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# The Peruvian Perspective: Geoeconomic and Geopolitical risks in 2020s Latin America

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# Table of Contents

<b>Executive Summary</b>	<b>2</b>
<b>1. Overview of the Prognosis and Analysis</b>	<b>5</b>
<b>1.1. What happened with the Peruvian Economic Miracle and What's Next?</b>	<b>5</b>
<b>1.2. Five Lessons Learned from COVID-19</b>	<b>10</b>
<b>1.3. A New Turn to the Left in Latin America</b>	<b>18</b>
<b>2. Policy Brief Overview from an Economic and Political Analysis</b>	<b>22</b>
<b>2.1. Quest for Sustainable Development: Labour Reform and State Modernisation in Peru</b>	<b>22</b>
<b>2.2. Raising the Bar</b>	<b>26</b>



# Executive Summary

*Alessia Mazuelos*

Latin America, despite its increasing global importance and connectivity from an economic, geopolitical, and humanitarian perspective is a region whose risks and opportunities have largely flown under the radar in mainstream Eurasian geopolitics. We hope to provide a multi-element report that sheds light on Latin America's recent situation, from the perspective of Peru, one of the region's most economically and politically dynamic states.

Peru has been set as the reports centre-focus due it being one of the region's most economically and politically dynamic countries, having a direct hand in addressing and experiencing many of the continent's wider issues as a prominent state.

Specifically, the report seeks to address some of the biggest crisis to emerge from the 2020s with an overview of the prognosis and analysis from a geoeconomics and geopolitical point of view:

## **1.1 What Happened with the Peruvian Miracle and What's Next?**

Mercedes Aráoz accounts the effects of geopolitical external shocks such as the COVID-19 pandemic, the increase in freight cost, the rise of energy and food prices as a result of the Russian invasion of Ukraine and the more restrictive monetary policy of the US federal Reserve on the Peruvian economy. Nonetheless, she also takes into consideration the existing internal factors including the economic informality, the ongoing domestic political crisis since 2016 and failures of the institutional framework that have been affecting the so-called economic miracle: Peru. Mercedes brings the perspective to this day with the unstable political equilibrium from the current administration's mismanagement and corruption; but she refers back to country's economic resilience and capacity of adopting reforms to strengthen institutions and improve multilevel governance of the State.

## **1.2 Five Lessons Learned from COVID-19**

María Antonieta Alva reflects on the deeply entrenched social problems from informality to inequality of access to basic utilities and opportunities due to structural and institutional problems reflect upon the ineffective health service that was evidenced by the arrival of COVID-19 to Peru, the region's stars in macroeconomic management since the 1990s reforms towards market-based, commercial and financially open economy. This way, structural problems such as the gap in human resources, weak primary care or lack of medical supplies arose with the global pandemic. María Antonieta draws five lessons learned from the COVID-19 pandemic: (1) The need to strengthen the epidemiological surveillance system, (2) Structural gaps affect the ability of instruments to responds to crises, (3) Inequality compounds



the effects of a pandemic, (4) The importance of quality public spending, and (5) Crises bring scope for innovation

### **1.3 A New Turn to the Left in Latin America**

Farid Kahhat argues that the so-called Pink Tide where we saw the political pattern in Latin America of left-wing governments being elected stems from a political turn in the region against the incumbents rather than towards the left. Both regional patterns contributing locally and international causes influencing Latin America result in discontent with incumbents. He mentions the biggest Boom in commodity prices since the 1950s would display the lowest growth rate in the region 2014-2020, the appearance of the COVID-19 pandemic worsening Latin America's income inequality, the war in Ukraine impacting on food and fuel international prices as well as the international and self-inflicted example of corruption, the Lava Jato Case, to be some of the most significant sources of discontent. Farid reflects on the influential implications for the prospects of left-leaning governments but insists on the left being less likely to repeat in the near future with a possibility of a 'Right Turn' as radicalisation and socio-political discontent play a greater role in Latin America than how promising the left-wing or right-wing forces appear to the public.

Furthermore, the report utilises the analysis to develop a geoeconomics and geopolitical assessment for potential recommendations and suggestions in the form of a policy brief to manage or ease the biggest crisis Latin America has faced since the beginning of the 2020s:

### **2.1 Quest for Sustainable Development: Labour Reform and State Modernisation in Peru**

Luis Miguel Castilla calls for the need of a sensible, effective, and transparent government through long-awaited political and institutional reforms for Peru to face the challenging period with its historic economic resilience in the last quarter century depicting economic progress while confronting periods of recurring crises. He retrospectively analyses this accounting the slowing down of the economic growth in Peru along with the historically low business and consumer pessimism due to the challenges of deterioration of the external environment like the fall in trade and high political instability, the hardships of the COVID-19 pandemic hit and the poor governance of Castillo's presidency. Luis Miguel suggests to tackle the persistent structural weaknesses evidenced by high vulnerability to external/internal shocks and natural disasters by achieving a greater formalization of the economy (especially labour informality) and strengthening government effectiveness and transparency (such as strengthening institutions and addressing acts of corruption).



## **2.2 Raising the Bar**

Giacomo Ugarelli delves into the debated question of whether democracy around the world is in recession hinting at the highly dissatisfied electorate, the rise of openly undemocratically oriented candidates and the curious stability of fragile democracies to conclude there is regression of democracy in Latin America. With Peru as an example, Giacomo answers the question of why many functioning democracies are experiencing high levels of dissatisfaction arguing that the problem originates not from the democratic system, but rather on the people who become elected. He presents the idea of rethinking democracy by proposing a series of democratic ‘experiments’ that modify the current rules of the game, or by ‘raising the bar’ of entry to elected office, finding a way to guarantee that the people becoming elected are better representatives (such as ensuring the leaders have the correct ‘character’). This ambitious ‘experiment’ would therefore design mechanisms or impose restrictions to help democracies elevate the quality of its representatives to continue to aspire to better democracy and ensure it remains in the region and the world.

It is hoped that this report will help in bringing to the fore Latin American, and particularly Peruvian concerns, issues, lessons, and ideas on how to tackle economic and political instability and will aid in better integrating a Latin American perspective into the Eurasian lens of current global geopolitics and geoeconomics from the high-profile and renowned guest writers involved.



# 1. Overview of the Prognosis and Analysis

## 1.1. What happened with the Peruvian Economic Miracle and What's Next?

*Mercedes Aráoz*

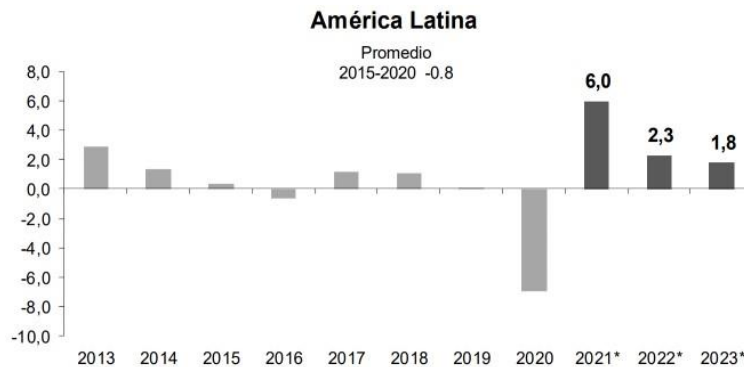
Mercedes Rosalba Aráoz Fernández is a Peruvian economist, professor, and politician who served as Vice President of Peru from 2016 to 2020 and Prime Minister from September 2017 to March 2018. She has previously served as Minister of Economy and Finance, Minister of Production, and Minister of Foreign Trade and Tourism. She is currently professor of International Economics and Public Policy at Universidad del Pacifico in Peru and has been also professor at Peru's Diplomatic Academy. Furthermore, she is a member of the Executive Board of the Global Crop Trust, commissioner of the Broadband Commission for Sustainable Development and a member of Friends of Multilateralism Group. She has previously worked as a Representative of the Interamerican Development Bank for Mexico.

