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Helping Reforms Deliver Inclusive Growth in Peru

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The performance of the Peruvian economy in the last half century has been less than stellar in terms of achieving inclusive growth, even during the recent boom. Although Peru has had spells of faster growth than the rest of the region, none lasted long enough to significantly reduce poverty and inequality. For decades the majority of Peruvians have lived at or below the poverty line, and in the past twenty years social and economic inequalities have worsened, fueling social discontent and leading to calls for radical change.

This is not to say that major economic reforms have not been attempted. On the contrary, dramatic swings between market-oriented and state-oriented policies have been part of the problem. In the late 1960s and the 1970s, a military-led “revolution” attempted radical transformation of the country’s inequitable economic and social structures, but internal and external crises put an end to that experiment. In the 1980s the introduction of more heterodox policies ended up deepening the economic crisis and fomenting political violence. This episode was followed by dramatic, market-oriented reforms under more authoritarian rule in the 1990s; these, too, ultimately failed to put the country on a more sustained and

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inclusive growth path. Growth in both decades was even more volatile than in the region as a whole. Peru's most recent growth spurt, which began in 2002, has occurred in the context of a world economic upturn of uncertain duration, accompanied by a revival of political movements denouncing the lack of "trickle down" and advocating a return to more statist and nationalist policies.

This chapter uses the CGD framework to evaluate Peru's recent reform efforts and determine their impact on the foundations for inclusive growth, and to analyze how to proceed with further reform. To many observers, Peru today seems ready to join the ranks of Chile and Mexico, countries that have achieved considerable macroeconomic stability and embarked on a positive growth path. However, we will argue that Peru still faces significant obstacles to truly inclusive growth.

The chapter is organized as follows. In the next section we present some stylized facts on growth, poverty, and inequality in Peru. We then discuss which of the growth foundations were addressed and which were ignored in the reforms of recent decades, and we select three areas for further analysis—public administration reform, education reform, and political reform—that we believe are largely "missing ingredients" in Peru's reform recipe to date. After summarizing the reforms of the 1990s, we discuss each of the above three areas in detail, analyzing their impact on the growth foundations. The final section offers some concluding remarks.

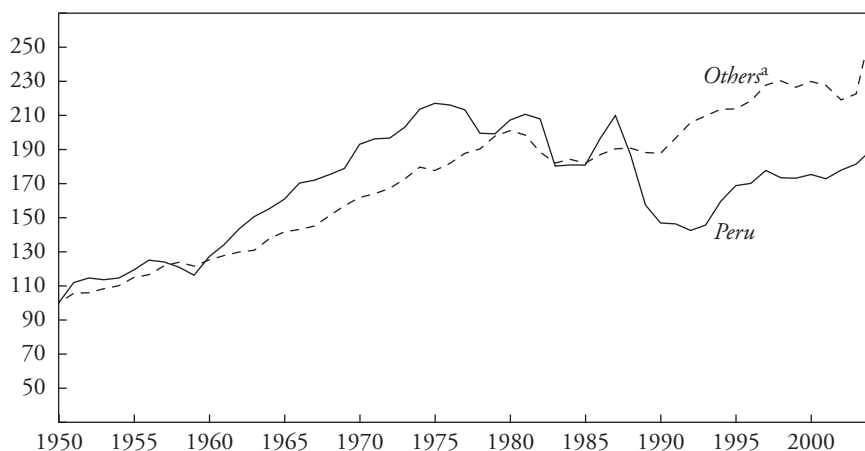
Growth, Poverty, and Inequality: Some Stylized Facts

A key difference between Peru and other countries in the region is that Peru reformed late, and when it did reform, often went to extremes (Frieden, 2007). But Peru's reforms were not those of the Washington consensus, but rather more fundamental political and social reforms, involving the creation of a legitimate national state and national identity, the extension of the voting franchise to all adults, basic land and labor reforms, and the provision of public education and health services, among others. Economic growth in the early twentieth century had not resulted in the development and modernization of the country's rural areas, even when the sources of growth were located there. Economic and political power has always been concentrated in Lima; indeed, one notable characteristic of the country is the absence of other large cities.

Through most of the twentieth century, political exclusion and economic and social exclusion ran in parallel. During much of its history since independence, Peru has been under military dictatorship; full political democracy with universal suffrage was achieved only in 1980. Throughout its modern history, Peru has had only one strong political party, the Alianza Popular Revolucionaria Americana (APRA), which for long periods operated secretly. The party system has remained weak and fragmented, based on individual *caudillos* (strongmen) rather than lasting

Figure 1. *Real GDP per Capita in Peru and Six Other South American Countries, 1950–2004*

Index, 1950 = 100



Source: World Bank data.

a. Average of the six major Latin American economies (LAC6), Argentina, Brazil, Chile, Colombia, Venezuela, and Uruguay.

institutions. Unlike some of its neighbors, Peru has no strong regionally based political movements, and significant political decentralization began only in 2001.

During the quarter century up to 1975, Peru's economic growth surpassed that of its largest neighbors (figure 1), with GDP per capita more than doubling in real terms, to almost 80 percent of the average of the six most developed economies on the continent. The Peruvian economy then got off track, compared not only with its neighbors but also with the rest of the world, and GDP per capita fell to only about half that in the above six countries. As Llosa and Panizza (2007) put it, Peru lost three decades of growth while the region as a whole lost only one. Growth resumed in the 1990s, however, and real GDP per capita returned to its previous peak in 2006.

These stylized facts raise two obvious questions: How did Peru manage to lose one-third of its GDP per capita? And what changed to allow Peru to make up that lost ground in a decade and a half? The potential explanations are, of course, the usual suspects: domestic policy decisions, external shocks, and initial conditions.

Peru, like most of the region, has faced significant problems in raising growth through increased productivity. A standard growth decomposition finds that over the last fifty years, only 10 percent of Peru's growth was due to higher total factor productivity (table 1). Perhaps the most obvious of many reasons for this poor performance is mistaken domestic policy decisions. GDP growth was close to zero in the "lost decade" of the 1980s. In that same period, the Peruvian economy

Table 1. *Peru: Accounting for Growth, 1950–2006*

<i>Period</i>	<i>Growth of GDP (percent a year)</i>	<i>Contribution of (percentage points)</i>		
		<i>Labor</i>	<i>Capital</i>	<i>Total factor productivity</i>
1950–60	5.73	1.34	1.20	3.19
1960–70	5.57	1.79	1.28	2.49
1970–80	3.12	2.19	1.81	–0.89
1980–90	0.36	2.63	0.89	–3.18
1990–2000	2.78	2.04	1.02	–0.28
2000–06	3.85	1.85	0.83	1.16
1950–2006	3.53	1.98	1.20	0.34

Source: Morón and Bernedo (2007).

reduced its openness (imports plus exports as a share of GDP) by half, from 60 percent to 30 percent, while fiscal imprudence and the absence of an independent central bank led to hyperinflation.

In the last twenty years, the poverty rate has varied between 45 and 55 percent, closely following the economic cycle. Yet even when growth has been accompanied by reduced poverty, it has not necessarily been inclusive. We will illustrate this by measuring the extent to which changes in poverty during the expansions and recessions of the last twelve years were accompanied by reduced inequality.¹

Following Datt and Ravallion (1992), we decompose changes in poverty into growth and inequality components. The first of these components measures the change in poverty that would have occurred had inequality remained constant while mean household income grew at the observed rate. The second measures the change in poverty that would have occurred had mean household income remained constant while inequality changed as actually observed. We then construct pro-poor indices and classify our results, presented in table 2 and summarized in figure 2, according to the method of Kakwani and Pernia (2000).

The pro-poor index (last column of table 2) measures the extent to which changes in inequality have contributed positively to reducing poverty. For a given growth component, the pro-poor index will rise as the inequality component becomes smaller. Clearly, a negative inequality component (meaning that the distribution of income improved during the period) will imply a pro-poor index larger than one. According to the threshold values and classifications proposed by

1. For this exercise we use a strong definition of “pro-poor”: we expect poverty to fall by more than it would have if all incomes had grown at the same rate. Other, weaker definitions regard growth as “pro-poor” if all households enjoy the same proportionate increase in income (thus maintaining inequality unaltered), or even if it is accompanied by a reduction in the poverty rate (which could well entail an increase in inequality).

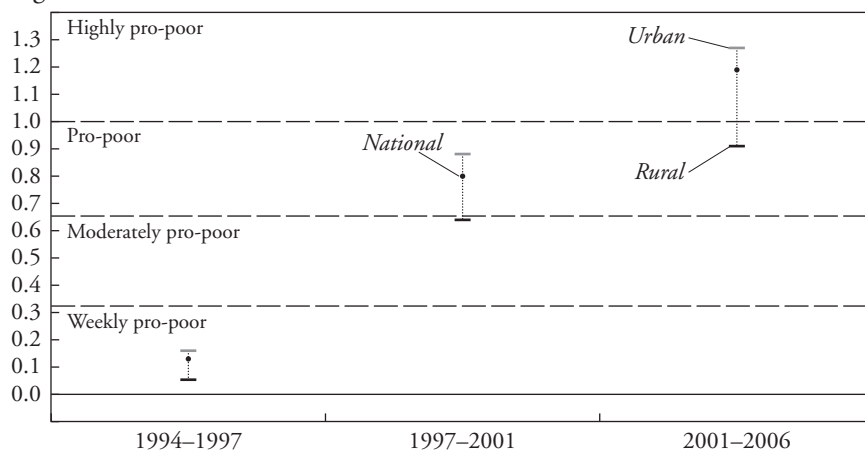
Table 2. *Peru: Growth and Inequality Components of the Change in Poverty*

Period	Domain	Poverty rate (percent)		Change in poverty rate (percentage points)	Growth component	Inequality component	Pro-poor index ^a
		In initial year	In final year				
1994–97	National	53.42	50.69	–2.7	–21.73	19.00	0.13
	Urban	46.88	42.95	–3.93	–24.19	20.26	0.16
	Rural	65.56	64.85	–0.71	–15.23	14.53	0.05
1997–2001 ^b	National	42.72	54.80	12.08	9.68	2.40	0.80
	Urban	29.72	42.04	12.33	10.81	1.51	0.88
	Rural	66.33	78.44	12.11	7.73	4.38	0.64
2001–2006 ^b	National	54.80	44.53	–10.2	–8.65	–1.62	1.19
	Urban	42.04	31.20	–10.84	–8.55	–2.30	1.27
	Rural	78.44	69.33	–9.11	–10.02	0.91	0.91

Sources: Encuesta Nacional de Hogares sobre Medición de Niveles de Vida (ENNV) for 1994 and 1997; Encuesta Nacional de Hogares sobre Condiciones de Vida y Pobreza (ENAH) for 1997, 2001, and 2006; authors' calculations.

a. Calculated as the change in the poverty rate divided by the growth component except for the period 1997–2001, which used the inverse because of the increase in poverty incidence.

b. Despite observed discrepancies, the 1997–2001 period was analyzed using the 1997 poverty rate reported by ENAH to maintain consistency between databases.

Figure 2. *Peru: Pro-Poor Index, 1994–97, 1997–2001, and 2001–06^a*

Source: Authors' calculations; see table 2.

Kakwani and Pernia (2000) and used in figure 2, this will, in turn, imply that growth is “highly pro-poor.” What table 2 and figure 2 show is that although the incidence of poverty has followed a cyclical path, the “pro-poorness” of Peru’s growth exhibits a clear positive trend, indicating that the benefits of growth are being enjoyed more broadly today than in the recent past.

Several caveats are necessary, however. First, the term “highly” can be misleading: strictly speaking, the 2001–06 period is the only one in which the term “pro-poor” can be related to a reduction in inequality. Second, figure 2 also reveals that urban-rural differences in “pro-poorness” are growing. Although expansions in income are now more evenly distributed on a national basis, urban-rural disparities are worsening.² Finally, and most important for this project, it is difficult to relate this recent reduction in poverty and inequality to any particular reform effort. This raises doubt as to whether this single “pro-poor” growth episode marks the beginning of a permanent reduction in poverty or is vulnerable to a future reversal. An important question, then, is what further reforms are still required to prevent another sharp increase in poverty and inequality, like that experienced during the mild recession of 1997–2001, when the next negative shock occurs.

As we have seen, until very recently Peru has been unable to achieve sustainable growth that also reduced poverty or inequality on a long-term basis. The current growth spurt has unique characteristics that call the previous path into question. The economy has now grown for more than six consecutive years, and poverty in 2007 was lower than in 2004 in all regions (table 3). Even extreme poverty (defined as the share of the population living on less than one dollar a day) has declined in all regions, although by more on the coast and in urban areas.

A striking feature of the Peruvian economy, as of many others in Latin America, is the government’s apparent inability to alter the income distribution through fiscal policy. In developed economies the distribution of income does not necessarily follow the distribution of assets, because fiscal policy serves as a potent equalizer of opportunities (Goñi, López, and Servén, 2008). In Latin America, however, the income distribution after taxes and transfers is usually worse than before. The region’s opportunity equalizer mechanism is broken.

The main problem for Peru is how to achieve relatively rapid economic growth that can be sustained not only across long periods but also across the country. As the next section will show, some reforms have been achieved, and the fact that Peru has enjoyed solid growth in the last six years speaks for itself. However, most of these reforms failed to focus on the bottom of the income distribution. The unspoken macroeconomic strategy in the last two decades has been to let economic growth trickle down. Apparently, gravity is not enough.

2. In fact, the inequality component in rural areas remained positive in 2001–06, and rural poverty has remained stagnant at around 70 percent in the last three years, while urban poverty has fallen by almost 6 percent. Rural poverty would have fallen more had rural growth been more pro-poor.

Table 3. *Peru: Poverty Rate by Geographic Area*

Percent of population

<i>Area</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>2007</i>
All Peru	48.6	48.7	44.5	39.3
<i>Urban versus rural</i>				
Urban	37.1	36.8	31.2	25.7
Rural	69.8	70.9	69.3	64.6
<i>Natural region</i>				
Coast	35.1	34.2	28.7	22.6
Highlands	64.7	65.6	63.4	60.1
Forest	57.7	60.3	56.6	48.4
<i>Geographic domain</i>				
Urban coast	37.1	32.2	29.9	25.1
Rural coast	51.2	50.0	49.0	38.1
Urban highlands	44.8	44.4	40.2	36.3
Rural highlands	75.8	77.3	76.5	73.3
Urban forest	50.4	53.9	49.9	40.3
Rural forest	63.8	65.6	62.3	55.3
Metropolitan Lima	30.9	32.6	24.2	18.5

Source: Instituto Nacional de Estadística e Informática (INEI).

Foundations for Growth in Peru: Promise and Reality

This section focuses on the reforms attempted during and since the 1990s and their potential for delivering inclusive growth. We use the proposed CGD framework to guide our discussion of a set of reforms that, working through the foundations identified in the framework, should have yielded inclusive growth but failed to do so. Given that all five foundations have (in principle) similar weight as growth engines, we focus our analysis on the most critical foundation for each reform, comparing what could have been achieved with what actually happened.

Table 4 summarizes the differences between promise and achievement using a simple notation. The first column under each foundation shows whether the indicated reform has a strong (✓✓) or a modest (✓) positive potential impact on that foundation. The second column indicates what impact the reform actually had, whether strongly positive (✓✓), modestly positive (✓), mixed (✓✗), negative (✗), or strongly negative (✗✗). To illustrate the rationale behind these assessments, we focus briefly on five reform areas where the stakes were particularly high: fiscal, labor, education, judicial, and political reform.

