

October 27, 2010

The Challenge of Making Democracies Work: The Case of Peru

Hernando de Soto
Institute for Liberty and Democracy

Article at a glance

- The challenge of making democracy work is the challenge of setting up a system that allows people to participate in governance between elections.
- Economic exclusion can lead to democratic disenfranchisement, as the case of the indigenous population in Peru shows.
- Equal access for all to the legal tools of a modern market economy requires first of all that the democratic process through which laws and regulations are created is responsive to public needs and concerns.
- Without the institutions that underpin democratic market economies, such as the rule of law and property rights, the democratic process can be hijacked even by democratically-elected leaders.

To comment on this article, visit the CIPE Development blog: www.cipe.org/blog.



CIPE Center for International Private Enterprise

1155 15th Street, NW | Suite 700 | Washington, DC 20005

ph: (202) 721-9200 | fax: (202) 721-9250 | www.cipe.org | cipe@cipe.org

What Does Democracy Mean?

The post-1974 “third wave” of democratization has greatly expanded the number of electoral democracies worldwide. Today, however, this wave is noticeably ebbing, especially in terms of the quality of democratic institutions. Oligarchic and authoritarian countries throughout the developing world and in the former Soviet Union have long understood that it is possible to look like a democracy while gutting the system of the details that make democracy work: comment and notice periods; accountability systems; district-based voting; and transparent decision-making.

What does democracy mean? The Institute for Liberty and Democracy (ILD), based in Lima, Peru, has been working since 1984 to spread the idea that democracy is not only a matter of elections, but also a matter of how decisions are made between elections. The ILD has consistently proclaimed the importance of democracy and emphasized its economic dimension. In its work on securing property rights for extra-legal entrepreneurs – who frequently account for the vast majority of the developing world’s economically active population – the ILD has witnessed grassroots expressions of democratic organization throughout the Peruvian informal economy and that of other countries. Through its work in many countries, the ILD has clearly seen that democracy, understood as free assembly of people who come together to reach common decisions and achieve mutually beneficial goals, is at the core of free economic activity.

Yet, going beyond street markets and village bazaars, this spontaneous democratic organization of economic actors does not automatically scale up. When it is not just a few hundred or thousand people making decisions about their local community – but instead 20 or 50 million people spread around the country – representative institutions are truly needed. Designing those institutions requires a degree of creativity. Day-to-day contact with millions of citizens is not possible. Therefore, ways of democratic representation and various feedback mechanisms are necessary to ensure citizens’ input into the larger policy decisions.

Ultimately, democracy requires institutions that make things come together. A good analogy comes from an early U.S. settler, William Jefferson. He was the nail maker in his family, a role he was very proud of. In those days, as settlers moved West, they built log cabins using nails, which were scarce and hard to come by. If they decided to move even further West, they would burn down those cabins, recover the nails, and keep going. When they reached their new destination, they would build another cabin with the same old nails because nails were very valuable. Nails themselves do not build anything, but they bring things together to create solid and lasting structures. Institutions of democracy work the same way. They bind together vital political and economic structures and make them last.

The question that the ILD always asked was: what are the “nails” of democracy? The answers are not always obvious because those institutions are often intangible, especially from the perspective of established democracies. Their democratic institutions were formed a long time ago and became so ingrained in people’s daily lives that they do not notice them anymore and forget how they came about in the first place. That is not the case in many developing countries where democratic institutions are still missing or do not extend beyond elections. Those absent institutions are the nails that countries need to make democracy work.

The Experience of Peru

Peru, like many other countries in Latin America, has a long history of striving to build stable democratic institutions and rule of law, laden with challenges and setbacks. Exploring best practices and lessons learned from others is crucial in order to address these challenges and build better democratic governance.

One example comes from comparing the Peruvian Congress with the U.S. Congress. They may seem similar but in fact they are very different. In the United States, Congress is elected on the basis of district representation from each

state. There is a representative from District 36 of New Jersey or District 16 of California. Not so in Peru. The Peruvian Congress is composed of representatives who were elected based on party lists. Party leaders – not grassroots constituencies – decide who is on those lists and who ends up in Congress. As a result, these representatives have no incentives to seek out the opinions of people they are supposed to represent. Their political future does not depend on their electorate; it depends on the head of the party.

When attempts were made to fix the situation in Peru, critics argued that reforms would create a “parochial” Congress modeled after the United States, where representatives often narrowly define their key role as bringing the most benefits to their home district. Yet, U.S. representatives are in touch with the people and bring real issues to the fore. Latin American congresses are very sophisticated, but they often represent themselves and their own class structure rather than representing the people they are supposed to serve.

