Number 31

THE PERUVIAN EXPERIMENT IN HISTORICAL PERSPECTIVE

by Rosemary Thorp
University of Oxford

Author's note: This paper was presented at the November 2-4, 1978 Workshop of "The Peruvian Experiment Reconsidered" organized by the Latin American Program of the Woodrow Wilson International Center for Scholars, Smithsonian Institution, Washington, D.C. 20560. The author wishes to acknowledge the contribution of Geoff Bertram, who co-authored the book on which the first and some of the second sections of the paper draw.

This essay is one of a series of Working Papers being distributed by the Latin American Program of the Woodrow Wilson International Center for Scholars. This series will include papers by Fellows, Guest Scholars, and interns within the Program and by members of the Program staff and of its Academic Council, as well as work presented at, or resulting from seminars, workshops, colloquia, and conferences held under the Program's auspices. The series aims to extend the Program's discussions to a wider community throughout the Americas, and to help authors obtain timely criticism of work in progress. Support to make distribution possible has been provided by the Inter-American Development Bank. Single copies of Working Papers may be obtained without charge by writing to:

Latin American Program, Working Papers
The Wilson Center
Smithsonian Institution Building
Washington, D.C. 20560

The Woodrow Wilson International Center for Scholars was created by Congress in 1968 as a "living institution expressing the ideals and concerns of Woodrow Wilson . . . symbolizing and strengthening the fruitful relation between the world of learning and the world of public affairs."

The Center's Latin American Program, established in 1977, has two major aims: to support advanced research on Latin America, the Caribbean, and inter-American affairs by social scientists and humanists, and to help assure that fresh insights on the region are not limited to discussion within the scholarly community but come to the attention of persons interested from a variety of other professional perspectives: in governments, international organizations, the media, business, and in the professions. The Program is being supported by three-year grants from the Ford, Kettering, Rockefeller, and Tinker Foundations and from the Rockefeller Brothers Fund.

ABSTRACT

The Peruvian Experiment in Historical Perspective

The paper examines the difficulties of the post-1968 military government in the light of certain long-run trends and consequences of Peruvian development. It argues that the rich resource base of Peru, the resultant large role of foreign capital, weak industrialization and role of the State all come together to explain both the elements of the post-1968 crisis and the lack of the means to handle it. Unfortunately, the chosen strategy required precisely the developed State and strong industrial sector which, for historical reasons, did not exist.

THE PERUVIAN EXPERIMENT IN HISTORICAL PERSPECTIVE

by Rosemary Thorp
University of Oxford

This paper attempts to shed light on the relationship between the difficulties and apparent failure of the experimental regime which took power in Peru in 1968, and certain long-run trends and consequences of Peruvian development in the twentieth century. The first section summarizes those long-run trends and consequences, drawing heavily on a detailed analysis made elsewhere,[1] while the subsequent sections discuss the first and second phases of the military government and explore how far the problems faced by each are linked to the historical pattern we have discerned.

The perspective is that of an economist, but one very conscious of the need for an interdisciplinary understanding in such a field. The paper was substantially aided by that presented by Julio Cotler to the same workshop,[2] and is essentially intended to be read as a complement to his work. The paper is also intended to complement and push further a number of the insights offered by other contributors--in particular E. V. K. FitzGerald's contention that the regime came about partly in <u>response</u> to the lack of a strong industrial bourgeoisie,[3] and John Sheahan's comment that "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."[4]

Our concern, then, is particularly with the kind of developmental problem produced by history as against the character of the agents available to confront that problem, themselves also the product of that same history.

Long-Run Trends in Peruvian Development

Peru's twentieth-century economic history is dominated by the fact that the country has possessed an exceptionally well endowed natural resource base, of an unusually diverse type. This has provided the basis for a succession of export booms: sugar, cotton and mining in the 1890's, oil and copper through the first decades of the twentieth century, cotton again and lesser mining products emerging soon after the 1930 collapse, and mining and eventually fishmeal providing the post-World War II impetus. The richness of the resources has meant that the country has, from a short-term point of view, quite rationally been knit particularly tightly into the international economy as a primary producer. Industry developed exceptionally slowly by Latin American standards,[5] since the forces pushing the economy to an export-led focus were stronger than elsewhere. In certain periods of strong export growth, the income and linkage effects were fairly strong (particularly from cotton), but this was not enough to compensate, in comparative terms, for the relative absence of government policy to promote diversification, policies which elsewhere arose originally from necessity, in due course building the class interests to sustain them. This was consolidated by the manner in which foreign capital was built into the process: it was, throughout, a crucial element in the story, above all in mining and in oil, but it was always present in a manner which allowed a fruitful symbiotic relationship with domestic capital--both because it never dominated all export sectors, and, more importantly, because in mining in particular the large foreign companies found it preferable to buy in the products of a number of Peruvian producers, rather than completely buy out the entire producing sector.[6] This symbiotic relationship, plus its corollary of significant profit opportunities within the export sector for the domestic elite, further weakened forces which elsewhere led to the development of "nationalist" groups, protectionist pressures, and in general a more interventionist style of policy-making, with resulting feedback effects on the development of administrative capabilities and structures.

This entirely logical pattern of development, then, had produced by the 1960's a rather distinctive situation, where the product of export-led growth was a rather underdeveloped state and a weak industrial base, and reasonably enough rather weak industrial groups strongly integrated with, and responsive to the manner of thinking of, foreign capital. This attitude, which has been discussed and documented elsewhere,[7] can perhaps be seen most vividly in the response of domestic elite groups to opportunities in the booming fishmeal business in the early 1960's, just as opportunities in the export sector in general were, as we show below, for almost the first time becoming considerably less attractive. Much Peruvian capital entered the sector--but largely indirectly, via the banking system, and only on the back of foreign capital. The most illustrative quote comes from a distinguished member of the Peruvian business elite, as he finally decided in 1964 to move into fishmeal in partnership with Mecom, a Texas oilman: "This whole fishmeal business has always smelled highly to me. But if Mr. Mecom is interested, why then, it smells like a rose."[8]

But this is only part of the significance of the historical pattern: we also find by the 1960's that Peru was confronting no less than the bankruptcy of the old socio-economic model which in part generated this constellation of forces and was essentially in harmony with it. In other words, by the 1960's the old export-led model was running into a deep-rooted crisis, stemming both from physical/technical aspects and, more profoundly, from inconsistencies between the needs of resource development and the changing socio-political context. This crisis manifested itself in two major and interrelated forms: in the increasingly profound stagnation of exports and of investment.

The basic data on each are given in Tables 1 and 2.

