenue collection (e.g., streamlining of the tax structure, creation and updating of tax rolls, technical-staff training, computerization, etc.).[8] Third, the increase in tax revenues was bolstered by the more stable base for economic recovery and higher growth that had been established as a result of the implementation of the entire package of structural reforms reviewed in this section.

As impressive as these advances have been, few inroads were made in shifting the tax structure toward greater reliance on direct taxation or taxes on income and property. Apart from the fierce political resistance by powerful economic groups to these more progressive tax categories, fiscal reform along these lines was further hampered by the very small percentage of Peruvians who were actually in the habit of paying taxes. To the government's credit, the number of income-tax returns filed rose from fewer than 200,000 in 1991 to more than 423,444 in 1994, yet 85 percent of the revenues collected came from less than three thousand large taxpayers (Durand and Thorp 1998, 221). Thus, while the tax structure had been simplified to just five categories (income tax, assets tax, excise duties, a housing and urban tax, and a value-added tax [VAT]), revenue collection depended disproportionately on indirect taxes and the tax on consumption (VAT) in particular. Peru is not unique in this respect, as the increased reliance on the more regressive VAT tax was a regionwide trend in the 1990s (ECLAC 1998, 67–71). But as the VAT came to account for 44 percent of all taxes collected by 1994, Peru's shift toward greater regressivity was compounded by preexisting inequities that were intrinsic to the tax structure at the outset of the reform.

8. See ECLAC 1998 for more detail on the bureaucratic and administrative aspects of the fiscal reform that has taken place in the region over the past decade.

Privatization

The fiscal collapse of the late 1980s also rendered privatization inevitable at this point. With the SOE share of GDP having peaked at more than 10 percent under García, operating losses amounting to more than US$500 million by 1989 could no longer be sustained (Manzetti 1999, 65). While the usual suspects lobbied for the same gradualist approach that had thwarted all earlier attempts at privatization in Peru, this time the executive's assertive elite-level decision-making style prevailed. In late 1991, with strong backing from Finance Minister Boloña and the multilaterals, a new privatization law was passed, and within a year the government's newly created privatization commission (COPRI) had begun to quickly unload state assets. In contrast to the footdragging and political charades that had surrounded previous efforts at privatization, COPRI staff moved forcefully in selling off some US$9.1 billion in state assets by the end of 2000. During Fujimori's first term, for example, seventy-two privatizations had been completed in such sectors as electricity, telecommunications, mining, industry, and banking, and the privatization program had generated commitments for another US$11.3 billion in private project investments (Araoz, Bonifaz, Casas, and González Vigil 2001, 40). What explains this abrupt departure from past practices?

Certainly the liberalization of Peru's foreign-investment regime and the overall economic recovery were important contributing factors, but it was the creation of COPRI and the long-overdue professionalization of the privatization strategy that accounted for these inroads (Franco, Muñoz, Sánchez, and Zavala 2000).[9] First, with the creation of COPRI, the legal guidelines for privatization were finally in place, the most important being an explicit set of instructions for assessing the value of individual firms and concrete procedures for divestiture. Second, the technical and financial expertise of COPRI's staff was such that the agency actively involved itself in the restructuring of companies to make them more attractive to potential buyers. Third, apart from better preparing state firms for sale and assisting in the preparation of proposals for financial backing, COPRI started its sell-off campaign with smaller firms, which are easier to unload; the strategy with the larger firms was to begin by offering stock options in a more piecemeal fashion. This latter approach represented a major difference from past efforts, which hinged on grand privatization schemes that simply stalled.

This is not to say that privatization's enemies had been completely neu-

9. These insights are based on my interviews conducted in Lima with two former COPRI directors, Carlos Montoya (interview with the author, May 25, 1992) and Manuel Llosa (interview with the author, July 18, 1995), and with COPRI official Carolina Castillo (interview with the author, Dec. 17, 1998).

tralized or that the strategy was free of problems. Along each step of the legislative way congressional foes sought to exclude key sectors such as mining and petroleum, which set the stage for a bruising fight over the privatization of Petroperu during the 1995 presidential campaign. This, in turn, helped to sour public opinion against the government's plan to sell off every last firm in its portfolio. Other problems, such as the challenge of raising sufficient funds to restructure the large number of SOEs that were in a semiliquid financial position, meant that potential buyers had to be guaranteed lucrative returns for some time to come. This made it all the more difficult to apply the kinds of antitrust criteria that typically prevail in the OECD countries: in the absence of a sufficient competitive policy to guide the process, the lack of transparency and solid financial information eased the way for new private owners to set above-market prices for public goods previously provided by the SOEs (e.g., transportation, electricity, telephones).[10]

Financial Reform

On the foreign front, financial reform meant completing the unfinished business of renegotiating Peru's outstanding debt and interest arrears with the multilaterals, the Paris Club, and the commercial banks. As a result of García's partial debt moratorium, Peru's debt had grown at an average annual rate of 6.8 percent between 1985 and 1989, as opposed to a 2 percent annual rate of increase for the rest of the region during this same period (Larrain and Sachs 1991, 228). Because the statutes of the IMF and the World Bank stipulated that no new credit could be obtained from these institutions by a country that had fallen into arrears on previous loans, policy makers began repairing Peru's damaged borrower status by negotiating with the IMF through its Rights Accumulation Program (Boloña 1996, 216). It took Fujimori's entire first term to restore Peru's good standing with the multilaterals. This, plus the reinstallation of democratic political procedures by 1995, then paved the way for the renegotiation of Peru's Paris Club debt in 1996 and the rescheduling of some US$10.6 billion in arrears and interest on the country's commercial debt under a Brady deal in 1997.

The remainder of the financial reforms involved a complete redefinition of

10. In March 1993 the National Institute for the Defense of Competition and Protection of Intellectual Property (INDECOPI) officially opened its doors for business. INDECOPI functions as an umbrella agency that oversees intellectual-property protection, consumer rights, the elimination of barriers to entry, and antitrust matters. Given the magnitude of these tasks, it was decided at the outset that INDECOPI would establish ex-post rather than ex-ante controls on economic activity (Beatriz Boza, INDECOPI director, interview with the author, Dec. 8, 1998, Lima). In the aftermath of privatization, some have questioned the efficacy of this ex-post approach (Barak 2000).

the government's presence in this sector (Paredes 1991, 314; Kisic 1998, 48). A new legal framework was written that simplified the rules of the domestic financial system and deregulated financial markets (e.g., the lowering of marginal-reserve requirements, the liberalization of interest rates, and a reduction of the tax on debits). At the same time, the capital account of the balance of payments was liberalized, and this included the opening of the banking system to foreign interests and the freeing of foreign-exchange transactions. These measures, along with the launching of the privatization program and the Foreign Investment Promotion Act of 1991, contributed to the development of the Lima stock exchange.[11] Having long been hampered by poor transparency and a burdensome regulatory backdrop, the combined effects of financial-sector reform helped to increase the capitalization of the Lima stock exchange from just US$800 million in 1990 to US$19.5 billion in 1997 (Manzetti 1999, 275).

Social Compensation

As noted earlier, the social fallout from the García period was a welfare deficit that had exploded into crisis proportions. The unmet basic needs of the population—including everything from food and housing to education and health care—were such that 55 percent of all households had fallen beneath the poverty line by 1991, compared to 38 percent in 1985 (Sheahan 1999, 108). Given that much of the violence over the preceding decade had been poverty-inspired, the multilaterals strongly encouraged the Fujimori administration to implement a safety-net scheme to help offset the burden of further adjustment.

After a first year of false starts, the president sidestepped the relevant line ministries that had long proved inadequate in delivering basic public goods and created the National Fund for Development and Social Compensation (FONCODES) in August 1991. Similar to compensatory social programs that had been implemented simultaneously with sweeping market reforms in Bolivia, Chile, and Mexico, FONCODES relied on a combination of traditional social-welfare relief and new demand-based criteria requiring that communities generate specific proposals for assistance (Graham 1994). Through FONCODES the administration targeted desperately needed compensatory resources toward poor communities; the bulk of these went toward economic infrastructure (road maintenance projects, irrigation, deforesta-

11. Under the new FDI regime, foreigners were allowed to invest in Peru and to repatriate profits and capital equipment as they saw fit. Additional legislation was passed that protected all investors, domestic and foreign, from sudden changes in existing laws and that established procedures for the resolution of disputes over investment (Manzetti 1999, 251).

tion) and social infrastructure (health facilities, schools, basic housing).[12] As with the other safety-net schemes being implemented in Latin America at this time, FONCODES was designed to temporarily alleviate poverty and to provide some political breathing space for sustaining market adjustment. With FONCODES's per capita expenditure averaging just US$12 from 1991 to 1994 (Graham and Kane 1998, 86), the program was never meant to resolve longstanding structural inequities in Peru.