Countries like Peru can also learn from other examples to improve the democratic quality of policymaking process. The Swiss do not make any major decision without using a consultation system where approximately 3,000 different organizations review and discuss the pending decision before it becomes final. In Japan, similarly, the Diet first passes draft laws to various consultative committees and seeks public input before any final decision.

Peru has too often neglected to learn from international best practices in governance and to reform its political institutions to make them more open, accountable, and truly democratic. The following section addresses the passage of the 1993 constitution, which was a wasted opportunity for democratic reform. Its failure highlights the dangers of using the guise of democracy to advance and institutionalize non-democratic practices.

Democracy Is More than Elections

In 1992, Peru’s President Alberto Fujimori grew frustrated with political stalemate and carried

Laws and regulations may have unintended consequences that decision-makers cannot anticipate without consulting the public. A law protecting shoemakers may be beneficial to cobblers, but detrimental for the shoe buyer.

out a coup d’état to dissolve the Congress. The coup was initially popular among the public, given the protracted inability of the Congress to enact much-needed economic reforms. As time passed, however, it became obvious that no one could agree on a way out of the political entanglement. The ILD was called upon to help mediate the conflict between President Fujimori and the Congress.

The ILD worked with the President to articulate the reasons why he carried out the coup and why the Congress was not working properly. The joint conclusion was that even though Peru looked like a democracy, its institutions were not really democratic. For example, the majority of policy decisions were not made by the legislative branch but by the executive branch. The executive branch was passing 28,000 laws and regulations a year, or 106 per working day, reaching into every aspect of citizens’ lives. At the same time, only 350 decisions a year were made at the legislative level. This meant in essence that once the government was elected, it could write out 28,000 blank checks with no public input and little accountability. If new laws were to be truly representative and address people’s needs and concerns effectively, the decision-making process had to become more open and participatory.

The ILD recommended that the President introduce a comment and notice period and pre-

Without the institutional “nails” that make democracy work and guarantee public participation in both political processes and in the economy, elections – even clean ones – cannot ensure a democracy that delivers.

publish new rules before they become law in order to allow the Peruvian people time to understand the proposed rules and provide feedback. Laws and regulations may have unintended consequences that decision-makers cannot anticipate without consulting the public. A law protecting shoemakers may be beneficial to cobblers, but detrimental for the shoe buyer. Solid cost-benefits analysis is needed to uncover the trade-offs inherent in most laws and regulations. In the United States, for instance, this process is institutionalized in the Office of Management and Budget that helps the White House evaluate the effectiveness of various government programs, policies, and procedures.

The ILD also recommended the establishment of test or sunset rules that are valid only for one or two years to test how they work in practice. Finally, the ILD suggested that President Fujimori, who was expected to present a plan for restoring democratic rule before the Organization of American States (OAS), propose scheduling elections for a Democratic Constituent Congress charged with drafting a new constitution. The constitution would then be ratified by a referendum so that the Peruvian people could voice their views and own the constitutional process through grassroots involvement.

The new constitution was drafted in 1993. However, the ILD proposals to improve the quality of Peru’s democratic institutions fell flat. Although the OAS approved the proposition to create district

elections, the president’s advisors suggested moving to district representation not until five years from that date. The ILD warned that action was needed immediately and that a delay would de-rail the reform effort. This is indeed what happened as the opportunity for reform was allowed to go by.

The constitutional referendum was another important ILD recommendation that went unimplemented. The government pushed for exchanging the referendum for a plebiscite, arguing that a referendum would be too complicated to be approved by the Peruvian people. There is a difference between a referendum and a plebiscite. A referendum means that the legislative initiative has to come from the people, that it is not just a yes-or-no vote on proposals from the executive branch. In a referendum, citizens are involved in the discussion on the exact formulation of issues to be voted on, so rather than voting on one project they vote on multiple initiatives. With a plebiscite, on the other hand, the form and substance of the question comes from those in power with no say from the public. It is a top-down approach, not a democratic bottom-up process, undermining the opportunity for meaningful public participation.

Unfortunately, neither ILD nor OAS were able to mobilize the Peruvian government to correct the situation. Although the new constitution was passed, it was not the hoped-for document that would ensure greater transparency, accountability, and public involvement in policymaking. Increasingly authoritarian President Fujimori remained in power for seven more years; none of the proposed consultation mechanisms or cost-benefit analysis ever came up again.

