

## **From the Streets to Markets: Formalization of Street Vendors in Metropolitan Lima**

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Reforms of the 1980s and 1990s altered the historical pattern of informal street vending in Lima, Peru, to create superior commercial opportunities for poor vendors. Hernando de Soto's Institute for Liberty and Democracy (ILD) identified and promoted the crucial elements of growth that had eluded policymakers and businesspeople for decades: property rights, low barriers to market entry, cost-effective regulation, and a democratic policy process. The Center for International Private Enterprise (CIPE) helped ILD design its economic reform agenda and a highly effective advocacy campaign based on increased citizen participation in decision-making.

- De Soto transformed the way the world viewed the informal sector.
- More than 200 informal markets in Lima acquired legal status by 2008.
- 382,100 Peruvian businesses belonging mainly to the poor were formalized from 1991 to 1994.
- Newly formalized businesses saved \$692.5 million in red tape and created more than 550,000 legal jobs.
- Land values doubled in formalized markets.
- Major urban districts were revitalized.



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A non-profit organization based in Lima, Peru, the **The Institute for Liberty and Democracy (ILD)** is an internationally respected think tank that has emerged not just as an intellectual force in the field of development but also as an agent of change in the developing and post-Soviet world in the effort to move the assets of the poor from the extralegal economy into an inclusive market economy.

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## Introduction

The busy urban neighborhood of Gamarra in Lima, Peru, attracts 60,000 shoppers daily who come in search of bargains and a wide selection of clothing and textiles. Gamarra's stores and workshops span more than two dozen city blocks, employ 70,000 people, and generate estimated annual sales of \$700 million. This hub of manufacturing and sales illustrates in microcosm a Peruvian victory in development that has profound lessons for other countries.

Gamarra was not always this way. Today's typical shopper may not even be able to imagine how the neighborhood looked 20 years ago. Its streets were filthy, crowded, and chaotic. Crime and prostitution were so rampant that even the police could not penetrate the neighborhood. The streets teemed with informal sellers who mostly eked out a living under trying conditions. Although thousands of sellers had come seeking opportunity in the city, they found it challenging to thrive under conditions of insecurity, a poor-quality market, and few avenues for growing a business.



*Textile shops in Gamarra, Lima, provide 70,000 jobs and attract 60,000 customers daily.*

Beginning in the late 1990s, private investors began transforming the neighborhood. These investors, many

of them street vendors themselves, constructed multi-story buildings, began paying taxes, and leased or sold spaces to former street vendors. This shift to formality opened the way to commercial and civic advancement. Ultimately, some who remained informal were excluded from the newly prosperous district, but tens of thousands found formal employment or business opportunities.

*“These are entrepreneurs;  
treat them as such.”*

*-Hernando de Soto*

Similar stories of achieving sustainable growth through formalization unfolded in markets all across Lima. Underlying this transformation was the groundbreaking work of the Institute for Liberty and Democracy (ILD). ILD assisted vendors in their quest to be heard and visibly improved Peru's small business environment. The Center for International Private Enterprise (CIPE) provided seed money and advice to this effort that stimulated ILD's rise as a world leader in property rights and commercial reform.

## Ingredients for Growth

Lima's street vendors and other small businesses have emerged into the world of mainstream commerce thanks to institutional reforms recommended, advocated, and in many cases implemented by ILD. ILD identified and promoted the crucial elements of growth that had eluded policymakers and businesspeople for decades. These elements were property rights, low barriers to market entry, cost-effective regulation, and a democratic policy process. Bolstered by ILD's pathbreaking work, Peru's small business owners, private investors, and policymakers have combined these ingredients in creative ways to open doors that lead away from informality and poverty toward formal commerce and growth.

In the early 1980s, Hernando de Soto, the founder of ILD, had the fundamental insight that the poor were not part of the problem but part of the solution. In fact, many poor Peruvians like the street vendors had a strong entrepreneurial mindset and resourcefulness to do business even when formal markets were inaccessible. “People had the entrepreneurship, they had the initiative, but they didn't

have the institutions,” said de Soto. De Soto’s analysis overturned the oligarchic notion that entrepreneurship was only for the elite. He demonstrated that a much larger entrepreneurial class could contribute to development and growth if given access to the institutions of a modern market economy. Above all, he established the respectability of street vendors and raised their profile as legitimate businesspeople whose voices were not being heard.

This case study follows the innovative history of ILD’s reform agenda and traces some of the positive impacts on Lima markets from the reforms of the late 1980s and early 1990s. ILD’s reforms of that era covered an astonishing range of institutions and constituencies at municipal and national levels. Of these, the story of the former street vendors’ transition to formal markets is one of the more visible and dramatic examples of ILD’s successes.

