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INFLATION, STABILISATION, AND THE RETURN TO DEMOCRACY IN PERU, 1975-1979

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ABSTRACT

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This paper discusses the acute stabilisation crisis of 1975-1978, and attempts to explain why, for so long, it proved so difficult to handle. The role of external creditors, in particular the International Monetary Fund, is discussed. In the final section, we analyse the implications of the total turn-around in 1979, when suddenly IMF targets were easily fulfilled, in the surprising context of a proposed return to democracy rather than Southern Cone-style repression. It is shown that the developments of 1979 in no way qualify the earlier analysis demonstrating the unsuitability of abrupt stabilisation on orthodox lines to an economy such as Peru's.

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In recent months, stabilisation policy in Peru suddenly appears to have turned a corner: IMF targets are being complied with, debt is being refinanced and credits even paid back, and there is talk of the need to encourage imports. And all of this is happening not in a context of increasingly severe dictatorship, but rather in one where the constitution will shortly be approved and full elections held in November, heralding the completion of a process of return to civilian government begun with the election of a Constituent Assembly in July 1978. All of this follows three years of acute disequilibrium and painful attempts at adjustment. International creditors were involved in increasingly difficult negotiations, resulting in July 1977 in a major crisis and the breaking-off of relations with the International Monetary Fund. For the next 18 months, events followed a stormy course, with the manner of the country's survival from one moment to the next always a matter of speculation. This paper attempts to throw light on the nature of the crisis, the reasons why its solution by conventional means for so long has been so problematical, and the significance of the apparently successful developments of 1979.

The first section of the paper explains the background to recent policies by describing the growing structural disequilibrium which has emerged since the 1950s. This was compounded by international events in the early 1970s, leading to the acute disequilibrium of 1976-1978. In the second section, we describe briefly the chronology of the various responses to this disequilibrium, and analyse in some detail why the different policies were so ineffective for so long. The third section considers very briefly the apparent improvement in recent months, and how far it modifies or confirms our analysis. In the concluding section, we attempt to suggest some possible lines of comparative analysis.

The Growing Crisis

It is essential to realise how far the problems of 1975-1977 were superimposed on a growing structural crisis. This is crucial to our analysis, not only because it vitally affects the handling of the situation but also because it colours the entire discussion of the increasing difficulty of stabilisation--a difficulty which stemmed before all else from the fact that in 40 years Peru had not faced a problem of such severity.

Since 1948, the year in which a right-wing military dictator took power ending a brief and incoherent period of interventionist policies, Peru had been almost a textbook example of commitment to laissez-faire export-led growth. The forces which operated elsewhere in Latin America to push the continent toward more autonomy, were felt in Peru only in a weak form, with the result that by 1948 the country had a relatively small public sector as well as a long tradition of little intervention in the economy and a welcoming attitude toward foreign investment. The reasons for such a situation lie in the country's rich resource endowment, its long periods of steady export expansion, and the manner in which the traditional groups had been able to further their own interest in close symbiotic relation with foreign capital without the need for a strong state.[1]

But in the course of the next 20 years, strains began to develop, despite rapid growth of exports and of the economy as a whole (see Table 1). The key symptoms are revealed in Tables 2 and 3, showing trends in export supply and in investment which in the light of previous rates of growth made some kind of adjustment crisis inevitable. These phenomena were related both as cause and effect to a third aspect: a growing disillusionment with "old-style" growth--partly with its overall performance but more with its distributional aspects. Along with political and social changes as the economy grew in breadth, and with increasing awareness of the implications of foreign penetration, there came increased nationalism and a growing sense that the traditional oligarchy had betrayed its responsibilities. This culminated after 1968 in pressures for radical reforms in ownership, and in the meantime interacted with other factors to aggravate the structural crisis--for example by precipitating a withholding of investment on the part of the multinationals in the mining sector from the early 1960s (in the hope of pressuring the government into a return to their former generosity).[2]

Unfortunately, these mining projects were more crucial to the continued functioning of the model than was realised at the time. As Table 2 shows, Peru 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 for guano, and for all products during the 1930s. In part it was the product of natural-resource constraints, as in fishing (though aggravated by poor resource management). Oil likewise faced a constraint of nature--despite great hopes and large investments by the multinationals, little oil was found. Sugar and cotton faced the limit of cultivated land--though here the nature of the constraint is complex, since there were major irrigation projects to be carried out which could relieve the constraint, but which required a more dynamic and developmental state than was the product of this type of model.

The problems in the export sector in turn explain the decline in the investment coefficient, although this is related also to the growth of rural unrest and the above-mentioned discontent with the distributional aspects of the model. This made it obvious that some

TABLE 1

PERUVIAN GNP AND EXPORTS 1950-1970

	Annual average growth rates (1963 prices)		
	GNP	GNP per capita	Exports
1950-55	6.0	3.9	7.9
1955-60	4.3	1.6	10.4
1960-65	6.6	3.5	4.9
1965-70	4.2	1.0	3.1

SOURCE: Banco Central, Cuentas Nacionales del Perú (annual).