TABLE 1

QUANTUM INDEX OF EXPORTS, 1960-77

1960	76	1971	102
1964	100	1972	110
1965	97	1973	81
1966	96	1974	81
1967	100	1975	76
1968	112	1976	74
1969	101	1977	93
1970	109		

SOURCE: 1960-69: Thorp and Bertram, Peru 1890-1977: Growth and Policy in an Open Economy; 1970-77: Central Bank, Memoria and unpublished data.

TABLE 2

INVESTMENT AS A PER CENT OF GDP

	Private	Public
1955-58	17.5	4.8
1959-63	15.3	3.3
1964-68	10.8	4.6
1969-73	7.9	4.8
1974-76	6.5	8.8

SOURCE: E. V. K. FitzGerald, The Search for National Development: The Political Economy of Peru 1956-76 (Cambridge University Press, 1979).

As Table 1 shows, Peru by the 1960's was facing an extraordinary stagnation of export supply--a situation unique in her economic history, since for once it was not a problem of external markets, as it had been both for guano and again in the 1930's. In Table 3, the detailed figures for production since 1955 reveal how uniform was the deceleration during the 1960's. (Mining is the one exception, which we discuss below.) This deceleration was in part the product of natural resource constraints, as in fishing (though aggravated by poor resource management). Table 3 shows the dramatic fall in the anchovy catch after 1971, reflected in the quantum of fishmeal exports. Oil likewise faced a constraint of nature: despite great hopes and large investments by the multinationals, little was found. Production rose very little during 1963-68, and not at all thereafter.

In other instances the problem was rather that the projects necessary to relieve the constraint were of a scale and complexity that they apparently required a more dynamic and developmental state than was the product of this type of model. This was the case in agriculture, where major irrigation projects on the coast were necessary to relieve the supply constraint both for cotton and for sugar. Table 3 shows that both products had reached a plateau by the mid-1960's.

Yet another inconsistency was evident in the remaining and crucial product: copper. Here the problem was that the kind of conditions which the multinational companies had come to expect in Peru--conditions of extreme liberality and security for such companies--were now becoming inconsistent with new social and political trends. In this sector there was no problem of a natural resource constraint: potential supply was abundant. However, the major deposits were all in the hands of multinational companies, and during the 1960's these companies carried out no major investments--the full import of which went unnoticed for a time since supply rose sharply with the coming into production of the Toquepala copper mine and the Marcona iron-ore project in 1959-60. This failure to invest on the part of the multinationals was related to broad changes occurring in Peru in the 1960's, which manifested themselves in the form of a growing disillusion with "old-style" growth--partly with its overall performance but more with its distributional aspects. With political and social changes as the economy grew in breadth, and with increasing awareness of the implications of foreign penetration, came a growth in nationalism and a sense that the traditional oligarchy had betrayed its responsibilities. We are familiar with the manner

TABLE 3

THE VOLUME OF PRODUCTION OF MAJOR EXPORT PRODUCTS
(Annual Averages, Indices, 1965-69 = 100)

	Cotton	Sugar	Fish-meal	Copper	Iron Ore	Silver	Lead	Zinc	Petro-leum
1945-49	60.9	57.8	0	12.7	0	31.5	34.0	21.2	58.3
1950-54	81.6	69.6	0.6	16.8	20.9	48.7	59.2	42.8	64.1
1955-59	101.7	92.3	7.2	25.4	38.0	70.0	80.8	53.9	72.9
1960-64	127.4	109.7	64.5	91.7	71.2	94.4	88.7	65.9	83.3
1965-69	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
1970-74	79.9	108.8	78.4	110.8	87.9	113.1	113.2	137.7	100.8
1975-76	59.5	111.5	42.6	108.2	48.8	103.4	115.5	157.4	108.0

SOURCE: Thorp and Bertram, Peru 1890-1977: Growth and Policy in an Open Economy, Tables 11.9, 12.2, 12.3, 12.5, Banco Central Memoria, sectoral yearbooks.

in which these changes were to culminate in pressures for radical ownership reforms after 1968; in the meantime they interacted with other factors to aggravate the structural crisis--for example by precipitating the withholding of investment by the multinationals in the mining sector during the 1960's, in the hope of pressuring the government into a return to its former liberal attitude.

In the 1960's the role of non-traditional exports was still minuscule: Peru was still moving into import substitution at this point and almost nothing was as yet being done towards export promotion. "Other products" amounted consistently to some 5 percent of total exports during the whole decade.

The problems in the export sector in turn explain the decline in the investment coefficient (Table 2) (though this is related also to rural unrest and the prospect of land reform, which led to a decline in investment in agriculture). Expansion of state spending to compensate for the declines in private investment and exports, without adequate financing, led to growing foreign debt under Belaúnde, while the slowdown in other sectors led to the promotion of industry along the typical lines of high import content and foreign technology, which also aggravated the balance of payments situation.

The coup of October 1968, which resulted in the military government of Velasco, has been analysed at many different levels. It is clear, however, that whatever else it was a response to, it was also in part a response to the emerging crisis that we have here described. The new government faced an enormous development task: the motor of accumulation in the economy had to be revived, and the supply bottleneck in exports broken, in a way that at the same time responded to the pressures for a somewhat wider and more nationally biased distribution of benefits than that yielded by the old system. Yet we have seen how at least part of that problem was a product of the inadequacy not merely of physical also of human resources, in the form of a lack of either a strong domestic industrial class or a well-developed and experienced state. Clearly, in the short run, such problems were also constraints on the solution.

Partly because of the political autonomy which Cotler has demonstrated, and the temporary economic autonomy provided by rising world commodity prices,[9] the response of the Velasco government was the radical-nationalist one with which we are all familiar. The next two sections discuss the difficulties experienced first by the Velasco regime, and then by the "segundo fase," the name given to the period since August 1975 when Velasco was replaced by Morales Bermúdez.

The Velasco Strategy vis-à-vis the Problems

The Velasco policies need no description here: their content, their implicit assumptions, and their remarkable effect on the ownership structure have all been fully documented.[10] Basically, the military perceived the traditional "Peruvian model" of export-led growth as running increasingly into difficulties, both in terms of its macro-economic performance as export and investment growth weakened, and in terms of its distributional aspects. Their strategy[11] to confront this situation assumed that the structural and distributional aspects of the problems were strongly related, and in a rather straightforward fashion. They claimed that it was the monopolisation and misallocation of economic resources by the oligarchy and by foreign investors that was responsible for the weakening of growth, for the growing disequilibrium, and for the failure of growth to filter adequately through the system, It therefore followed, they argued, that major ownership reforms were the crucial element necessary to release potential and achieve a restructuring of the economy. The concrete goal[12] was "new-style" export-led growth, with higher value-added in the export sector, and increased integration into the local economy. Central to their planning with respect to the balance of payments was the implementation of major mining projects in the newly expanded state sector. Gains would also come from import substitution in intermediate products and reduced outflows on account of profits, technology, etc., once the role of foreign firms was reduced and/or their activities more regulated. Non-traditional exports were now to be seriously promoted. With the ownership reforms and with increased protection, the domestic private sector would begin again to play its part, while the appropriation of profitable export sectors would itself help to provide a source of funds.

