



## CRS Report for Congress

# Peru: Political Situation, Economic Conditions and U.S. Relations

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### Summary

Peru, a coca-producing country in the Andean region of South America, has had a turbulent political history. Despite its tumultuous past, Peru has recently taken steps to consolidate its democracy and pursue market-friendly economic policies. For the past six years, Peru, a leading mineral exporter, has posted some of the fastest economic growth rates in Latin America. GDP growth reached 8% in 2006 and, despite damage caused by a recent earthquake, is expected to exceed 7% in 2007. In June 2006, former president Alan García (1985-1990) was elected president in a close race. Since taking office, García has embraced the proposed United States-Peru Trade Promotion Agreement (PTPA) and launched an aggressive coca eradication campaign. The United States has strong ties with Peru, with trade a key U.S. priority issue. The proposed PTPA was ratified by the Peruvian legislature in June 2006, and amended to include labor and environmental provisions in June 2007. After a trip to Peru in August 2007, congressional leaders reportedly indicated that consideration of the proposed PTPA would likely occur this fall. See CRS Report RL34108, *U.S.-Peru Economic Relations and the U.S.-Peru Trade Promotion Agreement* and CRS Report RS22521, *Peru Trade Promotion Agreement: Labor Issues*. This report will be updated periodically.

### Background<sup>1</sup>

Peru has had a turbulent political history, alternating between periods of democratic and authoritarian rule. Political turmoil dates back to Peru's traumatic experience during the Spanish conquest, which gave rise to the economic, ethnic and geographic divisions that characterize Peruvian society today. Since its independence in 1821, Peru has had 13

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<sup>1</sup> Cynthia McClintock, "Peru: Precarious Regimes, Authoritarian and Democratic," *Democracy in Developing Countries: Latin America*, Eds. Diamond et al., London: Lynne Rienner, 1999; CRS Report RL30918, *Peru: Recovery from Crisis*, by Maureen Taft-Morales.

constitutions, with only nine of 19 elected governments completing their terms. Peru's most recent transition to democracy occurred in 1980 after 12 years of military rule. The decade that followed was characterized by a prolonged economic crisis and the government's unsuccessful struggle to quell a radical Maoist guerrilla insurgency known as the Shining Path (Sendero Luminoso).<sup>2</sup>

In 1985, leftist Alan García of the American Popular Revolutionary Alliance (APRA) was elected president. During his first term (1985-1990) García's antagonistic relationship with the international financial community and excessive spending on social programs led to hyperinflation. His security policies were unable to defeat the Shining Path. By 1990, the Peruvian population was looking for a change and found it in the independent candidate Alberto Fujimori. Once in office, Fujimori implemented an aggressive economic reform program and stepped up counterinsurgency efforts. When tensions between the legislature and Fujimori increased in 1992, he initiated a "self coup," dissolving Congress and calling a constituent assembly to write a new constitution. This allowed him to fill Congress and the judiciary with his supporters. President Fujimori was re-elected in 1995, but his popularity began to falter as the economy slowed and civic opposition to his policies increased. He was increasingly regarded as an authoritarian leader, due in part to the strong-handed military tactics his government used to wipe out the Shining Path that resulted in serious human rights violations.

President Fujimori won a third term in 2000, but the elections were marred by irregularities. Within weeks of taking office, a bribery scandal broke that, combined with allegations of human rights violations committed by his top aides, forced Fujimori to agree to call new elections in which he would not run. An interim government served from November 22, 2000 to July 28, 2001, when the newly-elected government of Alejandro Toledo took office. Toledo's presidency (2001-2006) was characterized by extremely low approval ratings but high economic growth rates; 5.9% in 2005 and 8% in 2006. Toledo was able to push through several reforms, including tax reform and a pending free trade agreement with the United States. Despite the economic improvements, Toledo's presidency was marred by allegations of corruption and recurrent popular protests.

