Peru in Brief: Political and Economic Conditions and Relations with the United States

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Summary

This report provides an overview of Peru's government and economy and a discussion of issues in relations between the United States and Peru.

Peru and the United States have a strong and cooperative relationship. Several issues in U.S.-Peru relations are likely to be considered in decisions by Congress and the Administration on future aid to and cooperation with Peru. The United States supports the strengthening of Peru's democratic institutions, its respect for human rights, environmental protection, and counternarcotics efforts. A dominant theme in bilateral relations is the effort to stem the flow of illegal drugs, mostly cocaine, between the two countries. In the economic realm, the United States supports bilateral trade relations and Peru's further integration into the world economy. The United States is Peru's top trading partner. The U.S.-Peru Trade Promotion Agreement (PTPA) went into effect in February 2009. The Obama Administration requested $73 million in foreign assistance for Peru for FY2014 to advance these objectives.

Ollanta Humala, of the left-wing Gana Peru, was sworn in as Peru's president in July 2011 for a five-year term. Gana Peru initially won 47 seats out of the 130 seats in the unicameral Congress, requiring Humala to rely on political alliances with lesser parties in order to pass legislation. As Humala has moderated his stance, he has lost left-leaning allies within his and other parties. Deep social divides over how to pursue development continue to undercut political stability. The more radical elements of Humala's original support base and his party urge the pursuit of more leftist policies, such as nationalization of strategic industries, which Humala called for during the election campaign. Forces that resist more radical policies include a strong business sector; a conservative, wealthy elite; a centrist middle class; and a divided Congress. Social unrest, especially over exploitation of natural resources, remains a challenge for the Humala government. It has established an office of conflict prevention and taken other actions to reduce social conflict.

Since 2001 Peru's economy has been stronger than all others in the region, with its growth due mostly to the export of natural resources. High economic growth, along with social programs, has helped to lower Peru's overall poverty rates. Nonetheless, in some jungle, mountain, and rural areas of the country, over 60% of the population continue to live in poverty. The income distribution gap remains quite large as well. This economic disparity has contributed to rising social unrest. President Humala submitted, and the legislature approved, a bill increasing royalties mining companies must pay. The government estimates the royalties will generate about US$1 billion a year, which it will use to finance social development programs intended to narrow both the social divide and the economic distribution gap.

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Background

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 constitutions, with only 9 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).[1] President Alan García's first term (1985-1990) was characterized by many observers as disastrous. Of the leftist American Popular Revolutionary Alliance (APRA), García's antagonistic relationship with the international financial community and excessive spending on social programs led to hyperinflation (an annual rate above 7,600%) and a debt crisis.

By 1990, the Peruvian population was looking for a change and found it in the independent candidate Alberto Fujimori. Initially applauded for his aggressive economic reform program and stepped up counterinsurgency efforts, Fujimori became increasingly autocratic, dissolving the legislature in 1992, overseeing the writing of a new constitution in 1993—which allowed him to run again, and win, in 1995—and engaging in strong-handed military tactics to wipe out the Shining Path that resulted in serious human rights violations. Reelected in 2000, Fujimori's government collapsed with revelations of electoral fraud and high-level corruption, and he fled the country later that same year. In a landmark legal case, on April 7, 2009, former President Fujimori was convicted and sentenced to 25 years in prison for "crimes against humanity," on charges of corruption and human rights abuses. Analysts regard the court's decision as a considerable accomplishment for Peru's judicial system, which has been considered weak and subject to political influence.

Peru then entered a period of relative political stability, economic growth, and poverty reduction, begun by a capable interim government headed by President Valentin Paniagua (November 2000 -July 2001), and continued by Peru's first president of indigenous descent, Alejandro Toledo (2001-2006). Toledo pushed through significant reforms that increased tax collection, reduced expenditures and the budget deficit, and negotiated a free trade agreement with the United States.

Softening his populist rhetoric, Alan García launched a political comeback and won the presidential race in 2006. Many observers cast him as "the lesser of two evils" compared to his opponent, Ollanta Humala, who espoused nationalist, anti-globalization policies. García (2006-2011) maintained orthodox macro-economic policies. Economic growth continued under García, and so, too, did popular protests over the failure of that growth to improve social conditions for Peru's poorest people, and over the exploitation of natural resources. Humala went on to win the presidency in 2011.

[1] 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 Conditions

Following his unsuccessful bid for the presidency in 2006, Ollanta Humala moderated his stance five years later from an extreme leftist, populist, nationalist approach allied with Venezuela's President Hugo Chavez, to a more center-leftist approach modeled after Brazil's former President Luiz Inacio Lula da Silva. Won the elections and was sworn in as Peru's president in July 2011 for a five-year term. He defeated Keiko Fujimori, a conservative member of Congress and daughter of disgraced former President Alberto Fujimori. In his first address as president, Humala promised to maintain free-market policies while also working to narrow the wide economic distribution gap and eliminate the social exclusion of Peru's poor, mostly indigenous population. He reiterated that commitment in a speech to the Peruvian Congress as he completed his first year in office. Acknowledging that his government had not done all it pledged to do, Humala said his goal was to cut Peru's poverty by half, from 30% to 15% of the population by the end of his term in 2016. At the end of 2012, about a year and a half into Humala's term, the poverty rate had dropped to 26% of the population. Initially, Humala's cabinet encompassed a broad range of the political spectrum, from orthodox economists to former military officers and left wing radicals pursuing a consensus-based pragmatic approach. Humala shuffled his Cabinet three times in his first year, dismissing all of his top leftist advisers in a major cabinet re-shuffle in late 2011, and consolidating a more centrist approach since then.

Figure 1. Map of Peru

Source: Perry-Castaneda Library Map Collection.

After he was elected, Humala began negotiations with the mining sector, so that, once inaugurated, he was quickly able to propose an increase in mining royalties paid to the government. Mining companies accepted the increase as inevitable, since both presidential candidates had advocated it, and were willing to accept moderate increases in exchange for a stable set of royalty payment rules. The Peruvian Congress passed the bill, which became effective in January 2012. The increased royalties are expected to provide an additional US$1 billion annually to the national budget to fund Humala's proposed social inclusion programs and infrastructure projects.[2]

Addressing Social Conflicts

President Humala also committed himself to reducing the social conflicts that have impeded government functions over the last couple of administrations. But he has found it difficult to balance his stated desire to help the poor and indigenous with his effort to encourage investment by the business sector.