Unfortunately, a number of inconsistencies and false assumptions underlay this major and striking effort at reform. The assumptions can be reduced to four. First, it was believed that there was great latent potential in the Peruvian private sector which would respond to the nationalistic reforms with a surge of investment. Second, nationalisation was presumed to give access not merely to potential but to actual surplus. Third, a continued role for foreign investment on new terms was thought to be quite compatible with the government's plans. All these assumptions had implications for a fourth underlying premise: that in various rather unclear ways, the reforms would have significant and fairly rapid dividends in terms of the various disequilibria affecting the economy.

It will be obvious that the government was soon to be disillusioned on all fronts. First, the Peruvian private sector--not noticeable for its dynamism anyway after years of domination by foreign capital--had its confidence badly shaken by the Industrial Community legislation and by the generally increased level of intervention in the economy. The resulting low level of investment is shown in Table 4; growth between 1970 and 1973 was only 10 percent in total, despite the low absolute level of 1970. There was a fair amount of reinvestment of profits, since this was a means of avoiding the distribution of profits to the Industrial Community--but this was typically a second-best strategy, the best being to make no apparent profit at all, using techniques such as overpricing to remove capital from the firm and the country.[13] The overall result was a continuing fall in private investment as a percentage of GNP--despite the almost total protection available.[14]

TABLE 4

GROSS DOMESTIC PRODUCT BY EXPENDITURE 1970-77
(Indices, 1970 prices, 1971 = 100)

	1971 (bil. soles)	1970	1972	1973	1974	1975	1976	1977
Private consumption	177.5	96	104	117	128	132	135	135
Public consumption	30.9	94	109	113	118	134	138	148
Gross fixed investment	38.8	82	107	113	147	177	149	116
Public	12.6	87	109	128	201	225	213	143
Private	20.3	94	106	103	114	147	134	107
Exports	45.2	105	109	89	84	81	82	93
Minus Imports	39.3	100	100	109	144	162	136	125
Gross Domestic Product	253.0	95	106	112	120	124	128	126

SOURCE: Banco Central *Memoria*, 1977, and data supplied by the Bank.

Second, the facile expectation that nationalisation of a previously profitable foreign firm would give ready access to surplus proved false: enterprises often proved on takeover to have been run down, if not decapitalised, and to be actually in need of an input of funds.[15]

Third, it proved, not surprisingly, to be decidedly difficult to persuade foreign firms to invest on the scale required by the planners. What were to prove disastrous delays occurred, as deals were negotiated with very great difficulty, and eventually at the cost of some shift in the government's position.

We have seen that the all-important sector with regard to the export supply constraint was copper, and that the problem lay in the control by multinationals of the large deposits, which were already long overdue for exploitation. The problem was thus one of negotiation with the companies in a manner compatible with the overall goals of the regime. This story is also familiar;[16] in fact, after prolonged negotiations, the companies involved failed to proceed with the development of their concessions, and in late 1970 these were expropriated and passed to the new state company Mineroperu, which was given a monopoly of mineral export marketing, control of future projects in the area of metal refining, and the task of developing the mineral deposits recovered from foreign control. Further delays occurred, however, in financing the projects, chiefly as a result of the failure to settle the dispute with Standard Oil over the expropriation of IPC in 1968. It was only the signing of the Greene Agreement with the U.S. Government in February 1974 that ended the four-year freeze on credits for the development of the Cuajone copper mine--the most critical of the export expansion projects, completion of which had become dependent on the availability of U.S. finance through the Export-Import Bank.

As to the fourth assumption, there is no evidence, for example, that nationalisation did much to improve the balance-of-payments impact of the sectors in question--partly because the whole area of the costs implied by dependence on foreign firms and on foreign technology was not seriously tackled by the military government. Presumably there was some reduction of profit outflow with nationalisation--but in contrast to Chile, the Peruvians were willing to pay compensation, and outflows on account of technology and capital goods continued unabated.[17]

The only attempt to seriously tackle the question of outflows of foreign currency came in 1974. An import-control system had existed since the early years of the regime, but in name only: now reforms were introduced in the nature and functions of the Junta de Transacciones Externas (at that time an organ of the Ministry of Economy and Finance) designed to create an effective system of import control and to permit long-term planning of imports, using import permits and regulation of financing. But apart from grave difficulties arising from lack of information, the experiment proved short-lived once it conflicted seriously both with the private sector and the government itself over import needs.

But the problem was not only a question of false assumptions. It has to be admitted--even by those most sympathetic to the goals of the Velasco regime--that there was also considerable misallocation of limited resources and a total failure to develop adequate budgeting and control techniques to monitor the spending of the mushrooming public agencies and even of the ministries themselves.

Misallocation in terms of economic criteria seems to have been particularly conspicuous in regard to the food-supply bottleneck. Food is intimately tied up with the whole question of agricultural policy, which goes far beyond the scope of this paper. It is well known, however, that a serious effort was made to accelerate the land reform begun under Belaunde, while the complex infrastructure required to support such a process was almost entirely lacking. The main hope for increasing food production in the medium term was placed in major irrigation projects. Some were however to produce cotton (e.g., Chira-Piura); the main project aimed at food supplies--Majes--is widely regarded as a grave error in economic terms, and only comprehensible in geo-political terms.

The only area where the results were somewhat more promising was that of exports. An export promotion scheme ("Certex") was introduced in 1968, involving rebate of certain duties and taxes and exemption from others, in varying amounts according to a product-ranking on the basis of a number of criteria. The application of the scheme was gradually widened between 1970 and 1974 so that it successfully counteracted the effect of the frozen exchange rate. Table 5 shows that the effect of the rebates and exemptions was on average a subsidy of some 22-25 percent (this was increased with the 1976 reforms[18]).

TABLE 5

NON-TRADITIONAL EXPORTS AND INCENTIVES

	Non-traditional exports as % of total			
	Total	Under Certex Scheme	Manufactures only	Rebates and exemptions as % of value of Certex export
1970	5.4	1.2	0.3	22.0
1971	5.0	1.8	2.3	22.0
1972	6.7	3.4	4.1	25.5
1973	9.6	7.0	8.2	24.3
1974	10.4	8.1	8.2	23.9
1975	8.2	5.7	5.2	23.8
1976	9.8	7.1	6.9	31.5
1977	12.8	9.6	8.9	32.4

SOURCE: Hugo Gonzales Cano, "Evaluación de los Incentivos Tributanos a las Exportaciones no Tradicionales en Perú," (Buenos Aires, Programa del Sector Público de las OEA, 1978); and data provided by the secretariat of the Ministry of Commerce.