TABLE 2

QUANTUM INDEX OF EXPORTS

1960:	76	1969:	101
1964:	100	1970:	109
1965:	97	1971:	100
1966:	96	1972:	106
1967:	100	1973:	83
1968:	112	1974:	80

SOURCE: R. Thorp and G. Bertram, Peru 1890-1977: Growth and Policy in an Open Economy (New York: Columbia University Press, 1978).

TABLE 3

INVESTMENT AS PERCENT 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).

form of land reform was inevitable and further discouraged investment in agriculture. These forces were behind a shift in the focus of policy towards industrialisation; by the early 1960s Peru was embarked on a wave of import-substitution, with massive incentives, much-increased protection, and heavy participation by the multinationals. This was not enough to compensate for the decline in investment elsewhere, the net result being the steady fall in the coefficient shown in Table 3. It also in no way compensated for the declining dynamism of traditional exports; in fact it aggravated the problem owing to its high import content[3] and the cost of imported technology, while it was very far from providing a source of foreign exchange.

Under Belaunde (1963-1968), there was an expansion of public spending, in response to social and political changes and in part in an attempt to balance the declining dynamism of the private sector. As Table 3 shows, the increase was not enough to compensate. Neither was it adequately financed; resistance to tax reform pushed the government into borrowing abroad, with effects on the foreign-exchange content of the investment programme.[4] The increasingly unfavourable repercussions on the balance of payments are shown in Table 4, while debt service as a percent of exports rose from 6 in 1963 to 13 in 1968.[5] Also reflected in Table 4 is the increasingly negative balance resulting from inflows of private foreign capital.[6] The worsening internal and external disequilibria were thus closely related, and were the short-term symptoms of a long-term problem.

The military government of General Velasco which took over in 1968 was temporarily rescued from short-term problems by the world boom in commodities. (Table 5 shows the upturn in Peruvian terms of trade.) The internal disequilibrium was alleviated by domestic recession, by the effects of the tax reform Belaunde had achieved, too late for his own rescue, and by the time-lag involved in reorganising the public sector and launching new projects. Freedom from problems of short-term economic management facilitated major ownership reforms, which were meant, by their effect on the generation and control of the economic surplus, to set the economy on a new course. But the outcome was oddly like that under the preceding government: false assumptions as to the ease of maintaining the cooperation of the private sector, both domestic and foreign, and as to the access to surplus automatically deriving from nationalisation, resulted in a massive increase in State spending being required, without an adequate financial base. Unfortunately the financial need became acute just as the international banks' search for customers reached its high point. Between 1972 and 1974, Peru was able to borrow abroad, and refinance its growing debt, with an ease that ex post appears suicidal--but which at the time reflected apparently solid expectations as to petroleum wealth. It is important to note how far both the expectations and the borrowing were supported by external agencies, for example by a World Bank appraisal in October 1974. This permitted the continuation of a massive boom in imports, on the part of both public and private sectors, and including a very rapid increase in imports of military equipment. The result was

TABLE 4

THE BALANCE OF PAYMENTS UNDER THREE GOVERNMENTS
1950-68 (Mil. dollars, annual averages)

	Odria	Prado		Belaunde		
	1950-5	1956-8	1959-62	1963-5	1966-7	1968
Exports	244	314	458	641	765	840
Imports	-234	-363	-382	-565	-811	-673
Visible trade balance	10	-49	76	76	-45	167
Net services and transfers	-20	-38	-35	-69	-72	-56
Profits and interest	-20	-36	-57	-75	-130	-138
Current account balance	-30	-122	-15	-68	-246	-28
Long-term capital:						
public	11	8	-1	83	106	81
private	15	79	22	21	11	-26
Basic balance	3	-34	6	36	-129	27
Short-term capital	3	22	-14	-14	37	12
Monetary movements and errors	0	12	-20	-22	92	-39

SOURCE: Banco Central, Cuentas Nacionales, various issues.

TABLE 5

TERMS OF TRADE 1960-1975
1960 = 100

1960:	100	1970:	154
1965:	95	1971:	136
1966:	107	1972:	121
1967:	101	1973:	178
1968:	123	1974:	193
1969:	138	1975:	142

SOURCE: Banco Central, Boletin and Memoria 1976.

a rise in debt service as percent of exports from 16 percent in 1970 to 34 percent in 1975, while the overall public-sector deficit rose from -2 percent of GDP in 1969 to -10 percent by 1975. But the critical situation which evolved in the external balance is shown in Table 6.

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, as we have explained above, but also the gestation period of crucial investments proved lengthy, and at times the net foreign-exchange effect proved less dramatic than was hoped.[8] 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 <u>both</u> sides, international as well as domestic. The boom in international lending caught <u>all</u> actors in the system unprepared and without adequate criteria. Nothing equivalent had been experienced since the lending boom of the 1920s--a salutory parallel but not an effectively remembered lesson by the 1970s. It was surely not unreasonable in 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.