## The Original Problem: Street Vending in the 1980s

By the 1980s, street vendors had occupied Lima’s streets on a mass scale for decades, yet their activities and motivations remained poorly understood. To acquire a comprehensive picture of the phenomenon, ILD conducted a survey in 1986 and discovered there were 91,455 informal vendors across Lima, concentrated in low-income neighborhoods. As many as 314,000 people depended on street vending for their livelihoods, including the vendors themselves, their employees, and their families.

The street trade continually attracted new entrants, producing \$322 million in annual sales and per capita incomes of \$58 per month. Yet, the vendors were far from achieving their potential and wanted to leave the street for better locations to sell. Although the street was often a good place to start a business – no capital was required – vendors wanted, as any merchant would, to have a respectable location that would shield them from the sun and rain; be equipped with running water, bathrooms, and refrigeration; and provide them a place to hang their trade name.



*In the 1980s, approximately 5,000 street vendors were forced by the city to abandon their business locations and move to the Polvos Azules area.*

Over the years, numerous attempts were made by vendors and authorities to solve the challenges of street vending. Vendors sought to improve their situation by creating as many as 274 informal markets throughout the city. These markets lacked security and basic services, and were the source of disputes because property claims had no legal backing. Municipal and national authorities responded to safety, transport, and health problems by evicting sellers *en masse* and issuing new regulations. Authorities typically limited the size of businesses, regulated what could or could not be sold, mandated permits, levied taxes, and prescribed uniforms. Despite expanding regulations and occasionally violent evictions, sellers continued to occupy new locations and operate outside the bounds of the law.

The fundamental problem that repeatedly thwarted these efforts was an imbalance in the costs and benefits of operating in the formal sector compared to the informal sector. The costs of accessing the formal sector were kept excessively high by the red tape required to register a property or business and to comply with regulations. Remaining in the street also involved high costs due to insecurity and the threat of eviction, yet the benefits of street selling remained compelling to poor entrepreneurs. The key question was how to increase the overall benefit of being off the street while increasing the costs of being on the street.

## ILD's Reform Campaign

ILD's strategy for reforming the business environment rested on the premise that poor entrepreneurs would find their own way if given access to the formal sector. De Soto used the metaphor of building a bridge from informality to formality, instead of throwing the poor a raft. Upon reaching the far shore of the bridge, they would access "live capital," economic freedom, and new opportunities created through the legal recognition of their property and businesses.

The reform process entailed overcoming institutional barriers and mobilizing public support through democratic means. Using this approach, ILD successfully tackled a variety of challenges in Peru, including the street vendors' need to access formal markets. CIPE helped ILD design an economic reform agenda and an advocacy campaign based on increased citizen participation in decision-making.

### ILD's Strategy

- Analyze legal obstacles and extralegal practices.
- Outline institutional reforms.
- Draft legal proposals.
- Perform cost-benefit analysis of proposals.
- Build consensus; communicate the benefits of reform.
- Gain feedback from stakeholders: publish draft laws and organize public hearings.
- Fine-tune draft laws and regulations.
- Campaign for approval of the reform package.
- Create an action plan for implementing reforms.

De Soto's analysis of informality in Peru revealed that red tape and corruption took a toll on would-be business owners in the early 1980s. It took 289 days and \$1,200 in fees – 31 times the minimum monthly wage – to open a small apparel manufacturing shop. Moreover, it took 207 steps and more than 4 years to obtain state-owned land, and 20 years to title an informal property.

In 1985, ILD took up the cause of the street vendors when the municipality of Lima attempted to impose a regulatory solution on street vending. Recognizing the

unfairness and inefficiency of the Municipality's Order 002, ILD published its cost-benefit analysis of the order in the major news magazine *Caretas*. The order would cost each vendor approximately 15 percent of annual income and would cost sellers of prepared foods far more. Consumers would face a price increase of 9 percent and would be particularly affected in poorer neighborhoods that depended on informal sellers.

In its analysis, ILD described an alternative way forward: instead of new regulations, vendors operating on public streets should have permanent shops or markets. In fact, on their own initiative the vendors had already established 240 markets employing 21,000 vendors. ILD proposed three steps by which the process of building new markets could be shortened from 17 years to 6:

1. simplify the procedures, gaining time and money,
2. promote among the street vendors the best forms of entrepreneurial organization, which encourage the savings and efficiency of the managers, and
3. give them access to credit in order to accelerate the building.