A few years ago, Peru was considered an economic miracle, a land of opportunities, with sound economic policymaking, a market-based economy, and strong openness for trade and investment. In addition to this, Peru was part of [twenty-two signed trade agreements](#) that covered 75% of the world GDP and 95% of the Peruvian trade. Furthermore, the country saw an important [reduction of poverty](#) levels from over 60% to 20% in a few years as well as a reduced level of inequality which was shown by the [lowest Gini index](#) in Latin America. Of course, there were more than a few areas of improvement in the provision of public goods and services for the well-being of the population, more microeconomic reforms were needed, both at the social and the competitiveness aspects of development, especially reducing the large weight of the informal markets; but, in general, the country was on the right track.

Nonetheless, Peru was strongly hit by the COVID-19 pandemic, with the highest rate of deaths per million in the region, the health care system was not prepared for the overwhelming impact of the pandemic and the public management of the crisis was very poor. But then again, Peru showed, on the other hand, an enormous degree of resilience, given its strong macroeconomic fundamentals. Despite being one of the countries of Latin America with the longest lockdown during the pandemic, which caused the largest drop in the GDP, it has bounced back a little bit above the previous level of GDP and the perspective of [annual growth](#) for the next couple of years is around 3%, not good enough for generating more formal employment and development, but above the expected regional average.



## 02. Variación real del PBI: crecimiento por debajo del mundial



Fuente: BCRP, FMI y Consensus Forecast (2022)

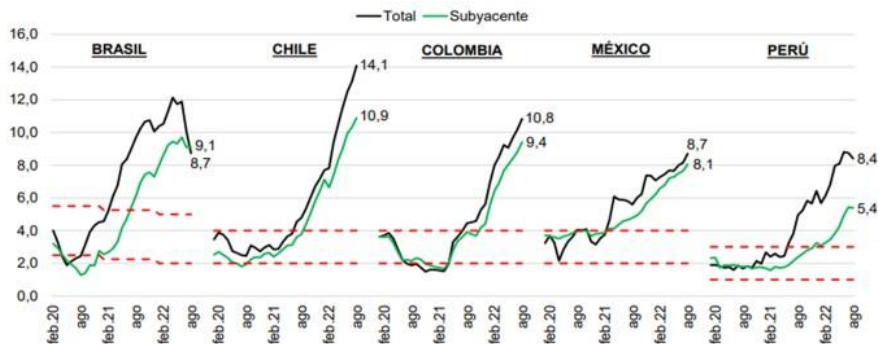
*Graph 1: Regional average of GDP growth in Latin America*

The level of public indebtedness is still very low, around 35%, compared to other major economies in the region, therefore the Peruvian credit rating is under observation because of the local policies, but the expectations are nevertheless stable. The Ministry of Finance is probably one of the few executive branches that are trying to ensure economic stability, with a reduced fiscal deficit and proposing some programmes to impulse growth through public and private investment, but the rest of the cabinet -and the President himself too- has been giving contradictory signalling to the private sector. So private investment, which has the largest multiplier impact on GDP, has been brought to a standstill and will have zero growth next year, accordingly to the forecast consensus.

Likewise, Peru has been impacted by several external shocks, first the increase in freight cost given the general COVID restrictions and in particular because of the strict closing of cities and ports in China due to it, being China one Peru's major trading partners, together with the USA; the increase of energy and food prices, that resulted from the Russia invasion to Ukraine (Russia is the main supplier of fertilisers for Peru); and, most recently, the more restrictive monetary policy of the US Federal Reserve that is raising its interest rate to reduced inflation, but on the other hand, generating stagflation. The independent Central Bank of Peru is an asset for the macro stability of the country. Its President has been re-elected for the fourth time and has important political support because of the good monetary policy. This year, the Central bank raised its interest rate several times to control inflation, the result is that Peru has the [lowest inflation rate](#) in the region, but with expectations of moderate growth.



## 02. Inflación en América Latina



Fuente: BCRP (2022)

\*Bandas rojas muestran rangos meta de inflación de cada país

**Graph 2: Inflation in Latin America**

Hence, in macroeconomic terms, it seems that Peru is solid, but with a very slow growth rate for the next years, still high inflation of around 8%, at list till the end of 2023, quite above the central bank goal of 3% and poor generation of formal employment and reduction of poverty. This, of course, can cause more public dissatisfaction and political instability in a quite critical political domestic turmoil. In other political conditions, without the deep political uncertainty about the direction of public policies, Peru should have a better prognosis, given that terms of exchange are favourable for the country.

Another element that affects the democratic system in Peru is informality, an escape valve from red tape, low productivity, and lack of opportunities, which was a safeguard in the previous economic crisis. Unfortunately, now this conduct is taking over all the State instances. It is hard to admit, but sometimes it is more than informality, some are illegal activities, like drug production and distribution, illegal logging, illegal mining, and so forth, they were more secluded in particular areas of the country in which they were operating, but now these factual powers are taking control of the national government and the congress, corrupting them. The danger of this situation is that these powers are difficult to eliminate once they are installed, as is seen in other countries of the region.

Besides all the external shocks that started with COVID-19 and now with the Russian-Ukrainian war and the geopolitical tensions between USA and China, Peru is going through a political crisis that started in 2016 but has strong roots in the failures of its institutional framework created during the Fujimori regime in the nineties; a paradox, given that during that period were settled the economic institutions that make possible the growth and





development obtain in the last three decades. The most impressive result of this political crisis is having five presidents since July 2016 to date. It is also true that the revelation of the corruption scandal of Odebrecht has tainted the political spectrum, but the crisis started before with the weakening of political parties and the electoral and political system in the nineties and the lack of clear definitions for the check and balances among the political powers of the Congress, the Executive branch, and the Judiciary. Besides, starting this century, some State reforms contributed to the decline of politics, for example, the decentralization process, gave a lot of power to the local governors, without real accountability and sometimes with strong links to the informal and/or illegal sectors.

Latin America is also involved in the global trend of political polarisation, populism, and post-truth, pointed out by [Moisés Naím](#). Peru is not the exception and part of its political crisis comes from the weakness of political institutions that is provoked by populist leaders, from a broad range of leftist to right-wing groups and non-ideological based parties. Social media has exacerbated the expansion of fake news and hate discourses, which brings more polarisation. In Peru, traditional party leaders were accused of corruption, some may be involved in corrupt activities, but not all of them were and were falsely accused. So now, for many people, politics is synonymous with corruption, and many good people do not want to participate in it anymore. Some new parties or movements are merely businesses, representing the corrupt corporate interests of the owners of the parties. Therefore, the precariousness of political activity has increased precipitously.

Peru passed a very polarized election between the daughter of former president Alberto Fujimori, Keiko Fujimori, whose party represented popular capitalism, related to the informal sector and a conservative view, on one side, and Pedro Castillo, who represented the extremist left, with a nationalist and conservative narrative. Pedro Castillo won. He presented himself as a poor rural teacher, from the highlands, that had been rejected and discriminated against for his origins. As a matter of fact, he is a rural teacher, a member of a fragment of the Teachers Union, which has links with a faction of Shining Path, who gained notoriety because he led a long strike of teachers against the educational reforms in order to provide a better-quality education for the children.

Since the beginning of Castillo's tenure, the political situation has turned more unsustainable. On one side, the government was trying to change the constitution outside the current constitutional framework. They were attacking the private sector with false narratives of over-exploitation and monopoly, announcing the nationalisation of the gas and mining sector, or the application of higher taxes, passing decrees affecting the relation workers and firms, without consultation in the triparty forum settle under the International Labour Organisation rules, also they are attacking the press and freedom of speech, anyone that expresses his or her opposition is blamed to be part of the privileged elite against the people, the poor, the regions, or anything that can cause polarisation. On the other hand, the opposition,



from the beginning, didn't want to recognise that Castillo won the election and they have been pushing, without strategic moves, the impeachment of the president, without success. After a year in power, Castillo did not go too far with the leftist promises of a new constitution, given the constitutional restrictions we have and the lack of popularity for that measure, and the opposition has been divided by the government, there are advance investigations by the nation's prosecutor, that several members of the congress, from different parties, were bribed to support the government.