<u>1976-1978: The Costly Non-Adjustment Process</u>

In 1975 President Velasco was replaced by President Morales Bermúdez, as it became apparent that the severity of the economic crisis necessitated a new broom, a "second stage" in which mistakes could be blamed on the Velasco era and a new direction sought. By the end of the year, the size of the external disequilibrium was at last fully recognized, and adjustment policies began to take the centre of the stage. This section recounts briefly the main phases of policies, before turning to a thematic discussion of the nature of, and problems encountered by, the adjustment policies.

TABLE 6

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 capital	-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 Memoria and Cuentas Nacionales. 1975-77 figures supplied by the Central Bank.

The first major stabilisation programme was introduced in June 1976, in conjunction with the negotiation of a $400 million loan from a consortium of private banks, and included the introduction of a "crawling peg" exchange rate, targets for cutting government expenditure and restraining credit to the private and public sectors, and increases in controlled prices, including a doubling of the price of gasoline. It was the government's impression that these terms were more favourable than would have been possible for a drawing on the Fund. The government did not, however, make the required cuts in expenditure, and in February 1977 the banks insisted that the drawing of the second half of the loan previously made would be conditional on agreement between the government and the Fund on the further steps to be taken. Agreement was not possible in the March 1977 negotiations, the most crucial areas of disagreement lying in the amount of credit to be granted to the public sector, the exchange rate, and the permissible loss in reserves. A new programme was introduced in June 1977 as the basis for a new agreement with the Fund. The programme involved substantial increases in food and fuel prices and increased monetary and fiscal restraint. But a wave of protest at the measures (involving riots in many cities outside Lima and the first general strikes in Lima for 20 years), in addition to continuing difficulties over cutting public expenditure, led to non-approval of the new Standby Agreement and the rescinding of many measures, including reversals of food-price increases and the elimination of the system of mini-devaluations.

The events of the next few months reveal the lack of options faced by a relatively small dependent economy once it reaches such a point of crisis. The government bought time--expensively--by arranging short-term financing, including "swap" agreements with a number of Latin American countries, and by ruling that all import credits must be for 180 days instead of the previous minimum of 90-120 days. It took until October 1977 to reach a new agreement with the IMF, and this was not signed until December. The Peruvians won acceptance of the need to freeze subsidies and petrol prices; but they had to agree to a sharp deflation of public spending. The exchange-rate system was reformed, with a free market being introduced.

According to the Agreement, the central government's current deficit was to swing from -3.4 percent of GDP in 1977 to +2 percent in 1978. By February 1978 it was more than clear that the Standby Agreement had not been kept; moreover, an agreement for a $260 million loan from a group of U.S. banks fell through because of the failure to satisfy the IMF. In May 1978, a major austerity programme was implemented, including all the familiar elements, and in July a Standby was signed with the Fund, apparently with comparative ease. The main elements were renewed curbs on public spending, a policy of mini-devaluations, and a series of increases in interest rates aimed at achieving a positive real rate by the end of the year.

It will already be clear then that the alternatives envisaged both on the Peruvian side and on the part of the international community were basically extremely similar. Both focused on the need to restore internal balance, fundamentally by cutting government expenditure and raising revenue by increases in controlled prices, although credit restraint to the private sector was to play its part. External balance would be assisted by internal balance, since this would prevent further increases in foreign borrowing and would involve cutting down on import-intensive investment programmes, and some limitation of imports with depression of internal demand. But external balance would also be sought directly by exchange-rate reforms to stimulate exports and make imports more expensive. The IMF hoped for favourable effects on both long- and short-term capital account from the changed exchange rate.

Thus the common framework was aggregate demand compression and reliance on the exchange rate to bring external equilibrium. The points which provided areas of disagreement in the long series of negotiations which followed were over the speed of the adjustment: the extent of compression to be attempted, rather than the tools. The Peruvians wanted to maximise the funds made available while minimising the "price" paid in terms of lost output (and, to be realistic, in terms of curtailment of public expenditure, particularly on defence). The international financial community was concerned that increased provision of funds would result directly in *increased* public expenditure, and therefore insisted with increasing firmness over time on commitments to curtailment of spending. At no time were alternative instruments seriously discussed, such as, for example, direct controls and selective taxes. In March 1977, coinciding with the breakdown of negotiations with the IMF over the terms of a Standby, there was an attempt to launch an alternative plan involving wage and salary increases and more credit to the private sector, but the plan contained no consistent proposals to handle the external gap. Again in July 1977, when relations were once more broken off following a wave of protest at measures taken as part of a new stabilisation effort, the measures were rescinded and a mission went to the U.S. to attempt to negotiate with the chief creditors on the basis of the "Plan de Reactivación" put forward by the Instituto Nacional de Planificación. But it appears that again the alternative did not amount to a coherent policy, and the reaction of the international banks and other creditors was to say that they had no confidence in existing policies and that Peru must work out a settlement with the IMF before refinancing would be forthcoming.[9]

The adjustment policies followed by the Peruvian authorities can thus be seen to have remained very constant over time in terms of their basic framework and goals, but to have varied in their intensity and consistency of application as internal political problems varied and as external options changed. In mid-1976 there was open to them the option of signing a loan agreement with a consortium of international banks, on easier terms than the Fund would have permitted. By early 1977 this option was no longer available, which strengthened the move towards a more severe policy. But throughout 1977 the government's resistance to public-expenditure cuts, industry's resistance to credit restraint, and popular resistance to rising prices and falling wages, prevented the effective and coherent implementation of a policy of disinflation.