Peru's Ombudsman for Human Rights reported that there were over 200 civil conflicts across Peru as Humala came into office.[3] The first law Humala signed was a prior consultation law, requiring mining, energy, and logging companies to consult with indigenous and rural communities about projects planned in their communities, which had been the source of much social conflict. Former President Alan García had vetoed a similar law, and violent conflicts over land use continued throughout his term. The law brings Peru into compliance with the International Labor Organization's Convention on Indigenous Peoples, which Peru ratified in 1993. The convention requires that companies consult indigenous groups before entering their ancestral territories to exploit natural resources. Implementing regulations went into effect on April 4, 2012. No prior consultations had been carried out as of May 2013.

As a complement to the new law, the Humala administration also created an office of conflict prevention. As part of that effort, the ministers' council released its first report on social conflict in December 2012, saying that 15 mining conflicts were under the auspices of state conflict prevention measures such as early alert mechanisms and communication strategies.[4]

Because the prior consultation law does not grant local communities veto power over investments in their area, however, and does not require consultation for government coca eradication efforts, tensions have continued and are likely to remain an issue. Some businesses worry that the new consultation process could add bureaucratic impediments to their projects. And some conflicts have political or other roots besides land use issues. Although the government said it hoped to reduce the number of conflicts by increasing dialogue among communities, investors, and the state, major conflicts have continued, and some critics say not much has changed. The Humala government has declared states of emergency in the northern Cajamarca region of Peru, but protests against mining efforts there have continued, often turning violent.

In the southeastern region of Madre de Dios, the government is contending with illegal mining, which has also led to violence, pollution, and destruction of the Amazonian rainforest. Estimating there to be up to 50,000 small-scale miners in the area, the government decreed stricter penalties for illegal mining in February 2012, has removed thousands of miners, and plan to remove all illegal miners working near national parks.[5] The ombudsman reported 84 new conflicts registered

[2] "Peru's Humala signs bills to raise mining taxes," *Reuter News*, September 28, 2011.

[3] "Peru: Humala's Biggest Challenge," *LatinNews.com Weekly Report*, vol. WR-11-25, June 23, 2011.

[4] "Social conflicts in Peru left 24 dead, 649 hurt last year-ombudsman," *Business News Americas*, January 16, 2013

[5] Rob Walker, "Peru's Gold Rush Pits Illegal Miners against Government," *BBC News*, July 11, 2012.

in 2012, involving 24 deaths and 649 injuries. That brought the total number of social conflicts for 2012 to 227. The ombudsman's office reported three cases as resolved in 2012, including one in the Ancash region involving a $1.3 billion expansion of a mine.[6] As of April 2013, there were 229 cases of social conflict, with 76% of them active. The vast majority of the cases are socio-environmental: 73% involve mining. About 9% involve local government issues, and just 6% revolve around territorial disputes.[7]

Tensions between indigenous and business concerns have created conflict within the Humala government as well. In an effort to speed approval of investment projects, the Energy and Mines Ministry proposed amending the Prior Consultation law to exclude groups that speak Quechua and Aymara, official national languages spoken by a substantial number of indigenous people. The proposal would make groups living in the highlands, where most mining occurs, and where most social conflict is occurring, ineligible for prior consultation. The deputy minister of intercultural affairs, whose office must implement the law, resigned in protest.[8]

Government delays in publishing an Official Database of Indigenous Peoples and the consultation process rules are hindering implementation of the consultation law. The database determines which indigenous populations in which areas will be eligible for prior consultation. Therefore its contents are extremely controversial. The Humala administration has decided that some 14 mining projects can proceed without prior consultation of indigenous communities, without having a clear process or definition of eligible communities in place on which to base those decisions. The government again argues that this is necessary to speed up approval of investment projects, especially where concessions predate the prior consultation law. The Human Rights Ombudsman argues, however, that all of these mining projects are situated in areas where indigenous peoples live, and that those communities should be consulted before the projects proceed further.

Deep social divides over how to pursue development continue to undercut political stability. The more radical elements of Humala's original support base and his party, Gana Peru, urge the pursuit of more leftist policies, such as nationalization of strategic industries, which Humala called for during the election campaign. Forces that resist more radical policies include a strong business sector; a conservative, wealthy elite; a centrist middle class; and a divided Congress. If communities in conflict believe that the Humala administration is ignoring the prior consultation law, those divides may deepen.

Humala and the Peruvian Congress

As Humala alienates the leftist forces that helped him win the election, his position in the Congress becomes weaker. Humala's party does not have an outright majority; it has 43 seats to Fujimori's party's 36 seats in the 130-seat chamber. His weak alliance with former President Alejandro Toledo's centrist Peru Posible party, which gave him a two-seat majority, has dissolved; Toledo's bench now has 15 members. Some members of Humala's own party have left as well, in response to his shift away from the left and the crackdown on anti-mining protests.[9]

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[6] "Social conflicts in Peru left 24 dead, 649 hurt last year-ombudsman," *Business News Americas*, January 16, 2013.

[7] Latin American Andean Group Report, "No end to social conflict in sight despite the prior consultation law," RA-13-05, May 2013, pp. 9-12.

[8] Ibid, and Economist Intelligence Unit, Country Report: Peru, June 2013, p.2.

[9] "Peru: Country Outlook," *Economist Intelligence Unit*, October 1, 2011; and "Country Report: Peru," *Economist* (continued...)

Unable to agree on candidates, the Congress left key positions including seven Constitutional Tribunal judges, the head of the human rights office, and three members of the central bank's board, vacant for over a year. Nonetheless, Humala was able to push through reforms in his first year, and in July 2012 his party was able to hold onto the leadership position in the Congress.