### Peru: Key Indicators

**Population:** 28.6 million

**Geographic Characteristics:** Pacific coastal plains, Andean mountain highlands, Amazon Basin lowlands

**GDP growth rate:** 8% (2006)

**Per capita income:** \$2,650 (2005)

**Ethnic Composition:** Indigenous (45%), Mestizo (37%), European (15%), African, Japanese, Chinese and other (3%)

**Languages:** Spanish, Quechua, Aymara, and other indigenous languages

**Sources:** World Bank, U.S. Department of State, "Background Note: Peru," 2007.

<sup>2</sup> Between 1980 and 2000, armed conflicts between Peruvian government troops, the Shining Path, and others resulted in some 69,260 deaths and disappearances. See Commission on Truth and Reconciliation in Peru, Final Report, Annex 2, August 28, 2003. For more information, see David Scott Palmer, ed., *The Shining Path of Peru*, New York: St. Martin's Press, 1994.

## Current Political and Economic Issues

**Political Situation.** On June 4, 2006, former President Alan García defeated populist Ollanta Humala 53% to 47% in a close election. García won in the second round after garnering support from Peru's business community, which had been reluctant to support him in the first round. A retired army officer who led an October 2000 uprising against then-President Alberto Fujimori, Humala espoused nationalist, anti-globalization policies. Many observers were concerned that Humala had authoritarian tendencies. Now the opposition leader in Peru's Congress, Humala was charged in August 2006 with murder in connection to his military actions in the 1990s. In the legislative elections, Humala's alliance won 45 of the 120 seats in the unicameral Congress; García's party APRA won 36 seats, the center-right National Unity coalition captured 17 seats, and Fujimori supporters won 13 seats.<sup>3</sup>

President Alan García has taken steps to assure the international financial community that he is running Peru as a moderate rather than as the leftist he had been in his early career. Since initiating his political comeback in 2001, when he made an unsuccessful bid for the presidency against Alejandro Toledo, García has softened his populist rhetoric and apologized for his earlier errors. During his first year in office, García is thought to have embraced sound economic policies and the Peruvian economy has continued to perform well, but his government has faced periods of social unrest and popular protests over lingering concerns about poverty and inequality. His approval rating dipped to 35% in mid-July, but has since rebounded to 76% after his leadership in responding to a mid-August 8.0 earthquake that hit Peru.<sup>4</sup> García has made solidifying strong relations with the United States a top priority of his government. In the past year, García has shown himself to be a strong U.S. ally and a leading supporter of free trade in Latin America. Key political challenges currently facing the García administration include:

- **Counternarcotics policies.** The government has increasingly relied on forced eradication to reach its coca eradication targets, which has in turn produced violent clashes between coca farmers and police. President García began a dialogue with coca growers on drug policy and allowed a temporary suspension of forced eradication in March, but has since said that his government will not negotiate with radical growers who have launched strikes to protest government eradication efforts. In 2006, the government eradicated 12,688 hectares of coca, making it the second year in a row that it surpassed its goal of eradicating 10,000 hectares.<sup>5</sup>
- **Reducing poverty and inequality.** According to the World Bank, the wealthiest 10% of the Peruvian population control 41% of the country's income whereas the poorest 10% control just 1% of the income. In recent years, Peru has seen rising popular demands for a solution to

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<sup>3</sup> See CRS Report RS22430, *Peru: 2006 Elections and Issues for Congress*, by Maureen Taft-Morales.

<sup>4</sup> "Earthquake Relief Effort Becomes First Big Test for Peru's President," *Financial Times*, August 22, 2007.

<sup>5</sup> Eradication and seizure figures taken from U.S. Department of State, *International Narcotics Control Strategy Report*, March 2007.

economic inequality. Poverty is more prevalent among indigenous households at 63% compared to 43% among non-indigenous households.<sup>6</sup> In July 2007, at his state of the nation address marking his first year as president, García publically apologized to poor Peruvians for failing to deliver the material benefits of the country's recent economic growth. He has pledged to increase public investment by building housing for 1.2 million Peruvians by the time he leaves office in 2011. President García's approval rating slipped during his first year in office in response to unmet popular expectations.<sup>7</sup>