To involve citizens, ILD created a private ombudsman's office known as El Balcón de Todos ("The Balcony for All"). Whereas citizens were accustomed to having politicians dictate to them from a balcony above the plaza, they now gained their own platform. Through this ombudsman's office, ILD gathered and publicized thousands of citizens' complaints related to property rights and administrative actions. In particular, ILD published a petition in opposition to Order 002, signed by 111 directors of vendors' associations, which raised a large roadblock to the poorly designed order. ILD's successful representation of the vendors on this matter demonstrated the necessity of consulting small business owners on regulatory changes.

## Administrative Simplification

From 1988 to 1989, ILD pushed a reduction in red tape across the board to ease transactions with authorities for citizens and businesses. ILD devised a draft law for overall administrative simplification based on the following principles:

- **Presumption of the truth** – The draft law introduced simplified forms and replaced various controls.
- **Elimination of unnecessary and costly requirements** – Unified registration fees were introduced, certified copies were accepted in place of original documents, and applications would henceforth be automatically approved if officials did not rule on them within a set time.
- **Decentralization of decision-making processes** – The proposed law facilitated the delegation of decisions and introduced mechanisms for intra-governmental coordination.
- **Citizens' participation in the application and control of administrative simplification measures** – Mechanisms were instituted to facilitate receipt of suggestions and complaints from citizens.

Following publication of the draft and public hearings, the Administrative Simplification Law (Law 25035) was passed unanimously by Congress in June

1989, and implementing regulations were enacted by the President 4 months later. As a consequence of the law, more than 400 rules were modified. These modifications reduced administrative costs in time and paperwork, primarily in areas affecting poor citizens such as business, housing, and education.

A distinctive feature of ILD's reform campaign and the government's follow-through was the mobilization of citizens to implement the new law. ILD compiled complaints against officials who were not complying with the law and discussed valid complaints with pertinent authorities. ILD publicized cases of continued non-compliance and, if necessary, forwarded cases to an administrative simplification tribunal chaired by the President of Peru. The President reviewed major complaints during 10 televised sessions in 1990, and 99 percent of the complaints filed were solved in just five months.

## Unified Business Registry

The quickest, most direct means by which ILD facilitated small business entry into the formal economy was the simplification of business registration. ILD called for the creation of a Unified Business Registry, which the government created in 1990. ILD advised a multisectoral committee that represented nine government agencies implementing the registry. The new registry coordinated procedures of the agencies under one roof and drastically reduced national registration requirements:

- From 289 days to 1 day
- From 9 approvals to 1
- From 6 offices involved to 1
- From 34 applications to 1
- From \$1,200 to \$174 in costs

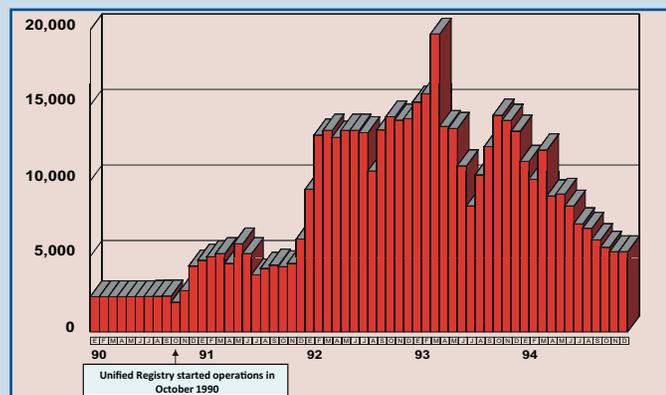
The new registry's positive effects were powerfully felt from 1991 to 1994. During those three years, 382,100 new businesses were registered (see chart above). The registered businesses saved \$692.5 million in red tape and created 557,770 new formal jobs. Government tax revenues increased by \$1.2 billion.

Legal status gave small business owners security and freedom to operate. Without status, business owners



*José Ignacio Neciosup, a retired submarine technician and former street vendor, bought a store and now sells toys and holds craft workshops.*

## Business Formalization in Peru



Source: Ministry of Industry and Trade, Republic of Peru

had been subject to continual harassment, often by authorities seeking bribes. Two merchants who registered through the new system, from Lima's open-air market of Polvos Rosados, expressed the difference succinctly: "Now we can work in peace."

Around the same time, ILD spurred improvements in municipal licensing, which had posed additional barriers on top of national registration requirements. Automatic municipal operating licenses, which could be obtained at one stop in a single day, were instituted in the Metropolitan Lima Municipalities of Ventanilla, Independencia, and San Juan de Miraflores, and in 15 interior cities.

