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PERU: INTERNATIONAL ECONOMIC POLICIES AND STRUCTURAL CHANGE, 1968-1978

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ABSTRACT

Peru: International Economic Policies
and Structural Change, 1968-1978

The social reforms instituted in Peru from 1968 to 1974 had great promise but were betrayed by an incomplete and inconsistent strategy of economic change, particularly in dealing with the external sector.

The reforms and the structural changes linked to them had their own weaknesses--concern for questions of ownership seems to have dominated concern for their effects on employment and for help to the very poor--but they did accomplish some redistribution and could have been consistent with rising national income if the basic economic framework had been functional.

The main failures of economic strategy are dismally familiar: they are the same inconsistencies that have damaged every serious effort at reform in Latin America. Aggregate demand was raised far faster than productive capacity, a frozen exchange rate in conditions of inflation discouraged exports and encouraged import-intensive investment, foreign borrowing was used as a substitute for both taxation and exports, and extreme protection for consumer goods created profits for socially wasteful investment. Question: why is the same disastrous pattern endlessly repeated? Hypothesis: concern for efficiency, export capacity, and balance between expenditures and income is so deeply identified with political and social reaction, for such good reasons, that governments with generous social objectives treat such considerations as a form of selling out. The identification is partly right but obscures something else that is both right and crucial. Productive capacity, export earnings, and aggregative consistency do not themselves improve human welfare but they do define the limits of sustainable generosity.

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For five surprising years, from 1968 to 1973, Peru achieved the near miracle of social reform combined with good economic growth. As if in revenge, the classic catastrophes that have plagued so many Latin American countries when they have tried to move in new directions surged up to stop the process: a foreign exchange crisis, accelerating inflation, paralyzed growth, rising unemployment, and intensified social conflict. Was all this necessary? What might Peru have done better? And what can be done now to resume growth without further taking apart the reforms?

The following analysis is focused on one central flaw in the Peruvian model for change, not because this is the most distinctive characteristic of the Peruvian experience but instead because it is so common, and so inescapably damaging, to all reform attempts in Latin America. The flaw is an impatience with, or antagonism toward, the minimal degree of consistency in economic policies needed if the economy is to function. This is an intellectual or temperamental problem more than one of any inherent political or economic impossibility. Why not, just once, combine social generosity with a serious effort to hold aggregate demand in line with productive capacity, to orient producer incentives in such a way that they minimize the use of imported equipment and foreign technologies, to stimulate exports to the extent needed to pay for imports, and in general to shape incentives toward the goals being sought? If one had to choose between creative imagination and intellectual consistency, the first would surely be the higher value. But nature does not rule that the two cannot come together.

The first section of this paper places the Peruvian experience in the context of a simple interpretation of what so often goes wrong with foreign trade and payments when Latin American countries try to produce structural change. It is a generalized version of a common set of problems. The second section considers the ways in which Peru's specific policies reenforced or departed from the general pattern outlined in the first section. Peru's situation and choices were distinctive; it might well have been able, or now be able, to escape the worst consequences of the common problem. Or it might not. The third section considers what might be possible now.

Modernization and External Crisis: The Common Pattern

Certain characteristics of the Peruvian experience are hauntingly familiar: initially, a relatively open economy relying on primary exports and foreign investment for the capacity to buy capital equipment and to maintain a slow process of industrialization; good periods of economic growth when primary exports were successful and then repeated relapse when either weakness of external demand or problems of domestic supply applied brakes to such exports; highly unequal income distribution and social power, with the owners of the resources which provided the essential foreign exchange readily able to dominate national policies. Expressed in such general terms, very nearly the same description could apply to Argentina prior to Perón, to Chile prior to Allende, to Colombia in the 1950's and--with more complications and reservations--to Brazil and Mexico somewhat earlier.

Whenever the political context permitted an effort to break out of this pattern, the main elements of industrialization strategy were the same in all cases. But the timing and proportions differed greatly among countries. These differences, in what might be considered the quantitative details of economic policy, had profound consequences. At one extreme, exemplified by Argentina, the economic policy mixture guaranteed failure. But the same elements of strategy used in different proportions by Colombia, Costa Rica, and Mexico--while they led to many problems, and accomplished more limited initial changes--permitted a continuing process of adjustment and more sustained economic growth. Peru's approach, starting later than all these cases, was different from all the others but closer to the more workable end of the spectrum.

The main common elements of industrialization strategy were: (1) high protection for manufactured consumer goods; (2) low-priced foreign exchange to hold down the prices of imported capital equipment and supplies; (3) low taxes on industry, often accompanied by tariff exemptions for any imported inputs; (4) subsidized credit and controlled interest rates; (5) an increased role of government, to exercise controls and implement promotional measures. All countries including Peru used all these policy instruments, but the quantitative differences were important. In those cases in which the government either relied upon or chose to appeal to urban groups almost exclusively, as in Argentina and Brazil, protective measures and favors to urban producers were extreme and real income in agriculture was sharply reduced.[1] But in other countries, perhaps most clearly in Colombia and Mexico, political forces were more nearly balanced, favoring a more coalition-style approach in which no participating group could be seriously damaged. This coalition style precluded extreme protectionism, kept the price structure somewhat closer to world prices, and kept alive an interest in maintaining incentives to primary producers and exporters.[2]

To explain these differences in policy orientation would require detailed knowledge of each of these societies, but one key factor is evident. In Mexico, the ruling party is based on compromise among multiple interest groups, aiming at something resembling a consensus.

In Colombia, a relatively open political system with competition between parties at regular elections, though again far short of any full-fledged popular participation, makes it difficult to inflict serious damage on any major group. In contrast to these cases, the policy changes toward import substitution in Argentina and Brazil were initiated by governments committed to urban industrial interests and strongly opposed to those of large landowners. The exporters, and by extension perhaps exports in general, were identified with political reaction, special privilege, and opposition to both social reform and industrialization. Argentina and Brazil thus opted for measures that pushed industrialization faster, and in the first country also achieved considerable redistribution of income, through changes in the structure of prices that departed much more radically from efficiency criteria. Efficiency criteria became in effect identified with political reaction.

While Argentina and Brazil stimulated industrialization aggressively, and Colombia and Mexico more moderately, Peru remained out of the game. As of the late 1950's, it had the lowest tariff rates and the least distorted pricing system of all these countries. One consequence was that its exports of primary products continued to do fairly well, not so much by rapid expansion of established lines of production as by the addition of major new primary exports, chiefly minerals and fishmeal. But the very wealth of opportunities in primary production and export processing acted to delay industrialization by providing the foreign exchange that kept up the value of the sol and thereby made it extremely difficult for Peruvian manufacturing to compete against imports. When industrialization did begin to get underway, in the 1950's and then more rapidly in the first half of the 1960's, it was partly in response to growing resource constraints in primary fields and partly because of increased protection. As Rosemary Thorp has emphasized, this pre-1968 industrialization had all the classic defects of import substitution: heavy dependence on imported inputs, capital-intensive methods using foreign technology, and low capacity to generate employment opportunities.[3]

Peru's belated try at forced-draft industrialization by import substitution led to much the same initial investment spurt and following letdown as Argentina and Brazil had experienced. Guillermo O'Donnell has shown especially well, with reference to the latter two, that the economics of the process had an exact political parallel. The initial stimulus to industry created a new sense of confidence that all social groups could gain jointly within the existing political structure: industrial wages and profits went up together, the professional-administrative groups opposed to change seemed to be breaking down.[4] Import substitution in the economic sense came to be identified with modernization in the political and social sense. But not for long.

