

A short note on Peruvian politics

By Jan Dehn and Gustavo Medeiros¹

Peru is characterised by a pronounced and somewhat unusual dichotomy between deeply dysfunctional politics and generally strong economic performance. However, recently the frequency and seriousness of Peru's political crises have been getting worse.

Peru's political problems are rooted in the deliberate exploitation of weak institutions by politicians for their own personal gain. If the failures of national elites to respond to national problems are allowed to continue the result could be deep and pervasive crises.

The upcoming general election on 11 April 2021 provides an opportunity for Peruvians and the political class to change course, but the odds are stacked heavily against reform.

This report explains the nature of Peru's political problems, outlines the reasons why reform is challenging, and sets out the changes to the political and judicial systems that would be required to break with the past.

The 'Peruvian dichotomy': economic performance and dysfunctional politics

Alejandro Toledo, president of Peru from 2001 to 2006, is fondly remembered in Emerging Markets (EM) investor circles as one of the few presidents anywhere to have ruled a country with a lower approval rating than the country's real GDP growth rate. Toledo's feat epitomises Peru's dichotomous experience over the past two decades of sound economics juxtaposed with dysfunctional politics.

Peru is one of the fastest growing economies in Latin America. The government is rated investment grade by all three international ratings agencies. International investors regard Peru as one of the best managed economies in EM, which is reflected in tight sovereign spread over US Treasuries, both absolute terms and relative to other EM countries. Yet, Peruvian politics is a mess. Peru has been a fully functional democracy since 2001 with regular competitive, free and fair elections, but despite the outwards appearance of a normal democracy Peruvians' confidence in their government, politicians, the Judiciary and the police are among the lowest in the world.

The Challenges

The Peruvian political system serves the self-interest of narrow groups rather than a broad base of the population. Corruption is ubiquitous and integral to the operation of the political system. Due to political dysfunction, the Peruvian state has poor capacity to deliver public services efficiently and large parts of the economy operate outside formal rules and regulations (the 'informal economy'). A big segment of the population endures lousy public services, bad living conditions and live in fear of crime. The elevated level of Dollarization in Peru reflects the twin problems of corruption and low confidence in the country's core institutions.

Change will not be easy. While Peru has formal separation of powers between the Executive (the government led by the president), the Legislature (parliament) and the Judiciary (the courts) these institutions do not have the capacity nor the integrity to hold each other to account, so the rule of law is neither fully enforced nor respected.

Peru's experience over the past two decades has been one of sound economics juxtaposed with dysfunctional politics

¹ With his permission, this report draws extensively on the insightful analysis of Carlos Montes, a Peruvian political economist associated with the Legatum Institute. See <https://li.com/commentaries/peru-200-years-innovations-to-ensure-competent-and-honest-political-leadership/>. The views expressed in this report are our own.

Weak institutional capacity and corruption in the Judiciary ensures that corruption of the political system and the public finances go unpunished

Weak institutional capacity and corruption in the Judiciary ensures that corruption of the political system and the public finances go unpunished. They also explain the deference of the Judiciary to the Executive and Parliament, which enables public officials to abuse public office to divert funds for their private benefit with impunity.²

Survey data from the Latin American Public Opinion (LAPOP) consistently shows that the Peruvian population is one of the most worried about corruption. Yet, at the same time *Proetica*, the Peruvian branch of *Transparency International*, regularly publishes surveys that show that Peruvians are also among most tolerant of corrupt practices. In practice, there has been little societal pressure for a reform of the Judiciary or to put an end to the corrupt practices within the political system, resulting in a generally persistent permissive environment.

Political exploitation of weak institutions

The permissive environment has turned the political system into an ideal target for self-interested individuals. Conventional political parties have been replaced since 2001 with 'informal' political groupings that are little else than temporary vehicles for political 'entrepreneurs' to run in elections. These 'entrepreneurs' are driven mainly by self-interest and manoeuvre to win power for the sole purpose of benefitting personally from electoral success and reward their financial supporters illicitly – the financial supporters are themselves usually narrow interest groups, such as illegal miners.

Over time, the political system has become based almost solely on this type of buying and selling of political favours and positions, rendering political loyalty highly fluid with a near complete absence of ideology. The 'informality' of political parties makes it far easier for 'politicians' to act without the constraints of party discipline, such as complying with internal party rules, maintaining a focus on longer horizons, following a collective approach, keeping consistency with a political philosophy, developing plans for government and building broader and more stable political coalitions.

The result is a political system with a myriad of highly atomistic political parties, which revolve around personalities, with no organisational capacity to discipline political candidates. There are no serious government plans, very few technically competent people (ministries are often given to 'independents'), and weak legislators.³

Dysfunctionality makes it difficult for citizens to assess political options. Political parties do not reflect key structural sectors of society or leaders of key sectors, such as labour trade unions, entrepreneurs, etc. The system allows successful candidates to be elected based on electoral promises and programmes, which are then changed once the candidate wins power in order to satisfy powerful interest groups. Voters cannot trust the information contained in the 'brand' of the political parties. This is why loyalty to politicians and political parties in Peru is among the lowest in any country in the world.

Downside risks

Dysfunctional politics makes it difficult to maintain political support for long, leading to frequent political crises and scandals. Running governments in this way is becoming increasingly more difficult as recent experience has shown. In just twelve months, Peru has been engulfed in no fewer than three major political crises.⁴ The collapse of near-by Venezuela, once an investment grade-rated democracy offers a stark warning about how far countries can fall if they fail to address underlying societal problems. Like Peru, Venezuela had a strong economy and many years of democratic rule before descending into a deep and pervasive crisis, in large part due to the failure of national elites to respond to national problems. Eventually, the rising frequency

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² The Comptroller General estimates that about 15% of total public expenditures is 'lost' to corruption in Peru.