Fujimori's simultaneous accomplishment of two main goals, increased political capital and short-term poverty relief, came through clearly in the process of implementing FONCODES. Especially after the 1993 constitutional referendum, where the president lost in all departments outside of Lima, FONCODES became a main venue for channeling public resources to those regional districts where the government had fared particularly poorly at the polls. As many of these districts had long been neglected by the central government, one result of the president's politically driven allocation of social resources was the direction of scarce funds to regions with extremely weak social indicators. This image of greater inclusion at the local level was bolstered by an overall increase in social expenditures, from 16 percent of government spending in 1990 to 40 percent in 1995 (Sheahan 1999, 125). This, in turn, helped deliver Fujimori's victory in all but one regional department (Loreto) in the 1995 presidential election. However, this fortuitous mix of politics and temporary social relief also distracted from the need to formulate a cohesive long-term strategy for poverty reduction and income distribution in Peru.[13] By 1994, 48 percent of the population was still living below the poverty line (Sheahan 1999, 108), and "for the average household, 1997 incomes were lower than those of 1975" (Webb 2000, 280).

Perhaps the most innovative social policy under Fujimori was the Citizen Participation Program, which sought to increase the participation of low-income groups, especially from the provinces, in the privatization program. Modeled after similar efforts in Bolivia and Chile, and run out of COPRI, Peru's Citizen Participation Program was authorized to sell 20 percent of all state assets. Purchasable shares could be bought in three-year installments during which the government guaranteed the price (Graham 1998, 124–34). The program showed that, when offered the chance to make even a small investment as shareholders, low-income groups responded enthusiastically. Beginning in late 1994 shares were sold, for example, in the state-owned cement company and subsequently in two electric firms and in the remaining

12. This information derives from various issues of "FONCODES: Nota Mensual."

13. For example, Fujimori focused on visible projects like school buildings rather then on core institutions, such as the education system itself, with obviously weak results.

portions of the telephone company that were still publicly held. While the very first auction of state shares in the cement firm was expected to last thirty days, more than three thousand bidders had purchased the available shares in a little less than four hours! However, as with FONCODES, the symbolic value of the Citizen Participation Program was much greater than the actual distributive impact (Manzetti 1999).

Reinventing the State

By definition, the sheer magnitude of market measures that had been introduced during Fujimori's first term implied a fundamental shift in the balance of public and private influence over the economy. Public activity, in particular, was restructured along three main institutional lines: the streamlining of the Peruvian state during the Fujimori era; the reconstruction and renovation of the country's main economic institutions; and the increased reliance on bureaucratic autonomy in the 1990s through the creation or overhaul of numerous state agencies involved in revenue collection, regulatory oversight, and the delivery of essential public services. Again, the underlying argument here is that, while laying the necessary groundwork for the impressive economic turnaround of the 1990s, the confinement of institutional reform to the state's internal organizations will not be a sufficient condition for sustaining sound economic performance. Rather, as the recent experiences of Argentina, Chile, and Mexico have shown, reform sustainability requires broader coalitional support and the strengthening of institutional ties between the state and those civic organizations that represent the ultimate stakeholders in the reform process.

The Streamlining of the Peruvian State

In Peru, "streamlining" has entailed both a haphazard retrenchment of the public sector, which began under García's watch, and a more purposeful restructuring of the Peruvian state after 1990 as fiscal reforms and the privatization program were launched. On the side of haphazard cuts was the steep compression of public spending from a peak of US$1,059 per capita in 1975 to just US$178 by 1990, a decline of 83 percent (Webb 1991, 2–3). Between 1987 and 1990 the public payroll shrunk by 75 percent, but the burden of adjustment fell mainly on real wages as very little workforce downsizing actually occurred (see table 16).[14] More than ever before, the public sector offered

14. Table 16 shows that public employment stood at 752,688 in 1998, whereas the 1990 figures were basically the same.

TABLE 16. Outline of Peru's Nonfinancial Public Sector: 1998

	No. of Entities	Expenditures		Remuneration		Employees		Average Remuneration	
		S/.billions	%	S/.billions	%	Number	%	S/.000	Index
Nonexcutive branches of government									
Constitutional agencies outside the executive	9	814	2	339	4	10,682	1	31.7	252
Executive of the central government									
Central government: 16 ministries and Council of Ministers	17	19,191	47	4,337	46	333,928	44	13.0	103
Decentralized institutions	63	4,210	10	207	2	11,378	2	18.2	145
National universities	28	937	2	356	4	31,092	4	11.5	91
Regional governments (CTARs)	23	3,662	9	2,113	22	301,663	40	7.0	56
Regional bodies (FONAFE)	10	1,043	3	501	5	6,512	1	76.9	612
ESSALUD Health/Social Sec. (FONAFE)	1	2,543	6	760	8	30,177	4	25.2	200
Revenue-generating entities (FONAFE)	78	8,152	20	847	9	27,256	4	31.1	247
Municipalities									
Provincial municipalities	192								
District municipalities	1,825								
Total (excluding municipalities)	229	40,551	99[a]	9,459	100	752,688	100	12.6	100

Source: Ministry of Economy and Finance, Lima.
[a]Rounding errors.

de facto employment relief for a rapidly shrinking middle and lower-middle class. In the meantime, the state's capacity to supply the most basic public services was drastically reduced. Nowhere was this more apparent than within the SOE sector, which on the eve of the privatization drive was running an astonishing US$2.5 billion in annual losses (Manzetti 1999, 248).

Obviously, the more purposeful effort at streamlining in the early 1990s would require the rationalization of the public sector but also the revival of the state's ability to provide an acceptable level of public goods. On the side of rationalization, the greatest strides were made with the SOEs, where close to half of the state's assets had been sold by 1998 (Manzetti 1999, 262–64). Similarly, a handful of state development banks were either sold or closed down, as was the Foreign Trade Institute and the National Planning Institute—the very symbol of populism in Peru. Despite the announcement of further cuts in public-sector employment and the intention to overhaul the central government ministries (Boloña 1996), these other aspects of streamlining never took off. In 1996 the government did propose a new "Program to Modernize the Public Administration," to be run out of the MEF, which ostensibly would have tackled these tasks. Yet in the end the president was not willing to expend the political capital that would be required to simultaneously downsize and reform the public bureaucracy.[15] The program died in less than a year.

Although the SOE workforce was cut from 140,000 to 50,000 between 1991 and 1994 (Manzetti 1999, 262), table 16 shows that over the course of the decade total public-sector employment held steady as hiring at the regional level offset central government layoffs. Likewise, the organizational contours of the central government had changed very little from the structure laid down post-1968. Some minor reforms were initiated, such as the merging of the Ministry of Housing and Construction with the Ministry of Transportation and Communications (Boloña 1996, 243), and the Ministry of Energy and Mines was overhauled, downsized, and made more efficient. In addition, the Ministry of the Presidency was revamped into a super-ministry in 1992, along with the Ministry of Economy and Finance. Throughout the 1990s, these two ministries, plus the Ministry of Defense, accounted for the mainstay of central government expenditures.

A second overriding change was the cultivation of numerous enclave or autonomous agencies involved mainly in revenue generation, service delivery, and regulatory oversight. These public entities stand apart from the

15. Leonie Roca and Rosa María Palacios, interview with the author, Dec. 17, 1998, Lima. Roca and Palacios are two consultants who worked on the Program to Modernize the Public Administration before Fujimori canceled it in 1997.

national budget and are instead financed through a separate fund (FONAFE) located within the MEF that the agencies themselves generate through user fees and other service charges. As table 17 shows, these FONAFE-financed entities staff far fewer employees, and the average remuneration is two to six times higher than the salaries paid by the central government ministries. It should come as no surprise, then, that this leaner and more modernized strand of the Peruvian state has been associated with highly professional service delivery in the 1990s (consumer protection, revenue collection, market regulation), while the services provided by the traditional line ministries (education, health, infrastructure) continue to lag far behind.

The Renovation of State Economic Institutions

As seen in the previous chapter, Peru's two main economic institutions, the BCRP and the MEF, had become mere shells of their former selves by 1990. The BCRP had lost all credibility, most obviously because of its failure to fight off hyperinflation but also because the García administration had rotated the bank's supposedly autonomous directorship four times in five years. Once Fujimori and his advisors had made the decision to attack hyperinflation by launching a market-shock program, the renovation of these two key economic policy–making entities quickly became an essential part of this effort. Overall, Peru's public administration suffered from four main shortcomings when the Fujimori team was handed the reins of government, and these two institutions were no exception.[16]

First, the very structure of government, in terms of the degree of centralization, autonomy, and the functions performed across agencies, was completely unproductive and inefficient. Second, there was little financial accountability with regard to how public resources were dispersed and few checks to discourage the diversion of state funds for illicit use. Third, personnel policies worked against the modernization of the public sector, as salaries were far too low to retain employees with the proper skills and civil-service tenure offered few incentives for improved worker performance or career advancement. And fourth, there were no mechanisms to deter officials from engaging in arbitrary or capricious behavior and few significant consequences when they did. From the analysis thus far it is clear that the Fujimori administration's track record in addressing these shortcomings was selective and uneven. But the BCRP and MEF were overhauled in ways that directly addressed these weak spots.