On the economic side, import substitution created demands for imported capital equipment and current inputs, while handicapping the exports needed to pay for them. Foreign debts rose sharply, inflation accelerated, growth stopped, and all participants in the process turned against each other in an effort to shift the blame and the costs of adjustment. On the political side, all the conditions for authoritarian reaction were created in abundance. Defeatism, bitterness, and unwillingness to compromise locked the societies into positions that blocked

solutions. O'Donnell concluded that the tensions of modernization make growth impossible except through persistent, enduring, political repression.

This particular kind of modernization certainly does lead to extreme economic difficulty and often to political repression. But it is possible that the severity of the problems and the reactions could be modified if the country concerned managed to turn away rapidly from insistence on further closing in, toward alternative economic policies designed to reduce reliance as capital-intensive imported technologies, and to accelerate the growth of more labor-intensive industries both for the home market and for export. Albert Hirschman has explained in a particularly striking way the difference between treating the problem as one of running into a stone wall when easy import substitution comes to a close, and treating it instead as one of defining a new path to release constructively the energies generated by the early stages of import substitution. Instead of the vision of "deepening" the production structure at steadily increasing cost, his is one of "transition" to a new structure of production through incentives redesigned continuously to promote answers to each successive difficulty as it arises.[5] Successful transition requires shifting protection and other incentives away from consumer goods toward capital goods producers, avoidance of particularly costly industries that burden other producers, and careful staging of new investment to extend the range of production at a pace that can be digested. Hirschman does not stress, but I would, that it also requires continuous use of exchange rate policy to promote new exports.

Such an outward-moving transition is difficult, and to many people it apparently sounds impossible. But Anne Krueger's recent review of detailed experience in ten developing countries, as they attempted what she terms "phase III" policies of liberalization and correction of price structures, makes clear that in at least some conditions success is possible. Not always: she finds four relatively successful cases out of the ten studied.[6] And one of them, Brazil, is precisely a case examined at length by O'Donnell as evidence that modernization in Latin America inescapably leads to political repression. Still, another of the cases considered successful by Krueger, Colombia, has so far managed to keep solving problems of external payments and domestic changes without recourse to such repression. This is no accident: the country never allowed its price structure to become extremely distorted in the first place, and responded, if somewhat belatedly, to its foreign exchange problems by taking measures to promote exports.[7]

The central issue should be considered on two levels. First, are there such inescapable difficulties in guiding production techniques or in the development of new exports that solutions are beyond the bounds of possible domestic choices? The answer to that question seems clearly to be no: where coherent policies have been adopted, as in Brazil under authoritarian repression or in Colombia and Mexico with much less repression, positive economic consequences have followed. But, on the second level, is it likely that the particular kinds of economic choices that solve these problems effectively rule out broadened political participation and more equalitarian societies? Neither

Colombia nor Mexico, let alone Brazil, has demonstrated a capacity to carry out significant social reform while acting to provide the kinds of incentives needed for growth. A possible answer is that they have not tried to do the first, only the second. A more troublesome thought is that it may be necessary not to try the first, lest it destroy the incentives necessary for growth. Could Peru have been the exception, proving that it is possible to implement structural reforms and still achieve effective answers to the problems of growth? For several years, it looked that way. Now Peru looks more like Argentina. Exactly what went wrong?

Peru's Distinctive Path

The changes introduced in Peru from 1968 onward constituted a unique mixture of genuine social reform and strangely old-fashioned monetary, fiscal, and protective policies.[8] The following discussion considers in sequence: (1) the changes in structure initiated from 1968 to 1973; (2) policies with respect to international trade and exchange rates; (3) price policies and macroeconomic balance; and (4) questions of the reasons underlying the particular choices of policy.

Initial Changes in Structure. The great innovation of Peruvian policy was to start promoting change by a thorough land reform. All the old land-holding interests were swept away. In political terms, the traditional oligarchy was wiped out, except insofar as it transformed itself into a new industrial group. In economic terms, the kind of warfare between wealthy landowner-exporters and industrial sector importers which had ruined Argentina was beautifully short-circuited: the peasants became the landowners and a positive concern of national policy. At least at first.

The other major innovations of Peruvian policy were the complex laws designed to provide greater protection and participation for workers, through collective ownership of specific agricultural and industrial properties, through the complex scheme requiring industrial firms to distribute part of their profits to their workers in the form of equity claims, through attempts to guarantee job security by the Ley de Estabilidad Laboral, and through new agencies designed to stimulate political consciousness and to provide direct financial and technical assistance to cooperative and worker-owned organizations.[9]

These measures in support of urban labor have rightly been identified as aiding disproportionately the higher-income workers with regular employment in the modern industrial sector.[10] But the Velasco government also implemented a more equalitarian effort to improve living conditions and establish dependable ownership rights for squatter settlements on the fringes of the major cities. Measures to aid urban squatters, in return for their political support, date back to prior Peruvian governments. But this time a major change was introduced. Instead of leaving ownership rights unsettled, as a deliberate means of keeping the squatters dependent on government favor, the Velasco government carried out an impressive program of vesting individual ownership rights and thereby lessening dependency of the squatters on the government.[11]

Along with the land reform, the efforts to develop worker participation, and the attempts to incorporate urban squatters within the society, one of the government's major objectives was to reduce dependence on foreign capital. Its first major policy step was to nationalize the assets and operating rights of the International Petroleum Company. This was probably the most wholly approved, spirit-lifting, and sensible step in what otherwise proved to be a decidedly erratic line of policy. It was followed by seizure of the agricultural properties of Grace and other foreign landowners, purchase at exceptionally high prices of the Peruvian assets of Chase Manhattan and the communications properties of ITT, and then a reluctant and incomplete nationalization of some of the foreign-owned copper mines. The generosity to Chase and ITT, and the government's indecision about treatment of foreign-owned companies in both manufacturing and mining, reflected a real problem: to carry out planned investment after taking over ownership required large-scale foreign borrowing. The government was able to cut down significantly the foreign share of productive wealth in Peru, but only at the price of greatly increased foreign debt.[12]

All these changes constituted a striking breakthrough from Peru's traditional immobilism. Every one of them raised difficult problems and led to continuously evolving compromises. It is possible to treat them all as mistakes, because they were all imperfect and did not fit any well-conceived overall strategy. The suggestion intended here is rather that they were a mixed collection of promising experiments and misconceptions, a collection that could have been improved through experience if the whole operation had been blessed by more concern for economic efficiency and aggregative consistency.