We now move to attempt to evaluate the modus operandi and the results of the type of adjustment policies chosen. As with earlier policies of the military, this policy too 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 principal 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 both via 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 6 shows how the balance-of-payments crisis initially worsened in 1976, to show a certain improvement by 1977. In both years there was a positive contribution from exports, although this was not really significant until 1977, when at last there was some recovery in the export quantum, which rose 48 percent in 1977, almost entirely because of the major copper projects coming on stream (the volume of copper exports rose 82 percent in 1977, while in value they formed 23 percent of exports). Iron-ore exports also recovered with the resolution of the Marcona boycott, and sugar production rose. Non-traditional exports also grew rapidly though from a small base; this was the area that benefitted most from the policy measures taken.

The evolution of imports is considered in detail below when we analyse the impact of policy measures; briefly, in 1976 there was a slight fall in most categories, with the ending of the extraordinary speculative boom in imports of 1974-1975. But in 1977 the figure was roughly constant in dollar terms, with a further fall in capital goods being compensated by a rise in defence items. As investment fell heavily in both public and private sectors, so there was a saving of $254 million on capital goods, but the "adjustment" figure rose by more than enough to compensate--$303 million--reflecting the massive increase in defence imports in this year,[10] and every other category rose slightly, except fuel. In 1978 the depression and fuel substitution at last significantly compressed imports.

In 1976 net long-term loans made a smaller contribution than in 1975; thus the overall result was the continuation of the massive loss in reserves which began in 1975. This was staunched towards the end of the year by the balance-of-payments financing which was achieved. In 1977 the main reason for the less unfavourable basic balance was the continuing improvement in current account, this coming almost entirely from the rise in exports, with imports constant in dollar values. But the improvement was not enough to prevent an increase in debt, with the rise in outstanding public indebtedness (shown in Table 7) from $3 billion in 1975, to $3.6 billion in 1976,

TABLE 7

EXTERNAL PUBLIC DEBT 1968-77[a] (millions of 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.

and $4.8 billion in 1977, with the debt-service-to exports ratio hovering close to 40 percent. In the newly contracted debt of 1976 (Table 8) 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.[11]

It will readily be seen, therefore, that the disequilibrium in the external balance was not removed by the measures taken. Why was so little adjustment achieved? One important element in the explanation is that fiscal restraint was not in fact achieved. Table 9 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 percent of GDP throughout the supposed "adjustment" period. The predominant reason was the rise in military outlays.[12] 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 percent of GDP, despite the effort involved.[13] (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

TABLE 8

NEW CONTRACTED DEBT BY USE, 1968-76 (billions of 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	500.3	1024.7	1294.2	984.3	1382.9

[a]Generally understood to comprise principally defence.

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

TABLE 9

PUBLIC SECTOR REVENUE AND EXPENDITURE (% 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
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: IMF, Peru-Recent Economic Developments (Washington, D.C.: 1977), and Banco Central, unpublished data.

to (see also Table 10), 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.[14] 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 build-up of foreign debt, even at short term.

TABLE 10

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.

The significance of this was not that more deflation was required--it was not--but that firstly the failure to attain balance led directly to continuing increases in external debt, and secondly, that 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 rates 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, as shown in Table 10, despite the fact that in a desperate attempt to woo the private investor further changes were made in 1976-1977 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 had naturally also involved the gradual abandonment of all pretence at redistributive goals. The area of demand which it was easiest to compress was real earnings; as the corrective inflation "bit," the fall in real wages and salaries was drastic, as Table 11 shows. This was reflected in what was for Peru an exceptional degree of political mobilisation and grass-roots reaction, beginning with the provincial

TABLE 11

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. Recent unofficial estimates give the decline in real wages in 1977 as -21 percent, in 1978 as -18 percent (BOLSA Review, March 1979, p. 192).