Petition for Fujimori's Release from Prison

Another potentially destabilizing element was thrown Humala's way when former President Fujimori's family petitioned the Justice Ministry for his release from prison on humanitarian grounds because he has mouth cancer. Fujimori was convicted for crimes against humanity, including for his role in the extrajudicial execution of 15 people, the forced disappearance and murder of nine students and a professor from a university, and two other abductions. The international organization Human Rights Watch opposes granting Fujimori amnesty, saying it "would be incompatible with Peru's obligations under international law," and that humanitarian pardons "should only be granted on the basis of an independent, thorough, and conclusive medical determination of the gravity of the prisoner's condition and the seriousness of the risk continued detention might pose."[10] Some opposed to his release warn it could lead to social unrest and greater influence by Fujimori; he is said to have played a key role in the last elections, in which his daughter lost her bid for the presidency but other supporters of his won seats in the Congress. A Mercy Commission is looking into the case, and will make non-binding recommendations to the President. Humala, who once led a failed coup attempt against Fujimori, says he will ultimately decide whether to grant the pardon, but "cannot rush" the Commission.[11]

Positioning for 2016 Elections

Possible contenders are already jockeying for position for the 2016 presidential elections. Presidents are constitutionally barred from running for consecutive terms, so Humala cannot run for reelection. But among those expected to run are two former presidents, Alan Garcia and Alejandro Toledo. Both are under investigation, and both say the investigations are politically driven to hamper their candidacies. Garcia's 2006-2011 administration is being investigated for alleged corruption, and Toledo is being investigated for possible links to multi-million dollar real estate transactions involving his mother-in-law that occurred after he left office. The Humala administration denies accusations made by pundits and opposition politicians that it is using government intelligence operations to discredit its opponents.

Humala's extremely popular wife, Nadine Heredia, has been active in social development issues, and is influential within her husband's administration. The First Lady is also barred by law from running for office in the next elections. Nonetheless, speculation has been rife that she is seeking a way to do so. Some suggest that Humala's party, Gana Peru, could seek a deal with Keiko Fujimori's party, Fuerza Popular, to allow Heredia to run in exchange for a pardon of Fujimori's father, the jailed former president. Major Minister Juan Jimenez recently denied "for the nth

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Intelligence Unit, March 2012, p. 4.

[10] Diego Moya-Ocampos, "International Human Rights Organisation Opposes Eventual Amnesty to Former Peruvian President," *IHS Global Insight Daily Analysis*, October 12, 2012.

[11] "Peruvian President Interviewed on Year's Achievements, Challenges," *BBC Monitoring Americas*, January 11, 2013.

time" that the government is trying to change the law to allow Heredia to run for president in 2016.[12] Keiko Fujimori, an influential member of Congress who lost to Humala in the last elections, is also considered likely to run again for president.

Congressional elections will also be held in 2016. Regional and municipal elections are scheduled for October 2014.

Socio-Economic Conditions

Peru's economy has been stronger than virtually all other Latin American economies since 2001. Its gross domestic product (GDP) growth rate averaged 8.8% from 2001 to 2008.[13] During the 2008-2009 global financial crisis, Peru's economy slowed to 0.9%, but was one of the few in Latin America to maintain positive growth. Meeting with then-President García in Washington in early June 2010, President Barack Obama called Peru an "extraordinary economic success story."[14] In 2011, Peru's economy grew by 6.9%.[15] The Economist Intelligence Unit estimates 6.3% GDP growth for 2012 and predicts continued strong growth of around 6% in 2013 and for the next several years.[16] Most of Peru's growth is due to the export of natural resources such as copper, gold, silver, zinc, lead, iron ore, fish, petroleum, natural gas, and lumber.

President Humala has generally pursued free market, business-friendly economic policies. Nonetheless, his administration recently tried to assert a stronger state role in the economy. His government was considering taking over the assets of a Spanish oil company, Repsol. Humala reportedly backed away from the effort in the face of negative pressure from his cabinet and business groups.[17]

Regional Economic Integration

Peru is affiliated with several regional economic integration organizations. It is an associate member of Mercosur (the Southern Common Market) and a member of the Andean trading bloc, CAN (the Andean Community of Nations), and of UNASUR (the Union of South American Nations), which was established in 2004 under the leadership of then-President of Venezuela Hugo Chavez as an alternative to what he saw as more pro-U.S. organizations.[18]

Pacific Alliance

Peru recently joined with some of the other strongest economies in the region to form a new organization, the Pacific Alliance. One year after forming the Alliance, Chile, Colombia, Mexico,

[12] Andean Air Mail and Peruvian Times, "Peru Officials Deny Use of Police Intelligence to Discredit Opponents," May 25, 2013.

[13] The World Bank, *Peru: Brief*, September 16, 2011, at http://web.worldbank.org.

[14] Federal News Service, "Remarks by President Barack Obama and President Alan Garcia of Peru after their Meeting (as released by the White House)," June 8, 2010.

[15] "Country Report: Peru," *Economist Intelligence Unit,* March 2012, p. 3.

[16] "Country Report: Peru," *Economist Intelligence Unit*, June 2013, p. 7.

[17] Ibid, pp. 4, 18.

[18] UNASUR, http://www.comunidadandina.org/sudamerica.htm.

and Peru agreed to its rules of operation on May 23, 2013, making it the largest free trade zone in Latin America. These four countries all have free market economies, embrace globalization, average 5% economic growth rates, and constitute 35% of Latin America's gross domestic product (GDP).[19] The three South American members have already merged their stock markets. When Mexico joins it in the next year, the Mercado Integrado Latinoamericano would become the region's largest stock exchange.[20] One of the Pacific Alliance's goals is to promote regional economic integration by promoting more trade within the region, creating economies of scale and more efficient value chains; and to coordinate development, services, and tourism. The member countries have already eliminated visa requirements among their citizens to allow for a freer flow of people. Another Alliance goal is to strengthen and coordinate the group's economic ties with Asia.