In agriculture, the land reform wiped out the old oligarchy but did not do much to distribute land to the poor. The haciendas were largely kept intact as collectives owned by previous permanent sharecroppers. On the one hand, this meant that only a small fraction of the rural population gained in the sense of membership in the collectives. The fraction was about one-fourth of the rural population.[13] It did not include the extreme poor, the migrant workers, who may have become even worse off, as the employees of collectives determined to keep down their membership and restrict their payments for outside labor.[14] On the other hand, the rejection of land distribution to individual families meant that incentives for individual effort to raise incomes through higher production were not favored. If the land had been distributed to small owners, production would surely have increased more rapidly: small land holdings cultivated by people who gain directly from working hard invariably yield higher production than large estates worked by hired labor.[15] Alternatively, the decision to maintain collective ownership might have made possible a planned restructuring of land use, redesigning units of production and choices of crops to fit a coherent overall program. But no effective program in this sense was implemented either. Worse, when prices of food imports shot up in 1973 and the cost to the country of its inability to produce sufficient food rose accordingly, the government opted to block food prices and subsidize imports, fostering urban consumption while discouraging rural production.[16]

Agricultural policy following the land reform can hardly be judged to have been much better than dismal. But the reform itself, and the experience of trying to get things going on a collective basis, greatly stimulated social awareness and a sense of capacity for self-determination on the part of members of the collectives.[17] Cynthia McClintock's field research on evolving reactions suggests a definite process of learning from mistakes, with a growing concern both for correction of special privileges and for the introduction of more effective work incentives.[18] Such social gains may outweigh temporary losses on the production side, especially if public investment in support of the poorer groups and price policies favorable to increased output are consistently maintained. The problem is to keep the learning process going while giving more emphasis than before to increased production.

The reforms of labor practices and measures to promote worker participation had somewhat similar consequences, both in the sense that they created a more socially desirable balance favorable to the previously weak, and in the sense that they were implemented in ways that worked against production and employment. The fact that owners of firms could lose control if they reported profits, because this meant that they would have to distribute equity claims to employees, naturally discouraged any recording of profits. Apart from the inducement to falsify accounts, this encouraged unnecessary administrative expenses, and acceptance of higher costs to set up separate marketing organizations through which to channel earnings, as well as substitution of machinery for labor even when this added to total costs. Given strong tax advantages for investment in machinery, plus the chance to postpone any eventual loss of control by increasing the equity base, conditions were made perfect for overinvestment in machinery. Abusada-Salah estimates that industrial capacity was raised at the rate of 28 percent a year from 1971 to 1976, while production in real terms was growing at only 6 percent a year.[19]

The job guarantees to employed industrial workers have been and remain a sore issue for employers. They may have weakened worker discipline to a degree making the organization of production difficult, but perhaps the worse effect was on employment: it discouraged employers from adding new permanent employees, favoring recourse to labor-saving equipment and to rapid turnover of temporary labor which could be discharged before acquiring job rights. These adverse consequences might have been counteracted by high charges for imported capital goods through the exchange rate or taxes, plus penalties for rapid turnover of employees on a short term basis. But they were not in fact counteracted, and the law thus worked against both productivity and employment.

No thorough study of the economic consequences of nationalization and government ownership in this period has yet been made. The operating losses of the public firms grew greatly after 1974, but this was chiefly due to the use of price controls on their sales to keep down the apparent rate of inflation. The greatest losses were those of the state firms charged with importing food and raw materials and required to sell them at lower domestic prices. These losses do not demonstrate anything at all about the operational efficiency of the public firms. But they may have been just as harmful as the private firms in excessive capital investment and importing: they were not guided by any conception of efficiency prices and opportunity costs.

The adoption of monopoly state trading in primary products had many purposes: to create more direct state control of foreign exchange earnings, to reduce commission charges in marketing, to gain advantages of mass bargaining power, and to open up new markets outside of the traditional western countries. The state trading agency acted as a broker, finding the customers and selling at the best price it could find, then paying the primary producer the actual price less a commission. Commissions were reduced from approximately 8 percent under private trading to 5 percent under the state system.[20] Markets were considerably diversified, in particular by increased sales to socialist countries. State trading thus achieved some of the purposes for which it was established. But it created problems too. The practice of negotiated buying and selling on a large scale sometimes locked the trading agencies into purchase or sales contracts that missed important price changes, and ended up costing more foreign exchange than a more flexible policy of following the market continuously would have done. And underinvoicing of exports apparently resumed even under state trading, as the overvaluation of the sol became clearer and clearer after 1974.

TABLE 1

ANNUAL GROWTH RATES OF GROSS DOMESTIC PRODUCT, AGRICULTURAL AND INDUSTRIAL PRODUCTION, AND WAGES AND SALARIES, AT CONSTANT PRICES, 1971-1978

	Percent Change from the Preceding Year				
	Gross Domestic Product	Agricultural[a] Production	Manufacturing Production	Wages (sueldos)	Salaries[b] (salarios)
1971	5.1	3.0	8.6	6.0	11.1
1972	5.8	0.8	7.1	3.3	8.8
1973	6.2	2.4	7.4	5.6	9.2
1974	6.9	2.3	7.5	-8.2	-5.8
1975	3.3	1.0	4.7	-4.5	-0.2
1976	3.0	3.3	4.2	-11.9	4.0
1977	-1.2	0.1	-6.1	-15.9	-19.4
1978 (est)	-1.0	0.4	-4.6		

[a]Data exclude fishing.

[b]Wages and salaries are averages for Metropolitan Lima.

SOURCE: "Información estadística entregada por el Señor Ministro de Economía y Finanzas, con motivo de su exposición al país el día 14 de junio de 1978," Lima, 1978.

All these structural changes embodied complex mixtures of gains and losses. The general interpretation suggested here is that they opened up possibilities of wider participation, and helped spread conceptions of new social alternatives, but were not well designed either to facilitate production or to help the poor. They may well have discouraged investment, and at the same time encouraged choices of techniques that were structured toward saving labor even at high cost in terms of imported equipment. They could presumably have been revised and improved by a government concerned with these defects, but not much was in fact done to improve them in the short time before the whole economy began to break down. The social reforms themselves may have contributed marginally to the breakdown, but certainly do not explain it: that was much more a matter of aggregative imbalance between demand and productive capacity, and the consequent external deficit.

Policies With Respect to Internatinal Trade and Exchange Rates. The center of the crisis that has forced the Peruvian economy into contraction of production and real wages, and an explosive combination of devaluation and inflation, is a problem of foreign trade and payments. If this particular problem had not arisen, Peruvian policies would be facing many other issues that might well be considered more fundamental, but since it did arise and was not resolved it has paralyzed nearly everything else. These problems were not necessary consequences of either the domestic structural reforms or of externally imposed constraints. They are due to a fundamentally non-workable model of development. Peru repeated and in some ways aggravated the kinds of choices that the earlier industrializers had tried out and abandoned. It is an absorbing question why policies were so unimaginative on issues that have turned out to be so costly, but it is useful first to consider what was done, or not done when needed.