The rise in non-traditional exports is shown in the same table (Table 5); it was certainly significant up to 1974, after which point the rise in internal prices and the constant exchange rate discouraged exports. But it should be noted that by 1974 the figure was still only 10 percent of exports, and within that are included many products with relatively low value added. And a 1977 World Bank report on exports of manufactures from Latin American countries found that Peru had per capita the lowest figure of any country except Ecuador, and a growth rate 1972-74 that was far below the average.[19]

The result of all these factors was that while on the one hand the government was forced to do more than it had originally intended, given the failure of the private sector, on the other hand the resources available to finance that increased role were less than anticipated. The problem became worse as the modern sector labour force, its expectations aroused by government propaganda surrounding the creation of labour communities, began to press for a larger share of the cake, thereby cutting still further into state enterprise profits. Real wage and salary figures are shown in Table 6.

TABLE 6

REAL WAGES AND SALARIES IN LIMA[a]

	Wages	Salaries
1970	76	86
1971	84	92
1972	92	96
1973	100	100
1974	94	92
1975	94	88
1976	98	77
1977	79	65

[a]These are the figures published by the Ministry of Labour for enterprises with 10 or more employees. Unofficial estimates exist giving a large fall in real terms 1973-76--for example, figures cited in Stallings (1978), showing a fall of 30 percent in wages 1973-76, where the Ministry data show only 23 percent.

SOURCE: La Economia Peruana en 1977 (Universidad Catōlica).

This became a problem for the regime basically because of a final and important inconsistency: that between the redistributive goals of the regime, which prescribed controlled prices of certain basic products, and the lack of a base for a rational solution to the resulting financial problem, once costs began to rise. The obviously logical solution was tax reform. But the military was unprepared to bite either into profits or the living standards of the middle classes.[20] Their unwillingness was made more feasible by the coincidence of acute financial need with surplus world liquidity--and a moment of peak optimism, internally and externally, about Peru's creditworthiness. This was the period not only of the commodity price boom, but also of the first oil strikes in the Peruvian selva. Unfortunately, the nature of the early strikes was such as to provide at least some ground for supposing that they represented a single source, leading to Petroperu's commitment to a production of 200,000 barrels a day[21]--a prediction which, especially once the oil price rose late in 1973, made it entirely rational to borrow abroad.

Perhaps the most vivid commentary on this period is given by Table 7, which shows export projections made in early 1974, compared with actual exports in 1977. These are Peruvian estimates made for the Paris Club negotiations of 1974. What is remarkable is the extent to which the optimism is universal. Apart from

TABLE 7

EXPORT FIGURES FOR 1977: PROJECTIONS AND REALITY ($000)

	1977 projection as of 1974	1977 actual	Degree of over or under estimation
Fishmeal			
Value	420	179	+135%
Volume (000 tons)	1,400	430	+226%
Price ($/ton)	300	416	- 28%
Cotton			
Value	84	50	+ 68%
Volume (000 q.q)	1,020	485	+210%
Price ($ q.q)	83	104	- 20%
Sugar			
Value	254	81	+214%
Volume (000 tons)	450	413	+ 9%
Price ($/q.q)	26	9	+187%
Coffee			
Value	69	196	- 65%
Volume (000 tons)	52	43	+ 21%
Price ($/q.q)	61	210	- 71%
Wool			
Value	12	18	- 33%
Volume (000 tons)	3	3	0%
Price ($/ton)	3,820	5,749	- 34%
Copper			
Value	737	392	+ 88%
Volume (mil. tons)	418	331	+ 26%
Price (US¢/1b)	80	54	+ 48%
Iron ore			
Value	85	97	- 12%
Volume (mil. tons)	9	6	+ 50%
Price ($/ton)	9	15	- 40%
Silver			
Value	144	179	- 20%
Volume (mil. oz)	42	41	+ 2%
Price (US¢/oz)	347	434	- 20%
Lead			
Value	82	87	- 6%
Volume (000 tons)	247	172	+ 44%
Price (US¢/1b)	15	23	- 35%

TABLE 7 (continued)

EXPORT FIGURES FOR 1977: PROJECTIONS AND REALITY ($000)

	1977 projection as of 1974	1977 actual	Degree of over or under estimation
Zinc			
Value	172	155	+ 11%
Volume (000 tons)	460	422	+ 9%
Price (US¢/lb)	17	17	0%
Petroleum			
Value	396	43	+821%
Volume (mil. barrels)		3	
Other products			
Value	400	221	+ 81%
Total	2,865	1,735	+ 65%

SOURCE: Unpublished data.

the fact that they have not foreseen the Brazilian frost and the resulting effect on coffee prices, while the beneficial effect of the 1976 exchange reforms and other measures on small and medium mining (i.e., zinc, lead, and silver) mean the overestimation there is somewhat less than in other cases, the phenomenon is widespread, and in volume more than in price.[22]

But this moment of peak optimism as to creditworthiness also coincided, as we have mentioned, with the peak of the boom in international lending following the growth in world liquidity in the early 1970s and the appearance of the Eurodollar market. These events are particularly significant when combined with the fact of recession in the industrialized countries following the oil price increase, for as "first class borrowers" dropped out of the market, the banks actively sought out clients among countries normally ranked as "second class" borrowers. This new source of borrowing available to Third World countries was relatively more expensive than official loans, but attractive because the loans came on exclusively commercial terms and free of all strings. By 1974 Peru was the fourth largest LDC borrower in the Eurodollar market.

External borrowing, then, was the solution chosen, with the results shown in Tables 8 and 9, and already described above. It was supported and approved by external agents: the World Bank's appraisal in October 1974 was that "the level of non-project borrowing appears justified as a means for bridging Peru's resource gap until mineral and possibly petroleum exports expand substantially starting in 1977-78."[23] But predictably enough, given the hostility of the World Bank and the U.S. government to the brand of radical nationalism displayed by Peru since 1968, ready access to the international capital market could be obtained only by moderating various elements of the military's policies.[24] As we saw above, in February 1974 Peru signed the Greene Agreement with the U.S. Government. The central feature of this agreement was payment by Peru of $150 million as full settlement of all outstanding disputes[25] with U.S. business interests in exchange for which the U.S.A. withdrew its opposition to the granting of loans to Peru.