Peru is in unstable political equilibrium; nobody can predict how long the country can stand in a situation like this, as institutions are becoming weaker. Each day, there is more evidence that the President and his relatives are involved in corruption, the nation's prosecutor has opened several preliminary investigations that involve family members, friends, and former ministers. The other side of the story is the lack of ability to manage the government itself. President Castillo has appointed more than 70 ministers in one year of government, and with that, many middle and lower-level public servants, without the required capabilities for the positions and some with previous involvement in criminal activities. This ineptitude has deteriorated the public service, there are no clear views of which public policies will be followed and there is large mismanagement of public resources, the policymaking is abandoned, and many good public servants are leaving, because the improvisation or the bad use of public resources.

It is true that Peru is in a deadlock situation, nonetheless, there is still hope for the people. The economic resilience of the country can be better if Peru adopts reforms that strengthen institutions such as the judiciary, the prosecutor's office, the political check and balances among powers and withing them. Furthermore, policies to improve multilevel governance of the State will be needed as well as focusing on creating a more decentralised development and minimizing and tackling all sort of corruption; a better provision of public goods and services, like education and health, is a must, as it is a reform on the social security system, that really protects the people, especially the poor, in different stages of their lives. Furthermore, there needs to be a focus on formalizing economic activities throughout the country and promoting growth of SMEs.

But nothing can be done if we don't reach a political agreement on minimal reforms that can bring economic and social stability and the rule of law. The recent invitation that Peru received to be part of the OECD could be an incentive to go through most of the mentioned reforms. Some people say we need new actors for this national agreement to occur, yet we need some political reforms related to political parties and the electoral system. But I'm not sure that in the middle of this crisis we wait for new leadership to appear, we must advance, so I think that Peruvians should be advocating for a national conversation that can settle the base of the reforms. Peruvians should recognise their differences and respect them, and at the same time, construct a better future based on those aspects that converges the population



together. Democratic values should be recovered to overcome these difficult times, with one purpose, enhancing the welfare of our nation. We did it 20 years ago, after the recovery of our democracy, so it is time to do it again.

## 1.2. Five Lessons Learned from COVID-19

*María Antonieta Alva*

María Antonieta Alva Luperdi is Peruvian public administrator, economist, and politician who served as Minister of Economy and Finance from October 2019 to November 2020. Alva previously served at various departments in the Peruvian government, mainly the Ministry of Economy and Finance and the Ministry of Education. She is currently a Project Director for Acasus - Brave Change based in Switzerland, a management consultancy focused in helping governments of developing nations develop and implement educational and health reforms.

Peru had two main enemies that challenged its economic and social progress in the 1980s: terrorism, led by Shining Path, and the economic crisis the country had been experiencing since the 1970s – amid the horror spread by Abimael Guzman and his followers – which meant a 28.23% drop in real GDP, historical hyperinflation in the country (the fourth highest in the world), the impoverishment of all sectors of the population, and the collapse of public services. These factors, in addition to a weak and fragmented political system, limited business capacity, and the lack of an [articulated economic policy](#) resulted in a significant economic and social setback in our country.

Starting in 1990, Peru undertook reforms which, together with the commitment of the governments that followed, laid the foundation for Peru to consolidate itself as one of the region's stars in macroeconomic management. These reforms transformed the Peruvian economy, which went from a statist and protectionist scheme to one based on market and commercial and financial openness. The most representative measures were trade liberalisation, which involved lowering tariffs and unblocking many non-tariff barriers; the liberalisation of the domestic financial market and opening of capital accounts; the enactment of a law promoting domestic and foreign private investment on equal terms; the privatisation of state-owned telephone companies, electric power companies, mining production and marketing companies, hotel companies, among many others; and an [aggressive tax reform](#). In addition, an autonomous Central Reserve Bank was created, and fiscal rules began to be applied to guide government spending. These measures would bring about remarkable macroeconomic improvement, but they were not enough to put an end to the social problems that continue to exist to this day.

All of these reforms paid off. Growth was positive for almost the entire period from 1990 to 2019. In addition, Peru was able to take advantage of a favourable international environment and encouraged reforms such as the signing of free-trade agreements or financial deepening.

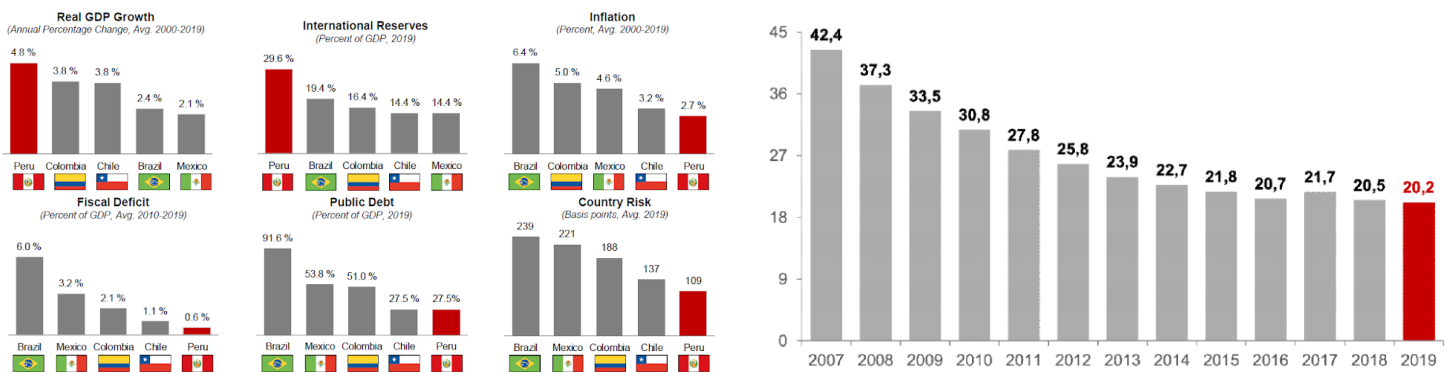


With regard to inflation, so far in the 21st century Peru has had the lowest annual average inflation in Latin America. On fiscal issues, in the 1980s, the average deficit was 8.6% of GDP. In the 1990s, it fell to 3.1% of GDP and in the 21st century, not counting 2020, it accounted for only 0.6% of GDP, thus achieving very prudent fiscal management. Similarly, in 2019 public debt fell from 89% of GDP to 27.5%. Finally, the fiscal deficit reached 0.6%.

**Figure 1**

**Main Macroeconomic Indicators**

**Monetary Poverty**



Source: Ministry of Economy and Finance [MEF]

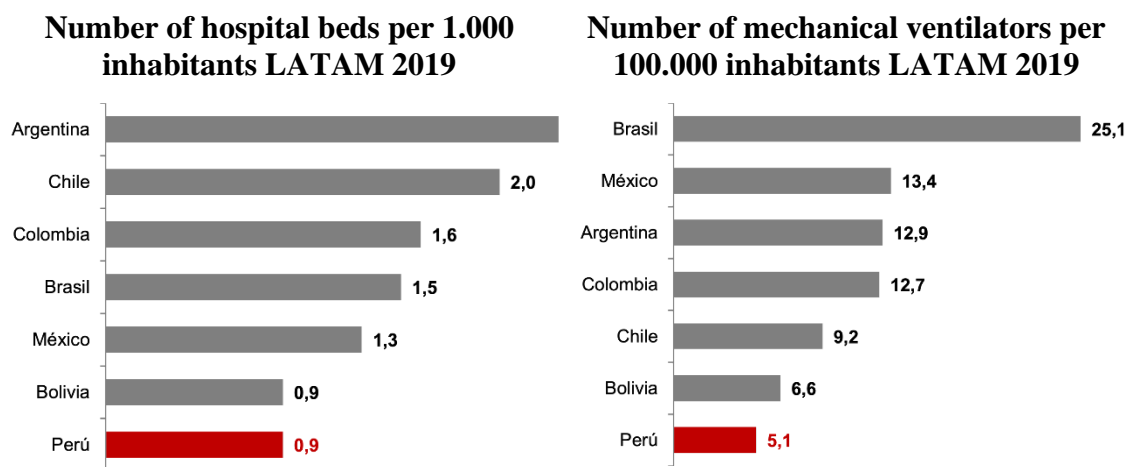
The evolution of per capita income also saw significant improvement in the relevant period of analysis, and with this, monetary poverty decreased to 20.2% in 2019.