Fiscal reform is fundamental to restoring *macroeconomic stability*, which is essential for sustainable and inclusive growth. A government that has problems financing its expenses can reduce the economy's growth potential. A large debt

Table 4. Peru: Potential and Actual Impact of Reforms

Reform	Property rights		Equal opportunity		Competition		Broad sharing of growth benefits		Macroeconomic stability	
	Potential	Actual	Potential	Actual	Potential	Actual	Potential	Actual	Potential	Actual
Trade			✓	✓	✓✓	✓X	✓	X		
Financial	✓	✓	✓	✓	✓	✓	✓	✓	✓✓	✓X
Labor	✓	X	✓✓	✓X			✓	X	✓✓	✓X
Pension	✓	✓	✓	✓			✓	X	✓✓	✓X
Fiscal							✓	X	✓✓	✓
Public administration							✓✓	XX		
Education			✓				✓✓	XX		
Judiciary	✓✓	XX	✓	X	✓	X	✓	X		
Political			✓	X	✓	X	✓✓	XX		

Source: Authors' evaluations.

a. ✓✓, strong positive impact; ✓, modest positive impact; ✓X, mixed impact; X, negative impact; XX, strong negative impact.

burden can likewise conspire against growth, by diverting the country's resources to debt service. A growing debt also increases the risk of default, which in turn raises interest rates and the cost of financing the debt. This increases macroeconomic volatility and crowds out private investment.

Labor reform should work to increase *equality of opportunity* in society, by reducing the information asymmetries that hinder equal access to job opportunities. If it does not, political or family connections, rather than skills, might dominate the matching of workers with job vacancies, leading to reduced productivity and ultimately slower growth.

The main promise of education reform in this framework is in promoting a *broad sharing of the benefits of economic growth*. A significant market failure occurs when individuals cannot finance their education by borrowing against their expected higher future income stream. Without that education they cannot accumulate enough human capital to command high earnings in the labor market. This market failure and the strong positive externalities from the provision of education justify government intervention in the market for education.

The judicial system is both a guarantor of basic rights, including *property rights*, and a mechanism for resolving conflicts. To serve those functions, the judiciary must be reliable, predictable, and accessible to all, or else individuals and firms will seek alternative means of securing their rights. Failure of the judicial system thus impairs a key element of growth, because property rights must be secure in order for agents to find it profitable to accumulate capital.

The establishment of a democratic political regime should positively affect at least three of the five growth foundations: *equal opportunity*, *competition*, and especially the *broad sharing of the benefits of growth*. The essence of a democracy is equal rights and opportunities for all citizens in the public sphere. Through universal suffrage, freedom of expression and association, and direct participation in politics and the election of representatives, the less privileged members of society can influence the state and the market and achieve a fairer distribution of resources and opportunities. Democracy is also characterized by competition for public office and for the definition of policy priorities, making it less likely that the state will be captured by a privileged elite. For the same reason, democracies are more likely than dictatorships to share the benefits from growth broadly, through greater responsiveness of government to voters and a stronger capacity of broad-based parties and interest groups to influence budgetary and other policies.

As table 4 suggests, the reforms since 1990 had the potential to transform Peru's economy. These reforms and the links between them and sustainable growth are quite standard and could apply to any emerging economy.³ What is distinctive about reform in Peru is not its potential but the real impact that reform has had.

3. As acknowledged in chapter 2 of this volume, the first three foundations apply to any market economy, whereas the last two refer specifically to Latin America.

Before summarizing the impact of the reforms undertaken (and avoided) since 1990,⁴ it is worth highlighting that Peru's reform process was not undertaken as a comprehensively thought out and fully detailed plan. The urgency of the country's situation profoundly influenced the choice of economic reforms. In fact, it was only the widely shared sense of emergency that allowed President Alberto Fujimori to secure special legislative powers to implement the first set of reforms (Kenney, 2004), which were soon followed by the interruption of constitutional rule and restrictions on democratic institutions and processes. Unsurprisingly, the bulk of the economic reforms were attempted in the first part of the decade. After that, Fujimori became less enthusiastic about policy change and more concerned with holding on to power. Only very recently, in June 2008, were new reforms adopted as part of the legislative package implementing the new free trade agreement with the United States. We do not include these reforms in our analysis because, as of this writing, the details have not been approved.

Table 4 presents a mixed overall picture of the impact of reform: although in some areas the reforms delivered as expected, in others they underperformed. Because some reforms are clearly more important than others, rather than assess each individual reform, we will measure the gap between promise and results on a foundation-by-foundation basis. This will allow us to focus on what remains to be done to secure growth and to assess a subset of reforms on this basis.

To begin, we can identify some progress in securing *property rights*, through reform of the financial markets and the pension system. However, a broader concern for citizens' rights and an adequate reform of the judicial system did not accompany this process, leaving the majority of Peruvians without sufficient access. In fact, during the 1990s the executive branch manipulated the workings of the judiciary for political ends. By the end of the decade, the judicial system remained highly unpredictable, inefficient, exclusionary, and corrupt. (See the appendix at the end of this book for more details).

Some progress was also made toward *equality of opportunity*, as a result of reforms in the trade regime and in financial, labor, and pension markets. However, the net gain is unclear, as there was no progress in other areas, such as education and justice.

The picture is also mixed with regard to increasing *competition*. The partial gains from trade and financial reforms were again blurred by the lack of progress in the judiciary and the semiauthoritarian concentration of political power.

Perhaps the clearest picture emerges in terms of the last two growth foundations. The reforms of the 1990s did partly restore *macroeconomic stability*, a key priority at that time, and were particularly successful in restoring fiscal and price stability. On the other hand, it is striking how completely the reforms ignored the

4. The assessments in table 4 benefited from the discussions with the group of experts mentioned in the acknowledgments.

broad sharing of the benefits of growth. Despite widespread demand for more equitable growth, none of the reforms took into consideration that progress on this foundation could avoid a backlash against the whole reform process and the new economic model. The apparent explanation is that the concerns at the time were more basic, and the focus was on reshaping that part of the economy that was easier to fix, namely, the more modern and urban part. The rest of the country was left mostly out of the picture.

Our attention to this foundation might seem at odds with the empirical evidence presented in the previous section, and in particular with the fact that Peru's current growth is clearly more pro-poor than that of the previous decade. However, reform thus far has done little to secure a *permanent* reduction in poverty and inequality; thus, the possibility of another sharp increase in these indicators remains. In fact, the absence of specific reform efforts aimed at greater inclusion in the long run suggests that the current "pro-poorness" of growth is more a consequence than a driver of growth. The latent risk of a negative shock reversing these recent positive trends undermines the sustainability of growth, because it translates into a danger of backlash.

Thus, in what follows we analyze more deeply what was done and what were the reasons behind the gap between promise and reality regarding this foundation. In particular, and given that the largest gaps in terms of this foundation are found in administrative, education, and political reform, we focus our attention on these three areas. The framework suggests that such gaps might be explained either by faulty design (technical inadequacies, inappropriate sequencing, lack of complementary reforms, or inadequate fit to the local context) or by local obstacles (institutional constraints, lack of legitimacy, or lack of implementing capacity). We will try to explain on this basis why the above three reforms failed to achieve their potential.

First, however, a brief assessment of Peru's reform successes is in order, because our analysis would be incomplete if we overlooked the importance of preserving what reform has already accomplished in terms of improving respect for property rights, increasing competition, and, especially, stabilizing the macroeconomy. As explained in chapter 2, macroeconomic stability has proved to be a necessary (although not sufficient) condition for growth throughout the region. Moreover, in Peru it is the accomplishments of reform with respect to these other foundations that has allowed private investment to benefit from the current boom.

Recent Economic Reforms: A Brief Assessment

In 1990 the Peruvian economy was in shambles. The monthly inflation rate was running at a four-digit pace without any sign of coming under control. Government revenue plummeted by a full three-quarters, leaving roads without mainte-

nance, public hospitals without basic supplies, and many civil servants having to work two jobs. Growth was completely out of the picture. GDP plunged 25 percent in real terms between 1988 and 1990. The outlook was bleak.

In a surprising turn of events, a political outsider, Alberto Fujimori, won the presidential election without the support of any well-established political party. Even more surprising, he ended up implementing most of the economic plan outlined by his right-wing opponent, Mario Vargas-Llosa. The plan was an aggressive bet on liberalizing the economy in order to spur growth, once an austere stabilization package had halted the hyperinflation.

Although the plan achieved dramatic turnarounds in terms of both stabilization and restoration of access to international capital markets, the most significant changes came in the area of structural reform, which completely reshaped the Peruvian economy. Both labor and capital markets were liberalized, almost every asset in public hands (except the water utilities and the oil companies) was privatized, and new laws were passed protecting and fostering private investment. Foreign investment was attracted through special contracts with specific clauses forbidding surprise changes in the tax code or in regulation. A new regulatory system was also put in place, including a new antitrust agency, a regulatory authority for each newly privatized sector, and a much stronger tax authority.

The political process that accompanied these economic reforms, however, was increasingly authoritarian. Although Fujimori enjoyed initial support for his hard-line postures, his concentration of power and the widespread corruption that was eventually revealed among top civil and military leaders ultimately tainted the whole reform process. The process was further discredited when, in late 2001, Fujimori abandoned the presidency and left the country after being accused of running a corruption ring through his spymaster, Vladimiro Montesinos.

These scandals and Fujimori's departure notwithstanding, the governments that succeeded him kept the main thrust of the macroeconomic reforms intact. After decades of government intervention and lackluster results, the common perception was that state intervention had been responsible not only for deterring growth, but also for provoking Peru's worst economic crisis ever. The economic reforms of the 1990s focused on using market forces to restore growth. In some cases markets were created; in others market rules were entirely rewritten. The problem was that the reach of market institutions is not homogeneous throughout the country. The modern economy predominant in Peru's coastal areas and major cities is quite different from the more traditional economy of its rural areas and highlands. Markets in these areas are full of rigidities, which explain why liberalization was not enough to spur growth in these areas, or indeed even for the change to be noticed.

For example, the public pension system was overhauled, creating private fund administrators (*administradoras de fondos de pensiones*, or AFPs) following the Chilean blueprint. However, the labor markets of these two countries are dissim-

ilar. Whereas in Peru two-thirds of the working population is in the informal sector, in Chile the figure is not more than a third. The reform failed to address the needs of these workers, a problem inherited from the previous pension system design. Now, almost twenty years after the reform, opinion about it is mixed. The new system works well for those with stable jobs in the formal sector. For other formal sector workers, however, it is not delivering the promise of a pension closely related to their salary history. And for the majority of Peruvians, the new system was irrelevant, as they were never part of the reform.

Reform of the financial system had similar results at first. Before 1990, the system was severely affected by inflation and by financial repression, which, together with legislation that did not guarantee the rights of lenders, produced a small financial sector from which many individuals and firms were rationed out. There were few long-term transactions, even in the mortgage market.

The 1990s saw a radical change, with a new banking law and the lifting of all price controls and restrictions. These changes attracted major international players into the banking system. The improvement in macroeconomic conditions allowed a credit boom, which, however, went bust with the Russian crisis of 1998. Yet even at the peak, many potential borrowers remained rationed out of the credit market, including many informal sector firms and many poor individuals with no collateralizable assets. Fortunately, over time new microfinance institutions of various kinds found ways to serve this market. It is unlikely that this could have happened in the absence of stabilization and financial market reform.

The first efforts at reform were thus a steppingstone toward the improved growth of later years. The most important reforms were the conquest of inflation, tariff reductions, financial sector reform, and a new framework for attracting private investment. However, rural poverty was not reduced at the same pace as in urban areas. The following section focuses on three areas that might be called the “missing ingredients” of future reform efforts: reform of public administration, education reform, and last but not least, political reform.

Missing Ingredient #1: Public Administration Reform

One of Peru’s main obstacles to achieving inclusive growth has been the lack of a well-functioning state apparatus. As is widely known, the Peruvian state before the reform process was bloated, bureaucratized, inefficient, and lacking in professionalism. Its profusion of red tape represented a significant deterrent to private investment. Above all, it was clearly biased against the rural population, as most of the public sector was located in Lima, and no significant effort was made to decentralize its power to the provinces.

As argued by Ugarte (2000), the administrative reforms of the 1990s were maintained only to the extent that they were viewed as necessary for keeping the concurrent economic reforms in place. The central bank regained its indepen-

dence, the tax authority was given budgetary and operational autonomy, the customs office was completely overhauled, and new regulators began to oversee the many newly privatized enterprises. Three characteristics were common to all of these cases. First, salaries in these agencies were de-linked from those of the rest of the public sector: employees were hired under rules similar to those in the private sector, with productivity bonuses and defined career tracks. Second, the institutions were well funded through sources of revenue not connected with the general government budget. Third, the new public officials were in most cases highly qualified.

The intense macroeconomic volatility of previous decades was tamed not only through much stricter macroeconomic policies but also through several mechanisms expressly designed for that purpose. These included the adoption of a multi-year budgeting framework and fiscal prudence legislation with explicit rules. The government also managed the public debt more actively, leading to Peru's achieving investment grade status. Although this turnaround was significant, so were the reforms still pending, including in particular the professionalization of the civil service and effective mechanisms for national integration.

The Lack of a Professional Civil Service

Before 1990 there was no such thing as a public career within the Peruvian state, and the situation is hardly any better today. Most public sector entities (the central bank is an exception) have nothing resembling a merit-based hiring system. Throughout the 1990s, public servants were part of a minority within the labor force whose paychecks may have been shrinking but who nevertheless enjoyed all basic labor rights as well as virtually complete job stability.⁵ Therefore, politicians were eager to use public employment as a source of patronage.

Another factor that has conspired against building a well-defined public career is the short duration in office of the highest-ranking officials. The average tenure of a cabinet minister since 1980 has been less than a year. Usually each new minister comes with his or her own team and imposes a career ladder, with the steps reserved for political appointees, rather than a merit-based system. This discourages the best of the permanent employees, who are likely to see their careers stagnate.

Finally, it is symptomatic of Peru's problems that degree programs in public administration have historically been absent from the university system. None of Peru's eighty universities offers public administration as an undergraduate major, and only a few graduate programs in the field have opened since 2001.

5. Permanent job stability was introduced by the military government in 1970, after a three-month trial period. By 1978 the government had increased the trial period to three years, but in 1986 this was reversed. See Saavedra (2000).

The last two decades have seen attempts to reform public administration and introduce a professional civil service. The first attempt was aborted after the 1992 “self-coup,” when President Fujimori dissolved Congress and suspended the constitution. The group designing the reform quit, and the project was forgotten. None of the ministries was closed, and only a few small public institutions (including the National Institute of Public Administration) were dismantled. Hyperinflation was the main incentive encouraging people to leave public employment: the real value of public sector salaries fell by more than 75 percent in the 1980s. The most significant change in terms of reducing the public payroll occurred in the state-owned enterprises, which were rapidly privatized.

At the end of Fujimori’s first term, a major reform of public administration was attempted, and Congress granted the executive branch broad powers in this area. A group of specialists prepared a serious proposal under the auspices of the prime minister’s office. However, the population was easily turned against the reform, as the political opposition claimed it would lead to a series of massive layoffs. There was also opposition within the government, and by the end of 1996 the idea had been abandoned. Eventually the impetus for reform faded, and all plans to reform public administration came to be perceived as too politically controversial.