The result was that new contracted debt, having risen by 100 percent in 1973, rose a further 26 percent in 1974. As Table 9 shows, of the new debt contracted in that year, the item "other" accounted for 26 percent, reflecting the growing concern about the possibility of a conflict with Chile.[26]

What is not shown in these tables but is extremely important, however, is the rise in short-term borrowing which also began to occur. This was in large part a product of the inadequate financial arrangements made for the wide range of new state enterprises. Without proper provision for their working capital needs, and limited by law as to local borrowing, these enterprises were also in many cases unable to generate their own resources through pricing policy, either because they lacked market or political power, or because, as we have mentioned, the distributional policies of the Velasco regime made low prices of basic products of overwhelming importance. The notorious case is that of Petroperu, whose external debt now began to rise at an alarming rate. The result of the extensive borrowing abroad in 1974 was that international reserves actually rose in that year by U.S. $282 million, despite a current account deficit of -$807 million (Table 10 below).

These credits thus financed the rise in imports which now began to occur: it is beyond doubt that they also encouraged them, by providing an incentive to higher import content.[27]

TABLE 8

EXTERNAL PUBLIC DEBT 1968-77[a]
(Mil. Dollars)

	1968	1970	1971	1972	1973	1974	1975	1976	1977
Gross inflow	199	190	183	286	673	1035	1077	846	993
Servicing	140	167	213	219	433	456	474	533	635
Net inflow	143	23	- 30	67	239	579	603	313	358
Outstanding debt	797	945	997	1121	1491	2182	3066	3641	4243
Debt services as % of exports	15	16	24	23	39	30	37	39	37

[a]This is debt of more than one year. If short-term debt and private-sector debt is included, the figure for outstanding debt as of 1978 is estimated at around $9 billion.

SOURCE: Banco Central Memoria, 1976, p. 169, and unpublished figures.

TABLE 9

NEW CONTRACTED DEBT BY USE 1968-76
(Billion Dollars)

	1968	1970	1971	1972	1973	1974	1975	1976
Primary	5.0	0.5	76.4	104.9	153.1	339.6	30.1	30.1
Secondary	30.7	15.2	6.0	110.2	113.7	33.8	84.6	188.6
Tertiary	29.5	25.2	103.3	142.1	135.4	406.0	445.9	372.6
Refinancing	93.0	49.5	3.1	114.6	293.0	135.4	160.0	15.0
Other[a]	16.7	64.8	29.3	23.3	329.5	379.5	263.1	772.6
Total	123.7	225.6	220.9	500.2	1024.7	1294.2	984.3	1382.9

[a]Generally understood to comprise principally defence.

SOURCE: Oficina de Crédito Público, Ministerio de Economia y Finanzas.

TABLE 10

THE BALANCE OF PAYMENTS 1969-76
(US $ million)

	1969	1970	1971	1972	1973	1974	1975	1976	1977
Exports	880	1034	889	945	1112	1503	1291	1359	1768
Imports	- 659	- 700	- 730	- 812	-1033	1909	-2390	-2100	-2095
Visible trade balance	221	334	159	133	79	- 406	-1099	- 741	- 327
Financial services									
Public	- 37	- 31	- 48	- 51	- 66	- 104	- 193	- 275	- 312
Private[a]	- 147	- 117	- 78	- 70	- 115	- 114	- 47	- 91	- 124
Non-financial services and transfers	- 37	- 2	- 67	- 44	- 90	- 183	- 199	- 85	- 48
Current-account balance	0	184	- 34	- 32	- 192	- 807	-1538	-1192	- 811
Long-term capital									
Public	124	101	15	116	314	693	793	479	596
Private	20	- 77	- 43	- 2	70	202	342	196	69
Basic balance	144	208	- 62	82	192	88	- 403	- 517	- 146
Short-term balance	- 56	21	- 80	24	- 125	244	- 173[b]	- 351[b]	n.a.
Monetary movements, errors and omissions	- 88	- 229	142	- 106	- 67	- 332	576[b]	867[b]	n.a.

[a]Undistributed profits for foreign firms are here treated as outflows on current account and inflows on capital account, in accordance with present Peruvian practice. If undistributed profits are excluded, the current-account deficit is reduced to $7.2 million for 1971 and $18.8 million for 1972, with a correspondingly greater net outflow of long-term capital.

[b]Errors and omissions are included with short-term capital in this year.

SOURCE: Banco Central <u>Memoria</u> and <u>Cuentas Nacionales</u>. 1975-77 figures supplied by the Central Bank.

The implicit logic of the strategy followed since 1968 was that with greater command over the economic surplus, investments could be made which would reduce the vulnerability of the economy, by increasing export supply, by increasing value added in the export sector, by expansion of domestic food supplies, and by import substitution at the level of intermediate imports, as well as by hardening the terms on which foreign capital entered and by moving into exports of manufactures. Unfortunately, not only did the financial aspects of the plan prove to be based on fatally mistaken assumptions, leading to a major increase in debt, as we have explained, but also the gestation period of crucial investments proved lengthy[28] and at times the net foreign exchange effect less dramatic than was hoped.[29] The net result, as far as one crucial long-run problem was concerned, was that the stagnation of export volume continued up to and including 1976, as Table 1 above shows. The financial constraint plus the political importance of urban food prices also led to a disastrous policy on the internal terms of trade, which, aided by misdirected investments, led to the continued stagnation of rural production plus increased external debt. By mid-1975 all these factors had combined to create a situation of acute external imbalance.

Looking back, it is clear that a major reason why the problems of the next three years were to be so great was the sheer size of that disequilibrium. In fact it becomes a puzzle to understand quite how the situation could have been allowed to become so bad. Here again ill luck comes in--for the inexperience was on both sides--international as well as domestic. The boom in international lending caught all actors in the system unprepared and without adequate criteria: nothing equivalent had been experienced since the lending boom of the 1920's--a salutary parallel but not an effectively remembered lesson by the 1970's. It was surely not unreasonable on post-war experience for borrowers to feel that it was "safe" to take what was offered: in other words to accept the international seal of creditworthiness as valid. Unfortunately this did not make the international community any more flexible or tolerant in the adjustment process which now had to begin, taking the Peruvian experiment into its second, and not very experimental, phase.

The "Second Phase:" the Adjustment Process[30]

Although initially, following the replacement of Velasco by Morales Bermúdez, an attempt was made to maintain the myth of a continuation of Velasquista policies, it rapidly became clear under pressure of the worsening crisis that aid was needed from the international financial community, and that internal stabilization measures were necessary, both in their own right and as the price of that aid. It took until mid-1976 to prepare and launch a policy, and the intensity of that policy varied over the following months according to the international options open and the degree of resistance at home; but the basic "shape" of the policy conformed to the general pattern of "orthodox" stabilization policy: a reliance on demand restraint and exchange-rate manipulation to improve the balance of payments, with strict ceilings on internal credit to both the public and private sectors as the major instrument of demand restraint and of directly limiting imports via limiting credit.