But we must not be over-confident about these results. There are still many social problems to be solved, and back then, in those years when we were able to change our history, we should have been able to deal with these too. But we didn't. For example, in 2019, close to 73 per cent of the population found itself in a situation of informality, meaning that they did not have a steady job and hence, didn't receive any benefits such as social security. In addition, by 2019, only 70 per cent of households in Peru had access to all three basic utilities: water, sewage, and electricity. Of the three, the largest gap in Peru is access to wastewater services, which is the basic utility with the least coverage – only 71.2 per cent of households have such access –, and this figure is correlated with diseases such as anaemia, and its consequences on the quality of educational learning. Finally, in our country, year after year we see an increase in budget appropriation for health. However, indicators show that the quality of service has declined, mainly driven by a lack of staff, a lack of training in the health sector, an inefficient supply of medicines, poorly maintained facilities and equipment, and poorly managed money. Peru is a clear example that greater public budgets do not necessarily imply better services for citizens.



The latter was evidenced by the arrival of COVID-19 in our country, which revealed the severity of its structural problems: gap in human resources, weak primary care, low response capacity, and lack of medical supplies. For example, in Peru there were 0.9 hospital beds for every one thousand inhabitants, 5.1 mechanical ventilators for every one hundred thousand inhabitants, and less than 100 ICUs for a population of more than thirty million people, positioning the country as the worst in Latin America in these aspects [See Figure 2].

**Figure 2**



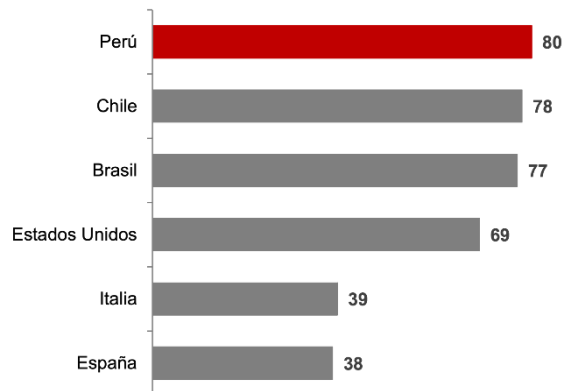
Source: Global Health Intelligence.

Given the inability of the health system to respond, containment measures were taken to reduce the health impact of the disease, where the priority was to save lives. In this regard, the authorities imposed a strict quarantine which began on the 16<sup>th</sup> of March 2020. As can be seen in Figure 3, the Peruvian government had the most stringent responses to counter the effects of COVID-19, through total social immobility.



**Figure 3: Severity index of government response to COVID-19**

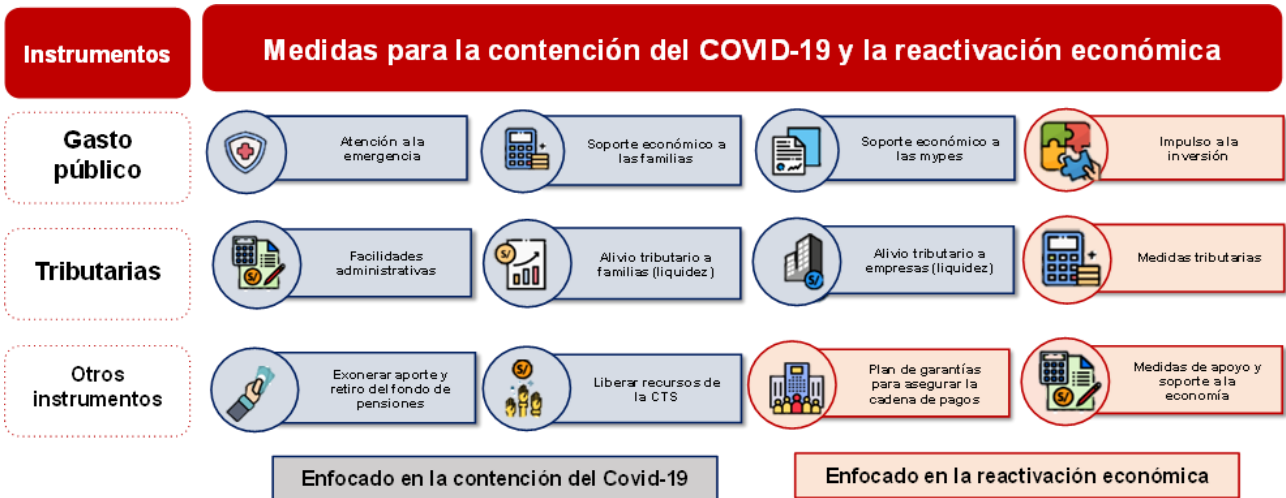
(100=strictest response)



Source: Hale et al. (2020). Oxford COVID-19 Government Response Tracker, Blavatnik School of Government.

These measures generated an unprecedented decline in economic activity, reaching a fall of -39.2% in April 2020. At that time, however, Peru enjoyed good health and macroeconomic stability, the product of three decades of responsible management by the country's economic authorities. For this reason, a series of economic measures were able to be implemented to protect the productive apparatus. Reactiva, for example, was an 8-point GDP plan that allowed many companies to have liquidity, as well as provide direct monetary aid to families (around 70 per cent of the country's families received at least one bonus during the pandemic).

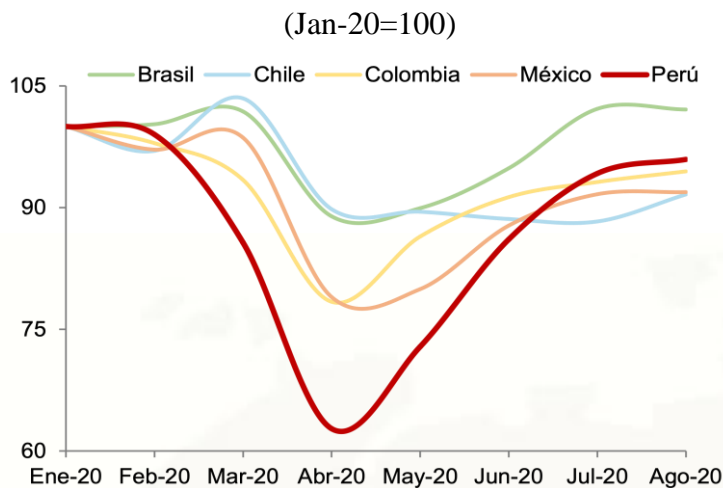
There were three instruments used to carry out the economic recovery plan in our country: public expenditure, tax instruments, and other instruments such as providing liquidity. Figure 4 represents this point. Public expenditure included attention to the health emergency; financial support to families through direct bonds; economic support to SMEs, through the Business Support Fund for SMEs (FAE-MYPE); and investment promotion. Tax measures applied included facilities for companies and families, and the other instruments applied included withdrawals from pension funds and compensation for time of service accounts, and guarantee schemes to secure payment chains. All these measures accounted for 20% of the 2019 GDP.



Source: La Contraloría General De La República Del Perú

The plan paid off and economic activity gradually recovered. By August 2020, GDP was already close to its pre-pandemic levels, but at enormous social cost.