³ The specific features of the electoral system that contribute directly to political dysfunction include:

- a) The use of closed lists in legislative elections;
- b) Large legislative constituencies, which breaks the links between parliamentarians and voters;
- c) Lack of internal party elections;
- d) The absence of sanctions for politicians who switch parties;
- e) Weak links between the Legislature and the Executive; and
- f) The system of second-round run-offs in presidential elections.

⁴ These include three presidents in less than a week, one of the world's worst Covid-19 pandemics and a scandal that saw politicians and VIPs jumping the queue for vaccinations.

of political crises ends up having serious economic costs, undermining Peru's hitherto enviable economic record. Indeed, there are already worrisome populist developments in the shape of serious attempts at defunding private pension funds and redistributing pension savings to the wider population. The gradual destruction of the domestic pension system puts at risk the Peruvian government's financial self-sufficiency and thereby Peru's macroeconomic resiliency.

The way forward: reform of political parties and the Judiciary

The power of legitimate political parties should be increased. In the same way that paying commissions to real estate agents can be the most effective way to buy a house and to obtain the best price, so funding well-functioning political parties transparently may be the best way to ensure that citizens select the most public spirited and honest politicians (and avoid the hidden corruption costs in terms of public expenditure, etc.). However, 'selling' the idea of reform of political parties to voters is challenging, because very few citizens would agree with any reform that has as a goal to increase the strength of political parties on account of their extremely poor reputation.

Judicial reform will also be difficult. Fear of crime in Peru is one of the greatest, but Peruvians do not associate these real-life issues directly with a weak Judiciary and the need for judicial reform. Reform-minded groups have yet to communicate effectively to voters that Peru can only provide public services efficiently and with minimal corruption, including crime fighting, if a competent Judiciary is able to sanction severely those involved in corruption.

A way forward for Peru

On 11 April 2021, Peruvians head to the voting booths again to elect a president, vice-presidents and 130 members of parliament. This provides a unique opportunity for Peruvians and the political class to decide to continue with the existing 'informal' political arrangements and a weak and corrupt Judiciary, or introduce regulations to ensure that the political system delivers leadership that focuses on the wider public interest, with integrity to deliver competent management.

Even if Peruvians agree that reform is a national priority – which is not clear – it will still prove difficult to achieve change, because the politicians who benefit from the existing 'informal' political system are exactly the same people, who would need to agree to legislate to change the system; Turkeys, proverbially, rarely vote for Christmas.

If Peru is fortunate enough to find itself with a genuinely reform-minded government after 11 April, its priority should be to lead Peru on a path away from political dysfunction. This can be done with the following four point programme:

1. Establish consensus for reform:

Build consensus around the need for political and judicial reforms to engineer corruption out of institutions, thereby establish the pre-conditions to build the Peru that the broader population wants;

2. Political reform:

Adopt reforms that strengthen both the capacity of political parties and accountability to make them more trustworthy for voters. Measures could include strong oversight by a regulator that makes it relatively easy to register new parties, but difficult for parties to remain registered by requiring:

- a. A minimal set of regulations that ensure transparency and minimise opportunities of corruption;
- b. A minimum capacity to monitor and ensure that all candidates and party members in general follow internal rules;
- c. Political parties to adopt internal democratic guidelines for the selection of their leaders (including allowing the general public to participate), and link activities to public campaign financing.

Few citizens would agree with reforms to increase the strength of political parties on account of their extremely poor reputation

The politicians who benefit from the political system are the same people, who would need to agree to change the system

- d. Modify laws to deepen links between:
- i. Politicians and voters, for example by changing the existing system of closed lists and providing for smaller electoral districts – so that voters can be more familiar with those that they elect;
 - ii. Executive and Parliament, for example by ensuring that members of the Executive are also members of the Parliament;
 - iii. Votes and political parties, by legislating that parliamentarians that switch parties before the end of their terms are not allowed to run for immediate re-election;
 - iv. Political parties and citizens' participation, for example by tying public funding to levels of popular participation in internal party processes.

3. Judicial reform:

Reform the Judiciary to make it more competent and independent to guarantee that everyone, including the state, is subject to the rule of law. When the integrity of the Judiciary is unquestioned, rulings are enforced and applied fairly to all citizens and the state. There should be no political interference in judicial processes. Independence is secured through the independent appointment of impartial, competent and honest judges. This requires full transparency with public vetting of named candidates before confirmation and broad participation in the appointment of Supreme Court judges with defined terms of office, security of tenure during the term in office, commensurate remuneration, adequate pension arrangements, etc. There should also be clear processes for disqualification and removal of judges from office to ensure integrity of the Judiciary.

Political and judicial reforms are essential if Peru is to escape the trap of dysfunctional politics

Conclusion

To a greater extent than almost any other country, Peru's economy has been able to thrive despite political dysfunction, but there is no guarantee that this continues to be the case.

The upcoming election offers an opportunity for Peruvians to end the strange hold of opportunists and charlatans on political power and kick out their enablers in the Judiciary. As always, the honeymoon period immediately after the election is the best time to effect change, so the coming month will be critical. However, the odds are stacked against deep reform.

The silver lining for Peru is that the country's economy is strong enough, for now at least, to withstand another term of sub-par politics.

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