As with the earlier policies of the military, this policy also could be described as based on a number of false assumptions, reducible to two principal points. First, it presupposed that cuts in demand could be achieved basically by cuts in public and private consumption, not investment--this being the basic means of achieving compatibility between short-term and long-term goods. Second, it assumed that contraction of demand plus exchange-rate adjustment would improve the balance of payments, in principle by three routes: first, the stimulus to exports via both adjustment of the price of tradables and increased supply following compressed internal demand; second, the compression of imports through the same two effects; and third, the beneficial effect on both long- and short-term foreign capital flows of removing distortions (basically, the distorted exchange rate).

Even a brief glance at the figures is sufficient to show that there must be something radically wrong with at least some of these assumptions. Table 10 shows how the balance of payments crisis initially worsened in 1976, and then showed a certain improvement by 1977. The improvement was related partly to a long-awaited reaping of dividends on the export side as new copper mines came on stream; it was only very slightly related to the effect of the exchange rate on non-traditional exports, and was partly related to the effect of falling investment in slowing down imports and to substitution in fuel. But the improvement was not enough to prevent an increase in debt, with the rise in outstanding public indebtedness (shown in Table 8 above) from $3 billion in 1975 to $3.6 billion in 1976 and $4.2 billion in 1977, with the debt-service-to-exports ratio hovering close to 40 percent. In the newly contracted debt of 1976 (Table 9) and 1977 (no figures available), defence played an overwhelming role, accounting for more than half in 1976.

The problem, however, was worse than this, since short-term debt was also rising. This was primarily on account of the failure to raise petrol prices to a level to put Petroperu's financing on an adequate basis: suppliers' credits for imports of crude petroleum sent the agency's short-term debt soaring from $195 million in 1974, to $228 million in 1975, $357 million in 1976, and $421 million by the end of 1977.[31]

By 1978, therefore, the external problem was still acute, even though in the meantime investment had fallen heavily, as had real wages (Tables 4 and 6), while in 1977 overall growth was negative and un- and under-employment was almost 60 percent of the economically active population.

Why was so little adjustment achieved? One important element in the explanation is that fiscal restraint was not in fact achieved. Table 11 makes it very clear that, whatever the intentions of the Central Bank, nothing was actually done to curb public spending. Current expenditure actually rose steadily as a percentage of GDP throughout the supposed "adjustment" period. The predominant reason was the rise in military outlays.[32] Cuts were made in real terms in the public sector wage and salary bill, but these were not enough to do more than cause a very slight fall as a percentage of GDP, despite the effort involved.[33] (In fact several elements of expenditure showed signs of levelling off in the second half of 1976: it was the 1977 failures, on top of the defence rise, which led to current expenditure reaching an all-time high of 38 percent of GDP by 1977.) By this latter year, compression of investment spending was resorted to, this falling even more in the early months of 1978. But this was not enough to offset the effect of the depression on tax revenue.[34] The only serious gains came from the increases in public enterprise prices, which were the main reason for the fall in the overall public sector deficit in the second half of 1976. As we have seen, though, even these increases were not enough to prevent the continued buildup of foreign debt, even at short term.

TABLE 11

PUBLIC SECTOR REVENUE AND EXPENDITURE (percent of GDP)

	1974	1975	1976 (1st half)	1976 (2nd half)	1977
Central Government					
Current expenditure	13.9	16.5	14.9	16.5	18.5
Wages and salaries	5.3	5.9	5.7	5.3	5.3
Military outlays	3.5	4.6	4.4	5.5	7.3
Other	5.1	6.0	4.8	5.7	5.9
Investment	4.5	5.1	4.0	5.5	3.8
Total expenditure	18.4	21.6	18.9	21.9	22.2
Revenue	15.2	16.0	14.4	14.2	14.3
State Enterprises					
Current expenditure	12.7	15.4	17.9	15.8	19.8
Investment	4.7	5.3	5.3	4.7	3.6
Revenue	13.1	14.5	17.3	20.2	22.0
Total Public Sector					
Current expenditure	28.7	33.6	34.0	33.7	38.3[a]
Investment	9.1	9.5	8.7	9.8	7.4
Revenue	31.6	32.7	33.2	35.8	36.3
Overall deficit	- 6.2	-10.4	- 9.4	- 7.7	- 9.4

[a]The total public-sector figure for 1977 does not include local government and municipal budgets. The weight of these in the total is tiny, as will be seen by comparing central government and state enterprises with the totals given for earlier years.

SOURCE: International Monetary Fund, Peru: Recent Economic Developments (Washington, D.C., 1977) and Banco Central, unpublished data.

The significance of this was not that more deflation was required--it was not--but that first the failure to attain balance led directly to continuing increases in external debt, and that, second, in order to succeed somewhere, failure on this front led to drastic cuts elsewhere--in private sector credit and in real wages and salaries. Thus it was the private sector which bore the brunt of credit restraint. The liquidity squeeze pushed the private sector increasingly into the informal credit market, where the higher wages formed another reason for rising unit costs with depression.

The squeeze on the private sector obviously meant that the second part of our first assumption also became invalid: private investment fell even further--despite the fact that in a desperate attempt to woo the private investor further changes were made in 1976-77 to both the Industrial Community legislation and to Social Property--to the point where by 1977 it was generally agreed that the last traces of the original novel elements of the revolutionary government had disappeared.

This naturally had also involved the gradual abandonment of all pretence at redistributive goals. The area of demand easiest to compress was real earnings: as the corrective inflation "bit," the fall in real wages and salaries was drastic, as Table 6 shows. This was reflected in what, for Peru, was an exceptional degree of political mobilisation and grass-roots reaction, beginning with the provincial riots of June 1977, and contributing to the lack of grasp on policy which characterised the following months.[35]

This rather uneven compression of demand was reflected in the fall in industrial production (Table 12) and in growing unemployment. Meanwhile, inflation accelerated due to the public sector price increases, the exchange rate movement, and rising unit costs as output fell. By mid-1978 the official consumer price index was estimated to be rising at an annual rate of nearly 60 percent, whereas in 1975 the rate of 23 percent.[36] Of the 34 percent increase in 1976, 23 points were estimated to be "corrective" inflation resulting from policy measures; in 1977 27 points out of 38.[37]

TABLE 12

MANUFACTURING: VOLUME OF PRODUCTION[a]

Percent Change			
1975	1976	1977	1978 (1st quarter)
+4.5	+5.3	-7.3	-4.1[b]

[a]The figures refer to that part of the sector administered by the Ministerio de Industrias.