**Figure 4: Indicators of Economic Activity**



Based on what we experienced during COVID-19, I believe five lessons can be learned:

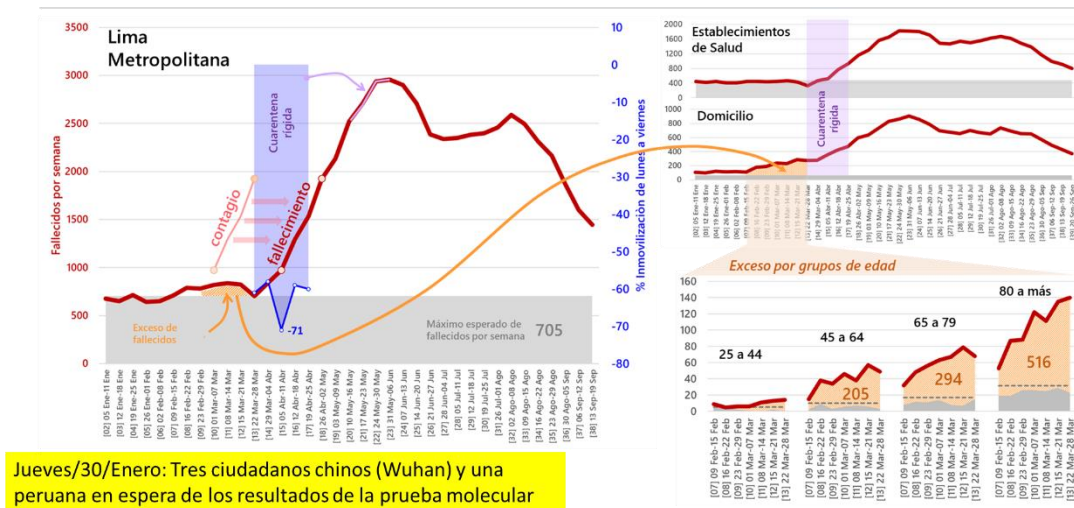
**1. The need to strengthen the epidemiological surveillance system**

Peru has a weak epidemiological surveillance system. By the time the first case of COVID-19 was confirmed on the 6<sup>th</sup> of March 2020, there was already an increase in the number of deaths in Metropolitan Lima. This increase occurred in homes and not in health facilities. In addition,





specifically among those age 80 and older, there were already 516 more deaths than the expected maximum (705 per week).



This evidently means that Peru needs to strengthen its surveillance capabilities significantly to be able to identify and respond quickly to cases of any other viral disease; track and quarantine contacts; and monitor disease trends over time. Comprehensive national surveillance of viruses such as COVID-19 will require adapting and strengthening existing national systems where appropriate and expanding surveillance capacities as needed. Digital technologies for rapid notification, contact tracing, and data management and analysis can support these capabilities. Once comprehensive and robust surveillance has been established, it must be maintained even in areas where transmission has been cancelled or controlled, even if there are few cases or none at all.

## 2. Structural gaps affect the ability of instruments to respond to crises

The instruments implemented as part of the Economic Plan were very powerful in their design, but structural gaps affected their implementation. For example, there were two specific problems regarding the family bond: a precarious system of household registration and a large number of households registered in the rural sector, compared to the urban sector (area with higher infection rates). To counter these problems, a new registration of residency was carried out. Another huge problem was – and continues to be – financial exclusion. Back then, only four out of ten Peruvians had a bank account which greatly affected the rapid disbursement of bonds, this in addition to a population still wary of telephone banking. Also, the National Bank of Peru had less than a thousand ATMs nationwide; private banking had many more ATMs.



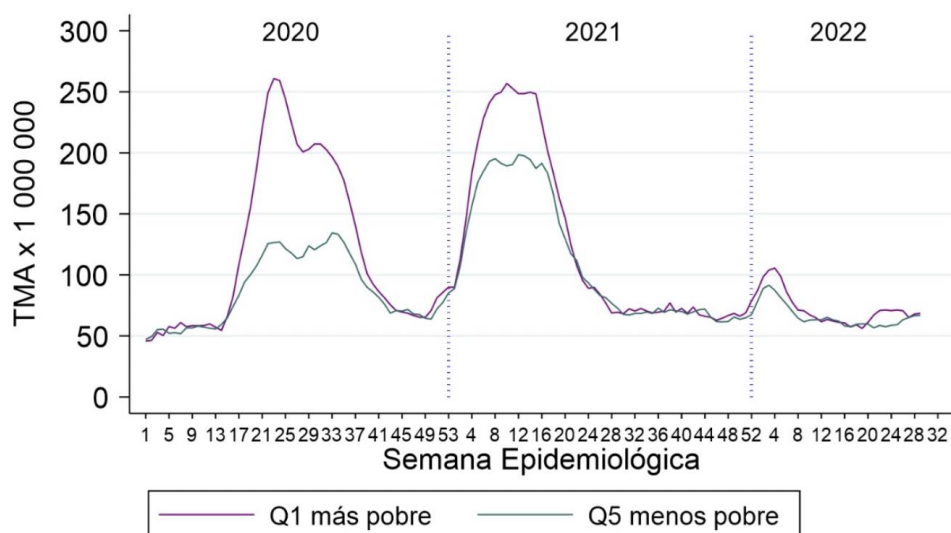


Something similar also happened with the SMEs and the huge expectations they had on accessing government-guaranteed loan programmes (such as Reactiva). Before the pandemic, only 5% of micro and small enterprises had access to the financial system and there was great difficulty in solving this type of problem in the midst of a crisis, with so many mobility restrictions, in addition to the great informality in these types of enterprises.

### 3. Inequality compounds the effects of a pandemic

While it was said that the COVID-19 virus was rather ‘democratic,’ given that infections were widespread and did not discriminate on the basis of social or economic class, it is clear that the most vulnerable families suffered much more, not only because of lack of access to healthcare services, but also because of overcrowding. It is therefore essential that economic policy protect the most vulnerable families. As can be seen, the number of deaths was higher in the lower-income districts of Metropolitan Lima and Callao than in those with higher incomes.

**Figure 5: Age-adjusted rates, according to income quintiles in Metropolitan Lima and Callao districts**



Source: Sinadef and INEI

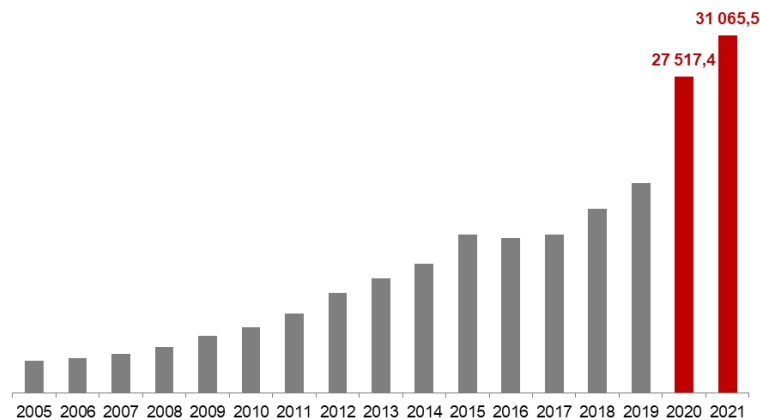


#### 4. The importance of quality public spending

Another key concept for implementation is that budget increases improve delivery. In recent years, the health budget has increased fivefold; however, services in general, and especially healthcare, have not improved significantly. It is essential that the government generate systems that guarantee greater productivity of these resources. More in-depth progress is needed in the results-based budget and in accountability mechanisms throughout the health system.

**Figure 6: Evolution of the health sector budget**

(Millions of S/)



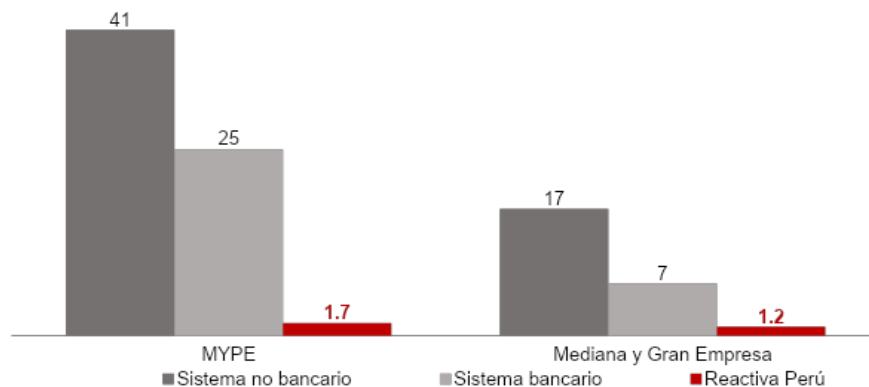
Source: Ministry of Economy and Finance [MEF]



## 5. Crises bring scope for innovation

A very complete example was Reactiva, the credit programme for state-guaranteed companies. The interest rates reached thanks to this programme were significantly lower than the rates of the banking and non-banking system. This resulted from the combination of the Central Bank's low funding cost, a lower credit risk associated with the guarantee, and the auction mechanism that allowed financial institutions to try to lower their operating costs. In addition, innovation has been seen in other sectors, such as the DNI account, which is a simple 100% digital bank account that will be opened progressively in favour of every Peruvian citizen. In that sense, financial inclusion has also been favoured, and the task ahead is to continue to close existing structural gaps.