SOURCE: La Economía Peruana en 1977, mimeo (Lima: Universidad Católica, Departamento de Economía, 1978).

riots of June 1977, and contributing to the lack of grasp on policy which characterised the following months.[15]

This rather uneven compression of demand was reflected in the fall in industrial production (Table 12) and in growing unemployment. Meanwhile, inflation accelerated (Table 13), due to the public-sector price increases, the exchange-rate movement, and rising unit costs as output fell. The rise in the official consumer price index in 1978 is estimated at 74 percent, where in 1975 the rate was 23 percent.[17] 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.[18]

The question of why so little adjustment was actually achieved in public spending derives only in part from its composition. Massive dismissals would be necessary to make a significant difference to the wage and salary figures; since it is inconceivable, as we mentioned, that the police, the military, or teachers could be seriously reduced in number (this being over 70 percent of the wage

TABLE 12

MANUFACTURING: VOLUME OF PRODUCTION[a] (% 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: Immobiliaria Santa Felicia S.A., et al., Informe Estadística de la Economía Peruana 1977; Actualidad Económica (June 1978); and Universidad Católica, La Economía Peruana en 1977.

TABLE 13

ANNUAL CHANGES IN CONSUMER PRICES IN LIMA (percentages)

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
Total	5.1	6.8	7.2	9.5	16.9	23.6	33.5	38.1	74	70
Food and Drink	3.1	6.9	7.4	10.1	18.8	32.8	32.1	40.3		
Housing	10.7	6.6	7.3	4.0	17.6	16.3	23.8	26.0		
Clothing	6.6	9.5	11.2	9.6	16.7	18.5	25.7	31.7		
Other	2.7	5.2	3.5	6.3	9.6	17.6	50.7	45.5		

SOURCE: Banco Central, Memoria; and Andean Report (March 1979).

and salary bill), only quite ridiculous cuts in other Ministries would be of any avail.[19]

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.[20] 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.[21]

But the difficulties of 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 it faces in this type of economy. As we saw, the strategy assumes essentially that the adjustment of relative prices and of 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. (For example, as we have shown, failure to achieve a sound financial situation for public enterprises results directly in external borrowing, often at short term.) But there are also good reasons why such measures do not function "efficiently" in a structure such as that of the Peruvian economy.

Taking exports first, the increase might come through increased competitiveness of exports with the adjustment of the exchange rate and the restraint on internal costs following the decline in real wages, and/or increased supply following reduced internal consumption of exportables. But we have already seen that the problem with existing export lines was not lack of competitiveness but a very fundamental supply constraint which would not be affected by short-run measures. Further, the internal consumption of exportables is low: only in the case of sugar is a significant proportion of output allocated to the internal market, and by 1975 the international sugar price was falling sharply, so that even if more were offered it would do little to increase revenue. Non-traditional lines formed only around 10 percent of the total, and in a time of world recession it was hardly to be expected that they rescue the situation. There was some expansion in this area: as we saw above 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, but involved a sharp increase in subsidies to achieve it, and still the quantitative effect was not very great. The other area potentially responsive to price is small and medium mining, but the time-lag is significant.

In other words, even a painful reduction in real wages[22] could gain just about nothing in the short run in terms of the export side of the equation.

As to foreign-exchange outflows, the problem here was partly that many items showing unfavourable trends would not be affected by demand restraint. One obvious such item is the continued outflow on account of technology.

But further, even within visible imports, the reach of the chosen instrument was very limited. When the bulk of imports are non-substitutable intermediate and capital goods, relative prices have a very small effect[23] on import demand; this is particularly true when over half of imports are for the State sector (it will only be effective here if it is combined with strict fiscal controls).[24] And in any case, the effect of the numerous different measures of relative price adjustment is to provoke such initial cost-push inflation that, unless the exchange rate is further adjusted, relative prices do not long favour import substitution.

As to demand contraction, it follows from the structure of imports which we have observed above that it is both an inefficient and extremely costly tool--yet it is the only means, within the policy as a whole, of moving toward equilibrium. The structure is as follows, taking the year 1975. If we take food, fuel, and agricultural inputs as sacrosanct, we are left with some 7 percent of other consumer goods, which presumably could be squeezed a little more but which will hardly solve the deficit problem. Apart from that, we have 49 percent representing investment goods and military equipment and 27 percent of industrial inputs excluding food. But the industrial-input category is shown in Table 14 disaggregated by industrial sector. It shows that 60 percent are accounted for by three sectors, which together comprise a mere 22 percent of industrial value added. When imports are thus concentrated in a few sectors, cutting demand uniformly will clearly be a costly way to achieve economies in imports, requiring a quite disproportionate degree of recession in the industrial sector. This explains, then, the limited success we noted above with respect to imports: even leaving defence aside, a recession of the size indicated by a fall of over 10 percent in industrial production in two years, and a heavy fall in real wages 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 were at last 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.[25]

TABLE 14

IMPORTS BY SELECTED INDUSTRIAL BRANCHES AS PERCENT OF TOTAL INDUSTRIAL IMPORTS, 1974

Industrial Sector:	
Food products	23 %
of which milk products	(6)
wheat products	(12)
Chemical products	17%
Vehicles	23%
of which Knocked-down kits	(21)
	63%
Total imported industrial inputs	100%

SOURCE: Ministerio de Industria, unpublished data.

