

## CLIENT CONFIDENTIAL

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### POLITICAL AND ECONOMIC BRIEFING – SEPTEMBER 2002

#### 1.) Palace continues to stumble over self-inflicted wounds

President Alejandro Toledo's decline in public opinion polls continued in September, due mainly to mistakes made by the President, his Cabinet and First Lady Eliane Karp. A late-September poll by the University of Lima put the President's popularity at 16.3 percent, two points lower than a similar poll by the university in August. Another survey firm, IDICE, had Toledo's popularity falling to only 11 percent. IDICE is linked to the opposition APRA party led by former President Alan Garcia. Both polls showed that presidential mistakes have contributed significantly to a loss of credibility in the President and his administration as a whole. Premier Luis Solari is the only Cabinet member with a negative rating below 50 percent.

According to the University of Lima poll, faring worst among the Palace figures is First Lady Karp, who received a negative rating of 80 percent. Karp's problems began in August, when the Palace lied about her whereabouts, first saying she had traveled to France, but then admitting that she was on vacation in the South Pacific. That problem was quickly overshadowed by news that she continued to work for the Banco Wiese as a consultant, receiving \$10,000 a month for her work. Karp had often said that she had stopped working after her husband's inauguration in July 2001. An added twist to the story is that the Banco Wiese continues under investigation for ties to the corruption network spun by former National Security Advisor Vladimiro Montesinos.

The government put on a show for Karp's return from the South Pacific, with the President and all but two Cabinet ministers on hand to receive the First Lady at the airport. Despite the show, Karp was reportedly furious with many high-ranking government officials, saying they did not back her completely. She lashed out at Peru's "ruling class," saying she was not born rich or with a well-known last name so had to work. She tried to frame the scandal as a problem of class and machismo.

Just as the issues were dying down, Karp was back in the news again on Sept. 9, lashing out at political parties. During a relatively innocuous speech about indigenous rights, the First Lady changed direction and began attacking the country's political establishment, saying opposition parties – she used the derogatory term *partiduchos*, which loosely translates as insignificant parties – were trying to destabilize the government and bring down President Toledo. The outcry from the Congress and political leaders was fast and furious, with some going so far as to threaten her with deportation.

The Palace immediately went into spin control, saying Karp had been misinterpreted, but adding that her opinions did not reflect those of the administration. Again furious with the Cabinet, she slammed Premier Luis Solari and First Vice President Raul Diez Canseco, telling the Palace staff that the two were part of the process to destabilize the administration. Several weeks later, Karp would announce her nationalization as a Peruvian citizen and begin a round of interviews, saying her problems were cultural and linguistic. Despite more than 30 years speaking Spanish, she said she still has problems with the language and did not understand the meaning of *partiduchos*.

The President also had problems with Spanish, with both First Vice President Diez Canseco and Finance Minister Javier Silva Ruete saying the President gets tongue-twisted when speaking and that not many people speak Spanish well. The comments were made after Toledo got into a war of words with the Associated Press news agency over comments made about Vladimiro Montesinos during a seven-day working trip to the United States. The President's high-level meetings with U.S. officials and business leaders, and pledges of loans from multilateral lending institutions were overshadowed by the comments that Montesinos could receive special treatment if he supplied certain information. The President's comments were taken somewhat out of context, but the slip up marred the success of the trip.

Diez Canseco said the President never should have made the remarks and that he needed to be more careful, setting off a firestorm of rumors that he would be quitting the government. He also criticized Karp, saying she was emotionally drained from years of campaigning with her husband. Diez Canseco denied that there was any bad blood between him and Toledo, but the two men avoided each other. Political analysts see Diez Canseco, who is also Foreign Trade and Tourism Ministry, attempting to distance himself from Toledo in case the President leaves office before his term is up in 2006. As First Vice President, Diez Canseco is first in line to replace the President if he were to leave office early.

Next came the language problem with Silva Ruete. During a visit to the jungle city of Iquitos, the President said his administration would not eliminate tax exemptions for the jungle region, contradicting Silva Ruete. Toledo added that he was running the show and that "second-level bureaucrats" were not making government policy. Silva Ruete said the President did not mean to talk about tax exemptions in the "present tense" but in the "plus perfect," adding that Spanish was a difficult language to master.