16. I borrow here from Keefer 1995 and Shepherd 2000. See both for greater detail on Peru's public administration.

TABLE 17. Peru's Autonomous Agencies: A Select Sample

Financial Oversight

Superintendency of Banking and Insurance (SBS): A preexisting financial oversight entity that exercises control over the banks and insurance companies, SBS was strengthened considerably during the early 1990s. Its director is nominated by the president and ratified by Congress for a five-year renewable term that coincides with that of the president. SBS is fully financed through state-mandated contributions from the banks and insurance companies, and its personnel policy has been placed under the private sector's legal regime.

Superintendency for the Administration of Private Pension Funds (SAFP): Created in 1992 as part of an overall effort to encourage citizen contributions to private pension funds, SAFP regulates those private entities that now manage pension funds in Peru. SAFP is a decentralized agency within the Ministry of Economy and Finance. The president chooses its director for a five-year term that coincides with that of the executive. The agency is self-financed through contributions from the private pension funds that it regulates, and private sector labor law governs its personnel policy.

Tax Administration

Superintendency for National Tax Administration (SUNAT): Although created in 1988 by the García administration, SUNAT has been completely modernized since 1991. SUNAT collects income and sales taxes and assists other public agencies in the collection of employment taxes. The president appoints its director, Congress approves its budget, and personnel policy is set by public sector criteria within the Ministry of Economy and Finance. SUNAT is self-financing, as the law authorizes it to draw on a fixed share of taxes (up to 2 percent) collected to cover all administrative and operating costs.

Superintendency for National Customs (SUNAD): Also created as part of the 1988 effort at tax reform, SUNAD has been similarly professionalized since 1991. As a customs agency, SUNAD is authorized to enforce tariff collection and to sanction illegal trade activity. It is a decentralized agency located in the Ministry of Economy and Finance. The latter nominates SUNAD's director, but the president has the final say in this matter. The agency is fully financed through the use of up to 3 percent of revenues collected for its own budget. SUNAD's personnel policy is governed by private sector labor law.

Miscellaneous Regulatory Bodies

National Institute for the Defense of Competition and the Protection of Intellectual Property (INDECOPI): Created in 1992, this is an omnibus regulatory agency with responsibilities ranging from the registration of intellectual property, to combating anticompetitive behavior, to enforcing newly defined norms of consumer protection. An especially innovative part of its mandate includes the adjudication of conflicts of interest through two different administrative review panels that operate apart from the judiciary system. A board of directors, an advisory council, and an internal control unit manage INDECOPI. It is an autonomous agency located within the Ministry of Industry, and the latter appoints the president of INDECOPI's board. INDECOPI is financed partly through its intellectual property rights registry and partly (about 20 percent) through the national budget. Its personnel are governed by the private sector's labor regime.

Supervisory Board for Private Investment in Telecommunications (OSPITEL): Created in 1994 with the objective of applying demonopolization guidelines and promoting market competi-

tion in the recently privatized telecommunications sector. OSPITEL reports to the office of the prime minister and is run by a six-member directive council, with each member serving a three-year term. All disputes are heard before quasi-judicial entities at two levels, with the second level offering the final decision. OSPITEL generates all of its operating budget through services charged to firms that fall under its supervision. Private sector labor law governs its personnel.

Other Independent Agencies

Commission for the Promotion of Private Investment (COPRI): Created in 1991 as an umbrella agency to manage the privatization of state assets. This has been done through the appointment of special expert subcommittees (CEPRIs) that implement the sale of particular companies to private bidders. COPRI reports directly to the president and is funded through its own proceeds from privatization.

Social Security Administration (ESSALUD): Established in 1999 to replace the Peruvian Social Security Institute (IPSS), ESSALUD administers Social Security funds. It is authorized to invest, enforce, and execute the collection of contributions; to formulate social security disbursement guidelines; and to develop disease prevention and other health related programs. ESSALUD is a decentralized entity under the Ministry of Labor and it generates 100 percent of its income through contributions and other nongovernmental sources.

National Fund for Compensation and Social Development (FONCODES): Created in 1991 with the stated objectives of generating employment, helping to alleviate poverty, and improving access to social services. Housed in the Ministry of the Presidency, FONCODES is a grant-making agency that responds directly to requests from local community groups for financing of small infrastructure projects (e.g., potable water, sewage treatment, school buildings). The fund is financed partly from international donors and from the ministry's own budget.

National Institute for Education and Health Infrastructure (INFES): A preexisting program that was revamped by the Fujimori administration in 1991 to address public infrastructure needs in education and health. As a decentralized agency within the Ministry of the Presidency, a five-member Directive Council that includes the president and the vice president of the Republic governs INFES. INFES generates its own income, and private sector law governs its personnel practices.

Source: Keefer 1995; Kim 1999.

With regard to the BCRP, important legal steps were taken to restore the bank's autonomy from domestic political intrusions and to reinforce its overriding mandate to preserve monetary stability (Velarde and Rodríguez 1998; Kim 1999). The 1993 constitution did retain the same seven-member board of directors (three appointed by congress and four by the executive, including the bank's president), as well as the stipulation that the BCRP president serve a five-year term parallel to that of the Peruvian executive. Although the recent historical record suggests that staggered terms between the Peruvian executive and the BCRP president would be more likely to promote central-bank autonomy, Fujimori saw this differently. Nevertheless, according to the new constitution, neither the BCRP president nor the board of directors can be removed at the whim of the executive, as this now requires a two-thirds congressional vote triggered by evidence that the parties concerned had failed to uphold the bank's monetary-policy mandate. Other important BCRP reforms concerned the establishment of a budgeting system separate from the national budget and the application of private-sector labor law to all BCRP personnel (Kim 1999).

The MEF was similarly strengthened in ways that supported the longer-run objective of carving out a new role for government as the facilitator of private initiative. As one of two "super-ministries," the MEF has been staffed with a highly qualified upper cadre of managers since 1991, and it has taken the lead in reforming public financial management in Peru (Shepherd 2000).[17] By 1997, a new budget-framework law was in place, which introduced programmatic spending and greater flexibility and transparency (Peru's national budget is now published on the Internet). A remaining challenge is for the MEF to take a stronger lead in expanding the scope and depth of reform throughout the line ministries. On this count, the MEF's failure to advance the aforementioned Program to Modernize the Public Administration is telling (Ugarte 2000, 421–27). The initial objectives of the program—to rationalize and professionalize the activities of the ministries, to deregulate administrative and procurement rules, and to introduce a performance-measurement system (Shepherd 2000, 6)—are every bit as relevant today as when they were proposed by the government in 1996.

The other designated super-ministry, the Ministry of the Presidency, had been created by the García administration in 1986 as a main venue for promoting miscellaneous APRA projects (e.g., Lima's electric train) and then deactivated as that party exited office in 1990 (Marcenaro 1996). The ministry

17. Although central government salaries, including those at the MEF, have remained low compared with those paid by the autonomous agencies, administrative talent has been retained at the MEF through multilateral financial assistance (e.g., the United Nations Development Programme) that supports a more competitive salary structure at the top.

was resurrected by legislative decree immediately following the 1992 civilian coup and went on to quickly capture around 23 percent of the central government budget by 1995 (Graham and Kane 1998, 85). With its revival, the ministry's formal objective was to promote a sweeping set of social programs in three functional areas: social development (health, food assistance), infrastructure (schools, housing, water purification), and regional development. Informally, it served as the much larger vehicle through which the president secured political support by channeling public resources to districts where voters had strayed.

It did not matter that each of these functional areas already occupied budget lines in various other central government ministries when the Ministry of the Presidency was brought back to life. Like his predecessor, Fujimori sought an institutional locus for an ambitious social program that he could personally take credit for at election time and for which there would be little budgetary oversight or procedural accountability. This he clearly found in the Ministry of the Presidency, which even Fujimori's most polite critics referred to as the president's own "mafia." However, this arrangement also worked to postpone debate over the urgent need for a longer-term social policy that would tackle inequality through improved access to much better quality education and healthcare services.[18]

Bureaucratic Autonomy

Ever since the political and economic meltdown of the 1960s, successive administrations in Peru have recognized the need to shield policy makers from undue populist and clientelistic pressures. Until 1990, this realization had been consistently manifested through the insulation of the executive and small elite-level working groups around the president. Except for a brief interlude during the early 1970s, insufficient effort has been made to nurture strategic sectors of the state bureaucracy to carry out executive policy preferences. This changed dramatically during the Fujimori era, as the degree to which autonomous public agencies were established and utilized effectively in Peru has perhaps been unparalleled in the region (Shepherd 2000, 5). The political impetus for this partial transformation of the public sector remains somewhat of a puzzle, particularly in light of Fujimori's avowedly anti-institutional stance on all other matters, not to mention the very half-hearted efforts that have surrounded the reform of the line ministries and bureaucracy at large.

18. This is the main theme of a powerful set of essays written by local social-policy analysts and published at the Universidad del Pacífico in Lima (see Portocarrero Súarez 2000).