Obstacles to Building an Integrated Nation

All governments in developing countries face a trade-off between reforms that focus on economic growth and those that focus on reducing inequality. When the starting point is one of persistently slow growth, the focus is unlikely to be on the latter. Once the economy is back on its feet, however, pressure to address inequality increases. Peru has been in this situation for some time now, yet the government’s actions to reduce inequality have been neither well articulated nor systematic, nor have they been very effective.

Because inequality in Peru has so much to do with the gap between the capital and the rest of the country, perhaps the obvious first step is to decentralize power and decision-making. The Peruvian state has embarked on a rather disorganized decentralization process since 2001. Although municipal authorities have been elected rather than appointed since 1981, and new regional-level authorities were elected in 2002, this was done without approval of the basic legislation intended to guide the process, and meanwhile another election was held in 2006. Decentralization today remains a work in progress. There have been none of the major fiscal problems that many had feared, primarily because very strict fiscal rules were centrally imposed. However, there have been significant problems in budget execution. Regional and municipal authorities lack the administrative capacity to spend their allocated budgets, and this inhibits the sharing of responsibility across levels of government. Delays continue, and the perception is still widespread that money is not being well spent. The National System of Public

Investment (SNIP) has its hands tied, as responsibility for most investment decisions lies with the regional governments.

But perhaps the most notorious problem is that Peru's twenty-five regional governments have not pursued any real integration. Decentralization merely changed the names of the existing national departments to regional departments; the idea of combining the regions into macroregions, although built into the law, has not been carried out. The reality is that some regions are simply too small to build an effective government. Nor do all regions have mineral, gas, or other natural resources to serve as a source of tax revenue, and so tension between poor and rich regions has increased substantially.

The main tool used by the government to reshape the income expectations of poorer families is social policy. Better nutrition, health, and education are key to improving the living standards of these families, who rely on the state to help meet their needs in these areas. But the role of the state goes beyond fulfilling these basic needs. The state can become an obstacle to inclusive growth if it does not also provide basic infrastructure, justice, and a minimum of peace and security. Although the state must exercise its vital regulatory functions, excessive red tape and bureaucracy can put a wrench in the wheels of growth. In sum, a growing economy needs an efficient and effective state apparatus, ready to work with the private sector in achieving economic growth.

Basic infrastructure is a powerful equalizer of opportunities, and given the disparities in public infrastructure across the country, there is much that public expenditure could do in this regard. It is hard to start a manufacturing business if there are no roads to connect with a larger market, no electricity, and no telephone network. Yet the technological progress that Lima takes for granted is simply absent in large parts of the country, and as long as the government grappled with large fiscal deficits, it could not cope with the mounting problem.

The prolonged economic crisis actually caused public investment to decline as a share of the economy, as cuts in investment spending were used to fend off fiscal deficits. From 55 percent of total investment outlays in 1975, public investment plummeted to less than 20 percent in 1990. The consequences were a significant deterioration of all public infrastructure (schools, roads, hospitals) and of the salaries of public employees. The collapse was even more pronounced in the 1980s, when terrorist groups repeatedly attacked the public electricity network.

How to Move Forward?

This review of the challenges to public administration reform suggests several areas where the need is critical to work toward a better state apparatus.

MERITOCRACY SHOULD BE THE RULE

Peru has long lacked a professional civil service with merit-based career paths. Many reform efforts have been blocked as policymakers focused on the existing

stock of personnel instead of building up a new group of professional public servants. A well-defined public career system would make it possible for the public sector to retain the talent it needs.

In June 2006, under the legislative powers granted by Congress to implement the free trade agreement with the United States, the executive issued a legislative decree implementing a civil service system with many desirable features. This circumvented the main obstacle, which was that the executive lacked a majority in Congress and therefore the reform had a slim chance of passage. The new system is based on merit, and its governance structure establishes a politically independent board that will manage the whole civil service.

A complementary legislative decree in June 2008 breaks the link between the salary structure of elected officials and that of a small group of key public managers, whose salaries as a result may now be set higher than the president's. Until now, in the existing "islands of efficiency" in the state apparatus, employees were offered market-based salaries so as to attract the best talent, but the salary structure for these public servants was tied to that of elected politicians. These two structures should not be determined together, as only the market for the former has a relevant shadow price. Of course, it remains to be seen whether this reform will get beyond the design stage.

FOCUS ON RESULTS, NOT JUST PROCEDURES

Another problem is that the whole state system has been geared toward fulfilling a long list of procedures instead of a short list of goals. Bureaucrats feel pressured to follow every single requirement imposed by the rules, even if the desired outcome is accomplished less efficiently or not at all. If they deviate from the rules, public employees can face judicial scrutiny, even prosecution, whereas they will never face prosecution for not meeting goals. This way of doing business generates enormous inefficiencies at every step, from unnecessary procedures and documents, to high administrative costs, to sluggishness and interminable delay. The system makes bureaucrats accountable not to the citizens they serve, but to internal audit bodies focused on procedures instead of goals.

The whole budgeting system should serve as a mechanism for making public expenditure more effective. For that to happen, budget programs should only be approved once a proper system of monitoring and evaluation is in place. Until then, bureaucrats will have little incentive to improve the quality of public expenditure.

One mechanism that has been implemented as a pilot process in recent years is results-based budgeting (Alvarado and Morón, 2007). A small group of programs have been selected in priority areas (including nutrition and education) and given explicit goals. The idea is to get the bureaucracy to think about what is needed to achieve those goals, instead of focusing on how much money is available for each task. So far only 5 percent of the total budget is subject to this ini-

tative. The rest is basically driven by inertia and without any evaluation of efficiency or goal fulfillment.

Proper use of results-based budgeting could partly resolve many of the issues related to lack of accountability. When clear outcome indicators are required, it will be much easier to educate citizens about what they have a right to expect from government. Today, for example, the state's "clients" have no clear idea how poor public education really is, or how inefficient the delivery of health services has become. True accountability requires linking inputs with outputs, and outputs with outcomes. For that, a proper monitoring system must be put in place as part of the results-based budgeting system.

DECENTRALIZE TALENT, NOT JUST PROBLEMS

The government needs to empower local and regional governments as a fundamental step toward improving both the efficacy and the coverage of basic social programs. For that to happen, the capacities of these levels of government must be strengthened. A more pressing reform is to establish macroregions out of the current smaller regions, as mentioned above. The central government can more easily focus on helping seven or ten macroregional governments than twenty-five at once. The distribution of public resources should be linked to the creation of these macroregions. Here incrementalism is the best strategy. For example, a single pilot macroregion could help deliver the message that consolidation is possible, desirable, and replicable. Unfortunately, the current commodity boom has created a division between rich and poor regions. Ninety percent of the canon proceeds (revenue levied based on the premise that those regions in which natural resources are being extracted should receive part of the proceeds) go to just twelve regions, and more than half goes to just four. Thus, there are few incentives to reduce the number of regions.

Missing Ingredient #2: Education Reform

Several endogenous growth models rely on human capital to provide an analytical link between economic growth and educational variables (Lucas, 1988). However, empirical evidence at the aggregate level remains inconclusive. A stronger consensus emerges when we connect educational attainment and quality with households' ability to maintain a high, steady income (Hanushek and Wöbmann, 2007; Castro, 2006). In fact, strong linkages can be found at the household level between the stock of human capital and both the level and the variability of income and consumption.

As already mentioned, households seeking to accumulate human capital face a significant market failure in their inability to pledge their increased future income stream; this is what justifies public intervention in education. We therefore expect education reform to exert its growth potential through the *broader sharing of the*

benefits of growth,⁶ by expanding access to an asset that the market values but fails to offer on an egalitarian basis. Obviously, reform is not just a matter of guaranteeing the existence of this valuable asset (public education of good quality) but also of providing it to households with poor initial endowments.

Why Has Education Failed to Contribute to the Broader Sharing of Growth?

Public interventions in the education system may fail in their goal of spreading more broadly the benefits of growth in either of two ways. First, they may result in services of little value delivered to those with poor initial endowments; second, they may deliver valuable services, but only to those with an already large endowment.

Regarding basic education in Peru, we argue that the problem has been mainly of the first type. As documented in Yamada and Castro (2007), attendance at publicly provided primary and secondary schools is concentrated among the poor.⁷ Coverage and attainment have increased, but because spending has been unchanged relative to GDP (around 3 percent over the past ten years), the result has been lower educational quality.⁸ To accommodate all enrollees within the existing physical and human infrastructure, public schools have resorted to teaching in three daily shifts of less than five hours each. Clearly, in these circumstances the same nominal educational attainment implies less real human capital accumulation than before, and thus smaller future income gains.

In fact, national school performance measures for 2004 show that only 12 percent of students complete primary school with age-appropriate reading comprehension, and only 8 percent can solve basic logical and mathematical problems (Ministerio de Educación, 2005). These students will need to extend their education if they are to command the same earnings as earlier graduates, thus compensating lower quality with larger quantity.

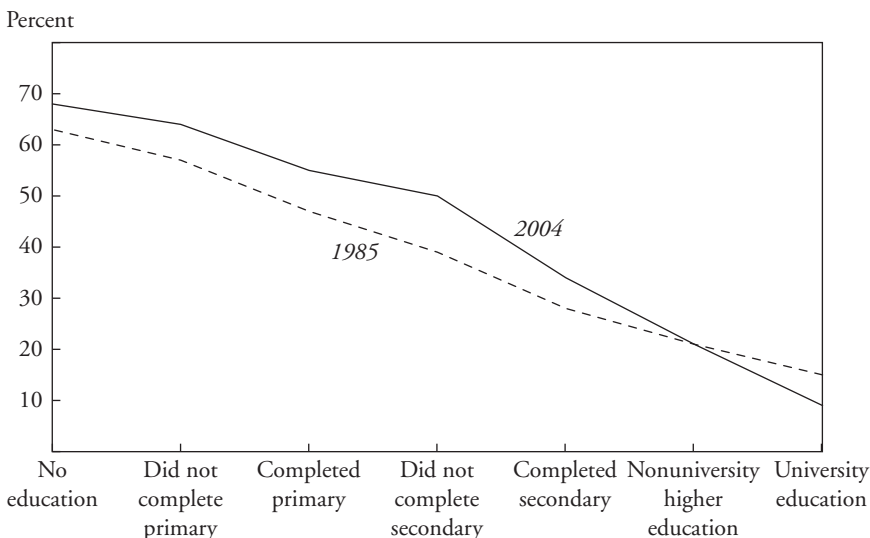
As documented in Yamada and Castro (2007), the flip side of this result emerges when we examine the probability of being poor for a given educational attainment: data from the national household surveys show that this probability was greater in 2004 than in 1985 for all levels of basic education (figure 3). This reveals to what extent the education sector has weakened as a mechanism of social mobility in the past twenty-five years. The average probabilities shown in figure 3, however, disguise strong differences between publicly and privately

6. The channel from education to growth can be traced analytically if we consider human capital as a production factor. Within the proposed framework, the link we propose is between education reform (understood as reshaping public intervention in the education sector) and growth via the “broad sharing” foundation.

7. Among Peruvians with access to publicly provided primary education, 72 percent can be regarded as poor or extremely poor, as are 60 percent of those with access to publicly provided secondary education.

8. As documented in Cotlear (2006), gross enrollment rates in primary and secondary education are now nearly 100 percent and 90 percent, respectively.

Figure 3. *Peru: Probability of Being Poor by Educational Attainment, 1985 and 2004^a*



Source: Yamada and Castro (2007).

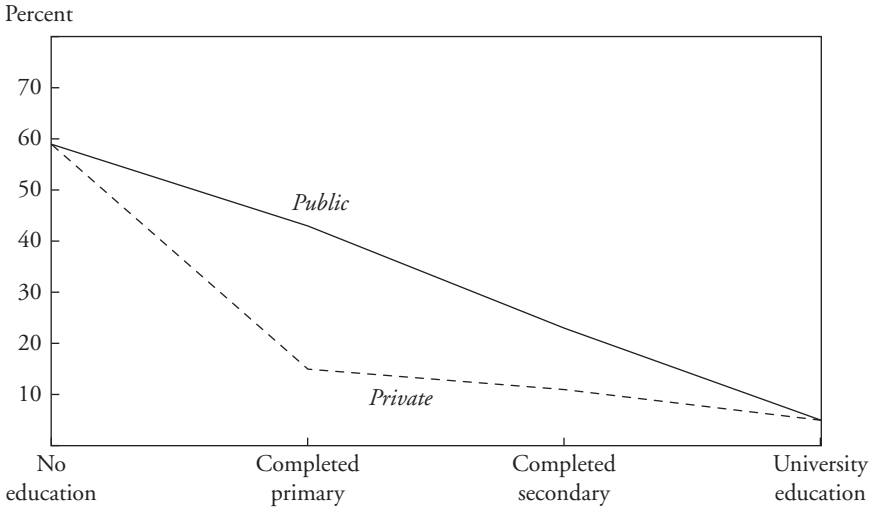
a. Estimates apply to the adult population only.

provided basic education. Whereas private basic education reduces the probability of being poor by 48 percentage points, the comparable figure for public basic education is only 36 percentage points (figure 4).⁹

The situation is different for tertiary education, which, as figures 3 and 4 show, appears to be a safe escape route from poverty, whether the institution attended is public or private. In addition, the steady increase in real wages for skilled workers in recent years proves that the market does value the assets acquired through tertiary education. Meanwhile several empirical studies (Castro and Yamada, 2006; Yamada and others, 2007) show that universal basic education may not suffice for Peru to achieve the Millennium Development Goal of halving the incidence of poverty by 2015—another strong argument for expanding access to higher education. Unfortunately, higher education today is being provided in a clearly regressive way (figure 5), delivering the promise of increased earnings

9. The results in figure 4 were obtained from a logit regression using the sample of the adult population captured in the 2006 household survey. This comparison is particularly prone to misspecification. The marginal contribution (in terms of poverty reduction) of a private school education can be biased upward by failure to control for the household's initial endowment. To reduce this bias, we extended the analysis proposed in Yamada and Castro (2007) and introduced an additional control variable available in the 2006 household survey: the educational attainment of the household head's parents. Absent such controls, the predicted probability of being poor after completing primary education in a private school would fall to 7 percent.

Figure 4. *Peru: Probability of Being Poor by Educational Attainment, Public versus Private, 2006^a*



Source: Authors' calculations based on Encuesta Nacional de Hogares sobre Condiciones de Vida y Pobreza (ENAHOC) data for 2006.

a. Estimates apply to the adult population only.

mainly to households already well off. Two out of every three students enrolled in publicly provided nonuniversity higher education, and almost eight out of every ten students enrolled in public universities, come from nonpoor households.