[b]January-March 1977/January-March 1978 (both 1977 and 1978 figures are preliminary).

SOURCE: Informe Estadística de la Economia Peruana 1977, Actualidad Económica (June 1978), and Universidad Católica Departamento de Economia, "La Economia Peruana en 1977" (Lima, 1977).

The question of why so little adjustment was actually achieved in public spending derives only in part from the latter's composition. Massive dismissals would have been necessary to make a significant difference in the wage and salary figures; since it is inconceivable, as we mentioned, that the police, the military, or teachers (constituting over 70 percent of the wage and salary bill) could have been seriously reduced in number, only ridiculous cuts in other ministries would have been of any avail.[38]

Nevertheless, perhaps more economies might have been achieved, especially in the public enterprises, were it not for the lack of solidarity behind the stabilisation policy. It is rather clear that even in the most coherent period of policy-making (June 1976-March 1977), the impetus came from one point: the Central Bank team, unevenly supported by the Minister of Economy. Far from identifying with and cooperating with the programme, it is only too clear that the objective of every other element of the public sector was to evade restrictions as far as possible.[39] This suggests that in addition to the obvious political preconditions for adjustment by cutting consumption and the impossibility of stabilising against a rising trend in defence spending, a widely based team able to control and/or speak for diverse elements of the public sector may also be a precondition.[40]

But the difficulties presented by the type of adjustment policy sprang not only (although perhaps principally) from the lack of the political preconditions; they also came in part from the inherent difficulties an adjustment policy faces in this type of economy. As we saw, the strategy assumes essentially that the adjustment of relative prices and demand will secure adjustment of the external disequilibrium, with, in the Peruvian case, particular attention to the relationship between the internal fiscal disequilibrium and the external debt.

But Peruvian exports are barely consumed at home, so that domestic demand contraction does not increase supply--and the problem <u>was</u> a supply constraint, not lack of competitiveness. Only non-traditional exports, and possibly small mining, might potentially benefit--but in a period of world recession this was not likely to bring significant gains.[41]

As to debit items, many (such as royalty payments) went unaffected, while even within visible imports, relative prices have virtually no effect. The impact of demand contraction is limited by the concentration of imported industrial inputs in a few sectors.[42] A contraction in this area, large enough to be of quantitative significance, will require a quite disproportionate degree of recession in the industrial sector, if all sectors are contracted uniformly. This explains the limited success we noted above with respect to imports: even leaving defence aside, a depression of the size indicated by a fall of over 10 percent in industrial production in two years and a fall in real wages of well over 25 percent has had very little effect on imports. Such economies as have been made have been achieved by cutting investment and by import substitution in fuel. Even in 1978, when imports are at last estimated to be significantly reduced, 49 percent of the reduction is from fuel, 44 percent from defence, and only 4 percent each from consumer goods and intermediate inputs, the two elements directly sensitive to the level of demand.[43]

The remaining important element in the balance of payments is the capital account. The IMF's negotiations with Peru at this point have tended to emphasize the relationship between the exchange rate, confidence, and short-term capital, while the underlying thinking of the Fund is clearly that a healthy undistorted economy will attract long-term capital.[44] Unfortunately, it appears that in the Peruvian context capital movements, both long- and short-term, are related far more closely to more intangible variables of confidence in internal policy-making and issues such as the Comunidad Laboral. Given this, the atmosphere of strikes and political uncertainty at least partly associated with the stabilisation effort was such as to make sure that movements on private capital account would not be favourable.

Conclusion

We have now reviewed two sharply different phases of the Peruvian experiment. As we have seen, many different factors contributed to its failure, including a number of elements of bad luck and unfortunate timing on the international scene, such as rising import prices in 1973-74 and optimism based on oil which was reasonable but ill-founded. But what we have tried to show is the extent to which the solution opted for required--and presupposed--a sophisticated, dynamic, local entrepreneurial group and a competent experienced state. Yet precisely because of the historical process leading to the situation of 1968, neither was encountered, with ensuing problems of mismanagement and lack of response and/or of resources which all culminated in the acute internal and external disequilibrium of 1975.

It is clear even from the summary analysis presented here that the route chosen to handle that disequilibrium was not a profitable one--with high social and economic costs and small gains, if any. In practice, it was investment which bore the brunt of the cuts, given the lack of political and institutional preconditions for cutting consumption, plus the effect of the depression on tax revenue. But even the cuts in investment expenditure were not enough to prevent a continuing rise in external debt. Meanwhile, sharp cuts in wages and in industrial output had minimal beneficial effects on the external imbalance.

Much of our analysis would suggest that a different type of policy, concentrating on <u>selective</u> cuts and restrictions and working positively to create new export openings, would have been far more effective. But precisely the point of the preceding analysis is that there was simply an absence of the necessary capacity to apply the type of sophisticated policy necessary, given the small room for manoeuvre left once the crisis had been allowed to become so acute. Nor were there in the private sector the groups ready to respond. Further, a history of export-led growth closes certain options--by producing dependence on imported foodstuffs, for example, it makes a moratorium on external debt virtually impossible in practical terms.

When we add to these elements the inflexibility of the position of the international financial communities,[45] it is small wonder that the government made no serious effort to pursue a non-orthodox line, but rather committed itself increasingly to orthodox policies, even though as we have seen this meant the progressive abandonment of all remaining elements of the original "revolutionary" policies.[46] Nor is it any surprise, having seen the difficulties of the route chosen, that in due course the problems encountered so sharpened divisions within the military as to lead to the decision to abandon power altogether by 1980--thereby finally ending the Peruvian experiment.

[1]R. Thorp and G. Bertram, Peru 1890-1977: Growth and Policy in an Open Economy (London: MacMillans, 1978).

[2]Cotler, "The Peruvian Experiment Reconsidered: A Political Overview," paper presented at Workshop on "The Peruvian Experiment Reconsidered," Woodrow Wilson International Center for Scholars, Washington, D.C., November 1978.

[3]FitzGerald, "The Limitations of State Capitalism as a Model of Economic Development: Peru, 1968-1978," paper presented at Workshop on "The Peruvian Experiment Reconsidered," Woodrow Wilson International Center for Scholars, Washington, D.C., November 1978.

[4]Sheahan, "Peru: International Economic Policies and Structural Change, 1968-1978," paper presented at Workshop on "The Peruvian Experiment Reconsidered," Woodrow Wilson International Center for Scholars, Washington, D.C., November 1978.

[5]Industrial production in 1950 was only 14 percent of GDP in Peru, compared with 17 percent in Colombia and 22 percent in Chile.