The literature on bureaucratic delegation, which analyzes this phenomenon from the standpoint of both the OECD bloc and that of the developing countries, offers three insights with regard to this strong reliance on autonomous agencies in Peru.[19] First, this was the first civilian administration since 1963 that did not command a majority vote in the Peruvian congress. This is the opposite scenario from the one that awaited other civilian presidents who inherited similarly daunting reform challenges in the early 1990s, such as President Carlos Salinas in Mexico and President Carlos Menem in Argentina. As they were relatively secure about their support bases and tenure in office, the impulse of these other executives was to delay delegating authority to independent public entities such as central banks (Mexico) or regulatory boards (Argentina) for fear that such bureaucratic reforms would diminish their political control over the policy-making process. In contrast, Fujimori, with no real political party to call his own and no guarantee of a "natural" legislative coalition to back him in congress, pursued the autonomous-agency route as the only certain means for controlling his market-reform agenda.

A second insight from the literature concerns the recognition that market reforms will flounder in the absence of a proper institutional base. As Philip Keefer (1995, 25) has observed, the potential benefit of autonomy is "that it insulates agencies from the influence of different government entities that attempt to use their oversight capacity to distort agency decisions in favor of narrow interests. The agency is relieved of the burden to balance every technical decision against the parochial concerns of a multitude of entities with oversight responsibilities." In a very real sense, then, the cultivation of a cluster of autonomous agencies to act as the standard-bearer for implementing and sustaining market reforms became part and parcel of the reforms themselves.

A third insight on bureaucratic insulation concerns policy efficacy. As voters in Peru had virtually abandoned party affiliation and instead cast their ballots according to the government's ability to visibly improve the delivery of essential public services (Stokes 1997; Graham and Kane 1998), the more efficient outputs from autonomous agencies became a main factor in enhancing Fujimori's electoral prospects. In short, they enabled the president to vastly improve the productivity and efficiency of fiscal spending, while simultaneously attending to the needs of key constituencies. There was, however, a distinct downside to this new link between political survival and the development of autonomous public agencies in Peru.

19. See Boylan 2000 for an excellent review of this literature.

For example, in other bureaucratic settings autonomous entities have more commonly been used as the surest way to render policy reforms irreversible (Boylan 2000, 5–7). As such, they tend to be governed by commissions composed of public and private representatives who serve staggered terms and are appointed by congress (Evans 1995; Keefer 1995). This is not so in Peru, where autonomous agencies remain under the direct control of the president, who can hire and fire agency staff at will. Thus, although Fujimori delegated authority to these autonomous agencies as a means of guaranteeing the success of his own policy goals, he did it in such a way as to render them "relatively easy to create and easy to disable" (Shepherd 2000, 7). While tremendous strides have been made in the way of efficiency, transparency, and service delivery, the future viability of this autonomous-agency approach will depend heavily on the extent to which the agencies can be integrated into a broader legislative and managerial framework.

In sum, as table 17 shows, Peru's autonomous agencies can be roughly grouped into four categories: those that deal with financial regulation, those that handle tax administration, other miscellaneous regulatory bodies, and new independent agencies that relate directly to the goals of sustaining market reforms. Despite the diversity of these activities, the independent agencies share the mandate to manage economic change at the point of service delivery (Keefer 1995; Wilkins 1999). As such, they operate with varying degrees of managerial autonomy and are not held to the normal budgetary process through which line ministries obtain resources. In contrast with the central government ministries, these autonomous agencies are subject to clear performance requirements and bottom-line limits. At the end of the day, however, they are still under the president's direct control.

"Second-Phase" Reform, First-Phase Politics

By the end of Fujimori's first term the economic rules of the game had been radically transformed. In other words, a first generation of market reforms had basically been completed against a political-administrative backdrop that resonated with the management strategies adopted by other market reformers in the region during this time: "presidents and technocratic economic cabinets were able to design and implement changes in macroeconomic rules with relatively little interference from the rest of the political system or the public sector" (Naím 1994, 35). Having implemented a somewhat generic Washington Consensus program in the early 1990s, political leaders and policy makers in Latin America began to turn their attention to the consolidation

of these reforms from the mid-1990s on. While all market reformers faced continuing challenges in the areas of macroeconomic management, income distribution, and the modernization of state organizations, the more specific content of "second-phase" reforms varied according to a given country's political, social, and institutional legacies.

For example, by the mid-1990s one of Argentina's most pressing second-phase challenges was the deregulation of domestic labor markets, while in Mexico the 1994 peso crisis had driven home the urgent need for a sweeping reform of the banking sector (Pastor and Wise 1999a; Kessler 2000). For Brazil, the rationalization of fiscal policy had been delayed to the point where this was the main trigger in setting off a massive run on the exchange rate in January 1999 (Cardoso 2000). While the specific tasks may vary, they present quite similar challenges in terms of the complexities and difficulties of following through on second-phase reforms. This is the case because, first, the gains from the policies now required (civil-service reform, administration of justice) are much more subtle than the obvious benefits of macroeconomic stabilization, while the pain (downsizing, loss of power and access to patronage) is more concentrated. Second, apart from the need to involve a much larger chunk of the central government in the reform process, the implementation of this next round of reform requires debate and negotiation with those most affected. In other words, second-phase market reforms require a more inclusive and accountable style of politics.

For Peru, it was the failure to shift to a more open and participatory mode of politics that constituted the most glaring reform gap in the 1990s. Again, this contrasts with the political trajectory of those market reformers mentioned earlier, where the patterns of executive autonomy and bureaucratic insulation that characterized the implementation of market reforms have given way to much greater levels of political competition and accountability in the consolidation phase. This is certainly true in the cases of Argentina, Brazil, and Chile, as attested to in the outcome of national elections that took place during 1998–99 in all three countries; even in semiauthoritarian Mexico, the seventy-one-year political grip of the single-ruling PRI party was finally broken by the opposition's victory in the July 2000 presidential elections. There, as elsewhere, the combination of deep market restructuring and internal state reform laid the groundwork for a political opening that not even the power-hungry PRI could prevent. Following, I examine the ways in which state-society relations evolved under Fujimori's long tenure, with an eye toward identifying both the constraints and the possibilities for Peru's transition to the same competitive political mode that has taken root in other countries now in the midst of consolidating second-phase market reforms.

The Leadership Coalition

As the dust began to settle on the mass of market measures that had been implemented during Fujimori's first couple of years, it became apparent that the postreform leadership coalition looked nothing like the elite party-controlled cliques that had ruled the country from 1980 to 1990. While the executive's style of governing Peru continued in the same insulated and autocratic vein, his two main allies—domestic business and the military—had not sustained a presence within the upper echelons of government since the return to civilian rule in 1980. Hindsight shows that the role of each of these allies in the leadership coalition lent credibility to the Fujimori administration at the very moment when public confidence in national leaders had sunk to an all-time low. However, as the 1990s wore on, the president's focus on indefinitely prolonging his own incumbency helped tip the balance of power uncomfortably on the side of the military. Not only did this disproportionate influence of the military puncture any myths about the depth of Peru's democratic transition, but, just as importantly, the lack of accountability and proper legislative oversight did not bode well for the ability of the second Fujimori administration to advance another wave of necessary reforms.

How is it that an executive like Fujimori, with no mentionable ties to the business community at the outset of his presidency, was able to forge a viable partnership with the Peruvian private sector when all of the other attempts reviewed in this study had failed? This remarkable alliance must be understood from the standpoint of Fujimori's own pragmatism, as well as the institutional strengthening and internal reform that occurred within the Peruvian business community during the early 1990s. The trend toward modernization of key state agencies must also be factored in here, as this provided the private sector with unprecedented guarantees in the way of property rights and policy continuity. With regard to the president's role in this alliance, once the decision had been made to proceed with a market-shock program back in 1990, Fujimori quickly grasped the need to bring the domestic private sector on board. In contrast to Belaúnde's constant waffling on market measures, or García's highly erratic behavior when it came to spurring private initiative, Fujimori toed a steady line in the announcement and implementation of market reforms.

Whereas the 1990–92 congress had been put off by this managerial executive style, the private sector found some comfort in it. This is not to say that business was enamored with the entire program, but the consistency and clarity of the new economic rules, and the positive signals from higher growth and lower inflation, helped forge a viable working coalition.[20] Even before his

20. Arturo Woodman, former CONFIEP president, interview with the author, July 18, 1995, Lima.

inauguration in 1990, Fujimori began meeting with representatives from CONFIEP, the private sector's umbrella organization, and during his tenure as president he gave the closing speech at the annual conferences of CONFIEP and CADE—the yearly meeting of business executives (Durand 1998, 270–72). Through the course of the 1990s, the president also appointed prominent business leaders to direct FONCODES and to key ministerial posts—for example, at the Ministry of Economics and Finance, the Ministry of Industry, and the Ministry of Foreign Affairs. The Fujimori team was also able to move past the collective-action gridlock that had long plagued government-business relations by offering some compensatory relief (labor-market flexibilization, lower taxes, political access) to domestic entrepreneurs.