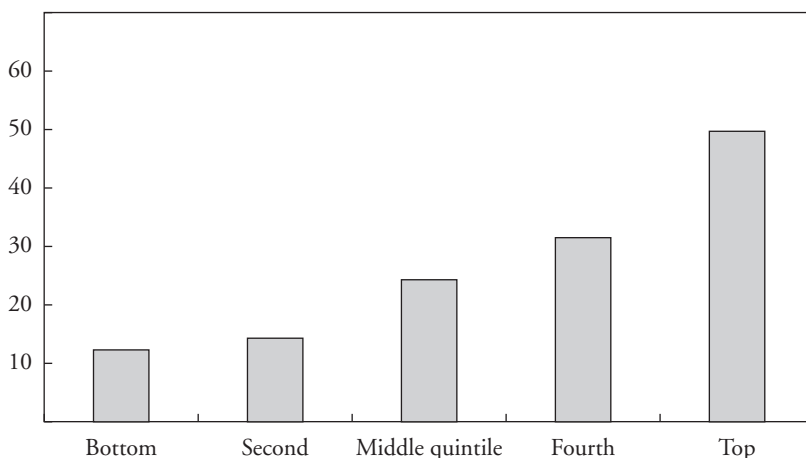
To summarize, reforms addressing public intervention in the education sector should seek to improve its ability to guarantee a more egalitarian distribution of human capital. This should, in turn, help secure faster economic growth through two channels: by reducing the risk of backlash against reform, as the benefits will be shared by a larger population; and by increasing the benefits to be shared, as the economy's human capital stock increases.

Specifically, education reform in Peru must address two critical issues: the poor quality of public basic educational services, and unequal access to higher education. Obviously, the two are interconnected, since better public basic education will give more students from poor households the chance to progress to higher education. In fact, given that public higher education is practically free, the low quality of public basic education conspires against more egalitarian access: many who finish their basic education in a public school have neither the resources to enroll in a private university or institute nor the skills to gain admission to the nation's highly selective public universities.¹⁰ It is with these issues in mind that

10. As documented in Rodríguez (2008), the average acceptance ratio at Peru's private universities is as high as 80 percent, but only 17 percent at their public counterparts.

Figure 5. *Peru: Enrollment of 17- to 20-Year-Old High School Graduates in Higher Education by Household Income Quintile, 2006*

Percent



Source: Authors' calculations based on Encuesta Nacional de Hogares sobre Condiciones de Vida y Pobreza (ENAHO) data for 2006.

the following section explores Peru's recent education reforms, analyzing their constraints and obstacles through the lens of the CGD framework.

Education Reform: A Play in Three Acts

ACT ONE: FAILURE TO IMPLEMENT

Following the 1992 self-coup, as part of its attempts to reshape the economic role of the state, the Fujimori government proposed a dramatic new education reform. Although the proposal was highly controversial and ultimately failed to be implemented, it is worth assessing, in terms of the CGD framework, its main components and the process by which it was put forward and then defeated.

As established in three legislative decrees issued in December 1992, the reform comprised three different aspects. First, it proposed reforming the administration of public education by transferring management of the public schools to local representatives convened in Municipal Education Councils (Comuneds), which would hire teachers under a private scheme, and by allowing private organizations (such as teachers' or parents' associations) to manage schools. Second, it proposed changing the funding scheme to one in which the Ministry of Finance would make monthly payments to each Comuneda according to the number of regular students attending school; schools would be allowed to generate additional resources by charging tuition. Finally, a performance evaluation system would have allowed the Ministry of Education to monitor the quality of services.

As documented in Webb and Valencia (2006), by 1991 public school teachers' salaries had reached a historic low. After a short-lived expansion during the first three years of President Alan García's first administration (1985–88), salaries had fallen by more than 75 percent as a result of the decline in public expenditure and the hyperinflation of 1988–92. Webb and Valencia argue that low salaries, combined with weak demand, the government's inability to enforce contracts, and an increasingly powerful teachers' union (SUTEP), led to a "low level equilibrium." Teachers compensated for their low salaries by taking second jobs, which reduced the time and effort they devoted to public school teaching. SUTEP's leaders meanwhile negotiated contract terms that reduced teachers' obligations and the government's ability to impose discipline, while building an organization to serve their own radical political agenda. Students and their parents failed to complain, since they remained unaware of how poor the services provided actually were.

Clearly, public education was failing to contribute to the broad sharing of the benefits of growth. Again, coverage was not the problem: gross enrollment rates at all levels were unaffected by the 1988–92 crisis and, as revealed in Cotlear (2006), have remained above the Latin American average for decades. Enrollment in elementary and secondary schools actually experienced a steady increase from 1970 onward. The problem, rather, was low quality, a direct consequence of the "low level equilibrium" described by Webb and Valencia.

The need for reform was thus compelling, and, in principle, the main features of the proposed reform arguably would have created the incentives to allow the educational system to deliver on its potential, both through the "broad sharing" foundation and, indirectly, by facilitating competition and enhancing macroeconomic stability. The proposed transfer of management of public schools to local representatives and the creation of a performance evaluation system were aimed at building a more efficient and accountable administration, where quality would emerge in response to local demand. In addition, decentralization would have allowed for better management of resources, which could, in principle, have alleviated the fiscal burden. In fact, the proposed reform of the funding scheme in favor of a voucher-type system was aimed at this objective. The scheme was also expected to foster competition between privately managed schools. The resulting improvement in quality would have helped the public schools deliver on their primary goal as a driver of growth by equalizing access to human capital.

A critical view of the ability of decentralization to deliver on these objectives must address potential problems of design (related to technical inadequacies) and particular obstacles arising from local conditions, such as lack of implementation capacity. In particular, success will be compromised if the reform lacks a proper balance between greater local autonomy and stronger central administrative capacity. This equilibrium is required to guarantee several things: first, that the funding scheme and contractual arrangements create effective incentives for schools and teachers on the basis of performance (and not just increased coverage and sen-

iority, respectively); second, that information generated by the performance evaluation system is used and disseminated so as to foster competition and demand for quality; and third, that disparities in the managerial abilities of local actors (which are typically correlated with the local poverty rate in a regressive way) are recognized so that capacities and funds can be transferred appropriately.

The proposed reform was flawed on some of these fronts, and this alone would have compromised its success. Although the proposal was based largely on the Chilean model, some effort was made to account for the poorer administrative capacity of Peruvian municipalities and to favor the decentralization of responsibilities from state actors to school actors, and not across bureaucracies. (Comuneds were supposed to convene local representatives, not just local authorities.¹¹) Moreover, the idea was to transfer public school management to communities gradually. However, the proposed funding scheme was based only on the number of students in regular attendance, no incentives were provided to foster quality-oriented reform at the school level, and no detail was given about how the evaluation system would be implemented or whether further incentives would be given to schools and teachers on the basis of merit. Furthermore, no specific acknowledgment was made regarding potential disparities among beneficiary communities. Thus, it seems the balance would have tilted in favor of local autonomy, with little emphasis on the need to strengthen administrative capacities or expand central funding. This bias probably stemmed from an excess of confidence in the market, combined with the compelling need to downsize the state and reshape its role in the economy.

Although these design problems failed to manifest themselves because the reform was never implemented, they permeated into the main obstacle to this reform, namely, its lack of political legitimacy. As documented in Ortiz de Zevallos et al. (1999), educational experts and veto groups with different motivations joined ranks to oppose the reform, persuading the public that its main purpose was privatization rather than decentralization and that it threatened the constitutional right to free and universal schooling.

The authoritarian nature of the regime, the top-down way in which the reform was proposed, and the absence of any prior public debate or dissemination strategy involving potential beneficiaries (including parents) all contributed to the reform's failure. In the public's mind, the transfer of educational responsibilities to local governments, which were (and remain) hardly synonymous with efficient administration, raised fears rather than enthusiasm. Further fueling these worries was the lack of any pilot experience that, if successful, could have reassured the

11. Some would argue that this decision was driven not only by the objective of overcoming obstacles from local conditions, but also by President Fujimori's discontent with the 1993 municipal elections, where independent candidates won in the majority of provinces and districts (Ortiz de Zevallos et al., 1999).

public of the reform's potential. At the end of 1993, amid strong public opposition that nearly cost the government the approval of the new constitution, President Fujimori abandoned the effort, and in May 1994 Congress repealed the three decrees that had launched the process.

It is worth noting that the rapid erosion of political capital observed in this episode is not a necessary attribute of education reform. In fact, Peru's experience contrasts sharply with that of Argentina, where education reform helped bring together political actors from different factions within the ruling party, thus fostering cooperation on later economic reforms (Corrales, 2006). Argentina's "provincialization" of education was packaged with promises of increased infrastructure spending, which helped soften the appearance of a reform that sought to reduce the central government's fiscal burden by delegating responsibilities. The political context in Peru was very different, and the general public came to believe that this reform was just another attempt to cut spending, this time by eroding a hard-won fundamental social right.

ACT TWO: COPING WITH THE STATUS QUO

By mid-1993 the Fujimori government's emphasis regarding public education had already changed in favor of the provision of basic infrastructure through the recently created Instituto Nacional de Infraestructura en Educación y Salud (INFES). The idea was to lower school dropout rates, especially in rural areas, by providing new schools. Several empirical studies relying on cross-sectional data (Castro and Yamada, 2006; Yamada et al., 2007) have indeed found that the number of students per school is a significant determinant of school achievement (in terms of enrollment and graduation rates), and that the provision of infrastructure and the quality of education can be highly correlated. But Peru's low-quality educational equilibrium was not just a matter of inadequate infrastructure. In fact, alleviating disparities in access to basic education infrastructure is only a necessary, not a sufficient, condition for improving quality in an equitable manner, because strong complementarities exist between physical and human resources in providing educational services. Moreover, mere provision of infrastructure can help perpetuate this perverse equilibrium, if users become contented with visible outputs and fail to develop a proper demand for overall quality.

In the years that followed, and especially during the administration of President Alejandro Toledo (2001–06), emphasis was given to developing training programs for teachers, accompanied by a revision of the national curriculum, provision of standardized textbooks, and improvements in teachers' salaries (by 57 to 69 percent, depending on category and level served). However, the higher salaries were largely due to pressure exerted by SUTEP, rather than a coordinated effort to reward performance and merit. Although low salaries were one of the main culprits behind Peru's "low level equilibrium," indiscriminate wage increases were not the solution. Moreover, failure to link wage negotiations to performance will

inevitably contribute to maintaining this undesirable equilibrium, by fueling the union's ability to negotiate contract terms in which obligations and discipline are of secondary importance.

The teacher training programs, the revised national curriculum, and the dissemination of standardized textbooks, meanwhile, had problems of their own, related to technical inadequacies that led to inadequate implementation. As documented in Benavides and Rodríguez (2006), little is known about the effectiveness of training programs, and several studies reveal that the new methodologies were not articulated around the objectives and contents of the new curriculum. The training programs thus failed to transfer the capacities required to take full advantage of the distributed material, and many teachers ended up discarding the official textbooks or “adapting” their content to their own pedagogical abilities and their students’ intellectual capacity. A comparison of 1998 and 2004 performance evaluation results (Ministerio de Educación, 2005)¹² reveals little progress, despite spending of nearly \$500 million in more than 3,000 schools from 1992 to 2000.

ACT THREE: REFORM REDUX

Setting the urgency of education reform aside, one could argue that delaying reform for nearly fifteen years may yet have positive consequences, but only if Peruvians take stock and learn from their experience and that of other Latin American countries. Soon after returning to office in 2006, President Garcia revived the idea of a thorough reform of the education sector, and of decentralization (which he called “municipalization”) in particular. Three milestones characterize the beginning of this third act, which is still under way: the introduction of a pilot decentralization program in October 2006; the regulation in July 2007 of the Sistema Nacional de Evaluación, Acreditación y Certificación de la Calidad Educativa (SINEACE), created in May 2006 under President Toledo; and the approval of a new Teachers’ Labor Code (Ley de Carrera Pública Magisterial) that same month.

The pilot decentralization program involves fifty-six of the country’s more than 1,800 municipalities during 2007–08. The proposed strategy involves creating in each municipality a Municipal Education Council (Consejo Educativo Municipal), led by the local authority with representatives (school principals, teachers, students, and parents) from all public schools in the district. The usual disclaimers related to design and implementation capacity apply, and just how funds will be transferred to local governments remains unclear. But what is new about this ini-

12. As reported in Ministerio de Educación (2005), no significant differences were found between 1998 and 2004 in the verbal communication performance of primary and secondary school students. In mathematics, primary school students performed no differently in the two years, and secondary school students did slightly worse in 2004.

tiative is precisely the fact that it is a pilot experience. This signals not only that the transfer will be gradual, but also, if correctly monitored and successful, that it will provide evidence of the potential gains from delegating school management to local actors.

The regulation of SINEACE is another important reform, since this office is now charged with evaluating and certifying quality and determining standards at all educational levels. As discussed later, this office could play a crucial role by providing the information required to tie incentives to quality and foster demand for better services.

Reviving the idea of decentralization led, not surprisingly, to the teachers' union again raising the privatization specter. Their concerns, however, were rapidly diverted toward two other policy initiatives that impinged directly on their interests: the system of teacher evaluation and the new labor code. The most important features of the new code are the recognition of merit and performance as the main determinants of promotions and raises, and a new system of individual evaluations to assess whether teachers should be retained and promoted.¹³ In an atmosphere of increasing mistrust toward this type of policy initiative, fueled by low salaries, poor working conditions, a limited budget, and government's failure to meet the objectives established in the previous labor code, opposition groups and union leaders easily convinced many teachers that this new code was nothing but an attempt to deprive them of their job stability. Massive public demonstrations nationwide followed passage of the law.

How to Move Forward?

We have already identified the two critical issues that any successful reform must address if the education sector is to fulfill its role as a vehicle of social mobility: the quality of public basic education and equality of access to higher education. On the quality front, the recent initiatives just described seem to point in the right direction. However, their success will depend crucially on policymakers' awareness of and skill in avoiding several of the constraints and obstacles noted in chapter 2.

The first of these is the potential lack of legitimacy, made worse by the fact that the costs of reform will be concentrated on a group with considerable veto power (the teachers' union), while the benefits will be dispersed throughout the population and difficult to observe and measure in the near term. A second issue is lack of adequate implementation capacity and problems of design related to technical inadequacies, which make it difficult to attain a proper equilibrium between local autonomy and central administrative capacities. As already mentioned, the for-

13. The first type of evaluation is compulsory and takes place every three years. Teachers who fail this evaluation will be provided further training and up to two chances to be approved; those who fail three times at the same career level will be dismissed. The second type of evaluation is not compulsory, occurs every three years, and must be passed for promotion to the next career level.

mer should promote efficiency and accountability, while the latter ties incentives to quality, gathers and disseminates information regarding performance, and promotes equity by recognizing and correcting local disparities.

Several policy recommendations follow. First, further confrontations with the teachers' union should be avoided, now that a new labor code that rewards merit and explicitly uses performance evaluation results has been approved. In fact, the code is a major breakthrough,¹⁴ and any new elements that cause distress to teachers could put the whole reform at risk. The central authorities must acknowledge that, given past experience, teachers will be wary of the new rules being abused, despite great efforts to ensure that the new code emphasizes training and rewards good performance. Second, efforts should now focus on defining the specific criteria and indicators to be used in monitoring quality and performance. Now that laws and basic regulations have been passed, this second, more technical stage is particularly prone to design problems that can end up disconnecting incentives from proposed objectives.

The primary objective of a basic education system is to provide children with the essential cognitive skills to interact effectively in society and possibly to pursue a college degree. Thus, quality must be measured in terms of whether such skills are being taught. The Ministry of Education, via its Quality Measurement Unit, has already conducted several performance evaluations, measuring students' reading comprehension skills and their ability to solve logical and mathematical problems. Several well-defined benchmarks also already exist: for example, after finishing second grade, students should be able to read with understanding at a rate of 60 words per minute. These benchmarks could be readily applied and the results disseminated.