The main lines of trade policy included one negative and one positive element. The negative element was a system of almost complete domestic monopoly granted to industrial producers. The Ley de Industrias, adopted in 1970, allowed any industrialist on the register of manufacturers to exclude imports of all of his own products. No matter how costly the production process, or how exorbitant the profit margins applied under this unlimited protection, the domestic market was guaranteed to be safe from any import competition.[21]

This system of import restriction was of course complemented by standard tariffs and other measures of direct trade control. Peru had adopted increasingly protectionist policies from 1959 on, in an attempt to stimulate industrial investment.[22] Some such stimulus was long overdue. The problem was the means. In the early 1960's it took the form of successive tariff increases as requested by potential producers, without any selection based on costs. The adverse consequences of this earlier approach were hardly in doubt, but the new 1970 law made things far worse. Even extremely high tariffs still provide some limit beyond which inefficiency or high profit margins cannot go, but the new law took away the limits.

The more positive component in the post-1968 set of trade policies was an increased concern for exports. Unfortunately for Peru, the

concern was mainly for increased exports of primary products. In a way, it was a marked step forward to give greater attention to primary production for exports, as opposed to the constraints of import substituting industrialization.[23] But these choices represent only the two weaker sides of a three-sided possibility. For a relatively small country it is essential to develop industrial exports. They offer the only hope of realizing economies of scale in most modern industries, they should normally utilize relatively labor-abundant production techniques, and they offer the one dependable way to put domestic producers in close touch with the evolution of new techniques and possibilities.[24] From all the evidence now available, the fastest growing among the developing countries are those which have been able to export high shares of their industrial production. These export shares run above 40 percent in the most dramatic cases, though much lower for the largest developing countries even when they do emphasize exports. If Peru set a target of exporting one-fourth of its industrial production by the early 1980's, and used policies appropriate to achieve such a goal, it could reasonably expect to achieve in the process higher employment, greater capacity to relieve poverty, and a lessened dependence on external credit.

Just prior to the 1968 change in government, the Certex scheme was worked out to give special export incentives to nontraditional exports, both manufactured and primary. The Velasco government went ahead with the method and it has been maintained since, with some variation in the value of the incentives and considerable variation in the degree to which the government has promoted it. Exporters are issued transferable certificates of tax exemption, equivalent to a given percentage of the value of their exports, if they are considered to qualify. Although the scheme always suffered from excess paper work, and sometimes from resolute neglect, it works in a positive and selective sense. Only those producers who can sell profitably with this limited subsidy can participate successfully: unlike firms operating behind protection, exceptionally high cost producers are not encouraged.

New exports did gradually respond to this scheme. The category of "diverse" exports reported by the Central Bank--after excluding fish products, copper, oil, sugar, cotton, coffee, and wool--came to a total of only $25 million as of 1969. This was equal to 3 percent of total exports. By 1971, the amount had risen only slightly, and was still just 3 percent of total exports. But by 1974 they had multiplied four times over, to $139 million.[25] That was equal to 9 percent of total exports for 1974. Then their growth stopped and the total plunged, to $70 million in 1975. The main reason for the sudden break is that the effective return from exporting was sharply reduced by rising domestic costs in the face of a frozen exchange rate.

The key factor determining the incentive to export is the ratio between soles received per dollar and the cost of producing the exports. This ratio, the effective exchange rate actually received, should combine the official exchange rate with a deflator measuring changes in costs of imports. In the absence of such a measure, an approximation can be made by using the index of consumer prices as the deflator. For those

TABLE 2

EFFECTIVE EXCHANGE RATES FOR EXPORTS AND VALUE OF EXPORTS, 1969-1977

	(1) Official rate at end of year, soles per dollar	(2) Price deflator[a]	(3) Effective rate for traditional exports	(4) Rebates and exemptions as % of Certex export value	(5) Effective rate with Certex	(6) Total exports $ millions	(7) Non-traditional exports $ millions	(8) Percent, non-traditional to total exports
1969	38.7	1.00	38.7	22.0	47.2			
1970	38.7	1.05	36.9	22.0	45.0	1034	65	6.3
1971	38.7	1.12	34.6	22.0	42.2	889	54	6.1
1972	38.7	1.20	32.3	25.5	40.5	945	78	8.2
1973	38.7	1.32	29.3	24.3	36.4	1112	128	11.6
1974	38.7	1.54	25.1	23.9	31.1	1506	173	11.5
1975	45.0	1.90	23.7	23.8	29.3	1277	102	8.0
1976	69.4	2.54	27.3	31.5	35.9	1342	137	10.2
1977	130.4	3.91	33.4	32.4	44.2	1725	240	13.9

[a]The deflator used is the consumer price index, transposed to a base of 1.00 for 1969.

SOURCES: Columns (1) and (2) from International Monetary Fund, International Financial Statistics. Column (3) is (1) divided by (2). Column (4) from Rosemary Thorp, "Economic Constraints and Policies of the Peruvian Military Government 1968-1978," paper prepared for the Woodrow Wilson Center workshop on Peru, Nov. 1978, table 3. Column (5) calculated by adding average Certex value to official rate in (1), and dividing by deflator. Columns (5) and (6) from *Actualidad Económica*, no. 2, Marzo 1978, cuadro 1.

non-traditional exports eligible for the Certex premium, it is also necessary to add the value of the premium to the official exchange rate. Figure 1 following charts the movements from 1969 through 1977 in (1) the official exchange rate, (2) the effective exchange rate for general exports, and (3) the effective rate for non-traditional exports under the Certex system.

For traditional exports, incentives in the sense of the effective exchange rate deteriorated steadily from 1969 on. For non-traditional exports, incentives were improved by the introduction of Certex in 1969, but by the end of 1973 they had fallen back below the level of the official rate as of 1969. The devaluation of 1975 was less than the rate of inflation in that year and so the effective exchange rate continued to fall. But the devaluations of 1976 and 1977 outpaced the rate of inflation and pulled the export yield back up. Non-traditional exports responded immediately, rising 2 1/2 times in dollar value between 1975 and 1977. Preliminary reports for the first half of 1978, following still steeper devaluations, indicate that the dollar value of non-traditional exports again doubled, as compared to the first half of 1977. Such exports clearly are responsive to incentives, and could have been raised in the mid-1970's when the foreign exchange crisis became intense.