**Figure 7: Interest rates of the Financial System and Reactiva Peru**  
(%)



Source: Ministry of Economy and Finance [MEF], Superintendence of Banking and Insurance [SBS]

## 1.3. A New Turn to the Left in Latin America

*Farid Kahhat*

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The victory of Gustavo Petro in Colombia was part of [a political pattern in Latin America](#): since 2018, it is the 14<sup>th</sup> consecutive occasion in which the ruling party loses the next presidential election (we refer here to competitive elections, so we do not include those that took place in Nicaragua and Venezuela). Thus, there is a political turn in the region, but against incumbents rather than towards the left.

Some sources of discontent with incumbents may be local, but such a clear regional pattern suggests that international causes may also be at work. And it is not hard to find potential causes of discontent with incumbents on the international stage. First, the biggest Boom in commodity prices since the 1950s came to an end in 2013. That is why in 2019 the [Economic Commission for Latin America and the Caribbean](#) warned that between 2014-2020, on average, the region's economies would experience the lowest growth rate in seven decades.

But even that forecast turned out to be optimistic since it preceded the appearance of a second international source of discontent with incumbents: the Covid19 pandemic. [According to the IMF](#), while the world economy contracted by an average 3% in 2020, Latin America's economy contracted by 7%. The region also had [the highest excess mortality rate](#) and four of the countries with the highest absolute number of deaths due to Covid in the world. [According to the Interamerican Development Bank](#), the pandemic also had as a side effect the reversion of a trend towards the reduction of income inequality in the region (measured by the Gini coefficient).

The third international source of discontent with incumbents in Latin America is the war in Ukraine. It affected the region in terms of its effects on the international prices of food and fuel, as well as on the price (and availability) of fertilizers (which might reduce the future supply of home-grown crops). It also affects the region through its effects on growth rates among its main trading partners (i.e., China and the United States), and the world economy at large.

Finally, we could add an international source of discontent that is, at the same time, a self-inflicted cost: the Lava Jato case. That is, [the biggest corruption scandal in regional history which affected twelve countries](#), most of them in Latin America and the Caribbean. It's a case in which one of the companies involved (Odebrecht), admitted paying 788 million dollars in bribes to politicians and public officers. And the actual amount of money paid in bribes seems to be much higher, considering that Odebrecht initially admitted that, overall, it paid only 26 million dollars in bribes in Peru, while we know now that former president Alejandro Toledo has been charged with receiving over 30 million dollars in bribes from that company. The current political crisis in Peru, for example, might not be as daunting if it wasn't for the fact that six out of the last eight presidents have been investigated, charged, or jailed under corruption charges.



It is true that, since they were usually the main opposition force, left-wing parties seemed to benefit the most from a discontent with incumbents. But one proof that there is a turn against incumbents rather than towards the left is that, when the incumbent is a left-leaning government, it also loses the next presidential election. It happened in El Salvador and Uruguay in 2019 and Costa Rica in 2022 (we may add here the case of Chile, in which the constitutional proposal supported by its left-wing government was turned down by a big margin in the plebiscite that took place in September of 2022).

What has been said may have implications for the prospects of left-leaning governments in the region. Overall, left-wing candidates won 30 presidential elections in 11 different Latin American countries [between 1998 and 2014](#). But that happened under very different circumstances from those that these parties may face soon: while in office during most of that period, left-wing governments benefited from the boom in commodity prices mentioned before. Those unusually favourable circumstances contribute to explaining why left-wing forces won several consecutive presidential elections: they won three times in a row in Argentina, Bolivia, Ecuador, and Uruguay, and won four consecutive presidential elections in Brazil. That changed in 2015 with, among other things, the end of the cycle of high prices for the region's commodity exports. Thus, the left might be less likely to repeat in the near future the electoral performance it had during the first decade and half of the twenty-first century.

Another reason why the electoral prospects of left-wing forces are less promising than in the past is that it faces right-wing forces that are more conservative and authoritarian than the ones they faced during what was briefly called the [“Right Turn”](#) (represented by the election as presidents of liberal-leaning politicians like Mauricio Macri in Argentina, Sebastián Piñera in Chile and Pedro Pablo Kuczynski in Peru). On the one hand, the overthrow in 2009 of Manuel Zelaya in Honduras was the first successful military coup in the region in the new century. Afterward, we had the removal from office under dubious circumstances of several left-leaning presidents (Fernando Lugo in 2012, Dilma Rousseff in 2016, and Evo Morales in 2019). In Brazil we had [a proven case of a practice sometimes called “lawfare”](#) (i.e., the alleged use of courts of law to prevent political rivals from running for public office): we now know that rather than remaining neutral in the case against former president Luis Inácio “Lula” Da Silva, judge Sergio Moro discussed with the prosecution the witnesses, evidence, and charges that it could use in order to guarantee a conviction. Later, the same judge who, through his guilty verdict, contributed to precluding “Lula” from running for the presidency in 2018 against Jair Bolsonaro, became Bolsonaro's first Minister of Justice.

Not only are right-wing individuals more likely to resort to non-constitutional means to remove left-wing politicians from public office, but they are also less likely to accept defeat in an election. That was the case of Keiko Fujimori in 2021 (in an electoral process that independent electoral observers, without exception, deemed free and fair), and might be the case of Jair Bolsonaro. Running for re-election, Bolsonaro now claims, for instance, that the electronic



voting system might be used to perpetrate an electoral fraud: the same electronic system, that is, under which he was elected to Congress several times, before winning the presidency through that same voting system.

Of course, those experiences are reminiscent of the case of Donald Trump in 2020. In fact, some authors would use the expression “radical right” to define the political movements behind the leadership of both Trump and Bolsonaro. But there is, among others, a significant difference between what you may call the radical right in Europe or the United States, on the one hand, and in Latin America, on the other hand. In Europe, the radical right emerged when traditional left-wing forces (mainly, social democratic parties), were undergoing a relative electoral decline. For instance, on the three occasions in which the radical right reached the second round of a presidential election in France, it faced in the run-off either a candidate from the traditional right (i.e., Jacques Chirac in 2002) or the liberal right (Emmanuelle Macron in 2017 and 2022). In the United States, at the national level, there never was an electorally successful social democratic party. In Latin America, on the other hand, [the radical right emerged](#) after the biggest wave of electoral victories for left-wing forces in the region’s history. Although some of those left-wing forces were moderate and democratic (like the Frente Amplio in Uruguay), others turned out to be both radical and authoritarian (like the Chavista movement in Venezuela). Thus, the sense of threat provoked by those trends among conservative movements seemed to contribute to their radicalization. For those reasons, the anti-communist leanings of Latin America’s radical right are more prominent than elsewhere. That is why, for example, it is far less likely that Latin America could experience social movements like the “Yellow Vests” protests in France. That is movements that could be supported at once by radicals from both ends of the political spectrum.