Global Economic Integration

Peru has been integrating into the world economy, signing free trade agreements with the United States and other key trade partners such as Canada, Chile, China, Japan, Singapore, South Korea, and Thailand. Peru joined the Asia-Pacific Economic Cooperation (APEC) in 1998, which promotes economic relations between Peru and Asian countries. Peru is an active member, hosting the APEC summit in 2008. Peru hosted the third South American-Arab Countries Summit in October 2012, during which 21 Middle Eastern and 11 South American countries agreed to create an investment bank to fund joint projects between the Union of South American Countries (UNASUR) and the Arab League, and Peru signed a commercial and technical agreement with the Gulf Cooperation Council (comprising Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates).[21] After a nine-year process, Peru's free trade agreement with the European Union went into effect on March 1, 2013.

Poverty Decreasing, Economic Disparity Still High

García, during his second (non-consecutive) five-year term, largely continued the orthodox economic policies of his predecessor, Alejandro Toledo, concentrating on reducing the fiscal deficit. The U.S. State Department described Peru's economy as "well managed" under García, and maintained that better tax collection and growth were increasing revenues.[22] President Humala has followed suit, appointing a conservative economic team that is continuing existing free-market economic and trade policies. He also insists, however, that he will enact policies to eradicate poverty by spreading Peru's wealth to the country's poorest population. President Humala has maintained that "Economic growth and social inclusion will march together," and that he will expand social programs to reduce the number living in poverty.[23]

[19] Latin American Andean Group Report, "Giving Shape to the Pacific Alliance," RA-13-05, May 2013,p. 16; and *The Economist*, "A continental divide: The region is falling in behind two alternative blocks: the market-led Pacific Alliance and the more statist Mercosur," May 18, 2013.

[20] Stephen Keppel, "Meet Latin America's Serious Side: The Pacific Alliance," abcnews.go.com, May 28, 2013.

[21] Diego Moya-Ocampos, "Third South American-Arab Countries Summit Issues Declaration," *IHS Global Insight Daily Analysis*, October 3, 2012, and "Peruvian President Expects Arab Countries' Investments Following Summit," *IHS Global Insight Daily Analysis*, October 4, 2012.

[22] Bureau of Western Hemisphere Affairs, U.S. Department of State, *Background Note: Peru*, May 2009, http://www.state.gov/r/pa/ei/bgn/35762.htm.

[23] "Ollanta Humala is Sworn In As New Peru President," *BBC News*, July 28, 2011; "Peru's Humala Renews Poverty (continued...)

Peru's rapid and sustained economic growth has substantially reduced poverty and increased employment. Peru's poverty rates have been dropping since 2000. Peruvians living in extreme poverty, unable to purchase the most basic basket of necessities, fell from 24.1% in 2001 to 9.8% of the overall population of 30 million in 2010. The percentage of Peruvians living in poverty fell from 54.3% in 2001 to 25.8% in 2012.[24] Social unrest has continued to rise in recent years, however, as Peru's poor have felt that the country's economic prosperity has not reached them. Indeed, the percentage of the population living in poverty in some mountain, jungle, and rural areas is over 60%. The disparity between rural and urban populations remains marked: as of 2012 over half (53%) of the rural population lives in poverty, while 16.1% of the urban population does so. The income distribution gap remains significant: the top 20% of the population garners 52.6% of the nation's income, while the lowest 20% garners only 3.9% of the income. According to the World Bank, "poverty rates are still high for a country with income levels like Peru's."

Similarly, the factors weighed in the World Bank Human Opportunity Index, which measures "how personal circumstances (birthplace, wealth, race or gender) impact a child's probability of accessing the services that are necessary to succeed in life" (timely education, running water, sanitation, electricity), have improved greatly in Peru since 1995, but remain significantly lower for Peru's poorer population as compared to the wealthier population.[25] Overall, for example, chronic malnutrition among children under the age of five declined from 28.5% in 2007 to 23.2% in 2010. But among the poorest 20% of the country's population, 47% of children displayed stunting from malnutrition, as opposed to only 5% of children among the wealthiest quintile. The infant mortality rate was 64 deaths per 1,000 live births among the poorest quintile, and 14 per 1,000 among the wealthiest quintile. On the 2010 World Bank Human Opportunity Index, Peru scores about 70 on a scale of 100 for universal access to services. It compares poorly to the rest of Latin America, however, ranking 14th out of 18 countries.

As mentioned above, President Humala and the Peruvian Congress have already approved an increase in mining royalties expected to generate US$1.1 billion a year to fund social development programs aimed at closing that social and economic distribution gap. The President also announced an increase in the minimum wage and a minimum pension to poor people over age 65. His administration proposed, and in March 2012 the legislature passed, a law to expand natural gas use, especially for low-income sectors.

Since Humala assumed office, an emphasis on social spending and poverty reduction combined with continued economic growth have led to poverty falling at a slightly faster rate in the more poverty-stricken rural areas. From 2011 to 2012 poverty fell in urban areas by 1.6% and in rural areas by 3.1%. Nonetheless, several factors will continue to drive social unrest: the economic disparity between urban and rural populations remains extremely wide; rural communities experiencing or fearing a detrimental impact on their environment from mining; and the

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Vow after Year in Office," *BBC News*, July 28, 2012.

[24] Poverty figures in this section from: Organization of American States, *Peru's Foreign Minister Trusts in a Fair Electoral Process in his Country*, Press Release E-290/05 (citing UN Economic Commission for Latin America and Caribbean figures), December 14, 2005; World Bank, *Peru Country Brief*, May 18, 2009, pp. 1-3, http://go.worldbank.org/AHUP42HWR0; and The World Bank, *Peru: Brief*, September 19, 2011, April 4, 2012; and World dataBank at http://databank.worldbank.org, April 4, 2012. 2012 data from "Country Report: Peru," *Economist Intelligence Unit*, June 2013, p.21.

[25] Socioeconomic information in this section drawn from The World Bank, *Peru: Brief*, September 16, 2011; and World Data Bank at http://databank.worldbank.org; quintile data is from 2000, October 19, 2011 and April 4, 2012.

perception among those communities that they are receiving few of the benefits from the country's mining economic boom.

Challenges of Funding and Managing Social Development Programs

According to the Economist Intelligence Unit, "several years' worth of large surpluses" provided ample finance for the García administration's social policies, but implementation of those policies was hampered by the limited capacity of Peru's institutions.[26] The same holds true for the Humala administration, which faces the challenge of making the government more effective in order to continue and expand the positive trends of the past decade.