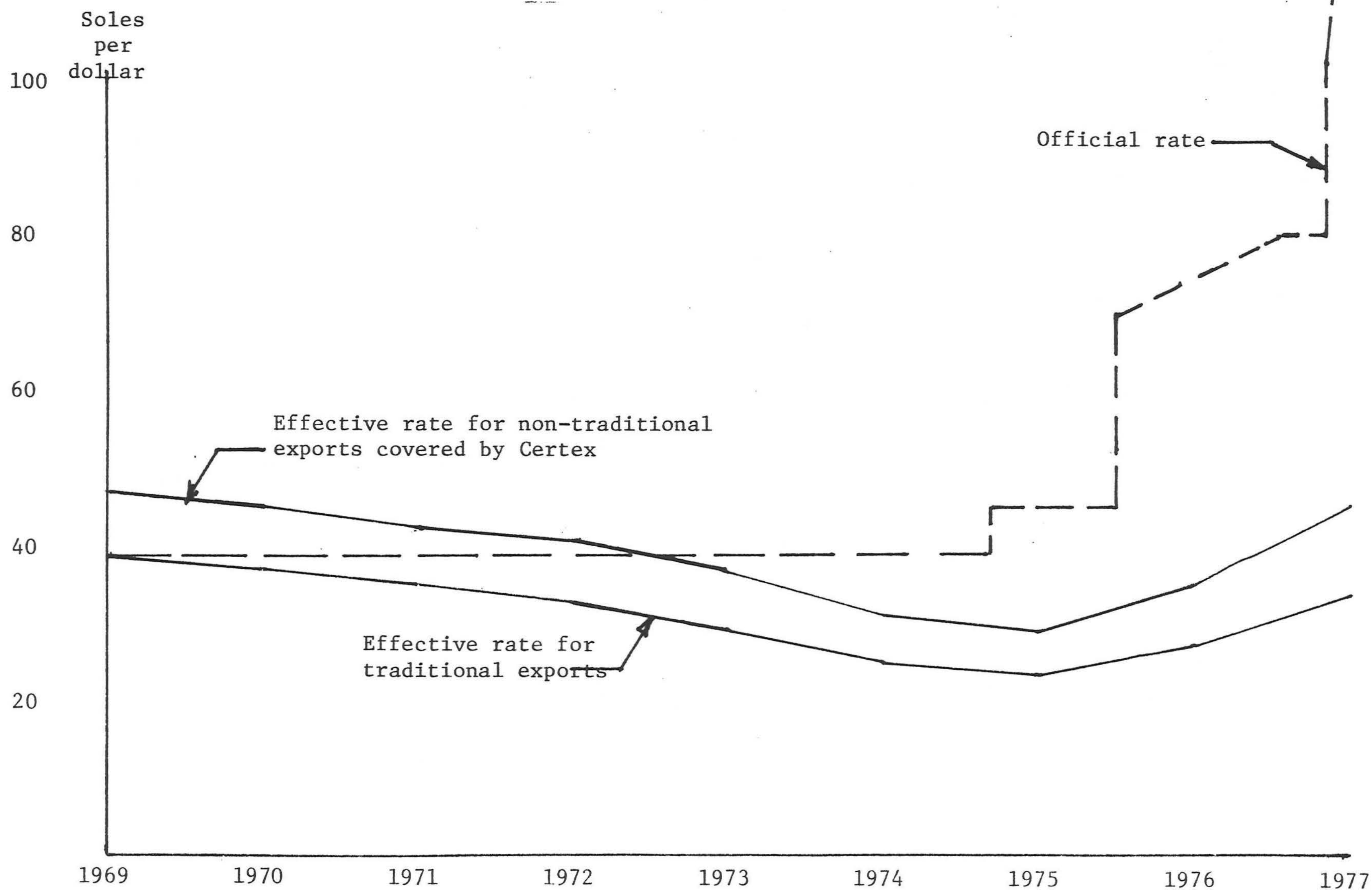
Current changes in exchange rates have a less direct effect on traditional exports, for which changes are determined within narrower limits by physical supply conditions and external markets.[26] But to allow the effective exchange rate for traditional exports to deteriorate for six years must have worked against decisions to expand the capacity to export for them as well.

Similarly, the fixed exchange rate in conditions of rising domestic prices must have favored rising imports. That effect of relative prices was countered to some degree by direct import restrictions, but aggravated by tax and tariff concessions for investment in machinery and purchases of current industrial inputs, and by subsidies for domestic sales of imported food products.

Import controls were used in the early years to block out almost completely the imports of consumer durable goods. These had averaged \$64 million a year from 1962 through 1966. They were pulled down by the deflationary policies used just prior to the Velasco regime, and then held to an average of \$19 million for the period 1969-72. This saving from prior levels of consumer durable-goods imports just about offset the increase in imports of capital equipment for industry between 1969 and 1972. But after that everything went through the roof. Between 1972 and 1975 the volume of total imports approximately doubled and their cost in terms of dollars approximately tripled.[27]

This dramatic rise in imports was due in part to rising aggregate demand as the economy grew, and in part to the policy of holding the exchange rate fixed while domestic prices were increasing, but perhaps above all to the extremely generous tax and tariff exemptions granted to industrial producers wishing to buy imported supplies and equipment. The dominant factor in the rise of imports was the increase of

FIGURE 1. OFFICIAL EXCHANGE RATE, AND EFFECTIVE EXCHANGE RATES DEFLATED FOR DOMESTIC PRICE INCREASES, AT ENDS OF YEARS, FOR TRADITIONAL EXPORTS AND THOSE NON-TRADITIONAL EXPORTS COVERED BY CERTEX, 1969-1977.



Source: Table 2

equipment and supplies for industry, from $564 million in 1972 to $1,544 million in 1975. Carlos Amat y Léon has calculated the profit tax reductions granted to industrial corporations from 1971 through 1975 at 9.9 billion soles, and the tariff exemptions at 9.5 billion. The combination of the two kinds of fiscal benefit equalled 92 percent of total internal financing by the industrial sector in these years.[28] That is to say, tax advantages accounted for nearly the entire value of equity investment. As a consequence of the favorable conditions for importing supplies, the ratio of imported inputs to industrial value added increased from 17 percent in 1971 to 23 percent in 1975.[29]

The increase of imports between 1972 and 1975 set the stage for the following financial crisis. More blame has been placed on the loss of exports due to the failure of the anchoveta catch, and this loss was important: exports of fish products fell by $189 million from their peak in 1970 to the lowest year, 1973. But the increase in imports between 1972 and 1975 was $1.8 billion, roughly nine times the value of the fall in fish exports. It was not the desertion of the anchoveta that caused the foreign exchange crisis; it was Peruvian economic policy.

Price Policies and Macroeconomic Balance. The Velasco government started from a position of relatively tight restraint on aggregate demand, with a modest export surplus. The deficit of the central government had been brought down from the very high levels of the mid-1960's to about 1 percent of gross national product in 1970. But then it again grew rapidly and reached 4 percent of GNP by 1972. The money supply was also allowed to increase at rates far greater than the rate of growth of real output (cf. tables 1 and 4). Rising aggregate demand and monetary expansion exerted increasing pressure on prices, on top of the upward trend of input prices. The only serious effort at restraint was directed to wage rates, which the government tried hard to hold down.

The export surplus did not disappear until 1973, when it was replaced by a small deficit. The new deficit coincided with rapidly increasing world prices for imports, which raised a critical issue for economic policy: how best to respond to a joint threat to domestic stability and to external equilibrium. The response chosen was to use subsidies to hold down the domestic prices of imported goods, and to apply tighter controls on imports and capital movements to hold down foreign exchange losses. This meant a rapidly growing public sector deficit to finance subsidized consumption.[30] And since nothing was done to encourage exports, it also meant a growing external deficit, financed by foreign borrowing.

The deficit of the public sector as a whole increased from 5 percent of GNP in 1973 to 10 percent of GNP in 1975. The excess of domestic use of goods and services over total production increased from 0.6 percent of GNP in 1973 to 9.8 percent in 1975 (Table 3). The fact that the domestic deficit of the public sector and the external deficit of the economy were both equal to 10 percent of total output was a coincidence, but a coincidence that underlines the direct connection between them. It could not

under any circumstances have been possible to avoid a rapidly rising burden of external debt, devaluation, and accelerating inflation, given the public sector deficits of the order allowed to develop from 1974 on.