## Formalization of Commercial Property

From 1987 to 1996, ILD built consensus for property formalization by publicizing the benefits of secure property rights to home and business owners. ILD facilitated approval of the 1988 Property Formalization Law, which simplified formalization procedures for all types of extralegal real estate, instituted mechanisms for dispute resolution, and established a new property registry. Following through on implementation of this law, ILD showed that municipal processes were not working well and advocated a specialized national entity for formalization. In 1996, the president responded by creating the Commission for the Formalization of Informal Property (COFOPRI), tasked with the formalization of urban, and later rural, real estate.

ILD and COFOPRI became famous for Peru's tremendous progress in conferring and registering titles for millions of poor property owners. Between 1991 and 2007, 1.7 million urban real estate assets were formalized, whose net value increased by \$2.9 billion. Less well known is that numerous formalized urban assets were commercial properties and markets, many of them owned by former street vendors. As of February 2008, 210 markets in Lima alone had been formalized by sale to the occupants, of which 169 were located on formerly informal holdings. In the latter case, market operators organized as a corporate entity were given the opportunity to obtain formal rights by providing evidence of "direct, continuous, peaceful, and public occupation" for more than one year.

## Las Malvinas

Following the wave of reforms led by ILD in the early 1990s, a transformation in street vending became apparent by the new millennium. Lima vendors were changing their operating methods and municipal authorities were changing their methods of handling informality. The Municipality of Lima now took up on its own an approach introduced earlier by ILD and CIPE. Lima's business development manager, Jaime Alva, observed how the city responded to ILD's example and expanded on its legacy: "The ideas of ILD through Hernando de Soto... put on the table not only that we had to attack the problem [of informality] but also provided tools and how to work [on the issue]."

The district of Las Malvinas exemplified a new approach to creating formal urban markets through the combined effort of the municipality and vendors' associations. From early 2003 to late 2004, the Malvinas project invested \$ 2 million in public funds plus \$ 52 million in private funds to convert an overcrowded boulevard into a viable business district. By August 2005, the project had recorded worthy results:

- 10,000 new store properties were created
- Daily business revenue grew from \$50 to \$150
- 25,000 jobs were created directly and 37,000 jobs indirectly
- Jobs were of higher quality and more stable
- Land value increased from \$ 250 per square meter to \$ 500 and higher



*Iris Ortiz is president of La Cachina store owners' association in Las Malvinas, where sales have tripled since formalization.*

Before the project, eight blocks of the thoroughfare in Las Malvinas had been clogged with informal businesses. These businesses sold a great variety of useful products: hardware, apparel, footwear, food, cellular telephones, consumer electronics, and more. They lacked access to city services and operated in a highly insecure environment plagued by crime and poor sanitation. Overcrowding denied all citizens use of the public space.

The Municipality of Lima embraced ILD's perspective that informal businesses should be part of the solution. Citing safety reasons, the city issued a declaration in February 2003 that would result in the temporary removal of street vendors from the neighborhood. At the same time, however, the city chose to involve the merchants in dialogue that would identify problems and alternative solutions. Officials expressed their desire to treat them like "real entrepreneurs."

According to the negotiated solution, the vendors vacated the boulevard while the street was renovated

and new market facilities were constructed adjacent to the street. The municipality of Lima promoted a licensing scheme based upon the following:

- Street vendors' associations bought the land and developed it through contracts with private companies.
- Financial companies provided financing through the associations.
- Future owners of the subdivided lots mortgaged their right in order to guarantee the loan.

The municipality monitored compliance with the agreements between associations and participating private companies. For its part, the municipality improved the streets and public areas to facilitate access.

After many months of construction, the former street vendors occupied their new stalls with great relief and new status as merchants formally recognized by the city. Their relatively strong initial financial situation had allowed them to cope until the new galleries were ready. When their customers loyally returned to the now more appealing district, the merchants were set for long-term opportunity and stability.

The new market arrangement offered advantages to customers and sellers. As the president of the Nicolini Commercial Center association related, "now they [the customers] have more guarantees, if a product is bad they can return it. When we were informal this did not exist... Also since becoming formal we can offer more security for all our clients." She mentioned continuing sales strength despite competition from other commercial centers. These store owners had the advantage that they were not simply salespeople, they also had valuable know-how. For example, customers came with plumbing questions and store owners helped them find solutions. The center's formal arrangement made possible these types of improvements in service and reputation.

Store owners in Nicolini such as Hector Escusel, who is a seller of bathroom fixtures and tiles, concurred that becoming formal had been positive. "Since becoming formal I have to pay taxes and do other things but it has been worth it... I have increased sales by 100 percent since becoming formal." When Escusel was on the streets he had just two people working for

him. After entry into the formal market, he had 18 employees in five stores and was planning to open stores in other provinces.