As mentioned, SINEACE is charged with designing indicators and standards to measure educational quality nationwide. Here two important issues must be considered. First, visible outputs (training for teachers, textbooks, infrastructure, and even enrollment and completion rates) should not be confused with outcomes (learning of basic skills), although the two can be correlated. Second, SINEACE must rapidly take stock of measurement techniques and simple standards already available to proxy such learning. It is important to determine and publicize, as soon as possible, how many and which public schools are meeting the standards.

Once this has been established, special recognition in the form of bonuses should be given promptly to well-performing schools, using the quality standards established by SINEACE. Waiting to award these bonuses until decentralization proceeds and funds are transferred to local governments could cause unnecessary delay in tying incentives to quality. Such rewards will create incentives for schools to implement quality-oriented reforms, thus promoting local capacity building.

14. Corrales (2006) identifies the failure to reform teachers' labor codes as one of the major design shortcomings of education reform in Latin America.

The rewards will also complement the reforms already introduced in the new labor code. A system of rewards is also important because although SINEACE's governing regulation establishes incentives for school certification, the accreditation process will be time consuming and remains voluntary.

The new labor code also establishes that SINEACE will play a role, together with the Ministry of Education, in designing indicators and measurement instruments for monitoring teachers' performance. This provides an opportunity to tie teachers' retention and promotion to the criteria and standards used to measure quality: well-performing teachers are those whose students demonstrate basic reading, mathematical, and logical skills. Giving more weight to these objective criteria will minimize the risk of corruption and help shelter the education system from politics.

Finally, performance results should be disseminated as a means of encouraging households to demand higher quality. Transparency and simplicity are essential to building public support: the expected benefits will become clearer, the better the population is informed about the outcomes they can expect from reform and the progress made. A string of successful teacher and student performance evaluations evidencing the impact of new selection criteria, training, and decentralization efforts will then build legitimacy for further reforms.

In this regard, the Ministry of Education recently announced that parents and teachers will be given the results of students' evaluations, and that parents will have access to a guide explaining the skills that their children should attain in each semester. Policymakers should be aware that, initially, this can have some costs in terms of parents' perception of the quality of service. However, it remains crucial to foster consensus around the need to persist with the reform.

The recent reform milestones and the recommendations so far point toward improvement in the quality of public basic education. Unfortunately, there has been little discussion of the second reform front: equalizing access to higher education. In fact, SINEACE's efforts currently emphasize the design of criteria for the accreditation of higher education centers that train basic education teachers. Although this is also a priority given the mixed quality of the existing centers, this effort is focused on the first reform front.

The primary objective of higher education is to increase future consumption by building a more highly skilled labor force. Unfortunately, performance evaluations and indicators like those available for basic education do not exist for higher education. As proposed in Yamada and Castro (2007), efforts to assess the quality of higher education must include not only periodic faculty evaluations, but also transparent, market-based indicators that reveal to all potential students the possible economic gains from studying at a given institution for a particular career.

If the benefits of growth are to be broadly shared, however, the most compelling issue for higher education is unequal access. Nearly nine out of ten high school graduates from the poorest 20 percent of Peru's population are effectively excluded

from higher education. Yet the empirical evidence demonstrates that access to such education, whether public or private, offers the best chance of escaping poverty.

Although quality improvements in public basic education should help equalize access to higher education, this is a long-term endeavor. Some complementary measures are therefore needed in the near term. Given that public higher education in Peru is currently free for anyone who can access it, charging tuition to non-poor students would arguably be a sensible first step, because it would reduce demand from nonpoor households while also providing funds that could be used to expand coverage.¹⁵

However, the lessons learned from past reforms and the obstacles identified by the framework argue against this recommendation for the near term: legitimacy problems would inevitably arise and generate confrontation. Instead we propose an expansion of higher education credits. Publicly provided credit for higher education is currently managed by the Ministry of Education's *Oficina de Becas y Credito Educativo*, which currently offers close to \$10 million in credits annually. However, a look at the schemes currently offered suggests that they fail to promote long-term investment in higher education. Students must begin repayment only a month after funds are transferred, making the current scheme more of a transitory shock absorber than an effective instrument for long-term financing.

An improved higher education credit scheme could help alleviate the problem of unequal access. In such a scheme, funds would be provided by the financial market and oriented to poorer households. Thus households would have to demonstrate their ability to repay not from current income, but rather from the increase in their future income stream resulting from the student's higher education. Second, the state should play a subsidiary role by, for example, providing the collateral that poor households are unable to pledge, thus assuming a contingent liability.

Realizing the promise of a larger incremental income stream depends, of course, on the quality of the education provided. To ensure that borrowed funds are spent on high-quality education, countries such as Chile lend only to students admitted to accredited universities. Since Peru's accreditation system is still in its inception, some other risk-sharing mechanism would have to be devised: for example, the participating universities could be asked to share the burden of providing collateral; the better universities would then self-select. Incentives for doing so (from a private point of view) could be provided by guaranteeing that the credit scheme will cover all educational expenses. Private universities would find this attractive, since they would otherwise charge poor students a modest tuition. In fact, most private universities in Peru already vary their tuition depending on the student's

15. As documented in Bejar and Montero (2006), charging tuition fees to nonpoor students can significantly increase the resources available to public universities. Working with the University of San Marcos (the most important public university in Peru), the authors show that collecting tuition from the richest 60 percent of the student population could secure up to \$9.3 million a year, or around 11 percent of the university's annual budget.

socioeconomic background. Although this implies that the credit scheme would be smaller in scope than one might wish, it could prove successful as a transitory mechanism until SINEACE can fulfill its larger role.

Finally, it is worth emphasizing that the legitimacy and design problems stressed throughout this chapter are interconnected. Although the former arise mainly when the government first puts forward a reform, and the latter when it is implemented, the latter also feed back into the former. Ambiguous messages about how the reform will be implemented and what outcomes are to be expected tend to foster impatience and discontent with the reform process.

In the 1990s both public administration reform and educational reform faced significant legitimacy problems related to the nature of the political regime, after President Fujimori concentrated power and exercised it in an authoritarian and arbitrary manner. In both cases the weakness of representative democratic institutions could itself be considered an obstacle to reform, and this helps make the case for the third “missing reform,” which we take up next.

Missing Ingredient #3: Political Reform

Comparative research suggests that in addition to their intrinsic value, democratic political systems tend to outperform dictatorships at adjusting to external shocks, investing in human development, protecting the property rights of the majority, and achieving economic stability and social equity over the long run. The elements of democracy considered most important for these ends include universal suffrage, a bill of rights, separation of powers, respect for the rule of law, and the existence of strong, autonomous institutions, including political parties, unions, and other interest groups (Karl, 1996; Rodrik, 1997; Sen, 1999).

Historically, of course, democracy in Peru has not worked this way. Authoritarianism has prevailed during most of Peruvian history, and until recently democracy was considered by both conservatives and radicals an obstacle to various national development goals. Political power has been highly concentrated and at the same time highly unstable, exercised arbitrarily with only limited checks and balances. Although separation of powers is constitutionally mandated, in practice both Congress and the judiciary have been weakly institutionalized and ineffective; political parties and most interest groups have also been weak and fragmented.

In our view, the volatility of Peru’s politics and the weakness of its representative institutions have been obstacles to laying the foundations for inclusive growth. They have made it difficult to enforce basic rules and rights, ensure government accountability, and promote sustained collaboration among key actors toward major policy goals, whether they be reducing poverty, reforming the educational system, or reforming the state apparatus. This situation, in turn, favors the emergence of popular “outsiders,” who propose to suspend democratic politics in order

to establish order and attempt bold social change (Sanborn and Panfichi, 1996; Morón and Sanborn, 2007).

Can the reform of Peru's political institutions improve the prospects for inclusive growth? If so, which institutions, and what kind of reforms? Over the last quarter century, numerous changes have been made in the formal rules and institutions of Peruvian politics, through new constitutions (1979 and 1993), electoral and party legislation, executive decrees, and extra-parliamentary agreements. Although diverse and piecemeal in nature, these changes have largely sought to strengthen the executive, expand electoral participation and competition, and regulate the political party system. Some of these reforms directly or indirectly addressed the foundations for inclusive growth, but only a few have made progress toward that end, while others have been ineffective and some clearly counterproductive.

Here we briefly examine the main challenges that political reformers have faced in Peru in recent years, highlighting some problems of design as well as difficulties in implementing institutional change in the volatile Peruvian context. The main question is: How has it been possible politically for Peru to continue so long without significant economic and social inclusion, and why has inclusion not been a top priority on the political agenda, at least between elections? We examine how various institutions and rules may have helped prolong this situation.

The Political Challenges to Building Inclusive Growth

WHO GETS ELECTED? WEAK PARTY STRUCTURES AND WHAT SUSTAINS THEM

Free and fair elections with universal suffrage were first held in Peru only in 1980 and were interrupted during the 1990s. Hence, although voting is obligatory and turnout high, informed electoral participation and constructive competition remain weak. Political parties in Peru have not served as effective vehicles for citizen education or representation of interests.

Although politics in the 1980s was marked by competition among three main parties or blocs—the centrist APRA, Acción Popular, and the Partido Popular Cristiano (PPC) on the right, and the Marxist United Left alliance—all were characterized by arbitrary and personalistic leadership and fraught with internal disputes, and each was widely rejected by voters after failing to govern effectively during its brief spells in power.¹⁶ During the 1990s these groups were overtaken by a plethora of smaller movements and splinter parties. The triumph of

16. In 1980–95 Acción Popular governed in alliance with the minority PPC, and APRA under Alan García governed from 1985 to 1990; meanwhile the United Left held numerous municipal governments, including Lima's. For more on Peru's parties in the 1980s see Sanborn (1991) and Tanaka (1998).

Alberto Fujimori, a political outsider who refused to build a solid party of his own, accelerated the downfall of the then-existing parties. Although low barriers to entry and other electoral rules facilitated this outcome, it was voter disgust with party performance that created the opportunity (Morón and Sanborn, 2007; Tanaka, 2006).

To varying degrees, Peruvian parties since 2001 have continued to revolve around personalities rather than programs or ideology; they have few roots in society and little institutional life between elections. They lack the ability to aggregate citizens' interests effectively and represent them in the public sphere, and they lack the professional cadres and cohesion necessary to manage the state or undertake effective oversight of government. Thus, although civic association and collective action are relatively strong in Peru, partisan identification is low (around 5 percent of the population), and parties are highly unpopular even by Latin American standards. Indeed, comparative analyses rank Peru as having the weakest party system in the region (Mainwaring and Scully, 1995, pp. 16–17; Payne et al., 2002, p. 143).

Why have Peru's political parties remained so weak? Part of the answer lies in their lack of historical continuity and their ideological and political sectarianism (Sanborn, 1991; Morón and Sanborn, 2007). The rejection of market economics by much of the Left, and the lack of consideration of human rights and equity concerns by most of the Right, made it especially difficult to forge working agreements through the 1980s or to respond to the violence of the Shining Path guerrilla movement. These factors have been compounded by electoral rules that, in the interest of pluralism, continue to encourage personalistic politics and party fragmentation.

Low legal barriers for the registration of parties and candidates, for example, encourage the proliferation of loosely knit movements with few lasting ties to voters. The majority runoff election format also encourages small parties to run separate candidates in the first round rather than form broad coalitions, and second-round alliances tend to be opportunistic and short-lived. The open-list, proportional representation electoral system without a threshold also encourages a proliferation of contenders (only since 2006 have parties had to win at least 4 percent of the total vote to gain a seat in Congress), as does the *voto preferencial doble*, which allows voters to choose their two favorite candidates from a party slate. These features, designed to enhance voter choice, also undermine party discipline and reward personality politics. In 2001, thirteen parties competed for power and eleven were represented in Congress.

REPRESENTATIVES THAT DO NOT REPRESENT

Once elected, Congress should serve as an intermediary between the citizens and the executive, while also producing legislation and preventing abuses of power by the other branches. Although presidents in Peru are also popularly

elected, members of Congress should be empowered to challenge or modify the executive agenda if it strays from campaign promises, or if they believe their constituents' voices are not being heard. For this to happen, several reforms are needed.

To begin with, links between citizens and their elected representatives are weak or nonexistent. The downsizing of Congress after 1993 to just one chamber with 120 members is cited by some analysts as contributing to its lack of popular responsiveness. In 1990 there was one member of Congress for every 30,000 voters, but by 2006 this had increased to 137,500, the highest ratio among the Andean countries. Because the number of members is constitutionally fixed, the ratio will continue to widen. However, the creation of twenty-five separate electoral districts in 2001 was designed to offset this problem, reducing the ratio of voters to members in most of the country and ensuring that all regions have some representation. Today twenty-two of the twenty-five districts are small, with two to five representatives each, and 40,000 to 80,000 voters per representative; these twenty-two districts elect 60 percent of all members of Congress. There are also two medium-size districts (La Libertad with seven members, and Piura with six), and one very large one, Lima, with thirty-five members, or 29 percent of the total, and over 152,000 voters per member. Proposals for dividing Lima into smaller districts are still on the drawing board.

Even in those districts with reasonable citizen-to-member ratios, members have few incentives to be attentive and accountable to their constituents. With few exceptions, members elected from the provinces move to Lima and soon become engaged in the capital's political life and in issues that may secure them more media attention than the bread-and-butter needs of voters back home. In practice, they have little time to return home while Congress is in session, unlike in Chile, for example, where the plenary sessions of Congress leave one week of every month free so that representatives can stay in touch with their districts.

Realistically, members of Congress can do very little to directly deliver what many voters back home want most, such as infrastructure projects or improved social services. Peru's last two constitutions stripped Congress of the "power of the purse," or the ability to amend the executive's annual budget proposal. Members may propose changes in the budget's composition, but not specific outlays. This limits their ability to transfer resources to their constituencies and encourages them to gain power and voter attention by other means.

In theory, an open-list, proportional electoral system should increase members' responsiveness and accountability. Accountability should be further enhanced by such elements as electronic voting boards and a congressional website, established in the late 1990s, where citizens can follow legislative decisions and members' voting records (Carey, 2003). In practice, however, Congress's public approval ratings have remained among the lowest for all public institutions, and turnover among

individual legislators remains high.¹⁷ Since 1980 the average legislative experience of a member of Congress has been 4.4 years, and most current members have no prior experience in this arena.¹⁸ For the most part, the media pay little attention to their voting records, and relatively few voters have access to the legislature's website or the motivation to review it. The media *have* paid attention to “scandalous” increases in congressional salaries and benefits and questionable hiring practices, which reinforce the public perception that members are basically rent-seekers rather than honest public servants.

Furthermore, Peruvians often do not view legislation as the best means to advance their interests and proposals. Real power is seen as residing with the president and members of the cabinet. However, the power of the media to deliver popular messages to the executive has increased substantially in recent years, and the semi-autonomous ombudsman's office (Defensoría del Pueblo) is widely seen as a more legitimate mechanism for investigating and documenting abuses of power, even though it lacks the authority to apply sanctions.

LEGISLATORS WHO PREFER NOT TO LEGISLATE

Under the 1993 constitution, Congress retains considerable formal authority. It can debate and pass legislation, including changes to taxes as well as approval of the budget, and it can still amend the president's budget proposal during the appropriations process. With a simple majority, Congress can also override a presidential veto of legislation and repeal decrees made under delegated authority, and the constitution itself can be amended by a supermajority. Although the president selects the cabinet, ministers can be formally questioned and censured by Congress. The president, cabinet members, and other high officials can also be impeached by a simple majority of the Permanent Commission (see below) and convicted by a simple majority of the remaining legislators (Schmidt, 2004).