TABLE 3

RELATIONSHIP OF TOTAL PRODUCTION TO TOTAL USE OF GOODS AND SERVICES, 1968-1976

	Billion of soles at current prices				Excess of total use over total production, in the years of excess, as a percent of GNP
	GNP	Exports	Imports	Export surplus	
1968	181	38	35	3	
1969	204	41	35	6	
1970	237	48	38	10	
1971	263	42	40	2	
1972	292	46	43	3	
1973	355	53	55	(-2)	0.6
1974	444	72	96	(-14)	3.2
1975	552	69	123	(-54)	9.8
1976	758	100	147	(-47)	6.2

SOURCE: First three columns from International Monetary Fund, International Financial Statistics, May 1978, p. 315. Column five is the ratio of excess imports to GNP, as a percent of GNP.

The failure to maintain aggregate balance was compounded by a policy of holding interest rates constant despite rising rates of inflation. The real rate of interest, the nominal rate corrected for the rate of inflation, remained negative in all these years. It went down from about minus five percent for 1973-1974 to minus 12 percent by 1976.[31]

The fiscal deficit could conceivably have been limited by an increase in taxes, but this was not attempted. As noted above, tax exemptions for industry grew rapidly in total value. Receipts could have been raised substantially just by reducing the exemptions given to industry. But they were not.

On the expenditure side, military spending was an important complication. The government concealed the amounts involved from the public, and they have not yet been fully clarified, but U.S. estimates indicate that Peruvian military spending was on the order of 3 percent of GNP for 1970-74, and increased to 4.8 percent in 1975.[32] Since the aggregate deficit of the public sector was equal to 10 percent of GNP in 1975, military spending was apparently equal to slightly less than one-half the total deficit.

TABLE 4

PUBLIC SECTOR DEFICITS AND INCREASES IN MONEY SUPPLY, 1970-1977

	Deficit of central government, billion soles	Deficit of whole public sector, billion soles	Deficit of central government, % of GNP	Deficit of whole public sector, % of GNP	Percent increase in money supply
1970	3.2		1		52
1971	8.1		3		13
1972	10.8		4		27
1973	14.0	16	4	5	27
1974	14.1	31	3	7	42
1975	30.6	54	6	10	17
1976	48.4	77	6	10	25
1977	79.1	89	8	9	24

SOURCES: Central government deficits for 1970-76 from Banco Central de Reserva, Memoria 1976, p. 38; for 1977 from "Información estadística entregada por el Señor Ministro de Economía y Finanzas, con motivo de su exposición al país el día 14 de junio de 1978;" total public sector deficits from Banco Central de Reserva, Departmento de Estudios del Sector Público; money supply from IMF, International Financial Statistics.

Subsidies to consumers of food and oil products are also difficult to measure exactly, but the estimates explained in Table 5 make clear that they were very large. For 1974-1976 they varied between one-fourth and one-half of total domestic expenditures on food and oil products, and from 18 to 25 percent of the total public sector deficit. The state firms involved, EPSA and Petroperú, did not actually receive these subsidies from the government: the figures give the amounts they requested, but the government rarely came through with the money. The solution of the firms was to borrow the money abroad.

New foreign borrowing by the public sector increased from $319 million in 1973 (31 percent of total imports), to $793 million in 1975.[33] This external borrowing created the present extreme burden of debt service. Requirements for debt service were about 13 percent of export earnings in 1970, increased to 36 percent by 1977, and were approximately 57 percent for 1978 prior to debt rescheduling.

The debt burden became so great because imports were allowed or encouraged to rise so greatly, while exports made little progress. It is possible to view some part of the increase in imports as a calculated gamble, a gamble to import equipment for major projects that were expected to yield rising exports of primary products. It is also possible to view the failure of primary exports to grow as due in part to a loss of confidence by foreign investors, who slowed up their own investment in the fear, perhaps understandable, that they might not be allowed to retain ownership. It is also likely that the debt service burdens were increased by the refusal of the U.S. to sanction official loans to Peru until 1973, as a reaction to

TABLE 5

ESTIMATES OF SUBSIDIES FOR FOOD PRODUCTS SOLD BY THE EMPRESA PUBLICA DE SERVICIO AGROPECUARIO AND FOR OIL PRODUCTS SOLD BY PETROPERU, 1974-1976

	1974	1975	1976
Empresa pública de servicio agropecuario			
Domestic sales, billion soles	10.8	16.2	21.5
Losses, billion soles	4.5	4.2	7.1
Ratio of losses to sales, percent	42	26	33
Petroperú			
Domestic sales, billion soles	9.6	12.9	23.1
Uncovered operating expenses, billion[a]	3.1	5.7	10.5
Ratio of uncovered expenses to sales, percent	32	44	45
Combined losses and uncovered expenses			
Total, billion pesos	7.6	8.9	17.6
Total as percent of aggregate economic deficit of the public sector	25	18	25

[a]Petroperú did not report losses, but included within the income statement an allowance for funds requested from the government to cover costs. This was not an actual subsidy to Petroperú because the government rarely paid the requested amounts, but the company included the amounts as income in the sense of outstanding claims. The money not covered by actual payments was borrowed abroad.

SOURCES: EPSA, "Estados Financieros y Consolidado," for December 31 each year; Petroperú, "Estado de Ganancia y Perdida," for each year. Public sector deficit from table 4

the uncompensated seizure of the International Petroleum Company. This block imposed by the U.S. helped drive Peru into higher-cost commercial credit in the Euromoney markets, and thus made interest costs of borrowing higher than they would otherwise have been.[34] Each of these factors had separate importance, and no interpretation of the present difficulties should leave them out. But it would certainly be misleading to suggest that Peru had a workable set of policies that would have avoided the debt problem if only the rest of the world had let the country alone. The country's own policies were not functional: they subsidized imports of capital goods and current inputs for industry, subsidized imports of consumer goods by maintaining an overvalued exchange rate as well as by direct subsidies, and failed to provide incentives to increase exports. If oil had appeared in infinite quantities, or if these policies had been corrected, the debt problems would not have become intense. The latter possibility was the one within national control.

Some Questions about Causation. The usual sphere of reference for which economics is appropriate extends from initial events or policy decisions--in this case, trade policies, exchange rates, fiscal policies, and interest rates--to their consequences for economic performance. These connections between choices and results are a necessary component of any explanation of events, but they leave untouched the underlying question of why the decisions were what they were. How could anyone have imagined that these mutually inconsistent policies could possibly work out successfully?

Is it a mistake from the start to look for a unified conception underlying economic policies? If there were a strong ideological strand guiding choices, or if they represented clear-cut class interests being imposed on everyone else, then one could reasonably expect to find some such conception expressed in the choices. The Velasco government seems, judging from results, to have been an in-between kind of regime: strongly influenced by a definite set of preferences, but unable to resolve key conflicts. Cynthia McClintock has documented this characteristic with respect to agrarian collectives: a series of head-on conflicts over policy, with the balance tilting to one side or the other as personalities and the background political scene altered.[35] The net result necessarily appears inconsistent, however one might have evaluated the individual strands. But at the same time there clearly were common themes expressed in many actual choices, particularly with respect to a decision to wipe out the historical oligarchy, to achieve greater equality, to lessen dependence on foreign influence, to lessen the use of market criteria, and to increase the directive role of the state.