## Unicachi Associations

The transition to formality has played out differently with other groups. Since the late 1990s, merchants of Aymara origin – from the Unicachi district near Lake Titicaca and the Bolivian border – have achieved commercial success in Lima. Their story suggests the presence of new opportunities in an improved institutional environment as well as the continuing utility of family and ethnic relationships in business. The Unicachinos developed an innovative business model based on collective arrangements that facilitate individual entrepreneurship.

Since the 1940s, numerous Aymara migrants left the Unicachi area to seek opportunities in the large Lima market. They found work in small service jobs, such as shoe shiners, or later in fishing factories, before venturing into commerce and textiles from the 1970s onward. In 1996, Aymara merchants formed an investment group, Inversiones Unicachi S.A. This was followed by the formation of the San Pedro de Unicachi Merchants Association in 1999 and other associations later on. The Unicachi associations invest in real estate, then develop, rent, and sell stores to members of the Aymara community and others.

Unicachi associations have devised their own institutional arrangements to establish formal markets throughout Lima for ex-street vendors and other merchants. They have acquired property by pooling capital and obtaining financing from banks. Members have bought spaces for their stores either with cash up front or by paying installments. The associations have also handled licensing for members' businesses, without any direct involvement from municipal authorities. Inversiones Unicachi, one of the largest associations, currently has 51 shareholders and 400 stores. The network of Unicachi markets provides jobs to thousands of former street vendors, Aymara families, and others.

## Continuing Demand for Formalization

Despite dramatic gains by Peruvian street vendors in accessing formal markets, many who have started along this path have farther to go. As some leave the street, new migrants and entrepreneurs starting out attempt to take their place. Thus, the process of reform and the expansion of access to opportunity must continue.

Progress from informality to formality occurs along several dimensions. To achieve formality in all respects, an entrepreneur must acquire property rights, register a business, obtain necessary licenses, secure financing, comply with relevant regulations, and pay taxes. Reforms are needed on all these dimensions to allow and encourage entrepreneurs to formalize their businesses. ILD's comprehensive package of regulatory reform, business registration, and property registration has set the blueprint for greater formality and prosperity.

Systemic reforms rarely occur in linear fashion, and the formalization of Peruvian small business has been no exception. Some of the gains that ILD scored were subsequently slowed or reversed. Rapid changes in national-level regulations have not been matched by equally rapid municipal reforms. The once highly successful Unified Business Registry was absorbed by the Tax Authority in 1998. Nevertheless, the institutional reform process that ILD initiated has proven remarkably resilient. Municipal and vendor-led reforms in the 21st century have followed the ILD paradigm and continue to stimulate new entrepreneurship.

## Conclusion

Bucking a long history of informality, Lima has seen a sharp increase in the number of formal businesses since the 1990s. During the era of ILD's active reform leadership in Peru, the number of Lima's small and micro businesses grew from 72,606 in 1993 to 160,040 in 1996, a 120 percent increase. This strong growth in business registration and business

formation continued, and in 2004 Lima had about 300,000 small and micro businesses. Small businesses now constitute a much more significant proportion of formal businesses and have boosted entrepreneurship in the mainstream economy. The change has brightened the prospects of the poor, since formal enterprises are associated with lower poverty levels.

Numerous factors encouraged the formalization of street vendors and other small businesses. Hernando de Soto and ILD pointed the way by identifying the entrepreneurial potential of informal entrepreneurs, demonstrating the need to lower costs of access to formal markets, and developing a strategy for policy change. A democratic approach to policy change was crucial to success. Under ILD's leadership, street vendors were consulted

and mobilized, and thousands of poor citizens relayed their grievances concerning property rights and dealings with authorities. Officials aiming to improve the city came to realize that entrepreneurs were part of

the solution, and they devised innovative rather than bureaucratic means to assist the creation of new formal markets. The entrepreneurs not only exercised business ingenuity, they also invented practical methods to organize and govern themselves. Often, although they obtained a collective license to operate, they arranged individual rights of ownership for themselves.

The effects of institutional reforms that helped Lima's street vendors flourish can be seen in hundreds of markets and thousands of stores across the city.



The reforms have generated tremendous job growth and higher public revenues. Consumers have acquired steady access to a diverse selection of affordable goods. The public has benefited from neighborhood improvements but also from continuing

vitality that new business growth brings. Lima's experience demonstrates the difference that good governance can make in supporting entrepreneurship for the public good.

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