- **Earthquake response.** On August 15, Peru was rocked by an 8.0 earthquake that killed at least 519 people and destroyed some 40,000 homes. President García has pledged money to rebuild communities and created 8,000 temporary jobs in order to help with the clean-up effort. While some have praised the García government response to the earthquake, humanitarian groups maintain that more aid and better government coordination are needed to provide shelter and medical attention to as many as 200,000 Peruvians who are in need of assistance.<sup>8</sup>
- **Fujimori Extradition Proceedings.** Charges have been brought against former President Fujimori, including allegations of corruption and major human rights violations. Fujimori went into exile in Japan for several years and tried to return to Peru in November 2005, but was arrested en route by Chilean authorities. In May 2006, the Chilean government released Fujimori on bail while processing Peru's extradition request. In July 2007, the Chilean Supreme court denied his extradition and the case is currently awaiting a ruling by the high court on appeal. Fujimori's return to Peru could have major political consequences for García's government which stands to lose its alliance with the Fujimorista bloc, which it relies on in order to pass legislation.<sup>9</sup>

**Economic Issues.** President García has continued the pro-market economic policies of his predecessor, Alejandro Toledo, who presided over one of the highest economic growth rates in Latin America throughout his term, with 8% growth in 2006. García has embraced the proposed U.S.- Peru Trade Promotion Agreement (PTPA), appointed a fiscally conservative finance minister, and cut government pay. Economic growth has been fueled by Peru's strong exports of minerals, textiles, and agricultural products like sugarcane, potatoes, and asparagus. Peru is the world's second largest producer of silver, sixth largest producer of both gold and copper and provides a large amount of the world's zinc and lead. The Peruvian economy has also been boosted by

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<sup>6</sup> Gillette Hall and Harry Patrinos, eds. *Indigenous Peoples, Poverty and Human Development in Latin America: 1994-2004*, New York: Palgrave Macmillan, 2006.

<sup>7</sup> EIU, "Country Report - Peru," July 2007; "Peruvian President Apologizes to Poor, Vows to Increase Anti-poverty Aid," *Associated Press*, July 28, 2007.

<sup>8</sup> "Relief Groups: Peru Still Badly Needs Aid 2 Weeks After Quake," *Dow Jones International News*, August 30, 2007.

<sup>9</sup> *Economist Intelligence Unit*, "Country Report - Peru," July 2007; "Chile Foreign Minister asks High Court to Decide on Fujimori," *Agence France Presse*, July 30, 2007.

U.S., Brazilian and Argentine investments in the Camisea natural gas project, which by 2009 is expected to be exporting liquified natural gas to the United States and Mexico.<sup>10</sup>

President García has sought to reassure poor Peruvians that he is addressing their needs by pledging austerity measures such as halving the Government Palace's annual spending and redirecting the funds to a rural irrigation project. García says he will also find ways to use trade to reduce the level of poverty in Peru and widen income distribution. His government is seeking to boost rural development by increasing its investments in road construction, sanitation projects, and water connections.

## U.S. - Peruvian Relations

Peru enjoys strong ties with the United States, characterized by extensive economic linkages and significant counternarcotics and security cooperation. Since the presidency of Alejandro Toledo in 2001, Peru has focused on strengthening those ties. Some 200,000 U.S. citizens visit Peru annually and over 400 U.S. companies are represented in Peru. President García met with President Bush at the White House in October 2006 and again on April 23, 2007, at which time the leaders discussed their shared commitment to fighting the production and consumption of illicit drugs and to secure congressional approval of the proposed U.S.-Peru Trade Promotion Agreement. Issues in U.S.-Peruvian relations include democratic development, human rights, counternarcotics, and trade issues, which are at the forefront of the bilateral agenda.

**U.S. Aid.** The United States provided \$141.7 million in foreign aid to Peru in FY2006, and another estimated \$138.9 million in FY2007. The FY2008 request for Peru is for \$93.2 million, with the most significant cuts occurring in counternarcotics funds traditionally provided through the Andean Counterdrug Initiative (ACI). ACI has been the primary U.S. assistance program to help Colombia and its neighbors address drug trafficking and related economic development issues. Beginning in FY2008, alternative development programs previously supported by ACI funds will be shifted to the Economic Support Fund (ESF) account. The U.S. Agency for International Development has four main goals for Peru: strengthening democracy; increasing governance in isolated areas where drug traffickers operate; reducing poverty; and decreasing maternal mortality and other health threats. Peru was recently selected to participate in the Millennium Challenge Account (MCA) Threshold Program. That program will focus on combating corruption, strengthening the rule of law, and improving resource management in Peru.