While these goals may not all fit together readily, and were in all cases subject to compromise in the face of resistance, it remains striking that so many actual choices ran directly counter to the presumed purposes. To reduce dependence on foreign influence surely requires avoidance of balance of payments deficits leading to heavy foreign debt: to go into debt does not increase independence. So why use policies that discourage exports and encourage imports? To increase equality one might wish to keep food imports cheap, but then why keep down prices paid to domestic food producers who have in general even lower incomes than the urban consumers? And why grant such enormous tax exemptions to the industrialists? To freeze domestic prices and the exchange rate might be explained as means to hold down inflation, but then why allow the enormous public sector deficit that ensured severe inflation?

Is it possible that the people formulating policy knew and cared deeply about social relationships but did not know or care much about any requirements of economic consistency? Albert Hirschman suggests that it is a common tendency of Latin American reform governments to overestimate the elasticity of the economic system, and this seems to be another case in which the point is valid.[36] But an evident objection to any explanation resting on the idea that economic constraints were not understood is that Peru has many capable economists inside and outside the government, and that the government includes many well-established agencies of economic analysis. How did they let all these inconsistencies

get by? Two suggestions: (1) the government was not run on an open basis, inviting discussion, but rather in a closed-circle military style: the way to get ahead was not to argue but to agree or keep quiet; (2) some economic agencies, or key people within them, may have been focused on objectives that blocked use of economic techniques. My favorite example, from an internal INP study, is a discussion of the case for and against devaluation in 1975. After making many good points on both sides of the question, the concluding sentence warns that policies must above all avoid "using too much monetary and fiscal policy."[37]

To an economist, the quoted conclusion is about equivalent to telling a civil engineer, called in to advise on what to do about a bridge on the point of collapsing, to avoid considering the forces of structural dynamics. But of course there is a level on which the argument is readily understandable. To use the price system at all, through monetary and fiscal policy or otherwise, seems to require yielding some degree of conscious control over economic variables. If the underlying social vision is focused on normative goals, on considerations of equity and of the ways in which each group should fit within an organic system, then efficiency considerations may easily be seen as inherently contrary to social purpose.

It is true that efficiency criteria usually work disproportionately in favor of those people and social groups with command over capital and skills, and that social conditions in Latin America have created extreme concentrations of such favored positions. Governments bent on social change in favor of less privileged groups almost necessarily find themselves in conflict with efficiency considerations.[38] Alfred Stepan notes that those Latin American regimes which value inclusionary criteria are much more likely to base their claims for legitimacy on populist principles and economic nationalism, while exclusionary regimes are much more likely to emphasize economic efficiency.[39] The difference is understandable, but terribly costly: it means that inclusionary regimes stack the cards against their own survival.

Two Peruvian analysts carry the point one crucial step further, by arguing that inclusionary populist regimes <u>cannot</u> succeed: a government which wishes to appeal to urban workers, industrialists, and primary producers as well, will choose policies that lead "indefectiblemente" to economic crisis.[40] Specifically, they argue that populist governments always overload the system by trying to help too many groups at once. Failure to impose an aggregate limit may not be fatal as long as good luck with exports keeps up the supply of goods and services, but the regime falls apart whenever exports fail to grow. "The deterioration of the external sector leads to slower rates of economic growth, which make it impossible to satisfy the claims of the social groups. In this way the repressed inflation explodes and with it the popular alliance."[41]

It is so often true that reform governments in Latin America break down in conditions of external crisis and inflation that Pennano and Schuldt must be correct in pointing to export performance as crucial. But is it only an incurable optimism which suggests that a breakdown is not inevitable? Two considerations seem to be missing in the argument.

One is that governments could favor all social groups, in the sense of making sure that all of them share in rising national income, without abandoning the necessary sense of a total that cannot persistently exceed the productive capacity of the system. This means that favors have to be limited, which they do. Some form of planning agency has to keep score to see if the parts add up, but that is surely not beyond the capacity of Peru or any other Latin American society now. What _is_ essential is that the concept of an upper limit be a matter of concern.

The other missing consideration, or misconception, is that nothing independent can be done on the export side, because export promotion can work only "at the expense of industrial development."[42] Almost everyone concerned with Peru seems to have been spellbound by the past absence of industrial exports, as if that were an eternal fact of life. It is instead a function of competing resources and incentives. Peru has been far behind other developing countries at its income level in this respect, partly because its primary resources were so rich and partly because public policy did not create the conditions under which investment in production and marketing of industrial exports was attractive to either private or public firms. This is an omitted line of policy which is just now getting a trial. It is not in itself a sufficient way out of Peru's present difficulties, but it is a way to gain space in which to move, a way which could help both to revive production and employment and to restore some semblance of autonomy by lessening the need for foreign credit.

So What to Do Now?

For Peru, the room for maneuver in the next few years is limited and the outlook grim. With the present burden of debt service and the import-dependent industrial structure fostered in the last decade, the government has little bargaining power to oppose to foreign creditors, and in particular to the International Monetary Fund. By running up such extraordinary debts the military governments from 1968 to 1978 have undermined the limited degree of autonomy Peru had to start with.

The IMF is surely right in some of the policies it has been forcing on Peru, and probably not helpful in others.[43] The country will regain strength more rapidly if military spending is restrained, tax privileges are reduced, exchange rates are kept favorable for exports, and the unlimited protection previously offered to Peruvian industry is replaced by a much lower and more selective system. On the other hand, it is not helpful to keep forcing down liquidity in real terms when the level of aggregate demand is already far below productive capacity. This makes unemployment worse than it need be, and poverty greater, while handicapping the investment necessary to change the structure of production.

There is no escape from the need to hold consumption down to fit the capacity to produce. But it is being held _below_ that capacity now. And fiscal policy permits choices with respect to the distribution of the restraints that are necessary. Steep taxes on consumer durables and on high incomes could spread the burden more equally than the present

approach of reduced aggregate demand without such changes in tax structure. Similarly, capital equipment could and should be made more expensive relative to labor, through the exchange rate, tariff policy, and positive real interest rates. This should shift the flow of income toward labor in the long run, and also make the structure of production less dependent on imports.

With respect to the structural reforms, the sad position at the moment is that most of them have been effectively reversed. The one major reform still intact is that of land ownership in agriculture. Since the land reform was not a main cause of the present problems, and since for all its imperfections it marked a great improvement in the political and social balance of the country, to reverse or undo it in any wholesale way would be pointless in terms of the present crisis and tragic in terms of the prospects for reasonably just long-term growth. It may be that the conditions of the poorest people in the rural sector could be improved by breaking down tendencies of existing collectives to build up their own special privileges and to bar new membership, and it may be that more individual rights are needed to stimulate production growth, but these never-ending operational problems need not call into question the achievement of eliminating the traditional haciendas.