For the private sector's part, domestic business had come a very long way from the days when bank owners chained themselves to their desks in protest of García's 1987 attempt to nationalize the country's financial institutions. This, in fact, turned out to be a catalyzing moment for CONFIEP, as it marked the point at which a highly heterogeneous set of domestic business interests began to set aside their differences and unite to become a peak organization proper. Since the García fiasco, CONFIEP has attracted generous external support to the tune of US$2 million annually from the U.S. Agency for International Development (USAID) and the multilaterals, which over the years has financed office space, support staff, conferences, publications, and even a business think tank (IPE).[21] As part of this process, CONFIEP realized the need to bring small businesses into its fold, as this sector generates the bulk of employment and constitutes by far the largest group of firms in Peru. Thus, the Confederation of Small Businesses (CONAMYPE) was formed and officially incorporated into CONFIEP in 1995 (Durand 1998, 268).

As for the military's strong presence in Fujimori's leadership coalition, up until late 1992 the military's high profile in national politics could perhaps be justified by the demands of quelling a long-running guerrilla insurgency and an explosion in drug trafficking (Elena Alvarez 1998, 123–24). But the president's continued reliance on military advisors like Montesinos and Hermoza Ríos for the remainder of the decade was a reflection of both his own unease with the give and take of competitive politics and the utter opportunism of those advising him. Once the guerrilla insurgencies and narcotics trade had been deftly brought under control, both Montesinos and Hermoza Ríos were there for the president at each subsequent critical juncture: the precoup battles with congress and the 1992 coup itself; the president's 1995 reelection

21. José Valderráma, IPE director, interview with the author, Dec. 18, 1998, Lima.

campaign; Peru's 1995–98 border conflict with Ecuador; the resolution of the 1996–97 hostage crisis at the Japanese embassy in Lima; and the prompt response to renewed damage from floods caused by El Niño in 1998.

Yet the flip side of this "loyalty" to the president was the increased politicization of the Peruvian military under Joint Chief Commander Hermoza Ríos, with SIN director Montesinos pulling most of the strings behind the scenes. The president had issued a new military law in November 1991 that eliminated the time-honored system of merit-based promotion and rotating appointments that had earned the Peruvian armed forces a reputation as one of the region's more professional military institutions. It was this new perverse system of incentives and disincentives that prompted a failed coup attempt against Fujimori in November 1992. As the 1990s wore on, those military personnel who displayed loyalty to the Fujimori-Montesinos–Hermoza Ríos triumvirate were rewarded with job security, promotions, and pay raises. Those who did not fell prey to threats of dismissal and blackmail, based on wiretaps and other forms of information gathering by Montesinos. The success of Montesinos and Hermoza Ríos in militarizing Peru's civilian regime once again put the country at odds with the rest of the region (Hunter 1997). Ultimately, these unsavory allies would prove to be Fujimori's undoing.

The Intermediation of Societal Interests

Throughout this study, the intermediation of societal interests in Peru has been discussed along two axes—the state-capital-labor axis and the party-congress-executive axis. On the first count, except for the military's anomalous presence in too many facets of everyday life, interest intermediation in the Peru of the 1990s has conformed to a regional trend. Like other elected leaders in Latin America, Fujimori constructed the kinds of state-capital alliances that are essential for signaling a serious commitment to private initiative. At the same time, the president and his advisors offered a sophisticated mix of incentives and compensatory schemes to those who were essential for sustaining market reforms (the private sector) and to those who were key to Fujimori's survival in office (the mass base of popular-sector constituents throughout the country who carried the president to victory in all three national elections after 1990).

The indisputable loser along this axis was labor, both organized and otherwise. In Peru and in the region at large, the combination of a prolonged period of economic restructuring, company downsizing under privatization, and labor-market deregulation has taken the wind out of the unions' sails. Furthermore, like García, Fujimori focused state resources and political

attention on the disorganized and poorest segments of the workforce and thereby cultivated a vertical relationship between the executive and the most marginalized sectors of the working population. Against this backdrop, after peaking in 1978, union activity and influence in Peru accounted for just 13 percent of private-sector workers in 1995 (Thomas 1998, 163). Peru having gone from being one of the most regulated Latin American labor markets in 1990 to being one of the most liberalized by 1995 (Burki and Perry 1997, 40–41), this rapid transformation has thus far meant a proliferation of temporary contract work and an urban unemployment rate of close to 9 percent between 1990 and 1999. When the continuingly high levels of informal work and underemployment are factored in, economic uncertainty and fears of job loss have also hampered the formation of those horizontal organizational ties that characterized Peruvian labor during its heyday in the late 1970s.

Although Peru fits the regional mold in terms of interest intermediation along the state-capital-labor axis in the 1990s, the same obviously cannot be said of the relationship among political parties, congress, and the executive. The inability of political parties in Peru to revive themselves and reform from within, or to forge a viable horizontal coalition of the kind that eventually unseated General Pinochet in Chile, is confirmed by the paltry percentage of votes that the standing parties captured during every election in the 1990s. By the time of the 1995 presidential election the three traditional parties (the APRA, the AP, and the PPC) together captured less than 13 percent of the total vote. This reflects the public's disgust with the abysmal performance of all three parties during their time in elected office in the 1980s, but the decline of traditional political parties in Peru also has to do with the adherence to a majority-runoff electoral format for the first time in 1990 and to the design of further rules under the CCD that complicated an electoral system that was already far too complex.

Matthew Shugart and John Carey (1992) have argued that, in contrast to plurality elections as in the United States, majority-runoff systems offer low barriers to entry and hence tend to generate larger candidate lists with much higher levels of uncertainty.[22] Peru's majority-runoff format also discourages alliance building and invites the rise of dark-horse candidates, Fujimori's ascendance being a case in point. Another deterrent to cohesive political brokering along the party-congress-executive axis was the decision of once-major parties like the APRA and the AP to boycott the 1992 elections for the CCD. At the time, potential opposition candidates for the CCD were understandably reacting to Fujimori's threat to require that CCD delegates sit out

22. For example, according to Peru's electoral law, any group wishing to field candidates in presidential or legislative races must obtain a minimum of just 120,000 signatures.

two full congressional terms before seeking reelection and to the president's plan to pare down the Peruvian congress into a unicameral body with 120 representatives elected under one single district (Maxwell Cameron 1997, 62–63). Hindsight shows that because these parties abstained from the CCD altogether, most of Fujimori's proposals prevailed while the traditional parties became all the more marginal.

The fact that the opposition parties never even tried to assert a presence in the CCD put them further at odds with a median voter who had emerged from the turmoil of the 1980s with a fierce sense of independence and antipathy toward traditional partisanship (Schmidt 1996; Tanaka 1998). Thus, the CCD marked the turning point where political organizing in Peru shifted toward large eclectic movements that coalesced around election time and then scattered until the next election (Cotler 1995, 349). Such was the case with Fujimori's Cambio 90 or the Union for Peru (UPP), which backed the losing presidential candidate and former U.N. secretary general Javier Peréz de Cuéllar in 1995. Geared almost entirely toward achieving electoral gains, and low on ideological or programmatic content, these movement coalitions were a far cry from demonstrating the internal discipline and institutional cohesion that now characterize political-party structures in countries like Argentina, Chile, and Mexico.

In sum, although the absence of authentic interest intermediation along the party-congress-executive axis is indisputable in the Peru of the 1990s, it is impossible to ignore the favorable economic returns over the past decade. These trends are contradictory, particularly in light of recent work that attributes successful instances of neoliberal reform in other emerging-market countries to the firmer grounding of such reforms along this very axis (Haggard and Kaufman 1995; Corrales 2000a). Similarly, the current thinking on political parties in Latin America implies that an inchoate or collapsed party system such as Peru's would be much less likely to succeed on the economic front (Mainwaring and Scully 1995, 22–23). This gap between political-economic theorizing and concrete outcomes has spawned a rich body of research on Peru in the 1990s, which has focused on two main questions: (1) what drives Peruvian politics in the era of market reform? and (2) what accounts for economic success, given that interest intermediation and policy formulation have circumvented the party-congress-executive axis since the advent of Fujimori?

Most of the literature to date offers society-based answers to these questions. Susan Stokes (1998), for example, analyzes public opinion as a proxy for the president's political support and the perceived success of market reforms. After voicing broad support for the president and his economic program even before it began to pay off, the public shifted from this "intertem-

poral" posture, based on the expectation of future prosperity, to a "normal economic voting" posture in which government support rose and fell more directly with the performance of the economy (Stokes 1998, 1). Yet the government's mediocre showing in the three elections held during 1992–93 showed that intertemporal responses to public-opinion polls do not always translate into votes. Because Peruvian respondents proved to be quite fickle during this period, others have emphasized the ways in which state resources have been strategically deployed as a way of winning back votes and tying the masses to an executive who has otherwise shunned the institutionalization of such ties (Graham and Kane 1998; Schady 2000).