The remaining important element in the balance of payments is the capital account. The Fund's negotiations with Peru in this area have tended to emphasise 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.[26] 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. Given this, the atmosphere of strikes and political uncertainty at least partly associated with the stabilisation effort was such as to make sure that movement on private capital account would not be favourable.

Further, even the control of the public-sector deficit is exceptionally difficult, not merely because of the structure of expenditure and the lack of will to resist pressure, which we mentioned earlier, but also because the recession itself affects tax revenue sharply. This is a combination of a lower level of activity and imports-depressing tax revenues, and a greater incentive to evasion as real incomes fall. Thus, for example, we observe that income tax was 4.9 percent of GDP in 1974, but only 2.8 percent in 1976. The net result of a succession of small tax changes over the last few years, plus the effect of inflation on tax brackets, has been no rise in the ratio of total tax revenue to GDP.[27]

Yet a further reason for the lack of results arises from the fact that the initial policies were not successful (and in part because they were not sustained). The lesson of the story we have told above is that the social cost in terms of wages, employment, and the fortunes of small enterprises tends to be cumulative, while short-term gains are easily reversed by subsequent events. As each programme was implemented and ran aground by failing to achieve certain targets, there were always three areas which could be, and were, affected: wages, employment, and small business. (The extent to which the large-scale private sector has been able to defend itself is reflected in the lack of major bankruptcies despite two years of recession.) As we have shown, cuts in wages did little to improve the export-import balance, but the prolonged recession did mean that what goodwill there was available at the start to back such an effort was soon dissipated. Further, whatever the pros and cons of the crawling peg, its termination just when the initial difficulties were well over and benefits could be expected is particularly damaging, since it reduces the effect such an instrument could have another time. Again, as programme succeeds programme, defence mechanisms may become better developed and certain gaps may even become wider (e.g., as short-term external borrowing continues because ambitious stabilisation targets are not reached, the gap may become wider than it might have done under an alternative path with planned external borrowing at lower possible cost).

Drawing together, then, the implications of our analysis so far, it would appear that the experience of 1976-1978 lends considerable weight to the case for more flexible and gradual adjustment policies. Quite apart from the elements of ill-luck and the exogenous factors which our first section pointed out, there is a case against such policies simply based on the difficulties and unproductive nature of short-run abrupt adjustment in this type of economy. Given the very limited benefits to the balance of payments from a policy of aggregate demand compression, there was rather a case, first, for selective action, concentrating on the import-intensive areas, and second, for focusing on the finance problem, given its direct relation to the external debt.

It also appears clear that the further result of the difficulties of short-run adjustment was severe disruption of long-run development policies. This appears most clearly in the eventual heavy cuts in investment which were necessary, but also is evident in a less tangible fashion in the effect on policy-making effort of having to wrestle constantly with short-term problems using instruments with high social costs; long-term constructive policy-planning and implementation necessarily have to suffer. Further, certain important elements of a long-term policy, such as tax reform, are virtually impossible to implement in political-economy terms in a context of acute depression.

By 1978, there were signs that these problems were well recognised both by the government and by the international financial community. In the successful negotiations for a Standby Agreement in July 1978, the IMF team apparently pressed the Peruvians to plan on more imports and a larger public deficit than they had intended, in order to maintain the level of investment. The agreement covered a longer period than usual, and was intended to be a serious attempt at gradual adjustment, coordinated with an investment programme worked out with the World Bank. The short-term goals were nevertheless very ambitious. The public-sector current account was in deficit to the tune of -2 percent of GDP in 1977; the programme assumed a surplus of 5.8 percent in 1979 and 1980, to be achieved by tax reform, increases in public-enterprise prices, and cuts in current expenditure, while public investment was to maintain its share of GDP. Interest-rate reforms were to gradually bring about a positive real rate of interest.

1979: Recovery Without Stabilisation?

Somewhat to everyone's surprise, these targets have in general (as of May 1979) been kept to, if not exceeded. Tax revenue by early 1979, for example, was running at 6 percent above the target figure. Further draw-downs on the IMF Standby credit have been arranged without difficulty.

It will be obvious from all that has been said so far, however, that such a turnaround comes not from a sudden responsiveness of the internal economy to this type of policy, but from an abrupt upturn in the export sector--due in large measure to buoyant mineral prices, although exports of fish for consumption have been rising.[28] The unexpectedness and size of the rise are revealed by the fact that, whereas in January 1979 the Central Bank's estimate of 1979 exports was \$2.2 billion, by April it was no less than \$3.2 billion.[29] With the largely exogenous recovery in exports, tax revenue has risen sharply due to the export tax, and targets in regard to reserves and the public-sector deficit suddenly become feasible.

The second point to note is that "success" in no way implies stabilisation. The cost of living rose 74 percent in 1978; the prediction as of April 1979 was almost 60 percent for the current year.[30]

There has, however, been one solid achievement: following a number of sharp confrontations with the public-sector enterprises,[31] it appears that at last some measure of control over public spending has been achieved.