What do Peruvian legislators actually do? And why is their performance so poorly evaluated? A lack of empirical research makes these questions difficult to answer. What is known is that legislators do not even do most of the legislating; as table 5 shows, more than half of all legislation from 1980 to 2001 was issued by executive decree, including most major initiatives affecting the economy, the labor market, and the provision of social services.

When Congress does legislate, as in the more proactive 2001–06 period, it has passed some important measures, including the legal framework for decentralization, public sector pension reform, a new law governing mining royalties, and the

17. In 2003 Congress had a public approval rating of 10 to 12 percent, which by 2006 had fallen to 8 percent. Approval of the new Congress in mid-2008 was around 10 to 20 percent. Individual parties received approval ratings of just 6 to 9 percent in 2003. See Apoyo, *Opinión y Mercado*, Opinión data: *Resumen de Encuestas de la Opinión Pública*, año 6, número 83, December 11, 2006; año 8, número 101, June 23, 2008; and año 8, número 102, July 21, 2008.

18. Sixty-two percent of members in the 2001–06 Congress were newcomers, and 85 percent had less than five years of experience. The majority of the 2006–11 Congress are also first-timers (Santiso, 2004).

Table 5. Peru: Decrees and Legislation by Presidential Term, 1980–2006

Legal Instrument	Fernando Belatunde, 1980–85		Alan García, 1985–90		First term, 1990–92		Second term, 1992–95		Third term, 1995–2000		Valentín Paniagua, 2000–01		Alejandro Toledo, 2001–06		Total
	Number	Percent of total	Number	Percent of total	Number	Percent of total	Number	Percent of total	Number	Percent of total	Number	Percent of total	Number	Percent of total	
Legislative decrees	348	20	263	13	156	20	174	15	119	9	10	4	41	3	1,111
Emergency decrees ^a	667*	38	1,033	53	562	72	744	62	507	38	122	49	210	15	3,845
Laws	724	42	665	34	67	9	275	23	725	54	117	47	1,122	82	3,695
Total	1,739	100	1,961	100	785	100	1,193	100	1,351	100	249	100	1,373	100	8,651
Laws vetoed (percent) ^b	38	5.2	60	9	35	52	46	17	88	12	16	14	320	29	

Source: Morón and Sanborn (2007).

a. Before 1993 this type of legislation (decrees issued under the legal protection of Article 211–20) was not formally called by this name but had the same legislative value.

b. Percent of all laws passed by Congress in the indicated period.

law on political parties discussed below. However, Congress also devotes large amounts of time to passing laws of minor importance, as well as introducing numerous bills that have little chance of passage.¹⁹ Rules allowing legislators to sponsor projects individually, rather than by party blocs, or *bancadas*, have favored this trend. In mid-2006 the new Congress changed the rules to require party sponsorship of legislative proposals, with a minimum number of members signing on. In its first eighteen months this rule appears to have reduced the number of bills, although over 2,000 were still in the works. Of the 427 laws and resolutions approved in this period, 48 percent had been proposed by the executive (Campos, 2008).²⁰

The broader problem of party discipline also makes it hard for party blocs to maintain a firm stance on key policy issues or negotiate with other groups to advance needed reforms. Once elected, members have few incentives to follow the party line. Since competitive primary elections are still uncommon, each elected legislator may feel that his or her personal agenda has priority over any broader agenda. The *voto preferencial doble* encourages this, as does the fact that some “parties” are actually loose-knit collections of individual candidates, some without clear agendas. The lack of sanctions on legislators who renounce or change their parties after election further exacerbates these tendencies. Although the new voting rules may have reduced the total number of bills proposed, they have not resolved the general lack of party discipline.

POLICYMAKING BY DECREE AND LACK OF EFFECTIVE BALANCE OF POWERS

An essential part of a well-functioning democracy is horizontal control over presidential authority and policymaking, ideally by a solid party system, an experienced Congress, and an impartial and autonomous judiciary. Weak and unstable democracies, however, tend to concentrate power in the executive and encourage government by decree.

One legacy of Peru’s long period of military rule in the 1970s was a new constitution in 1979 that gave the civilian executive strong budget prerogatives and the ability to legislate by decree, bypassing the deliberative role and accountability of Congress. The 1993 constitution expanded the president’s powers to dissolve Congress and to pass emergency decrees; it also reduced the number of members by half. In the current design, a Permanent Commission of twenty-five members convenes between the two annual sessions and has the same powers as the whole Congress, although its agenda is supposed to be defined and limited in advance.

19. More than 10,000 *proyectos de ley* were presented (and 1,200 approved) in the 2001–06 Congress, compared with fewer than 1,000 in Colombia and fewer than 300 in Chile.

20. Under President Toledo, 82 percent of laws were actually passed by the legislature. The president retained a key role, however, as 78 percent of bills presented by the executive were approved, and 29 percent of bills passed by Congress were vetoed (Morón and Sanborn, 2007; Campos, 2008).

The constitution empowers the executive to issue two types of decrees, legislative and emergency. Besides restricting legislators' ability to increase the proposed budget or insert line items, it stipulates that if the new budget is not approved by a set deadline, the executive's proposal automatically becomes law. Designed to neutralize opposition and avoid deadlock, this measure "significantly diminishes the legislature's bargaining power" and oversight capacity (Santiso with Garcia Belgrano, 2004, p. 14).

However, the current asymmetry in executive-legislative relations derives not only from the constitution's design, but also from electoral outcomes—the existence of a pro-government majority in Congress—and the relative institutional weakness of the legislative branch. In the 1990s Fujimori resorted to both licit and illicit means to control Congress and the judiciary, including generous salary increases, bribes, and blackmail (McMillan and Zoido, 2004). Although a lack of significant opposition or oversight facilitated the initial economic reform efforts of the 1990s, it also permitted unprecedented corruption and unchecked abuse of power by both civilian and military leaders. Once exposed, the scandals greatly undermined the credibility of government and brought widespread demands to restore the rule of law and place more effective checks on executive power. Since 2001 the challenge has been to do this without returning to the polarization and policy stalemates of the past.

Congress also tends to function poorly as a forum for informed public debate: the delegation of legislative authority in practice means ducking public deliberation. Furthermore, as mentioned above, Congress largely fails to hold other agencies of government accountable for their actions. This is notable in public budgeting, where the constitution limits what Congress can do, but it is also true in taxation, where Congress regularly delegates authority to the executive and rarely monitors the latter's tax initiatives (Santiso with Garcia Belgrano, 2004).

Many members of Congress lack the technical capacity or the political incentives to hold government accountable, because of the weakness of their parties, their own limited experience and high turnover, and the limited institutionalization of the committee system (Santiso with Garcia Belgrano, 2004). Each of the 120 legislators serves on three to five committees, on average, whose membership changes annually, and even the budgetary review process is not governed by stable rules or personnel (Santiso with Garcia Belgrano, 2004, p. 20; Campos, 2007b). Most parties do not provide expert advisers to their congressional blocs, and although individual members may hire their own advisers, they often do so based on nontechnical criteria. Once the budget is approved, Congress also has little say in how public resources are actually spent. The authority to issue emergency decrees gives the executive discretion over subsequent budget changes, and legislators lack the skills or the motivation to monitor spending closely. Although limited resources may partially explain the lack of a professional congressional research service or reliable partisan think tanks, the parties have shown little interest in changing this situation or challenging executive dominance.

Although Congress became more active after 2001, when presidents lacked majority control, legislators with short time horizons and little party support or discipline remained reluctant to engage in complex and potentially controversial policy matters. Furthermore, given that legislators lack authority to initiate spending, they depend primarily on contacts with and favors from the executive to provide benefits to their constituents; hence they often agree to delegate authority to the president in exchange for these favors (Morón and Sanborn, 2007; Santiso, 2004, p. 11).

Poll results and qualitative evidence suggest that Peruvians today perceive most legislators as ineffective, corrupt, or both. In the popular stereotype, a legislator is someone who aspires to Congress in order to enrich himself or herself (as quickly as possible, given the general volatility of politics), obtain jobs for friends and family members, and secure other sources of income and power through political contacts or outright corruption. Although members' motivations are more complex than that, and some are genuinely motivated by ideology, party militancy, or commitment to public service, the clientelism and corruption of the parties in power during the past twenty-five years tends to confirm the stereotype. Because many of the weaknesses of Congress stem from those of the party system, reformers since 2001 have focused on trying to address this situation directly.

*Political Party Reform: “Hecha la Ley, Hecha la Trampa”?*²¹

After the Fujimori debacle, the country's more experienced party leaders came to agree that the country's weak and fragmented party system seriously undermined the quality of governance and their own legitimacy. Although an array of measures was proposed to correct this situation, ultimately the leaders agreed on a more concerted effort to regulate parties directly. The Political Party Law of 2003 (PPL) aimed to raise barriers to party formation and competition, encourage alliances among smaller movements, and promote internal democracy and transparency.

Until 2001, Peru was one of the few countries in Latin America without specific legislation regulating parties and party competition. From 1980 to 2002, proposals to reform the party system were repeatedly thwarted in Congress. According to Fernando Tuesta (1996), political scientist and former head of the National Office of Electoral Processes (Oficina Nacional de Procesos Electorales, or ONPE), competitors formed an implicit pact to avoid setting clearer and stricter rules in this arena. Although party reform had been discussed before the 2001 election, it took twenty months to negotiate a law acceptable to a majority of contenders. The draft proposal was produced by a small group of congressional

21. Roughly “make the law, make the loophole.” Unidad Nacional candidate Lourdes Flores used this common phrase to describe the implementation of the Political Party Law (cited in Crabtree, 2006, p. 50), and Tuesta and Mendieta use it to title their recent article on party finance (2007).

leaders, including Jorge del Castillo of APRA and Henry Pease of Perú Posible, working with experts from ONPE and several nongovernmental organizations (Crabtree, 2006, p. 43). The final proposal was approved by a close vote in Congress and promulgated on October 1, 2003.

The new law covers three main issues: the constitution and recognition of parties, internal party democracy, and party finance and access to media. Under the law, to register for electoral competition, a party must have a set of internal rules, a government program, and a list of supporters totaling no fewer than 1 percent of voters in the last election (128,000 as of 2001). Parties are also required to demonstrate the existence of local committees in at least 65 of Peru's 194 provinces and 17 of its 25 departments. Each party committee must have at least fifty members, who are legally inscribed in a *padron partidario* and have rights and obligations in the organization; this list must be published on the party's website (Tuesta, 2005). This rule was designed to discourage what Martín Tanaka has called "electoral franchises," in which local personalities are temporarily recruited to run on party slates—often paying for the opportunity—without being party regulars or having established ties to the main organization. The PPL also introduced an electoral threshold (*valla electoral*): a party must receive at least 5 percent of the total vote cast in a general election to be awarded congressional seats and retain its electoral registration.²²

To promote internal party democracy, the PPL requires that parties hold democratic elections in which all registered affiliates have the right to participate, and that they hold leadership elections at least once every four years. This was one of the more controversial provisions, and the original proposals had to be modified to win approval in Congress (Crabtree, 2006, p. 44). The law also expands a pre-existing gender quota—at least 30 percent of candidates on a party's slate must be women—and extends it to internal party leadership positions as well. The law requires that parties present detailed reports of their income and expenditure, sets restrictions on the amount and sources of private campaign finance, and for the first time establishes direct public financing for parties that attain congressional representation. Negative public opinion, however, forced Congress to postpone this measure indefinitely.

In the short term, the PPL did not have the desired effect of raising barriers to entry and reducing fragmentation. Before its passage, twenty-two parties and movements were legally registered; in 2006, thirty-five were registered, and twenty-four fielded candidates in that year's elections. Although the media reported deliberate falsification of signatures and nonexistent committees in at least eleven organizations, the National Election Board (Jurado Nacional de Elec-

22. In September 2005 Congress lowered the barrier to 4 percent for the 2006 race (700,000 votes), with an exception for parties winning at least two seats in separate jurisdictions. The difference is important, since members can be elected from some departments with fewer than 10,000 votes.

ciones, JNE) ultimately approved the registration of all that applied (Keller, 2006).²³ The main problem was not the law itself, but the inability of the electoral authorities to implement it effectively and the lack of sanctions for non-compliance. Critics also charge that the JNE had little desire to confront the parties and therefore basically practiced conflict avoidance (Tuesta, 2005). Experts have estimated that had the law been applied correctly, no more than eight parties would have been legally registered.

The effect of the electoral threshold is more ambiguous. Seven groups made it into Congress in 2006, compared with eleven in 2001, and 111 of the 120 seats were won by the four main blocs. However, the threshold itself apparently had little effect, as only one potential congressman was eliminated as a result of his party not passing the bar. The small parties of the Left, which might have passed the threshold had they formed a single alliance, nevertheless failed to do so.²⁴ Four of the seven winning slates were formed hastily for the 2006 election, including the UPP-PNP coalition, created to back the “outsider” candidate and first-round winner, Ollanta Humala. Fujimori’s Alianza por el Futuro was also hastily forged by three different *fujimorista* movements. Although seventeen parties failed to make the cut and were de-registered, it remains to be seen whether this will have a lasting effect on the next elections in 2011.²⁵

Changing the rules also had little immediate effect on party cohesion or construction. Apparently, a considerable number of reported party committees were fraudulent or were deactivated soon after registration. The practice of selling party slates to the highest bidder and making deals with local power brokers seeking a trampoline to Congress remained widespread. This was clearest in the case of Humala’s electoral operation. Humala used the existing UPP to back his presidential bid and list of newcomers, after failing to register his own Partido Nacionalista. Although they held the largest single voting bloc, the forty-five individuals who reached Congress on his coattails began to distance themselves even before inauguration, and the head of his list soon broke ranks to form a party of his own.

Various parties did hold internal elections to select or ratify their leaders, a positive step that was encouraged by heightened media attention. However, the media also reported numerous cases of party leaders ignoring or overturning the results of internal elections. It was harder for civil society to monitor transparency in campaign finances, because numerous parties delayed submitting their accounts

23. Only the Si Cumple movement was denied the right to compete, because its presidential candidate, former president Alberto Fujimori, had been banned from holding public office until 2010.

24. According to Rici (2006), only César Acuña of Alianza para el Progreso in La Libertad was eliminated by the *valla*. Running separately, the leftist parties received 3.2 percent of the total vote.

25. By late 2007 eleven parties were represented in Congress in six parliamentary groups (Campos, 2007b). As of February 2008, 137 groups had requested party registration forms, including groups seeking re-registration after being excluded by the 2006 results, according to *El Comercio*, February 12, 2008.

until well after the elections, and in many cases the information presented was of dubious credibility. The electoral authorities were equally ill prepared to review and verify parties' financial reports: ONPE had just three auditors to supervise all party finances (Keller, 2006). Because the main sanction for noncompliance is the loss of public funding—under a rule that had yet to be approved as of late 2007, and that applies only to those parties with elected representatives—there are few incentives for the rest to comply.