Coined by some as "neoliberal populism" (Dresser 1991; Roberts 1995; Kay 1997)—the use of inclusive political gestures and targeted material rewards to smooth over the exclusive and regressive impact of neoliberal reforms on the population at large—this strategy definitely helped to extend Fujimori's incumbency beyond all expectations.[23] But precisely because of its shallow roots in civil society, and its failure to tackle the underlying structural roots of poverty and inequality, this neoliberal populist strategy seemed to have run its course by the end of the decade. Despite the continued channeling of generous state resources to those districts and regions where the president sought to lure voters into his camp, he was not able to avoid the lightning-bolt rise of opposition candidate Alejandro Toledo in the first runoff vote for the 2000 presidential elections. For fear that not enough votes could be bought, the president and his cronies resorted to the kinds of balloting fraud and dirty campaign tricks that Mexico's PRI party had long been famous for but that set new unseemly records in post-1980 Peru.[24]

Returning to the earlier questions, my answer is decidedly state-centered and meant to complement these societal explanations. I have argued throughout this chapter that the internal reform and modernization of those state agencies that are essential to the success of a market strategy constituted a necessary condition for sustaining economic reforms and for stabilizing politics. For the first time in the post–World War Two period, at least some quarters of the Peruvian state could be taken seriously. The private sector responded in kind and forged the closest thing to a government-business pact that the country had yet seen (Durand 1998). For better or for worse, a coali-

23. As Bruce Kay (1997, 56) notes: "Fujipopulism seems to depend on executive philanthropy bankrolled by a liberal state. . . . [I]t is anti-elitist and anti-ideological in its orientation, multi-class in its composition, autocratic in its style of management. . . . [It] bypasses, and weakens, intermediary institutions and creates new institutions that permit the president to establish a direct, personalistic relationship with the masses."

24. Clifford Kraus, "Peruvian's Lead in Vote Prompts Charge of Fraud," *New York Times,* Apr. 11, 2000, A1.

tion composed of the state, domestic capital, and the military provided the stability needed to restructure the economy along market lines. But the exhaustion of first-phase market reforms by the mid-1990s, and the contagion from massive external shocks in Asia, Russia, and Brazil from 1997 to 1999, again highlighted the fact that state renovation and stable leadership are necessary but not entirely sufficient conditions for coping with new economic challenges.

Markets without Politics

It was the quest for political stability and continuity in economic policy that enabled the president and his backers to amend the rules surrounding reelection in 1995 and to neutralize political conflict over that decision. Similar concerns had underpinned constitutional amendments to allow for the reelection of the executive to a second consecutive term in Argentina and Brazil in the mid-1990s. Like Fujimori, President Menem of Argentina had also sought to further bend constitutional rules in order to run for a third term. However, it was Menem's own party that reined him in on the grounds that, within a democracy, such fundamental rules as those surrounding presidential succession should not be up for periodic renegotiation.[25] In Peru, obviously, there were no such reliability checks to deter the executive from almost single-handedly reinterpreting these same rules. Even apart from the highly questionable legal justification for a third term, there were at least two other reasons why an extension of Fujimori's stay in office was not in the country's best interests.

First, little that was new had actually been accomplished in the way of deepening market reforms during his second term. As reelection in 1995 afforded Fujimori a much longer time horizon on his tenure in office, the president's appetite for further reform was visibly curbed (Durand and Thorp 1998; Boylan 2000). As a result, privatization slowed considerably, exports were still lackluster and too dependent on raw materials (fish meal, mining, and services related to the processing of primary goods), and social policy had yet to reach sufficiently beyond the executive's concern for political survival and hence his doling out of immediate adjustment relief. Second, the prospect of a third term predictably provoked broad opposition (national opinion polls showed that nearly 70 percent of Peruvians felt that it was time for the president to move on); this prompted Fujimori and his congressional allies to exert their will through direct intervention in the country's legal and

25. Senator Augusto Alasino, leader of the Peronist Party in the Argentine Senate during Menen's second term, interview with the author, May 8, 1998, Buenos Aires.

judicial apparatus. The parties always at odds, the relationship between the country's democratic transition and Fujimori's prolonged incumbency became even more conflictual.

Done in the name of maintaining political stability, the executive's rash legal interventions ultimately provoked a series of political crises (Tanaka, forthcoming, 2003). For example, when the equivalent of Peru's supreme court ruled that a third consecutive term was unconstitutional, congress quickly dismissed the dissenting justices.[26] Various civic organizations then mobilized and gathered 1.2 million signatures in support of a referendum on the matter, only to have congress fabricate a package of questionable laws that killed the referendum. In the period leading up to the 2000 presidential elections, the judicial system, and in particular the main electoral agencies that fell under its jurisdiction (the National Elections Board, the National Registry for Voters, and the National Office for Electoral Procedures), had all been tampered with in ways that favored Fujimori's reelection. Any critical voices within the media were subjected to constant surveillance and harassment by Fujimori's foot soldiers within the SIN.

The 2000 presidential election was a grand finale of sorts, at least in terms of Fujimori's efforts to project a technical, apolitical image in what turned out to be a quintessential show of dirty politics. Whereas debates over second-phase policies regarding such issues as education, health, and the administration of justice had dominated presidential elections in other Latin American countries in the late 1990s, Peru's 2000 contest was notable not for serious debate but for the procedural infractions and venomous attacks that emanated from the Fujimori camp. Like opposition candidates in Argentina, Chile, and Mexico, Peru's leading opposition candidate, Alejandro Toledo, vowed to uphold and strengthen the market program now in place, while also tackling the distributional problems associated with it. Toledo also promised to advance political reforms that would set the country firmly back on a democratic trajectory.[27] Not surprisingly, public-opinion polls in Peru had shown for some time that these were the issues that most concerned the electorate.

But the tone of the election quickly fastened onto the ethnic and racial themes—"El Chino" Fujimori versus "El Cholo" Toledo—that had been so crucial in sinking the candidacies of European-style elites like Vargas Llosa and Peréz de Cuéllar. The difference this time, however, was that there was no front-running *criollo* candidate for Fujimori to scapegoat. Rather, the Stan-

26. See Coletta Youngers, "Fujimori's Relentless Pursuit of Re-election," *NACLA: Report on the Americas,* Jan./Feb. 2000, 6–10.

27. Campaign speech by Alejandro Toledo, sponsored by the Inter-American Dialogue and the Brookings Institution, Washington, D.C., Apr. 28, 2000.

ford-educated Toledo infused the race with an Andean ethnic identity and a Horatio Alger–like rise from poverty that topped Fujimori's own image of the struggling Japanese immigrant. Fujimori's dark-horse victory of 1990 also overshadowed any serious debate, as it appeared that Peru's majority-runoff system could again wreak unexpected havoc, this time on the president himself. Indeed, not only did Toledo place second to Fujimori in the first round of voting on April 9 and therefore force a runoff race, but the opinion polls showed that the two would run a virtual dead heat in the second round of voting.

The first-round election had been wrought with accusations of government-sponsored fraud and therefore met with the same international disapproval and threats of sanctions that the 1992 coup had provoked. As the Fujimori administration refused to guarantee a fair and clean runoff race, Toledo bowed out of the second-round election, vowing to reenter only when the electoral playing field had been cleared of all irregularities. In the end, the second-round vote was held on May 28, but Fujimori took just 51 percent of the vote and, after failing to secure a majority bloc in congress, managed to cobble together different independent factions to back him in the legislature. The fact that voters had invalidated 30 percent of the ballots cast in the second-round runoff election left few doubts concerning the lack of legitimacy for a ruling coalition that had served its political and economic purposes but simply refused to rotate out in democratic fashion.

As it turned out, just as international actors and local opposition forces in Peru seemed to have resigned themselves to a third Fujimori term, in September 2000 the president suddenly announced that new elections would be held and that he would not be a candidate. Despite steady demands at home and abroad—for everything from the reinstatement of the constitutional tribunal to the firing of Montesinos—it appears that the impetus for Fujimori's announced withdrawal was mainly an internal crisis. The triggering event was a videotape that fell mysteriously into the hands of the political opposition and that showed Montesinos blatantly bribing a newly elected member of congress to switch his party affiliation over to the legislative coalition that backed Fujimori.[28] This prompted the president to dissolve the SIN and request the resignation of his treacherous security chief and right-hand advisor. Not surprisingly, the military split ranks, with Montesinos and his backers mustering enough incriminating evidence to bring Fujimori down with them but not enough power to invoke a full-fledged military coup.