**Human Rights.** The government of Peru has taken steps to expand and enforce its labor laws and to prosecute those accused of past and current human rights violations. According to Human Rights Watch, while the Peruvian government has made some progress in holding those accused of past abuses responsible for their actions, many are still able to avoid prosecution. The State Department's *Country Reports on Human Rights Practices* covering 2006 says that while the Peruvian government generally respects the rights of its citizens, ongoing problems include abuse of detainees and inmates by police and prison guards; poor prison conditions; trafficking in persons; child labor in the informal sector; and failure to enforce labor laws, among others. Human rights groups have also expressed concerns that a law passed in December 2006 to regulate the

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<sup>10</sup> "High Growth Masks Peru's Two Diverging Economies," *Financial Times*, July 28, 2007.

activities of non-governmental organizations operating in Peru unnecessarily restricts freedom of expression and association in the country.<sup>11</sup>

**Counternarcotics Cooperation.** Peru is a major illicit drug-producing and transit country, accounting for 28% of global cocaine production. In 2006, according to United Nations figures, coca cultivation increased by 7% in Peru even though the government increased its coca eradication efforts by 4% from 2005 levels.<sup>12</sup> The United States and Peru signed a five-year cooperative agreement for 2002-2007 that links alternative development to coca eradication more directly than past programs have. Peru is the second largest coca cultivating country in the world after Colombia, but receives less than one quarter of the funding Colombia receives through the Andean Counter Drug Initiative. The FY2008 counternarcotics assistance request for Peru is for \$66.8 million, down from the \$106.5 million allocated in FY2006 and an estimated \$103.3 million in counternarcotics funding provided in FY2007. Recent aid reductions appear to be due to overall budget cutbacks rather than any U.S. government dissatisfaction with Peru's counternarcotics efforts.

**U.S. - Peru Trade Promotion Agreement.** The United States is Peru's largest trading partner. Since December 2001, exports from Peru have received preferential duty treatment through the Andean Trade Preference Act (ATPA), later amended by the Andean Trade Promotion and Drug Eradication Act (ATPDEA) in August 2002. These trade preferences were scheduled to end on December 31, 2006. However, the acts have been extended twice, and are now scheduled to expire on February 29, 2008.<sup>13</sup> ATPDEA gives duty-free market access to selected Peruvian goods without requiring reciprocal trade concessions or addressing issues such as intellectual property rights. The United States and Peru completed negotiations for a U.S.-Peru Trade Promotion Agreement in December 2005, which was ratified by the Peruvian legislature in June 2006. Whereas the ATPDEA provides temporary trade preferences to some goods from Peru, the proposed PTPA is a comprehensive trade agreement that would permanently eliminate tariffs and other barriers on U.S.-Peru bilateral goods and services trade. President García views the PTPA agreement as essential to ensuring Peru's continued economic growth and achieving poverty reduction. After several Members of Congress indicated that some of the provisions in the agreement would have to be strengthened, the Bush Administration and Congress reached an agreement on May 10, 2007 on a new trade framework that includes core labor and environmental standards. On June 27, 2007, Peru's Congress approved the amendments to the PTPA. After a recent trip to Peru, congressional leaders reportedly indicated that action on the proposed PTPA would be a "priority" for this fall.<sup>14</sup>

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<sup>11</sup> Human Rights Watch, "World Report 2000"; CRS Report RS22521, *Peru Trade Promotion Agreement: Labor Issues*, by Mary Jane Bolle and M. Angeles Villarreal; "García Forges Ahead with his own War on Terror," *Latin American Andean Group Report*, January 11, 2007.

<sup>12</sup> United Nations Office on Drugs and Crime (UNODC), *World Drug Report 2007*.

<sup>13</sup> See CRS Report RS22548, *ATPA Renewal: Background and Issues*, by M. Angeles Villarreal.

<sup>14</sup> For more information see CRS Report RL34108, *U.S.-Peru Economic Relations and the U.S.-Peru Trade Promotion Agreement*; Martin Vaughan, "Peru Visit Sparking Interest in Early Markup for Trade Pact," *Congress Daily*, August 7, 2007.