A case in point where increased effectiveness is needed is that of the Camisea natural gas project. Peru began to decentralize government functions in earnest in 2002. Some analysts reported that provincial and local governments were therefore not prepared, only two years later, to absorb the $1.13 billion in revenue generated by the Camisea project that the national government transferred to them between 2004 and 2009.[27] The nascent sub-national governments appear to have lacked the skills to manage the social and environmental risks, resulting in reported damage to many indigenous communities, their livelihoods, and their ecosystems. The governments also reportedly lacked the fiscal management skills to marshal the funds effectively, and poverty in those areas remained as high as 60%. U.S. assistance programs help provide training and technical assistance to sub-national (and national) institutions to plan and manage social services, improve citizen access to information, and prevent and mitigate conflict.

Debate over Exploitation of Natural Resources and Environmental Protection

During his presidential campaign, Humala promised to protect Peru's environment. His administration has taken several important steps toward that end, but has also been criticized for taking steps that favor business interests. The first law the president signed was the prior consultation law, requiring mining, energy, and logging companies to consult with indigenous and rural communities about natural resource exploitation projects planned in their communities. The government has yet to define either the procedures for that consultation process or the communities that may participate in it, however, and no prior consultation process has taken place so far. Furthermore, the government has approved 14 mining projects to proceed without prior consultation of the communities in which the projects are located. (See aboveAddressing Social Conflicts above.)

Part of the challenge the government faces is how new it is to protecting the environment. While mineral extraction has gone on for decades in Peru, the government ministry responsible for protecting the environment is only five years old. In an effort to reduce a conflict of interest, the Humala administration shifted responsibility for approval of environmental impact studies from the mining and energy ministry to the environment industry. But tensions between the

[26] Economist Intelligence Unit (EIU), *Country Report: Peru*, London, May 2009, pp. 3, 4, 15.

[27] World Resources Institute, Bank Information Center, Oxfam, "People, Power, and Pipelines: Lessons from Peru in the governance of gas production revenues," June 16, 2010.

government's desire to promote investment and to protect the environment persist. Humala has shuffled his cabinet twice due to conflicts over a major gold mine project (discussed below), and a top official in the environment ministry resigned in response to a government crackdown on residents protesting the mine.

In a major move, President Humala declared an environmental state of emergency in part of Peru's Amazon jungle region in May 2013. He ordered an Argentinian oil company to clean up the pollution where it is operating within three months. The company, Pluspetrol, said it would clean up the area, although it blamed the pollution on the company that preceded it there.[28] Residents in the region, along the Pastaza River, say the pollution from the oil has damaged the river and the surrounding rainforest, killing fish and animals and introducing new illnesses among the people.

Social unrest and debate over exploitation of natural resources is likely to remain a challenge for the Humala government. The biggest dispute has involved a mine owned by U.S. parent company Newmont Mining and operated by its local subsidiary, Yanacocha. Work at the Conga gold and copper mine in Cajamarca, in northern Peru, has been suspended since late November 2011 due to violent protests there over its impact on the environment. Opponents worry that the $5 billion project—the country's largest foreign investment project ever—will contaminate water resources that provide the region's water for drinking and agriculture by draining lagoons and filling them with mining waste. Many residents of the dairy and agricultural region say they want sustainable development based on agriculture and eco-tourism instead.

The government hired a team of international experts to reassess the project's environmental impact assessment, which the García administration had approved in 2010. After receiving the report on April 17, 2012, President Humala imposed additional conditions on the project. Newmont halted the mine construction while it builds four reservoirs called for in the assessment and says that it will carry out its work in an environmentally sensitive way, and correct errors made in the past.[29]

Violent protests have erupted sporadically over the mine. Five protesters were killed when police shot into the crowd in July 2012. Protesters again clashed with police on May 29, 2013 after Newmont Mining announced it was transferring water from a lake the protesters have been trying to protect to the second reservoir the company is building.[30] According to the Yanacocha company, the new reservoirs would increase some communities' access to water year-round. Newmont Mining's local partner, the Buenaventura company, said the communities' response to removal of the lake water could be the "breaking point" determining whether or not the mine construction moves forward. Environment Minister Manuel Pulgar-Vidal says the first two reservoirs are strictly for community use, an effort on the part of the company to contribute to development of the region. The Minister also said that the government will not allow construction of the mine to begin until both reservoirs are completed and the company has earned its "social license" by earning the community's trust.

[28] Mitra Taj, "Peru's President Orders Environmental Clean Up in Amazon Oil Region," The World, May 22, 2013.

[29] Ibid.

[30] Sources for this paragraph include: *Reuters*, "Foes of Newmont's $5 billion Peru mine in standoff with police," May 29, 2013; *Business News Americas*: "Yanacocha calls for more government involvement in Conga," May 28, 2013, and "Peruvian government won't allow construction of Conga before reservoir completion, says minister," June 4, 2013.

Cajamarca's regional president, Gregorio Santos Guerrero, continues to oppose the gold mine expansion. A Peruvian congressional committee has recommended that the attorney general investigate Santos for allegedly misusing public funds. Santos has denied the charges and said the government is targeting him because of his opposition to the mine.[31]

Investors see the outcome of the case as an important indicator of Peru's business environment.[32] Four other regions are experiencing protests against mining and energy projects as well.

Peru's Relations with its Neighbors

Peru generally has friendly relations with its South American neighbors, although tensions with Chile arise occasionally. Peru's Congress triggered renewed tensions in 2005 when it declared new maritime borders; Chile claims that the maritime borders had been agreed to in fishing pacts signed in the early 1950s. In 2008 the García administration asked the International Court of Justice (ICJ) in the Hague to arbitrate the dispute; the court recently heard the case, and is expected to hand down a decision this summer. Actions on both sides of the border led to tensions again in 2009. Chile conducted multinational military exercises that rankled Peru, and Peru arrested a member of its Air Force for allegedly spying and providing classified defense information to Chile.[33] During the presidential campaign, Humala made inflammatory remarks regarding Chile, demanding Chile apologize to Peru for assaults during the War of the Pacific in 1879 and warning Chile not to discriminate against Peruvians residing in Chile, or Peru would do the same against Chileans within its borders.