No Silver Bullet: How to Move Forward with Political Reform

Peruvian democracy today is certainly competitive. Civil liberties have been largely restored since 2000, free and fair elections are held, and dozens of parties and movements have competed for and held public office in recent years. In this sense the opportunity to participate in the electoral process is “broadly shared.” However, the majority of citizens do not participate in or identify with any party, and voter preferences remain highly volatile. Citizen discontent is reflected in the rise and fall of presidential approval ratings, in congressional turnover rates of 75 to 80 percent each term, and in negative public opinion regarding virtually all representative institutions.²⁶ For many Peruvians, the institutions and rules of democracy are not working, and many would be willing once again to trade them away for a promise of greater social and economic benefits (see table 6; Programa de las Naciones Unidas para el Desarrollo, 2005; Camacho and Sanborn, 2007).

Although it is not the only factor, the weakness of the party system contributes to political volatility, the recurrence of unpredictable “outsiders,” and a Congress characterized by inexperience and improvisation, in which the desire to be reelected apparently plays a limited role in shaping behavior. These traits, in turn, make government less accountable and less responsive to citizens' needs and demands.

Although few of the institutional reforms undertaken in the past quarter century can be called irrelevant, some did have design problems, and there were contradictions between different rules and reforms. For the most part, changes were made piecemeal rather than as part of an integrated package. The granting of greater authority to the executive, for example, was not accompanied by measures to guarantee the autonomy and effectiveness of the other branches. The virtues of inclusion and pluralism were overshadowed by the weakness of the multiparty system and the frequent changes in leadership, traits that the electoral system and other factors tend to perpetuate. The effort to reform parties from the supply side provided inadequate incentives for voluntary compliance.

26. *Latinobarómetro 2006* reported that only 20 percent of respondents said they thought the government works for the well-being of the whole nation and not just the elite. By mid-2008, García's approval ratings placed him among the least popular presidents in the region. See the Consulta Mitovsky website, www.consulta.com.mx.

Table 6. *Peru: Popular Views on Democracy, 1995–2007*

Percent of all respondents

<i>Year</i>	<i>Support for democracy^a</i>	<i>Satisfaction with democracy^b</i>
1995	52	44
1996	63	28
1997	60	21
1998	63	17
2000	64	24
2001	62	16
2002	55	18
2003	52	11
2004	45	7
2005	40	13
2006	55	23
2007	47	17

Source: Latinobarómetro.

a. Share of respondents agreeing with the statement “Democracy is preferable to any other government system.”

b. Share responding “very satisfied” or “more or less satisfied” with the functioning of democracy.

In addition to these design problems, both external and local constraints have inhibited effective reform. One of these constraints, especially during the 1980s, was ideology, although the country has become significantly less polarized since the 1990s. Another major constraint is the state itself and its limited capacity to uphold the law and apply sanctions, as in the case of the PPL. A third constraint is the structural weakness of the civil society organizations that monitor the government and defend the interests of those who most need its attention.

Although the country’s leaders have agreed in principle on a range of broad policy objectives, moving from declaration to action remains difficult. Political and social sector reforms still have few effective and sustained advocates, and public opinion remains uninformed in key areas. The weakness of parties and interest groups and the inexperience and short time horizons of most politicians continue to hinder congressional action; meanwhile the executive continues to take the credit when things go right and the blame when they do not. Between elections, the lack of connection between local communities and national politics is tremendous. The political system still offers few incentives to focus on longer-term development needs or to engage in public dialogue about them.

If political reform is a priority in Peru, how to move forward? To achieve inclusive growth, ultimately it is the state that has to change, not just by encouraging private economic activity but by effectively taxing and redistributing wealth, changing public investment priorities, and expanding opportunities. But reform of the state is itself a political process. When done from the top down, its effectiveness

and duration have been limited. When done through a more democratic process and rooted in society, it tends to endure. Measures to reduce poverty and increase equity cannot simply be decreed from above; they require political negotiation and the engagement of diverse interests.

What more could be done to strengthen the role of the political system in this process? The first step is to give democracy more time to work, however imperfectly. Comparative research suggests that the ability to deliberate, resolve conflicts, and play by the rules tends to improve with practice (Rodrik, 1997; Schmitter and Karl, 1995). Hence it is encouraging that an unpopular president without majority support was able to complete his term in 2001 and transfer power to an elected successor. It is also encouraging that the main “anti-system” candidate in 2006, Ollanta Humala, opted for the electoral route and was ultimately spurned by a majority of voters.

Beyond merely “waiting and seeing,” more could be done to strengthen the party system and encourage more-solid party organizations, with a broader reach in society and enhanced capacity to select and retain competent members. At a minimum, the capacity of electoral authorities to monitor compliance with the existing party law should be increased, as well as the sanctions for noncompliance. Various changes in the electoral rules are also being debated in Congress. These include eliminating the *voto preferencial doble*, making voting voluntary, dividing Lima into smaller and more representative voting districts, holding staggered or separate elections for president and Congress, and imposing sanctions on members of Congress who change parties between elections. Some of these proposals have implications for other objectives, such as affirmative action and broad representation of interests.²⁷ Therefore, there is a need for clearer public discussion of what the core problems are and what changes can most effectively resolve them (Tanaka, 2006). The current legislature has avoided this task and, as of mid-2008, has shelved or postponed debate on all significant political reform proposals.

Although a Congress with fewer, more disciplined parties should be a more effective Congress, further reforms within the legislature itself could also enhance its oversight capacity. In addition to enforcing the requirement that parties screen and approve their members’ legislative proposals, important steps would be to institutionalize the committee system and procedures, reduce turnover in their composition and leadership, and encourage greater thematic specialization by members (Campos, 2007b). Establishing more professional criteria for congressional advisers, assigning them to party blocs rather than individuals, and creating

27. For example, studies by Schmidt (2004) suggest that the *voto preferencial* tends to favor female candidates. And it is widely assumed that in the short run, voluntary voting would lead to reduced turnout among poor and rural citizens.

a well-endowed congressional research service available to all members would also be steps forward (Tanaka, 2006).

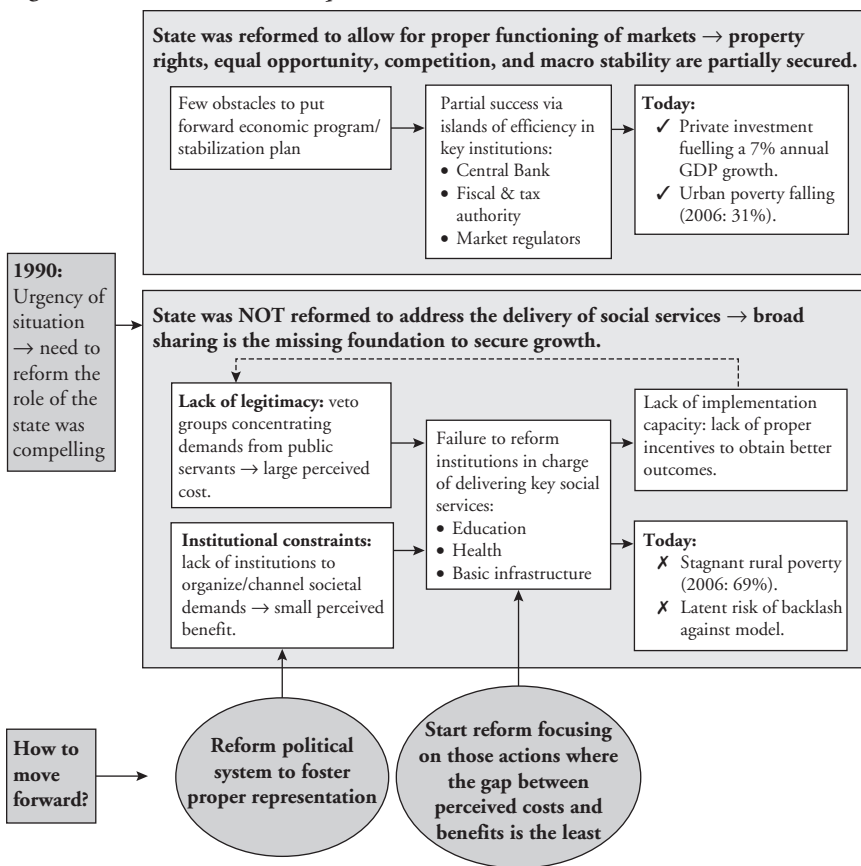
Important as it is to enforce and, where necessary, modify existing rules and institutions, that alone is not sufficient. Given the weakness of the current parties and the reluctance of elected authorities to reform political institutions once they are on the inside, nongovernmental organizations (NGOs) and the independent media must work to monitor politicians' behavior and keep political reform on the agenda. It is important to defend and enhance their capacity to do so. NGOs of different orientations involved in research and advocacy are monitoring public agencies, trying to hold leaders accountable, and providing public education to improve the quality of citizen demand. They have also provided dozens of trained professionals to the public sector. In recent years NGOs have been created specifically to promote various aspects of good government, including fair elections, voter education, stronger parties, budget transparency, and the monitoring of local governments and Congress. Although these organizations share some of the same traits as political parties, they may be better organized and more disposed to form alliances. Combining citizen vigilance with promotion of policy alternatives, and coordinating with the ombudsman and sympathetic members of Congress, such organizations teach citizens to defend their rights and monitor their authorities. Ultimately, such empowerment of citizens is the best antidote to *caudillismo* and a necessary complement to reform from within.

Conclusions

The CGD framework has allowed us to identify the broad sharing of the benefits of growth as the “missing foundation” in Peru and to focus our discussion of administrative, educational, and political reform accordingly. This in itself is a major and novel contribution of the framework, in our view, as it prevents policymakers from being swamped by a laundry list of reforms, all of them necessary but in the aggregate surpassing the implementation capacity of the country's institutions. With these limitations in mind, we have proposed a short list of policy initiatives that we believe can help advance reform. In closing we will rely on the framework once again to explain the potential role of each of these ingredients in the reform “recipe.”

We argue that Peru finds itself today at the vulnerable equilibrium depicted in figure 6. As explained earlier, our analysis of Peru's reform efforts starts from a point when the economy was in a state of emergency. Much of the reform effort of the 1990s was driven (and justified) by this fact. The main concern of government was to return the economy to viability, restoring basic macroeconomic balance and the ability of private business to ignite economic growth. This was the route taken by the stabilization plan, which was accomplished by means of “unbridled presidentialism” (Morón and Sanborn, 2007).

Figure 6. *Peru's Vulnerable Equilibrium*



Obviously, the reforms of that period could have also focused on distributive issues or on policies aimed at improving the long-run potential of the less favored share of the population, but this path was not taken. The magnitude of the crisis left by President Garcia and the longer-term failure of state-led development since the 1970s partly explain why the thrust of the reforms of the 1990s had to be thus circumscribed. However, the main reason that the state was not reformed to improve the delivery of social services and encourage expanded opportunities for the majority was a combination of a lack of legitimacy and strong institutional constraints.

Our analysis of the attempted reforms in the education sector showed that reforms that explicitly address the issue of exclusion have concentrated costs but dispersed benefits. From the supply side, reform implies designing the right incentives for a large number of public servants, and it is difficult to build legitimacy for such changes in a public sector where salaries have always been disconnected

from results, and where the social sectors have historically been poorly funded. Thus, reform will easily face opposition by veto-wielding groups representing the demands of public servants. From the demand side, although no one living below the poverty line would disagree about the need for better social services, the desired final outcome of any proposed intervention, namely, the more rapid accumulation of human capital, is difficult to measure and invisible in the near term. Thus, the lack of strong institutions to help organize and channel societal demands translates into a small perceived benefit from reform.

As a result, although the reforms undertaken since the early 1990s have partly succeeded in securing property rights, strengthening competition, and improving macroeconomic stability, these have not been secured for all, and meanwhile the broad sharing of the benefits of growth remains the missing foundation. The outcome to date is an economy in a vulnerable equilibrium, capable of sustaining growth but still leaving a large share of the population out of the growth process. As we have seen, the benefits of Peru's current growth may be somewhat better distributed than in the past, but they are still concentrated in the country's urban areas and exclude the rural poor.

We believe the present situation can be characterized as an equilibrium in that it is backed by an economic model in which four of the five foundations for growth are at least partly secured: Peru offers private sector firms the opportunity to thrive in a market-based environment with no significant administrative impediments. In addition, the same problems of representation that thwart organized demand for public intervention in the social arena also contribute to this equilibrium. In fact, the combination of a pervasive centralism and a skewed electoral calculus still tend to leave the poor out of the solution.

However, we also believe this equilibrium is vulnerable, because of the risk of backlash from those who are excluded and those who resent the highly unequal distribution of benefits. This risk is greatest around elections and when adverse economic shocks occur. As we have seen, Peru is characterized by high electoral volatility, where underrepresented groups see each presidential election as an opportunity to revisit all economic arrangements. Between elections, political support for revising the model tends to wane if the economy is performing well; hence the ability to maintain equilibrium depends on the likelihood that the economy will get into trouble. Since a small open economy is certain to get into trouble eventually, the real question is how to minimize the impact on growth and inclusion.

Obviously, part of the answer has to do with further securing the first four growth foundations by, for example, increasing the availability of resources for countercyclical fiscal policies, and further advancing in terms of property rights and competition, to allow new businesses to flourish and promote the diversification of exports. However, because our analysis has focused on broad sharing as the missing foundation, the link we propose between adverse economic shocks and growth has more to do with the danger of exacerbating the risk of backlash

against the model. The question then becomes how to distribute the benefits of growth in a more egalitarian way, and a significant part of the answer has to do with reforming the quality and delivery of critical social services.

Before summarizing our answers, we should mention that another consequence of not having reformed the delivery of social services is the current lack of adequate implementation capacity in several key areas. In fact, problems on this front are as much a consequence as a cause of the lack of reform in the social arena: although islands of efficiency were established within key institutions that served the main objectives of stabilization, other sectors, such as justice, education, health, and the provision of basic infrastructure, were virtually ignored, and this, in turn, has contributed to the lack of legitimacy of reform within those sectors.

In concluding, then, we return to the framework and try to take stock of what we have learned about the recent reform processes so as to organize our short list of priority reforms. As discussed above, failure to address the delivery of social services has led to a vulnerable equilibrium characterized by a potential risk of backlash from those excluded. Understanding the role of our proposed policy initiatives requires organizing them in terms of the causes and consequences of this decision.

As explained above, reform in the social arena faced two major obstacles: weak legitimacy and strong institutional constraints. We believe our earlier recommendations for political reform can play an important role by mitigating these obstacles. In particular, working toward a party system that offers better representation should help organize and channel societal demands in a way that reduces fragmentation and raises the perceived benefit of embarking on a reform that addresses the broad sharing foundation. All the individuals involved—politicians, government administrators, and citizens—tend to be short-sighted, and therefore it is hard to set goals that require a longer horizon. In the absence of organizations that can channel societal demands in a responsible manner (and away from electoral calculus), the impatience of the potential beneficiaries can easily influence the planner's own behavior, who then succumbs to the temptation of avoiding policies that will deliver only in the long run.

Fine tuning the mechanisms through which the state communicates with its citizens and attends to their demands must therefore be an essential part of any serious attempt to reform the delivery of social services. Again, political reform cannot be simply decreed from above; it must be accomplished through a process rooted in society for it to endure.

The path toward a new, less vulnerable equilibrium where growth is more broadly shared, however, also requires results in the near term. In fact, the longer-term trickle-down process will surely need more time than remains until the next presidential election, during which the probability of experiencing an adverse shock is rather high. Thus, policy actions aimed at building up legitimacy and reducing institutional constraints must be accompanied by interventions that

directly address the delivery of public services. In this respect, we believe our policy recommendations addressing administrative reform and the education sector should play a vital supplementary role. For this to happen, however, reform must be decisive, focusing on those actions where the gap between perceived costs and benefits is the smallest. As already discussed, good examples of such actions include introducing a merit-based career path for new public servants, programming budgetary expansions in a results-based format, focusing decentralization efforts on a pilot macroregion, and avoiding further confrontations with teachers in order to focus on realizing the results to be expected from education reform.