The government also lost support because of price increases, particularly two increases in fuel prices that led to a ripple effect across the board. The prices of most goods, especially bread, increased. The government dropped fuel prices by 2 percent, but the price increases remained.

Finally, Second Vice President David Waisman got involved in the government antics, criticizing the administration for wasting money on Karp's nationalization ceremony in Cusco. Waisman is also one of the three Presidents of Peru Posible. His colleague in the

Peru Possible ruling team, Housing Minister Carlos Bruce, immediately said the party and not the government had footed the bill. Waisman also took a few shots at Toledo, blaming the President for allowing himself to be misguided by Palace advisors.

Topping off a month of government theatrics was a “duel” between Waisman and Rep. Eittel Ramos (Independent-Callao). Ramos accused Toledo of being surrounded by a “Jewish” mafia, which set off Waisman, who is Jewish. As the war of words escalated, Ramos challenged Waisman to a pistol duel to prove who was more manly. While the legislators reconciled their differences late in the month, the press – including the state-run *El Peruano* – used the word “circus” to describe the current state of Peruvian politics.

## **2.) Citizen security takes center stage**

September began with the high-profile kidnapping of Mariana Farkas, wife of Toledo’s closest ally, Adam Pollack. She was snatched early on the night of Sept. 3 in Lima’s Lince district. The Administration went into high gear, with Interior Minister Gino Costa setting up a high-level task force to solve the kidnapping. More than 100 National Police officers were put on the case. Farkas was rescued three days later from a safe house in Villa El Salvador, on Lima’s southern edge. National Police Spokespeople said the crime was solved thanks to telephone communications intercepted between the kidnapers and inmates at Lima’s Castro Castro Maximum Security Prison.

The kidnapping was followed by a number of other high-profile crimes, including an armed robbery at the Catholic University of Peru and several business establishments throughout Lima. Reversing a tight-lipped policy, the National Police reported that there were more than 300 kidnappings in the first seven months of the year, the majority “express” kidnappings. A typical express kidnapping involves the spontaneous seizure of a seemingly well-off individual in a public place; this typically involves forcing the individual to make multiple withdrawals from ATMs, followed by, sometimes, a visit to the person’s home for expanded looting.

The quick rescue of Farkas brought support to the National Police in public opinion polls, with 65 percent of people polled mid-month by Apoyo approving of the police officers’ actions. The approval of the police, however, contradicted another opinion voiced by voters – that the kidnapping was a government-orchestrated hoax. In the Apoyo poll, 55 percent said they believed the government faked the kidnapping to gain sympathy. The CPI survey firm registered a similar result. In that poll, 58.8 percent of voters said the kidnapping was a hoax. While there is no evidence of this, and security experts say Farkas was indeed kidnapped, the heads of the polling firm say the government’s lack of credibility has fallen to such low levels that no one believes anything Toledo says.

In response to the kidnapping and other violent crimes, the government unveiled a new National Commission on Citizen Security on Sept. 11 to design new mechanisms to fight crime. Initial proposals include eliminating prison benefits for inmates convicted of

violent crimes, increasing vigilance at maximum security prisons with cameras and devices to block telephone communications and upping prison sentences.

In addition, William Bratton, former New York City Police Chief, presented his proposal for citizen security for Lima. Lima Mayor Alberto Andrade had hired Bratton as a consultant. Among the many warnings in his report, Bratton said that if drastic measures are not taken soon Lima may well be overrun by crime within the next few years.

### **3.) Hitting hard at the Shining Path**

The National Police's Anti-Terrorism Bureau (DIRCOTE) announced the arrest of several members of the Shining Path, who they charged with attempting to reorganize the Maoist rebels' committee in Lima. The rebels were accused of participating in the March 20 bombing near the U.S. Embassy, which killed 10 people. Other Shining Path members were arrested in Chicalyo and Trujillo in the north and Cañete in the south.