## 2. Policy Brief Overview from an Economic and Political Analysis

### 2.1. Quest for Sustainable Development: Labour Reform and State Modernisation in Peru

*Luis Miguel Castilla*

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The history of Peru in the last quarter century has been one of economic progress while confronting periods of recurring crises. Between 2002 and 2013, Peru distinguished itself as one of the most dynamic countries in Latin America. The adoption of prudent macroeconomic policies under a favourable external environment, supported a scenario of high GDP growth and low inflation. Steady growth in employment and wage incomes significantly reduced the poverty rate, making it one of the countries with the best social prospects in the region. However, between 2014 and 2019, the economy slowed down because of a deterioration in the external environment, especially due to the fall in the terms of trade in the context of lower global growth, and high political instability, and [current situation](#).

During the Covid-19 pandemic, Peru was one of the most affected economies in the world in economic and sanitary terms, despite having adopted one of the most aggressive countercyclical policy responses in its history. After two years of hardship in which the country posted significant social setbacks (higher poverty and vulnerability), the economy has recently recovered its pre-pandemic per capita income levels. Although the predecessors of President Castillo have faced serious restrictions (primarily political), few governments have had such a disappointing and chaotic first year in office as the current president. Seven out of ten Peruvians feel that the country is going backwards, a perception like that registered at the end of the 1980s, with a much worse material situation (in terms of hyperinflation and economic collapse). Business and consumer pessimism are at historical lows and limit future [economic prospects](#).





The containment of the pandemic thanks to high vaccination coverage, approval of legislative locks that prevent disruptive constitutional changes, continuity in macroeconomic management, and favourable external headwinds gave the new administration margin of manoeuvre to pursue its policy agenda. However, the inability to propose coherent pro-employment growth policies and to put together a minimally qualified team have prevented the administration from appropriately undertaking its main responsibilities. These challenges have been compounded by a spike in inflation and food vulnerability in view of commodity market disruptions, inefficacy in dealing with higher urban poverty, and complacency in the face of social conflicts (associated with mining projects, primarily).

Moreover, external risks have increased significantly, and [Peru's growth](#) is very sensitive to changes in the international environment. For its part, monetary policy tightening to curb global inflation has increased the probability of a [recession in industrialized countries](#). In this context, emerging market perspectives will be negatively affected by lower external demand growth and declining terms of trade, higher risk aversion and external capital flight. Amid an ongoing economic slowdown, instead of counteracting these shocks with greater public investment, the current administration is imbued in an institutional crisis and subnational governments (both at the regional and local levels) are amid an electoral transition which will curtail their public investment execution capacity. At the same time, a [contraction of private investment](#) is expected due to regulatory uncertainty and the adoption of unsound and erratic policies that have undermined the business environment. A very challenging period is looming that will once again test the country's economic resilience. Peru has ample strengths; however, it needs a sensible, effective, and transparent government. This in turn calls for long-awaited political and institutional reforms.

Notwithstanding this current juncture, the last two years clearly indicate that Peruvian society stood on more precarious foundations than generally anticipated. Persistent challenges include having 75% of the population employed in the informal sector, an unequal distribution of wealth and ineffective institutions that have lost public confidence. Peru must avoid falling into a "secular stagnation" and lose much of the social progress experienced in recent decades. Not only should the Government accelerate growth to resume poverty reduction and achieve greater social cohesion but should also tackle structural reforms to overcome social and institutional shortcomings. Persistent structural weaknesses are evidenced by high vulnerability to external *shocks* and natural disasters; high labour informality, as a result low labour productivity and a cumbersome and costly regulatory environment; and [gaps in access](#) to quality public services. The latter has generated a great [distrust of citizens](#) towards public entities.

Immediate progress is required in multiple fronts, although two areas are particularly critical to move forward: achieving greater formalization of the economy (especially labour informality) and strengthening government effectiveness and transparency.





The formalisation agenda involves improving labour productivity and streamlining regulations that prevent micro and small businesses from growing and having a sufficient scale to bear the costs of being formal. Peru shows the [highest non-salary costs](#) in Latin America, 70%, compared to the regional average of 48% (with severance pay as a percentage of salary being the highest in the region). This rigidity clearly discourages formal job creation. Productivity growth has also been insufficient and the [gap with most advanced countries](#) persists. Low labour productivity reflects deficiencies in human capital development; although results have improved, educational outcomes of secondary school students remain below expectations. [Higher education](#) also presents important challenges to develop the skills required by the labour demand.

Addressing informality will require abandoning dogmatic positions and facing politically sensitive reforms in areas such as labour regulation. It is evident that existing legislation has not managed to protect most workers, nor achieved the desired job stability, as evidenced by the fact that Peru has one of the [highest job turnover](#) rates in the region. Reducing job insecurity requires interventions in various aspects. From the firm's point of view, non-wage costs are those that are most associated with informality. In this context, an option to be pursued would be to [finance social security](#) contributions with general tax receipts instead of relying on payroll taxes. However, more flexible labour regulations would require setting a system of unemployment insurance, combined with an efficient framework of labour reinsertion policies. Pension reform to increase coverage and pension sufficiency is also necessary, especially in view of ongoing demographic trends and the expansion of [aging-populations](#) in Latin America. Ensuring the financial sustainability of pension schemes and setting appropriate incentive structures are critical to avoid undermining public finances and ensuring a much-needed universal social safety net.

The adoption of more aggressive reforms in labour, tax and regulatory codes have not attracted public support nor political consensus. Nonetheless, the need for change becomes more compelling as policymakers and politicians internalise that inaction is no longer an option. The discussion in Peru, as in much of Latin America, has lagged what is happening in the rest of the world, where the traditional employer-salaried worker relationship has changed, and an important process of labour disintermediation is underway. Institutions that have the competence to change this situation —Congress, Judiciary, Constitutional Court— continue echoing old social demands, with motives that have little connection with the future of work. However, progress will depend on these same institutions to build new arrangements that meet the demands of these times, going beyond the traditional [tension between labour stability and flexibility](#).

In addition to tackling labour market informality, Peru urgently needs to [strengthen its institutions](#) –social and political– and improve public sector delivery of quality goods and services to meet citizen demands, especially of the poorest segments of the population.



Achieving a more prosperous country with social cohesion requires a new understanding between the Government, business, labour, and citizens in general. The severity of the recent crisis has exposed the precariousness of Peruvian society and should be taken as an opportunity to build a set of values and actions that put the well-being of citizens as the central objective of public policies.

Citizen distrust also responds to the high incidence of corruption that has worsened in recent years. According to the Comptroller General Office, [acts of corruption](#) generated losses equivalent to 15% of the national budget. Given this situation, internal controls have been tightened, although with limited results given ongoing corruption scandals. Ineffective controls, inexperienced and ill-suited appointments, and high public official instability due to very high turnover rates have rendered public service provision even more ineffective and led to paralysis in public sector decision making. In some cases, [the discretionary application of regulations](#) has generated inaction in public officials for fear of facing legal proceedings in the future. However, in most instances, a context of impunity has been maintained with the acquiescence of elected officials.

With the general objective of improving the efficiency and quality of public services, reducing corruption, and improving the transparency of public management, there is an urgent need to [accelerate the adoption of reforms](#) and apply measures in at least three fronts, that is, boosting civil service reform, accelerating the expansion of digital government, and strengthening internal control and integrity standards. Progress in these areas is essential to improve the delivery of public services. Unfortunately, despite rhetorical objectives of joining the OECD, the Peruvian Government has made very little progress to boost the effectiveness of public institutions and improve its governance; quite the contrary, setbacks have been the norm so far in this administration.

To reverse this situation, both political, social, and economic actors must work together to build spaces that lead to authentic public-private agreements. Entering a virtuous cycle of investments, especially private ones, that generate jobs and allow Peru to weather current adversity, demands a complex task of establishing a new logic and understanding among actors responsible for forging a vigorous and sustained economic recovery. This will require greater proactivity and efficiency from the public bureaucracy, greater commitment and long-term vision from private firms, greater resilience from workers, and greater responsibility and sense of history from politicians. The latter demands honest and effective leadership that is up to the challenges facing the country.