Shortly after he was elected, however, Humala traveled to Chile, saying he wanted to get relations between the two countries off on a good foot. At a meeting in May 2013, the Foreign Ministers of both countries, Rafael Roncagliolo of Peru and Alfredo Moreno of Chile, said their countries will respect the ICJ's decision in the case. The ministers also signed an agreement to work on a joint "unit for peace maintenance operations."[34]

Peru and Ecuador resolved their sometimes violent border disputes by signing a peace accord in 1998, of which the United States was one of four guarantor states. Peru and Ecuador coordinate a border integration project with U.S. and other international support.

As mentioned earlier, Peru is a member of the South American regional integration organizations, CAN, UNASUR, and the Pacific Alliance, and an associate member of Mercosur. (See Socio-Economic Conditions, above.)

About 200 Peruvian troops participate in peacekeeping operations as part of the U.N. Stabilization Mission in Haiti.[35]

[31] *Reuters*, "Troubles grow for opponent of $5 bln Peru gold mine," June 6, 2013.

[32] "Resource Nationalism: Conga's Outcome to Set Precedent for Future Mining Projects in Peru," American Metal Market, March 25, 2012.

[33] U.S. Dept. of State, *Background Note: Peru*, January 3, 2012, http://www.state.gov/r/pa/ei/bgn/35762.htm.

[34] *Andina, Agencia Peruana de Noticias*, "Peru, Chile say to respect ICJ ruling on maritime dispute," May 4, 2013.

[35] U.S. Dept. of State, *Background Note: Peru*, op. cit.

Relations with the United States

Peru and the United States have a strong and cooperative relationship. The United States supports the strengthening of Peru's democratic institutions and its respect for human rights. The two countries also cooperate on environmental protection and counternarcotics efforts. In the economic realm, the United States supports bilateral trade relations and Peru's further integration into the world economy. President-elect Humala met with Secretary of State Hillary Clinton and President Barack Obama in Washington in early July 2011. Humala said he wished to further strengthen ties between the two countries, and Clinton said that "the United States stands ready to be his partner."[36] Presidents Obama and Humala met briefly at the Summit of the Americas on April 14, 2012, in Cartagena, Colombia.

The two presidents are scheduled to meet again on June 11, 2013, during President Humala's first official visit to the White House. According to the Obama Administration, they will discuss U.S. efforts to support the Humala Administration's agenda of social inclusion, broad based economic growth, and citizen security. They will also discuss joint efforts to further Trans-Pacific Partnership Agreement negotiations, and cooperate on education, energy and climate change, science and technology, and bilateral trade. Humala will also launch partnerships with several U.S. universities during his trip, including the Massachusetts Institute of Technology and universities in Maryland, Delaware, and Utah.

U.S. Defense Secretary Leon Panetta met with President Humala and Defense Minister Pedro Cateriano in Peru on October 6, 2012. The officials said the two militaries cooperate in areas including humanitarian assistance, such as joint disaster response training; internal security; defense reform; U.N. peacekeeping; and regional security, and they discussed further collaboration. Panetta said the United States was prepared to work with Peru "on joint planning, information sharing [and] trilateral cooperation with Colombia to address our shared security concerns in this area," and on updating their Defense Cooperation Agreement, which dates from 1952, to improve cooperation.[37] The officials also reportedly discussed Peru's desire to acquire 20 U.S. helicopters, and to use counternarcotics resources for counterinsurgency efforts as well.[38] (See "Counternarcotics Efforts" below.)

U.S. Assistance and Congressional Interests

According to the Department of State, the goals of U.S. assistance to Peru are to help it consolidate democratic rule, invest in its people, combat narcotrafficking and terrorism, and reform state institutions to improve public infrastructure and service delivery.[39] Congress has supported these goals through appropriated funding. Nonetheless, funding for Peru has been declining since at least FY2010, when the United States provided almost $120 million in assistance to Peru. Funding decreased to $97 million in FY2011, and to $79 million in FY2012, and requested funding for FY2013 and FY2014 continue the decline. (See Table 1 below.)

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[36] Diego Urdaneta, "Peru President-Elect Meets Obama, Clinton," *AFP*, July 6, 2011.

[37] Department of Defense, *FDCH Regulatory Intelligence Database*, October 6, 2012.

[38] Diego Moya-Ocampos, "Peru Considers Satellite Monitoring for Coca Region," *IHS Global Insight Daily Analysis*, October 15, 2012.

[39] U.S. Dept. of State, *Peru: Foreign Assistance Program Overview*, Congressional Budget Justification, Foreign Operations, Annex: Regional Perspectives, Fiscal Year 2012.

Congress designated funding to Peru as part of several other regional programs. In the Consolidated Appropriations Act of 2012 (P.L. 112-74), Congress stipulated that "not less than" $10 million of Development Assistance, and "not less than" $10 million of Economic Support Funds shall be made available for Peru, Central American countries, and the Dominican Republic for labor and environmental capacity building activities relating to free trade agreements with the United States. In its Joint Explanatory Statement, Congress said that $10 million should be made available for biodiversity conservation programs in the Andean Amazon region.[40]

The Obama Administration requested $73 million for Peru for FY2013. FY2013 foreign assistance is being funded through a continuing resolution (P.L. 113-6), however, which funds most accounts at the FY2012 enacted level. Furthermore, sequestration required by the Budget Control Act of 2011 (P.L. 112-25), as amended by the American Taxpayer Relief Act of 2012 (P.L. 112-240/H.R. 8, signed into law January 2, 2013), is currently in effect and requires an across-the-board reduction from the FY2013 enacted funding level. Given uncertainty over the country allocations that would be used as the base line to calculate the sequestration, CRS is unable to calculate post-sequestration funding levels for Peru. A possible rough estimate could be reached by reducing FY2012 figures by 5%; that would assume that all cuts would be even across the board, which they will not necessarily be.

The Administration requested just under $73 million for Peru for FY2014. There has been no legislative action on FY2014 foreign operations funding yet.