The Anti-Terrorism police also led a raid on a major Shining Path camp in the jungle region of Junin, in the central highlands. The police had been monitoring the camp for some time. More than 30 buildings were destroyed in the raid. The police managed to recover important Shining Path literature, including documents that may establish links with the Revolutionary Armed Forces of Colombia (FARC) rebels. One police officer was killed and several others injured in the raid.

### **4.) Nation-wide strike fizzles**

There were numerous local and regional protests registered in September, but the nationwide strike called for Sept. 26 did not pack the wallop organizers had hoped it would. The country's major unions and regional defense fronts originally planned the strike, but organizers began changing their strategy as the strike date approached. The General Confederation of Peruvian Workers (CGTP) and the Teachers' Union (SUTEP) said the Sept. 26 action was not a strike, but a mobilization. A week before the planned action, members of the CGTP and other unions came to blows in front of the Labor Ministry over the demands included in the strike.

The strike or mobilization was most successful in the southern departments of Puno, Arequipa, Huancavelica and Ayacucho. It went basically unnoticed in Lima, despite some press reports calling it "massive" and "impressive."

The government deemed the strike a failure and, as with an earlier nationwide protest in June, was helped in demonizing the protest by comments from the Communist Party of Peru-Patria Roja. Patria Roja once more called for Toledo to step down and for new elections to be held. Premier Luis Solari and Interior Minister Gino Costa immediately used Patria Roja's comments to portray the strike/mobilization as an attempt to destabilize the government and not an effort to improve the conditions of workers.

## **5.) Controversial ruling by Constitutional Tribunal**

The government and business community were caught off guard by a mid-September ruling from the Constitutional Tribunal ordering the dominant telecommunications company, Telefonica, to rehire hundred of workers who had allegedly been fired without just cause. The Tribunal went to length to explain that the ruling was exclusively related to the case between Telefonica and its labor union, but constitutional lawyers said it created legal precedent re-establishing absolute labor stability in the country.

The business community said the decision was yet another sign that Peru was not serious about attracting investment, arguing that the rules of the game were constantly under review and being changed.

The government attempted to stay out of the debate, but did undertake a few actions to smooth over problems. President Toledo vetoed a bill that could change the way telecommunications companies charge customers. Under the bill, charges would have been by the second and not the minute, which is the current system. Premier Luis Solari also announced the creation of a high-level commission, which he would head, to work with Telefonica on outstanding touchy issues. Solari said there was no danger of changing the privatization contract with Telefonica, which has been operating in Peru for nearly eight years.

## **6.) Green light from U.S. on ATPDEA**

The U.S. government announced in late September that Peru was indeed eligible for tax benefits under the Andean Trade Preference and Drug Eradication Act (ATPDEA), which takes effect in Oct. 1. Under the act, Peru and other Andean countries can export more than 6,000 products to the United States tariff free. The other countries certified were Bolivia and Colombia. Ecuador was put on a waiting list. ATPDEA replaces the Andean Trade Preferences Act, which expired last December.

Peru's certification was in doubt because of more than a dozen outstanding disputes with U.S. companies with interests in the country. The problems run from differences over patents to complaints that Peru charges too much import duty on microwave popcorn.

President Toledo's visit to the United States in early September and the work of former Premier Roberto Dañino, ambassador-designate to the United States, were credited with helping Peru receiving ATPDEA certification.

The Peruvian government, however, is taking a much more realistic approach to the ATPDEA. The government is no longer saying the Act will help create 1 million new jobs or radically change the agriculture sector. The one area that will benefit almost

immediately is the garment industry, which has witnessed a flood of new orders since U.S. President George W. Bush signed the ATPDEA in early August.

### **7.) Positive numbers**

The tax agency, SUNAT, predicts that tax collection in September will increase by 10 percent. Private investment firms report that inflation for the month should come in at about 0.5 percent and the economy is expected to have grown by approximately 3 percent. Official statistics will not be available for several weeks.

Premier Luis Solari said that private investment in the third quarter of the year should increase by more than 4 percent, reversing a downward trend that began in early 2000. International financial observers say Peru will register the highest gross domestic product growth in the region this year, coming in between 3.5 and 4 percent. Most predict that the country will not have a difficult time meeting its international commitments next year, thanks to new loans and other mechanisms.

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