Reforms still pending that address the broad sharing foundation will require changing the process by which public services are delivered, and this, in turn, means dealing with established bureaucracies at the different levels of government. Removing public intervention in markets and creating a new bureaucracy to deal with regulatory issues is one thing; transforming the way the state provides services that have historically come under its purview—and that employ a large number of public servants—is quite another. Thus, if results are to be seen in the short term, it must be acknowledged that reform from within is not easy and that changes must be introduced incrementally. Focusing and persisting on a narrower set of reforms in the social arena, in turn, will make it much easier to avoid potential design problems and foster implementation capacity at lower levels of government.

APPENDIX

Judicial Reform in Peru

One of the main obstacles to inclusive growth in Peru is the lack of a well-functioning state, essential to which is an independent and efficient judicial system. A strong judiciary is indispensable for upholding the rule of law and the rights of all citizens and for ensuring a stable investment climate in which property rights and contracts are respected. The separation of powers and government accountability are incomplete if the judiciary is subordinated to other powers and interests.

Peru's judicial system has been historically weak, and the majority of citizens do not use it to solve their problems. As documented in numerous studies, access to justice is limited by longstanding economic, social, and institutional barriers, including ethnic and gender discrimination, the high cost (direct and indirect) of using the system, extreme delays, and corruption (Bhansali, 2007; Morón and Sanborn, 2007). The judiciary has also been historically subject to external control and manipulation, making it difficult to undertake necessary institutional reforms and give the judiciary greater autonomy. This situation reached a climax in the 1990s, when the executive formally intervened and subordinated the judiciary to its own political agenda.

Since 2001 the judiciary has regained formal autonomy, and some important reforms have been initiated. These include the creation of special commercial courts, increases in the judicial budget and the number of judges, and the introduction of a new penal code in two pilot districts—all measures designed to reduce the excess caseload. Through other, extrajudicial measures, including the awarding of tax stability contracts and the promotion of alternative forms of conflict resolution, those with resources and power are now better able to defend their rights, within the courts or outside them. However, barriers to access remain in place for the majority of citizens—as does political resistance to a broader reform of the system.

Justice in Peru: The Basic Structure

Peru's judicial branch comprises the Supreme Court, superior courts in each of the country's twenty-nine judicial districts, courts of first instance, and justices of the peace. The latter, who account for approximately 76 percent of all judges in the country, are not lawyers or career magistrates but respected community leaders who serve voluntarily and resolve conflicts on the basis of local custom and culture. Their decisions tend to be widely accepted, but they lack the resources to operate effectively in all parts of the country (Bhansali, 2007, p. 791).

The 1993 constitution created several new judicial institutions. The National Judicial Council is charged with monitoring the designation, promotion, and dismissal of judges. To ensure judicial independence, neither the executive nor the legislative branch is represented on the council. A National Judicial Academy is responsible for selecting applicants to judgeships and training judges at all levels. The Tribunal of Constitutional Guarantees is an autonomous organ charged with ruling on the constitutionality of all laws passed. The Public Ministry is responsible for representing society in general and for investigating and prosecuting crimes.

The 1993 constitution also created the Public Defender or Ombudsman as an autonomous position entrusted with the defense and protection of civil rights and oversight of public administration and the provision of public services. Although enjoying broad public legitimacy, the Ombudsman is also politically vulnerable. He or she is elected by Congress, serves a five-year term, and can be dismissed or impeached by a congressional majority. The Ombudsman's office also faces considerable resource limitations that prevent its full presence in all regions.

The Ministry of Justice, which is part of the executive branch, not the judiciary, is charged with defending the interests and rights of the state, advising the executive on legal matters, and overseeing the development and revision of the state's legal framework. The ministry also establishes ad hoc prosecutors when necessary to investigate charges of corruption and abuse of power.

During the 1990s the Fujimori government intervened extensively in the judiciary. After the 1992 "self-coup," the executive disbanded the existing judiciary,

dismissed thirteen members of the Supreme Court, named a large number of provisional judges, and formally placed the judiciary under executive control. By 1997, 73 percent of judges had been shifted to provisional status, making them subject to dismissal at any time and hence highly susceptible to political and economic pressures (McMillan and Zoido, 2004, p. 13). Members of the judiciary were coerced, intimidated, and bribed in order to advance the political objectives of the president and his core advisers.

Although Peru's Tribunal of Constitutional Guarantees enjoys broad public legitimacy, it, too, has been politically vulnerable, and it lacks the power to reverse government policies that its counterparts in Brazil and elsewhere enjoy. Congress elects the tribunal's seven members, who serve five-year terms that coincide with those of the president and Congress, may not be immediately reelected, and may be impeached.

Under the interim government of President Valentín Paniagua (2000–01), the Executive Commission in control of the judiciary was deactivated, and another, temporary council was charged with reforming this branch. Anticorruption proceedings were also initiated against leading political and military figures of the 1990s, led by respected special prosecutors named by the executive.

In 2003 judicial reform received a new impetus, led by a Comisión de Reestructuración del Poder Judicial (Ceriajus), and congressional commissions were created to undertake constitutional reform of the system and draft new laws governing judicial careers and public defenders. Yet so far relatively little progress has been made within the judiciary itself toward reducing the main barriers and problems in the system. And according to judicial expert Fernando Eguiguren (2007), reform efforts by Congress have been stalled by disagreement among those who want integral reform of the 1993 constitution, a return to the 1979 constitution, the convocation of a new constituent assembly, or no further reform at all. Hence, although overt executive intervention has been reduced, resource limitations and case backlogs remain severe, many judges and attorneys are poorly qualified, and procedures and technology remain outdated. Incentives for corruption remain great, and experts suggest that it will take considerable time before independent and efficient behavior by the courts can become the norm (Morón and Sanborn, 2007).

Barriers to Access

As emphasized in a recent World Bank report (Bhansali, 2007) and other sources, there are at least three major types of barriers to access to justice in Peru: economic, social, and institutional.

Economic barriers include the official and unofficial costs of judicial services and the resulting systemwide corruption. Costs include the payment of judicial fees and lawyers' fees, the opportunity cost of time involved in litigation, and the

cost of bribes for speeding up a case. These costs are especially onerous on the poor and on rural Peruvians generally, who may have to travel and miss work to pursue a case. The scarcity of free legal services exacerbates this situation: according to one recent study, of the 547 lawyers assigned to the justice ministry, only 55 work in the free legal clinics available to needy citizens (Hernandez Breña 2004, cited by Bhansali, 2007, p. 794). The typically long duration of legal proceedings is also a barrier for all users, especially the poor.

Costs are especially high for small and microenterprise owners. Studies show that the costs of litigation are proportionally higher for those with smaller debts, which discourages them from using the system. According to the World Bank report *Doing Business 2005*, it takes 381 days and 35 separate procedures to conclude a commercial contract in Peru. One study cited by Bhansali (2007, p. 794) suggests that if access to justice for small businesses were improved, their economic activity would increase by 25 to 50 percent.

Peru's judiciary is rife with corruption, which is both a cause and an effect of the system's inefficiency, and which undermines the system's legitimacy. According to Transparency International, Peru has one of the highest judicial corruption indexes in the region, and the *perception* of corruption in the judiciary is the highest of all public institutions (Bhansali, 2007, p. 794). Users with the necessary resources can make informal payments to get a case assigned to a specific judge, speed up proceedings, and influence the judge's sentence. Although several specific cases of judicial corruption have been identified by the media and dealt with, those who benefit from the current situation resist proposals for broader anti-corruption reforms.

Social barriers to justice in Peru include language barriers and culture and gender disparities. As with other public services, indigenous people, the rural poor, and especially low-income women lack equal access to the courts. The predominant language in the judicial system is Spanish, and the system is formalistic, complex, and based heavily on written proceedings. Many rural and indigenous Peruvians have an inadequate grasp of Spanish to understand the legal technicalities involved, and have difficulty presenting their cases to lawyers and judges and exercising fully their right to a defense. Efforts to train translators in native languages and to encourage use of such languages in the courts have been limited, as have efforts to incorporate cultural and gender sensitivities into legal and judicial training.

Traditional forms of community justice, although widely respected by the population, remain subordinated to a legal system that is not always appropriate for resolving conflicts. Although the 1993 constitution recognizes special jurisdiction for peasant and indigenous communities, little attention has been paid to its effective and fair implementation (Bhansali, 2007, p. 797). The media frequently cover stories of exasperated community members "taking justice into their own hands" in cases involving robbery, rape, or property disputes.

Gender discrimination and the sexist application of laws are also a serious problem and are aggravated in the case of rural women. The inefficiencies of the system also affect women more, to the extent that they have lower incomes and less education and are less informed about their rights. Men and women in Peru tend to have recourse to the judicial system for different needs, following the roles assigned them by society. Women tend to be plaintiffs in cases related to child support, domestic violence, and the dissolution of marriage. The sheer volume of unresolved cases of this type, the slowness of the proceedings, the lack of prepared judges, and the vulnerability of the system to corruption all take a toll on the women involved. One study shows that 75 percent of demands for child support presented by women in 1998 were still unresolved in 2002 (Bhansali, 2007, p. 798). A recent media report (*El Comercio*, February 16, 2008, p. A2) suggests that a case of domestic violence takes a year or more on average just to get a hearing.

Institutional barriers to access to justice include lack of transparency in the selection of judges and lack of adequate training, resulting in inadequate knowledge of norms and jurisprudence in the material they must resolve. The excessively formalistic and bureaucratic behavior of judges and their often literal and closed interpretation of laws create especially difficult obstacles to the execution of contracts. Many judges are unfamiliar with the fields of law that most affect private economic activity, such as those pertaining to antitrust regulation, banking, insurance, and securities.

The excessive backlog of court cases is another major problem, causing long delays and errors and encouraging corruption. As of June 2007 over 2.2 million cases were pending, including civil and penal cases (and not including the Supreme Court). The largest caseload is in the Superior Court of Lima, and the heaviest backlog of cases is in the administrative area, which includes cases relating to pension benefits. Family courts also have an especially excessive caseload, as do penal courts in the low-income periphery of Lima (“Poder Judicial Emprende Plan de Descarga Procesal, Anuncia Távara,” ANDINA, February 14, 2008, citing Távara, 2007). To catch up, each of the country’s 1,617 judicial entities would have to resolve 1,376 cases a year—a clearly impossible task.

The precarious, provisional status of most judges is another major problem. Although efforts have been made to formalize judicial hiring through the National Judicial Council and to extend to legal professionals the kind of job stability that an independent judiciary requires, a report in December 2007 claimed that 51 percent of judges and 34 percent of prosecutors still held provisional positions (Villavicencio, 2007). Among them are judges temporarily assigned to cover a vacancy for which they may not be prepared, and judgeships temporarily assigned to lawyers who are not career judges or prosecutors. Although this precariousness is partly the result of efforts to expand coverage and address the backlog of cases, it poses continued problems for judicial independence and leaves judges vulnerable to internal and external pressures

Reform Efforts and Their Limitations

One of the most celebrated recent reforms has been the creation of a set of commercial courts to resolve conflicts facing private business. According to various reports, the initiation of negotiations toward a free trade agreement with the United States underscored the need for improvement in the administration of commercial justice, given the lack of specialization of civil judges in this area as well as the excessive case backlog.

In 2005 a pilot program of seven commercial courts and one superior court began in Lima, as part of a larger program supported by the U.S. Agency for International Development. Civil society organizations initially questioned the credentials of these judges and the lack of transparency in their selection, and it remains unclear whether the judges hired have the skills and experience needed to resolve commercial, banking, and tax controversies involving large sums. Nonetheless, in their first year of operation these courts resolved 80 percent of the 6,437 cases submitted to them, and after two years their superior efficiency and greater transparency were cited by judicial experts and business leaders alike as a model for the rest of the system (Bhansali, 2007, p. 803, reports that they have reduced the duration of commercial proceedings by 70 percent). According to *Doing Business 2007*, this is one of five reforms that have placed Peru among the ten countries that have undertaken the most reforms to facilitate commercial activity (“Firma del TLC Obliga a Estructura una Agenda Interna para su Implementación, opinan,” ANDINA, December 25, 2007; “Premio 20007 Buenas Prácticas Gubernamentales: Ganadores 2007” [www.ciudadanosaldia.org/premio_bpg2007/ganadores_2007.pdf]). The main limitation so far has been their limited scope, and the challenge now is to expand their number and reach beyond the capital.

Another recent reform, also in the pilot stage, is the introduction of a new penal code that will replace the traditional, inquisitional system with a more agile system with impartial judges and both sides entitled to an equal and separate defense (*Ideele* no. 184, December 2007, pp. 42–43). This system was introduced in the districts of Huaura and La Libertad in 2007, with promising results, and is set to go into effect in Tacna, Moquegua, and Arequipa in 2008. It will not be introduced in Lima until 2013.

In May 2007 the judiciary launched a new National Plan for Caseload Reduction, involving the review and updating of files on existing cases and the creation of 116 new judicial organs in the 29 superior courts, as well as 120 transitory jurisdictional organs. Yet it is widely recognized that creating more temporary courts is not enough. The system also needs to be modernized and endowed with more effective controls.

In 2007 Congress also approved (but the president did not sign) new legislation regulating the judicial career. That same year a respected female judge was

named as the new anticorruption czar, but it is not clear what her jurisdiction will be or how this office will interact with other public sector entities.

Meanwhile the majority of citizens remain excluded from the system, and little has been done to extend access to justice more broadly to the poor. The provisional and precarious nature of judgeships exacerbates the other inefficiencies of the system and makes it harder to achieve reform from within. Salaries and working conditions for judges and judicial employees also remain a sore point, as demonstrated in a prolonged strike by judicial workers in late 2007 and early 2008.

Policy Recommendations and Priorities

The need to reduce costs and other inefficiencies in the judicial system is widely recognized, and numerous reform proposals have been debated in recent years. External donors and lenders have also given judicial reform high priority, both in the 1990s (ironically) and since 2001. Proposals on the books range from mechanisms to improve judicial training, increase transparency, and increase sanctions on corruption to further initiatives to reduce caseloads directly by increasing the number of judges and courts.

There has been far less emphasis on efforts aimed at the broader sharing of benefits through reducing costs and increasing access for the low-income population, including individuals and small businesses. Proposals pending in this area include strengthening the justices of the peace and improving coordination between them and other levels of the system; providing better training for the judges and community leaders who exercise these functions; and including language, cultural, and gender understanding as part of that training. There is also an urgent need to install more basic institutions of justice in areas of high poverty, facilitate access to legal assistance and orientation for the most vulnerable, and expand initiatives such as the Centers for Free Legal Advice (Asistencia Legal Gratuita, or ALEGRA), which combine public defenders, legal consultants, and extra judicial conciliation services in one place. Expanding the commercial courts to include other jurisdictions beyond Lima, with judges versed in the needs and rights of small businesses as well as of larger firms, would also be an important step forward. However, in order to move from pilot efforts to broader systemic change, and to shift priorities to the most vulnerable sectors of society rather than the rich and powerful, considerably more political will is required than has been shown so far.

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