[6]This is the key reason, for example, why "returned value" in Peruvian copper mining was historically relatively high: over 50 percent on average for the major firm, Cerro de Pasco Copper Corporation, for the years 1922-37, compared with 17 percent for the International Petroleum Company in the same period, and the 30-40 percent level found by Reynolds in the case of the Chilean Gran Mineria. (The estimates are taken from I. G. Bertram, "Development Problems in an Export Economy: A Study of Domestic Capitalists, Foreign Firms, and Government in Peru, 1919-1930" [D. Phil. thesis, Oxford University, 1974], ch. 5.)

[7]E. V. K. FitzGerald, "Peru: The Political Economy of an Intermediate Regime," Journal of Latin American Studies vol. 8, p. 1; A. Ferner, "The Industrial Bourgeoisie in the Peruvian Development Model" (Ph.D. dissertation, University of Sussex, 1975); Thorp and Bertram, ch. 13.

[8]Peruvian Times, March 1965, quoting Augusto Weise.

[9]Economic management was also facilitated by the depressed state of the economy 1968-70, and by the tax reform finally achieved by the Belaunde government.

[10]For accounts, see Abraham F. Lowenthal (ed.), The Peruvian Experiment: Continuity and Change under Military Rule (Princeton University Press, 1975), ch. 1; E. V. K. FitzGerald, The State and Economic Development: Peru Since 1968 (Cambridge University Press, 1976); Thorp and Bertram, Peru 1890-1977. FitzGerald (p. 36) shows how the weight of the State in GNP rose from 11 to 26 percent, while foreign capital fell from 21 to 8 and domestic private capital from 30 to 22 percent.

[11]Not that there was at first a very coherent strategy. Various authors have made it clear that policy evolved largely on an *ad hoc* basis as short-run pressures pushed the government first in one direction, then another.

[12]*E.g.*, as reflected in the first Development Plan.

REFERENCES

[13]An interesting hypothesis to explore would be whether reinvestment of profits was negatively associated with the practicality of capital flight.

[14]The "Industrial Register" forbad imports of goods which could be produced locally, and was in practice administered in a very protectionist fashion.

[15]This was true of both IPC and Cerro.

[16]See Shane Hunt, in Lowenthal, (ed.), The Peruvian Experiment.

[17]"ITINTEC" was the agency created by the General Law of Industries to further the development of local technology and to supervise foreign contracts. But it had very little impact, suffering from institutional factors as well as the long-term nature of the problem.

[18]A fund for granting subsidised loans was also introduced. See Gonzales Cano (1978).

[19]International Bank for Reconstruction and Development, "Tendencias Recientes en las Exportaciones Manufactureras y Totales de Paises en vias de desarrollo" (Washington, D.C., June, 1977).

[20]See R. C. Webb, Government Policy and the Distribution of Income in Peru, 1963-1973 (Harvard University Press, 1977), ch. 4, for an analysis of the tax policies of the Velasco regime.

[21]Based on the report of a North American firm which assessed the prospects for the government.

[22]But note that the margin of error in making projections is no greater than that frequently found even in those made by more developed countries.

[23]International Bank for Reconstruction and Development, "Economic Developments in Peru" (Washington, D.C., October 1974).

[24]See Barbara Stallings, "International Capitalism and the Peruvian Military Government," Latin American Program Working Paper No. 20 (Washington, D.C.: Woodrow Wilson International Center for Scholars, 1979).

[25]Officially, no compensation was paid for I.P.C. But a lump sum was paid over, for the U.S. to allocate as it saw fit.

[26]It is generally accepted that the item "other" is comprised very largely of defence items.

[27]The fact that this phenomenon is unmeasurable does not make it any the less important. Conversations with officials involved in the import programme in 1974 confirm that the fact that finance was sought abroad did increase import content. This was not only for the usual reasons, but also because it was administratively easier to obtain funds for an entire project from one source, tied to the purchasing of imports, rather than disaggregate a project and be forced to find separate financing for locally purchased components.

[28]Partly because of the unexpected difficulties of organising external co-operation.

[29]This was in part related to the financial aspect, which necessitated borrowing abroad for all major projects, reducing the favourable balance-of-payments effects.

[30]Adjustment policies in Peru in this period are discussed more fully in R. Thorp and L. Whitehead (eds.), Inflation and Stabilisation in Latin America (London: MacMillans, forthcoming), ch. 4.

[31]Ministerio de Economia y Finanzas, "El Problema de Caja de Petro-Peru en 1978" (Lima, Febrero 1978).

[32]In the case of military spending, purchases of equipment appear under "current expenditure."

[33]About 73 percent of wages and salaries are comprised by the Ministries of Education, Interior, and Defence. In this period it is inconceivable that the last two could have been cut, and the extremely influential left-wing teachers union, SUTEP, would certainly have prevented more compression on that point.

[34]For example, income tax was 4.9 percent of GDP in 1974 but only 2.8 percent in 1976.

[35]The regional commanders who had to handle the troubles were very influential in achieving the policy reversals of July 1977. In that month it was obvious that internal tensions within the military were extremely high.

[36]Instituto Nacional de Estadística.

[37]Estimates made by Carlos Amat, Ministerio de Economia y Finanzas.

[38]In mid-1978 large numbers of dismissals were in fact decreed in certain ministries, but the measure was eventually rescinded after considerable protest and a number of strikes.

[39]This resulted, for example, in devices such as making sure that when the budget was exhausted before December, the element left uncovered was wages and salaries. Another example is the rash of advertisements for new posts which appeared when a freeze on public appointments was known to be coming in May 1977.

[40]This was one of the chief conclusions of a report written at the government's request by Diusenberg, a Dutch economist and ex-Minister of Finance, in May 1978.

[41]There was in fact a strong expansion in this area: as we saw above (Table 5), exports of manufactures rose from 5 percent of total exports in 1975 to 7 percent in 1976 and 9 percent in 1977, under the impact of the exchange reform of 1976 and the increase in subsidies. The contribution on this front was important, although it involved a sharp increase in subsidies to achieve it, but still the quantitative effect was not very great.

REFERENCES

[42]Sixty percent of imported industrial inputs go to only three sectors, comprising a mere 22 percent of industrial value added (calculated from unpublished data of the Ministry of Industry).

[43]Estimated from preliminary figures supplied by the Banco Central. But it is stressed that the actual figures may be very different.

[44]See, for example, E. Spitzer in M. de Vries, et al., The International Monetary Fund, 1945-1965 (Washington, D.C.: IMF, 1969), Vol. III, ch. 20.

[45]The degree of flexibility is always a matter of the bargaining strength of the two sides, as well as a question of confidence in the capacity of the government to handle different types of policy. Peru had recently been in a relatively poor position on both counts.

[46]Though not to the extent of selling enterprises back to the private sector, apart from the fishing fleet.