The Challenge of Building Democracies that Deliver

Because sound macroeconomic policies are in place, Peru’s economy has grown quickly in recent years, with growth rates mirroring those of the Chinese. On the democracy side, however, the country is still struggling, as evidenced by indigenous rebellions in the Amazon region.

Despite market-oriented policies at the top, at the grassroots level the lack of fully democratic institutions is often coupled with the lack of market institutions that would enable broad participation in the economy. Indigenous people in particular remain excluded from both the political and the economic system. They do not have secure property rights or other legal protections and therefore cannot reap the benefits of Peru's rapid growth. Instead, they often feel victimized by the global economy and lack proper representation by the government when mining and other industrial activity in the Amazon region encroaches on their ancestral lands.

International organizations often send a mixed message to developing countries by encouraging free market policies at the macro level while simultaneously criticizing the human rights fallout that occurs in the absence of strong market institutions at the grassroots level. The only way to resolve this conflict is to make sure that a country like Peru does not have two separate classes of people: those who are protected by the law and thus economically empowered, and those who are not. With globalization creating great economic opportunities for developing countries while at the same time increasing pressures on the disenfranchised communities in those countries, the time to act is now.

Such equal access for all to the legal tools of a modern market economy requires first that laws and regulations are created in a democratic process responsive to public needs and concerns. In Latin America, much attention is given to elections. Yet, without the mechanisms that ensure transparent decision-making and public engagement—many Latin American countries continue electing dictators – for five years at a time. They are elected officials, but between the elections they do whatever they want without proper checks and balances.

Many leaders in the region gained and retained power – Hugo Chavez in Venezuela, Manuel Zelaya in Honduras, Rafael Correa in Ecuador, Evo Morales in Bolivia – by following the Fujimori

model to some degree. They were democratically elected into office, but then used the plebiscite to confirm their right to a third, fourth, or fifth term.

The objective of Peru's referendum model of public participation in decision-making back in 1992 was to put the people into power as sovereigns of their country. Instead, strongmen from Latin America and elsewhere twisted this model to stay in place under the guise of a democracy. Without the institutional "nails" that make democracy work and guarantee public participation in both political processes and in the economy, elections – even clean ones – cannot ensure a democracy that delivers. Therefore, when reformers around the world talk about the need for democracy and market economy in their countries, they must be very clear on what those terms mean and what underlying institutions are required to make democratic market economies work.

This article is based on the remarks delivered by Hernando de Soto at "Democracy that Delivers: An International Conference on Improving the Quality of Democratic Governance and Economic Growth," held in Washington, DC on October 27, 2009.

*Hernando de Soto is President of the Institute for Liberty and Democracy (ILD) in Lima, Peru. The ILD is an internationally respected think tank that has emerged not just as an intellectual force in the field of development but also as an agent of change in the developing and post-Soviet world in the effort to move the assets of the poor from the extralegal economy into an inclusive market economy. De Soto has served as an economist for the General Agreement on Tariffs and Trade (GATT), as President of the Executive Committee of the Copper Exporting Countries Organization (CIPEC), as CEO of Universal Engineering Corporation, as a principal of the Swiss Bank Corporation Consultant Group, and as a governor of Peru's Central Reserve Bank. He has written two influential books about economic and political development: *The Other Path* and *The Mystery of Capital*, both of which became international bestsellers and are available in more than 20 languages.*

The views expressed by the author are his own and do not necessarily represent the views of the Center for International Private Enterprise (CIPE). CIPE grants permission to reprint, translate, and/or publish original articles from its Economic Reform Feature Service provided that (1) proper attribution is given to the original author and to CIPE and (2) CIPE is notified where the article is placed and a copy is provided to CIPE's Washington office.

The Economic Reform Feature Service is CIPE's online and electronic article distribution service. It provides in-depth articles designed for a network of policymakers, business leaders, civic reformers, scholars, and others interested in the issues relating to economic reform and its connection to democratic development. Articles are e-mailed and posted online twice a month.

If you would like to subscribe free of charge, please join the CIPE network by entering your e-mail at www.cipe.org. CIPE welcomes articles submitted by readers. Most articles run between 3-7 pages (1,000-3,000 words). All submissions relevant to CIPE's mission will be considered based on merit.

The Center for International Private Enterprise (CIPE) strengthens democracy around the globe through private enterprise and market-oriented reform. CIPE is one of the four core institutes of the National Endowment for Democracy. Since 1983, CIPE has worked with business leaders, policymakers, and journalists to build the civic institutions vital to a democratic society. CIPE's key program areas include anti-corruption, advocacy, business associations, corporate governance, democratic governance, access to information, the informal sector and property rights, and women and youth.