The social property sector, the scheme for shared worker ownership, and the state-owned firms themselves, all needed rethinking and redesigning. It may be best for all concerned that these institutions go through a searching process of criticism and redirection for the time being: they had promising characteristics but many unnecessary problems. The fundamental question is: will Peru be able to maintain a sufficiently open society that such reform measures can be tried out in more constructive ways once the crisis is past?

The job security offered in the Ley de Estabilidad Laboral is a particularly nasty issue at present. The law has been thoroughly watered down, by requiring a three-year period of employment before workers become eligible for the protection, and by revised interpretations that make it much easier to get rid of specific workers. But it is not quite dead. The intensity of the efforts to eliminate it reflects the very real problem for firms that they are unable to make general cuts in their wage costs in a period in which macroeconomic policy is driving down demand. Coupled with the squeeze on liquidity, the law greatly increases the risks of bankruptcy. On the other hand, it converts labor into a fixed cost and encourages choices of higher output as a way to minimize losses. It holds back the socially undesirable reaction of firms to reduce output because of weak aggregate demand. A more positive solution would be to stimulate aggregate demand again, both by way of export promotion and for domestic consumption, until the existing labor force in industry can be more fully utilized. The social retrogression of taking away job protection is itself a cost that should be weighed heavily against potential gains on the side of efficiency, especially when the latter could be achieved by an increase of production desirable in its own right.

Conclusion

The courage and imagination needed to break through the constraints of an unjust social order do not often come combined with the patience and attention to consistency needed to make the new system work. In Peru, the groups able to shape policies seem to divide into reformers unable to achieve a coherent economic program, and opponents able to design consistent economic policies but unable to achieve reforms. Success would require a bridge, or coalition, or capacity to compromise, including both sets of positive qualities. Revolutions, or even modest reforms, need to be followed by consistent economic policies if they are to survive. In Peru, as so often in Latin America, they were not.

The most costly inconsistencies were the combined choices of incentives that fostered an increasingly import-dependent structure of production, a foreign exchange regime adverse to exports, and a public sector deficit that raised demand much faster than the capacity to produce output. Recourse to increasingly tight controls on trade and prices as the tensions mounted served only to divert pressures to the external sector and give the breakdown its form of a foreign exchange crisis. If all external conditions had been favorable the system could have lasted longer, but the eventual breakdown would have been much the same when it came. The crisis was ensured by a non-workable strategy.

The main danger at present is that the extreme tensions generated by what seems to be a colossal failure, and by the drastic measures being taken to reorient production and restrain demand, may provoke the creation of yet another repressive totalitarian system. Peru does not need to fall into this deadly trap. Reasonably good economic management should make it possible to get out of the present crisis without further reduction of real wages and living standards. Demand is already far below productive capacity, exports are responding to improved incentives, interest rates are at a level more consistent with reality, and even military spending seems to be coming under some degree of restraint. If the country can avoid the installation of a repressive system it still has a chance for successful transformation.

A key step needed toward a viable economic system in the near future is to make the industrial sector begin to focus on exports. This requires a consistent set of promotional policies, not pushed so hard as to reduce real income in the primary sector or real wages, but adequate to pull a major share--a fourth or more--of industrial production into exports on a steady basis. Coupled with an agricultural sector that has been transformed from a stronghold of resistance to change, an industrial sector capable of exporting could give Peru a good chance for a more equalitarian set of economic policies consistent with growth. To get an industrial sector capable of exporting, without sacrificing the interests of agriculture or urban labor, is not going to be easy. But there is nothing inherent in the Peruvian situation which makes it either impossible or dependent on totalitarian methods.

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[24]Bela Balassa, "Export Incentives and Export Performance in Developing Countries: a Comparative Analysis," World Bank Staff Working Paper no. 248, January 1977.

[25]Banco Central de Reserva del Perú, Memoria 1976, anexo XXVII, p. 175. These figures do not fully agree with other sources, even with cuadro 8, p. 33, in the same document. The pattern of change, with rising exports through 1974 and a plunge in 1975, does agree with other measures. Data for all exports classified as "non-traditional " are given in table 2 below. They show higher figures in all years, a three-fold increase from 1970 to 1974, and a decrease in 1975.

[26]Cf. Krueger, op. cit., pp. 203-205. For the ten developing countries included in her econometric analysis, the effective exchange rate proved to have a systematic positive effect on the rate of growth of non-traditional exports, but not significant consequence for traditional exports.

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[30]The scale of these subsidies is discussed below. They were allied to imports made by state trading firms. These firms handled nearly all the imports of the public sector, which in turn constituted 30 percent of all imports for the period 1971-76. See Carlos Boloña, "Las importaciones del Estado: aspectos teóricos y el caso peruano, 1971-1976," Apuntes, No. 8, 1978, pp. 99-141.

[31]"Información estadística entregada por el Señor Ministro de Economía y Finanzas, con motivo de su exposición al país el día 14 de junio de 1978," Lima, 1978. The main official interest rates in Peru were held constant, regardless of financial conditions, for all these years. Details of interest rates and an excellent analysis of their consequences are given in "Propuestas para la adopción de una política de tasas de interes," Banco Central de Reserva, Marzo 1978. Official interest rates were doubled on August 1, 1978.

[32]U.S. Arms Control and Disarmament Agency, World Military Expenditures and Arms Transfers, 1966-73, Washington, 1976. It might be noted that in this period of rising military expenditures, salaries of officers were exempt from income taxes.

[33]"Información estadística entregada por el Señor Ministro de Economía y Finanzas, op. cit.

[34]Instituto Nacional de Planificación, Oficina de Investigación y Capacitación, "El caso de la deuda pública Peruana: 1965-1975; Las empresas transnacionales y el endeudamiento externo," Lima, Mayo de 1977.

[35]McClintock, "Reform Governments and Policy Implementation: Lessons from Peru," chapter 3 of draft manuscript. See also her paper "The Ambiguity of Peru's Third Way: Costs and Benefits," Latin American Program Working Paper No. 23 (Washington, D.C.: Woodrow Wilson International Center for Scholars, 1979).

[36]Hirschman, "The Turn to Authoritarianism in Latin America and the Search for its Economic Determinants," op. cit. Charles de Gaulle felt much the same way: it is up to the General to decide, and "l'intendance suivra."

[37]INP, "Devaluación," Documento de Trabajo, Octubre 1975, p. 21A. This is an internal working paper and not an official position of the INP.

[38]Sheahan, "Market Oriented Economic Policies and Political Repression in Latin America," op. cit.

[39]Stepan, op. cit., especially pp. 73-81 and table 3.1.

[40]Guido Pennano y Jűrgen Schuldt, "Premisas y antecedentes para la evaluación del proyecto del Plan Tupac Amaru," Apuntes no. 6, 1977, p. 57. Alex Fort points out that it is an exaggeration to say that the Velasco government tried to help everyone: the rural sector was sacrificed quickly when the government had to choose between farmers and urban consumers on food prices.

[41]Ibid., p. 59.

[42]Ibid.

[43]Negotiations with the IMF are detailed and discussed in Hugo Cabieses and Carlos Otero, Economía Peruana: un ensayo de interpretación (Lima: DESCO, 1978), pp. 133-206. See also the lively critique of the running battle between the IMF representatives and the government in Actualidad Económica no. 2, Marzo 1978.