Table 1. U.S. Assistance to Peru by Account and Fiscal Year 2012-2014

	Fiscal Year			FY2012-14 Change	
($ in thousands)	2012 Actual	2013 Request	2014 Request	$	%
TOTAL	**79,129**	**73,165**	**72,635**	**-6,494**	**-8.2%**
Development Assistance	41,280	47,300	43,100	+1,820	+4.4%
Foreign Military Financing	1,980	1,980	2,500	+520	+26.3%
Global Health Programs - State	0	0	0	0	0
Global Health Programs - USAID	5,000	0	0	-5,000	-100%
International Military Education and Training	619	585	585	-34	-5.5%
International Narcotics Control and Law Enforcement	29,250	23,300	26,300	-2,950	-10.1%
Nonproliferation, Antiterrorism, Demining and Related Programs	1,000	0	150	-850	-85%

Source: Congressional Budget Justification, Foreign Operations, Fiscal Year 2014.

[40] Joint Explanatory Statement for Consolidated Appropriations Act of 2012, P.L. 112-74, http://rules.house.gov/Media/file/PDF_112_1/legislativetext/HR2055crSOM/psConference%20Div%20I%20-%20SOM%20OCR.pdf

Peru and the United States signed a $35.6 million Millennium Challenge Threshold program for 2008 to 2010 that supported Peru's efforts to reduce corruption in public administration and improve child immunization coverage. The program, implemented by the U.S. Agency for International Development (USAID), was extended to July 2011. The nationwide immunization program is completed. To allow the completion of one remaining anti-corruption program, the Millennium Challenge Corporation (MCC) extended the end date until September 2012. These activities were to be incorporated into USAID programs for the remainder of FY2012 and probably into FY2013.

Counternarcotics Efforts

A dominant theme in the relations between the two countries is the effort to stem the flow of illegal drugs, mostly cocaine, from Peru to the United States. Peru is one of the three Andean countries that produce virtually all of the world's coca. According to the State Department, Peru "has the world's highest potential production of pure cocaine," and is the second-largest cultivator of coca.[41] Estimates of Peru's total area of coca production vary widely.

According to the United Nations Office on Drugs and Crime, coca cultivation increased by 2% over the previous year, from 61,200 hectares in 2010 to 62,500 hectares in 2011. The U.S. government, using a different methodology, estimated that 53,000 hectares were under cultivation in Peru in 2010, and 49,500 hectares in 2011, constituting a 6.6% decrease.

Within the country, there have been significant changes in production. The upper Huallaga valley, formerly the country's largest producer of coca, experienced a strong drop in cultivation, due mostly to intensive eradication there. Producing as much as 40% of the country's coca, the valley of the Apurimac and Ene rivers, known as the VRAE region, is now Peru's largest coca cultivating region. Because of security concerns there, however, Peru's eradication agency does not conduct operations there. According to the State Department, 93% of the coca grown in Peru is illegal and intended for cocaine production. The rest is for traditional domestic consumption. The State Department also reports that Peru is a major importer of precursor chemicals that are used to produce cocaine.

The cultivation of coca and production of cocaine has contributed to social problems in Peru. Coca eradication is highly controversial in Peru, with coca farmers violently resisting it. Some coca farmers have become allied with remnants of the Shining Path, or Sendero Luminoso, terrorist organization. Now closely linked with narcotics trafficking, the Shining Path conducted 87 terrorist acts in 2012, killing one civilian, 13 members of the military, and five police officers.[42] A faction of the Shining Path operates in the VRAE, with several hundred armed members.

Drug addiction has become a serious problem, but an insufficient number of treatment and rehabilitation centers to treat them. The State Department estimated there were150, 000 addicts across the country in 2011, but reported "32,000 to 45,000 cocaine addicts and an even larger

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[41] This and other figures in this section are from U.S. Dept. of State, Bureau for International Narcotics and Law Enforcement, *International Narcotics Control Strategy Report [INCSR], Peru,* vol. I, Drug and Chemical Control, March 2012 and March 2013.

[42] U.S. Dept. of State, Office of the Coordinator for Counterterrorism, *Country Reports on Terrorism 2012, Peru*, May 30, 2013.

number of marijuana addicts" in its 2013 report. Illicit coca cultivation and production has damaged the environment, contributing to the deforestation of 2.5 million hectares over 30 years, and the pollution of forests and streams from 118 million liters of precursor chemicals dumped in them over a period of 5 years.

U.S. counternarcotics programs in Peru focus on three areas: eradication, interdiction, and alternative development. The Obama Administration's request for FY2014 includes $26 million in International Narcotics Control and Law Enforcement (INCLE) funds, an increase of $3 million from the FY2013 request. According to the 2011 INCSR, from 2009 to 2010 alternative development programs led to a 24% increase in the legal incomes of participating families, and to a 25% decrease in their level of poverty. The 2013 INCSR reports that USAID programs supported over 19,000 families with the cultivation of alternative crops in 2012.

When he took office, President Humala said he was reevaluating Peru's counternarcotics policy, and also that he saw the United States as a "strategic partner" in combating illegal drug production and trafficking.[43] The United States has required total eradication of coca before a farmer can enter into alternative development programs in Peru; critics say farmers should be allowed to make a gradual transition to alternative crops so that they maintain a source of income. When the Humala administration stopped eradication shortly after assuming office, many observers thought it indicated a major shift in policy, especially considering that Humala had support from coca growers in his campaign. But the Humala administration quickly resumed eradication in August 2011, and soon removed the officials he had initially placed in charge of counter-narcotics policy, some said out of concern their policies might antagonize the United States.[44]

In March 2012 Peru adopted a new five-year (2012-2016) counternarcotics strategy, and according to the 2013 INCSR, "dedicated substantial resources to implement it." The new plan calls for a 200% increase in coca eradication by the end of the five years.