By November 2000 Fujimori had faxed his resignation to the Peruvian

28. David Gonzalez, "Peru Spymaster Stays Out of View as Rumors Swirl," *New York Times,* Sept. 18, 2000, A1.

people from Japan, where he had secured political asylum, and Montesinos had literally gone underground. Congressional president Valentín Paniagua, a former justice minister under the first Belaúnde administration, stepped in as president of a transitional government, and a new set of national elections were scheduled for April 2001. Earlier, I argued that Peru's most glaring second-phase reform gap had been the failure to shift to a more open and participatory mode of politics. And now, almost uncannily, domestic actors were given a second chance to seize this political opportunity structure. In just eight months, Paniagua's transition cabinet proved how much could be accomplished when politicians and policy makers truly committed themselves to rebuilding Peru's public institutions and to governing by consensus according to the preestablished constitutional rules.[29]

As interim president, Paniagua recruited top-notch advisors from quite diverse political backgrounds, all of whom voluntarily refrained from entering their names on the April 2001 ballot so as to focus steadfastly on the reforms at hand.[30] The most immediate tasks taken up by this interim team included purging the government of the thick web of corruption that had finally sent Fujimori and Montesinos into exile and the restoration of fair and competitive elections. On the first count, numerous investigations were launched with regard to allegations of the previous administration's involvement in widespread money laundering, drug trafficking, illicit enrichment, torture, and murder. The armed forces were also restructured, and those top officers who had violated the law were dismissed. At the same time, control over social expenditures was shifted away from the Ministry of the Presidency, and interim leaders introduced new mechanisms for consulting with civic organizations about reform strategies in such crucial areas as education, labor codes, and the country's institutions of justice.

On the second count, the main electoral authorities were completely overhauled, and the Paniagua government invited five international observer missions to oversee the April 2001 election. A quickly reformed National Elections Jury approved the registration petitions of nine presidential candidates for the April race, three of whom forged ahead to dominate the contest. Predictably, Alejandro Toledo took the lead as the candidate who had fought the hardest for the restoration of democratic norms. To the political right of

29. Steven Levitsky and Cynthia Sanborn, "A Hard Choice in Peru," *New York Times,* May 9, 2001, A31.

30. For example, Diego García Sayán, one of the country's most prestigious civil-rights lawyers, stepped in as justice minister, and former U.N. secretary general Javier Peréz de Cuéllar took over as prime minister. Equally important, a top academic expert in electoral politics was appointed to direct the highly tainted National Office for Electoral Procedures.

Toledo emerged Congresswoman Lourdes Flores Nano, backed by a coalition composed of remnants of the PPC, some Fujimori defectors, and the Catholic church. From the left-wing flanks sprang another flash candidate in the form of the APRA's Alan García, who had returned from nearly a decade of self-imposed exile just weeks before the election. With the Peruvian courts having ruled that earlier charges of corruption and human-rights abuses against García had expired under the country's statute of limitations, Peru's former president and longstanding persona non grata surged virtually out of nowhere to edge out Flores Nano and capture second place after Toledo in the first-round vote.

Three main themes dominated the first- and second-round elections in April and June 2001—both considered the cleanest the country had yet to sponsor. The first was the vehement anti-Fujimori sentiment, fueled by a steady stream of corruption scandals that were now erupting daily in the media. While the track record confirms that the country had benefited overall from the deep market reforms that had been implemented in the 1990s, the costs of economic restructuring and the lack of sufficient social supports were still keenly felt. This, plus revelations of multimillion-dollar foreign bank accounts and hidden assets that kept cropping up in relation to the Fujimori-Montesinos government, understandably incensed voters. While Montesinos was finally apprehended in Venezuela in June 2001 and incarcerated in Lima to face some 140 different criminal charges, Fujimori continued to lead the good life in Japan protected by that country's political asylum law.[31]

A second theme was the personal mudslinging that went on among all three candidates and that no doubt cut into Toledo's margin of victory. Whereas the election had been Toledo's to lose when Fujimori resigned, he ultimately won the June 2001 runoff with just 52 percent of the valid votes cast, compared to García's truly remarkable comeback at 47 percent.[32] But at least 13 percent of all vote casts were blank, as voters punished the candidates for their irresponsible antics. The shrill banter surely sunk the first-round candidacy of Flores Nano, who, despite being favored by the United States and endorsed by a group of former Latin American Christian Democratic heads of state, had failed to distinguish herself sufficiently from the incumbent Fujimori bloc in congress and therefore could not withstand the hostile anti-Fujimori attacks waged against her. The completely unpredictable emergence of García as a candidate proper was similarly related to the electorate's

31. Scott Wilson, "The Stakeout That Snared a Spy," *Washington Post,* June 26, 2001, A1; Calvin Sims, "Fujimori Is Wined and Dined by Tokyo's Powerful," *New York Times,* June 28, 2001, A3.

32. Sebastian Rotella, "Peru's Victor: Happy, but Anxious," *Los Angeles Times,* June 5, 2001, A1.

antipathy toward Fujimori. However, García's ability to rebound from having just an 8 percent approval rating in preelection polls to actually capturing 47 percent of the second-round vote confirmed that he had not lost his touch as a consummate politician. By apologizing to voters for his past errors and casting himself as a reconstructed market-friendly democrat, García was able to remobilize a dormant APRA base and compensate for the negative campaigning in ways that eluded Flores Nano and Toledo.

Finally, following at a distant third was the campaign theme that most concerned Peruvian voters: the kinds of second-phase policies that would better promote sustainable growth and more broadly distribute the benefits of economic reform. While both García and Toledo offered up proposals that were variations on this theme, the latter more firmly committed to the continuation of the ongoing market strategy but in ways that more aggressively addressed its shortcomings to date. More than once during the campaign García sent jitters through regional markets with his proposals to cap utility prices, limit Peru's debt payments, and expand employment through state support in sectors like construction and agriculture.[33] Again, Toledo's inability to steer the campaign away from his own personal peccadilloes and sustain a much higher-level debate about concrete policy options was costly in that he assumed the presidency with a much weaker electoral mandate than had been widely expected. However, the return of competitive politics and the momentum established by the interim Paniagua government certainly placed the entire reform trajectory on much more optimistic footing than the previous option of waiting another five years to breathe new life into the political economy.

Markets without Planning

In spite of these extraordinary political machinations, the Peruvian economy showed strong signs of recovery by mid-2000. It appeared that Peru had finally crossed a major threshold in the sense that sound performance and professional management practices were more credibly grounded in the country's main economic institutions. This was reflected in the response of the external sector, as capital flows and interest-rate spreads remained favorable to Peru and as multiyear lending agreements went forward with the IMF, the IDB, the World Bank, and the Andean Development Corporation. Negotiations were also on track with a German consortium for the construction of a new US$1.2 billion international airport in Lima, and a previously stalled US$3 billion transportation and distribution contract for the Camisea gas project in the south of the country was brought back to life. However, Fuji-

33. James Wilson, "Overcoming Fujimori's Shadow," *Latin Finance*, May 2001, 34.

mori's ratings in national public-opinion polls lagged right up until his resignation, despite this more favorable economic news (Schmidt 2000).[34]

The normal economic voting posture described by Stokes (1998) seemed to have run its course by 2000, which could be partially explained by the self-inflicted political shocks described earlier. But a widening gap between macroeconomic dynamism and microeconomic stress had also shaped Peruvian public opinion in ways not well captured by either the normal economic voting or the intertemporal model. According to the latter, economic recovery in the early 1990s had met with a pessimistic response on the part of the population, as higher growth and real wage increases called up painful memories of hyperinflation. Ironically, in the first stage of market reform, pessimism concerning present performance correlated with optimism about the future (Stokes 1996b). Yet, a decade later, the future had arrived, and the gains from market reform still eluded the majority of Peruvians. Household surveys showed that in the average Peruvian household, "income either stagnated or fell slightly between 1985 and 1997" (Webb 2000, 217).

In light of these figures, and given the increasingly cynical political backdrop, the president's lower approval rating in the midst of an economic recovery surely reflected a distributional response on the part of those who had yet to fully benefit from Peru's higher growth rates in the 1990s.[35] Again, it was similar distributional trends that prompted demands for second-phase reform in the other emerging-market countries discussed here and that ultimately helped to elect proreform political coalitions that sought to more aggressively bridge the distributional gap. In Peru, distributional demands were muted by authoritarian politics right up until the very end of Fujimori's tenure. In particular, it was the executive's tight control over social expenditures, which provided short-term relief to the poor but did little to tackle the underlying causes of inequality, that emerged as one of the few points of policy consensus among the leading candidates in the 2001 presidential election.

Across the region, the tenacity of these regressive distributional patterns flies in the face of neoliberal thinking, which holds that market reforms will expand the national pie and enable a wider segment of the population to gain access to this newly found wealth (Balassa, Bueno, Kuczynski, and Simonsen

34. Alfredo Thorne, "Presidential Elections Heat Up in Peru and Mexico," *Global Data Watch,* Banco de J. P. Morgan, S.A., Mar. 24, 2000, 8.

35. In an innovative study of social mobility in Peru from 1991 to 1996, Carol Graham (2000, 261) analyzes new panel data that show that nearly 38 percent of the respondents (N = 676) experienced either upward or downward mobility. Between 1991 and 1994, about 20 percent crossed above the poverty line, while about 8 percent dropped below it. But the 1994–96 figures were literally flat: of the 23 percent of respondents who crossed the poverty line, 11.4 percent rose above it and 11.4 percent sunk further into poverty. See Stokes 1997 for a compelling analysis of how such trends have fed back into voting patterns in Peru.