## 2.2. Raising the Bar

*Giacomo Ugarelli*

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For many years the question on whether democracy around the world is in recession continues to be debated. Usually, it is the demagogues and populist politicians who receive most coverage on the media, the authors of controversial tweets and the ones who make headlines on the news. However, one could argue that, at least in appearance, we are currently experiencing a regression of democracy. This is due to a highly dissatisfied electorate, the rise of openly undemocratically oriented candidates, and the curious stability of fragile democracies. According to *EIU* annual survey published by *The Economist*, a third of the global population lives under some kind of authoritarian government, while only 6.4 percent enjoy a [\*full democracy\*](#). This survey measures the condition of democracy using five variables: “electoral process and pluralism, the functioning of government, political participation, democratic political culture and civil liberties”. The survey also measured the average democracy levels around the world, and, compared to last year (5.37 out of 10), 2022 has seen this measurement decrease to 5.28.

This retraction has a lot to do with a general world crisis. The crash of 1929 was the beginning of the end of what seemed to be a thriving Weimar Republic in Germany. The global financial crisis of 2009 had a similar effect on many democracies, including some within the eurozone (Greece elected to parliament several members of a neo-Nazi group called ‘Golden Dawn’). Moreover, the pandemic also played its role with lockdowns, movement, activities, and civil liberty restrictions, in both democratic and authoritarian regimes.

Nonetheless, after the end of the Cold War, the third wave of democratisation, and Dr. Fukuyama’s essay on ‘the End of History’, the expectations of enlarging the ‘blue block’ of democracy, globally and universally, has not been fulfilled. As Charlie Chaplin claimed in ‘The Great Dictator’ film of 1940, “we have lost the way”, and we need to continue asking ourselves why.

In the past thirty years we have seen a spectacular proliferation of democratic governance (or an aspiration to become one). Undeniably, the idea of democracy is attractive: among some of its qualities, it strives for equality, justice, and accountability. However, according to different polls, many citizens living in democratic countries are not happy with the way democracy is



working. In a [survey in Peru](#) towards the end of 2020, 67 percent of Peruvian households believed democracy worked *badly* or *very badly*. Yet, contrary to popular belief, and compared to other developing regions of the world, the democratic system and lifestyle are working quite well in Latin America. With few exceptions, there are free and fair elections (confirmed by electoral observation missions as the ones from the Organization of American States, OAS), a free press, civil liberties, autonomous institutions and a separation and balance of power of the ‘big three’ (executive, legislative and judiciary). Therefore, we need to ask why many functioning democracies are experiencing these high levels of dissatisfaction.

Quite recently, a colleague of mine told me that we ‘never have we had that many bad leaders at the same time.’ Although a seemingly nostalgic remark to the past, this comment made quite a lot of sense when looking at leaders who start unprovoked wars, others who denied the Covid-19 virus and the ones who continue to openly nudge and reject the science behind the warnings of climate change. The problem is not therefore found on the ‘democratic-system’, but rather on the people *who become elected*. In Peru, this hypothesis would be supported by a 2021 [opinion poll](#), where 88 percent of the people surveyed considered most politicians to be ‘corrupt’. Furthermore, we rarely see a [disruption of democracy](#) through violent takeovers or military coups. As Steven Levitsky and Daniel Ziblatt wrote in their book ‘How democracies die’ (2018), the regression of democracy starts today at the polls. We therefore need better democratic leaders.

As with most political issues, there are both immediate and long-term solutions. The long-term solutions would be to tackle some of the long-postponed demands governments have been slow and inefficient to address, which include inequality, basic human resources, security and, in the case of Peru, [interpersonal trust](#) with fellow citizens which is at a 43 percent low (July 2022). Delivering these lost-postponed demands for millions of citizens would [raise the citizens trust](#) in government and faith in its democratic institutions and system. Of course, institutional changes are urgent to attract good public servants. One can have the best and most sophisticated team, but if the system does not allow them to work properly, we should not expect much improvement. Likewise, [political parties](#) in many countries are still weak as they are perceived not as institutions but rather as vehicles to run for office. Strengthening political parties through culture and norms will also be essential. These reforms will take time, but they must be address in parallel with the more immediate ones.

For the immediate changes, we must rethink our democracy by proposing a series of democratic experiments that modify the current rules of the game. Although the word ‘experiment’ carries a risky-feeling sensation with it, as the phrase attributed to Einstein suggested, “insanity is doing the same thing over and over and expecting different results.”

An alternative is to introduce the ancient practice of ‘sortition’, which means randomly selecting citizens to fill government positions. Although this idea may seem ‘too experimental’,



it is a [system that was used in ancient Athens](#), where the names of citizens were placed into a randomisation device called a *kleroterion*. The idea of randomly selecting citizens to assume some of the nation's responsibilities has been put in practice in 2011 in Iceland for the writing of a new constitution among other examples. As Brett Hennig reflected in his presentation on sortition in [TEDxDanubia](#) (2017); “if you give people responsibility, they act responsibly.”

It is likely that many citizens will be sceptical of sortition (even though a similar practice is used in many countries when randomly selecting members of a jury). However, a balance could be found with a mixed system, where some members are elected by citizens while others are selected by random. According to a study published in 2011 by Italian physicists, parliaments become more efficient when *some* of the members are chosen at random, because these *newcomers* have [no party-commitments](#). In this study, [efficiency was defined](#) “both the number of laws passed and the average social welfare obtained from those new laws.” Moreover, in countries with diverse demographic and social features as many Latin American nations, sortition could ensure a more representative parliament by randomly selecting people who belong to certain communities and minorities that have an electoral disadvantage. Another way to think about sortition would be, in the case of bicameral parliaments, that the upper house (Senate) is composed of randomly selected citizens and the lower house by elected officials (or vice versa).

Another option would be to *raise the bar* of entry to elected office, finding a way to *guarantee* that the people becoming elected are *better representatives*.

Naturally, with a challenging proposal as this, many questions arise, including how to define what a *'better representative'*. *'Better'* will not necessarily mean those with a superior academic or professional background; one can be academically gifted and still become a corrupt politician. The proposals should not only be limited to establishing minimum conditions to run for office, or other restrictions for citizens to be able to participate, because and especially in unequal societies, such as many countries in Latin America, this could leave out many citizens who have not had the social, economic, and educational opportunities other may have had.

Therefore, the challenge would be to design mechanisms to help democracies elevate the quality of its representatives using a system that guarantees the election of better representatives without compromising one of the core values of democracy where everyone can run for office and become elected. The idea is not to look at these as simple restrictions but rather aspirations, hoping that future candidates will make a stronger effort to become better representatives before running for office.

For example, a common attribute of newcomers of Congress is that many commit mistakes or unworkable laws due mainly to their lack of knowledge on how the institution works and what a member of the legislative role is. Some colleagues have discussed the possibility of making



those people who wish to run for congress first pass through an academic institution focused on the legislative branch, as the diplomatic service of many countries requires. This would mean that, despite the educational background, all future candidates without exception will have to go through a course to run for office. This academy should be free, accessible (virtual classes can be an alternative) and the final evaluation scores of each participant, public. The results, however, should not limit a candidate's possibility to run. If a candidate fails the course of barely went to the sessions, he or she should still be able to run, but the general public will be aware of the results.

We also require leaders who have the correct *character* for public office. Citizens can agree that elected officials should be able to clearly distinguish the difference between private and personal matters to public affairs, and the distinction between right and wrong. Whatever the alternative or proposal may be, we must rethink our democracy until we obtain better representatives to have a better government performance. As John F. Kennedy once claimed, 'our problems are man-made and therefore they can be solved by man'; the key words here are 'man-made'. Democracy is, after all, what we as citizens make of it, and we therefore have the capacity to improve its shortcomings.

There is no doubt that any of the so called 'experiments' or 'alternatives' to test new ways of working democracy will have those who call out the flaws, weakness, and doubts. That is great. Debating is what needs to happen in a democracy. To paraphrase former UN Secretary General Dag Hammarskjöld in a [speech of 1954](#) regarding the UN and humanity, we can argue that *democracy* "was not created to take mankind to heaven, but to save humanity from hell." Democracy is not perfect, and we shall accept that it will never be, but we must continue to aspire to make it better.