President Humala declared a 60-day state of emergency in several coca-producing areas with a Shining Path presence in September 2011. These areas were also the site of protests by coca farmers opposed to the government's forced eradication of their crops. Days after the state of emergency was declared, the defense minister announced that the military was going to "take total control of the VRAE."[45] According to the government, the military intervention to re-take control of the region was to be coupled with the development of infrastructure such as roads, communications, schools, and hospitals by army engineers. Nonetheless, the imposition of full military control of the area for the first time since the administration of former President Alberto Fujimori, now imprisoned for human rights violations and other crimes, raises concerns for many over human rights and development issues. Protests over eradication have continued, and the VRAE continues to be an emergency zone.

Securing the VRAE is complicated by the presence there of remnants of the Shining Path (Sendero Luminoso) insurgency movement, who reportedly operate alongside local drug traffickers. A Shining Path faction killed two police agents and injured two others in October

[43] "Ollanta Humala is Sworn in as New Peru President," *BBC News: Latin America and Caribbean*, July 28, 2011.

[44] "Humala Stops Rocking the Boat," *Latin American Weekly Report*, vol. WR-12-02 (January 12, 2012).

[45] "Peru: Security; Militarisation of the Vrae - Then and Now," *Latin American Weekly Report*, vol. WR-11-38, September 22, 2011, p. 4.

2012. In response, the Humala Administration said it planned to monitor the Shining Path via satellite, and was in discussions with U.S. officials to allow helicopters provided by the U.S. for counter-narcotics operations to be used for counterinsurgency operations as well.[46] The State Department says a primary focus of U.S. support is to enhance the ability of Peruvian security forces to counter the Shining Path's narcotics and terrorist activities in the VRAEM and to increase the government's presence there.

Trade and Environment

The United States is one of Peru's top trading partners. U.S. goods exports to Peru in 2012 totaled $9.4 billion, a 12% increase over 2011. Peru exports to the United States decreased almost 3% over the same period, to $6.4 billion. Peru is the 32nd largest export market for U.S. goods.[47] Peru's other top trading partners are China and Switzerland.

Both the executive branch and Congress have promoted trade with Peru, and protection of its environment, often linking the two. The U.S.-Peru Trade Promotion Agreement (PTPA) went into effect February 1, 2009. Congress passed environmental amendments to the PTPA that commit Peru (and the United States) to enforce its domestic environmental laws, and adopt new laws to fulfill obligations under multilateral environmental agreements. Other amendments to the PTPA call for the two countries to take steps to enhance forest sector governance and promote legal trade in timber products.

On April 17, 2012, a conservation non-profit organization invoked those amendments in petitioning the U.S. Trade Representative to investigate and verify the legal origin of wood shipments from Peru.[48] An Environmental Investigation Agency (EIA) report indicated that millions of dollars' worth of illegal wood from the Peruvian Amazon were exported to the United States between 2008 and 2010.[49] If the U.S. government finds evidence of illegality, it can take actions, including prohibiting the companies involved from exporting to the United States until Peru produces evidence that each company is complying with the law and regulations. EIA noted that Peruvian agencies are exercising greater oversight over the industry; to conduct its analysis, the group used data from a government agency it said was reformed and strengthened under provisions of the PTPA.

As mentioned above, Congress stipulated in the FY2012 appropriations law that both Development Assistance and Economic Support Funds shall be made available for Peru for labor and environmental capacity building activities relating to free trade agreements with the United States. In its Joint Explanatory Statement, Congress said that $10 million should be made available for biodiversity conservation programs in the Andean Amazon region.

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[46] Diego Moya-Ocampos, "Peru Considers Satellite Monitoring for Coca Region," *IHS Global Insight Daily Analysis*, October 15, 2012.

[47] U.S. Trade Representative, *2013 National Trade Estimate Report on Foreign Trade Barriers: Peru*.

[48] Andrea Johnson and Fiona Mulligan, *US Government Requested to Use Free Trade Agreement to Take Action on Illegal Timber Exports from Peru; Environmental Organization Submits Formal Petition To US Trade Representative With Evidence On Dozens Of Shipments In Violation Of International Laws and US-Peru FTA*, Environmental Investigation Agency, press release, Washington, DC, April 19, 2012.

[49] "NGO Alleges Illegal Logging Shipments from Peru; Will urge USTR to Act," *Inside U.S. Trade*, vol. 30, no. 15 (April 13, 2012).

In 2009 the United States announced it would be entering into an Asia-Pacific trade agreement known as the Trans-Pacific Partnership (TPP).[50] Peru is one of the negotiating partners. According to the USTR, the TPP will be "a means to advance U.S. economic interests with the fastest-growing economies in the world, and a tool to expand U.S. exports."[51] Critics assert that any economic benefits deriving from the agreement "will be relatively small and the regulatory costs could be significantly high—especially for the emerging market and developing countries engaged in the negotiations."[52] The 17th round of TPP negotiations were held in Lima, ending on May 24, 2013. Outstanding issues still being negotiated include services, government procurement, sanitary and phytosanitary standards, trade remedies, labor, and dispute settlements. The countries also discussed how to integrate Japan into the next round of the negotiations in July.

Peru and the United States signed a debt-for-nature swap in 2008 that reduces Peru's debt to the United States by more than $25 million over seven years, until 2015. In exchange, Peru agreed to use those funds to support grants to protect its tropical forests. Peru and the United States held the fourth meetings of joint environmental commissions to review progress on implementation of the TPA environmental provisions, and of environmental cooperation activities under the U.S.-Peru Environmental Cooperation Agreement. The two countries reportedly made progress toward establishing an independent secretariat to consider enforcement matters as called for in the TPA, and said they would sign an agreement on the secretariat soon.[53]

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[50] For further information on the TPP, see CRS Reports 42694, *The Trans-Pacific Partnership Negotiations and Issues for Congress* and 42344,*Trans-Pacific Partnership (TPP) Countries: Comparative Trade and Economic Analysis*.

[51] U.S. Trade Representative, *2012 National Trade Estimate Report on Foreign Trade, Peru*, 2012, p. 307.

[52] Kevin Gallagher, *Bamboozled by the TPP: The Small Benefits and Real Costs of the Trans-Pacific Partnership Agreement*, Global Development and Environment Institute, Tufts University, Globalization Commentaries, Medford, MA, January 23, 2012.

[53] *Andina*, "Peru, U.S. meet on environmental affairs," June 6, 2013.