1986; Krueger 1990; Przeworski 1999). Recent research on Latin America's distributional shortcomings in the aftermath of market reforms offers two main explanations for this counterintuitive outcome. First, income inequality has lingered in the region because of the high levels of asset concentration—both productive and human-capital assets—that are still present in these economies (Baer and Maloney 1997; Birdsall and Londoño 1997). And second, the failure of liberalization and privatization to penetrate these entrenched dualistic structures is no longer seen as an adjustment lag but rather as an endogenous feature of market reforms that must be addressed through more assertive public policies (Sheahan 1997). In other words, the region's track record suggests that, over time, microeconomic adjustment will not occur solely at the hand of market forces.

Tellingly, both Fujimori terms passed without the generation of an integrated development plan that reflected the government's policy goals on this very question. Understandably, "planning" had been given a bad name by both the RGAF and the García debacle of the late 1980s; nevertheless, it is sobering to think that the Peruvian military was the only national institution to offer a longer-term vision for the country in the era of market reform, and this more than a decade ago in the form of the "Green Book."[36] The Fujimori administration had succeeded in attracting a higher level of professional expertise than any of the preceding administrations reviewed in this study, so the lack of an integrated development strategy that linked macro- and microeconomic goals into the medium term cannot be laid at the feet of technical incompetence. The failure to better harness the talent of this sophisticated policy segment surely had to do with the peculiar circumstances that led to the vetting of executive access by the likes of Montesinos and to the president's own discomfort with talented technocrats who might upstage him.[37] This situation is worlds apart from that in other emerging-market countries in the region, where executives have purposefully armed themselves with large, high-profile technical teams that have themselves come to signal reform credibility.

36. As a matter of planning by default, the national budget has served as a guideline of sorts, as have the periodic sectoral plans generated by the line ministries. However, Reynaldo Bringas, the director of the national budget at the MEF, admits that in the absence of a larger set of policy guidelines, MEF budgeted mainly according to "estimates" in the Fujimori era. Reynaldo Bringas, interview with the author, Dec. 10, 1998, Lima.

37. This explains Boloña's abrupt dismissal by Fujimori in January 1993 and his replacement by Jorge Camet, an elderly industrialist and former CONFIEP president who had none of Boloña's talent but did not compete with the president for the national spotlight (Bowen 2000, 170). If Boloña was the mastermind of the market-reform program, Camet was the caretaker (Durand 1998). This explains Camet's ability to survive an unprecedented six-year term as minister of economics, but even so, the president kept him on a short leash, offering Camet a series of six-month contracts during his entire tenure at the MEF!

In the final chapter I review the piecemeal steps that have been taken to infuse microeconomic dynamism into the Peruvian political economy and to attack inequality at its roots. In doing so I borrow from the experiences of other market reformers in the region to highlight the ways in which the Peruvian effort could be strengthened. Peru again finds itself at a very critical juncture. Wittingly or not, Fujimori and his small base of advisors reinvented the Peruvian state in ways that make it more capable of steering the economy onto a higher growth–higher productivity track, regardless of who occupies the executive office. To tinker with the impressive array of state agencies that appears in table 17 would be to derail these goals. Thus, the institutional incentives work in favor of executive action to insure the longevity of these agencies (Keefer 1995). While this was never Fujimori's style, the Toledo team would do well to carefully nurture these modernized pockets of the state. They are germane not only to the next administration's political success but also to the promotion of greater economic stability and more widely shared prosperity in the post-Fujimori era.

Conclusion

Up until 1990, the tendency in Peru had been for each successive administration that prevailed from 1963 on to hand over an even bigger bundle of political and economic problems than it had inherited upon taking office. The crisis of the late 1980s finally put an end to these delay tactics, as the combination of state collapse, hyperinflation, and civil war made it virtually impossible for politicians and policy makers to avoid implementing a long-overdue set of reforms. In hindsight, a maverick independent politician such as Fujimori may have seemed the least likely candidate of all to succeed in restructuring the economy along market lines and in reconstructing the Peruvian state. Yet the magnitude and longevity of the 1980s crisis, combined with Fujimori's own fortitude, created a unique set of opportunities for the initiation of sweeping political-economic change.

Already, Peru's transformation in the 1990s stands on par with that of the 1970s: just as the twelve-year nationalist military regime put a final end to the country's longstanding oligarchic class, Fujimori's decade in office marked the demise of traditional political parties controlled by ineffectual *criollo* elites. And as the RGAF had radically redrawn the lines between state and market in favor of the former, Fujimori reversed them just as radically in favor of the latter. While the tasks of fine-tuning Peru's market model in a more dynamic and distributive direction, and of deepening the process of democratic transition, have been left to Fujimori's successor, the country that emerged from the

decade of the 1990s is considerably different from the one that entered it. This is so both in regional terms and when Peru is assessed according to the macroeconomic and institutional variables laid out in chapter 1.

When compared with the rest of Latin America, Peru, as the data in this chapter confirm, has as its main reference point for measuring economic performance no longer an Andean bloc still struggling to implement market reforms but rather such emerging-market countries as Argentina, Chile, and Mexico. Furthermore, whereas the previously identified cluster of adverse trends related to state-led development (reckless borrowing, bloated SOEs, a fickle private sector, and regressive income distribution) were still fully intact at the outset of the first Fujimori administration, a decade later all but the distributional challenges had basically been resolved. With regard to institutional reform, the modernization of key entities like the BCRP and a handful of ministries (Economy and Finance, Energy and Mines, Industry and Commerce), as well as the renovation or creation of a range of highly professional and efficient autonomous agencies, has catapulted Peru into the ranks of the top ten developing countries on such competitiveness indicators as the quality of state management and public spending (Vial and Sachs 2000, 10–11).

There is, however, much more to political-economic success than the inroads just mentioned. While I have argued throughout this chapter that Peru's cup is now more than half full on the reform front, progress in eradicating poverty and bridging the distributional gap has not kept pace with the country's impressive growth and investment performance over the past decade. Peru is certainly not alone on this count, but regressive distributional trends have been exacerbated by the politicization of social spending and by the bias toward short-term adjustment relief at the expense of initiatives that target human-capital development over the longer term. These shortcomings in social policy are symptomatic of a larger problem, which is the failure to articulate an integrated trade-led development strategy geared toward the promotion of higher value-added exports, the expansion of local labor markets, and the strengthening of domestic firms. As Brazil, Chile, and Mexico have all ventured down this path, Peru's reticence stems not from a lack of technical expertise but rather from the concentration of economic policy making in an elite executive-level clique that prevents the kinds of policy debate and ideological flexibility that gave rise to more competitive development strategies in these other countries.

Numerous other institutional bottlenecks still need to be tackled. In this chapter I have argued that, of the four institutional variables identified at the outset of this study as most conducive to successful policy outcomes (bureaucratic autonomy, sound economic organizations, stable leadership, and cohesive ties between the state and civil society), Peru has made tremendous strides

at the level of internal state reform. Yet even here, there is a need to dig much deeper in overhauling the central government's line ministries, especially those that pertain directly to social-service delivery and human-capital development; and, if the autonomous agencies are to continue as the main anchors of market reform, they must be incorporated into the state apparatus in ways that make them accountable to more than just the whim of the executive.

Similarly, the unraveling from within of a decade-long leadership coalition composed of Fujimori, the military, and the business community now offers the recently elected democratic opposition a vital chance to stake out its leadership claims in a manner that is both more accountable and more inclusive. Although the outgoing coalition was patently successful in launching the first phase of market reforms in Peru, this same coalition emerged as the main bottleneck in the pursuit of second-phase market reforms. This was due to Fujimori's rejection of the kinds of interest intermediation and inclusive politics that underpinned the implementation of second-phase reforms—not to mention the transition to democracy—in other emerging-market countries in the region. At the very moment when Fujimori's leadership coalition became unstable, it collapsed amid a swirl of scandals involving bribery, blackmail, and trafficking in various illicit goods. The moral of the story appears to be that neopopulism, or the doling out of state largesse in ways that endear a leader to the masses without undermining market reforms, can take a politician like Fujimori far, but in the end, the country's disorganized mass of poor cannot save that leader from his own political excesses.

As the Toledo administration seeks to carve out a new leadership coalition, and civic organizations clamor for greater representation and dialogue between the state and society, the economic risks now lie mainly in the political realm. The question is not of which policy course to follow but of whether Fujimori's successors will have the wherewithal and tenacity to restore the administration of justice and to more fully institutionalize the reforms now in place. Albeit brief, the impressive track record of the Paniagua transition government along these very lines suggests that politicians and policy makers may not have as far to go as they think in accomplishing such goals. What is at stake is the difference between settling into a political stalemate that could condemn the country indefinitely to mediocre growth, social instability, and regressive income returns or forging ahead with a Chilean-style broad-based coalition that can craft a pragmatic set of political and economic reforms that would render free markets and liberal politics more compatible in Peru.