Apart from this one element, however, we would argue that the "success" in no way qualifies our earlier analysis: it is the product of exogenous factors and is therefore so far dependent on such factors, unless in some manner internal economic structures can be changed in the room given by such factors. But most observers do not view the room as more than ephemeral.

Review and Conclusion

In reviewing the process which we have preferred to call one of non-adjustment, or non-stabilisation, we must first ask why for three years the Peruvian experience appeared in comparative terms to be so particularly painful and unfruitful, and second how it has been possible nevertheless to combine orthodoxy, and even eventually a considerable measure of external adjustment, with re-democratization--again a remarkable combination in comparative terms.

Taking first the costs of 1976-1978, it is clear that they were high. Growth fell from an average of 3.2 percent per capita 1970-1975 to -2 percent 1975-1977. Investment fell 35 percent in real terms 1975-1977. Private investment in real terms was at the same level it was at in 1972. No new major public-investment programmes were started and many were cut--precisely the programmes which ought to be resolving the situation in the medium term by increasing exports and expanding food supplies. Perhaps more serious still, if less tangible, the entire focus of policy-making effort over three years was on the very short term, so that policy innovations which are vitally necessary went undreamed of.[32] Living standards fell; even calorie consumption tables show a fall from already low averages.[33] Yet for all this, the balance of payments was still not in balance.

We have argued that the problem is that the kind of orthodox measures that are typically tied to balance-of-payments loans tend to work particularly badly in an economy such as Peru's--with, as we have shown, high social cost and low dividends--which indicates a need for flexibility and a sympathetic attitude to policy innovations and long-run reforms. But the problem is precisely that since, as we have seen, lack of control over public spending is central to the country's difficulties, the international system has reason to fear that increased flexibility may actually be negative. In other words, the overlaying of the two problems produces a contradictory situation, which makes it clear why the Fund found the problem of Peru so difficult to handle.

The problem is that over time it is the Peruvian people who lose out--both in the short run in terms of wages and employment, and in the longer run, since the whole process is at the cost of reforms and developmental investment. The difficulty, of course, is that once the economy arrives at the degree of crisis encountered in 1977-1978, all options appear to be virtually removed--for the kind of capacity required to implement an alternative type of adjustment policy will be ex hypothesis lacking.

But this immediately raises the question of how it is that the whole experience was not more radicalising, precipitating a "Pinochetazo" rather than a genuine move back to civilian government. We can offer no more than suggestions on this point, since it requires an analysis which goes far beyond economic variables. But in the hope of contributing to the comparative theme of this Workshop, we suggest that the answer lies in three main areas.

First, the Peruvian economy contains relatively large informal and subsistence sectors. This has at least two important implications. In part it explains the weak development of left-wing politics overall. Angell, in a stimulating recent paper,[34] has analysed the growing strength of the left since 1968, but his underlying comparative thesis is that the traditional, partly semi-feudal, character of the society explains the relatively underdeveloped nature of such movements.

The further significance of the existence of this large informal sector is closely related to the above: in the context of severely contractionary measures, it explains the lack of politicization, quite simply by the extent to which it offers an alternative and/or a social-security system. Reichmuth has shown how the initial impact of mild recession in the formal sector was a strong expansion of the informal sector;[35] even in the severe recession of 1976-1978 he found that labour and capital were still moving into the informal sector, whose relative expansion was complemented by the shift in demand to inferior goods as real incomes fell.[36] These effects become even more significant once it is realised how far families typically bridge the formal-informal gap.

It will at once be apparent also that this may provide yet another reason why orthodox measures are apparently so ineffective. In part this may be because, with an elastic monetary system and the possibility of informal credit, and with the endogenous capacity of the informal sector to keep going and even profit from the recession in the formal sector, a given degree of monetary and fiscal restraint is less effective than it would be were the alternative options less extensive.

The second point to make about the Peruvian experience in comparative terms is that in a sense it has, for all its severity, been half-hearted orthodoxy. It has not followed the Southern-Cone model of a discontinuous move to a more liberal and open economy, with sharp tariff cuts and many other measures attempting to remove the accumulated distortions of years. It has therefore not risked in any extreme degree the alienation of that part of the private sector hurt by such restructuring,[37] and hence has been able to remain more open.

In the third place, we would point out that since the recovery, such as it is, is not dependent on endogenous factors, it does not rely, as do the Southern-Cone solutions, on continuing restraint of internal consumption. So the very reasons that made orthodoxy ineffective while external events were unfavourable also mean that Peru can "succeed" without repression once exports do recover.

But the two latter points also imply that relatively little has been achieved internally. "Success" is ephemeral and dangerously dependent on mineral prices. Can even better control of the public sector survive a new and very inexperienced civilian government? Certain policies are now being attempted, such as some measure of rationalisation both of protection and of factor prices, but enormous problems remain: the neglect of agriculture, the plight of the sugar cooperatives, the inefficiencies in numerous public enterprises, to mention but a few. It is urgent that the breathing space now being experienced be made use of, or the view round the corner will look depressingly familiar.

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[1]This summarises themes developed at length in R. Thorp and G. Bertram, Peru 1890-1977: Growth and Policy in an Open Economy (New York: Columbia University Press, 1978).

[2]A clear example of the dangers of half-breaking with one model, while no clear alternative has been developed.

[3]See R. Abusada, "El Costo de Ahorro de Divisas Externas," Economía, Vol. 1, No. 1 (1978) for instances of negative value added at world prices.

[4]A point which has not yet been adequately documented, but is strongly suggested by, for example, Kuczynski's description of rushing through foreign tenders for building cargo boats in 1967, in order to secure the cash loan which was part of the contract. P.O. Kuczynski, Peruvian Democracy Under Economic Stress: The Belaunde Years (Princeton University Press, 1977), pp. 100-101.

[5]Instituto Nacional de Planificación (I.N.P.), "El Caso de la Deuda Publica Peruana: 1965-1975. Las Empresas Transnacionales y el Endeudamiento Externo," mimeo (Lima, 1977), p. 103.

[6]See I.N.P., "El Caso de la Deuda Publica Peruana: 1965-1975" for a demonstration of the increasingly unfavourable impact on the balance of payments of foreign investment up to the present.

[7]Partly because of the unexpected difficulties in organising external cooperation.

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

[9]The large measure of agreement between the IMF and the Peruvian side is, we would argue, the chief significance of conditionality and of the role of the Fund. The effect of pressure from the Fund or from other external agents is seen not so much in the specific bargaining over the extent of the devaluation or the permissible public-sector deficit, as in the discarding of alternative routes such as direct controls--probably the failure to even discuss other options--long before the negotiating table is reached. In other words, conditionality is "internalised" and has a deep effect on policy making far beyond that apparent in actual negotiations.

[10]Non-monetary gold imports are in fact zero. The figure almost entirely represents defence, although civilian purchases of ships, for example, might appear here.

[11]Ministerio de Economía y Finanzas, Peru: The October 1977-December 1979 Stabilization Program and Its Implementation up to Date (Lima, 1978).

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

[13]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.

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

[15]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.

[16]Andean Report, March 1979.

[17]Instituto Nacional de Estadística.

[18]Estimates made by Carlos Amat, Ministerio de Economía y Finanzas.

[19]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.

[20]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.

[21]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.

[22]The fall between 1973 and 1977 was 21 percent in real wages, 35 percent in salaries. As we mention, recent unofficial estimates give the decline in real wages in 1977 as -21 percent, in 1978 as -18 percent. BOLSA Review, March 1979, p. 192 (Table 11).

[23]Pirani, "La Demanda para Importaciones," unpublished study (Lima: Banco Central, 1977) found the price variable non-significant in explaining the behaviour of imports 1970-75.

[24]This is made less significant, however, by the fact that here the State in large part acts as intermediary for the private sector.

[25]Estimated from preliminary figures supplied by the Central Bank.

[26]See for example, E. Spitzer, chapter 20 in M. de Vries, et al., The International Monetary Fund, 1945-65, Vol. III (Washington, D.C., 1969).

[27]In other words, as so often, the real problem is more fundamental: the need for measures against tax evasion, with the institutional changes this presupposes.

[28]See Latin America Economic Report, 23 March 1979. The rise is to a figure of perhaps $100 million out of a total of $3,200 million--i.e., accounting for a tiny percentage of the increase.

[29]Latin America Economic Report, 13 April 1979.

[30]Andean Report, April 1979.

[31]See Andean Report, March 1979, p. 21, for a report of the rows between the government, Petroperu, and EPSA, with the Banco de la Nación bouncing cheques of agencies considered to be overspending.

[32]For example, measures which really reach the peasant, or a serious strategy on unemployment, or a long-run energy policy.

[33]For a low-income family in Lima in the first quarter of 1978, calorie consumption was 62 percent of F.A.O. requirements, compared with 78 percent in March 1977. For a middle-income family, the fall was from 96 percent to 66 percent. Actualidad Económica.

[34]A. Angell, "The Peruvian Labour Movement," mimeo (Oxford University, 1978).

[35]M. Reichmuth, "Dualism in Peru: An Investigation into the Interrelationships Between Lima's Informal Clothing Industry and the Formal Sector," unpublished B. Litt. thesis (Oxford University, 1979), p. 198. There are many mechanisms involved here. For example, formal-sector firms induced their labour force to leave by offering them machines at bargain prices. Certain enterprises might fight rising unit costs with falling demand by shifting more activities into the informal sector ("putting out," in circumstances where non-compliance with, or non-applicability of, legislation means lower costs).

[36]Ibid., pp. 198-209.

[37]Though it is remarkable how far even the import-substituting groups in the private sector appear to have been willing to back the Southern Cone governments.